BEFORE THE ILLINOIS COMMERCE COMMISSION

Docket No. 08-0569

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

AT&T Illinois Exhibit 1.2

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SURREBUTTAL 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 and Rebuttal Testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your Surrebuttal Testimony?

A. In this Surrebuttal Testimony, I will respond to portions of the Additional Rebuttal Testimony of Attorney General ("AG") witness Dr. Lee Selwyn.

II. EVIDENCE OF COMPETITION

Q. Dr. Selwyn suggests that economic barriers to entry exist because, "with the exception of cable operators . . . in the period since reclassification most CLECs have exited the MSA-1 market altogether or have suffered a significant loss of market share." (AG Ex. 3.0, p. 6). Do you have any comments in response to this assertion?

A. Yes. In assessing the level of competition faced by AT&T Illinois with respect to its residential local exchange services, it makes no sense to focus solely on non-cable CLECs to the exclusion of AT&T Illinois' major competitors – cable companies, wireless providers and VoIP entities. Moreover, even excluding "cable operators," most CLECs have not "exited the MSA-1 market altogether." The overall number of CLECs serving residential access lines in MSA-1 fell from 78 (which included 3 cable companies) as of December 31, 2005 to 72 (including 3 cable companies) as of December 31, 2007. Of these 72 CLECs, 10 were new non-cable CLECs which entered the MSA-1 residential local exchange market between December 31, 2005 and December 31, 2007, indicating that the market remains open to new, non-cable CLECs.

As I discussed in my Rebuttal Testimony, the fact that some of the CLECs that serve residential customers in MSA-1 at the end of 2005 are no longer in business or have fewer customers is not surprising, given that one of the FCC's policy goals in eliminating UNE-P was to remove "disincentives to investment posed by the availability of unbundled switching, in combination with unbundled loops and shared transport." *TRRO*, ¶ 200. The FCC barred unbundling requirements for switching "because unbundling would seriously undermine infrastructure investment and hinder the development of genuine, facilities-based competition." *Id.*, ¶ 218. The share of residential access lines served by wireline competitors of AT&T Illinois in MSA-1 increased approximately 43%, from 16.4% to 23.4%, between the end of 2005 and the end of 2007.[1] The percentage of those wireline competitors who provided service using their own facilities (switching and/or loops) increased from 59% to 88%. Thus, competition in Illinois has taken precisely the direction that the FCC intended to promote in the *TRRO*.

III. WIRELESS COMPETITION

Q. Dr. Selwyn contends that the "vast majority" of the population considers wireline service to be "essential" and that wireless service is not a competitive alternative. (AG Ex. 3.0, p. 16). Is this supported by the available evidence?

A. No, not at all. Dr. Selwyn simply assumes that every customer that subscribes to both wireline and wireless service or wireline service only *today* are AT&T Illinois' "captives." Dr. Selwyn used the same kind of static analysis in the MSA-1 proceeding where he claimed that there was only a "minimal amount of 'substitution' of wireless for wireline telephone service by a minute percentage of customers in certain demographic groups" and that wireless service was not an adequate substitute for anyone else. (AG Ex. 1.0, pp. 16-17). If Dr. Selwyn had been right that the customer group for whom wireline service was essential was immutably fixed, then the percentage of wireless-only households would remain unchanged since then. However, in just two years, the 9% of households that were wireless-only at the time of the MSA-1 case has almost doubled to 17.5%. Conveniently overlooking his testimony in the MSA-1 case, Dr. Selwyn now claims that the *current* percentage of customers that subscribe to wireline service

[1] Using a conservative 13.6% estimate of the percentage of wireless-only households in 2007 (the CDC estimated 15.8% for the second half of 2007), the combined CLEC/wireless share of the residential market for MSA-1 increased from 23.9% to 33.8% from year-end 2005 to year-end 2007.

(whether wireline-only or dual wireless/wireline) is immutably fixed and that wireless service is not a substitute for *them*. If customers keep transitioning from wireline to wireless service – and they clearly do – then it is absurd to suggest that the customer group that happens to subscribe to wireline service at any given point in time considers it "essential" and will never find wireless to be an adequate substitute. He was wrong in the MSA-1 case, and he is just as wrong now.

Q. Dr. Selwyn raises certain other issues relative to wireless service (*e.g.*, alarm service capabilities and single point of contact). (AG Ex. 3.0, p. 16). Please comment.

A. I do not understand Dr. Selwyn's argument that wireless phones cannot substitute for wireline service for "most households with existing central station burglar and fire alarm systems." As I explained in my Rebuttal Testimony, most alarm companies today give the customer a choice between a wireless and a wireline connection to the central station. ADT, one of the largest home monitoring companies, has offered a service that is specifically tailored for those households that do not have a traditional telephone line for several years. The service uses a cellular signal to transmit alarm signals to ADT.[2] Brinks will be rolling out a cellular-only service next month.[3] Some alarm companies,

[2] See http://www.adt.com/wps/portal/adt/for_your_home/products_services/security_systems/store?ru=http://alpha.commerce.adt.com/webapp/wcs/stores/servlet/ProductDisplay&storeId=10101&langId=-1&parent_category_rn=10112&productId=11406&catalogId=10101&commerceParams=ru,storeId,langId,URL,categoryId,debug,productId,parent_category_rn,catalogId&categoryId=10112 , viewed on January 28, 2009.

[3] Per conversation with a Brink's customer service representative, called January 26, 2009.

like Guardcom, only sell systems that use cellular radio to signal the 24 hour monitoring emergency center.[4]

I agree that wireline service can provide a single point-of-contact for a household. However, it is not at all clear how important that is to many consumers. Customers today are just as likely (if not more likely) to use their cell phone numbers as their primary contact numbers for friends, neighbors, family, companies they do business with, medical professionals, co-workers, and so forth because that is the number at which they can most reliably be reached. Teenagers live and die by their cell phones and typically have no interest in the "family" wireline phone. In fact, well before cell phones became ubiquitous, many families installed second lines as "teen/children" phones. For a substantial number of customers, the single point-of-contact concept harkens back to the *Father Knows Best* era.

Q. Dr. Selwyn contends that the fact that AT&T Illinois has not performed cross-elasticity studies between its products and those of its competitors means that the Company does not consider competitive price movements to be of ". . . real consequence . . ." (AG Ex. 3.0, p. 19). Is this correct?

A. No. There are numerous ways to assess competitive price movements short of cross-elasticity studies. As I understand cross-elasticity studies, they use large amounts of very detailed price change data to develop models that allow a company to translate the effect

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[4] See http://www.guardcom.net/Security_Alarm_Monitoring.html , viewed on January 29, 2009.

of, for example, a 1% increase or decrease in its own price into a percentage increase or decrease in demand for competitors' products. Far less complicated and expensive approaches would include a straightforward monitoring of competitors' prices (*e.g.*, by reviewing tariff filings, television and radio advertisements, direct mail solicitations and so forth). These prices can be compared to AT&T Illinois' prices over the relevant time periods and the competitive effects evaluated in light of AT&T Illinois' line loss data, line gain data for its competitors, customer "exit interviews" when they terminate service, and so forth. *That* AT&T Illinois does do. And, apparently, this is all that Dr. Selwyn intended by his testimony in any event. See Schedule WKW-S1.

Q. Dr. Selwyn dismisses Dr. Taylor's contention that there has been little independent variation in wireline prices, arguing that there has been "a substantial increase in MSA-1 prices over the past several years." (AG Ex. 3.0, p. 18). Please comment.

A. These rate changes have to be viewed in context. For Network Access Lines, there have been *two* $1.00/month rate increases in *18 years*. For local Bands A and B usage, there have been *two* $.005/message rate increases in the more than *20 years* since the current rate structure was adopted (and rates under the prior rate structure had been stable since at least the mid-1980s after the era of inflation-driven, back-to-back rate cases). These rate changes hardly constitute a wealth of data points.

IV. PRICING

Q. Dr. Selwyn asserts that, in an effectively competitive market, prices over time will come to equal long run incremental cost. (AG Ex. 3.0, p. 3). Please comment.

A. As Dr. Taylor explains, this statement reflects abstract economic principles that have little to do with the real world or the telecommunications industry in particular.

LRSIC costs in Illinois have always been treated as a price floor, not a price ceiling. With respect to individual competitive services, the Illinois statutory requirement is that revenues from the competitive service at least equal the LRSIC cost of the service, plus any imputed costs required by the PUA. Beyond that minimum price requirement, prices will reflect other market-related factors, such as the customer's perceived value of the service, willingness to pay, and the actions of competitors. Consequently, the revenues of some competitive services exceed LRSIC by narrow margins while other competitive services generate substantial margins. This does not mean that the latter services are priced too high. It simply means that market forces (and/or the residual impact of past regulatory policies) allow some services to generate more contribution than others – contribution that is essential if AT&T Illinois is to recover its actual costs of providing service, including its shared, common, and other costs that are not captured in LRSIC studies.

These price/cost relationships are, in part, a function of long-standing Commission pricing philosophies for the various components of local exchange service. For example, Network Access Lines ("NALs") are a major factor in AT&T Illinois' revenue stream and cost structure. Although residence NAL rates cover costs on a LRSIC basis, historically they have made little contribution toward covering AT&T Illinois' overall costs of operation. As a result, AT&T Illinois (as well as the Commission) has historically looked to other residential products to make up the difference between LRSIC and total costs: *e.g.*, Central Office Features, and local Bands A and B calling. This means that these products have always been priced well above LRSIC and have generated a substantial amount of contribution ("contribution" is defined as the difference between the rate and the LRSIC cost of the service). However, the contribution from local calling and Central Office Features has declined over time as those rates have borne the majority of the rate reductions required under AT&T Illinois' Alternative Regulation Plan. Most of the rate increases implemented by the Company for both local calling and Central Office Features over the last two years simply reversed (in whole or in part) the negative, anti-competitive pricing effects of the Alternative Regulation Plan.

LRSIC costs are particularly useless in assessing the reasonableness of any particular price due to the highly theoretical assumptions required by the Illinois Cost of Service Rule. For example, a significant component in LRSIC studies is the "utilization factor" – i.e., the percent of AT&T Illinois' network that is assumed to be used by customers and producing revenues. The Illinois Cost of Service Rule requires use of a utilization factor that assumes that there is no spare or unused capacity in AT&T Illinois' network, other than the amount required for network administration and maintenance. Because spare capacity is a cost that otherwise needs to be recovered from all of the revenue-producing facilities that are in use, the higher the utilization factor, the lower the LRSIC cost. Conversely, the lower the utilization factor, the higher the LRSIC cost. Recalculating LRSIC costs (especially NAL costs) using a utilization factor that reflects the actual amount of spare or unused capacity in AT&T Illinois' network would produce a substantial increase in these costs. Similarly, the Illinois Cost of Service Rule requires redesign of the network based on theoretical, forward-looking assumptions that substantially understate AT&T Illinois' actual network costs. AT&T Illinois also incurs a substantial amount of shared and common costs that are not addressed in LRSIC studies at all. As a general proposition, AT&T Illinois would soon be out of business if all of its services were priced at (or even slightly above) LRSIC. This is why LRSIC costs are a floor, not a ceiling, on prices.

In short, Dr. Selwyn is living in an economic fantasy world if he thinks that AT&T Illinois' rates will (or should) decline to the level of LRSIC costs. Most of the Company's rates substantially exceeded their LRSIC costs between the late 1970s (when cost studies were first developed) and the mid-1990s – a period when the Company was subject to strict rate-of-return regulation. Most of the Company's rates have continued to substantially exceed their LRSIC costs since 1994, when they became subject to the Alternative Regulation Plan. The mere fact that certain residence rates in MSA-1 were reclassified as competitive in 2006 did not magically transform AT&T Illinois' underlying cost structure or suddenly make LRSIC cost studies a realistic benchmark for prices. In fact, the advent of competition has made the dichotomy between AT&T Illinois' actual costs of operation and its LRSIC costs more pronounced. The loss of customers and network usage to competitors and competing technologies has resulted in a smaller base of customers/usage to support the costs of its existing network – which has *not* shrunk. LRSIC cost studies, on the other hand, are being performed as required by the Cost of Service Rule and continue to assume a level of network utilization that has nothing to do with the real world.

Q. Dr. Selwyn criticizes your reference to the prices charged by the other AT&T Midwest companies for Caller ID and Call Waiting. (AG Ex. 3.0, pp. 22-24). Please comment.

A. Dr. Selwyn argues that this comparison is irrelevant because the prices charged for AT&T Illinois' services ". . . were traditionally set to reflect the costs caused by Illinois consumers," referencing the geographical prices for Network Access Lines in Access Areas A, B, and C. This is a correct statement as applied to Network Access Lines. But it is beside the point for Central Office Features. As Dr. Selwyn recognized elsewhere in his testimony, the LRSIC costs associated with features are typically *de minimus*. (AG Ex. 3.0, p. 27). No telecommunications carrier establishes its feature prices based on costs. Furthermore, feature costs are not state-specific (except to the extent that different states have different approved service cost methodologies), because they are driven by central office switch costs which do not vary by geography. In other words, Illinois is *not* a "low cost area" relative to Central Office Features, and there are no cost "benefits" to be retained by Illinois consumers. (AG Ex. 3.0, p. 24). As a result, the rates charged by AT&T Illinois' sister companies in the Midwest are useful comparators in the context of Dr. Selwyn's claim that these price increases were inappropriate.

Q. Dr. Selwyn contends that, "interestingly," most of AT&T Illinois' competitors typically do not charge "extra" for Central Office Features. (AG Ex. 3.0, p. 23). Please comment.

A. Dr. Selwyn is being deliberately obtuse. These competitors do not charge "extra" for Central Office Features because they are providing services in *packages* – which provide the Network Access Line, local usage and Central Office Features for a single price. AT&T Illinois does not charge "extra" for features either when it offers customers *packages*. Pricing practices for packages demonstrate nothing about how features are (or should be) priced when offered on an á la carte basis to customers buying stand-alone local exchange service. Thus, Dr. Selwyn's "interesting" point is not interesting at all.

Q. Dr. Selwyn points out that AT&T Illinois will not achieve region-wide pricing consistency, because there are still some exchanges where these residential services have not been reclassified. (AG Ex. 3.0, p. 24, n. 26). Please comment.

A. Dr. Selwyn is correct that certain of AT&T Illinois' exchanges will remain under price caps even if this reclassification is approved. However, the exchanges that remain under price caps constitute approximately 1% of AT&T Illinois' total lines in service. The number of orders placed by this customer group is necessarily very small and has a minimal impact on service representative activities.

Q. Dr. Selwyn asserts that "AT&T Illinois increased revenues as a result of the competitive classification in MSA-1 by $73.1 million." (AG Ex. 3.0, pp. 26-27). Is that assertion accurate?

A. No, it is not. The competitive classification of residential local exchange services in MSA-1 did not result in "increased revenues" for AT&T Illinois. The competitive classification occurred in November of 2005. Through 2008, there has been a decrease in both the annual level of AT&T Illinois' total revenues and the annual level of revenues derived from residential local exchange services for MSA-1, as compared to the levels in 2005.

Q. Assume that what Dr. Selwyn intended to assert was that the annualized revenue impact of the changes to rates for residential local exchange services that occurred during 2007 and 2008 was an increase of $73.1 million. Is that assertion accurate?

A. No. Dr. Selwyn arrived at the $73.1 million figure by starting with $55.8 million, which is Dr. Selwyn's estimate, as presented in his Direct Testimony, of the annual revenue increase resulting from price increases for certain residential local exchange services in MSA-1 during 2007 and 2008. To that figure, Dr. Selwyn added $17.2 million, his new estimate of the annual revenue impact of a price increase allegedly attributable to the Select Feature Package.

In my Rebuttal Testimony, I explained at length the many conceptual and factual errors reflected in Dr. Selwyn's calculation of the $55.8 million figure, all of which resulted in overstating the revenue impact of the price changes that occurred in 2007 and 2008. (AT&T Ill. Ex. 1.1, pp. 44-46). Dr. Selwyn does not even address, much less refute, my Rebuttal Testimony on these points. In addition, I note that Dr. Selwyn's calculation does not take into account the annualized reductions in revenues resulting from the "Safe Harbor" package reductions which became effective in late 2006. (*Id.*, p. 48).

Dr. Selwyn's attempt to attribute increased revenues of $17.2 million to the Select Feature Package is without merit because there was no increase in the price of that package. As I discussed in my Rebuttal Testimony, the Select Feature Package, which offered customers a Network Access Line, unlimited local usage and eight features, was introduced on December 19, 2006 at a price of $28, and that price has remained the same even since. Accordingly, the annualized impact on revenues of changes in the price of the Select Feature Package is exactly zero.

Q. What do you say in response to Dr. Selwyn's continued assertion that the $28 price for the Select Feature Package should be recognized as a price increase relative to the price of the uSelect 3 Package?

A. Dr. Selwyn's assertion makes no sense. No customer on uSelect 3 has ever been forced to purchase the Select Feature Package. Furthermore, as I discussed in my Rebuttal Testimony, Dr. Selwyn is comparing "apples to oranges" when he compares the price of the Select Feature Package to uSelect 3, because the Select Feature Package contained eight features compared to only three features included with uSelect 3. Thus, while a customer would have paid more for the Select Feature Package than he or she would have paid for uSelect 3, the customer would also have received five additional features for the additional price. As I stated in my Rebuttal Testimony, a more "apples-to-apples" comparison would be to compare the Select Feature Package to uSelect 6, which includes six features (two fewer than the Select Feature Package) for a price that is more than the Select Feature Package.

In defense of his approach, Dr. Selwyn assumes that most customers who would have subscribed to uSelect 3, but can no longer do so because it has been grandfathered, would have subscribed to the Select Feature Package "because that is the smallest bundle in which all three of the desired features can be obtained." (AG Ex. 3.0, p. 25). This assumption, however, constitutes pure conjecture on the part of Dr. Selwyn. It is more plausible that customers who might have subscribed to uSelect 3 would subscribe to the existing Consumer's Choice Plus package, which offers customers a Network Access Line, unlimited local calling and two features at prices which are between $2.25 and $9 cheaper (depending on the Access Area) than uSelect 3. (AT&T Ill. Ex. 1.1, p. 34). Of course, any such customer would be free to purchase one or more additional features on an á la carte basis.

Finally, Dr. Selwyn's analysis completely ignores the fact that, as I previously testified, the Select Feature Package was grandfathered in late 2008 and that a new package (Complete Choice Enhanced), which provides even more features than the Select Feature Package, was introduced in September of 2008, at a price of $26, which is $2 less than the price of the Select Feature Package. (See AT&T Ill. Ex. 1.1, p. 35). This represents a price reduction, not a price increase.

Q. Dr. Selwyn asserts that increases in rates for Call Waiting and Caller ID with Name which occurred on January 5, 2009 will generate additional annual AT&T Illinois revenue in the range of $6.5 million to $7.0 million. (AG Ex. 3.0, p. 27). Is this estimate accurate?

A. No. As in the case of his estimates of the impact of price increase that occurred in 2007 and 2008, Dr. Selwyn did not base his estimate of the impact of the January, 2009 increases in rates for Call Waiting and Caller ID With Name on the current demand for those features on a stand-alone basis. Rather, he used demand levels as of December 31, 2007. Because of continuing reductions in residential demand, Dr. Selwyn's failure to use the most current demand data available caused him to overstate the annualized impact of the price increases on revenues. Even using year old demand data as of December 31, 2007, as Dr. Selwyn claims he does, the additional annual revenue generated is less than $6.5 million. If Dr. Selwyn had based his calculation on demand levels as of June 30, 2008, which were reported in the most recently filed MSA-1subscribership report, the annualized rate impact of the rate increases at issue would amount to about $5.2 million. Thus, Dr Selwyn overestimates the annualized rate impact by at least 25 to 35 percent. In fact, using end-of-year demand data for 2008 would show that Dr. Selwyn's estimate is overstated by an even greater amount.

V. FINANCIAL MEASURES

Q. At page 6 of his Additional Rebuttal Testimony, Dr. Selwyn makes the following assertions, which he quotes verbatim from his Direct Testimony: "[p]rior to the competitive classification granted in Docket No. 06-0027, AT&T Illinois consistently

earned a rate of return of approximately 10%, in line with the rates of return last authorized by this Commission and the FCC. 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%." Do you agree with Dr. Selwyn's assertions?

A. No. In my Rebuttal Testimony, I responded directly to these assertions and demonstrated that they are incorrect. (AT&T Ill. Ex. 1.1, pp. 53-56). Dr. Selwyn failed to even address, much less refute, my testimony in this regard.

Q. In his Rebuttal Testimony, Mr. Dominak presented evidence showing that, for the period from 2000 through 2007, AT&T Illinois experienced a 57% reduction in net operating revenue. Dr. Selwyn criticizes that testimony, asserting that "during the same time frame there was a significant *transfer of revenues* from what was then SBC Illinois to one or more non-regulated affiliates, offset by a significantly less than proportionate transfer of investment costs and operating expenses." (AG Ex. 3.0, p. 9) (emphasis in original). Do you agree with Dr. Selwyn's assertion?

A. No. In support of his assertion, Dr. Selwyn speculates that AT&T Illinois' drop in operating revenues over the past eight years is attributable to the loss of second lines, which Dr. Selwyn claims "were being used primarily for dial-up Internet access." Dr. Selwyn suggests that customers formerly served by such lost second lines have all shifted from dial-up Internet to AT&T-provided DSL or U-verse^{SM} Internet service, thereby transferring revenues "over to a non-regulated affiliate." (AG Ex. 1.0, p. 9).

Dr. Selwyn's assertions are unsupported. First, contrary to Dr. Selwyn's suggestions, the loss of second lines is responsible for only a small fraction of the decrease in AT&T Illinois' total operating revenues. For the period from December 31, 2000 to December 31, 2007, AT&T Illinois lost a total of 1.6 million residential access lines, of which only ***BEGIN CONFIDENTIAL *************** END CONFIDENTIAL*** were second lines. The vast majority of lost lines, ***BEGIN CONFIDENTIAL *** *************** END CONFIDENTIAL***, were primary lines.

Second, there is no basis for Dr. Selwyn's speculation that the lines that were lost were lines that had been used "primarily for dial-up Internet." Thus, there is no basis for Dr. Selwyn's assumption that the loss in second lines is due primarily to a shift from dial-up Internet service to high-speed Internet access. Many second lines, like primary lines, were used for voice service and such second lines have been lost to CLECs, wireless carriers, and VoIP providers.

Third, to the extent that some portion of second lines lost by AT&T Illinois represent a shift from dial-up Internet service to high-speed Internet service, Dr. Selwyn is wrong to suggest that all of that shift was to AT&T's DSL or U-verse℠ Internet service. In fact, as Dr. Taylor points out in his Surrebuttal Testimony, according to data reported by the FCC, as of December 31, 2007, 72% of all customers purchasing high-speed Internet service purchased modes of service other than DSL.

Thus, even assuming that all lost second lines represented a shift from dial-up Internet access to high-speed Internet service (and there is no basis for such an assumption), no more than ***** BEGIN CONFIDENTIAL** ******END CONFIDENTIAL *****of all access lines (including both primary and second lines) lost by AT&T Illinois over the last eight years could represent a migration of customers to high-speed Internet access that could have been provided by AT&T Illinois or an affiliate.

Q. Dr. Selwyn suggests that, to the extent that customers have dropped second lines from AT&T Illinois in favor of purchasing unregulated high-speed Internet access service from an affiliate of AT&T Illinois, all of the revenues are "transferred" from AT&T Illinois even though "the services still involve extensive use of AT&T Illinois' network facilities that remain in the Company's regulatory books of account." (AG Ex. 3.0, p. 9). Do you have any comments in response to this testimony?

A. Yes. Dr. Selwyn's suggestion is extremely misleading. To the extent that AT&T Illinois' "network facilities" are used by an affiliate to provide a non-regulated service (including DSL service), AT&T Illinois is compensated for the use of those facilities and the revenues from that compensation are included in the operating revenues reported on AT&T Illinois' regulatory books of account. For example, ATTIS is the affiliate of AT&T Illinois which provides DSL internet access service to retail customers. To provide that service, ATTIS relies on the network facilities and services provided to it by another affiliate, AT&T Corp., which uses its own ATM switches and other equipment in conjunction with line sharing arrangements purchased from AT&T Illinois pursuant to contract and special access transport services purchased from AT&T Illinois' interstate special access tariff.[5] AT&T Illinois is also compensated for the billing and collection and marketing services AT&T Illinois provides to ATTIS. As discussed by Mr. Dominak in his Surrebuttal Testimony, the revenues derived from all of these wholesale transactions are recorded as revenues on the regulated books of AT&T Illinois. As further discussed by Mr. Dominak, AT&T Illinois properly allocates costs and expenses between regulated and unregulated activities. Accordingly, there is absolutely no basis for Dr. Selwyn's insinuations that AT&T Illinois has improperly "transferred revenues" or is subsidizing the operations of its non-regulated affiliates, or that the use of AT&T Illinois' network facilities by affiliates somehow serves to understate AT&T Illinois' rates of return.

Q. Are revenues derived from the sale of U-verse[SM] Internet service "transferred over to a non-regulated affiliate," as Dr. Selwyn asserts? (AG Ex. 3.0, p. 9).

A. No. U-verse[SM] service is provided by AT&T Illinois, not an affiliate, and, therefore, all revenues from the sale of U-verse[SM] service are recorded on AT&T Illinois' books (albeit below-the-line).

VI. CONCLUSION

Q. Does this conclude your Surrebuttal Testimony?

A. Yes.

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[5] This role was formerly played in Illinois by Ameritech Advanced Data Services of Illinois ("AADS of Illinois"). Effective December 3, 2008, AADS of Illinois and other advanced data services subsidiaries were merged into AT&T Corp., a direct subsidiary of AT&T, Inc.