TDS Statement No. ___
Administrative Case No. 2010-00398
Witness: Bruce H. Mottern
Date Admitted: ______________

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE	)	ADMINISTRATIVE CASE
SWITCHED ACCESS RATES OF	)	NO. 2010-00398
KENTUCKY INCUMBENT AND	)	
COMPETITIVE LOCAL EXCHANGE	)	
CARRIERS	)	

PREPARED REBUTTAL TESTIMONY OF BRUCE H. MOTTERN
ON BEHALF OF
TDS TELECOM
(LESLIE COUNTY TELEPHONE COMPANY,
LEWISPORT TELEPHONE COMPANY, AND
SALEM TELEPHONE COMPANY)

Distributed: September 30, 2011

I. INTRODUCTION

Q. Please state your name, occupation and business address.

A. My name is Bruce H. Mottern. I hold the position of Manager – State Government Affairs for TDS Telecom. My business address is 10025 Investment Drive, Suite 200 Knoxville, TN 37932.

Q. Are you the same Bruce Mottern that submitted prepared direct testimony in this proceeding on behalf of Leslie County Telephone Company, Lewisport Telephone Company, and Salem Telephone Company all of whom are subsidiaries of TDS Telecommunications Corp. (collectively "TDS Telecom" or "TDS Companies")?

A. Yes.

II. SUMMARY OF TESTIMONY

Q. What is the purpose of your rebuttal testimony?

A. The TDS Companies welcome the Commission's inquiry into intrastate switched access rate reductions. We believe, however, that access reductions cannot be considered in a vacuum, and that when contemplating reductions to intrastate access charges, the Commission must take a comprehensive view and at the same time consider comparable and universal availability of local service, particularly in the rural areas of Kentucky served by rural incumbent local exchange carriers (ILECs) such as the TDS Companies. Over the last ten to fifteen years, the telecommunications environment has shifted from a purely regulated industry to a hybrid environment that is highly competitive but still regulated for some carriers, particularly the ILECs. Some areas of rural Kentucky, however, do not enjoy the same options that are available in the more densely populated, lower cost suburban and urban areas served primarily by AT&T and sought out by competitive providers for obvious business case purposes. For that reason, the Commission must continue to take into consideration interests that include the rural ILECs' customers. These interests are best served through comprehensive action not just on access, but also local rates and universal service through implementation of a revenue replacement mechanism.

Unfortunately, not all parties have advocated for such comprehensive reform. Thus, in my rebuttal, I will respond primarily to AT&T, Verizon, Sprint, and Cincinnati Bell, parties that focus either predominantly or exclusively on local rate rebalancing as the only means of reducing access, or which present a transitional revenue replacement mechanism that is too limited to accomplish the goals of access restructuring, which would include the maintenance of universal service. I will also comment upon the testimony of other parties to the proceeding as necessary or appropriate, though my absence of commentary on any proposal does not convey and should not be interpreted as agreement with that proposal.

Q. What is the TDS Companies' position with respect to access reductions?

A. The TDS Companies remain supportive of intrastate switched access reductions; however, the manner in which the reductions are implemented must continue to balance all interests affected, and not just reward those that seek the immediate reduction of one of their expenses of doing business. While TDS is agreeable to rebalancing rural local rates, the rebalancing must be achieved over a reasonable transition period so that rural customers avoid rate shock. The rebalancing must also be accompanied by an explicit support mechanism -- just as the FCC has done on the interstate side. This will ensure that rural local rates remain comparable to urban rates. Finally, the explicit support mechanism must be sustainable so that rural providers of voice service retain predictable revenue sources as they invest in long range network investment planning and continue to meet their carrier of last resort obligation ("COLR").

Q. What form of explicit universal service support do the TDS Companies recommend?

A. TDS suggests that the Commission implement a revenue replacement fund such as has been considered or adopted in other states. A revenue replacement fund recognizes the needs of the rural ILECs to maintain a sufficient and predictable level of revenues necessary to continue to carry out their COLR network responsibilities in a manner that is simple, administratively workable, and effective. A high cost fund, on the other hand, as both Verizon and AT&T recognized in support of their individual proposals, would invoke "anachronistic cost-based approaches"[1] that would require the calculation of costs involving "costly, contentious and lengthy investigation of carrier access cost studies."[2]

The adverse effects of mandating the imposition of cost-based proceedings on both the regulator and regulated entities was best addressed by Verizon witness Price: "If each carrier were required to support its intrastate switched access rates by demonstrating its own, individual costs either through the use of cost studies or some other method, that

[1] Verizon Price Direct at 42.
[2] AT&T Oyefusi Direct at 5.

demonstration would impose potentially significant costs on each carrier, lead to a flood of time-consuming proceedings before the Commission, and serve no real purpose[.]"[3]

III. THE TDS COMPANIES' REBUTTAL

A. The Other Parties' Positions

Q. What do other parties recommend with respect to access restructuring?

A. There are variations among the parties' recommendations. AT&T witnesses Aron and Oyefusi set forth a proposal that addresses the trilogy of access, local rates, and universal service, as the TDS Companies believes must occur. AT&T rightly recognizes that in the Telecommunications Act of 1996 ("TCA-96"), Congress set up a statutory framework to which the FCC has adhered on the interstate side, which requires implicit subsidies be replaced with competitively-neutral explicit universal service support mechanisms that are specific, predictable, and sufficient.[4] However, AT&T's plan is too ambitious with respect to achieving immediate access reductions, and it does so at the expense of unreasonable local rate increases that are too large and are implemented too quickly in an effort to minimize its recommended explicit universal support mechanism. This, in turn, renders its explicit support mechanism too restrictive in its application and duration, thus failing to adequately address the needs of the rural ILECs, whose access revenues will be decreased, and their customers.

Verizon witness Price wholly ignores the approach to access reform mandated by Congress in TCA-96 and pursued by the FCC. Verizon seeks access expense reductions, but rejects any explicit universal service support mechanism to replace the implicit

[3] Verizon Price Direct at 43-44.
[4] AT&T Aron Direct at 12, 20-22.

support Verizon demands be removed. In Verizon witness Price's opinion, "[b]y replacing lost access revenue, a state USF merely would take the implicit subsidy reflected in excessive access charges and make it explicit through state USF payments."[5] Of course, this is precisely what TCA-96 provides, and Verizon's outright rejection of it is evidence of the purely self-serving nature of Verizon's position. It should be rejected outright.

Sprint's position with respect to universal service support is like Verizon's, with Sprint witness Appleby also disregarding federal law and regulatory policy. According to witness Appleby, removing the implicit support from access rates and rendering it explicit through "universal service payments <u>fixes nothing</u>."[6] Sprint takes Verizon's position one step further, however. Sprint not only rejects the "implicit to explicit" paradigm set forth by Congress in TCA-96 and as implemented by the FCC on the interstate side, but also proposes that the Commission exceed its jurisdiction by developing a "revenue replacement plan" for the ILECs that essentially provides Sprint free access expense reductions. Sprint witness Appleby would compel the ILECs to reduce their intrastate access revenues to Sprint's benefit, but then have the ILECs be content to be considered compensated for these regulated revenue losses through deregulated and competitive service earnings that are not only outside the Commission's intrastate jurisdiction, but also not always even earned by the regulated ILEC.[7] Like Verizon, this proposal also should be rejected outright.

[5] Verizon Price Direct at 53.
[6] Sprint Appleby Direct at 10 (emphasis in original).
[7] Sprint Appleby Direct at 23-24.

Cincinnati Bell questions the need to reduce intrastate rates to parity, but recommends that if the Commission pursues that course, it should phase in retail increases up to a benchmark, phase in access reductions, and do so without any universal service support.

In the end, each of these parties unreasonably burdens rural end-users with access restructuring that assuredly will benefit their corporate bottom lines, but not at all assuredly benefit the rural end-users who will be paying for it.

Q. As a general principle do these parties universally oppose the concept of universal service?

A. No. In fact, AT&T, Verizon, and Sprint are each significant recipients of universal service support in the federal jurisdiction where they have not opposed explicit universal service support mechanisms. In 2011, the AT&T ILEC and wireless operations are expected to receive approximately $320 million in federal USF support. Verizon and Sprint, respectively, are expected to receive approximately $245 and $80 million in federal USF support.[8] Thus, these parties do not tend to be averse to universal support in principle. Their aversion arises only when they are not recipients of the support.

Q. Would you please address each of these proposals in greater detail, starting with AT&T's proposal?

A. AT&T witness Aron spends a great deal of time discussing the economics of today's telecommunications market and why in her opinion intrastate access rates must be reduced to parity with interstate rates immediately because competition is suffering

[8] See www.usac.org/about/governance/fcc-filings/2011/quarter. Quarterly amounts are annualized.

most from high intrastate access rates.[9] While Dr. Aron does not advocate that intrastate access rates be set at “cost,” she recommends what she describes as a “*more* cost-based system”[10] that allows local exchange and possibly other rates “to rise to a cost-recovering level, to the extent the market permits such increases.”[11] Also, while Dr. Aron does not actually recommend that all intercarrier compensation rates be equal, she appears to be setting that argument up as perhaps AT&T’s next stage for intercarrier compensation, using the term she calls the “‘access/interconnection regime’ to address all regulator-approved charges that wireline LECs charge to other carriers”[12] for originating or terminating calls of any distance or jurisdiction.

AT&T witness Oyefusi sponsors AT&T’s plan, which he describes as a “modest middle ground,”[13] that would require all ILECs to reduce all intrastate switched access rates and elements to parity with interstate rates and structure; to allow ILEC lost revenues to be recovered through “flexibility in retail rates” and limited universal service support; and to require CLEC parity with the rates of the ILECs with which the CLEC competes, with CLEC revenue recovery attained through “their existing unlimited retail rate flexibility.”[14]

Q. What is the time frame that AT&T proposes with respect to reducing intrastate access rates?

[9] AT&T Aron Direct at 6-11.
[10] AT&T Aron Direct at 5.
[11] AT&T Aron Direct at 6.
[12] AT&T Aron Direct at 14-15. AT&T witness Oyefusi on the other hand acknowledges that the Commission cannot equalize all rates because it lacks jurisdiction. AT&T Oyefusi Direct at 6.
[13] AT&T Oyefusi Direct at 4.
[14] AT&T Oyefusi Direct at 3-4.

A. The "relief" AT&T seeks is immediate, rather than phased in. In other words, AT&T wants its access expenses reduced in full, now. AT&T also calls for the immediate reduction or elimination of the NTSRR even before a KUSF is established.

Q. How does AT&T propose that the affected ILECs recover revenues lost as a result of these immediate intrastate access rate reductions?

A. To recover lost revenues, ILECs would have to raise basic local rates to a "reasonable 'benchmark' to be established by the Commission"[15] or have those revenues imputed to them. By way of illustration, AT&T posits $20.50 per month as a benchmark, which AT&T characterizes as at the "low end of reasonable ranges," to be phased in over five years subject to an annual "transitional cap" of $2.00.[16] KUSF funding would be available to ILECs to the extent the ILEC could not recover all lost access revenues. Additionally, AT&T proposes regulatory language that should be adopted to implement the KUSF.[17]

Q. Given that AT&T's proposal provides for revenue neutrality and an explicit universal service support mechanism, what about AT&T's proposal do you oppose?

A. Although Oyefusi Exhibit OAO-6 purports to make the transition over a five year period, given AT&T's position that access reductions should take place 30 days after the KUSF is operational, which it expects to take approximately five months, and that the NTSRR should be eliminated immediately, the "transition" period may be shorter than five years and could leave a shortfall, for example due to the immediate elimination of

[15] AT&T Oyefusi Direct at 38.
[16] AT&T Oyefusi Direct at 42, 44.
[17] AT&T Oyefusi Ex. OAO-2.

the NTSRR, that is unrecovered. That is one concern: the explicit support mechanism is simply too abbreviated in duration to provide "sufficient and predictable support" as required by federal law.[18] Further, the local rate increases that the TDS Companies either would have to impose, or waive by having them imputed as if imposed, would almost *double* the local exchange rates of the TDS Companies' customers over that same less than five year time period under AT&T's calculations,[19] and would *more* than double TDS' rates to $29.61 under my calculations.[20]

Also, AT&T's proposal provides that, once achieved, parity must be maintained automatically and forever.[21] Given the uncertainty currently over what the FCC may do, on what timetable, how it may impact states, and how it may impact different carriers (price cap versus rate of return), it is more prudent for the Kentucky Commission to continue to monitor developments at the federal level to determine their impact, but then and only then *implement* changes in Kentucky. Immediate and automatic intrastate adjustments based on unknown interstate adjustments simply provides for too speculative a result for this Commission to accept now, and therefore should not be adopted in this Kentucky access proceeding. I should also add that if Kentucky were to continue to mirror what happens at the federal level, Kentucky should also implement explicit universal service support mechanisms as the FCC has done as well.

Also, AT&T proposes that its KUSF support be recalculated annually and trued up against each year's billable retail local exchange lines in service (excluding

---

[18] 47 U.S.C. §254(b)(5) ("There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.")
[19] AT&T Oyefusi Ex. OAO-6.
[20] TDS Telecom Mottern Direct at 9-10.
[21] AT&T Oyefusi Ex. OAO-2, ¶2.

administrative and official lines) as of October 31 of the prior year.[22] A preordained and scheduled annual reduction in receipts based upon lost access lines is not reasonable policy.

Q. Why should companies continue to receive support for lines that they are no longer serving?

A. While such an adjustment may be facially attractive on the basis that the rural ILECs should not be compensated for lines they no longer have, the adjustment really ignores the reason behind the support, and that is to preserve the integrity of a COLR network that must be maintained to serve the last customer standing.

The TDS Companies' costs are not reduced when access lines are lost, rather they are stranded. The investment to provide service was undertaken as a result of a long-standing regulatory compact that AT&T itself recognized required the ILECs to provide ubiquitously available and affordable universal service, the lost access support for which must be recovered from increased regulated retail rates or "other means."[23] As the TDS Companies lose lines to competition, which I demonstrated they have in my direct testimony,[24] we must still maintain the associated plant and stand ready to serve not only any new customer, but also returning customers. Since none of the fixed costs of maintaining the network go away when we lose customers, we are left with fewer revenues available from which to continue to provide high quality service to those customers that do remain on the network.

[22] AT&T Oyefusi Ex. OAO-2, ¶4.
[23] AT&T Aron Direct at 71.
[24] See my direct testimony at pages 5-6.

The revenue losses directly and adversely affect our ability to perform public policy functions in an era of competition and universal service. Having met, and continuing to meet, our carrier of last resort obligations over a period of decades, the regulatory compact and sound public policy should also acknowledge the continued need to maintain the commitment to investment while avoiding stranding that investment because there are fewer customers to pay for its support. Wireline ILECs will most likely continue to experience the adverse revenue consequences of line loss, because their tariffed local service and access revenues will continue to erode as lines are lost. But that does not equate to a lower cost of continuing to provide quality COLR service. For that reason, AT&T's proposal – to reduce explicit USF support as access line reductions themselves actually erode the rural ILECs' COLR abilities – should be rejected.

Q. What are your conclusions about AT&T's proposal?

A. The short duration and the annual recalculation aspects built into AT&T's proposed KUSF should be rejected and a fixed and predictable source of revenue based upon reasonably rebalanced local exchange rates should be established and maintained. In the event that the Commission, nevertheless, believes that a periodic recalculation should occur and that a review time for the KUSF should be set, the TDS Companies believe that the recalculation should be performed at the longer interval of five years and the explicit USF support mechanism be maintained for a period of at least ten years. Longer recalculation and transition periods have the benefits of capturing receipts over a longer period, ensuring their sufficiency and predictability as required under federal law.

No matter how much AT&T characterizes its proposal as "middle ground," its impact on the TDS Companies will be to raise local rates to unacceptable levels or force TDS to forego those revenues through imputation. This will render the Companies less competitively able to retain or grow its customer base, and more likely facing a continuously shrinking customer base. This leaves the Companies a smaller and smaller base over which to recover embedded costs that not only are not decreasing concomitantly with access line loss, but also which will continue to grow as long as the carrier of last resort obligation exists. These cumulative negative impacts on the rural ILECs cannot be ignored. Therefore AT&T's proposal should be modified accordingly.

Q. AT&T also proposes that contributions to the KUSF be based upon an assessment of all retail intrastate telecommunications revenues, including wireline ILECs, CLECs, wireless carriers and IXCs. What is your response?

A. I agree with this aspect of AT&T's proposal with one exception, and that has to do with interconnected VoIP providers. I believe the FCC has given states clear direction that interconnected VoIP providers are as much users of the PSTN as every other service provider that AT&T has recommended be assessed. Therefore interconnected VoIP providers should likewise contribute to the recovery of costs associated with the PSTN through a state USF contribution.[25]

---

[25] *See In the Matter of Universal Service Contribution Methodology; Petition of Nebraska Public Service Commission and Kansas Corporation Commission for Declaratory Ruling or, in the Alternative, Adoption of Rule Declaring that State Universal Service Funds May Assess Nomadic VoIP Interstate Revenues*, WC Docket No. 06-122, Declaratory Ruling Released November 5, 2010 ("*Nomadic VoIP State USF Declaratory Ruling*").

Q. Verizon also proposes that rural ILEC intrastate access rates be reduced. Would you please describe Verizon's proposal?

A. Ultimately Verizon believes that negotiated intercarrier compensation agreements are the best long-term solution to an efficient telecommunications market.[26] Of course, any one who has ever negotiated with Verizon would understand completely why Verizon favors its own form of "I win/you lose" negotiations over any other objective standard. Until such time as the market can discipline access, however, Verizon concedes to "regulatory intervention."[27]

Q. What form of "regulatory intervention" does Verizon approve?

A. Verizon proposes to eliminate all NTSRR elements and cap intrastate access rates at the benchmark of AT&T's levels.[28] Unlike AT&T, however, which recognized that explicit external support in addition to local rate rebalancing was necessary, and contrary to Verizon's own position at the federal level where it receives substantial external universal service support, Verizon proposes that lost access revenues be replaced exclusively through retail rate rebalancing. As Verizon witness Price opines, "simply shifting the revenue burden from one carrier-funded source (access rates) to another (a state fund) would not solve the underlying problem nor represent meaningful reform."[29] Rebalancing to the AT&T benchmark is also appropriate in Verizon witness Price's opinion because AT&T has already eliminated the NTSRR and has competed effectively for the past decade, the rate of the dominant provider approximates the rate that would

[26] Verizon Price Direct at 4.
[27] Verizon Price Direct at 4.
[28] Verizon Price Direct at 38.
[29] Verizon Price Direct at 6.

prevail in a competitive market, the AT&T rate has undergone most regulatory scrutiny and therefore is just and reasonable, and it is also reasonable for Kentucky because other Kentucky LECs already have interstate rates that are comparable to or lower than the AT&T intrastate switched access rate.[30]

Q. What is your response to Verizon's recitation of other jurisdictions that have undertaken intrastate access reductions?[31]

A. As I address in further detail in Section B below regarding other parties' misleading, incomplete, and erroneous arguments, Verizon only selectively discloses actions taken by other jurisdictions, which if reviewed in total, would not support Verizon's proposals here. Verizon contends that there no longer remains a need or policy justification for a revenue replacement fund because ILECs can attain revenues from other revenue streams or cost cutting measures, even benchmarked to AT&T's rates the ILECs will recover costs, and the rural ILECs' services are not needed in their service territories because "there are a host of other providers that already stand ready to provide service throughout the Commonwealth at rates consumers already have demonstrated are affordable and that they are willing to pay."[32]

Q. Do you agree with Verizon's conclusions and recommendations?

A. No.

[30] Verizon Price Direct at 40, 44-45.
[31] Verizon Price Direct at 21-23.
[32] Verizon Price Direct at 51.

Q. Why not?

A. Verizon overstates the abilities of rural ILECs to recover all lost access revenues through local retail rate rebalancing and increased productivity and efficiencies. I agree that the telecommunications market has undergone tremendous change over the past decade or so. However, much of that change has already included substantial consolidation within the industry to bring about increased productivity while contracting work force and other expenses in other ways. While I am not stating that increased efficiencies are no longer attainable, Verizon's assertions are more opportunistic than realistic given the tremendous change that has already occurred within the industry.

Moreover, Verizon also wholly ignores federal and state law and regulatory policy and practice developed over the past ten to fifteen years that has moved to render implicit support explicit, not non-existent. It was only through the establishment of competitively-neutral and sufficient and predictable universal service means as required in TCA-96 that the FCC has been able to reduce interstate switched access rates to their current levels. While paying lip service to the FCC's *CALLS* and *MAG Orders*, Verizon literally ignores the universal service mechanisms these orders established as the means by which to support reductions to and elimination of interstate access rates and rate elements. Instead, Verizon jumps straight to the FCC's end result, declares it compensable, and demands immediate parity *without* any explicit state USF.

By focusing solely on local rate increases, Verizon excludes the otherwise comprehensive reforms that were taken at the FCC as well as other state levels and paints only half a picture, the half that provides it all the gain, while putting all the pain on the rural ILECs and their customers. All this accomplishes is an increase to Verizon's bottom line. It serves no public purpose and should be rejected.

Q. Sprint also presents a proposal. Would you please comment on that?

A. Yes. Sprint's proposal is similar to Verizon's in that Sprint, too, rejects the federal law and FCC regulatory practice that mandates that implicit support be made explicit, not eliminated.[33] Instead, like Verizon, Sprint also concludes that explicit support should mean no support at all, and that the rural ILECs' customers should be the sole source for all the revenues that had previously been supported through intrastate access rates. Sprint also calls for elimination of the NTSRR, which Sprint describes as having been designed to recover local loop costs, and that parity should be achieved immediately and should continue in the future.[34] Sprint goes one step further, however, in its recommendation that rural ILECs recover lost access revenues from services other than regulated jurisdictional services, such as "long distance, broadband, video services and an expansive list of customer calling features."[35]

Q. What is your response to Sprint's proposal?

A. For the reasons I have presented in response to Verizon's proposal, I also think that Sprint's proposal should be rejected as not at all giving consideration to the common good of Kentucky. Moreover, I do not believe that Sprint's proposal to consider rural ILECs' revenues from unregulated or deregulated services is sustainable either legally or

---

[33] See the acknowledgements of AT&T in Witness Aron's Direct Testimony at page 21, note 16; 47 U.S.C. §254; and the FCC's *CALLs* and *MAG Orders*, establishing new, explicit federal USF mechanisms.
[34] Sprint Appleby Direct at 19-20.
[35] Sprint Appleby Direct at 24.

conceptually. While I will leave the legal arguments to the lawyers, I do not think the Kentucky Public Service Commission can exert jurisdiction, implicit or otherwise, over the revenues from services that are either unregulated or deregulated, or in the case of broadband, entirely within the federal jurisdiction. Also, on a conceptual level, I think considering the profitability of a rural ILEC's, or the rural ILEC's affiliate's, unregulated services sets a dangerous precedent. If the Commission were to consider an unregulated source of profitability to sustain a regulated source's revenues, there is no reason why the rural ILECs should not be able to consider a regulated source's revenues for an unregulated, or an affiliate's unregulated, lack of profitability. If the Commission does not want or cannot sustain the latter, it should not endorse the former.

Q. Finally, would you please describe Cincinnati Bell's position in this proceeding?

A. Yes. Cincinnati Bell maintains that upon its adoption of a price regulation plan at KRS 278.543 in July 2006, its intrastate access rates were deemed reasonable and the Kentucky PSC has no jurisdiction to affect those rates as long as they are compliant with KRS 278.543.[36] Cincinnati Bell expresses no position on whether the Commission should reduce the intrastate switched access rates of other rural ILECs that have not elected price regulation under KRS 278.543, except that the Commission must make a finding that the rates are unreasonable before proceeding further, and that if the rates are found to be unreasonable, then the Commission should first look to rebalancing to offset access reductions.

As for rebalancing, Cincinnati Bell believes that any access rate reductions should be phased in over time, and not flash cut, and that the Commission should establish a

[36] Cincinnati Bell Rupich Direct at 3.

statewide benchmark rate based on the rates of carriers whose interstate and intrastate switched access rates are already at parity and any carriers that elected price regulation at KRS 278.543.[37]

Q. What is your response to Cincinnati Bell's proposal?

A. I agree with Cincinnati Bell's proposal for reasonable rate rebalancing that may include the establishment of a state benchmark; however, I do not agree with a benchmark that is not comparable.

Q. What is your opinion of an appropriate benchmark?

A. In terms of a benchmark, I believe that TCA-96 establishes an appropriate benchmark standard when it prescribes that customers in rural areas must have access to services at rates reasonably comparable to rates charged for similar services in urban areas.[38]

As the FCC has explained:

> Congress adopted section 254 to help ensure that, as competition develops, explicit support mechanisms would replace, as far as possible, implicit support mechanisms in order to preserve the fundamental communications policy goal of providing universal telephone service in all regions of the nation at reasonably comparable rates.[39]

Moreover, the FCC has consistently recognized that the states set local rates and are best positioned to meet the standard:

---

[37] Cincinnati Bell Rupich Direct at 3-5.

[38] *See* 47 U.S.C. § 254(b) and my direct testimony at 10.

[39] *In the Matter of Federal-State Joint Board on Universal Service,* CC Docket No. 96-45*, Order On Remand*, Further Notice Of Proposed Rulemaking, And Memorandum Opinion And Order (Order released October 27, 2003) at ¶ 16. ("In this Order…[we] adopt measures to induce states to ensure reasonable comparability of rural and urban rates in areas served by non-rural carriers.")

> States, of course, retain primary responsibility for local rate design policy and, as such, bear the responsibility to marshal state and federal support resources to achieve reasonable comparability of rates.[40]

Thus, I maintain the position set forth in my direct testimony that rates cannot be set at the levels suggested by AT&T, Verizon, or Sprint, as they result in rural consumer rate increases that are too high and rural ILEC rates that are not comparable to their urban counterparts. If a benchmark is established, it should be one that maintains comparability between rural and urban rates as Congress has mandated, the FCC has prescribed, and several states, including Arkansas, California, Colorado, Hawaii, Idaho, Indiana, Maine, Missouri, Nebraska, Nevada New Hampshire, Oregon, and Wyoming, have adopted.

B. The Other Parties' Misleading, Incomplete, and Erroneous Positions

1. The misleading proposition that Kentucky should restructure intrastate switched access rates because other states have done so.

Q. You earlier identified as misleading Verizon's recitation of states that have undertaken intrastate access reform as support for its proposal in Kentucky. What did you mean by that?

A. In support of their various proposals, AT&T, Verizon, and Sprint offer grounds to justify their proposals that are misleading and do not support the action these parties propose here in Kentucky if scrutinized beyond the simple statements presented in their testimonies. One of these misleading assertions is that because other states have reduced intrastate access rates to parity, Kentucky should too. Simple review of other states' actions reveals that very few, if any, state jurisdictions have simply rebalanced rural

[40] *Seventh Report & Order and Thirteenth Order on Reconsideration*, FCC 99-119, CC Docket Nos. 96-5, 96-62 (Order released May 28, 1999) at ¶ 31.

ILECs' local exchange rates in isolation of consideration of the other issues of affordability and universal service.

Q. Would you please cite specific examples?

A. Yes. AT&T witness Oyefusi declares that "[n]umerous states have, in one form or another, required local exchange carriers' intrastate switched access rates to mirror their interstate switched access rates[,]"[41] and then proceeds to identify 16 states. While he includes a minor parenthetical "fact" about each state, he fails to acknowledge the import of the few details he does provide, or in other respects, wholly ignores other very relevant details.

For example, while Pennsylvania has recently undertaken action to reduce intrastate access rates to parity, it has provided that each RLEC may maintain or even increase the non-traffic sensitive Carrier Common Line Charge ("CCLC") to a $2.50 level in order to recognize that the CCLC was designed to contribute to the cost of the local loop. As the PA Public Utility Commission stated:

> Because existing precedent and policies mandate the sharing of the NTS joint and common costs by all the users of the RLECs' intrastate access services, the complete elimination of the per access line intrastate CC rate element for the RLECs cannot be condoned. Such an approach would lead to the inequitable, discriminatory, and unlawful result of potentially "loading" 100% of the recovery of the RLECs' joint and common NTS costs associated with intrastate access upon end-user consumers alone. . . . This [CCL] approach accomplishes multiple objectives while fostering the achievement of several important goals [including that] the recovery of the NTS joint and common costs of the RLECs' intrastate carrier access services will not be borne by end-user consumers alone. Instead, such recovery is shared by all those who use the RLECs' network. [42]

---

[41] AT&T Oyefusi Direct at 28.

[42] *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund, Docket Nos. I-00040105* et al., (Order entered July 18, 2011) at 120.

So, clearly while Pennsylvania has determined to reduce intrastate access rates to parity, it has done so under conditions that are different than what AT&T, Verizon, and Sprint advocate before the Kentucky Commission. At a minimum, under the rationale of the PA Commission, the rural ILECs should *retain* the NTSRR at a level this Commission determines to provide an appropriate contribution to the recovery of the costs of the local loop, the same reason for which it was originally designed in Kentucky. While the PA Commission declined additional USF support at this time, the TDS Companies believe that the Kentucky Commission, in addition to retaining the NTSRR, should also adopt explicit universal service support as well if it chooses to reduce intrastate switched access rates to parity.

Q. What about the actions of the other states that witness Oyefusi cites?

A. These are also distinguishable from the relief the AT&T seeks here. Of the other 15 states witness Oyefusi cites, the restructuring for more than half of them affected *only* the largest ILEC and/or CLECs,[43] several incorporated state universal service funds or some other explicit universal service, revenue recovery, or CCL-type mechanism to afford revenue-neutral access restructuring and/or mandate contributions to the local loop,[44] one has a relatively dense population with service provided by Verizon, Embarq and just one small rural carrier,[45] and at least one opted not to reduce intrastate rates to parity with interstate rates because to do so would have required a state USF, which that

[43] Massachusetts, Ohio, New Jersey, Texas, Nevada, Wisconsin, Mississippi, and West Virginia. Sprint witness Appleby also confirms that access reform to date primarily has been undertaken with respect to the largest ILECs. Sprint Appleby Direct at 12.
[44] Kansas, Georgia, New Mexico, Illinois, Michigan, Indiana, Wisconsin, Maine, and Texas.
[45] New Jersey.

state declined to institute.[46] As I stated in my direct testimony, as of 2006, at least 22 states had decided to implement an explicit universal service recovery mechanism.[47]

Thus, while the circumstances in each state are all very different, they all have one thing in common: Each state took a more comprehensive view that provided a more meaningful transition period and a meaningful opportunity for lost access revenue recovery, often including a more enduring explicit support mechanism such as what TCA-96 prescribed and the FCC adopted, than what AT&T, Verizon, and Sprint propose for Kentuckians. Most importantly, none of the actions in the states identified by these witnesses stands for the simple premise for which they are cited, namely that there is this wave of state restructuring to parity, as defined by those parties, that Kentucky should ride.

Q. What other misleading, incomplete, or erroneous positions do other parties advance to support their proposals in this proceeding?

A. There are several. Perhaps the most disingenuous is the position that Kentucky's intrastate switched access rates are impeding the development of competition in Kentucky. There are others, however, including that the application of intrastate switched access charges is faulty, that parity of intrastate switched access rates to interstate rates means a comparison of rates only, and not the concomitant explicit support, and that without such explicit support the interstate rate is compensable, and the erroneous

[46] Missouri.

[47] See my direct testimony at 11 for a discussion of the National Regulatory Research Institute ("NRRI") 2006 Report and reference to at least three more states (Indiana, Louisiana, and Michigan) that implemented explicit functional funding sources for universal service support including for access restructuring after that 2006 report was issued. In a 2010 Report, NRRI continues to report that a substantial number of states continue to support affordable and ubiquitous universal service either through some explicit means or through continued implicit support through intrastate access charges.

position that this Commission can regulate competitive, non-jurisdictional, or unregulated revenues as part of any regulated restructuring. None of these arguments is valid.

2. The misleading statement that intrastate switched access rates impede competition.

Q. Do you agree that the current level of intrastate access rates has impeded the development of competition in Kentucky and elsewhere?

A. Absolutely not. And I am not the only witness in this proceeding that thinks that competition is quite robust notwithstanding current intrastate switched access rates. The AT&T, Verizon, and Sprint witnesses all agree that competition is quite robust *regardless* of intrastate levels of switched access charges.

Q. What is your support for that statement?

A. Despite repeatedly offering economic theory that competition suffers most from high intrastate access rates, each and every witness has also correspondingly acknowledged that competition is rampant. These same witnesses, as well as others, also confirm that stand alone long distance service (the service provided by the IXCs that purportedly need the intrastate access reductions) or customers of such service are both virtually non-existent. By logical extension, therefore, these non-existent services and customers are not likely to be beneficiaries of reduced access charges (which itself is further supported by evidence that in at least two states, Virginia and Pennsylvania, after intrastate access charges were reduced the cost of stand-alone intrastate toll service was subsequently increased).

AT&T witness Aron, for example, an economist with undeniable academic economic pedigree and practice, describes "excessive access prices" as harming consumers not simply by causing them to pay higher prices for long distance services, but also by restricting their usage more than is justified by the "societal cost of producing the product" resulting in "'allocative inefficiency'" that is a "social 'deadweight loss' to the economy."[48] Notwithstanding this economics lesson, AT&T witness Aron contradicts herself by admitting that society has not suffered. As Dr. Aron states, "as a result of dramatic developments in wireless and internet technologies and infrastructures, the continuing advancements in headsets, the ability of a variety of new devices to provide voice and video communications, and a variety of associated innovations, *consumers increasingly enjoy a rich and almost dizzying array of communications modalities, among which they choose depending on circumstances and objectives.*"[49]

Witness Oyefusi's statements are similarly inconsistent, depending on which point he is trying to support. While Dr. Oyefusi claims that Kentucky's intrastate access rates distort the competitive playing field, deprive consumers of the benefits of competition, and hinder local competition and the transition to new technologies,[50] he likewise cites data that shows just one new technology, text messaging, increasing by more than 1400% in just 4 years![51] He also describes similar growth in new technologies such DSL, broadband cable, and VoIP, and concludes that competition is "now widespread in all segments of the communications marketplace" and "flourishing."[52]

[48] AT&T Aron Direct at 52-53.
[49] AT&T Aron Direct at 31 (emphasis added).
[50] AT&T Oyefusi Direct at 12-13.
[51] AT&T Oyefusi Direct at 19.
[52] AT&T Oyefusi Direct at 20-21.

Verizon witness Price agrees that "myriad technological advances in recent years have led to consumers today being able to obtain service from a wide variety of providers," wireline, wireless, cable, VoIP, "such that Kentucky consumers can choose from a host of different retail providers."[53] And Sprint witness Appleby confirms that most consumers have competitive options through cable, CLECs, wireless and VoIP providers.[54]

Except for in a regulatory proceeding such as this, neither the IXCs nor the other carriers blame rural ILECs' intrastate access rates for competitive inhibition or decline generally within the market or specifically to the wireline IXC business model. Rather, as AT&T, Verizon, and Sprint acknowledge, it is the impact of intermodal competition on today's business models, specifically technological advances and resulting changes in customer preferences, and not the specific level of any intrastate access charges, that is the cause for the shift in the wireline IXC business model and the decline generally of the wireline segment.

Q. Are there other examples of such inconsistent advocacy regarding the impact on competition purportedly arising from the level of intrastate switched access charges?

A. Yes. To support mandated access reductions, both the Verizon and Sprint witnesses claim, on one hand, that today's intrastate access rates are impeding competition. However, to support their opposition to a revenue replacement mechanism, each also claims on the other hand that competition is booming. Verizon witness Price

[53] Verizon Price Direct at 10-11.
[54] Sprint Appleby Direct at 10.

states newer technologies "are increasingly preferred by consumers" and they "drive innovation and investment in Kentucky."[55] Sprint witness Appleby also claims that "[c]onsumers are harmed by unreasonable access rates" all while acknowledging that "consumers are now afforded more choices for their voice communications needs[.]"[56]

AT&T witness Aron got this much right: the customer choices available today in many areas are "dizzying." New technologies that appear today become outdated tomorrow. The highly demanded iPhone just introduced to the world in 2007 will soon be replaced, a mere four years later, by the iPhone 5. The fact is that new technologies and customer choices are exploding *regardless* of the level of Kentucky's rural intrastate switched access charges.

Q. Will reductions in intrastate switched access rates in Kentucky improve the state of competition in Kentucky as these carriers claim?

A. No. If the Kentucky Commission chooses to follow a path of parity with interstate rates, it should do so for the proper public policy reasons, for example that in a competitive environment, implicit support must be made explicit, and not on the false premise that it will benefit competition.

IXCs have long been in the process of abandoning the IXC market as AT&T demonstrated in a declaration filed before the FCC to support the AT&T/Bell South merger. In that declaration, attached to my rebuttal testimony as TDS Exhibit 1, AT&T explained its June 2004 decision to abandon the local and long distance mass market, setting forth a litany of reasons why its business plan was failing, but not once

[55] Verizon Price Direct at 57.
[56] Sprint Appleby Direct at 10.

mentioning intrastate access rates, or even access rates in general, as a reason that it would no longer promote long distance service.

Contrary to the general economic theory AT&T presents in this proceeding, the evidence clearly shows that forces much larger than intrastate access rates have prevailed against the IXC business plan for years: the existence of "powerful competitors," wireless package plans, the "RBOCs [win of] authority to offer interLATA services throughout the country[,] competing aggressively and winning market share very quickly[,] E-mail and instant messaging," for example, all contributed to the decline and abandonment of AT&T's long distance business plan.[57]

AT&T decided that it could no longer serve stand-alone toll customers, but instead would have to market bundles that matched what its unregulated or lightly regulated competitors were doing.[58] AT&T in fact had as a goal that wireline toll service would retreat as a competitive option because by design toll customers "dwindled away over time through churn."[59]

Q. What evidence of an improved competitive state do these parties offer?

A. AT&T witness Aron presents data she claims shows a "strong positive relationship on average between the intrastate access rate paid by AT&T and the average per minute intrastate long distance price charged by AT&T."[60] AT&T witness Oyefusi claims it "premature," however, to predict how its long distance prices will change, since it offers "a variety of toll plans and packages" and prices can change anywhere within

[57] *See* TDS Ex. 1 at ¶ 4.
[58] *See* TDS Ex. 1 at ¶ 6.
[59] *See* TDS Ex. 1 at ¶ 9.
[60] AT&T Aron Direct at 50.

those plans.[61] However, AT&T makes a concession to its claim of consumer benefits and offers to reduce its $1.25 per line In-State Connection Fee (ISCF) applicable to its stand-alone long distance customers and to reduce in-state rates for its prepaid calling cards.[62]

Sprint witness Appleby offers no specific benefits, claiming generally that more resources will be available to "expand service coverage, enhance service quality, develop new and innovative service offerings, <u>and</u> provide better pricing in the market."[63]

Q. What is your reaction to these claimed benefits?

A. AT&T's offerings are no more than nominal gestures not likely to match or even approximate in magnitude the amount of access savings that AT&T will realize. In exchange for millions of dollars of access reductions, AT&T's long distance customers will realize pennies per month. This "benefit" is further marginalized because it does not apply to every AT&T customer subscribing to AT&T's long distance service. Rather, the savings will only accrue to those AT&T customers subscribing to AT&T's stand-alone long distance service, the same service AT&T abandoned in 2004 and purposefully allowed to "dwindle" over time because of changing technology and competition from the RBOCs.

Other parties also openly admit that the stand-alone long distance market is effectively non-existent. Kentucky Cable Telecommunications Association witness Gillan declares originating access "a vestige of a market structure that has virtually disappeared" because "the factual reality is that stand-alone long distance services are not

---

[61] AT&T Oyefusi Direct at 25.
[62] AT&T Oyefusi Direct at 26.
[63] Sprint Appleby Direct at 11 (emphasis in original).

price leaders (or even followers), as much as remnants of a bygone era."[64] Sprint witness Appleby agrees: "Significant market changes have greatly diminished the role of stand-alone long distance service providers. Customers no longer expect to purchase long distance as a separate product from another service provider other than their local service provider."[65] So AT&T offers very little to very few.

Of course, Verizon and Sprint do no better, offering nothing concrete, preferring to rely instead on general promises of better quality or prices.

Q. Are you aware of any instances where AT&T has raised consumer rates after having secured intrastate access rate reductions?

A. Yes.

Q. Would you please describe them?

A. Yes. While both Verizon witness Price and AT&T witness Oyefusi tout the fact that in Virginia carriers were directed to eliminate their CCLCs,[66] neither mentions the fact that effective March 2011, AT&T notified its customers of increases. As you can see on my Exhibit 2, these increases ranged anywhere from 10% to nearly 50%, to their intrastate direct dialed, toll free, and calling card per minute usage rates for selected AT&T long distance rate plans. Virginia's intrastate toll rate increases were just another example of the questionable benefits flowing to consumers as a result of AT&T's long distance pricing strategy *after* reaping access expense reductions.

---

[64] Kentucky Cable Telecommunications Association Gillan Direct at 8.
[65] Sprint Appleby Direct at 5.
[66] Verizon Price Direct at 21-22; AT&T Oyefusi Ex. OAO-5.

Q. Are there other examples?

A. Yes. In Pennsylvania, following the implementation of intrastate access reform in the 2003-04 time frame, AT&T also raised rates for its all-distance bundles in Pennsylvania by anywhere from $2 to $5, increased the monthly recurring charge on many plans typically by either $1 or $2, and increased a number of basic rates for international service, all with the goal of focusing on value-added services to large commercial, government and wholesale customers.[67] Claims that competition is impeded and customers of long distance services will benefit are contradicted by AT&T's own subsequent actions and words.

Q. Outside of regulatory access proceedings do AT&T and the other carriers blame high intrastate access charges for their wireline losses and the change in their business plans?

A. No. As I stated previously, AT&T repeatedly emphasizes that it is intermodal competition primarily from changing technologies and customer preferences that affects its business plans. It is only in regulatory proceedings such as this, where the national dominant communications carriers are seeking a direct cut to their operating expenses, that rural ILEC access rates are cited by IXCs as a cause for the decline of their landline business model or impediments to competition. It is common knowledge, however, that it is the impact of intermodal competition on today's business models, specifically technological advances and resulting changes in customer preferences, and not the specific level of any intrastate access charges, that caused the shift in business model and the decline generally of the wireline segment.

[67] *See* TDS Ex. 1 at ¶¶ 2, 33-34.

Wireless service is growing because of mobility, convenience and the high tech functionalities of the phones. The iPhone is a phenomenon by any measure. Wireless phones no longer offer just voice service, or voice and camera services. They have data plans and "apps" that take wireless phones to a level that exceeds dramatically any impact rural ILEC wireline intrastate access rates may have. Web browsing and data transmission over wireless phones are exponentially expanding wireless' viable options. Consumers in younger generations are very willing to use wireless exclusively for their communications needs. VoIP phones are gaining widespread favor. Reliability, security, and privacy are less valued features.

This overall maturation of technology and usability has driven the growth of competitors' lines, including the wireless, cable, VoIP and other carriers, at the expense of the traditional fixed lines, including stand alone long distance service. AT&T made this case itself in 2004 before the FCC to justify its withdrawal from the mass long-distance market and the facts are even more compelling today. By its own testimony, consumers today have a "dizzying" array of choices that transcend any purported impact from intrastate access rate levels.

Q. From other available sources, how does it appear that these other carriers intend to continue to maintain the traditional network?

A. It appears that none of the companies that oppose universal service support for the rural ILECs intend to continue to support the traditional wireline network.

For years now, Verizon has been shifting its focus, and investment, away from its own rural and wireline properties. "Verizon is selling off most of its operations in rural areas and is spending billions to wire most of the rest of its territory with its fiber optic network, or FiOS ….”[68] Verizon indicated its “main growth engines are wireless voice and data; high-speed consumer broadband and video services; and Internet Protocol (IP) networks, applications and professional services for global business.”[69] “[C]apitalizing on the size and breadth of the customer base of Verizon Communications[,]” Verizon promotes “the ‘Verizon Wireless’ brand”[70] with the “business strategy [] to be the premier broadband and entertainment service provider in the mass market[.]”[71] Verizon’s cutbacks in its wireline business figured prominently in its recent workforce strike.[72]

AT&T, too, has been focusing more on its wireless segment than its wireline services. AT&T’s wireless revenues continue to account for a greater percentage of total segment (wireless, wireline, advertising & publishing, and other) income, comprising 46% in 2008 total segment income compared to 32% in 2007. From 2009 forward, AT&T plans to focus on wireless, service to large business customers, data/broadband, its U-verse television service (akin to Verizon’s FiOS service), and its VoIP offerings.[73]

---

[68] http://bits.blogs.nytimes.com/2009/09/17/verizon-boss-hangs-up-on-landline-phone-business/. See also http://www.onetrak.com/ShowArticle.aspx?ID=4196.

[69] Verizon Communications Inc. 2008 Annual Report (“Verizon Annual Report”) at 1.

[70] Verizon Communications Inc. 2008 10-K (“Verizon 10-K”) at 7.

[71] Verizon 10-K at 10.

[72] *See* www.forbes.com/sites/greatspeculations/2011/08/12/verizon-strike-highlights-weakeness-in-wireline-business (“Last Sunday, 45,000 Verizon workers went on strike opposing the large-scale concessions that the company is planning in order to cut costs for its wireline business, which has struggled in recent years.”); www.online.swg.com/article/SB1000142405311190345450457693212587100674.html (“[Verizon Communications Inc.] is seeking concessions from its unionized workers to help offset declining revenue in its division encompassing the traditional phone business and its FiOS Internet and television.”); www.telecompetitor.com/verizon-strike-illustrates-vulnerability-of-wireline-business/ (“Verizon is going out of its way to inform the public that this strike does not impact their ‘crown jewel’ wireless business. But it does affect their wireline crown jewel of FiOS. Why put that at risk? Because the broader issue – residential wireline services – has a dwindling impact on Verizon and its profits.”)

[73] AT&T Inc. 2008 10-K (“AT&T 10-K”) at 2-3.

Sprint also remains clearly focused on wireless services, as evidenced by its recent sale of the Embarq properties and wireless capital expenditures which increased 43% from the quarter ended September 30, 2008.[74]

The TDS Companies, on the other hand, while progressing with the development of broadband and other services in order to remain competitive, also remain committed to continuing to provide and maintain traditional wireline services in some of the most sparsely populated areas.

AT&T, Verizon, and Sprint are increasingly becoming more reliant on their wireless and data networks and customers, and less reliant on and even supportive of their legacy wireline networks and customers. Quite simply, the level of intrastate access rates has nothing to do with competition; however, their corporate opportunity to obtain an operating expense reduction on the backs of rural ILECs and their customers has everything to do with it.

3. The misleading statement that the intrastate switched access rate regime is faulty in its application.

Q. You also identified as misleading the statement that the application of intrastate switched access charges is somehow faulty because of how it impacts IXCs compared to other carriers. Do you agree with this premise?

A. No.

Q. Why not?

[74] http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTg4OTR8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1, "Sprint Nextel Reports Third Quarter 2009 Results" at 3, 5.

A. Let me state up front, again, that the TDS Companies are not opposed to rational and comprehensive intrastate access reform that renders the implicit support currently found in intrastate access charges explicit, and which would also include expanding the base of contributors that should be required to contribute to an explicit support mechanism. Given the evolution of the communications and telecommunications market that virtually every witness in this proceeding has described, it would be a *better* public policy if universal service were universally supported by all providers that benefit from the privilege of conducting business in Kentucky. That said, I do not agree at all with any premise that intrastate switched access charges have to be restructured because the present system is either unfair or faulty.

AT&T witness Oyefusi concludes that current intrastate access charges distort competition because other providers do not bear the same access charge burden as the IXCs.[75] Sprint witness Appleby complains that the access compensation arrangement has put wireless carriers in a "difficult situation"[76] because wireless carrier only pay access, they do not charge it. However, these payment arrangements either have been set by the regulators or the wireless carriers themselves. The FCC and the Commission set rates in their respective jurisdictions. It is not unfair because all carriers pay the same rates. If the call is interstate, all IXCs pay the same rate. And it is the same for an intrastate call. The Commission has approved these tariffed rates and the tariffs are applied uniformly. Nor is it "difficult," since as Mr. Appleby notes, wireless carriers can address any perceived unfairness in their contracts.[77]

[75] AT&T Oyefusi Direct at 15-16.
[76] Sprint Appleby Direct at 9.
[77] Sprint Appleby Direct at 9.

It was also the FCC that defined the wireless carriers' local calling areas as the entire metropolitan trading area ("MTA"). While Sprint may complain about the "asymmetric"[78] application of access charges as between the rural ILECs and wireless carriers, the fact is that the FCC approved a geographic application of rates that are different between the wireless and wireline carriers, resulting in a different compensation scheme for different technologies. This is a federal policy decision, supported by the wireless carriers,[79] with which the rural ILECs must comply. There simply is no support for the suggestion that this Commission has to revise its intrastate access rates in a manner that substantially impacts Kentucky RLECs' rural customers in order to compensate IXCs for the FCC's determinations regarding wireless service. The Kentucky PSC should not be put in the position of setting intrastate wireline local exchange policy directly affecting Kentucky's rural consumers on the basis of the impact of federal wireless policy on other carriers.

4. The incomplete and misleading statement that mirroring interstate switched access rates without mirroring interstate explicit support mechanisms results in "parity" to a "compensable" rate.

Q. AT&T, Sprint, and Verizon urge the Commission to reduce intrastate access rates to parity with their interstate counterparts. Would setting the rates at the same level result in parity?

---

[78] Sprint Appleby Direct at 9.

[79] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,* CC Docket Nos. 96-98 and 95-185, First Report and Order, 11 FCC Rcd 15499, 16016, ¶ 1036: *See also T-Mobile et al. Petition for Declaratory Ruling Regarding Incumbent LEC Wireless Termination*, CC Docket No. 01-92, Declaratory Ruling and Report and Order, released February 24, 2005 ("As a consequence, most traffic sent to CMRS providers from small incumbent LECs is terminated without compensation.").

A. No.

Q. Would you please explain why not?

A. Yes. As I stated in my direct testimony, parity means replicating the federal tariff *rate* as well as the federal *means* to achieve that rate. That means a state USF should be created. Otherwise, the Commission is only looking at half the picture. If a state USF is not also implemented, then intrastate access rate should mirror the total compensation paid and received by carriers at the federal level. In other words, we should use the "real interstate rate" as the basis of mirroring.

RLEC witness Staurulakis agrees with this approach, and in fact has calculated what he calls the "true difference" between the interstate rate and the intrastate rate by taking into account the Local Switching Support ("LSS") and Interstate Common Line Support ("ICLS") received at the federal level as a result of the FCC's *CALLS* and *MAG Orders*, in addition to the interstate tariff rate by itself. If calculated in the same manner, the TDS real interstate rates would be $0.0628 for Leslie County Telephone County, $0.1462 for Lewisport Telephone Company, and $0.1277 for Salem Telephone Company.[80]

While AT&T, Verizon, and Sprint all recognize that reforms occurred at the federal level, their analyses disregard the federal support systems that were put into place in order to accommodate the reduced interstate rate and merely highlight the final end interstate rate. For example, AT&T witness Oyefusi stated:

[80] This calculation is derived from the Companies' 2010 billed interstate access minutes and revenues, to which is added the 2010 ICLS and LSS federal support.

> Originally, the system of embedding large subsidies in excessive access rates also existed at the federal level, but over several years, mostly in the 1980s and 1990s, the FCC implemented significant reforms to the federal regime. These federal reforms have significantly reduced - although not eliminated - the implicit subsidies that had been buried in interstate switched access rates.[81]

Conveniently omitted from Dr. Oyefusi's discussion was the creation of the LSS and ICLS support mechanisms that allowed the significant reductions to the rates. Verizon witness Price presents the same "half-picture," identifying the FCC's elimination of the CCLC but refusing to acknowledge the explicit support mechanisms that took its place,[82] while Sprint witness Appleby is simply mute on the subject.

Thus, it is inaccurate to suggest that mirroring the interstate rate will achieve parity and misleading to suggest that the FCC simply cut access revenues without creating an access replacement mechanism. Parity can only be achieved if both the interstate *rate* and the interstate *means* are mirrored. The FCC has simply taken the cost of the local loop out of the switching cost and reassigned it to an explicit support mechanism. The FCC did not decide that there are no joint and common costs associated with the transmission of interstate calls. Thus, the equivalent of the NTSRR remains an element at FCC and other state levels, it is just known by another name. Without the local loop, exchange access services could not be provided. Therefore the local loop is a joint and shared cost that should be recovered from all users. Only through recognition of these federal explicit support mechanisms can any comparison to the federal "rate" be considered compensable.

[81] AT&T Oyefusi Direct at 10.
[82] Verizon Price Direct at 17-20.

5. The erroneous proposition that ILECs can be compensated for intrastate access revenue losses by imputation of revenues from other nonregulated revenue sources.

Q. You also identified as misleading, incomplete, or erroneous the proposition that rural ILECs may be considered compensated for mandated intrastate switched access rate reductions by giving consideration to or imputation of revenues from other non-jurisdictional sources. Would you please explain further?

A. Yes. Sprint witness Appleby suggests that rural ILECs may recover lost access revenues through their increasing revenues from the sales of other services that use the local loop. As an example, Mr. Appleby cites to Windstream's DSL, long distance market penetration, and video services.[83]

Q. What is your response to such a proposal?

A. Again, Mr. Appleby's proposal has superficial appeal in its suggestion that any revenues that are obtained through use of the local loop should be considered. However, as with every other misleading, incomplete, or erroneous position advanced, the proposal does not withstand scrutiny. There are serious problems with Mr. Appleby's proposal, not the least of which is this Commission's jurisdiction.

Mr. Appleby essentially contends that all of the revenues the rural ILECs and their *separate legal entity* affiliates receive from various regulated, unregulated, and nonjurisdictional sources, including both inter- and intrastate access charges, broadband services, vertical features (e.g., caller ID), special access, private lines, etc. should be imputed to the regulated rural ILEC as "found revenues" to compensate for any mandated reductions to intrastate access revenues.

[83] Sprint Appleby Direct at 23-26.

This Commission lacks jurisdiction to impute revenues from services that are jurisdictionally interstate (for example broadband), to offset intrastate access revenue losses. The FCC has determined that DSL is an interstate service.[84] Therefore, the FCC has sole jurisdiction over DSL service and has ruled that existing interstate loop allocations capture all interstate uses of the loop, including DSL. Contribution to local loop cost from broadband services is not required by the FCC for policy reasons. No further allocation is required or permitted for DSL service. These are federal jurisdictional services, controlled exclusively by federal tariff and the FCC. Further, the FCC does not require contributions to the local loop for broadband beyond the federal Subscriber Line Charge, which is paid by the end user. Likewise, this Commission cannot exert jurisdiction over services that have been deregulated. The revenues from non-jurisdictional federal or deregulated state services cannot be used to compensate for intrastate revenue reductions.

Mr. Appleby's proposal is factually impaired as well. First, the fact that Mr. Appleby is stretching his proposal as far as he can, and well beyond any tie to the local loop, is evidenced by his recommendation that Windstream's video revenues be considered *despite his recognition* that Windstream provides video service over *satellite*, which, obviously, does not use the local loop. Aside from this gross overextension, however, the foundation of Mr. Appleby's proposal is wrong.

Mr. Appleby suggests that rural ILECs today receive revenues from a host of sources that did not exist years ago. However, Mr. Appleby overlooks the fact that rural ILECs have also experienced a substantial reduction in revenues from other services as

[84] *Framework for Broadband Access to the Internet over Wireline*, CC Docket No. 02-33, Report and Order and Notice of Proposed Rulemaking released September 23, 2005 ("*FCC Wireline BB Order*").

well. There are now fewer lines providing local and toll/long distance service. There are now more high speed lines, true, but there are also fewer local lines being used for dial-up calling. According to published FCC statistical information, in 1998, 26.2% of households had Internet access (dial-up). By 2000 that Internet access grew to 41.5%, with broadband ("high speed") comprising only 4.4% (37.1% dial-up). In 2008, Internet access was 61.7% with 50.8% of households accessing by broadband, and 10.9% through dial-up.[85] Some of this post-2000 increase in broadband would be cable modem service as FCC statistics indicate cable modem service represents 34.1% of all high speed connections while DSL is only 28.3%.[86] So the rural ILECs have had a shift in the type of usage (narrowband vs. broadband), but not in the overall usage or even necessarily in the amount of usage of their facilities for internet access.

Another service mentioned by Mr. Appleby is video. While some rural ILECs may use broadband to provide IPTV, the TDS Companies do not. However, even if TDS were to provide it, Mr. Appleby fails to account for the extraordinary amount of investment, including reduction of loop length to produce the bandwidth necessary to provide video services as well as DSL, and sizeable expenses, including programming and franchise fees, incurred to provide these other services, which offset revenues. If all revenues from these different services are to be included, then the Commission must consider all the costs involved in providing these services as well.

Moreover, as Mr. Appleby recognizes, many of these non-jurisdictional services are provided by "separate affiliated legal entities."[87] As I stated earlier, the premise behind Mr. Appleby's proposal is very dangerous from a policy perspective. If Sprint

[85] FCC Trends in Telephony (August 2008), Chart 2.10.
[86] FCC Trends in Telephony (August 2008), Chart 2.2.
[87] Sprint Appleby Direct at 27.

proposes to shore up regulated revenue losses through revenues received from non-jurisdictional, non-rural ILEC revenue streams, this Commission must be willing to shore up competitive revenue streams from regulated services.

C. Miscellaneous Issues

Q. Sprint witness Appleby contends that appropriate measures by which to conclude that the rural ILECs' intrastate switched access rates are too high is by comparing those rates to interstate switched access rates, reciprocal compensation rates, a comparison of AT&T Kentucky's rates to Windstream's rates, and a comparison of Windstream's and AT&T's teledensities, and a comparison of the average ILEC teledensity to national non-BOC teledensity.[88] What is your response?

A. It is improper on any level to compare the rural ILECs' intrastate switched access rates to their interstate switched access rates for the reasons I stated above. A "rate-to-rate" comparison is irrelevant without inclusion the new LSS and ICLS support mechanisms the FCC implemented to support the lower interstate rates. In the alternative, one should compare the "real" or "true" interstate rate, with the revenues from the explicit support mechanisms considered in order to make a valid rate-to-rate comparison.

A comparison to reciprocal compensation rates is equally invalid. Reciprocal compensation and access rates were developed using different pricing standards and cost allocations. Reciprocal compensation is based upon TELRIC methodology, an incremental cost modeling used for UNEs and local transport and termination (reciprocal) compensation and not interexchange (toll) access. The FCC has never required the use of TELRIC for the development of access rates. In fact, the FCC stated that "the reciprocal

[88] Sprint Appleby Direct at 15.

compensation provisions of Section 251(b)(5) for transport and termination of traffic do not apply to the transport and termination of interstate or intrastate interexchange traffic."[89] In developing reciprocal compensation for transport and termination rates, the FCC concluded that non-traffic sensitive costs should not be considered additional costs when a carrier is terminating a local call originated on a competing carrier's network.[90] This is the key reason why reciprocal compensation rates are lower than access rates, and does not mean that access rates that are higher than reciprocal compensation rates are per se too high.

As for any comparisons to Windstream's or the rural ILECs' rates and teledensities, again there can be no valid comparison of interstate rates to intrastate rates without consideration of the explicit external funding that the FCC implemented in order to recover revenues lost through mandated reductions to interstate access costs. While Mr. Appleby makes the implication, there is no evidence upon which to conclude that the rural ILECs' and AT&T's costs are the same or even similar. The rural ILECs have no urban base over which to average their rural high costs. Moreover, none of the rural ILECs carries the type of buying power and clout that AT&T, Verizon, and Sprint enjoy.

Q. What about teledensity? Isn't teledensity a relevant comparison?

A. Yes, teledensity is relevant, but teledensity is but one measure. Economies of scale and scope (buying power) must also be considered if one is to engage in a comparison of markets. As I said, the TDS Companies do not match AT&T, Verizon, or Sprint in terms of economies of scope and scale. Service area demographics are also a

---

[89] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, FCC 96-325, CC Docket Nos. 96-98 and 95-185, First Report and Order at ¶ 1034.
[90] *Id.* at 1057.

factor to consider. As a rural carrier, the TDS Companies exclusively serve rural territories. As I stated in my direct testimony, the TDS Companies serve some of the most rural and agrarian communities in Kentucky, and have an overall customer mix that is highly residential. The median household income ranges from $23,863 to $48,464, and unemployment is between 9% and 14%.[91]

Finally, even if one were to focus on teledensity alone, Mr. Appleby's facts either do not support the conclusion to which he leaps or are irrelevant to Kentucky. Mr. Appleby states that the average teledensity of other (non-Windstream) ILECs in Kentucky is approximately 17.5 lines per square mile, which he describes as "nearly double" the average *national* non-BOC teledensity of 9.56 lines/sq. mile.[92]

The TDS Companies' customer density ranges from 7 to 31 customers per square mile.[93] The TDS Companies' densities, therefore are either below (Leslie County and Salem) the rural ILEC average, or just slightly above it. In all cases, the TDS Companies' teledensities are well below AT&T's teledensity of 48.3. Further, any comparison to national (non-Kentucky) non-BOCs' teledensity, the source of which is not provided by Mr. Appleby, is irrelevant. None of those carriers is providing service in Kentucky and we do not know any of their rate information. Thus, Mr. Appleby's teledensity analysis is meaningless.

Q. Verizon witness Price opposes imposition of an explicit universal service support mechanism because he asserts the need is based upon three assumptions – that

[91] TDS Mottern Direct at 2-3.
[92] Sprint Appleby Direct at 18-19. Although Mr. Appleby's testimony refers to 17.5 *working loops per square mile*, his Exhibit JAA-G5 shows 17.54 and 9.56 as lines/square mile.
[93] TDS Mottern Direct at 3.

wireline LECs will only continue to serve if guaranteed revenues at today's levels, that only wireline LECs can assure universal service, and that affordable equivalent service is unavailable from alternative providers – assumptions that Mr. Price characterizes as either not proven or false.[94] Do you agree with Mr. Price's characterizations?

A. No.

Q. Why not?

A. No other carrier has a regulatory COLR obligation. For this reason, the rural ILECs *have* to continue to serve even if *not* guaranteed revenues at today's levels. To assume the rural ILECs have any other choice has no basis legally or factually. For this same reason Mr. Price's self-proclaimed false "assumption" – that *only* the wireline LECs can assure universal service – is, in fact, true because comparable service is unavailable from alternative providers. Every other carrier providing competitive service in rural territories is doing so on a business case basis where it makes economic sense to do so. This is why competition, though vibrant and challenging to the rural ILECs in their most populated town centers, is not ubiquitous. And this is why only the rural ILECs can assure universal service. No carrier without a regulatory COLR obligation is going to agree to implement and continue to provide service to a remote customer where such service is not reasonably or even remotely profitable.

[94] Verizon Price Direct at 51.

Q. AT&T witness Aron,[95] Verizon witness Price,[96] and Sprint witness Appleby[97] all claim that disparate intrastate and interstate switched access rates promote and facilitate arbitrage. Is this sufficient reason to reduce Kentucky's intrastate rates?

A. No. Arbitrage between inter and intrastate compensation is *one* reason to bring the two closer to parity, but in a way that is moderate and rational and recognizes all other competing factors. Inter/intrastate (Percent Interstate Use or "PIU") arbitrage is only one form of access avoidance. Some carriers also disguise traffic as local or decline to include their carrier identification so the call cannot be billed to them. Other carriers simply refuse to pay. PIU arbitrage in and of itself is not a basis for blindly lowering intrastate access rates in a vacuum. It is *one* factor.

Q. Since the time that direct testimony was filed in this proceeding, have there been any new developments on the federal level that warrant this Commission's attention?

A. Yes, since direct testimony was filed, a consortium of carriers has filed what has been identified as the "ABC Plan" at the FCC.

Q. What impact will there be on this proceeding as a result of the ABC Plan?

A. That question is difficult to answer. Some issues are common, as it appears that the FCC may address matters such as benchmarks, rates (including possibly intrastate access rates), financial impacts on end-users, and explicit universal service funding.

---

[95] AT&T Aron Direct at 12.
[96] Verizon Price Direct at 45.
[97] Sprint Appleby Direct at 21.

However, at this point we just do not know what the FCC will do, other than it does appear poised to act soon.

Q. Haven't other proposals been made over the years before the FCC that have not come to fruition?

A. Yes. But the FCC took quick action on this proposal and on August 3, 2011, just five days after the ABC Plan was filed, issued a Public Notice of a *Further Inquiry Into Certain Issues In The Universal Service Intercarrier Compensation Transformation Proceeding* at WC Docket Nos. 10-90, 07-135, 05-337, 03-109; CC Docket No. 01-92, 96-45; GN Docket No. 09-51 seeking parties' comments on several issues, including some of the very same issues being addressed by parties before the Kentucky Commission. Placed on an extraordinarily expedited track, Comments were due August 24, 2011, with Replies due one week later.

Q. What is your recommendation with respect to the FCC's potential actions?

A. It is difficult to make a recommendation to this Commission without knowing what the FCC will do. The TDS Companies will simply state that they support intrastate switched access rate reform *on the condition* that intrastate action *not* come exclusively at the expense of the rural ILECs and their customers, as Verizon and Sprint recommend through their opposition to the implementation of explicit support mechanisms, or through the overly restrictive support mechanism that AT&T proposes.

Q. Does this conclude your testimony?

A. Yes. This concludes my rebuttal testimony at this time. I reserve the right to supplement this testimony at hearing or as otherwise may be allowed.

TDS EXHIBIT 1

DECLARATION OF JOHN POLUMBO

Introduction

1. My name is John Polumbo. I am President and CEO of AT&T Consumer Services ("ACS"). The ACS division of AT&T is responsible, among other things, for all aspects of providing and supporting traditional local and long distance services (collectively, "mass market" services). In my capacity, I am involved in all strategic decisions affecting ACS. In 2004, I participated in AT&T's decision to cease actively competing for mass market customers and to scale back our operations to retain only enough infrastructure to continue to serve existing customers at a high level of service as they migrate to active competitors. I am presently involved in overseeing the implementation of this strategy.

2. The purpose of this declaration is to describe the mass market services ACS provides and to explain AT&T's carefully considered 2004 decision to cease actively marketing traditional telephony services to the residential and small business customers that ACS has historically served. I will also explain the many steps AT&T has taken in response to that decision, including the cessation of active marketing, substantial reductions in headcount, termination of relationships with outside suppliers and the retirement of infrastructure. As I explain below, those actions are so extensive that AT&T's decision is now effectively irreversible as a practical matter. I will also describe the price increases AT&T has instituted since its decision to focus on providing world class communications and value-added services to large commercial, government and wholesale customers. Finally, I will describe how

quickly AT&T's mass market customer base is leaving AT&T and migrating to other mass market providers.

I. AT&T's Decision To Stop Actively Competing In The Consumer Market.

3. In the months and years leading up to AT&T's mid-2004 decision to cease actively competing for new customers, AT&T was faced with a strategic dilemma. Its long distance services (stand-alone long distance, or "SALD") offered to residential and small business customers were under severe competitive attack and revenues associated with those services had been declining rapidly for some time.

4. This was due to several factors. New, powerful competitors had entered the market. For example, wireless carriers offering "all-you-can-eat" plans were stealing away more and more minutes from traditional IXCs every year. The RBOCs had won authority to offer interLATA services throughout the country, and they were competing aggressively and winning market share very quickly. E-mail and instant messaging were also reducing traditional carriers' minutes of use.

5. In the context of these developments, pricing competition had become extremely fierce. AT&T's revenue per customer was declining rapidly, and its margins were decreasing steadily. AT&T was losing millions of SALD customers every quarter.

6. It quickly became obvious that AT&T could remain an active competitor in the residential and small business markets only if it could find a viable and profitable means of augmenting its long-distance offerings with economically viable local service offerings that would allow AT&T to match other wireline and wireless providers' attractive "all distance" offerings. AT&T had already made substantial investments in various local entry strategies

that had not been successful. The only local entry option that AT&T was still actively pursuing was UNE-P.

7. In March of 2004, however, the D.C. Circuit vacated the Commission's unbundling rules. *USTA* v. *FCC*, 359 F.3d 554 (D.C. Cir. 2004). Shortly thereafter, the Government decided not to seek review of that decision in the Supreme Court, and AT&T recognized that the availability of UNE-P at TELRIC pricing would likely be effectively eliminated. AT&T had always understood that UNE-P would not be available forever, but now it was clear that UNE-P at TELRIC pricing would be phased out far more quickly than AT&T had previously projected.

8. Thus, the economics of AT&T's mass market offerings were expected to change radically for the worse in the very short term. Indeed, AT&T's costs were set to increase substantially even as new competitors (*e.g.*, cable) were entering and as its competitors' costs were declining. Moreover, the decision simply underscored the uncertainty inherent in *any* UNE-based approach to entering the local market.

9. In the wake of these developments, AT&T made a difficult, but inevitable decision: it had to cease actively competing for residential and small business markets, but it sought to manage its change in strategy in the most customer-friendly way possible. AT&T thus decided to stop its marketing efforts, to stop attempting to compete with other mass market entrants on price, and selectively raise prices. The inevitable effect of these actions is that AT&T's mass market customer base will dwindle away over time through churn. AT&T redirected its focus and resources almost entirely to its enterprise, government and wholesale customers.

10. During the eight months since this decision was made, the mass market environment has become even less attractive to AT&T. The FCC issued an order, on remand from the D.C. Circuit, that eliminates access to UNE-P for new customers and requires all carriers to transition their existing customers off of UNE-P within one year. Cable providers that have the ability to provide the full suite of local and long distance services as well as broadband Internet and video services have greatly expanded their VoIP telephony efforts. Other new VoIP providers continue to enter, and minutes continue to shift from traditional wireline providers to wireless and other providers.

11. AT&T has chosen not to take steps, however, that would cause immediate termination of service to its legacy customers, many of whom have been with AT&T for years. AT&T has accordingly been careful to maintain enough mass market infrastructure to continue to provide quality service to existing customers as they decide, on their own terms, how, when, and whether to move to another provider. In anticipation of the phase-out of UNE-P, therefore, AT&T has made efforts to negotiate commercial agreements with incumbent LECs that will allow it to continue to serve those customers who have not yet chosen another provider when the UNE-P transition ends. For example, AT&T has recently negotiated such an agreement with Qwest, which will allow a gentle glidepath for rate increases rather than abrupt rate shock upon the expiration of UNE-P. It remains the case, however, that AT&T is not actively seeking new residential or small business customers.

12. AT&T's strategic decision regarding the mass market includes its DSL and ISP offerings. AT&T has a minimal presence in the broadband Internet access market. It offers DSL almost exclusively in conjunction with its UNE-P-based local offer, with Covad through line splitting or line sharing arrangements. AT&T is no longer actively seeking new DSL

customers. Similarly, AT&T has also ceased all marketing efforts and has selectively increased prices for its WorldNet ISP service. AT&T has about 1.2 million customers for its WorldNet and DSL services. And AT&T has also ceased efforts to win new wireless customers. AT&T provides wireless services today only to several thousand customers in a reselling arrangement with AT&T Wireless that has been terminated. Moreover, AT&T has also cancelled plans announced last year to sell AT&T-branded wireless service to its mass market customers pursuant to an arrangement with Sprint.

13. The only mass market retail service that AT&T is today marketing to new customers is its AT&T CallVantage Service, a VoIP service that AT&T launched only shortly before its decision to cease actively competing for mass market customers. In the wake of the strategic refocus on business services, however, AT&T has substantially reduced investment in the marketing of this VoIP service. AT&T's VoIP service is now marketed predominantly through retail outlets such as Best Buy. AT&T has won a modest amount of customers for this service nationwide, with only a fraction of those in SBC's region.

II. AT&T Has Taken Extensive Steps To Implement Its Mass Market Strategy.

14. In the eight months since it made its strategic decision, AT&T has taken extensive steps to implement its new strategy. AT&T has taken numerous actions to scale back its mass market operations to only those functions necessary to provide high quality service and customer care functions for its declining customer base.

15. Specifically, after announcing its strategy change, AT&T immediately eliminated or drastically reduced its marketing and advertising activities. AT&T also undertook extensive headcount reductions, principally in the areas of marketing and customer care,

and AT&T will continue to scale back customer care functions and institute additional headcount reductions through 2005 as its customer base continues to decline. AT&T has also retired much of the physical infrastructure used to support these activities, including dialers, databases, computers and servers, 800 numbers, switches and high capacity lines, and much else.

16. In short, AT&T has already taken many actions to dismantle its mass market operations relating to its unilateral decision to cease actively competing for mass market customers.

A. Cessation of Active Marketing.

17. Immediately after the decision to stop competing for mass market local and long distance customers, AT&T ceased virtually all marketing and advertising activities in the consumer market. AT&T is simply no longer actively attempting to win new customers.

18. For example, AT&T immediately ceased almost all outbound telemarketing efforts. In the latter half of 2004, AT&T terminated most of its outside telemarketing vendors, and it also closed down its telemarketing centers. AT&T also immediately stopped almost all direct mail advertising, and now sends only those mailings that are legally required (such as notices concerning changes in rates or other required notifications).

B. Headcount Reductions.

19. After the decision to cease active marketing, AT&T also undertook a very substantial headcount reduction in its consumer operations.

20. ACS took substantial reductions in headcount in 2004, and further headcount reductions are expected in 2005.

21. Consistent with the strategy, which is to scale operations back to only those functions necessary to provide quality service for its dwindling mass market customer base, the reductions were focused on marketing, sales, and customer care functions. For example, AT&T has drastically reduced its headcount (including outsourcing to vendors) in sales and customer care functions. Similarly, the telemarketing division (including outsourcing), which handled both inbound and outbound telemarketing, was cut even more drastically, and the remaining employees perform more traditional customer care functions rather than telemarketing.

22. As a result of these large headcount reductions, AT&T does not have the capacity today to re-enter the consumer mass market on a basis consistent with historic practice.

C. Retirement of Infrastructure

23. AT&T has also retired much of the infrastructure that supported its marketing and customer care activities for mass market services.

24. For example, AT&T eliminated outbound telemarketing (OTM) mass market sales and ordering capabilities. Both the AT&T internal and external vendor OTM system capabilities were shutdown as of November 2004 – *e.g.*, sales script support and ordering platforms, customer call list management applications, Integrated Voice Response (IVR) applications, outbound dialing applications, and outbound sales tracking and reporting applications. Additionally, all hardware (servers, PCs, dialers, IVR, etc.), network resources (800 numbers, T1s, switches, etc.), and licenses associated with these applications were eliminated. Today, ACS has no technical infrastructure to support a significant outbound telemarketing sales campaign.

25. AT&T is also in the process of retiring the consumer marketing applications and technical infrastructure that allowed ACS to produce automated marketing campaigns. The acquisition infrastructure, data, and reporting applications associated with consumer marketing campaigns are being removed – *e.g.*, customer prospect data, market and customer modeling data, tracking capabilities, and processes and campaign management reporting. Once this effort is completed ACS will no longer have the capability to launch a large scale automated acquisition campaign.

26. AT&T has also extensively dismantled the infrastructure supporting its mass market operations, including outbound telemarketing sales and ordering capabilities (*e.g.*, support and ordering platforms, Integrated Voice Response systems, outbound dialers, servers, PCs, 800 numbers, etc.), databases associated with customer marketing campaigns, 70% of the Integrated Voice Response infrastructure and other computers and servers used for customer service calls, and the infrastructure to support online billing.

27. While maintaining the capability to provide high quality service to existing customers, AT&T is also shedding infrastructure in the area of customer service, to coincide with the reduction of customers, call volume, and operational centers.

28. For example, AT&T's Consumer Integrated Voice Response (IVR) infrastructure was built to handle 200 million calls annually. This consisted of 56 IVRs and supported natural language voice recognition capabilities. As of today, AT&T has reduced this infrastructure to 30 IVRs, and they now support only 80 million calls annually, without natural language capabilities.

29. AT&T has also reduced service desktop capacity, by eliminating PCs, servers, network resources, 800 numbers, and the like. In January 2004, AT&T's desktop infrastructure had the ability to support 17,000 customer service representatives. By the end of 2005 the remaining infrastructure will be able to support only a small fraction of this amount. Capacity and disaster recovery capabilities have been correspondingly reduced by 50 percent.

30. In short, given the extensive retirement of infrastructure, AT&T could not market and acquire new mass market customers unless it made a substantial investment to build a new information technology infrastructure.

III. AT&T Has Raised Prices For Its Residential And Small Business Services.

31. When ACS was seeking to build its all-distance customer base, it offered prices that generally were consistent with those available from the incumbent carriers. Following its announcement to cease actively competing for mass market customers and in the face of expected increases in the costs to provide service, AT&T is not competing on price with other active mass market providers. Although other mass market entrants, most notably the VoIP providers, continue to compete vigorously on price and continue to introduce new service packages at low rates, AT&T has raised its rates for many of its consumer and small business services to recover its increasing costs.

32. *Local Service.* In September, October, and November of 2004, AT&T raised many of its retail rates for local service in almost every state in the country. AT&T offers various local service packages (*e.g.*, "Call Plan Unlimited Plus," "Call Plan Unlimited," and "Call Plan

Deluxe") that have different sets of features and range roughly from $12 to $30 per month. AT&T has raised the rates for almost all of these services in every state from $1 to $3.

33. AT&T has also raised rates for its all-distance bundles in some states. In December 2004, AT&T raised the retail rates for its "One Rate USA" and "One Rate Advantage" all-distance bundles in Massachusetts, Pennsylvania, Rhode Island, North Carolina, South Carolina, Tennessee, Iowa, New Mexico, Kansas, and Oklahoma by anywhere from $2 to $5.

34. *Toll Services.* AT&T also has a range of interstate toll service plans. Many of these plans have a monthly recurring charge, and AT&T has increased the charge on many of these plans (typically by either $1 or $2). AT&T also increased a number of basic rates for international service.

IV. AT&T's Customer Base Is Eroding Quickly And Will Continue To Do So.

35. AT&T's actions in the marketplace are having a predictable effect. Customers are canceling their service with AT&T and purchasing the services of AT&T's competitors. In the absence of active marketing to replace customers who leave, AT&T's customer base is eroding away quickly.

36. *Local and All-Distance Services.* As of June 2004, when AT&T decided to exit the mass market, AT&T had gained about 4.7 million local residential customers. As of December 2004, AT&T had approximately 4.2 million local residential customers – a loss of half a million customers in just six months.

37. *Stand Alone Long Distance.* AT&T's stand-alone long-distance customer base has been declining for years. As recently as the first quarter of 2003, AT&T had 38.4 million SALD customers. By the end of 2003, that number had fallen to 30.3 million, and by the end of 2004 it had declined again to about 20 million – a loss of almost half of its customer base in just two years.

38. *Revenues.* The effect of these customer losses can be seen clearly in AT&T's revenues. For example, AT&T's revenue from stand-alone long-distance voice and other services in the first quarter of 2003 was $2.1 billion. For the fourth quarter of 2004, such revenue had shrunk to only $1.1 billion.

39. ACS's total revenue was $9.4 billion in 2003, and $7.9 billion in 2004.

40. The FCC's recent decision in the *Triennial Review* Remand Order, which will shortly raise the costs of UNE-P and requires all carriers to transition off of UNE-P within one year, may accelerate these trends.

I declare that the foregoing is true and correct.

Signature: /s/ John Polumbo
John Polumbo
President and CEO
AT&T Consumer Services

Date: February 21, 2005

TDS Exhibit 2

Notice of Price Increase – Virginia

at&t

Effective March 1, 2011 the Intrastate Direct Dialed, Toll Free and Calling Card per minute of usage rates for selected AT&T Long Distance Rate Plans will increase. The rate increases will vary by calling plan and type of call. Please refer to the charts below for both the current rates and the new rates. If you wish to change or cancel your service prior to the new rates taking effect, or if you have any questions, please call the toll-free billing inquiries number listed on your invoice or contact your AT&T Sales Representative.

				Daytime Initial and Additional Per Minute of Usage		Percent Increase	Evening/Night Initial and Additional Per Minute of Usage		Percent Increase
Rate Plan	LATA	Type	Access	Current	New	Percent	Current	New	Percent
CNET Plan A	Inter	Inbound	Switched	1.1820	1.4160	19.80%	.9240	1.1100	20.13%
CNET Plan B	Inter	Inbound	Switched	1.3320	1.5960	19.82%	1.0740	1.2900	20.11%
Simply Better Type 1 & 2	Inter	Inbound	Switched	.9840	1.1820	20.12%	.9840	1.1820	20.12%
CNET Plan A	Intra	Inbound	Switched	1.1820	1.4160	19.80%	.9240	1.1100	20.13%
CNET Plan B	Intra	Inbound	Switched	1.2600	1.5120	20.00%	1.0440	1.2540	20.11%
Simply Better Type 1 & 2	Intra	Inbound	Switched	.9840	1.1820	20.12%	.9840	1.1820	20.12%
Simply Better Type 1 & 2	Inter	Inbound	Dedicated	.5100	.6120	20.00%	.5100	.6120	20.00%
Simply Better Type 1 & 2	Intra	Inbound	Dedicated	.5100	.6120	20.00%	.5100	.6120	20.00%
CNET Type 1	Inter	Outbound	Switched	1.0740	1.2900	20.11%	.7920	.9480	19.70%
Simply Better Type 1	Inter	Outbound	Switched	.9840	1.1820	20.12%	.9840	1.1820	20.12%
CNET Type 1 & Simply Better	Inter	Outbound	Dedicated	.5100	.6120	20.00%	.5100	.6120	20.00%
CNET Type 1	Intra	Outbound	Switched	1.0440	1.2540	20.11%	.7920	.9480	19.70%
Simply Better Type 1	Intra	Outbound	Switched	.9840	1.1820	20.12%	.9840	1.1820	20.12%

Percent of Increase	12.50%	12.12%			10.05%	5.56%	11.11%					
IntraLata, DD & TF - Basic Current	$0.2800	$0.2780	$0.1030	$0.0830	$0.3980	$0.2510	$0.2200	$0.0930	$0.2330	$0.2330	$0.0830	$0.0830
IntraLata, DD & TF - Basic New	$0.3200	$0.3180	$0.1130	n/c	$0.4380	$0.2710	$0.2400	$0.1130	$0.2730	$0.2730	n/c	n/c
Percent of Increase	14.29%	14.39%	9.71%		10.05%	7.97%	9.09%		17.17%	17.17%		
IntraLata, DD & TF - Connected Current	$0.1600	$0.1650	$0.0600	$0.0600	$0.3980	$0.1800	$0.1800	$0.0600	$0.0600	$0.0600	$0.0500	$0.0600
IntraLata, DD & TF - Connected New	$0.1800	$0.1850	n/c	n/c	$0.4380	$0.1900	$0.2000	n/c	n/c	n/c	n/c	n/c
Percent of Increase	12.50%	12.12%			10.05%	5.56%	11.11%					
All Intrastate CC - Current	$0.5500	$0.5500	$0.4180	$0.4140	$1.1840	$0.4500	$0.5210	$0.4330	$0.5140	$0.5140	$0.5140	$0.5140
All Intrastate CC - New	$0.7500	$0.7500	$0.5180	$0.5140	$1.3840	$0.5500	$0.7210	$0.6330	$0.7140	$0.7140	$0.7140	$0.7140
Percent of Increase	36.36%	36.36%	23.92%	24.15%	16.89%	25.10%	38.39%	46.19%	38.91%	38.91%	38.91%	38.91%

DD = Direct Dialed, TF = Toll Free, CC = Calling Card

n/c = No Increase

*Connected Pricing applies to Toll Free Only

NC21614
ABS-3205

CNET Type 1 & Simply Better	Intra	Outbound	Dedicated	.5100	.6120	20.00%	.5100	.6120	20.00%
CNET Type 2	Inter	Outbound	Switched	.8760	1.0500	19.86%	.6840	.8220	20.18%
Simply Better Type 2	Inter	Outbound	Switched	.9840	1.1820	20.12%	.9840	1.1820	20.12%
CNET Type 2	Intra	Outbound	Switched	.8760	1.0500	19.86%	.6840	.8220	20.18%
Simply Better Type 2	Intra	Outbound	Switched	.9840	1.1820	20.12%	.9840	1.1820	20.12%
CNET Option S Option I - V	Both	Inbound	Switched	1.3680	1.6440	20.18%	1.3680	1.6440	20.18%
CNET Option S Option VI	Both	Inbound	Switched	1.2900	1.5480	20.00%	1.2900	1.5480	20.00%
CNET Option S Option I - V	Both	Outbound	Switched	1.2900	1.5480	20.00%	1.2900	1.5480	20.00%
CNET Option S Option VI	Both	Outbound	Switched	1.1100	1.3320	20.00%	1.1100	1.3320	20.00%
Pro Wats Plan Q Schd A	Inter	Outbound	Switched	1.0740	1.2900	20.11%	.7920	.9480	19.70%
Pro Wats Plan Q Schd A	Intra	Outbound	Switched	1.0440	1.2540	20.11%	.7920	.9480	19.70%
Pro Wats Plan Q	Both	Inbound	Switched	1.1100	1.3320	20.00%	.8940	1.0740	20.13%

				Sub Minute Rate Initial Period		Percent Increase	Sub Minute Rate Additional Period		Percent Increase
Rate Plan	LATA	Type	Access	Current	New	Percent	Current	New	Percent
CNET Simply Better Flex	Both	Inbound	Switched	.2310	.2760	19.48%	.0077	.0092	19.48%
CNET Simply Better Flex	Both	Outbound	Switched	.2310	.2760	19.48%	.0077	.0092	19.48%

AT&T Commercial Long Distance Rates - Intrastate Direct Dial Station Switched

	1-10	11-22	23-55	56-124	125-292	293-430	431+
Daytime Initial Minute - Current	$0.8400	$1.0000	$1.0800	$1.2200	$1.3000	$1.3500	$1.3500
Daytime Initial Minute - New	$1.0100	$1.2000	$1.3000	$1.4700	$1.5600	$1.6200	$1.6200
Per Cent of Increase	20.24%	20.00%	20.37%	20.49%	20.00%	20.00%	20.00%
Daytime Add'l Minute - Current	$0.8400	$1.0000	$1.0800	$1.2200	$1.3000	$1.3500	$1.3500
Daytime Add'l Minute - New	$1.0100	$1.2000	$1.3000	$1.4700	$1.5600	$1.6200	$1.6200
Per Cent of Increase	20.24%	20.00%	20.37%	20.49%	20.00%	20.00%	20.00%
Evening Initial Minute - Current	$0.7000	$0.8300	$0.8700	$1.0000	$1.0500	$1.0800	$1.0800
Evening Initial Minute - New	$0.8400	$1.0000	$1.0500	$1.2000	$1.2600	$1.3000	$1.3000
Per Cent of Increase	20.00%	20.48%	20.69%	20.00%	20.00%	20.37%	20.37%
Evening Add'l Minute - Current	$0.5800	$0.6200	$0.7000	$1.0000	$1.0500	$1.0800	$1.0800
Evening Add'l Minute - New	$0.7000	$0.7500	$0.8400	$1.2000	$1.2600	$1.3000	$1.3000
Per Cent of Increase	20.69%	20.97%	20.00%	20.00%	20.00%	20.37%	20.37%
Night Initial Minute - Current	$0.6200	$0.6200	$0.6900	$0.7500	$0.8300	$0.8400	$0.8400
Night Initial Minute - New	$0.7500	$0.7500	$0.8300	$0.9000	$1.0000	$1.0100	$1.0100
Per Cert of Increase	20.97%	20.97%	20.29%	20.00%	20.48%	20.24%	20.24%
Night Add'l Minute - Current	$0.6200	$0.6200	$0.6900	$0.7500	$0.8300	$0.8400	$0.8400
Night Add'l Minute - New	$0.7500	$0.7500	$0.8300	$0.9000	$1.0000	$1.0100	$1.0100
Per Cent of Increase	20.97%	20.97%	20.29%	20.00%	20.48%	20.24%	20.24%

AT&T All In One Intrastate LD Rates - Per Minute Initial and Additional

LD Calling Plan	A	B	C	D	F	G	H	J	M *	E (Int'l) *	K	Q
InterLata, DD & TF - Basic Current	$0.2800	$0.2780	$0.1030	$0.0830	$0.3980	$0.2510	$0.2200	$0.0930	$0.2330	$0.2330	$0.0830	$0.0830
InterLata, DD & TF - Basic New	$0.3200	$0.3180	$0.1130	n/c	$0.4380	$0.2710	$0.2400	$0.1130	$0.2730	$0.2730	n/c	n/c
Percent of Increase	14.29%	14.39%	9.71%		10.05%	7.97%	9.09%		17.17%	17.17%		
InterLata, DD & TF - Connected Current	$0.1600	$0.1650	$0.0600	$0.0600	$0.3980	$0.1800	$0.1800	$0.0600	$0.0600	$0.0600	$0.0600	$0.0600
InterLata, DD & TF - Connected New	$0.1800	$0.1850	n/c	n/c	$0.4380	$0.1900	$0.2000	n/c	n/c	n/c	n/c	n/c