BEFORE THE ILLINOIS COMMERCE COMMISSION

Docket No. 08-0569

Rebuttal Testimony of W. Karl Wardin
On Behalf of AT&T Illinois

AT&T Illinois Exhibit 1.1

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DIRECT TESTIMONY OF W. KARL WARDIN

ON BEHALF OF AT&T ILLINOIS

I. BACKGROUND AND QUALIFICATIONS

Q. Please state your name and business address.

A. My name is W. Karl Wardin. My address is 225 West Randolph Street, Floor 27C, Chicago, Illinois 60606.

Q. Are you the same W. Karl Wardin who previously submitted Direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your Rebuttal Testimony?

A. In this Rebuttal Testimony, I will respond to portions of the Direct Testimony of Illinois Commerce Commission Staff ("Staff") witness Dr. Qin Liu and Attorney General ("AG") witness Dr. Lee Selwyn.

Q. Please provide a summary of your Rebuttal Testimony.

A. In my testimony, I address assertions made by the AG and Staff related to the evidence I presented demonstrating the competitive alternatives available to customers in the Greater Illinois MSAs, the functional equivalence of those alternatives to AT&T Illinois' wireline local exchange services, and Dr. Selwyn's arguments regarding price changes and earnings.

Q. Please summarize the topics being addressed by AT&T Illinois' other rebuttal witnesses.

A. Dr. William Taylor addresses many of the same issues I address from an economic perspective. Mr. Timothy Dominak addresses Dr. Selwyn's arguments regarding earnings and explains the basis for certain adjustments that AT&T Illinois made to the return on equity and return on investment data filed with the Commission on which Dr. Selwyn relied in making those arguments.

Q. Do you have any schedules supporting your Rebuttal Testimony?

A. Yes, I have the following Schedules:

- Schedule WKW-R1: AT&T Illinois' 2007 Report on the Competitiveness of the Residential Telecommunications Market in MSA-1
- Schedule WKW-R2: 2006 Comcast Triple Play Offers
- Schedule WKW-R3: Recent AT&T and Comcast Triple Play Offers
- Schedule WKW-R4: AT&T ad highlighting cables' promotional price
- Schedule WKW-R5: Comcast response – everyday low prices ad
- Schedule WKW-R6: Mediacom's 18-month promotional pricing

II. EVIDENCE OF COMPETITION

Q. Dr. Selwyn dismisses AT&T Illinois' analyses of competitive activity in the Greater Illinois MSAs as mere "headcount" or "market share" data. (AG Ex. 1.0, pp. 12, 19). Please comment.

A. The market and competitive information which I supplied in my Direct Testimony is exactly the same type of information that I supplied in the MSA-1 reclassification proceeding. The fact that Dr. Selwyn does not find it compelling is hardly surprising. As he concedes in his testimony, his views on the competitive data in this proceeding are the same as they were on the comparable data presented in Docket No. 06-0027. (AG Ex. 1.0, pp. 15-18). What is important is that the *Commission* and the *Commission Staff* rejected Dr. Selwyn's views and found this information to be both useful and relevant in determining whether AT&T Illinois' residential services in MSA-1 were competitive. In fact, the Commission ordered AT&T Illinois to provide the same type of information in its Initiating Order in this proceeding.

As my Direct Testimony demonstrated, competitive market shares today in the Greater Illinois MSAs are *higher* than they were in MSA-1 in 2005. Thus, AT&T Illinois' case in support of this competitive classification is, if anything, even more compelling than it was in Docket No. 06-0027.

Q. Dr. Selwyn contends that AT&T Illinois should have provided a demand cross-elasticity study in support of its filing. (AG Ex. 1.0, p. 13). Do you agree?

A. No. Dr. Selwyn made the same argument in the MSA-1 proceeding. However, nothing in the Illinois Public Utilities Act ("PUA") requires such a study. The Commission did not accept Dr. Selwyn's recommendation then, and it has no greater merit here.

Q. Dr. Selwyn contends that "most" of AT&T Illinois' competitors have either ". . . scaled back their operations or have exited the marketplace altogether." (AG Ex. 1.0, p. 4; Sch. LLS-2, pp. 14-16). Is that true?

A. No. AT&T Illinois' major competitors – *i.e.*, the cable companies, wireless providers and VoIP entities – have been ramping up their operations, not scaling them back. For example, since the MSA-1 proceeding, Comcast has completed a $3 billion investment upgrading its broadband networks in the state, which also enables it to provide IP-based residential basic local exchange services to its cable customers.[1] Since 2005, wireless providers, in total, have been investing $20 billion a year. Since the first quarter of 2007, Vonage, one of the major pure-play VoIP providers, has increased its customer base by about 10%, from 2.39 million subscribers to 2.62 million subscribers.[2]

It is true that some of the CLECs that appeared on my schedules in 2006 are no longer in business or have fewer customers. This is not surprising, given that the Federal Courts found UNE-P to be an illegal requirement. One of the FCC's policy goals in eliminating the UNE-P was to weed out uneconomic and artificial competition that existed solely because of regulatory mandates. As the FCC stated in the *TRRO* (¶ 200) "we exercise our authority and conclude that the disincentives to investment posed by the availability of unbundled switching, in combination with unbundled loops and shared transport, *justify a nationwide bar on such unbundling*." The shake-out in the wireline CLEC

[1] See http://www.dailyherald.com/story/?id=63553 viewed on December 15, 2008.

[2] Vonage reports direct margins of 66%, and in November of 2008, Vonage also was able to complete the refinancing of its convertible debt. http://files.shareholder.com/downloads/VAGE/438916503x0x56424/ad50fa02-58fb-4dc5-abfc-5bd1100ce9be/FactSheet.pdf, viewed December 18, 2009.

portion of the marketplace, therefore, was expected from an overall competitive policy perspective. In any event, many of the CLECs that were active at the time of the MSA-1 case are still competing in the marketplace. The fact that the competitive "story" is now dominated by the cable, wireless and VoIP providers simply reflects changing marketplace dynamics – not a failure of competition.

Q. Dr. Selwyn mentions "AT&T Illinois' 2007 Annual Report on the Competitiveness of the Residential Telecommunications Market in MSA-1" ("2007 Annual Competition Report") which was filed with the Commission in April of 2008. Does that Report contain statistics which allow the Commission to compare the state of competition in MSA-1 at the end of 2005 and the end of 2007?

A. Yes, it does, and it shows that competition for AT&T Illinois' local exchange services has continued to remain very strong since the Commission issued its Order approving the competitive classification of residential services in Docket No. 06-0027. I have attached a copy of the AT&T Illinois' 2007 Annual Report on the Competitiveness of the Residential Telecommunications Market in MSA-1 as Schedule WKW-R1. As indicated in the report, the number of residential access lines served by CLECs (including cable companies) increased by about 170,000[3] (a 34% increase) from 502,454 at December 31, 2005 to 673,478 at December 31, 2007. As a percentage of the total number of wireline-served access lines, the CLEC/cable share increased from 16.6% to 23.4%. During the same two-year period, AT&T Illinois lost 354,251 residential access lines in

[3] See Schedule WKW-R1 at pages 1-2.

MSA-1, a decrease of about 14%, and it lost over *****BEGIN CONFIDENTIAL** ******* **END CONFIDENTIAL***** primary residential access lines, a decrease in excess of *****BEGIN CONFIDENTIAL** **** **END CONFIDENTIAL*****. The fact that AT&T Illinois' lost lines are about twice the number of CLEC/cable lines added during this two-year period reflects the continued increase in the number of households that rely exclusively on alternative technologies, such as wireless service and pure-play VoIP services (lines which are not fully reflected in the E9-1-1 data used to develop the estimated number of CLEC/cable lines).

Q. Dr. Selwyn and Dr. Liu contend that the carriers which rely on the market-based replacement for the UNE-P (*i.e.*, Local Wholesale Complete) may not be able to effectively compete with AT&T Illinois. (AG Ex. 1.0, pp. 17-18; Staff Ex. 1.0, pp. 12-15). Do you agree?

A. No. The LWC platform enables the carrier to provide not only local usage and features but also Band C and intraLATA toll, interLATA toll and originating and terminating switched access services. Presumably, the revenues available from selling these services provide a sufficient margin for those carriers that have entered into LWC agreements to justify their decisions to enter (or remain) in the market using that platform. There currently are 35 CLECs operating in Illinois who have entered into LWC agreements with AT&T Illinois and rely on the LWC platform to compete with AT&T Illinois in the provision of service to residential and business customers. In the Greater Illinois MSAs, 29 CLECs currently serve residential customers using the LWC platform. In fact, two of

the carriers cited by Dr. Liu as offering packages that are comparably priced with the packages offered by AT&T Illinois rely on LWC.

Q. Dr. Liu expresses concern that resale may not be a viable platform for competition because resale rates increase and decrease as retail rates increase and decrease. (Staff Ex. 1.0, pp. 9-10). Is she correct?

A. No. That is the way the resale rate-setting formula in the federal act is *supposed* to work. However, in Illinois, the Commission (over AT&T Illinois' objection) placed resale rates under the Company's Alternative Regulation Plan – which means they are capped. Therefore, resale rates do *not* increase when retail rates increase. As a result, resale competitors enjoy much larger margins on most resold services than the resale formula would permit and their costs do not increase when AT&T Illinois' retail rates increase.

Q. Dr. Liu raises a question why carriers use a combination of their own and a third party's facilities, rather than using AT&T Illinois' or their own. (Staff Ex. 1.0, pp. 20-22). Would you provide some perspective on this issue?

A. Yes. The most obvious reason a carrier uses a combination of its own and a third party's facilities, rather than using AT&T Illinois', is that the third party carrier either is offering a better price or is more convenient due to the proximity of the third party carrier's facilities. The types of services offered by CLECs and other third party carriers on a wholesale basis includes not only local switching, but also long-haul transport, termination services, origination services, tandem services, and back-office operations

that the purchasing carrier would otherwise have to develop for itself. This is similar to the many long-distance companies which use the wholesale offerings of other carriers in order to transport and terminate the calls of their customers. The availability on a wholesale basis of facilities and service from third parties other than AT&T Illinois further promotes the ability of carriers to effectively compete for residential basic local exchange customers. For example, as I stated in my Direct Testimony, Mediacom uses a combination of its own facilities and those of Sprint to provide basic local exchange service to its customers. Mediacom relies on Sprint, among other things, to assign and port telephone numbers and to provide the interexchange routing and hauling of calls. Mediacom clearly believes that Sprint has an expertise in these areas and has determined that it would rather use Sprint to provide these functions than spend the time and capital necessary to provide those functions on its own. The growth rate for Mediacom is *****BEGIN CONFIDENTIAL** *****END CONFIDENTIAL***** times that of Charter.[4] Pure-play VoIP providers also have partnered with CLECs that provide wholesale services, enabling the VoIP providers to offer local residential telephone service to their customers. For example, Vonage partners with Level 3 and other CLECs, which provide Vonage with numbering resources and termination services.

Q. Dr. Selwyn claims that there is no correlation between AT&T Illinois' continuing loss of lines and the concomitant increase in wireless subscribers. (AG Ex. 1.0, Sch. LLS-2, pp. 18-19). Do you agree?

[4] Calculation based on residential E9-1-1 listings as of 12-31-2006 compared to 6-3-2008.

A. Obviously not. It is true, as Dr. Selwyn points out, that wireless "additions" have grown at a much faster rate than AT&T Illinois has lost lines. I would agree that many of these cellphone lines are new lines – not replacements for AT&T Illinois' wireline service. But it would be absurd to suggest, as Dr. Selwyn does, that *none* of these cellphone lines are substitutes for wireline service. The cut-the-cord phenomenon is real and growing, as documented by all available research data.

Q. Dr. Selwyn also attempts to minimize the significance of the shift in usage from wireline to wireless service. (AG Ex. 1.0, Sch. LLS-2, p. 19). Please comment.

A. Dr. Selwyn wants to minimize or negate the shift in usage patterns because it demonstrates that consumers are substituting their wireless services for wireline services. As my Direct Testimony pointed out, intrastate billed switched access minutes have dropped 80% since 2000. Furthermore, the substitution effect is not just on toll calls but also local calls. From 2000 to 2007, the annual number of local calls originated by AT&T Illinois fell by 9.4 billion, a drop of over 50%. This 50% reduction in local calling is far greater than the 30% drop in access lines AT&T Illinois experienced over that same time period. The difference reflects a reduction in the number of local calls per access line. Annual local calls per residential access lines fell from 2,724 in 2000 to 1,955 in 2007. The calls that are no longer being made over the wireline network are being made using wireless phones. Thus, on an annual basis, almost 770 local calls per access line that were formerly being originated on the wireline network are now being originated on a wireless network.

III. COMPETITION FROM CABLE, WIRELESS, AND VOIP PROVIDERS

Q. Dr. Selwyn generally contends that the competition AT&T Illinois faces from cable, wireless, and VoIP providers should be disregarded in determining whether its local exchange service in the Greater Illinois MSAs is competitive. Please comment.

A. As was the case in the MSA-1 reclassification proceeding, Dr. Selwyn ignores the very real competition that exists for AT&T Illinois' local exchange services in the Greater Illinois MSAs. Although Dr. Selwyn advances different theories as to why each of these competitor groups do not "count," his bottom line is the same: there is no competition. This flies directly in the face of the observable activity in the marketplace and the loss of lines and usage being experienced by AT&T Illinois.

A. CABLE

Q. Dr. Selwyn claims that cable competition does not count because AT&T Illinois and the cable companies constitute a "duopoly" in these MSAs, and they do not compete. (AG Ex. 1.0, pp. 27-29). Is this true?

A. No. Dr. Taylor discusses the issue of duopoly from an economic perspective. From an AT&T Illinois perspective, the Company certainly views the cable companies as major competitors. In fact, the Company's network and marketing decisions over the last four to five years have been heavily driven by the need to compete effectively with them. AT&T would not have embarked on its $4-$6 billion network initiative to provide video services to customers ("U-verse"), or entered into a strategic marketing agreement with Direct TV, if it did not take the full range of competition from cable providers (telephony, broadband, and video) very seriously. Since the record was developed in

Docket No. 06-0027, AT&T has spent over $900 million rolling out U-verse, and this service is now available in more than 69 metropolitan areas passing 14 million living units in AT&T's 22-state footprint, including two metropolitan areas and 270 communities in Illinois.

The cable companies also see AT&T as a serious competitor. For example, Stephen B. Burke – Comcast Chief Operating Officer, Executive Vice President, and President of Comcast Cable, stated the following during Comcast Corporation's 3rd Quarter Earnings Call on October 29, 2008: "We continue to grow (phone service) penetration and are now over 13%. We have some markets with penetration in excess of 20% and others that are quickly approaching. We are confident that there is plenty of room for growth left in this business and we are on pace to add over 2 million new phone customers this year." Then, during the question and answer portion of the call, Mr. Burke responded to a question on competition as follows: "We are actually seeing more competition from AT&T than Verizon right now and that was the exact opposite a year ago. We monitor it very, very carefully. AT&T has so much broader a footprint that we actually think they are having a greater effect on our business than Verizon. In both AT&T and Verizon's case, we obviously believe that we are taking more phone and data customers from them than they are taking video from us but clearly we've seen a shift of late where AT&T is proving to be a more formidable competitor than they were."[5]

[5] See Comcast Q3 Earnings Call Transcript at http://seekingalpha.com/article/102684-comcast-q3-2008-earnings-call-transcript?page=1 , viewed on December 9, 2008.

Q. Has there been price competition between AT&T Illinois and cable companies during this period?

A. Definitely. The prices for bundled service have been dropping. In 2006, Comcast was making offers for the triple play for promotional period of either 6 months or 1 year, at prices between $99 and $129.95 per month. (See Schedule WKW-R2). Today, the triple play is offered by both AT&T and Comcast for between $69 to $79. (See Schedule WKW-R3). This represents a discount of 20% to 40% from the low-priced end of Comcast's 2006 offers. Also the price of stand-alone voice service from Comcast has dropped from $54.95 to $34.95, a 36% price drop.

Q. Dr. Selwyn asserts that "even a cursory examination of the mass media and direct mail advertising" of AT&T Illinois and Comcast "confirms" that the "two providers overwhelmingly concentrate on selling these service bundles . . . via promotional offers with limited-time discounts that automatically increase to higher non-discounted levels once the promotional period has ended." (AG Ex. 1.0, Sch. LLS-2, p. 16). Is this assertion accurate?

A. No. To the contrary, starting in 2007, much of AT&T Illinois' mass media and direct mail advertising responded to Comcast's promotional offers by emphasizing that the advertised prices for AT&T Illinois' bundles, unlike Comcast's, do *not* reflect "limited time discounts that will automatically increase to higher non-discounted levels once the promotional period has ended." (See Schedule WKW-R4). Apparently, AT&T Illinois' marketing practices in this regard have had an impact on Comcast, which has recently

been running an ad campaign stating that the advertised prices for its bundles are not limited-time promotional rates. (See Schedule WKW-R5).

Q Have other cable companies done similar things?

A. Yes. For example, in apparent response to AT&T's advertising, Mediacom, over the past couple of years, has lengthened its promotional price period from 6 month to their current offer of 18 months. (See Schedule WKW-R6).

Q. Do AT&T Illinois' customers view cable telephony to be functionally equivalent to AT&T Illinois' wireline service?

A. Yes. The cable companies have been very successful in persuading customers to switch telephony providers. The charts below show the increase in cable telephony subscription levels in MSA-1 and the Greater Illinois MSAs over the last several years:

*****BEGIN CONFIDENTIAL**

Chart 1

Cable Residential E-911 listings in MSA-1				
	12/31/2004	12/31/2005	12/31/2006	12/31/2007
Estimated Lines				
% Yr/Yr increase				
% Total increase				

Chart 2

Cable Residential E-911 listings in the Greater Illinois MSAs		
	12/31/2007	6/30/2008
Estimated Lines		
6 month increase		

END CONFIDENTAIL ***

As Chart 1 above indicates, the total number of cable residential lines in MSA-1 now exceeds the total of all CLEC and cable lines that were in service in MSA-1 as of the end of 2005, the time period of the MSA-1 proceeding. Cable subscriber levels would not be increasing at this dramatic rate unless residence customers viewed cable telephony service as equivalent to and as a substitute for AT&T Illinois' wireline basic local exchange service.

Q. Dr. Selwyn claims that cable telephony is not the functional equivalent of AT&T Illinois' wireline service because the customer has to subscribe to some other service to obtain it "at all or at the best price." (AG Ex. 1.0, p. 12). Do you agree?

A. No. Customers do not have to subscribe to other cable services to obtain cable telephony. The cable providers described in my testimony and that of Mr. Panfil offer telephony service on a stand-alone basis. Furthermore, Mr. Panfil's price comparisons include both the stand-alone and bundled prices and demonstrate that cable telephony is a viable alternative under either pricing plan. The fact that customers can obtain an even better

price if they also subscribe to the cable company's cable TV and/or cable modem Internet service is a "plus" to the customer, not a "minus." Dr. Selwyn seems to assume that no one subscribes to cable TV or broadband services today. This is hardly the case. The cable companies pass about 96.5% of all U.S. households and about 90% of the U.S. television households subscribe to a pay TV service. About 60% of TV households receive their pay TV from cable (this figure is 59% for the Greater Illinois MSAs), 28% from satellite and about 2% from historical telephone companies.[6] Further, about 63% of Illinois households receive high speed Internet service from either cable modem or DSL providers.[7] In Illinois, 98% of households that are passed by cable have cable modem service available to them. A survey by the Claes Fornell International Group found that nearly 60% of households now have bundled services – this represents an increase of 13% over the 2007 survey[8] – and in the Greater Illinois MSAs, about 60% of the households subscribe to bundled services (this assumes that all cable telephony customers also subscribe to one or more additional services offered by the cable company). In short, many customers could switch to the telephony service offered by cable companies at the attractive bundled price without increasing their total "spend" on the combination of cable TV and/or broadband access and telephony services.

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[6] See IDC Report U.S. Pay TV Service Provider Quarterly Update, 3Q08, by Greg Ireland, December 2008. Total US Television Households estimated of 112,275,000 from National Cable & Telecommunications Association.

[7] Figure derived from dividing total residential high speed internet access lines, Table 13 from FCC's High-Speed Services for Internet Access: Status as of June 30, 2007 report, by the 2007 Household estimate for Illinois, see http://factfinder.census.gov/servlet/STTable?_bm=y&-qr_name=ACS_2007_1YR_G00_S1101&-geo_id=04000US17&-ds_name=ACS_2007_1YR_G00_&-_lang=en , viewed on December 18, 2008.

[8] 2008 Telecom-Cable Industry Satisfaction Report, Phil Doriot and John Gilbert, at page 3.

Furthermore, in October 2007, Angelynne Amores, a Comcast Spokesperson, stated that "Comcast brought Illinois consumers a real choice for local phone service, and today we add 1,000 new Comcast phone customers every single day we do installations, most of whom have left AT&T." By anyone's count, losing a thousand customers a day to just one of AT&T Illinois' competitors is significant.[9]

B. WIRELESS

Q. Dr. Selwyn claims that wireless plans are a substitute for wireline service only for " . . . at best certain demographics, such as young single adults." (AG Ex. 1.0, p. 11). He further claims that this substitution is ". . . minimal . . ." and represents a ". . . minute percentage of customers in certain demographic groups . . ." (p. 17). Is he correct?

A. No. It is true that young adults have embraced wireless substitution, as Mr. Shooshan acknowledged in his Direct Testimony. (AT&T Ill. Ex. 4.0, p. 23). However, this substitution is not minimal, and it is by no means limited to young adults. *First*, as I stated in my Direct Testimony, 15.8% of all households nationwide have "cut the cord," according to data developed by the Center for Disease Control ("CDC"). Based on Scott Taylor's data, *20%* of all households in the Greater Illinois MSAs have cut the cord. (AT&T Ill. Ex. 5.0, pp. 8-9). Since my Direct Testimony was filed, on December 17, 2008, the CDC released its latest wireless substitution data and the CDC now estimates,

[9] See http://www.dailyherald.com/story/print/?id=63553 , viewed on December 15, 2008.

as of the first half of 2008, 17.5% of all households nationwide are wireless[10] . These are hardly "minute" percentages, and my estimate of 16% of the households in the Greater Illinois MSAs being wireless-only may be understated.

Second, wireless-only households are not limited to one demographic group. The CDC breaks its wireless-only household data down by age groups. The chart below demonstrates that, although young people represent the biggest percentage of wireless-only users, customers in *all* age groups have cut the cord and the fastest growing age group, in 2008, of wireless-only households are those households with adults who are over 65 years old:

Percentage of adults living in wireless-only households, by age (United States)			
Age	Jul-Dec 2007	Jan-Jun 2008	Percent Change
18-24 years	30.6	31.4	3%
25-29 years	34.5	35.7	3%
30-44 years	15.5	19.1	23%
45-64 years	8	9.2	15%
65 years and over	2.2	2.8	27%

Q. Dr. Selwyn suggests that, because many households are still dual users – i.e., they use both wireless and wireline service – wireless service is complementary to wireline service, not a substitute. (AG Ex. 1.0, pp. 11-12). Do you agree?

A. No. As the Company has regularly conceded in this proceeding and in Docket No. 06-0027), wireless and wireline service are not identical and have different attributes (*e.g.*,

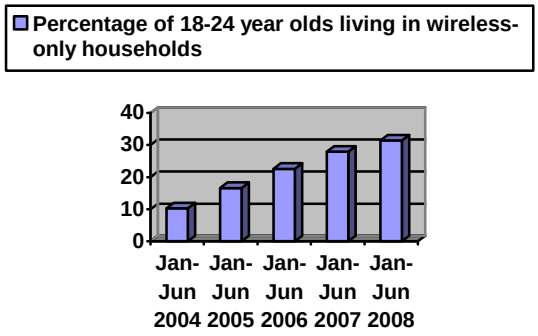
[10] See http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless200812.pdf , viewed on December 18, 2008.

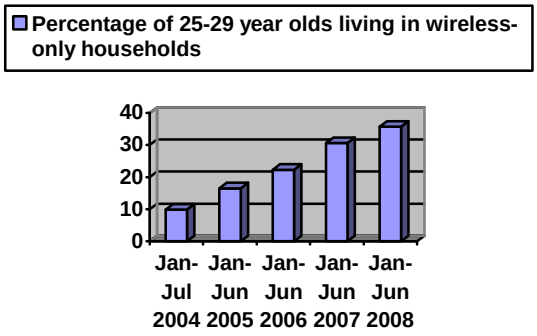
wireless is mobile and wireline is not). To the extent that customers have sufficient room in their budgets, they often choose to retain both. That does not mean, however, that wireline service is perceived by all dual-user households as superior to wireless service or that they could not or would not choose to be wireless-only if circumstances change. If a customer is budget-minded and have both services, which is the situation for the majority of households, the economic calculation boils down to the following question: is the incremental cost of going 100% wireless cheaper than keeping my landline phone? Many customers have clearly decided that the answer is "yes."

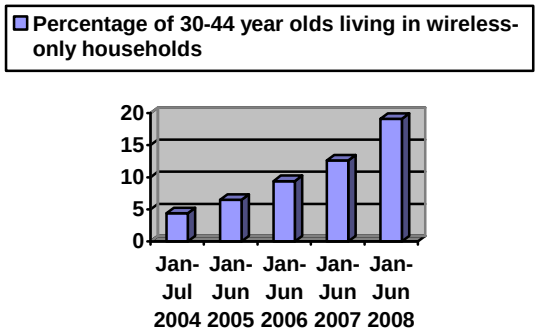
Q. Dr. Liu suggests that wireless service is a "good" substitute for wireline service only for these customers who have already cut the cord and that wireless service may not be a "good" alternative for other users (*i.e.*, those customers who currently use both wireless and wireline service). Is this supported by the empirical data?

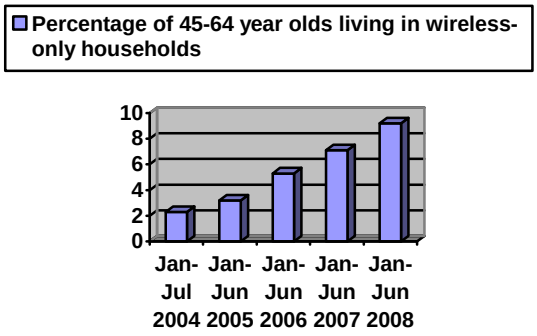
A. No. Customer decisions either to use wireless service only or to maintain both wireless and wireline service are much more fluid than Dr. Liu suggests. Customers are continually migrating from wireline-only to dual user wireline/wireless and from dual user wireline/wireless to wireless-only. Moreover, as Mr. Scott Taylor noted, dual users now make 41% of their at-home calls using their cell phone, and this in-home use of cell phones is increasing year-over-year. (AT&T Ill. Ex. 5.0, p. 13). As this percentage increases, the cost of maintaining both wireline and wireless phones will become harder to justify for many customers.

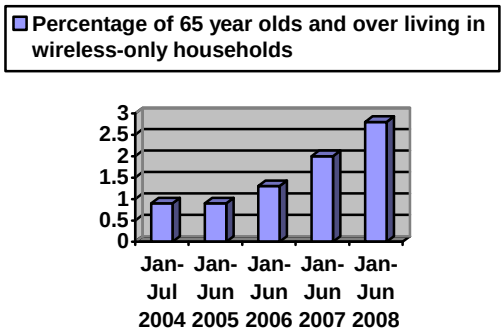
This continuing shift from dual users to wireless-only users is well-supported in the empirical data. CDC data demonstrate that the percentage of wireless-only households nationwide has more than tripled over the last four years, from 5.0% in the first half of 2004 to 17.55% in the first half of 2008. Equally important, it has more than tripled in *every age group* (with the exception of the elderly over 65, where it only doubled):











It is clear that all customers are making choices about the relative value of wireless vs. wireline service and that wireless – not wireline – is winning.

Q. Dr. Liu also expresses a concern about wireless reliability. (Staff Ex. 1.0, p. 29). Please comment.

A. Dr. Liu expresses a concern that, although wireless service has advantages over wireline service relative to mobility and text messaging functionality, it may not be superior with regard to service quality. In support of that concern, Dr. Liu compares call quality data for wireless phones (measured as problems per 100 wireless calls as reported by J.D. Power and Associates) with the trouble reports per 100 access line measures in the Commission's rules and AT&T Illinois' Alt Reg Plan. She suggests that the standards for wireline service are higher than what wireless service is achieving today.

I would not dispute the fact that AT&T Illinois' wireline service call quality is excellent, with very few uncompleted, dropped or static-y calls. I would also agree that, historically, wireless service has been less consistent on these types of service measures. However, Dr. Liu's concerns are premised on a number of misconceptions and do not provide a meaningful analysis of at-home call quality as between wireline and wireless service.

First, the wireless and wireline call quality measures Dr. Liu refers to are entirely different and cannot be directly compared. J.D. Powers asks users for the percent of *individual calls* out of *all calls* where there were service problems. Thus, the J.D. Powers

and Associates data reflects every call – not deficient service overall on a wireless "line." Also, the wireless problems that J.D. Powers surveys range from service issues that have a counterpart in wireline service (*e.g.*, dropped calls, failed connection on the first try, or static) to issues that do not have a counterpart in wireline service (*e.g.*, no immediate voicemail notification or no immediate text message notification). In contrast, the Commission's standard is the number of *trouble reports* per 100 *access lines*. In other words, the Commission's trouble report standard relates to service-affecting or out-of-service conditions on a *line* that are sufficiently serious or long-lasting to warrant a call to AT&T Illinois' repair operations – not individual *calls* that did not complete or the occasional bad connection that required redialing.

Second, and more importantly, the J.D. Powers and Associates data is not limited to *at-home* wireless calls. Most of the reliability problems experienced by cell phone users relate to the *mobility* aspect of the service. Customers can make wireless calls while moving from location to location because wireless networks are constructed using cell sites that are deployed throughout a geographic area. When customers move out of range of their wireless provider's network, depending on carrier-to-carrier agreements, an active call may be terminated because wireless calls cannot be rerouted over the wireline network while in progress. Customers making wireless calls at home are not outside the range of their wireless provider's network. Moreover, each cell site within a wireless provider's network has a defined geographic radius, and customers are handed off from one cell site to another as they move around. In some instances, calls are dropped during the hand-off. This is often due to a traffic imbalance between the two cell towers – if the

new tower is at capacity and the phone cannot find an alternative cell tower, the call will be dropped. These hand-offs do not occur when the cell phone is being used inside the home, because the customer is not moving from one cell site to another. There can also be line-of-sight issues as customers move through hilly or other problematical terrain, which are inapplicable in the context of in-home use.

Customers who intend to use their cell phone in their homes presumably choose wireless carriers that provide good service in the area where their homes are located. If call quality were not good in a customer's home, customers would switch to a service provider with better signal strength in that area. Switching between wireless providers has become much easier for customers since the FCC ordered wireless number portability in 2003 – i.e., customers may now switch wireless providers while keeping the same wireless number. In that same order, the FCC also required wireline to wireless number portability. As a result, customers who cut the cord can keep their wireline number.

Q. Are the cell phone providers ramping up their efforts to provide high quality service?

A. Yes. The wireless industry generally has made improved call quality a major focus over the last several years. Most of the major carriers have added network capacity and new cell sites to avoid problem calls. Nationally, over the last three years, the number of cell sites has increased by 42,447, from 178,025 in June of 2005 to 220,472 in June 2008. Also during this time period, wireless carriers invested $20 billion dollars each year in their networks, enabling them to increase the number of subscribers from 194.4 million to

262.7 million. Also during this time period, the annual number of minutes carried over those wireless networks almost doubled, rising from 1.26 trillion to 2.23 trillion minutes of use. Monthly SMS messages increased over ten-fold rising from 7.2 billion SMS messages a month in June 2005 to 75 billion SMS messages in June 2008. [11]

Q. Are the wireless companies making it easier for customers to ensure good call quality where they live and work?

A. Yes. Most wireless companies now provide coverage maps so that customers can make sure that signal strength is good in locations that are important to them before they are contractually committed. For example, T-Mobile provides very detailed coverage maps on its website and advertises as follows:

> ". . . T-Mobile shows that your phone will work where you live, work and play. You can see your signal strength, in the street level detail, before you buy."[12]

AT&T Mobility has one of the best coverage maps in the business. At the AT&T Coverage Viewer,[13] the customer types in an address and then can zoom down to the street level or zoom out to a national level. Users can define the level of detail they want to see. The coverage map is color-coded to indicate signal strength.

Verizon has a mapping application available on Verizon store computers. Customers can find locations by address, zip code, GPS coordinates, or landmark name. The map

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[11] See CTIA Wireless Quick Facts at http://www.ctia.org/advocacy/research/index.cfm/AID/10323 ,Viewed on December 18, 2008.

[12] See http://www.tmobilehasyoucovered.com/ and http://www.t-mobile.com/coverage/pcc.aspx

[13] The AT&T Coverage viewer can be found at: http://www.wireless.att.com/coverageviewer

depicts color-coded areas that represent the various service areas. Customers can pan around and zoom in/out, similar to Yahoo! Maps or MapQuest. Sprint has a similar on-line mapping application.[14]

Most of the major wireless carriers have also adopted liberal return policies, where customers can cancel service for any reason whatsoever within a defined period without incurring early termination charges on their contracts. For example, AT&T Mobility and Verizon Wireless both provide customers with a 30-day return option, while T-Mobile provides customers with a 20-day option. These policies allow customers to test their cell phones at home (and in other locations where they use them) to ensure that call quality is good.

Q. Do you have any other comments on Dr. Selwyn's claims regarding the alleged deficiencies of wireless service, citing to his Direct Testimony in Docket No. 06-0027?

A. Yes. In Docket No. 06-0027, Dr. Selwyn stated that wireless service is not a substitute for wireline service because of inoperability problems with alarm services. While it is true that some alarm companies install alarm equipment that is designed to dial out alarm messages to their central monitoring centers over the wireline phone lines, not all do. In fact, most alarm companies give the consumer a choice between a wireline or wireless

[14] The Sprint Coverage Tool can be found at http://coverage.sprint.com/IMPACT.jsp?language=EN viewed December 18, 2008.

connection to the central monitoring center and some alarm companies only sell systems that use the wireless cellular network to signal the 24-hour emergency center.[15]

The problem with wireline equipment is the fact that a burglar can simply cut the phone line outside the premises to prevent the alarm signals from reaching the emergency dispatchers. Therefore, many alarm professionals prefer a cellular, rather than a wireline, connection to their central monitoring centers.

Dr. Selwyn asserted that wireless technology was not a good substitute for faxing. However, today, the vast majority of residential households do not have a fax machine and those that do probably have not used it recently due to advancements in technology. Faxes have been largely replaced by email, which provides the document in its native form or in .pdf format. Fax machines are outdated technology and do not represent the future needs of residential consumers.

Dr. Selwyn also stated that a wireless phone was not a substitute for wireline service since it will run out of a charge during extended power outages. Once again this is a tired and outdated argument. Cellular phones hold charges far longer than they once did. For example, the Sony Ericsson W350 has a Talk time of up to 7 hours and a Standby time of up to 12.5 days. Another popular phone, the Motorola Razr V3, has similar capabilities. Furthermore, most residential consumers use cordless phones, whose functionality ceases altogether during a power outage.

[15] See http://www.guardcom.net/Security_Alarm_Monitoring.html and http://www.protectamerica.com/pa/monitoring/security-system both websites viewed December 18, 2008.

Dr. Selwyn also indicated that wireless E9-1-1 was not as precise and, therefore, was not a substitute for wireline service. Once again Dr. Selwyn is wrong. PSAPs receive millions of E9-1-1 calls from wireless phones and they are accustomed to handling such calls. According to the FCC, the number of 911 calls placed by people using wireless phones has radically increased. Public safety personnel estimate that about 50 percent of the millions of 911 calls they receive daily are placed from wireless phones, and that percentage is growing.[16] 911 call centers are accustomed to receiving calls from wireless callers and are trained to ask the pertinent questions when full E9-1-1 functionality is not received with the call.

Further, the FCC's Phase II E9-1-1 rules require wireless service providers to:

- within six months of a valid request by a PSAP, provide more precise location information to PSAPs; specifically, the latitude and longitude of the caller. This information must be accurate to within 50 to 300 meters depending on the type of technology used.

- by September 11, 2012, provide even more precise location information, specifically, information accurate to the closest PSAP. The FCC established a five year phase-in period for this requirement to allow wireless service providers more time to develop this capability. Wireless service providers must report to the FCC annually on their progress in supplying this more accurate location information for PSAPs with Phase II E9-1-1 capability.

C. PURE-PLAY (STAND-ALONE) VOIP SERVICE

Q. Dr. Selwyn claims that pure-play VoIP service is not a functional equivalent to AT&T Illinois' wireline service because broadband capabilities are required. Do you agree?

[16] See http://www.fcc.gov/cgb/consumerfacts/wireless911srvc.html viewed December 18, 2008.

A. No. It is true that customers must have broadband capability such as DSL or cable modem service to take advantage of pure-play VoIP service. However, over the last several years, high speed Internet service has become a mass market product. There are 2.9 million residential high speed lines in Illinois today (in 63% of the households). Most of these customers subscribe to DSL or cable modem service. For those still on dial-up access, given the extremely low prices for many VoIP services, the savings obtained from using VoIP rather than wireline telephony could pay for an upgrade to a broadband connection.

Q. Dr. Selwyn suggests that IP-providers like Vonage face a "highly uncertain future" because the FCC has not issued a clear response on the regulatory status of their services. (AG Ex. 1.0, Sch. LLS-2, p. 20). Please comment.

A. Although the FCC has not definitively stated what charges are applicable for VoIP-to-PSTN traffic, the FCC has made several rulings in recent years that are beneficial to IP-providers and that encourage IP- based market entry. *First*, in the FCC's Vonage Order,[17] the FCC preempted an order of the Minnesota Public Utilities Commission (Minnesota Commission) from applying its traditional "telephone company" regulations, such as certification and tariffing requirements, to Vonage's DigitalVoice service. In that Order, the FCC further explained that state regulation of services having the same capabilities as DigitalVoice would also be pre-empted.

[17] FCC 04-267, Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission, Released November, 12, 2004.

Second, the Enforcement Bureau inquired about allegations that Madison River was blocking ports used for VoIP applications, thereby affecting customers' ability to use VoIP through one or more VoIP service providers. On February 11, 2005, the Enforcement Bureau issued a Letter of Inquiry to Madison River. In less than one month, a Consent Decree was adopted[18] which bars Madison River from blocking ports used for VoIP applications or otherwise preventing customers from using VoIP applications. Here, the FCC sent a strong signal to LECs that it will not tolerate the blocking of IP-based services.

Third, the FCC made it clear in its Time Warner Interconnection Order[19] "that telecommunications carriers are entitled to interconnect and exchange traffic with incumbent LECs pursuant to section 251(a) and (b) of the Act for the purpose of providing wholesale telecommunications services. The Bureau finds that a contrary decision would impede the important development of wholesale telecommunications and facilities-based VoIP competition, as well as broadband deployment policies developed and implemented by the Commission over the last decade, by limiting the ability of wholesale carriers to offer service." In this Order, the FCC made it clear that the pure-play business VoIP business model is viable. Contrary to Dr. Selwyn's assertion, therefore, the FCC has ensured that these independent providers can maintain their access to the public switched telephone network. Moreover, pure-play VoIP providers can

[18] FCC DA 05-543, Released March 3, 2005.
[19] FCC 07-709, Released March 1, 2007.

continue to partner with wholesale CLECs[20] that will wholesale call termination, call origination, E9-1-1 capabilities, numbering resources, transport, and so forth.

What Dr. Selwyn glosses over is that the pure-play VoIP service represents a major technological advancement. In the residential market, this is the first time that the provision of basic local exchange service has been separated from transport. This affords the pure-play VoIP provider enormous cost advantages. Mr. Shooshan's Direct Testimony at lines 576-578 lists a few of the many pure-play VoIP carriers that provide residential basic local exchange service.

IV. PRICE CHANGES

Q. Dr. Selwyn contends that this reclassification should not be approved because prices in MSA-1 increased after the Commission's Order in Docket No. 06-0027, particularly stand-alone local service rates. (AG Ex. 1.0, pp. 20-23; Sch. LLS-2, pp. 3-9). Would you provide a summary reaction to his argument?

A. Yes. Dr. Selwyn's analysis is more than a little odd. The Commission's Order in Docket No. 06-0027 contained a lengthy analysis of AT&T Illinois' stand-alone local exchange rates and concluded that they were too low to attract competition. (*Order in Docket No. 06-0027*, adopted August 30, 2006, at 94-95). In approving the reclassification, the Commission accepted a proposal by AT&T Illinois and the Citizens Utility Board ("CUB") which established a schedule for future rate increases for network access lines

[20] The FCC's Order mentions Sprint and Verizon Business (formerly MCI) as wholesale CLECs.

and local usage. The Commission also ensured that there would be "safe harbors" for customers for whom rate increases were problematical, by accepting the AT&T Illinois/CUB proposal to lower and cap the prices for certain packages for a number of years (now called the "Consumer's Choice" packages). Nowhere does Dr. Selwyn mention these critical components of the plan approved in the Commission's Order, despite the fact that he actively participated in that proceeding. Instead, he implies that the MSA-1 rate increases were entirely unexpected and purports to be shocked by them.

Given the extensive debate over this proposal in Docket No. 06-0027, these omissions are puzzling. AT&T Illinois notes that, according to Dr. Selwyn, his Report (including the pricing analysis) was actually prepared last summer at the request of the Attorney General – not for use in this docket. (AG Ex. 1.0, p. 6). It is not clear who was the intended audience for the Report or what purpose it was to serve. In any event, Dr. Selwyn's pricing arguments are, at best, materially incomplete and add little of value to *this* proceeding.

I will discuss Dr. Selwyn's arguments with respect to MSA-1 and the Greater Illinois MSAs separately.

A. MSA-1

Q. Dr. Selwyn dismisses out-of-hand the idea that AT&T Illinois' stand-alone local exchange services are being provided "below a competitive price." (AG Ex. 1.0, p. 23). Please comment.

A. Dr. Selwyn ignores the fact that this Commission made *exactly* that finding in the MSA-1 proceeding, and that this finding was the basis for approving increases in the network access line and usage prices on a phased-in basis.

Q. Dr. Selwyn provides a chart comparing the price increases for the network access line in MSA-1 with the lack thereof in the Greater Illinois MSAs. (AG Ex. 1.0, p. 22, Figure 2). A similar chart is provided in his Report that contrasts the increases for local usage in MSA-1 with the decreases in the Greater Illinois MSAs. (AG Ex. 1.0, Sch. LLS-2, p. 6). Please comment.

A. These charts demonstrate nothing. As I stated earlier, the network access line and usage increases in MSA-1 were clearly contemplated by the Commission at the time of the Order in Docket No. 06-0027. Similarly, the Commission would have been well aware that network access line and usage rates would remain flat or decline in the Greater Illinois MSAs because they were still subject to the Alt Reg Plan. What Dr. Selwyn intended to show by this comparison is a mystery.

Q. Are the prices that result from the Alt Reg Plan appropriate benchmarks in determining reasonable rates in any event? (AG Ex. 1.0, p. 22, Figure 2; AG Ex. 1.0, pp. 8-9).

A. No. As AT&T Illinois explained in Docket No. 06-0027, the Alt Reg Plan has out-lived its usefulness as a regulatory mechanism and has actually had an anticompetitive effect on the marketplace. Since 1994, when the Plan was first adopted, the price index has forced AT&T Illinois' local exchange rates – particularly its stand-alone rates – to levels

that no competitor could match and make a profit. The Commission recognized the need for rate increases in Docket No. 06-0027. The fact that rates have continued to go down in the Greater Illinois MSAs (or stay flat, as in the case of network access lines) is a negative – not a positive – outcome. These decreases make the environment even more hostile to competitors than in MSA-1 and make it even less likely that they would offer a stand-alone local service rate option to their customers.

Q. Is there a counterpart today to AT&T Illinois' Alt Reg Plan in other jurisdictions?

A. No. Price indexes are a thing of the past at the FCC and in almost all states. The FCC eliminated annual rate adjustments from the federal price cap plan in the 2000-2004 time frame. Most states followed suit at that time (or earlier). Today, Illinois is the *only* state that still requires annual rate reductions. In fact, many states have effectively deregulated local exchange service altogether, e.g., Indiana, Arkansas, Missouri, Michigan, Iowa, and Oklahoma. Other states have deregulated optional services such as packages and central office and allow rate increases on basic services like network access lines and usage, subject to annual limits, e.g., New York, Mississippi, Kansas, South Carolina, and Alabama. These latter plans have provisions that are quite similar to the caps that the Commission adopted in the MSA-1 case for network access lines and local usage.

Stated another way, one of the *benefits* of a competitive classification is that it removes the reclassified services from the Alt Reg Plan and stems the downward spiral in their rates.

Q. Dr. Selwyn contends that, with the exception of the Consumers' Choice packages, AT&T Illinois has ". . . increased prices for its service bundles as well" during this period. (AG Ex. 1.0, Sch. LLS-2, pp. 8-9). Is he correct?

A. No. Dr. Selwyn has fundamentally mischaracterized AT&T Illinois' pricing activities with respect to packages. Overall, AT&T Illinois' package prices have gone down, not up.

Q. Did the prices for uSelect 3 go up as Dr. Selwyn contends?

A. Yes. However, they only increased in Access Areas A and B. The revenues associated with those rate changes represent only $3.7 million, or 7% of the total increased annual revenue identified by Dr. Selwyn[21]. The prices for most of the other packages that AT&T offered (e.g., one-line uSelect 6 and the Select Feature Package) did not change during this period.

Q. Dr. Selwyn suggests that the Select Feature Package, priced at $28, was the replacement service for uSelect3, priced at $25.00.[22] Is he correct?

A. No. *First*, the Select Feature Package was introduced on December 19, 2006. The uSelect3 and uSelect6 feature packages were not grandfathered until January 1, 2008. So all three packages coexisted for more than a year. *Second*, it is not appropriate to compare the Select Feature Package to uSelect3. The uSelect3 package offered customers a network access line, unlimited local usage, Caller ID and a choice of two

[21] Dr. Selwyn's figures were corrected to remove the IMF elimination.
[22] During 2007 and 2008 uSelect3 rates in Access Area C been reduced from $23.05 to $22.10.

additional features, for a total of only three features. The Select Feature Package offered customers a network access line, unlimited local usage, and eight features. The uSelect6 package offered customers a network access line, unlimited local usage, Caller ID and a choice of five features, for a total of six features. Therefore, it would be more appropriate to view the Select Feature Package as comparable to uSelect6, not uSelect3.

Q. Was the Select Feature package more expensive than uSelect6?

A. No. It was cheaper. The Select Feature Package was priced at $28.00, compared to $29.00 for uSelect6. Moreover, it contained two extra features. Therefore, it represented a price reduction, not a price increase.

Q. What package was the alternative to uSelect3?

A. The alternative package for customers who would otherwise have subscribed to uSelect3 would have been the existing Consumers' Choice Plus package, which offers customers a network access line, unlimited local calling and 2 features (instead of 3).

Q. Is Consumers' Choice Plus more expensive than uSelect3?

A. No. It is cheaper. Consumers' Choice Plus costs $16.00 in Access Area A, $19.00 in Access Area B and $19.85 in Access Area C. These prices are all lower than the $25 price for uSelect3 in Access Areas A and B and the $22.10 price for this package in Access Area C. Customers purchasing Consumers' Choice Plus instead of uSelect3, therefore, would see lower rates.

Q. Has there been subsequent pricing activity relative to the Select Feature Package?

A. Yes. In September of 2008, AT&T Illinois rolled out Complete Choice Enhanced and grandfathered the Select Feature Package on November 14, 2008. Complete Choice Enhanced offers customers a network access line, unlimited local calling, 7 standard features, as well as 4 additional voicemail features and Privacy Manager on a optional basis, all for no additional charge.

Q. Is Complete Choice Enhanced more expensive than the Select Feature Package?

A. No. Prices have gone down again. The price for Complete Choice Enhanced is $26.00 in all Access Areas, compared to $28.00 for the Select Feature Package. And it offers more features that customers may find valuable (e.g. the voicemail features). Again, this represents a price reduction, not a price increase.

Q. Was Complete Choice Enhanced actually part of a larger suite of packages?

A. Yes. In the other Midwest states, the AT&T company rolled out both Complete Choice Enhanced and Complete Choice Basic. Complete Choice Basic offers customers a network access line, unlimited local calling, Caller ID and Call Waiting, as well as four additional voice mail features on an optional basis, for $21. This is a substantially less expensive package than had been offered before in those states. However, in Illinois, Consumers' Choice Plus already offers essentially the same thing for less. And it gives the customer more options and flexibility in terms of feature selection (among other things, customers can subscribe to voicemail as one of their two features, which includes

the voicemail features). Therefore, AT&T Illinois did not offer Complete Choice Basic in this state.

Q. Dr. Selwyn also points to increases in the Company's rates for Caller ID, Call Waiting, the Late Payment Charge, the Convenience Fee, and Private Directory Listings in 2007 and/or 2008. (AG Ex. 1.0, pp. 20-21). Please comment.

A. These prices increases are entirely consistent with AT&T Illinois' position in the MSA-1 proceeding: i.e., that regulation had kept stand-alone local service rates below competitive levels and that increases would be appropriate to bring them closer to the market and/or were required to cover costs or other obligations. I will discuss separately (1) central office features, (2) the Late Payment Charge, (3) the Convenience Fee, and (4) Private Directory listings.

Q. Please discuss the increases which AT&T Illinois implemented for Caller ID and Call Waiting.

A. It is important to recognize that regulation, not the marketplace or customer demand effects, caused these features to be priced at a low level at the time of the Commission's Order in the MSA-1 case. A comparison of the rates for Call Waiting, Caller ID – Number, and Caller ID – Name & Number in 1988 (or when they were originally introduced, if later), in 2005, and today is shown below. Because additional increases are planned for January 2009, the 2009 rates are displayed as well:

	1988[23]	2005	2008	2009
Call Waiting	$2.50	$2.00	$4.68	$6.00
Caller ID – Number	$6.50	$4.84	$7.59	$7.99
Caller ID – Name & Number	$9.00	$5.66	$8.54	$9.99

Prior to the rate change in 2007, the rate for Call Waiting had not been increased since *1982*. There had been no previous increases for Caller ID- Number or Caller ID – Name & Number since they were introduced in the early 1990s. In fact, as the chart makes clear, these rates had actually declined prior to the MSA-1 case. These rate reductions were the combined result of AT&T Illinois' 1989 rate case (Docket No. 89-0033), the original Alternative Regulation Plan proceeding (Docket No. 92-0448/93-0239) and the Alternative Regulation Plan itself.

As is evident from the chart, the increases that led up to the current (*i.e.*, 2008) rates for these services largely recouped the regulatorily-required reductions. Even after the 2009 rate increases are taken into account, the "real" prices for two of the three features have still *declined*. The following chart compares the 2009 rates for these features with their inflation-adjusted 1988/introductory rates:

	2009	1988 Adj.[24]
Call Waiting	$6.00	$4.38
Caller ID – Number	$7.99	$9.90
Caller ID – Name & Number	$9.99	$12.91

[23] Caller ID – Number was introduced in 1991 and Caller ID – Name & Number in 1993.
[24] These rates were inflation-adjusted from 1988, 1991, and 1993, respectively, using the Bureau of Labor Statistics' inflation index.

Thus, for all intents and purposes, the January 2009 price increase for Call Waiting will be the first "real" increase in its price since *1982* and the rates for Caller ID – Number and Caller ID – Name & Number will still be below their inflation-adjusted levels.

Q. Are the rates charged by AT&T Illinois similar to the rates charged by other companies?

A. Yes. A comparison for the AT&T Midwest states is provided below:

	IL MSA-1 (2009)	**IN**	**MI**	**OH**	**WI**
Call Waiting	$6.00	$6.00	$6.00	$5.98	$6.00
Caller ID – Number	$7.99	$7.95	$7.86	$6.00	$7.45
Caller ID – Name & Number	$9.99	$9.95	$9.95	$9.95	$9.95

Thus, these rates are not out-of-line with those charged by other companies. These rate changes also reflect the corporate objective of standardizing pricing in the Midwest. Although customer service centers were at one time dedicated to specific states, they have since been centralized to achieve greater efficiencies, and they now serve multiple Midwest states. Consistent prices for services across the AT&T Midwest region reduce service representative training costs, desktop support costs and the likelihood of service representative errors in quoting prices to customers.

Q. Are these rate changes for central office features pro-competitive?

A. Yes. As the Commission recognized in its Order in Docket No. 06-0027, the unwillingness of competitors to offer local measured service in Illinois results in large part from the low profit potential for that type of rate structure. (*Order in Docket No. 06-*

0027, adopted August 30, 2006, at 94-95). Although the Commission's Order focused on the under-pricing of network access lines and local usage, revenues from popular features like Call Waiting and Caller ID also contribute to the overall profitability of providing local service on a stand-alone basis. Thus, these increases are just as pro-competitive in effect as the increases authorized by the Commission for stand-alone network access lines and local usage.

Q. Do increases in stand-alone central office feature rates impact a large portion of AT&T Illinois' customer base?

A. No. The majority of AT&T Illinois' customers buy services in packages, which are unaffected by these increases. Specifically, only 12% of AT&T Illinois' customers subscribe to stand-alone Call Waiting, 16% to stand-alone Caller ID – Number, and 15% to Caller ID – Name and Number.

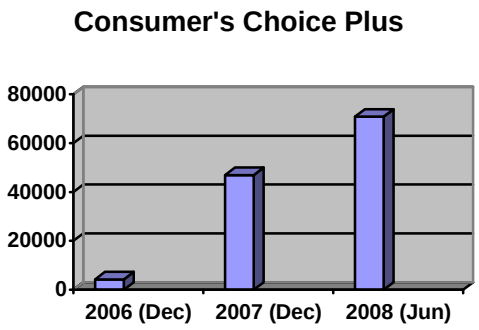
Q. Do customers have alternatives within AT&T Illinois' rate structure if these rate increases are problematical for them?

A. Yes. AT&T Illinois offers Call Waiting and Caller ID at discounted rates when purchased in packages or bundles. Importantly, these packages include Consumer's Choice Plus, which allows customers to choose two features at the bundled price which can include Call Waiting and Caller ID. This package was approved by the Commission in Docket No. 06-0027 as one of the "Safe Harbor" packages. This package allows price-sensitive customers to protect themselves from rate increases on central office features.

Customers can switch at any time to the Consumer's Choice Plus package, or any other package, in response to price changes implemented by the Company.

Q. Have customers, in fact, made use of their "Safe Harbor" option?

A. Yes. As the chart below demonstrates, the number of subscribers to Consumer's Choice Plus has increased steadily since the MSA-1 case order was adopted.



Q. Dr. Selwyn also complains about the change in the Late Payment Charges from 1.5% of the unpaid balance to $5.00 or 1% of the unpaid balance, whichever is higher, contending that it has resulted in a "four-fold" increase. (AG Ex. 1.0, p. 10; p. 21, Table 1). Please comment.

A. This rate change has already been the subject of several rounds of correspondence between the Attorney General's office, AT&T Illinois and the Commission in late 2007 and early 2008. *First*, customers can easily avoid this fee by paying their bills on time. *Second*, as the Attorney General's office has been advised several times, an increase was *required* for this rate element to cover its LRSIC costs – a mandatory obligation for competitive service pricing under Section 13-502 of the Act. AT&T Illinois' previous

Late Payment Charge of 1.5% on unpaid amounts was established in *1987*. Labor and other costs associated with treating delinquent accounts have increased substantially since then. Since AT&T Illinois' prior 1.5% charge was not compensatory, it had to be increased to comply with Illinois law applicable to competitive services.

Q. Is AT&T Illinois' Late Payment Charge consistent with those of other carriers in Illinois?

A. Yes. For example, according to Talk America's tariff, it charges a late payment charge of $5.00 plus 1.5% per month on unpaid balances. Comcast charged a flat $5.00 per month for its tariffed Digital Voice Service. It now charges a sliding scale for its Digital Phone Service in the Chicago area ($1.50 on day 30 with an additional $1.50 for each 30 days that payment is late, $5.45 on day 47 with an additional $5.45 for each additional 30 days that payment is late) and $7.00 outside Chicago ($7.00 on day 37, with additional $7.00 charges for each additional 30-day increment). Verizon North's tariff imposes a late payment charge of $5.00 or 1.5% of the unpaid balance, whichever is greater. AT&T Illinois' charge is identical to Verizon's, with the exception that the 1% of the unpaid balance alternative in AT&T Illinois' tariff is *lower* than Verizon's.

Q. Please discuss the "Convenience Fee" instituted by AT&T Illinois.

A. With the institution of the Convenience Fee, customers are charged $5.00 when they ask a Customer Service Representative to process payment of their bill over the telephone. Customers continue to have all of the free bill payment options that are available today (*e.g.*, they can pay by mail, use automatic bill payment arrangements and make on-line

payments). Charging such fees is standard in the industry. All of the other AT&T Midwest companies charge a Convenience Fee. Commonwealth Edison charges its customers a $3.50 fee for paying a bill over the telephone *or* over the Internet (AT&T Illinois does not charge for on-line payments). Peoples Gas charges $3.95 for both telephone and web-based payments. While Verizon refuses to process such telephone-based requests at all, it will on-line transfer customers to a third party vendor who will process the payment for a $3.50 charge.

Q. Did implementation of the Convenience Fee have anything to do with the MSA-1 reclassification case?

A. No. As even Dr. Selwyn acknowledges, it was implemented state-wide in all of AT&T Illinois' exchanges, both competitive and non-competitive. (AG Ex. 1.0, p. 5, n. 1).

Q. Please discuss Private Directory Listing charges.

A. Private Directory Listing charges apply when customers do not want their phone number listed in the telephone directory (*i.e.*, their phone number would be available only from Directory Assistance or would not be available at all). AT&T Illinois has charged for this option for many years to discourage customers from removing themselves from the directory unless they have a compelling reason to do so. Non-published numbers work a hardship on *other* customers – they have to incur Directory Assistance charges to obtain the number or they cannot reach that subscriber at all. Therefore, AT&T Illinois believes that increases in these rates were appropriate. However, as a result of concerns expressed

by the Commission Staff, the Company has decided to roll back the rates to their prior levels. The reduced rates will go into effect in March.

Q. In Schedule LLS-2 (p.9), Dr. Selwyn asserts that, "at current subscriber levels", price increases for the MSA-1 residential services that were the subject of the competitive classification investigation in Docket No. 06-0027 have resulted in "a net annual revenue increase of $51.6-million." Elsewhere, in his testimony, Dr. Selwyn asserts that the annual revenue impact of those price increases "was actually fairly close" to his estimate of "$30.6 million" made in Docket No. 06-0027 and that "[i]n aggregate, cumulative MSA-1 rate increases have resulted in approximately $80 million in added revenues for AT&T Illinois between January 1, 2007 and the end of 2008." (AG Ex. 1.0, p.8). What is your understanding of the basis for these assertions?

A. Based on my review of work papers obtained from the Attorney General through discovery, it appears that Dr. Selwyn purported to calculate the annual impact of what he determined to be price increases that occurred in 2007 and 2008. Dr. Selwyn calculated the annualized net increase in revenues resulting from 2007 price changes (both increases and decreases) to be $32.8 million. This is apparently the basis for Dr. Selwyn's assertion regarding the alleged accuracy of his $30.6 million estimate in Docket No. 06-0027. The $51.6 million figure cited at page 9 of Schedule LLS-2 is Dr. Selwyn's estimate of the annualized net increase in revenue resulting from the rate changes (both increases and decreases) in both 2007 and 2008. Implicit in this calculation is an estimate that the rate changes that occurred in 2008 produced an annualized increase in revenues

over 2007 of approximately $19 million ($51.6 million - $32.8 million). Dr. Selwyn's estimated "aggregate, cumulative added" revenues for the years 2007 and 2008 of approximately $80 million was derived by adding the $32.8 million and $51.6 million figures.

Q. Did Dr. Selwyn accurately calculate the annualized increase in revenues resulting from the price changes that occurred during 2007 and 2008?

A. No. Dr. Selwyn's calculations reflect a number of conceptual and factual errors that result in overstating the revenue impact of those price changes. *First*, Dr. Selwyn did not base his calculations on current demand. Rather, he used subscribership levels at December 31, 2007. Because of continuing reductions in residential demand for AT&T Illinois' access lines and usage in Illinois, including MSA-1, Dr. Selwyn's failure to use the most current demand data available serves to inflate his estimates of the annualized impact of rate changes on revenues. In early October, 2008, AT&T filed with the Commission a report showing subscribership levels in MSA-1 as of June 30, 2008.

Second, in calculating the annualized increase of rate changes in 2007, Dr. Selwyn incorrectly assumed that, in 2007, AT&T Illinois increased the monthly stand-alone access line rate by $2.00 and increased the local measured service usage rate by $0.01 per message unit. In fact, AT&T Illinois increased the access line charge and usage rate by $1.00 and $0.005, respectively, in 2007 and implemented additional increases in those amounts in 2008. As a result of this error, Dr. Selwyn overestimated the annualized revenue increases for 2007.

Third, in calculating the annual impact of price changes in 2008, Dr. Selwyn incorrectly assigned a price increase of $0.79 for every package. The amount of $0.79 represents the elimination of the infrastructure maintenance ("IMF") monthly credit. That credit was implemented in 1999 in response to 1997 legislation which established line item billing of certain state and municipal fees that had previously been embedded in rates for local service. The credit was intended to serve as a temporary measure to insure that customers were not billed twice for the same fees. The IMF credit did not represent a decrease in the price of any particular service or package. Rather, the IMF credit was applied to the total amount billed to each customer for the services purchased by that customer. Effective October 20, 2007, the IMF credit was eliminated for customers of all packages (including those classified as noncompetitive and purchased by customers in the Greater Illinois MSAs, as well those competitively classified packages purchased by customers in MSA-1).[25] The credit was eliminated because the local rates for package customers have never reflected an allowance for the recovery of the state and municipal fees recovered through surcharges and, therefore, a credit is not now (and was never) needed to prevent double recovery of such fees from package customers. Thus, the elimination of the IMF credit is not a result of, and has absolutely nothing to do with, the competitive classification of residential services in MSA1. For these reasons, it is inappropriate to treat the elimination of the IMF credit as package price increases

[25] To be conservative and in the spirit of the Joint Proposal of AT&T Illinois and the Citizens Utility Board approved in Docket No. 06-0027, AT&T Illinois did not remove the IMF credit from bills of customers who subscribe to the "Safe Harbor" packages.

resulting from the Commission's approval of the competitive classification of the residential services at issue in Docket No. 06-0027.

Fourth, Dr. Selwyn made a number of miscellaneous errors in his assumed price changes for certain specific packages and features, e.g., he failed to reflect a price decrease for the Economy Solutions Package, and included a non-existent price increase for the uSelect 6 package**.**

Q. Have you recalculated the annualized revenue impacts of the 2007 and 2008 price changes, correcting for the errors in Dr. Selwyn's analysis summarized above?

A. Yes, correcting for Dr. Selwyn's errors and using the data on subscribership levels as of June 30, 2008, the annualized increases in revenues resulting from the MSA-1 residential service rate changes in 2007 was $21.3 million (not $32 million, as claimed by Dr. Selwyn) and the annualized increase in revenues resulting from the additional price changes that took place in 2008 was $23 million. As a result, the combined annualized increase in revenues resulting from the price changes that occurred in both 2007 and 2008 was $44.3 million, not $51.6 million, as claimed by Dr. Selwyn.

Q. Do you have any comments on Dr. Selwyn's assertion that the "aggregate, cumulative MSA-1 rate increases have resulted in approximately $80 million in added revenues for AT&T Illinois between January 1, 2007 and the end of 2008" ?

A. Yes. Dr Selwyn has attempted to exaggerate the impact of the annual rate changes in MSA-1 by adding up his estimated annualized revenue increases for the years 2007 and

2008. As discussed above, those annualized increases were incorrectly calculated. Using Dr. Selwyn's approach and the corrected annualized revenue figures would result in cumulative total revenues of $65.6 million. Furthermore, even as corrected, Dr. Selwyn's approach overstates the total amount of additional revenues resulting from MSA-1 residential price changes actually collected by AT&T Illinois during the years 2007 and 2008 because (1) it assumes that all of the rate changes during a particular year took place at the beginning of that year when, in fact, the changes were implemented at various times throughout the year; and (2) it fails to take into account changes in demand during the year.

Q. Do you have any comments on Dr. Selwyn's assertion that the prediction he made in Docket No. 06-0027 regarding the annual impact of rate increases that would occur as a result of the competitive classification of residential services in MSA-1 was fairly accurate?

A. Yes. Dr. Selwyn claims that he predicted annual increases in revenue of $30.6 million. Dr. Selwyn forgets that, in errata to his testimony filed on June 1, 2006 in Docket No. 06-0027, he increased that figure to $32.94 million. This translates into a predicted annualized increase in revenues resulting from price increases for two years (2007 and 2008) of $65.88 million ($32.94 plus $32.94). Compared to Dr. Selwyn's own estimate in this case of $51.6 million, Dr. Selwyn's estimate in Docket No. 06-0027 was off by over $14 million, or over 27%. When compared to my corrected calculation of the annualized impact of the 2007 and 2008 price changes of $44.3 million, Dr. Selwyn's prediction in Docket No. 06-0027 was off by $21.5 million, or about 48%.

Q. Dr. Selwyn suggests that you were wrong in Docket No. 06-0027 to challenge the revenue increase predictions made by Dr. Selwyn in that case as "being an exaggeration." (AG Ex. 1.0, p.8). Do you agree with that suggestion?

A. No, I do not. As I have discussed, Dr. Selwyn's prediction was, fact, inaccurate. One of the primary reasons why Dr. Selwyn's prediction was so far off is because, in Docket No. 06-0027, he erroneously assumed that AT&T Illinois would increase the monthly price of every package by $1 per year in tandem with the stand-alone network access line increases. This assumption accounted for $37.68 million of the $65.8 million predicted annual revenue impact of price increases in 2007 and 2008. It was this assumption that was the focus of my criticism of Dr. Selwyn's predictions in Docket No. 06-0027. (Docket No. 06-0027, AT&T Ex. 1.5, p.25). As it turns out, my criticism of Dr. Selwyn's prediction, unlike the prediction itself, *was* accurate. Prices for the vast majority of residential packages have not increased at all in MSA-1. The annualized net impact of all price changes in the MSA-1 residential packages during 2007 and 2008 was less than *$61,000*, 98% less than the revenues reflected in Dr. Selwyn's prediction. Taking into account the reductions in the prices for the "Safe Harbor" packages which were implemented in late 2006, the impact of all changes in MSA-1 package prices since the issuance of the order in Docket No. 06-0027 was an annualized *reduction* in revenue of approximately $4 million.

Q. Dr. Selwyn asserts that when "revenues from the uSelect replacement plan 'Select Feature' are included, the *annual net revenue increase rises to $149.0-million per*

***year* as a result of price changes." (AG Ex. 1.0, Sch. LLS-2, p. 9) (emphasis in original). Do you agree with Dr. Selwyn's assertion?**

A. No. To arrive at that number, according to his workpapers, Dr. Selwyn assumes that the entire $28 price of the Select Feature Package represents a price increase in 2007 and that the entire price of the Select Feature Package (plus elimination of the 79 cent IMF credit) represents a price increase of $28.79 in 2008. This is nonsense because it essentially assumes that all customers who take this service were previously paying $0 for the same or a comparable service.[26] This number is not even consistent with Dr. Selwyn's stated theory in his testimony that the Select Feature Package was a replacement for the uSelect 3 package, and, therefore, that the $28 price of Select Feature Package represented a $3 price increase when compared to the $25 price of the uSelect 3 package in Access Areas A and B. Even under this theory, Dr. Selwyn's calculated estimate of the revenue impact of the Select Feature Package would be overstated by a multiple in excess of 9 times ($28/$3). Moreover, Dr. Selwyn's theory is wrong. As previously discussed, the Select Feature Package is far more comparable to the more expensive uSelect6 package, which has also been grandfathered. Accordingly, if anything, the price of the Select Feature Package represents a price decrease, not a price increase.

[26] It also erroneously assumes that elimination of the 79 cent IMF credit represents an increase in the price of the Select Feature Package.

B. GREATER ILLINOIS MSAS

Q. On page 9 of Dr. Selwyn's testimony, he presents a graph showing the increases in the prices for network access lines, "message units"[27] and Caller ID that could be expected in the Greater Illinois MSAs. Please comment.

A. There are a number of problems with his chart. *First*, it implies that all of these increases will take place at once. In fact, they will be phased in, just as the MSA-1 increases were phased in. *Second*, the increase in the network access line price is exaggerated, because Dr. Selwyn starts the bar chart at $8.20 (the other charts start at $0). *Third*, the absolute amount of the increases in the Greater Illinois MSAs will be higher than in MSA-1, but only because the Alt Reg Plan resulted in economically inappropriate *reductions* in rates for usage and Caller ID in the Greater Illinois MSA since the MSA-1 reclassification. In any event, they will be phased in starting at the lower level, just as the MSA-1 rate increases were.

Q. Dr. Selwyn estimates that, as a result of the competitive classification of residential local exchange service in the Greater Illinois MSAs, residential customers in those LATAs "will experience rate increases totaling approximately $13.95 million annually, following whatever transitional rate increase schedule AT&T Illinois adopts." Do you have any comments regarding Dr. Selwyn's estimate?

A. Yes. Based a review of Dr. Selwyn's Schedule LLS-4 and his responses to AT&T Illinois' data requests, it appears that the $13.95 million figure is Dr. Selwyn's estimate

[27] Dr. Selwyn's use of the term "message units" is woefully out of date. AT&T Illinois eliminated message unit pricing for Bands A and B calling at least 15 years ago and replaced it with conventional price/minute pricing.

of the annualized effect on revenues of all rate increases that he predicts will occur over a three-year period. For example, Dr. Selwyn's calculation assumes that the monthly stand-alone access line rate will increase by $2.00 and that the local measured service usage rate will increase by almost two cents in the Greater Illinois MSAs. Dr. Selwyn, however, appears to acknowledge that rate increases of these amounts would not necessarily occur all at once in the first year following approval of the competitive classification and, therefore, that his estimated $13.95 million increase in annual revenues may be phased in over a number of years. In fact, as I will discuss, AT&T Illinois commits, for a period of four years, to limit any increases in the monthly access line rate to $1.00 per year and to limit any increases in the usage rate to one-half a cent per year. Thus, the annualized increase in revenues resulting from any price increases in the first year following this docket would be significantly less than $13.95 million.

Q. Do you have any additional comments regarding the $13.95 million estimate?

A Yes. As indicated in Schedule LLS-4, in calculating this estimate, Dr. Selwyn assumes that AT&T Illinois will raise the price of every package by $0.79, equal to the IMF credit that the Company removed in October of 2007. As I have previously discussed, the removal of the IMF credit does not represent a price increase resulting from the competitive classification of residential rates. Moreover, the credit was removed for customers of packages in the Greater Illinois MSAs in October of 2007, at the same time that it was removed for customers of packages in MSA-1. Accordingly, there will be no future increases in costs to the Greater Illinois LATA package customers resulting from removal of the credit.

Dr. Selwyn's calculation is also flawed because it erroneously assumes that there will be no reduction in present demand for the services and packages represented on Schedule LLS-4 due to continued competition from alternative service providers. Dr. Selwyn's analysis also erroneously assumes that not one of the existing 207,000 local measured service customers in the Greater Illinois MSAs would take advantage of the "Safe Harbor" packages, which were designed for the express purpose of providing local measured customers who make few calls or use two or fewer features with a means of avoiding the impact of potential increases in prices for stand-alone network access lines, usage and features.

Q. Dr. Selwyn estimates that, over a three-year period, the average residential customer will experience cumulative rate increases of between $68 and $85 for the services they currently purchase. Do you agree with this estimate?

A. No. Dr. Selwyn's testimony in this regard is misleading. He apparently arrived at this estimate by dividing his estimate of the range of "accumulated" additional revenue resulting from price increases over a three-year period ($28 million to $35 million) by the number of access lines (407,005[28]) in service in the Greater Illinois MSAs as of June 30, 2008. These "accumulated" additional revenue numbers, however, do not represent Dr. Selwyn's estimate of the annualized revenue impact of all of the rate increases that are assumed to occur over the next three years (that estimate is $13.95 million). Rather, Dr.

[28] Dr. Selwyn does not identify the precise number of lines he used to perfrom his calculation. Therefore, I have used the number of residential lines in the Greater Illinois MSAs in service as of June 30, 2008.

Selwyn's estimated "accumulated" additional revenues represent the addition of (1) three years of the annualized revenue increases resulting from rate increases assumed to occur in year 1, (2) two years of the annualized revenue increases resulting from rate increases assumed to occur in year 2, and (3) one year of the annualized revenue increases resulting from rate increases assumed to occur in year 3. As a result, in arriving at his estimated average rate increase per residential customer of $68 to $84, Dr. Selwyn effectively triple counts and double counts the rate increases assumed to occur in years 1 and 2, respectively. Based on Dr. Selwyn's estimate of the annualized revenue increase of $13.95 million, the average annual increase in revenues per residential customer in the Greater Illinois MSAs resulting from Dr. Selwyn's assumed rate increases over the next three years would be approximately $34 ($13.95 million/407,005). This equates to an increase in the average monthly bill of less than $3.00.

VI. FINANCIAL MEASURES

Q. Dr. Selwyn alleges that there has been a "persistent escalation in AT&T Illinois' profitability" which, he claims, "confirms" the absence of competitors for the provision of basic local exchange service in Illinois. (AG Ex. 1.0, p. 23; Sch. LLS-2, p. 9). Do you agree with Dr. Selwyn's allegation?

A. No. In support of his allegation, Dr. Selwyn charts AT&T Illinois' rates of return ("ROR") on intrastate investment, as reported in the Annual Monitoring Reports filed by AT&T Illinois pursuant to the Commission Order approving the Company's Alt Reg Plan, for the years 2002 through 2007. Based on this chart, Dr. Selwyn claims that "prior to the competitive reclassification" of residential basic local exchange service (which

occurred in November 2005), AT&T Illinois had "consistently earned a rate of return of approximately 10%," but that "following AT&T Illinois' price increases on residential services in MSA-1, the Company's intrastate rate of return has jumped to well over 25%." (AG Ex. 1.0, p. 24). Dr. Selwyn's claims are extremely misleading.

Q. In what way are Dr. Selwyn's claims misleading?

A. *First*, the intrastate ROR for 2007, as reported in the Annual Monitoring Report, was 24.72%, not "well over 25%." Dr. Selwyn relies on a higher ROR figure developed based on data that does not reflect Commission-required adjustments.

Second, Dr. Selwyn arbitrarily begins his analysis with the year 2002. The rates of return on intrastate investment reported by AT&T Illinois in the years 2000 and 2001 at the time of the Alt Reg Review proceeding in Docket Nos. 98-0252 and 98-0335 (Consolidated) were 23.80% and 18.97%, respectively. Thus, contrary to Dr. Selwyn's assertion, it is not true that, prior to the November 2005 competitive classification of residential service in MSA-1, AT&T Illinois "consistently earned a rate of return approximately 10%." A comparison of the reported intrastate rate of return of 24.72% for 2007 to the 23.80% intrastate rate of return reported for 2000 indicates that AT&T Illinois is not earning significantly more on its intrastate investment than it did at the time of the Alt Reg Review proceeding. In fact, as I discuss below, when properly normalized, the reported ROR for 2007 is actually less than the ROR for 2000.

Third, Dr. Selwyn's own evidence does not support his assertion that there was a huge jump in the intrastate rate of return "[f]ollowing AT&T Illinois' price increases in residential services in MSA-1." (AG Ex. 1.0, p. 24). According to Dr. Selwyn's chart, the largest increase in the intrastate rate of return was from approximately 9% in 2005 to approximately 22% in 2006. However, none of the increases in the prices for residential services in MSA-1 about which Dr. Selwyn complains occurred until 2007. There were no price increases during 2006 for any of the residential services classified as competitive in November of 2005.

Q. In your opinion, do the intrastate RORs, as reported in the Annual Monitoring Reports filed by AT&T Illinois for the years 2000 through 2007, accurately illustrate the "trend" in profitability for AT&T Illinois' intrastate operations during the period from 2000 through 2007?

A. No. As discussed in the Rebuttal Testimony of Tim Dominak, those ROR results would, at a minimum, need to be adjusted to reflect (i) adjustments made by AT&T Illinois to income statements and balance sheets in Automated Reporting and Management Information System ("ARMIS") refilings for the years 2000 through 2006; (ii) normalizations for certain large one-time nonrecurring credits issued to customers in 2001 and 2002; and (iii) changes to depreciation expense and reserve to reflect a correction to accrual rates that were used to calculate the depreciation expense included in the Reports for the years 2003 through 2007. As adjusted, the intrastate rates of return for the years 2000 through 2007, are shown in the Table below:

YEAR	ADJUSTED RATE OF RETURN
2000	25.68%
2001	18.97%
2002	14.63%
2003	15.34%
2004	14.52%
2005	14.22%
2006	17.26%
2007	18.33%

As adjusted, it is clear that AT&T Illinois' intrastate ROR did not precipitously increase from around 10% in the years prior to 2006 to "well over 25%" in 2007, as Dr. Selwyn claims. Rather, the ROR fell from 25.68% in 2000 and 18.97% in 2001 to 17.26% in 2007 and 18.33% in 2007. While there was a modest increase in the ROR from a low of 14.22% in 2005 to 17.26% in 2006, that increase cannot be explained in any way by the competitive classification of residential services in MSA-1. As I stated earlier, there were no price increases for those services in 2006.

Q. Do the ROR figures, even as adjusted, represent the best measure of the "profitability" of AT&T Illinois' local exchange services?

A. No. As discussed by Mr. Dominak, even as adjusted to reflect the ARMIS accounting changes and other normalizations, the ROR figures – and, to an even greater extent, the return on equity ("ROE") cited by Dr. Selwyn and discussed below – significantly overstate the Company's financial performance, relative to its actual operating fundamentals. In fact, AT&T Illinois has suffered major losses due to competition in the local exchange marketplace. Specifically, from 2000 to 2007:

- Total switched access lines (business and switched) fell from 6.9 million to 4.8 million, a decrease in excess of 30%;[29]

- Total residence switched access lines fell from 4.2 million to 2.7 million, a decrease of 36%;

- Total Company operating revenues fell from $4.66 billion to $3.35 billion, a decrease of 28%;[30]

- Local service revenues fell from $2.59 billion to $1.28 billion, a decrease of 51%;[31]

- Total Company operating expenses fell only 10%, from $2.88 billion to $2.59 billion;

- Total Company billed switched access minutes of use fell from 32.2 billion to 14.7 billion, a decrease of 54%;

- Net Operating Revenue (the difference between Operating Revenues and Operating Expenses) fell from $1.778 billion to $761million, a decrease of 57%; and

- Net income fell from $853 million to $490 million, a decrease of 43%.

In sum, AT&T Illinois' access lines, local service revenues, total operating revenues, net operating revenue and net earnings have all declined dramatically over the past eight years. Moreover, these declines have been consistent year over year, with no "spike" resulting from the competitive classification of residential services in MSA-1. Accordingly, there is no basis whatsoever for Dr. Selwyn's assertion that there has been a "persistent escalation in AT&T Illinois' profitability" confirming the "absence" of

[29] Switched access lines exclude payphone.

[30] Total Company = State, Interstate, and Nonregulated. As discussed in Mr. Dominak's rebuttal testimony, normalization adjustments were made to revenues in 2000 to eliminate a $98 million customer credit for business reclassification and to revenues for the year 2002 to eliminate a $197 million customer credit for SBC/Ameritech merger savings. Revenues and expenses exclude non-customer AT&T affiliate charges.

[31] Usage, and Calling Features and excludes Payphone, Private Line, Cellular Mobile Access, and Public Utility Fund Tax and Fees.

competition. To the contrary, the significant reductions in access lines, revenues, and earnings are directly attributable to competition throughout the State of Illinois.

Q. Dr. Selwyn asserts that AT&T Illinois' rate of return on equity ("ROE") for the "jurisdictionally intrastate services" was "over 40% in 2007," a level which he asserts is "highly atypical when compared with the average ROE of other large US firms" and raises "serious concerns about the Company's market power." (AG Ex. 1.0, pp. 25-26). Do you agree with Dr. Selwyn's assertions?

A. No. AT&T Illinois does not calculate or report an ROE for "jurisdictionally intrastate services." Dr. Selwyn has provided no support for the 40% figure other than an extra-record reference to the "declaration" of a non-witness, Colin Weir, which was attached to Comments filed by the Attorney General's office in another case, Docket No. 08-0249. As AT&T Illinois pointed out in its Reply to those Comments, the ratio technique used by Mr. Weir for developing an estimated intrastate, jurisdictional ROE is "entirely one of [his] own invention" for which the Attorney General provided no support in the financial or economic literature. (*Reply Comments of AT&T Illinois*, Docket No. 08-0249, p. 5 (May 16, 2008)). For these and other reasons discussed in the Rebuttal Testimony of Dr. William Taylor, the ROE figure cited by Dr. Selwyn should be disregarded.

Q. Dr. Selwyn notes that AT&T Illinois' reported ROE exceeded 30% in each of the years 2006 and 2007. (AG Ex. 1.0, Sch. LLS-2, p. 10). Do you have any comments regarding those ROEs?

A. Yes. *First*, I would note that these ROEs, as presented in AT&T Illinois' Annual Monitoring Reports, are based on total Company data, and do not represent the return attributable to any particular segment of AT&T Illinois' operations. They are ROEs calculated for all of AT&T Illinois' operations, both interstate and intrastate, and both regulated (including competitive and non-competitive) and non-regulated. In this regard, it should be noted that, in 2007, local service revenues (which includes all business and residential local exchange services) were approximately $1.46 billion, equal to only 39.6% of the total operating revenues of $3.69 billion.

Second, the ROE figures, like the ROR figures included in the Annual Monitoring Reports, need to be adjusted in the manner summarized above and discussed by Mr. Dominak in his Rebuttal Testimony. As adjusted, the total Company ROE figures for the period 2000 through 2007 are as follows:

YEAR	ADJUSTED RATE OF RETURN ON EQUITY
2000	33.44%
2001	25.29%
2002	12.84%
2003	14.10%
2004	17.83%
2005	21.82%
2006	22.86%
2007	20.40%

As indicated, between 2000 and 2007, the adjusted, normalized ROE fell from 33.44% to 20.40%, a decrease of 39%. Contrary to Dr. Selwyn's suggestions, there has been no increase in "profitability" as measured by ROE as a result of increases in the prices for

services reclassified as competitive in November 2005. To the contrary, the adjusted normalized ROE fell approximately 11% from 2006 (22.86%) to 2007 (20.40%), the first year in which the prices for any of those services were increased.

Q. In your view, are the ROEs derived for AT&T Illinois, even as adjusted in the manner described by Mr. Dominak, the best metric for drawing conclusions regarding AT&T Illinois' financial performance?

A. No. While ROE, which is equal to net income divided by shareholder equity, is one of many metrics used to compare the performance of a firm with other firms in the same industry, it is not used to compare firms in dissimilar industries. Moreover, the ROEs reported for the companies used by Dr. Selwyn to compare with AT&T Illinois, are ROEs calculated for each company as a whole, and for financial reporting purposes using Generally Accepted Accounting Principles ("GAAP"). Thus, for example, for financial reporting purposes, AT&T Inc. reports an ROE for all business segments on a consolidated basis. For 2007, that ROE was 10.35%. AT&T Inc. does not calculate or report an ROE for individual business segments such as wireline. In contrast, the ROE figures for AT&T Illinois included in the Annual Monitoring Reports are calculated on the basis of regulated books of accounts. Moreover, as discussed by Dr. Taylor and Mr. Dominak in their rebuttal testimonies, any comparison of an ILEC wireline ROE to the reported consolidated ROE results calculated for other companies is meaningless because of the non-comparability of the companies' business and corporate organizational and financial management structures and practices, including, for example, differences in

debt structure, dividend policy, capitalization policy, depreciation and expensing practices.

Q. Does the Federal Communications Commission ("FCC") require ILECs to calculate a ROE?

A. No. ROEs are not reported to the FCC on the ILEC ARMIS Form 43-02. Furthermore, the Illinois Commerce Commission does not require the reporting of ROEs by ILECs on the Commission's Annual Form 23.

Q. Do you have any examples that illustrate the unreliable nature of ROEs calculated for ILEC subsidiaries on the basis of regulated books of accounts?

A. Yes. The chart below compares consolidated ROEs calculated on the basis of GAAP for financial reporting purposes for three communications holding companies (AT&T Inc., Verizon, and Qwest) to the ROEs calculated on the basis of the regulated books of accounts for the wireline operations of those companies or their subsidiaries:

	ROE, Consolidated Financial Results[32]		ROE, Wireline Regulated Books[33]
AT&T	10.35%	AT&T Illinois	20.40%[34]
Verizon	11.12%	Verizon New Jersey	162.68%
		Verizon New York	-44.45%
		Verizon North (Illinois)	18.21%
		Verizon South (Illinois)	31.32%
		Verizon West Virginia	278.22%
		Verizon DC	44.61%
		Verizon Maryland	40.00%
		Verizon Delaware	10.22%
		Verizon Pennsylvania	6.14%
		Verizon New England	-29.62%
		Verizon California	24.70%
Qwest	3.80%	Qwest	181.98%

The wireline ROEs shown above vary so wildly and unpredictably, including even among ILEC subsidiaries of the same holding company (Verizon), that it is obvious they do not represent meaningful information regarding the profitability of local exchange service in today's competitive environment. Using Dr. Selwyn's measure, one would conclude that Qwest is the most profitable and stable RBOC, which is definitely not the case.

VII. STAND-ALONE LOCAL SERVICE

Q. Dr. Selwyn argues against the reclassification on the grounds that none of AT&T Illinois' competitors offer a stand-alone local service option. (AG Ex. 1.0, p. 11). Please comment.

[32] Source = Wall Street Journal year ending 12/31/07.
[33] Source = ARMIS 4.1.08.
[34] Normalized for customer credits, depreciation, and ARMIS refilings.

A. The competitive situation in the Greater Illinois MSAs is essentially identical to the one in MSA-1 relative to stand-alone local service rate plans. As Mr. Panfil explained in his Direct Testimony, neither the wireline CLECs nor the cable companies offered a measured service rate option in MSA-1; and, for all the same reasons, they do not offer one in the Greater Illinois MSAs. There are low-cost wireless plans that are available to customers who make little use of the network. However, to fully address regulatory concerns over this group of customers, the Company concluded that it should mirror its MSA-1 commitments to cap annual increases in the rates for network access lines and local usage and offer Safe Harbor packages in the Greater Illinois MSAs. Dr. Selwyn ignores this commitment.

Q. What is Staff's position on stand-alone local service rates and AT&T Illinois' commitment?

A. Dr. Liu agrees that stand-alone local service rates should be declared competitive on the same terms that they were declared competitive in the MSA-1 case. (Staff Ex. 1.0, pp. 47-50). The only material difference between AT&T Illinois' position and Staff's position is that, under the Company's proposal, the rate cap and Safe Harbor package protections would expire in the Greater Illinois MSAs when they expire in MSA-1. Staff recommends that the protections remain in place in the Greater Illinois MSAs for a four-year period comparable to what the Commission approved in the MSA-1 proceeding.

Q. What is AT&T Illinois' position?

A. AT&T Illinois believes that it would be better, from a public policy perspective, to bring the rates in the Greater Illinois MSAs in line more rapidly with the rates in MSA-1. However, the Company is willing to make the commitment requested by Staff.

Q. Dr. Liu also lists four other commitments from the MSA-1 proceeding that AT&T Illinois should extend to the Greater Illinois MSAs. (Staff Ex. 1.0, pp. 49-50). Please comment.

A. Dr. Liu recommends that AT&T Illinois: (1) send bill inserts to its customers in the Greater Illinois MSAs reminding them of the Safe Harbor packages; (2) semi-annually report to the Commission the number of customers subscribing to each of its services in the Greater Illinois MSAs, including the Safe Harbor packages; (3) allow customers to subscribe to the Safe Harbor packages online; and (4) file an annual report on competition that includes data for the Greater Illinois MSAs. AT&T Illinois understands these requirements to be modeled on the commitments agreed to in the MSA-1 proceeding. However, with the passage of time, some modifications would be appropriate. Therefore, I will discuss each of them separately.

Q. Please discuss the customer notification commitment.

A. In the MSA-1 proceeding, AT&T Illinois committed, in conjunction with CUB, to send out seven customer notifications over a four-year period: two bill inserts and two bill page messages in the first two 12-month periods following adoption of the Order (i.e., 2006-2008), two bill page messages in 2009 and one bill page message in 2010. AT&T

Illinois sent out the four required notifications in 2006-2008, and will send out the additional three in 2009 and 2010.

This obligation should be modified somewhat in connection with the Greater Illinois MSAs reclassification. The bill inserts and bill page messages which AT&T Illinois sent out to its MSA-1 customers were *also* sent to its customers in the Greater Illinois MSAs. Therefore, the customers who will be affected by the outcome of this proceeding are already well aware of the availability of the Safe Harbor packages and their prices (which are the same state-wide). In these circumstances, AT&T Illinois recommends that the bill insert requirement (which only applied during the first two years following the MSA-1 reclassification) not be part of any going-forward notification obligation for the Greater Illinois MSAs. AT&T Illinois will continue to include the Greater Illinois MSAs customers in the bill page messages issued during 2009 and 2010. At that point, any notification requirements can appropriately terminate, since *all* customers have received the same number and types of notification.

Q. Please discuss the semi-annual Subscription Report.

A. In compliance with the Commission's Order in Docket No. 06-0027, AT&T Illinois files a semi-annual report that shows the number of customers subscribing to each of its services in MSA-1, including the three Safe Harbor packages (Order, p. 122). It would be possible to submit the same data for the Greater Illinois MSAs as part of an expanded semi-annual report, and AT&T Illinois commits to making this change in its reporting practices.

Q. Please discuss the online ordering commitment.

A. In Docket No. 06-0027, the Commission ordered AT&T Illinois to allow online ordering of the stand-alone network access line and local usage, as well as the Safe Harbor packages, in a manner similar to the ordering of its other residential services. (Order, p. 123). Changes were made to AT&T Illinois' online-ordering systems in response to this requirement. Subsequently, in 2008, AT&T Illinois, the Attorney General's Office, the Citizens Utility Board ("CUB"), and Staff engaged in discussions regarding the scope of this obligation. As a result of these discussions, AT&T Illinois made further modifications to its online ordering systems to make it easier for consumers to order stand-alone service and the Safe Harbor packages. All participants in the discussions agreed to the modifications (as well as associated extensions in the duration of the cap on Safe Harbor package rates and the timing of the next $0.005/call increase in local usage rates) in June of 2008.

All of the online ordering system changes were implemented statewide. As a result, the customers in the Greater Illinois MSAs have had the same ability to order these services online as the MSA-1 customers since the Commission's Order in Docket No. 06-0027.

AT&T Illinois assumes that Ms. Liu's intent was to seek a commitment from AT&T Illinois that the online processes implemented as a result of the Commission's Order and the further changes resulting from the agreement between the parties in 2008 would

continue – not to impose any new or different obligations on the Company. AT&T Illinois agrees to make such a commitment.

Q. Please discuss the Annual Report on competition.

A. Pursuant to the Commission's Order in Docket No. 06-0027, AT&T Illinois is required to file an Annual Report that includes, at a minimum, updated versions of what were labeled Schedules WKW-5 and WKW-9 in the MSA-1 proceeding. Similar information for the Greater Illinois MSAs has been provided in this proceeding, as Schedules WKW-5 and WKW-8. It would be relatively straightforward to expand the Annual Report to include this data for the Greater Illinois MSAs, and AT&T can agree to such a commitment.

VIII. CONCLUSION

Q. Does this conclude your Rebuttal Testimony?

A. Yes.