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**OFFICIAL FILE
ILLINOIS COMMERCE COMMISSION**

April 27, 2009

Elizabeth A. Rolando
Chief Clerk
Illinois Commerce Commission
527 East Capital Avenue
Springfield, Illinois 62794-9280

*Public
Version*

Re: Docket 06-0027 Report on the Competitiveness of the Telecommunications Market in Illinois MSA-1 and Semi-Annual MSA-1 Subscribership Report

Dear Ms. Rolando:

The Commission in its Order in Docket 06-0027 directs AT&T Illinois to file an annual report on the competitiveness of the residential telecommunications market in MSA and a semi-annually report of the number of customers subscribing to each of AT&T Illinois' service.¹

Enclosed are Public and Proprietary originals and two copies of the Illinois Bell Telephone Company ("AT&T Illinois") 2008 Report on the Competitiveness of the Residential Telecommunications Market in Illinois MSA-1 and semi-annual report of the number of customers subscribing to each of AT&T Illinois' service.

These reports are confidential and proprietary and have been placed in a proprietary envelope. A public version is also being filed.

Any questions and correspondence regarding this filing should be directed to W. Karl Wardin, Regional Vice President, Regulatory, who may be reached at:

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ILLINOIS COMMERCE COMMISSION
GENERAL CLERK'S OFFICE

Please acknowledge receipt by returning the extra copy of this letter.

Sincerely,
W. Karl Wardin (KB)
Attachments

¹ Illinois Commerce Commission v Illinois Bell Telephone Company, Investigation of specific tariffs declaring certain services to be competitive services, Illinois Commerce Commission Docket No. 06-0027 (August 30, 2006) at pages 98, 122 and 123.

ICC Docket No. 06-0027

AT&T Illinois 2008 Report on the Competitiveness of the
Residential Telecommunications Market in Illinois MSA-1

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**REPORT ON THE COMPETITIVENESS OF THE RESIDENTIAL
TELECOMMUNICATIONS MARKET IN ILLINOIS MSA-1**

This Public report is filed pursuant to the Commission's Order in Docket No. 06-0027. The Order (p. 98) directed AT&T Illinois to file a report on an annual basis, beginning with information as of December 31, 2006, that will be used in analyzing the competitiveness of the telecommunications market in MSA-1 ("Chicago LATA"), including information regarding competition for the provision of local service from CLECs, wireless carriers, VoIP providers and other alternative technologies. The Order states that this information should include, but not necessarily be limited to, an updated version of the Schedules WKW-5 and WKW-9, attached to AT&T Exhibit 1.0 in Docket 06-0027. This 2008 Annual Report was developed based on data as of December 31, 2008.

**OVERVIEW OF THE COMPETITIVE LANDSCAPE FOR RESIDENTIAL LOCAL
EXCHANGE SERVICE IN ILLINOIS AND THE CHICAGO LATA.**

AT&T Illinois continues to face competition from a variety of telecommunications service providers which provide local exchange service, its functional equivalent, or a substitute service to residential customers in the Chicago LATA. These competitors fall into three general groups: (1) traditional wireline competitors, consisting of 75 competitive local exchange carriers (including cable companies)¹ ("CLECs"), such as Comcast, RCN, TDS MetroCom, Sage, MCI (Verizon), McLeodUSA², Nexus, PT Communications, SOS Telecom, WOW!, Charter Communications and Mediacom³; (2) independent Voice over Internet Protocol ("VoIP") providers, such as Skype, Vonage, Lingo, Sunrise, voip.com, Voip Your Life, via:talk, Packet8, Earthlink trueVoice, ooma, etc.; and (3) Wireless carriers, such as Verizon, US Cellular, T-Mobile, AT&T Mobility, Sprint, Virgin Mobile, TracPhone, Illinois Valley Cellular, etc. Altogether, such competitors have captured approximately 40% of the residential local exchange market in the Chicago LATA, up 65% from the 23.9% market share held by such competitors at the time the record in Docket 06-0027 was developed.

AT&T Illinois' residential wireline service continues to be significantly impacted by competition. Between January 1, 2001 and December 31, 2008, the number of

¹ For a complete list of the 75 CLECs who are providing residential local exchange service in the Chicago LATA see Schedule WKW-9.

² McLeod USA provides wholesale services to other CLECs.

³ Mediacom, a cable company that offer telephone services to its customers, receives numbering resources from Sprint.

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residential lines served by AT&T Illinois in the Chicago LATA dropped by more than 1.4 million, over a 42% decrease. During the same time period AT&T Illinois lost more than ***BEGIN PROPRIETARY xxxxxxxx END PROPRIETARY*** primary residential access lines in the Chicago LATA, about a ***BEGIN PROPRIETARY xxx END PROPRIETARY*** decrease (see Table 1 and Table 2 below). In 2008, AT&T lost over ***BEGIN PROPRIETARY xxxxxxxx xxxxxxxx END PROPRIETARY*** of its residential lines – over ***BEGIN PROPRIETARY xxxxxx END PROPRIETARY*** residential lines per month (see Table 2A below). These line losses exceeded the line losses experienced in each of the years 2006 and 2007. Of the residential lines lost in 2008, more than ***BEGIN PROPRIETARY xxxxxxxx END PROPRIETARY*** were primary residential lines.

At the same time, the number of residential lines served by CLECs and independent VoIP providers not affiliated with AT&T Illinois increased to over 729,000 as of December 31, 2008, an increase of about 56,000 lines (or about a 8% increase) over end of year 2007. Since 2005, the number of residential access lines served by CLECs increased by over 225,000 lines (or about a 45% increase) (see Schedule WKW-5 as of 12-31-08) and the number of wireless only households increased by about 250,000 (or over a 80% increase) (see Schedule WKW-5). The majority of the new CLEC residential lines added in 2008 were lines served by carriers which own their own switches

For the year 2008, there are at least ***BEGIN PROPRIETARY xxxxxxxx END PROPRIETARY*** lines (***BEGIN PROPRIETARY xxxxxxxx END PROPRIETARY*** primary lines less 56,000 CLEC and independent VoIP adds), plus any growth in the Chicago LATA residential market, that are not captured in the CLEC and independent VoIP line counts presented in this report. Therefore, as detailed in this report, the use of residential alternative communications services, in the Chicago LATA, is understated and conservative

In its annual report on telecommunications markets in Illinois the ICC also found that wireline voice service is losing ground to new platforms such as VoIP and wireless.

As there is no evidence to suggest or reason to believe that overall demand for telecommunications services is shrinking, these reductions in total reported lines strongly suggest that customers are substituting non-reported telecommunications services for reported POTS services.

There are several substitutes for reported POTS service that likely are not reflected in the figures reported in Table 1. Two services in particular serve, to some degree, as substitutes for POTS services, but are not fully reflected in the competition numbers reported above. The first such

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service is wireless mobile or cellular service. The second is voice over Internet protocol or VoIP service.⁴

With respect to wireless service, the Commission also stated:

In the past, most telecommunications customers purchased cellular service in addition to, rather than as a substitute for, their traditional wireline POTS service.⁶ As noted by the FCC, however, recent survey data and substitution studies indicate that consumers increasingly are substituting wireless service for wireline service.⁷ These data indicate that by the second half of 2006 approximately 13% of the adult population lived in households with only wireless service, which suggests that the decline in reported POTS lines in Illinois is, in part, a result of wireless substitution.⁸⁵

The trend in residential customers using wireless phones as substitutes for wireline service that was noted in past reports has continued to increase. The percentage of households in the Chicago LATA which have "cut-the-cord" (i.e., no longer take wireline service and rely exclusively on wireless phones) is conservatively estimated to be in excess of 17%⁶, compared to 13.6% in the 2007 Report and 9% at the time of Docket 06-0027. Mr. Scott Taylor, in his direct testimony in Docket 08-0569, at pages 12-13 stated:

Q. How did you determine the usage patterns of customers who subscribe to both wireless and wireline service?

A. That information was obtained from the telephone survey conducted by my company. We asked "dual-user" respondents who personally used their cellphones the following question: "And when you are at home, in particular, what percentage of your calls are through your cellphone and what percentage are through your home phone? Your best estimate is fine." Based on the survey responses, consumers nationwide who use both wireless and wireline services made 41% of their at-home calls over their cellphone. This is an increase over a similar study I performed for AT&T in 2007, where the percentage was 36%. This increase is statistically significant at the 95% confidence interval. In my opinion, based on the trends that I have observed, wireless usage inside the home is likely to increase further over time.

These percentages have continued to grow each year.

⁴ *Illinois Commerce Commission Report: Results of 7th Annual Report on Telecommunications Markets in Illinois*, September 10, 2008, at page 11.

⁵ Id. at page 11 -12

⁶ See Wireless section below and Table 3.

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The mobile providers are taking advantage of this trend by rolling out new offerings designed to make it even easier and less expensive for consumers to use their mobile service at home. For example, T-Mobile now offers "T-Mobile @Home", which gives its subscribers the ability to use their existing cordless or traditional touchtone phones to make and receive calls at home over the T-Mobile wireless network. The plan costs \$10 a month for those with a qualifying T-Mobile voice plan. It includes Unlimited Calling, Voicemail, Caller ID, Call Forwarding, Call Waiting and Conference Calling. When it rolled out this service nationwide in June 2008, T-Mobile said:

T-Mobile is now delivering the best priced home phone service in America for our existing and future customers. In addition, we are not only delivering the traditional features of a landline service, we are also including the innovative features consumers love in their more widely used mobile phones.⁷

Another noteworthy milestone recently occurred. According to Mediamark Research, Inc.⁸, the percentage of people living in U.S. households with one or more cellphones (86.2%) now exceeds the number of people living in a household with a landline phone (84.5%).

AT&T Illinois' annual switched access minutes of use, since 2000, have dropped by over 18.6 billion minutes, about 58%. During the same time period, wireless minutes, nationally, have soared to over 2.2 trillion (see Table 5 and 7 below). Not only has wireless calling affected switched access minutes but wireless calling has also been substituted landline local calling. The total number of AT&T IL local calls and the number of local calls per AT&T IL subscriber have been dropping. Since 2004, AT&T IL's average annual number of calls per access line has dropped 2.4 times faster than the drop in access lines.⁹ This difference is primarily due to consumers substituting their wireless phone for their landline phone to make local calls.

In sum, residential consumers are choosing wireless and independent VoIP providers, as well as CLECs, as substitutes for traditional wireline services to meet their local voice communications needs.

⁷ [http://www.t-mobile.com/company/PressReleases_Article.aspx?assetName=Prs_Pr_20080625&title=T-Mobile%20to%20Launch%20\\$10%20Home%20Phone%20Service](http://www.t-mobile.com/company/PressReleases_Article.aspx?assetName=Prs_Pr_20080625&title=T-Mobile%20to%20Launch%20$10%20Home%20Phone%20Service)

T-Mobile reported very successful results in its two test markets (Dallas and Seattle) where virtually all customers (97 percent) who had a traditional landline phone service reported dropping that service since adopting T-Mobile @Home.

⁸ See Mediamark Research Inc. Survey of the American Consumer (Waves 43-56) (Survey of the American Consumer).

⁹ See Table 6 and 6A below.

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Analysis and Key Findings

The focus of the analysis in this Report is on the extent to which residential local exchange service is available in the Chicago LATA from alternative communications companies. For purposes of this analysis, included among CLECs are cable companies that offer IP-based telephone service. Research was performed to determine the number of such carriers and the number and percentage of residential local exchange customers served by those carriers in the Chicago LATA. An analysis also considered the impact of services being provided by wireless carriers and non-CLEC independent VoIP providers.

Analysis of the data produced the following key findings:

- As of December 31, 2008 there currently are 75 CLECs providing basic local exchange service to residential customers in the Chicago LATA. These include 24 CLECs that were not providing residential service in the Chicago LATA on December 31, 2005.
- As of December 31, 2008, CLECs and Independent VoIP providers have captured 27.1% of the residential local exchange market in the Chicago LATA, compared to approximately 16.4% as of December 31, 2005. This percentage rises to about 40% taking into account the percentage of households that rely solely on wireless (i.e., households that have “cut the cord”).
- ***BEGIN PROPRIETARY xx% END PROPRIETARY*** of CLEC residential lines use CLEC-owned switching and ***BEGIN PROPRIETARY xx% END PROPRIETARY *** of CLEC lines use both CLEC-owned loops and CLEC switching.
- Nationally, wireless minutes have increased to over 2.2 Trillion and consumers with wireless service make 51% of their local calls and 68% of their long distance calls using their wireless service from their home.
- As a conservative estimate, 17% of the households in the Chicago LATA have “cut the cord”, i.e., they do not have a wireline phone connection within the home and rely exclusively on wireless phones to make and receive calls within the home.
- There are more wireless phones in Illinois than wireline phones.
- There is a greater percentage of adults who live in households with a wireless phone than with a wireline phone.
- Independent VoIP providers, such as like Vonage and Earthlink, offer number portability - which enhances their position in the residential market.

CLEC and Wireless Competition Generally

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Based on the information shown in the attached Updated Schedule WKW-5, AT&T Illinois conservatively estimates that CLECs (including cable companies), Independent VoIP providers and wireless competitors serve approximately 40% of the residence lines in AT&T Illinois' service territory in the Chicago LATA. This figure is comprised of three components: (1) ***BEGIN PROPRIETARY xx% END PROPRIETARY*** represents residential lines served by CLECs, (2) ***BEGIN PROPRIETARY xx% END PROPRIETARY*** represents Independent VoIP providers with residential E-911 listings¹⁰ and (3) 17% represents residential wireless customers who have "cut the cord", i.e., customers who rely exclusively on wireless service for their network access and local usage and have no wireline service in their homes.¹¹

The CLEC and Independent VoIP provider percentage ("CLEC/VoIP") was calculated by first determining the total number of residential lines in the Chicago LATA served by CLECs/VoIP providers that are unaffiliated with AT&T Illinois.¹² This figure was derived by adding the number of lines served by UNE-P, LWC and resale arrangements together with the number of residential telephone numbers submitted by CLECs/VoIP providers for inclusion in the E9-1-1 database. The E9-1-1 database reflects CLEC/VoIP lines used to make outgoing calls. It will reflect some, but not all, lines provisioned through UNE-Ls. It will also reflect some, but not all, lines provisioned using non-AT&T Illinois loops. While conservative, it provides a reasonable approximation of the number of CLEC/ VoIP lines served by means other than resale, LWC or UNE-P. Next, the number of AT&T Illinois' retail lines, both AT&T IL and AT&T CLEC, were added to arrive at the total number of lines in the market. Finally, the total CLEC/ VoIP lines were divided by the total number of lines to arrive at the CLEC/VoIP market

¹⁰ This percentage reflects the lines of certain independent VoIP providers which receive numbering and E-911 capabilities from CLECs. For example, Vonage receives its E-911 from Level 3 and numbering from Focal (now a Level 3 company) see <http://www.level3.com/newsroom/pressreleases/2005/20050919a.html>; XO offers wholesale services to independent VoIP providers see XO press release at <http://www.xo.com/news/290.html>; Global Crossing, offers wholesale services to cable companies and independent VoIP providers see http://www.globalcrossing.com/carrier/carrier_isp_esp.aspx; WorldCom provide numbering resources to independent VoIP providers see <http://www.verizonbusiness.com/about/news/releases/2005.xml?newsid=16011&mode=long&lang=en&width=530&root=/about/news/releases/&subroot=2005.xml>. Note, however, that not all independent VoIP providers report their lines to the E9-1-1 data base. Thus, this percentage does not reflect the full extent to which residential customers are using independent VoIP services as a substitute for local exchange service provided by AT&T Illinois.

¹¹ The percentage of residential wireless-only lines was estimated by dividing the estimated wireless-only customers as of 12-31-08 (550,212) by the total CLEC, Independent VoIP, AT&T and wireless-only lines. Due to the formula, the combined percentage of wireless and CLEC/Independent VoIP market percentages is not the simple sum of 27.1% plus 17%.

¹² For the purpose of determining the percentage of lines that CLECs serve in the Chicago LATA, all of the lines served by the CLECs that were subsidiaries of pre-merger AT&T before that holding company's merger with SBC Communications were treated as if they were lines provided by AT&T Illinois.

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share of 27.1%. This is the same procedure that was used to develop Schedule WKW-5 in AT&T Exhibit 1.0 in Docket 06-0027.

The CLEC/VoIP market share for residential local exchange service of 27.1% as of December 31, 2008 represents an 65% increase for the from the 16.4% market share as of December 31, 2005. This increase in CLEC/VoIP market share, along with the competition from wireless explains in large part why AT&T (both AT&T Illinois and AT&T CLEC) experienced residential line losses of about ***BEGIN PROPRIETARY xxxxxx END PROPRIETARY*** lines since the beginning of 2006.¹³

The 17% estimate for those households who have cut the cord does not fully capture the extent to which AT&T Illinois faces competition from wireless service alternatives for the provision of residential local exchange service. For example, this percentage does not take into account the extent to which customers who continue to maintain an access line from AT&T Illinois use their wireless phones, rather than their landline phones, to make local calls. Mr. Taylor, in His Direct Testimony in Docket 08-0569 found that: consumers nationwide who use both wireless and wireline services made 41% of their at-home calls over their cellphone. This is an increase over a similar study I performed for AT&T in 2007, where the percentage was 36%. This increase is statistically significant at the 95% confidence interval. In my opinion, based on the trends that I have observed, wireless usage inside the home is likely to increase further over time. These and other results confirm what other studies performed by the FCC and other independent sources show, i.e., that wireless service is considered by customers, and is increasingly being used by customers, as a substitute for both wireline connections and wireline usage

CLEC FACILITIES

As shown in the attached Updated Schedule WKW-9, for the Chicago LATA, as of December 31, 2008, approximately ***BEGIN PROPRIETARY xx% END PROPRIETARY*** of the residential access lines served by CLECs were provisioned entirely over CLEC-owned facilities, including CLEC-owned switches and loop facilities. Another ***BEGIN PROPRIETARY xx% END PROPRIETARY*** were provisioned using CLEC-owned switches and AT&T Illinois-provided UNE loops. In total, therefore, ***BEGIN PROPRIETARY xx% END PROPRIETARY*** of the CLEC residence lines are served using CLEC-owned facilities. By comparison, at December 31, 2005, ***BEGIN PROPRIETARY xx% END PROPRIETARY*** of the CLEC/VoIP residence lines were served using either CLEC-owned facilities or broadband facilities in conjunction with independent VoIP providers. This increase is largely due to

¹³ See Table 2A.

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BEGIN PROPRIETARY xxxxxxxxxxx xxxxxxxxxxx xxxxxxxxxxx xxxxxxxxxxx
xxxxxxxx xxx xxxxxx xxxxxx xx xxxxxxxxxxx. END PROPRIETARY***

As of December 31, 2008, Comcast has captured ***BEGIN PROPRIETARY xx
END PROPRIETARY*** percent of the Chicago LATA wireline residential lines,
***BEGIN PROPRIETARY Comcast is Illinois' xxxxxxx largest dial-tone provider
in the state – xxxxxx xxx xxxxxxx, END PROPRIETARY*** an increase over its
BEGIN PROPRIETARY xxx END PROPRIETARY percent of the residence
wireline marketshare at December 31, 2005.¹⁴ RCN, WOW!, Charter
Communications and Mediacom are also offering voice service to their residential
customers. For example Mediacom offers residential service to customers
residing in Grant Park, Watseka, Dwight and Ottawa¹⁵.

Of the remaining CLEC residence lines, as of December 31, 2007, ***BEGIN
PROPRIETARY xx% END PROPRIETARY*** were provisioned using Local
Wholesale Complete (“LWC”), a commercial substitute for UNE-P. About
BEGIN PROPRIETARY xx% END PROPRIETARY of the CLEC-served
residential lines are provisioned through the resale of AT&T Illinois services.

Nationally, cable companies have made inroads into the local exchange
marketplace with their telephony offerings as they rolled out their IP-based
offerings. As of December 2008, there were 19.6 million households buying
telephone services from their local cable company, up from 7.5 million
households in June 2006.¹⁶ The largest cable telephony operator is Comcast
Digital Voice, which had 6.5 million customers at the end of the second quarter of
2008.¹⁷ This total represents 13.9 percent of homes passed by Comcast cable
systems. As of December 31, 2008, Charter Communications announced that it
had surpassed 1.3 million voice subscribers, representing 12.9 percent of
available households.¹⁸ As of December 31, 2008, Mediacom Phone had
248,000 subscribers nationally and was available to approximately 2.6 million of
the Company's 2.85 million estimated homes passed.¹⁹

The pace of the take-up of cable telephony has been rapid. Since 2005 the
number of cable telephony subscribers has increased from ***BEGIN
PROPRIETARY about xxxxxxx END PROPRIETARY*** to about ***BEGIN
PROPRIETARY xxxxxxx or an increase of xxx% END PROPRIETARY*** by the
end of 2008.

¹⁴ See Attachment 1 (Schedule WKW-5 Updated) and Attachment 2 (Schedule WKW-9 Updated).

¹⁵ See, *Mediacom's website*.

¹⁶ <http://www.ncta.com/Statistic/Statistic/Statistics.aspx>

¹⁷ <http://www.cmcsk.com/phoenix.zhtml?c=118591&p=irol-newsArticle&ID=1257468&highlight=>

¹⁸ <http://phx.corporate-ir.net/phoenix.zhtml?c=112298&p=irol-newsArticle&ID=1266279&highlight=>

¹⁹ <http://phx.corporate-ir.net/phoenix.zhtml?c=98270&p=irol-newsArticle&ID=1259894&highlight=>

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Independent Voice over Internet Protocol (VoIP) Providers

Residential Independent VoIP providers include Vonage, Skype, Viataalk, PhonePower, ConnectVoIP, Packet8, ITP, TalkSpree, Sunrise, voip.com, Voip Your Life, via:talk, ooma, majicJack. etc.. Companies such as these are providing low-cost, high-quality voice service to residential customers using *packet* – not circuit – switches, and *broadband* – not narrowband – local transport. These competitors sell voice service not as a bundle of switching and transport, but as a discrete service that runs on top of broadband data connections sold separately by third parties. It is estimated that over ***BEGIN PROPRIETARY xx% END PROPRIETARY*** of residential consumers in the Chicago LATA have already abandoned circuit-switched service entirely in favor of independent VoIP providers and the number is rising. As previously discussed, this percentage is based on the number lines served by independent VoIP providers that are reported in the E9-1-1 data base (See fn. 11, supra). Because not all lines served by independent VoIP providers are reported to the E9-1-1 data base, this percentage is a conservative estimate.

Since 2001, not only has VoIP been introduced into the market but it has become both feasible and economical for independent VoIP providers to provide voice service to any residential customer in the Chicago LATA who has access to a broadband connection. The main prerequisite for providing VoIP service is the broadband connection itself. Over 98 percent of Illinois households with cable television can now obtain a broadband internet connection from a provider *other than* their incumbent local telephone company.²⁰ Cable operators have committed to a policy of ensuring that consumers will be able to connect to independent VoIP providers just as easily as they may browse the Internet.²¹ Also over 85% of Illinois households have access to DSL service. Riding on this competitive infrastructure, a wide range of competitive providers are deploying and marketing VoIP services in the Chicago LATA.

²⁰ FCC Report, High-Speed Services for Internet Access: Status as of December 31, 2007, released January 2009, Table 14.

²¹ See D. Jackson, *NCTA: Cable Won't Get in Vonage's Way*, TelephonyOnline (Dec. 19, 2003) ("Vonage will not be stopped by the cable industry from providing its phone service, even though it competes directly with many cable operators in this emerging market, according to Robert Sachs, president and CEO of the National Cable & Telecommunications Association. This policy is a reflection of the 'network neutrality' philosophy adopted by the cable industry that allows broadband users to access any Web site and use any DOCSIS-approved equipment, Sachs said. . . . For a cable company to strip out voice bits of a Vonage transmission would represent a departure from this philosophy, and the industry has 'no intention' to do that, he said."); see also AT&T News Release, *AT&T To Offer AT&T CallVantage Service with Adelphia High-Speed Internet Access* (Sept. 1, 2004) (announcing an agreement under which "Adelphia will now serve as AT&T's preferred broadband solution for customers wishing to sign up for AT&T CallVantage Service in areas served by Adelphia.").

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About 70% of the households in Illinois²² subscribe to broadband service and can easily subscribe to one of the many independent VoIP offerings that I describe below.

Many new companies that do not offer traditional circuit switched voice service at all have also begun providing VoIP services. These VoIP-based providers all offer service nationwide, and the larger providers now offer local telephone numbers and number portability in virtually all the markets they serve. Vonage, the largest of the new providers, currently offers local number portability for residential customers in the Chicago LATA. As of December 31, 2008, Vonage served over 2,600,000 subscribers nationwide. In 2008, Vonage grew revenue by 9% and for the first time in its history, Vonage reported positive operating income, generating \$3 million in operating income, up from operating losses of \$9 million in the year-ago quarter. Marc Lefar, Vonage Chief Executive Officer, said, "Not only is the business model solid, but the market opportunity for digital voice remains robust."²³ Vonage recently sent customers in the Chicago LATA mailers that indicated that customers could keep their existing number if they switched.²⁴ The ability to offer number portability enhances Vonage's appeal to residential customers.

The following independent VoIP offerings are widely available with a wide range of prices, minutes and features. For example, among its offerings in Illinois, Vonage provides what it describes as: "Vonage Basic 500 Plan \$17.99/month...500 outgoing minutes a month anytime anywhere in the US (including Puerto Rico) and Canada. Only 3.9¢ per minute."²⁵ For \$7 more per month, a subscriber can get unlimited calling with the Premium Unlimited Plan. Service is provided on a month-to-month basis; there are no long-term contracts. Vonage equipment and software can be purchased at Best Buy stores or ordered over the Internet.

Viataalk's offering includes 500 minutes a month to anywhere in the US and Canada for \$9.95 a month.²⁶ For about \$16 a month (based on an annual subscription), Viataalk provides two phone lines and unlimited calling with one year free (reducing the actual cost for the first two years of service to about \$8 a month).

²² Ibid at Table 12 divided by divided by the 4.7 million Illinois households as estimated by the U.S. Census Bureau in 2007

²³ See Fourth Quarter 2008 Earnings at <http://pr.vonage.com/releasedetail.cfm?ReleaseID=367800>

²⁴ See Attachment 3.

²⁵ <https://subscribe.vonage.com/plans>

²⁶ <http://www.viataalk.com/>

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Skype offers its SkypeOut Unlimited Plan that costs just \$2.95 per month and includes unlimited calling to any phone in the U.S. and Canada with no connection fees and no per-minute charges.²⁷

Packet8 offering includes 500 minutes a month to anywhere in the US and Canada for \$9.95 a month.²⁸ For about \$16 a month (based on an annual subscription), Packet8 provides unlimited calling in the U.S. and Canada.

Wireless Competition

In the Chicago LATA, the major wireless carriers are Verizon, AT&T Mobility, T-Mobile, Sprint, US Cellular and Illinois Valley Cellular. There are also many companies that provide service through wholesale arrangements such as Virgin Mobile, Firefly, Disney Mobile and TracPhone.

Residential competition from wireless providers has had an impact on AT&T Illinois' share of residential lines in the Chicago LATA. Table 1, below, details AT&T Illinois' residential access lines in the Chicago LATA. It shows that over the last 7 years, AT&T Illinois has lost over 1.4 million residential access lines in the Chicago LATA. This represents over a 42% reduction since 2001 and is equivalent to about 73% of AT&T Illinois' current residential access lines.

Table 2, below, details the number of AT&T Illinois' primary residential access lines in the Chicago LATA. It shows AT&T Illinois has lost over ***BEGIN PROPRIETARY xxxxxxxxx END PROPRIETARY*** residential customers since 2001. Table 2A, below, details the number of AT&T Illinois and AT&T CLEC network access lines in the Chicago LATA. It shows that AT&T lost over ***BEGIN PROPRIETARY xxxxxxxx END PROPRIETARY *** network access lines during 2008.

AT&T Illinois' residential line loss is attributable to wireline (including cable), wireless, and independent VoIP provider competition.

²⁷ <http://www.skype.com/allfeatures/subscriptions/uscanada/>

²⁸ http://www.packet8.net/residential_services/

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Table 1

AT&T Illinois Chicago LATA Residential Access Line Changes (Dec 2000 - Dec 2007)					
Year End	AT&T IL Chicago LATA Residential Access Lines	Annual Residential Line Loss	Cumulative Residential Line Loss	Annual Residential Line Loss Percentage	Cumulative Residential Line Loss Percentage
2000	3,372,979				
2001	3,048,504	-324,475	-324,475	-9.6%	-9.6%
2002	2,721,082	-327,422	-651,897	-10.7%	-19.3%
2003	2,535,531	-185,551	-837,448	-6.8%	-24.8%
2004	2,422,559	-112,972	-950,420	-4.5%	-28.2%
2005	2,383,477	-39,082	-989,502	-1.6%	-29.3%
2006	2,304,140	-79,337	-1,068,839	-3.3%	-31.7%
2007	2,204,905	-99,235	-1,168,074	-4.3%	-34.6%
2008	1,954,205	-250,670	-1,418,744	-11.4%	-42.1%

Source: AT&T Illinois records.

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Table 2

AT&T Illinois Chicago LATA Residential Primary Access Line Changes (Dec 2000 - Dec 2007)					
Year End	Chicago LATA Primary Residential Access Lines	Annual Residential Line Loss	Cumulative Residential Line Loss	Annual Residential Line Loss Percentage	Cumulative Residential Line Loss Percentage
2000					
2001					
2002					
2003					
2004					
2005					
2006					
2007					
2008					

Source: AT&T Illinois records

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Table 2A

AT&T Illinois and AT&T CLEC Lines Total Residential Access Line Changes				
Year End	Total Chicago LATA Residential Access Lines	Annual Residential Line Loss	Annual Residential Line Loss Percentage	Cumulative Residential Line Loss Percentage
2004				
2005				
2006				
2007				
2008				

END PROPRIETARY***

Table 2B

(000)				
Year Ending	Total Operating Revenue	Total Operating Expense	Net Operating Revenue	Local Service Revenues
2000	4,659,007	2,880,999	1,778,008	2,588,784
2001	4,147,646	2,744,438	1,403,208	2,079,680
2002	3,961,102	2,908,850	1,052,252	1,768,078
2003	3,739,032	3,017,925	721,107	1,509,561
2004	3,536,878	2,854,685	682,193	1,354,916
2005	3,424,728	2,649,850	774,878	1,310,823
2006	3,437,563	2,618,447	819,116	1,307,741
2007	3,352,504	2,591,185	761,319	1,278,444
2008	3,357,816	2,662,445	695,371	1,247,873
Change: 2000 to 2007	(1,301,191)	(218,554)	(1,082,637)	(1,340,911)
% Change	-28%	-8%	-61%	-52%
Source: ARMIS 43-02 and Form 23A Adjusted and Company Records. Local Service Revenues = Business and Residence Access Lines, Usage, and Calling Features and exclude Payphone, Private Line, Mobile, and Public Utility Fund Tax and Fees.				

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The access line losses demonstrated in Tables 1 through 2A have resulted in a significant negative impact on AT&T Illinois' Revenues and Net Operating Revenues (Revenues less Expenses). As demonstrated in Table 2B, Local Service Revenues and Net Operating Revenues have decreased 52% and 61%, respectively, since 2000.

The increased number of wireless-only users in the Chicago LATA has contributed significantly to AT&T Illinois' residential line loss. In the Chicago market area, which includes the Chicago LATA plus Gary, Indiana and Kenosha, Wisconsin, 86% of the population had wireless service as of the end of 2007, compared to 49% at the end of 2001.²⁹ There are about 2.74 persons per household in the Chicago LATA and, therefore, on average, there are about 2.35 wireless subscribers per household in the Chicago LATA. In its Thirteenth Annual Report on wireless competition, the FCC stated that the national penetration rate for wireless service was about 86 percent.³⁰

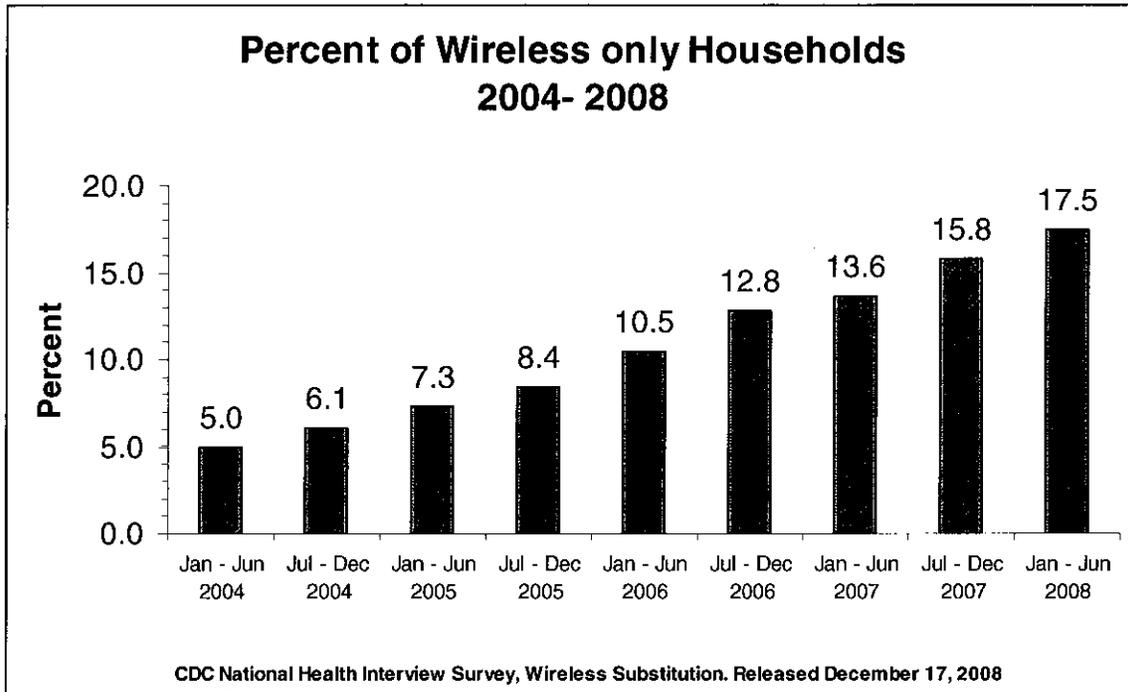
Wireless substitution has grown significantly in recent years. Many people are "cutting the cord" and some have never had landline service. Based on surveys performed by the Center for Disease Control ("CDC"), the percentage of households that have "cut-the-cord" has increased every year during the past five years, from 5.0% during the first half of 2004 to 17.5% during the first half of 2008. (See Table 3, below). While some may debate the exact percentage of wireless households there are – what is not in debate is the fact that the percentage of wireless households has grown each and every year and that trend will continue in the future.

²⁹ *Thirteenth Report, Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, WT Docket No. 05-173, released January 16, 2009 (FCC Thirteenth Report) at Table A-3 and the *Seventh Report, Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993; Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services, Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services*, WT Docket No. 02-179, released July 3, 2002 at Table III.

³⁰ FCC Thirteenth Report, at page 6.

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Table 3



CDC's survey results are corroborated by surveys many analysts. For example, a recent report by The Nielsen Co. finds that the percentage of households that have abandoned their landline phone for wireless service increased from 16.4 percent as of year-end 2007 to 17.1 percent as of June 30, 2008. That same report predicts that 20 percent of U.S. households will be wireless-only by the end of 2008.³¹ This report found that most "cord cutters" have incomes of \$40,000 or less.³²

Morgan Stanley Research points to "a weak economy, unlimited wireless pricing plans, new rollouts by Leap and MetroPCS and products such as T-Mobile@home" as having "made the case for cutting the cord even more persuasive."³³ The same report indicates that, as of 2007, 15.8 percent of all households have "cut-the" cord and predicted that 2008 may turn out to be a "record year for cutting the cord."³⁴ The report further predicted that the "cut-the-cord" percentage "can more than double to 32 percent of households by 2012".³⁵

³¹ "Call My Cell: Wireless Substitution in the United States", The Nielsen Company (September 2008) at 2.

³² *Ibid.*

³³ "Cutting the Cord: Voice First, Broadband Close Behind" Morgan Stanley Research (October 1, 2008) at 1.

³⁴ *Ibid.*

³⁵ *Ibid.*

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The substitution effect is even more pronounced among those households that move.³⁶ Nearly half of those households decide to shift their telephone service away from the traditional service provider, with 25 percent choosing to go wireless-only.³⁷

The effect of wireless substitution on wireline telephone *usage* has been even more pronounced. The CDC 2008 Survey found that of those households with both wireless and wireline phones, over 14 percent received all or almost all their calls on their mobile phones. J.D. Power and Associates found that 56 percent of the displacement of wireline calls (both local and long distance) was attributable to wireless.³⁸

A recent report released by the CDC, which breaks down wireless households by state, found that, in 2007, the number of wireless households in Illinois for 2007 was 16.5% and the state of Illinois figure was about 2% points higher than the U.S. average. The Chicago LATA is no different and probably has higher percentage of cord cutters than the national average. In a survey of customers in the Chicago LATA, 20.7 percent stated that they do not purchase wireline telephone service.³⁹ To be conservative, this report uses a very conservative 17 percent estimate of wireless only households, in Chicago, when in fact 20% of the households are wireless only..

The wireless business in Illinois has been very successful. Growth rates have averaged above double digits over the last eight years. Table 4 details the wireless growth since year end 1999. The 163% growth in wireless service is in stark contrast to the 42% decline in AT&T Illinois residential lines. In Illinois, at the end of 2008, there were 5 times more people with wireless service than there were AT&T Illinois residential lines (10,330,274 wireless subscribers and 1,957,086 AT&T Illinois residential lines).

³⁶ It is estimated that about 14 percent of the population move each year.

http://wiki.answers.com/Q/How_many_people_move_a_year

³⁷ "Moving fuels shift from wireline service", Telephony Online (April 27, 2007).

³⁸ "All Distance Displacement, Of all Calls made, all Respondents—Local or LD," J.D. Power and Associates (2006).

³⁹ See Survey of Local Measured Use Customers Page A-2. Filed on March 1, 2007 pursuant to the Commission's Order in Docket 06-0027.

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Table 4

Illinois Wireless Telephone Subscribers (1999 – 2008)					
Year End	Illinois Wireless Users	Annual Change	Cumulative Change	Annual % Change	Cumulative % Change
1999	3,922,482				
2000	5,143,767	1,221,285	1,221,285	31.1%	31.1%
2001	5,631,172	487,405	1,708,690	9.5%	43.6%
2002	6,476,683	845,511	2,554,201	15.0%	65.1%
2003	7,183,989	707,306	3,261,507	10.9%	83.1%
2004	8,075,938	891,949	4,153,456	12.4%	105.9%
2005	8,654,888	578,950	4,732,406	7.2%	120.6%
2006	9,588,517	933,629	5,666,035	10.8%	144.5%
2007	10,330,274	741,757	6,407,792	7.7%	163.4%

Source: FCC, Local Telephone Competition: Status as of June 30, 2006, released January 2007 (Dec '99 – Dec '04), FCC, Local Telephone Competition: Status as of December 31, 2007, released September 2008 (Dec '05 – Dec '07).

Comparing AT&T Illinois' minutes to the wireless industry minutes and revenues provides some interesting observations. Switched access minutes are the originating and terminating minutes of a long distance call. Under the FCC's rules, when a person makes a similar call using a cell phone many of those calls and minutes to and from the wireless phone are not counted as switched access even if the person is calling to or receiving a call from a AT&T Illinois residential wireline customer. AT&T Illinois' billed switched access minutes are listed in Table 5 and Table 5A. Table 5 includes long distance minutes where both ends of the call stay in the state (e.g. Chicago to Springfield) and also those calls where one end of the call is in another state (e.g. Chicago to Milwaukee). Table 5 shows that, since the end of 2000, AT&T Illinois' total billed switched access minutes have dropped by about 58% while during the same time period AT&T Illinois' Chicago LATA residential lines dropped 42% (see Table 1). Table 5A shows that, since the end of 2000, AT&T Illinois' intrastate switched access minutes (*i.e.*, where both ends of the long distance call are in Illinois) have fallen over 81%. The decline in switched access minutes cannot be explained by just the loss of AT&T Illinois residential access lines. It is most likely the result of residential consumers using their cell phones or the Internet to make these calls, rather than using their AT&T Illinois landline residential phone. Local calling per access line, since 2004, has also seen dramatic decreases. Table 6A shows that local calling per line has dropped by more than 1,000 calls per year or by about 39%. This reduction in local calling per line can only be attributable to consumers substituting their wireline local calling with their wireless phone.

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Table 7 shows the dramatic increase in wireless usage. Since 2000, wireless usage has increased to over 2.2 trillion minutes. Consumers continue to increase their use of mobile telephones for both voice and data services. Partly because of the prevalence of mobile service packages with large buckets of inexpensive minutes, the average amount of time U.S. mobile subscribers spend talking on their mobile phones rose to 823 minutes per month in 2007. This usage is nearly five-times the average usage of mobile subscribers in Western Europe and Japan.⁴⁰ Table 1, from a Merrill Lynch Global Wireless Matrix report dated October 4, 2007, highlights that the United States has among the lowest wireless phone rates in the world. The average price per minute in the U.S. is 15% - 20% of European and Japanese prices. Therefore, wireless phone service is far more affordable in the United States than in other developed countries, which contributes to both the wide availability of the service and the high level of usage of wireless phones in the United States. Wireless rates per minute are also forecasted to continue to drop, making wireless an even more competitive alternative to wireline service. Recently Sprint/Nextel, Verizon and AT&T announced wireless plans that include unlimited minutes.

Table 5

AT&T Illinois Total Company Switched Access - Minutes of Use (2000 - 2008) (000's)					
Year End	MOU	Annual Change	Cumulative Change	Annual % Change	Cumulative % Change
2000	32,203,970				
2001	23,166,485	-9,037,485	-9,037,485	-28.1%	-28.1%
2002	19,044,614	-4,121,871	-13,159,356	-17.8%	-40.9%
2003	16,178,530	-2,866,084	-16,025,440	-15.0%	-49.8%
2004	16,495,950	317,420	-15,708,020	2.0%	-48.8%
2005	16,241,310	-254,640	-15,962,660	-1.5%	-49.6%
2006	15,365,227	-876,083	-16,838,743	-5.4%	-52.3%
2007	14,699,483	-665,744	-17,504,487	-4.3%	-54.4%
2008	13,546,869	-1,152,614	-18,657,101	-7.8%	-57.9%

Table 5A

AT&T Illinois Intrastate Switched Access - Minutes of Use (2000 - 2008) (000's)					
Year End	MOU	Annual Change	Cumulative Change	Annual % Change	Cumulative % Change

⁴⁰Glen Cambell, et al., "Global Wireless Matrix 2Q07," Merrill Lynch, Oct. 4, 2007, at Table 1 ("Merrill Lynch").

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Year	AT&T Illinois Access Lines	Illinois Line Loss	Illinois Line Loss %age	Illinois Line Loss %age	Cumulative IL Line Loss %age
2000	10,402,550				
2001	5,171,493	-5,231,057	-5,231,057	-50.3%	-50.3%
2002	3,004,822	-2,166,671	-7,397,728	-41.9%	-71.1%
2003	2,466,118	-538,704	-7,936,432	-17.9%	-76.3%
2004	2,788,098	321,980	-7,614,458	13.1%	-73.2%
2005	2,538,436	-255,662	-7,870,114	-9.2%	-75.7%
2006	2,246,666	-285,006	-8,155,119	-11.3%	-78.4%
2007	2,066,994	-179,959	-8,335,078	-8.0%	-80.1%
2008	1,955,812	-111,082	-8,446,160	-5.4%	-81.2%
2008	4,368,608	-413,852		-8.7%	-16.3%

Sources for Table 5, Table and 5A are from the ARMIS 43-08 Reports, Table IV and AT&T Illinois records.

Table 6

Table 6A

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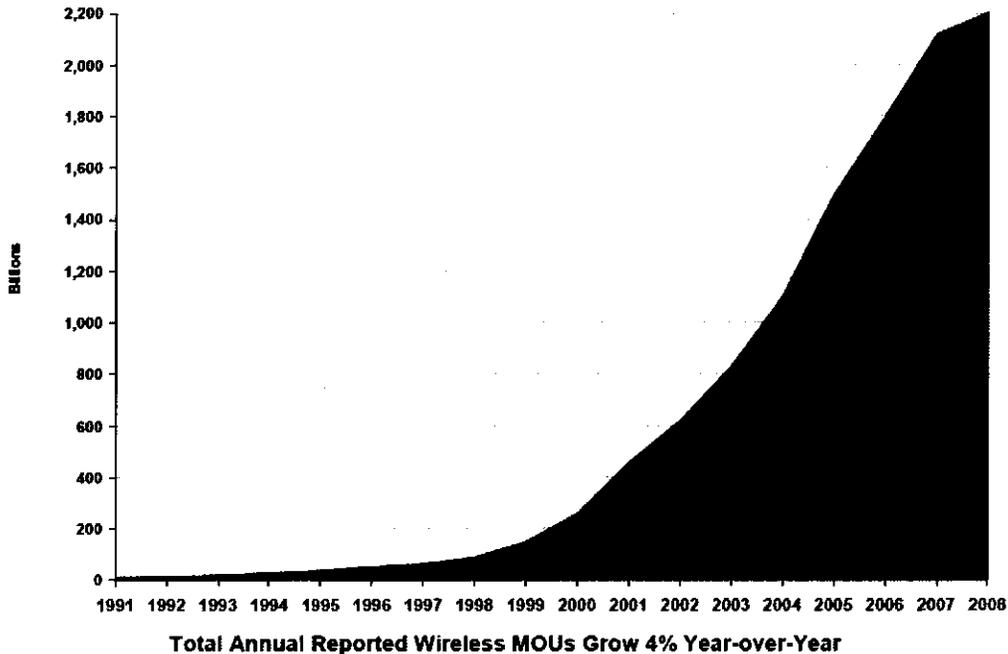
Source: ARMIS and AT&T IL Records

Year End	AT&T Illinois Local Calls per Access Lines	Local Call Loss per line	Annual Local Call Loss %age	Cumulative Local Call Loss %age
2004	2,835			
2005	2,537	-298	-10.5%	-10.5%
2006	2,299	-238	-9.4%	-18.9%
2007	1,955	-344	-15.0%	-31.0%
2008	1,733	-222	-11.4%	-38.9%

Table 7

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Reported Wireless Minutes of Use Exceed 2.2 Trillion in 2008



Source: Background on CTIA’s Semi-Annual Wireless & Wireline Industry Survey Report *viewed April 2009.*

The Yankee Group, from its 2002 to 2006 Technologically Advanced Family Surveys (TAF), states that consumers are growing more accustomed to using their wireless phone in place of their landline phone. The Yankee Group states that 51% of all local calls and 68% of all long distance calls in households with wireless service are made using their wireless service.⁴¹ Therefore the wireless phone, a device that was developed for consumers when they were outside the home, has found its place inside the home and has become a more convenient device than the wireline phone for many households. The Yankee Group TAF survey found that 41% of all wireless calls were made inside the home.

Table 8 depict the wireless revenues and their growth. Since 2000, nationally, wireless service revenues have increased by over 217%. This Table also can

⁴¹ Yankee Group Exhibit 2, at page 4.

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derive, that since 2000, wireless carriers in Illinois have increased their revenue by about \$4.0 billion.⁴²

Table 8

Wireless Industry Total Service revenues (000's) (6/1999 - 6/2008)					
July 1 to June 30	Industry Wireless Revenues	Annual Change	Cumulative Change	Annual % Change	Cumulative % Change
2000	45,295,550				
2001	58,726,376	13,430,826	13,430,826	29.7%	29.7%
2002	71,117,599	12,391,223	25,822,049	21.1%	57.0%
2003	81,185,272	10,067,673	35,889,722	14.2%	79.2%
2004	95,515,593	14,330,321	50,220,043	17.7%	110.9%
2005	108,534,727	13,019,134	63,239,177	13.6%	139.6%
2006	118,299,682	9,764,955	73,004,132	9.0%	161.2%
2007	132,893,824	14,594,142	87,598,274	12.3%	193.4%
2008	143,710,400	10,816,576	98,414,850	8.1%	217.3%

Source: CTIA Semi-Annual Wireless Industry Survey, Annualized Wireless Industry Survey Results – June 1985 to June 2008

Nationally, over \$200 billion has been invested in wireless carrier capital investment, not counting private wireless networks and not counting the \$24 billion wireless carriers invested in acquiring spectrum. In the past few years, wireless companies have been spending about \$20-\$25 billion in annual additional investment⁴³. To put it another way, wireless carriers are spending about \$2 billion a month in additional investment in their networks.

The wireless industry is also creating new applications like e-mail, digital photographs, SMS (text messaging (over 110 billion SMS messages per month in 2008 – see Table 9 below), MP3 player, video and voice messaging, location capability, Internet browsers, and contacts and calendar functions.

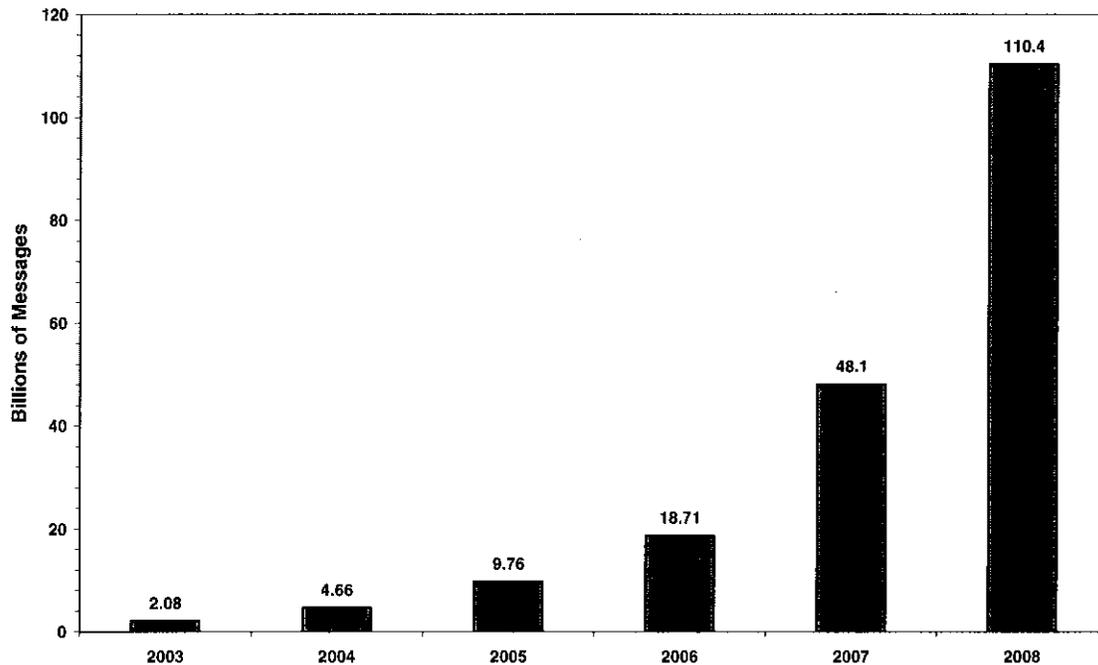
⁴² The Illinois wireless number was derived by taking Illinois wireless growth from Jun '00 to Dec '07 (7,209,261) and dividing it by wireless growth from Jun '00 to Dec '07 (179,404,206) and multiplying that result by the change in revenue since June 2000 (98,414,850).

⁴³ CTIA's Wireless Quick Facts. <http://www.ctia.org/advocacy/research/index.cfm/AID/10323>, viewed April 2009.

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Table 9

Monthly Text / SMS Traffic Volumes



They are also adding entertainment and games to increase demand for wireless phones and usage. Wireless subscribers are also comfortable with the wireless E9-1-1 service, which is in wide use, with over 290,000 E9-1-1 calls from wireless phones each and every day (*i.e.*, over 2 million per week or 105 million calls per year). To improve service quality and reach wireless carriers have added cell sites. Wireless carriers had 242,130 cell sites in December 2008, up from 178,025 in June 2005, for an increase of over 60,000.⁴⁴

⁴⁴ See CTIA Wireless Quick Facts at: <http://www.ctia.org/advocacy/research/index.cfm/AID/10323>, viewed April 2009.