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Case No.: TO-2005-0035

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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY OPERATIONS DIVISION

REBUTTAL TESTIMONY

OF

BILL PETERS

**SOUTHWESTERN BELL TELEPHONE, L.P.,
d/b/a SBC MISSOURI**

CASE NO. TO-2005-0035

**Jefferson City, Missouri
December 2004**

****Denotes Highly Confidential Information****

NP

Exhibit No. 22
Date Prepared Case No. TO-2005-0035
Reporter

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Second Investigation)
into the State of Competition in the)
Exchanges of Southwestern Bell)
Telephone, L.P., d/b/a SBC Missouri)

Case No. TO-2005-0035


AFFIDAVIT OF BILL PETERS

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Bill Peters, of lawful age, on his oath states: that he has participated in the preparation of the following Rebuttal Testimony in question and answer form, consisting of 24 pages of Rebuttal Testimony to be presented in the above case, that the answers in the following Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true to the best of his knowledge and belief.


Bill Peters

Subscribed and sworn to before me this 16th day of December, 2004.


Notary Public

My commission expires _____
DAWN L. HAKE
Notary Public - State of Missouri
County of Cole
My Commission Expires Jan 9, 2005

REBUTTAL TESTIMONY

OF

BILL PETERS

SOUTHWESTERN BELL TELEPHONE, L.P.

d/b/a SBC MISSOURI

CASE NO. TO-2005-0035

Q. Please state your name and give your business address.

A. My name is Bill Peters and my business address is Post Office Box 360, Governor Office Building, Suite 500, 200 Madison Street, Jefferson City, Missouri 65102-0360.

Q. By whom are you employed?

A. I am employed by the Missouri Public Service Commission (PSC or Commission).

Q. How long and in what capacity have you been employed at the Commission?

A. I was hired as a Regulatory Economist for the Telecommunications Department Staff (Staff) in September 2001, and was recently promoted to Economist II.

Q. Describe your educational background and employment history.

A. I received a B.S. in Economics from Illinois State University in August of 1998 and an M.S. in Applied Economics from the same institution in May of 2001. My Master's sequence was "Regulation of Public Utilities: Telecommunications, Electricity and Natural Gas." In between my degrees, I volunteered with Peace Corps -- Armenia as an instructor of Economics and English at Shirak University in Gumri, Armenia. After

Rebuttal Testimony of
Bill Peters

1 returning from the Peace Corps, I completed a four-month internship at the Citizens
2 Utility Board, a consumer advocacy organization, in Chicago, Illinois.

3 **Q. What are your duties at the Commission?**

4 A. Since beginning employment with the Commission, I have reviewed,
5 analyzed and written recommendations for various case filings, tariff filings and
6 interconnection agreements, worked on special projects such as a report on Voice Over
7 Internet Protocol (VoIP), and filed testimony in contested proceedings before the
8 Commission. Filings are reviewed and recommendations are written to ensure
9 consistency with the public interest, Missouri and Federal rules and regulations. I have
10 also reviewed various cost studies and conducted general research related to
11 telecommunications and economics.

12 **Q. Have you previously testified before the Commission?**

13 A. Yes, I testified in Case No. TO-2002-222, *In the Matter of the Petition of*
14 *MCImetro Access Transmission Services LLC, Brooks Fiber Communications of*
15 *Missouri, Inc., and MCI WorldCom Communications, Inc., for Arbitration of an*
16 *Interconnection Agreement With Southwestern Bell Telephone Company Under the*
17 *Telecommunications Act of 1996*, and in Case No. IT-2004-0015, *In the Matter of*
18 *Southwestern Bell Telephone Company, d/b/a SBC Missouri's Proposed Revised Tariff*
19 *Sheet Intended to Increase by Eight Percent the Rates for Line Status Verification and*
20 *Busy Line Interrupt as Authorized by Section 392.245, RSMo, the Price Cap Statute*. I
21 also filed testimony in Case No. TC-2002-1076, *Staff of the Missouri Public Service*
22 *Commission, Complainant, v. BPS Telephone Company, Respondent*.

Rebuttal Testimony of
Bill Peters

1 **Q. What is the purpose of your Rebuttal Testimony in this proceeding?**

2 A. My testimony presents economic analysis that responds to concepts in the
3 SBC Direct Testimonies of Craig Unruh and Dr. Debra Aron. Specifically, I will address
4 the issue of where SBC is facing effective competition for basic local
5 telecommunications service. The testimony of Staff witness Walter Cecil will address
6 SBC's request to have its directory assistance services declared subject to effective
7 competition. Staff witness Adam McKinnie will address SBC's request to have specific
8 access-line related services deemed subject to effective competition and will analyze the
9 impact of alternative technologies on competition for basic local telecommunications
10 services.

11 **Q. In Staff's opinion, after reviewing the evidence presented in this case,**
12 **where does SBC face effective competition?**

13 A. In the residential market, SBC continues to face effective competition for
14 its residential access-line and line-related services in the exchanges of Harvester and
15 St. Charles. In the business market, the evidence of competition indicates that SBC
16 Missouri continues to face effective competition for its business access-line and line-
17 related services in the exchanges of St. Louis and Kansas City, and now faces effective
18 competition for business access lines (and related line services) in the 17 exchanges of
19 Farley, Harvester, Fenton, Chesterfield, Springfield, Greenwood, Valley Park,
20 Manchester, St. Charles, Grain Valley, Marionville, Pond, Smithville, Eureka, Imperial,
21 High Ridge, Maxville.

Rebuttal Testimony of
Bill Peters

1 **Q. How did Staff determine when the criteria for effective competition**
2 **had been met?**

3 A. Staff considered the evidence available and concluded that evidence of
4 significant exchange-specific facilities-based market penetration, along with information
5 on the availability of wireless, cable and VoIP services, as discussed in the testimony of
6 Staff witness Adam McKinnie, is sufficient to meet the threshold definition of effective
7 competition. Staff's determination of 'significant' market penetration is admittedly
8 similar to a grading on a curve. Where the measured market penetration was zero, when
9 looking at the e911 proxy of facilities-based competition, Staff was not confident that the
10 mere possibility of competition from VoIP, cable modem and/or wireless is sufficient to
11 meet the standard of effective competition. However, Staff recognizes that these services
12 do provide some competition and took this into account when analyzing those exchanges
13 with facilities-based competitive local exchange carriers.

14 Based on Staff's review, SBC provided evidence that 19 of SBC Missouri's 160
15 exchanges face significant facilities-based competition in the market for business wire
16 line products. For residential lines, the data provided by Mr. Unruh show only two
17 exchanges with greater than a four percent facilities-based share of the market, 10
18 exchanges with slight evidence of facilities-based competition, while the remaining
19 exchanges exhibit varied UNE-P and resale penetration.

20 There were instances where some exchanges exhibited a relatively small degree
21 of facilities-based competition but still did not meet the criteria of effective competition.
22 For example, in the residential market, Staff views a four percent facilities-based market
23 penetration as insignificant compared to penetration levels exhibited in St. Charles and

Rebuttal Testimony of
Bill Peters

1 Harvester. In the business market, a facilities-based penetration rate of at least nine
2 percent was sufficient to meet the standard of effective competition, especially when
3 considering the higher prices commanded in the business market.

4 Herculaneum-Pevly, which is an example of an exchange where, in Staff's
5 opinion, SBC does not face effective competition, the data shows the exchange to have a
6 minimal amount of facilities-based competition. The data show ****HC**** CLEC business
7 e911 listings in Herculaneum-Pevly, which represents that facilities-based competitors
8 have ****HC--**** percent of facilities-based business lines reported in that exchange. Staff
9 is not confident in the sustainability of competition in that exchange, or any other
10 exchange, exhibiting a small sum of facilities-based CLEC lines and minimal market
11 penetration. At some point, the evidence is simply less compelling and does not meet the
12 criteria of effective competition.

13 **Q. Are you aware of any well know economic methodologies that set**
14 **standards to measure 'effective competition' as defined in RSMo 386.020 (13)?**

15 **A.** No, I am not. Recognizing effective competition is not a simple task that
16 is easily defined, the best we can do in a situation such as this is to attempt a dutiful
17 interpretation of its statutory definition with guidance of previous Commission Orders
18 and from our legal counsel.

19 The Missouri Public Service Commission was particularly interested in a local
20 analysis in its previous orders regarding effective competition. For instance, in the first
21 SBC effective competition case (Case No. TO-2001-467), the Commission made the
22 following statements:

23 *While specific market share thresholds should not be utilized to*
24 *determine whether or not Southwestern Bell faces effective*

Rebuttal Testimony of
Bill Peters

1 *competition, it is one factor, which the Commission finds*
2 *particularly determinative of "[t]he extent to which services are*
3 *available from alternative providers in the relevant market."*
4

5 *The Commission finds that the evidence presented by Southwestern*
6 *Bell in the form of a count of the number of CLECs or IXCs*
7 *certified or tariffed in the state or in any particular exchange is*
8 *evidence of competition; however, the mere existence of such*
9 *"paper competition" by itself does not persuade the Commission*
10 *that effective competition exists.*
11

12 *The Commission considers alternative communications that are*
13 *not regulated by the Commission, such as e-mail, cable*
14 *broadband, and mobile phones as "other factors" under*
15 *Subsection 386.020(13)(e) that might be "relevant ... and*
16 *necessary to implement the purposes and policies of Chapter 392."*
17 *However, the evidence did not persuade the Commission that the*
18 *generalized presence of such alternative communications*
19 *throughout the state constitutes, in the absence of CLEC-owned,*
20 *facilities-based competition, effective competition to Southwestern*
21 *Bell's telecommunications services.*
22

23 *While the Commission considers resale a form of substitutable*
24 *service, the mere presence of resellers is not substantial evidence*
25 *for the Commission to determine that effective competition exists.*
26

27 *With due consideration to all factors set forth under Section*
28 *386.020(13), the Commission finds that Southwestern Bell's*
29 *residential access line services in Southwestern Bell's other*
30 *exchanges do not face effective competition. In particular, the*
31 *evidence did not establish that a substantial number of residential*
32 *customers were being provided service from widely available*
33 *CLEC-owned facilities in any of Southwestern Bell's other*
34 *exchanges.*
35

36 Similarly, in the Sprint effective competition case (Case No. IO-2003-0281), the
37 Commission said:

38 *Although ExOp is an ETC in Platte City, and may someday be able*
39 *to serve a larger proportion of the customers in that exchange, its*
40 *status as an ETC does not immediately make it an effective*
41 *competitor for Sprint. The Commission must decide whether there*
42 *is effective competition now, not whether there will be competition*
43 *someday. The Commission concludes that effective competition*
44 *does not exist in the Platte City exchange.*

Rebuttal Testimony of
Bill Peters

1 Staff, maintains that evidence for 'effective competition' must be analyzed on an
2 exchange basis, service-by-service. Staff also maintains that several factors, including
3 such things as market share, extent of facilities-based competition and the comparability
4 of services actually offered by alternative providers are relevant to an analysis of
5 effective competition.

6 **Q. How does Mr. Unruh, throughout his Direct Testimony, come to**
7 **conclude that effective competition exists for SBC's services?**

8 A. Rather than present a local analysis of competition in its exchanges, SBC
9 takes a more global approach when presenting evidence to justify its case. UNE-P, resold
10 and evidence of non-SBC e911 listings are presented on an exchange basis, however,
11 SBC fails to mention any specifics for those exchanges. It fails to identify its key
12 competitors in those exchanges and instead relies on generic data that identifies, in effect,
13 *possible* competition. Mr. Unruh presents a survey of the capabilities of technology (for
14 example, one switch may be able to serve the entire globe from a collocation cage in St.
15 Louis, MO) in an effort to prove effective competition by proxy of potential. While I do
16 not necessarily disagree that there may be a degree of potential energy in the
17 telecommunications market, I cannot reasonably predict when and to what extent that
18 competition may manifest itself. SBC provides schedules that purportedly outline where
19 CLEC switches are located and where wireless providers are providing service, but
20 makes it difficult for the reader to assess the validity of this information¹. Mr. Unruh and
21 other SBC witnesses have simply asserted that effective competition exists and have not
22 engaged in the granular analysis contemplated by the Missouri statutes; the sort of
23 analysis Staff considers is required.

¹ See SBC's response to Staff DR 39, attached as Schedule 5.

Rebuttal Testimony of
Bill Peters

1 **Q. Mr. Unruh argues (page 5 of Direct) that SBC should be regulated in**
2 **the same fashion as other regulated telecommunications companies. Is his position**
3 **relevant to this case?**

4 A. No, Mr. Unruh states in his Direct Testimony on Page 5 lines 8-10,
5 "...SBC Missouri faces more onerous regulations than does its traditional landline
6 competitor." Clearly, SBC and other like telecommunications companies (incumbent
7 local exchange carriers or ILECs) are treated differently than competitive local exchange
8 carriers (CLECs) by Missouri and Federal law. This proceeding's only objective is to
9 evaluate the extent of competition for SBC services in its Missouri exchanges as set forth
10 in RSMo 386.020 (13).

11 **Q. Do you agree with Mr. Unruh that a competitive classification would**
12 **move the regulation of SBC's service closer in line with CLEC regulation²?**

13 A. Yes, a primary difference between these companies is that SBC is subject
14 to price cap regulation and CLECs are allowed, within some limited constraints, to price
15 services as they see fit.

16 **Q. Would you agree with Mr. Unruh that whatever decision the Missouri**
17 **Commission makes regarding effective competition does not affect other aspects of**
18 **the Commission's regulatory authority over SBC?**

19 A. Yes, if the Commission finds effective competition, the Missouri PSC still
20 retains authority over such things as terms and conditions for retail services, quality of
21 service, and wholesale arrangements such as interconnection agreements, interconnection
22 agreement arbitrations, and setting UNE prices. A finding of effective competition

² See the Direct Testimony of Craig Unruh, Pages 46-47.

Rebuttal Testimony of
Bill Peters

1 means the company will gain pricing flexibility and will no longer be limited by the
2 constraint of price cap regulation.

3 If a service is deemed subject to effective competition, SBC will be free from the
4 price constraints of price cap regulation. SBC would then be able to raise prices outside
5 of those constraints, and submit 10-day tariff filings for price changes on existing
6 services. SBC would be able to lower prices outside those constraints, and submit seven-
7 day tariff filings for price changes on existing services. The company would still be
8 required to submit 30-day tariffs for new services.

9 **Q. According to SBC, "...pricing flexibility...will enhance competition."**
10 **Does Staff agree with this statement?**

11 A. Not necessarily. Staff would argue that a competitive market enjoys
12 pricing flexibility, and the latter doesn't automatically produce the former. Pricing
13 flexibility, in this case, means a lack of pricing constraints³. This pricing freedom may
14 result in various price changes; some may be substantial increases, some substantial
15 decreases, and some prices may change little if at all. SBC has provided little evidence
16 that the ability to price flexibly will necessarily lead to a competitive market. In fact, it is
17 entirely possible, especially in the lower-priced residential wire line market that the
18 company could lower prices for a period of time in order to squeeze out any current
19 competition and subsequently raise prices until there are no longer economic rents
20 available in the market⁴. To the extent there is sufficient competitive activity for a
21 service, exchange, and/or class of services, Staff supports SBC's request for pricing

³ This case contemplates removing the regulatory ceilings on current prices, and a slightly reduced tariffing deadline required to reduce prices on existing services.

⁴ If residential services are truly under priced and UNE prices increase, a decrease in prices may not even be necessary. SBC could potentially price-squeeze competitors out of the market by maintaining their current residential prices.

Rebuttal Testimony of
Bill Peters

1 flexibility. Without sufficient evidence of competition, I am hesitant to recommend the
2 Commission surrender its oversight of SBC's prices.

3 **Q. In Staff's opinion, will SBC raise prices for all of its services if the**
4 **Commission were to find those services subject to effective competition?**

5 A. No, Staff tends to predict that prices for some services would increase and
6 others would decrease. Unfortunately, there is no way to know for sure the exact changes
7 SBC would make to its schedule of prices. In a response to a Data Request where Staff
8 asked for any formal plans of the company's intentions, SBC replied, "SBC Missouri has
9 not determined what marketing programs it would initiate as a result of an expansion of
10 competitive classification. Analysis needs to be performed to determine how customers
11 desires can be better served with new flexibility.⁵" This response leads Staff to conclude
12 that even SBC doesn't have formal plans of how it would proceed if it were freed from
13 the constraints of price cap regulation.

14 However, SBC has dropped some meaningful hints during the process of this
15 case. In the Direct Testimonies' of both Mr. Unruh and Dr. Debra Aron⁶, SBC alleges
16 that its current structure of prices, which came about due to the consequence of historic
17 telecommunications regulation, subsidizes basic local prices with revenues from other
18 services.⁷ From SBC's testimony, it appears to Staff that SBC would lower some prices
19 at the expense of higher prices for basic local service. I would caution the reader to note
20 that this analysis is Staff's interpretation of the testimony provided in this case, and to

⁵ See Schedule 6 (DR 35 and response).

⁶ See Aron Direct, Pages 53 and 69, Question 41 and 60; Unruh Direct, Page 45.

⁷ This structure of pricing was implemented historically to maintain and improve universal service, which is an important policy obligation of both the FCC and the MoPSC. In Case No. 18,309, the Commission set forth a pricing philosophy that encouraged certain categories of services to be priced at high levels in order to support basic local service. In other words, prices for basic local service were kept low by pricing other services at high levels.

Rebuttal Testimony of
Bill Peters

1 also keep in mind that even SBC does not appear to have any tentative plans for price
2 changes. It could be that nothing at all happens, but I think that scenario is highly
3 unlikely, and the aforementioned scenario much more likely. For the few services which
4 SBC can price flexibly it has done little as yet, but with no formal plans it is almost
5 impossible to predict exactly how SBC might use newfound pricing flexibility. It could
6 be that the company is waiting for a wider array of pricing flexibility before making
7 many changes.

8 **Q. On Page 45 of Mr. Unruh's testimony he says, "Dr. Aron recommends**
9 **that the Commission should consider whether the currently regulated prices are**
10 **below what would likely prevail in a competitive market because that could mask**
11 **the degree to which the market is open to competition. I believe that to be the case**
12 **in the residential basic local service market where prices were kept artificially low**
13 **to promote universal service." Are these conclusions reflected in the data SBC has**
14 **provided to support its testimony, and what are the competitive implications?**

15 **A.** Yes. However, the fact that a rational business will tend to engage a
16 market where economic rents are available does not provide any specific evidence of
17 effective competition in and of itself. The main consequence of the historic pricing
18 disparity between residential and business services is that there is significantly more
19 money to be had in the business market than the residential market. A rational
20 competitor will compete in the segment of the market that exhibits higher prices, the
21 market for business access lines. Dr. Aron states on page 53 of her testimony, "One
22 reason that competitors might serve only a negligible portion of consumers is that, at the
23 prices currently charged to those consumers, the market might be unattractive." While

Rebuttal Testimony of
Bill Peters

1 this assumption may be reflected in the data, it is not indicative of the existence of
2 effective competition. Using SBC's data on non-SBC e911 listings, ** HC-----
3 HC----- ** total listings are classified as business⁸. However, this data at the aggregate
4 level does not demonstrate the extent of competition in any specific SBC Missouri
5 exchange, a necessary component when examining effective competition on an
6 exchange-by-exchange level.

7 **Q. For which services does SBC Missouri seek competitive status?**

8 A. SBC Missouri is claiming effective competition to exist in all of its
9 Missouri exchanges for its business and residential access line services, their related line
10 services, and directory assistance services. From a reading of Mr. Unruh's Direct
11 Testimony⁹, SBC claims that effective competition exists in all of its Missouri exchanges
12 for its business and residential access line services and their related line services like
13 caller ID, call waiting, etc. SBC Missouri also claims that its directory assistance
14 services face effective competition in all of its Missouri exchanges. Although SBC
15 seems to be claiming effective competition for most all of its services, aside from
16 switched access service which SBC explicitly excludes, page 18 of Mr. Unruh's Direct
17 Testimony affirmatively asserts that SBC Missouri believes the statutory definition of
18 effective competition has been met only for those services listed in schedule 2.

⁸ That comes to a little over 94% business. (These e911 data are the closest approximation available to estimate a minimum level of facilities-based competition.)

⁹ See Unruh Direct, Page 8, Case Overview.

Rebuttal Testimony of
Bill Peters

1 **Q. On page 19 of his Direct Testimony, Mr. Unruh states, "The FCC in**
2 **its First Report and Order at paragraph 332 discusses that CLECs offering services**
3 **via resale are offering the same service that the incumbent is offering at retail. This**
4 **demonstrates that CLECs are providing substitutable services when they are**
5 **reselling SBC Missouri's services." Does this lead Staff to conclude resale of SBC**
6 **Missouri's services represent effective competition for those same services?**

7 **A. No, in fact, Staff draws the exact opposite conclusion. The fact the two**
8 **"would-be" competitive services are both provided by SBC Missouri, leads Staff to**
9 **conclude that resale offers essentially no competition for SBC Missouri's retail services.**
10 **Since resale prices are derived from retail prices, meaning they change proportionally,**
11 **and in concert with retail prices, it is difficult to accept a scenario where the former**
12 **influences the latter. If there is a disagreement between Staff and SBC on this matter, it**
13 **is essentially rendered moot since Mr. Unruh concedes, "...the vast majority of CLEC**
14 **competition in SBC Missouri's exchanges is from service providers using their own**
15 **facilities or SBC Missouri's UNEs."**¹⁰ **Even then, SBC still presents resale as part of its**
16 **calculations for minimum CLEC lines in its schedules.**

17 **Q. On Page 28 of Dr. Aron's Direct Testimony, while explaining why she**
18 **reasons that resold and UNE-P services compete for SBC's service, she states,**
19 **"UNE-P-based service is also functionally equivalent insofar as it rides the same**
20 **network end-to-end as the incumbent's." Why does Staff discount evidence of**
21 **UNE-P and resale lines as reliable proxies for effective competition?**

22 **A. The mere repackaging of SBC service is not representative evidence of**
23 **effective competition. Further, the UNE Platform, where the CLEC purchases essentially**

¹⁰ Page 19, lines 11 - 13. Craig Unruh's Direct Testimony.

Rebuttal Testimony of
Bill Peters

1 an end-to-end service from the ILEC, is a thinly veiled resale product. The only
2 ostensible difference between resale and UNE-P is that UNE prices are set by the
3 Commission under TELRIC as required by the FCC. Even this admittedly important
4 distinction is not enough, in Staff's opinion, to give UNE-P any more credence than
5 resale, since the future of the UNE Platform is quite uncertain at this point in time and is
6 likely doomed to extinction.

7 With the FCC's UNE rules thrice struck down by the judiciary, it is difficult to
8 accept UNE-P lines as competition to SBC's wire line product, no matter how substantial
9 they may be. Since the FCC's latest judicial remand, the continued existence of UNE-P
10 remains questionable. The FCC addressed its unbundling rules at its December 15, 2004
11 open meeting. If additional information is obtained prior to Surrebuttal, Staff will
12 provide that information as part of its Surrebuttal Testimony.

13 Staff is further convinced that UNE-P access lines do not represent effective
14 competition, since AT&T reported, shortly after the future of UNE-P became unclear,
15 that it would not take new residential customers¹¹.

16 SBC's own 2004 Q3 earnings report, which is available to the public on their
17 website, reports that in the third quarter on 2004 SBC saw its first ever quarterly decline
18 in wholesale (UNE-P and Resale) lines. SBC reported a decline of 213,000 lines across
19 the company. This report follows the recent expectation that UNE-P may be phased out

¹¹ In a July 22, 2004 News Release, AT&T states, "As a result of recent changes in regulatory policy governing local telephone service, AT&T will no longer be competing for residential local and standalone long distance (LD) customers." This News Release is attached to my testimony as Schedule 7. Staff is fully aware of AT&T's subsequent introduction of its CallVantage broadband-based telephone product, which is not relevant to the discussion in this question.

Rebuttal Testimony of
Bill Peters

1 and the exit of AT&T from the residential access line market and competitive concerns
2 expressed by companies like MCI.¹²

3 **Q. On Page 20 of his testimony, Mr. Unruh states, "As explained by**
4 **Dr. Aron in her Direct Testimony, requiring a certain threshold, or level, of**
5 **competition as defined by something such as market share is inappropriate because**
6 **such measures may not accurately reflect the level of competition." Does data that**
7 **measures the extent or level of competition accurately reflect the level of**
8 **competition?**

9 **A. Yes, although that data may not act as a precise barometer of competitive**
10 **activity, such data certainly provides actual market observations that should be taken**
11 **seriously. What that data may lack in the way of substantiating competition from**
12 **wireless providers, cable Internet providers, VoIP, or instant messaging should certainly**
13 **not be a reason to discard the data entirely. In fact, without such data, we would be**
14 **arguing this case at an almost purely speculative level.**

15 **Q. On Page 13 of Direct Testimony, Mr. Unruh stated that SBC has**
16 **simplified toll prices and restructured business pricing as a result of competitive**
17 **classifications and made few other changes. What did SBC fail to mention?**

18 **A. Recently the company has amended its residential tariff so that customers**
19 **in Harvester and St. Charles are subject to a higher late fee, \$5 instead of \$1.60, than in**
20 **other SBC Missouri exchanges. This is another instance Staff found where SBC utilized**

¹² In a March 2, 2004 press release regarding a judicial review of the FCC's Triennial Review Order, MCI states, "The court sharply restricted the ability of MCI and other companies to offer local phone service to residential customers by denying competitors the right to lease the facilities still controlled by local Bell monopolies. Without access to those facilities, MCI and others simply cannot continue to offer lower prices and better residential services." This publicly available News Release is attached as a Schedule 8 to my testimony.

Rebuttal Testimony of
Bill Peters

1 competitive pricing flexibility. SBC PSC MO No. 35, Section 17, 8th Revised Sheet
2 12.01 is attached to my testimony as Schedule 1. The tariff page was effective
3 September 12, 2004, and the exchange-specific fee increase was effective October 25,
4 2004.

5 **Q. Should the preceding evidence be accepted as a predictor of future**
6 **pricing decisions?**

7 A. No, the instances where SBC has used its pricing flexibility are a very small
8 sample and do not provide Staff with any assurances of future pricing behavior of the
9 company, if left unrestrained by price cap regulation. The sample was merely provided
10 as guidance to the Commission of past SBC activity in areas where services and
11 exchanges were found to be subject to effective competition.

12 **Q. Mr. Unruh states SBC is not aware of any complaints because**
13 **customers thought they were being harmed by SBC Missouri's competitive**
14 **classifications. Dr. Aron also talks about a lack of customer complaints or other**
15 **problems related to and previous finding of effective competition. Does this indicate**
16 **that no customers have or may be harmed by competitive classification?**

17 A. No, even if this evidence were quantifiable, I would expect a relatively
18 low number of complaints on the matter, since the company has done very little with
19 competitive classification thus far. Additionally, the unfavorable price change mentioned
20 above, the increase in late fees, has only recently been implemented.

21 **Q. Does Staff consider all CLECs to be equally competitive?**

22 A. No, Staff finds most relevance in data detailing the extent to which
23 facilities-based competitors have gained a foothold in SBC exchanges simply because it

Rebuttal Testimony of
Bill Peters

1 is the most tangible evidence. Resold and UNE-P competition is not indicative of strong
2 competition. Resold telecommunications, where wholesale prices are tied to SBC retail
3 prices do not offer substantial competition for SBC wire line products, even though they
4 are, at core, the same product. This is, in fact, why resold telephone service offers, in
5 Staff's opinion, a negligible amount of competition. And although, UNE-P-based
6 competitors have gained a foothold in many SBC exchanges, the expectation that the
7 UNE platform will soon be priced much higher if not eliminated entirely, makes its
8 future, and the underlying CLEC service, quite uncertain. Additionally, the Missouri 271
9 Agreement (M2A) expires in March of 2005. CLECs will have to renegotiate
10 replacement agreements. It is unclear whether such negotiations will result in arbitrations
11 and how decisions at the FCC may affect the outcome of any negotiations and/or
12 arbitrations. Staff is not comfortable granting very much credibility to UNE-P
13 competition. With the degree of uncertainty attached to it, predicting its sustainability is
14 nearly impossible at this point in time. The most relevant CLEC data in this proceeding
15 is the data on non-SBC e911 listings in Unruh Schedule 13 HC and CLEC-Specific e911
16 listings included as a HC Schedule 2 to my testimony.

17 **Q. How did Staff analyze Unruh Schedule 13 HC?**

18 A. Attached to my testimony are HC Schedules 3 and 4 where I have
19 consolidated and added to the data in Unruh's Schedule 13HC. There are two schedules,
20 one each for the residential and business markets (HC Schedules 3 and 4, respectively).

21 Since I was particularly interested in the facilities-based information contained in
22 the schedule, I added an additional column to represent estimated CLEC market share
23 without considering UNE-P and resold data. In Staff's opinion, these columns provide

Rebuttal Testimony of
Bill Peters

1 the greatest insight when determining those areas where effective competition exists since
2 Staff discounted the applicability of competition for resale and UNE-P as more fully
3 explained throughout my testimony.

4 The schedules include data by exchange for SBC Residential Access Lines,
5 Resold CLEC lines, UNE-P CLEC lines, and non-SBC e911 listing. The schedule also
6 includes SBC's estimates of CLEC lines and market share by exchange. The right
7 column, labeled 'MKT Share Minus UNEp and Resold', is Staff's calculation of the
8 degree of facilities-based competition (facilities based CLEC lines as a ratio of total
9 facilities-based lines in the exchange) in each exchange. I have sorted those schedules so
10 that the exchanges with the highest degree of facilities-based competition come first.

11 **Q. On page 20 of Mr. Unruh's Direct Testimony, SBC seems to discount**
12 **market share as an indication of competition because, "...such measures may not**
13 **accurately reflect the level of competition." Does Staff agree with this analysis?**

14 **A.** No. SBC appears to contend the potential for competition, which in
15 SBC's testimony is purely speculative, is sufficient to meet the statutory definition of
16 effective competition. SBC argues that tangible evidence such as market share should be
17 thrown aside and trumped by subjective speculation because market share can merely
18 offer the Commission a 'perceived' level of competition at a certain point in time. Staff
19 understands that the Commission is interested in Missouri-specific evidence of
20 competition, as it now exists¹³, and market share information is one of the few pieces of
21 objective data available. As the Commission stated in the Sprint effective competition
22 case, "The Commission must decide whether there is effective competition now, not
23 whether there will be competition someday." Therefore, Staff would rather rely on

¹³ Missouri Public Service Commission's Report and Order in Case No. IO-2003-0281, page 35.

Rebuttal Testimony of
Bill Peters

1 tangible evidence than on speculation when making its recommendations to the
2 Commission.

3 **Q. Does this mean that market share information should be the sole**
4 **indicator of effective competition?**

5 A. No, other evidence should most certainly be considered when deciding
6 whether effective competition exists. However, without evidence of CLEC market share
7 by type and by exchange, it is difficult to recognize effective competition from the
8 remaining evidence presented by SBC in this case.

9 **Q. On page 21 of his Direct Testimony, Mr. Unruh sets forth SBC's 2004**
10 **statewide estimate of CLEC access lines in Missouri, along with the corresponding**
11 **numbers for 2001. Please explain Staff's analysis of this particular evidence.**

12 A. Although statewide SBC Missouri evidence is useful to get an overall
13 picture of the telephone access line market in SBC's Missouri exchanges as a whole, it is
14 not particularly useful when analyzing any specific exchange. Mr. Unruh himself states,
15 "...The CLEC market share in many of the exchanges is much higher than these state-
16 wide numbers reflect." As we see when these numbers are disaggregated at the exchange
17 level, the data indicate that a few SBC exchanges appear to be experiencing a much
18 higher level of competition than the remainder. Additionally, since these aggregate
19 numbers represent the sum of UNE-P, resale, and a minimum estimate of CLEC access
20 lines (based on e911 listing information), Staff has further reason to discount the insight
21 provided by these aggregate SBC estimates. In Staff's opinion, resale and UNE-P
22 estimates should be given only a minimum amount of credit when evaluating whether
23 effective competition exists.

Rebuttal Testimony of
Bill Peters

1 Additionally, if this data had been presented on an exchange-by-exchange basis,
2 the information could have provided insight on the sustainability of competition. For
3 instance, if an exchange had only a minimal amount of competition in 2001, but that
4 same exchange now had significant competition, it might indicate that competition was
5 viable in the exchange. The data might also have been useful in showing where
6 competition does not appear viable.

7 **Q. Does evidence of CLEC switches and CLEC collocation arrangements**
8 **represents evidence of effective competition?**

9 A. Although this information, at a very high level, is useful to begin to
10 analyze the potential for competition, it does not address the degree of competition for
11 SBC wire line products at the exchange level. Without data that shows actual service to
12 customers in SBC Missouri exchanges, Staff finds little reason to grant much authority to
13 these global data.

14 In order to consider collocation as evidence of effective competition, Staff would
15 need to see additional evidence detailing whether and to what extent collocators were
16 actively providing wire line telephone products in competition with SBC Missouri
17 products. SBC testifies that with collocation, CLECs *can* provide service by using
18 UNEs. Staff finds it necessary to consider evidence of active UNE purchase rather than
19 potential use. In other words, we would like to know if these arrangements are being
20 used to compete with SBC Missouri. If a CLEC has deployed equipment that *can* serve
21 customers, there is a distinct possibility that they are serving few, if any, customers at all.

Rebuttal Testimony of
Bill Peters

1 **Q. Mr. Unruh presents data on CLEC numbering resources from the**
2 **LERG (Local Exchange Routing Guide). Does this represent evidence of effective**
3 **competition?**

4 A. No, this 'evidence' is yet another attempt at establishing effective
5 competition by proxy of competitive potential. Even if a CLEC has numbering resources
6 in an exchange, this information does not indicate how many customers are actually
7 being served with those numbering resources.

8 **Q. According to Mr. Unruh, "SBC Missouri lost over 375,000 lines**
9 **during the past three years while CLECs gained over 273,000 lines during the same**
10 **three year period." Is this evidence of effective competition across all of SBC's**
11 **exchanges for all of its services?**

12 A. Unfortunately, those data are too broad to draw any conclusions about
13 specific SBC exchanges or services. In fact, the disaggregated data show that facilities-
14 based CLEC competition is concentrated in just a few of SBC's exchanges. Staff does
15 not agree that competition in some exchanges is the equivalent of competition in all
16 exchanges.

17 **Q. Is prepaid telephone service an issue in this case?**

18 A. Since SBC has chosen to consciously exclude prepaid CLEC information,
19 it is not an issue in this case.

Rebuttal Testimony of
Bill Peters

1 **Q. Mr. Unruh states, "We identify a CLEC as actively serving customers**
2 **by their purchase of resold lines, purchase of UNE-P, or the presence of an E-911**
3 **listing in the 911 database...Schedule 13HC, as described more fully below,**
4 **identifies the actual minimum number of CLECs actively serving customers in each**
5 **SBC Missouri exchange...Based on the number of CLECs passing orders during**
6 **recent months, there are over 65 CLECs actively competing in SBC Missouri's**
7 **service territory throughout the state." How does Staff interpret this data?**

8 **A. The SBC data mentioned above is not a clear indication of the extent to**
9 **which those CLECs are competing in each SBC Missouri exchange. Simply aggregating**
10 **the number of active CLECs, even if we use SBC's definition of "active", provides very**
11 **little indication of the extent of competition in any of SBC's exchanges. Without**
12 **additional exchange-specific measures that identify CLEC penetration by type, Staff does**
13 **not find data on the total number of CLECs useful. Based on an HC response¹⁴, to Staff**
14 **Data request 26, Staff has learned that only 16 CLECs are represented in the e911 data,**
15 **which indicates at least some degree of CLEC facilities, while the remaining 46 'active'**
16 **CLECs provide service via resale and UNE-P. Of that e911 data, about 93% of those**
17 **access lines are business access lines. Of 21,714 e911 listings for residential customers,**
18 **** HC----- ** are held by Charter Communications in the Harvester exchange and**
19 **** HC----- ** are Charter lines in St Charles. Substantial evidence of residential**
20 **competition remains concentrated in St. Charles and Harvester. Staff continues to**
21 **recognize effective competition in the residential access line market in the Harvester and**
22 **St. Charles exchanges, but notes that facilities-based competition is markedly limited in**

¹⁴ This SBC response is attached to my testimony as HC Schedule 2. HC Schedule 9 identifies the 16 unique company identifiers in the e911 database information supplied in HC Schedule 2. HC Schedule 10 and 11 provide CLEC specific subtotals and totals by exchange alongside exchange-wide information.

Rebuttal Testimony of
Bill Peters

1 the other 158 SBC exchanges. Although the 10 exchanges of Pond, Eureka, Manchester,
2 Chesterfield, Fenton, Valley Park, Pacific, Kansas City, Springfield, and St. Louis show
3 at least nascent signs of facilities-based competition, those exchanges have not yet met
4 the standard of effective competition when considering all evidence Staff reviewed.

5 **Q. Is CLEC information from the Commission's website or the white**
6 **pages evidence of effective competition?**

7 A. No. This is another example where SBC places the cart before the horse
8 and purports that the possibility of competition is synonymous with effective
9 competition. The information on the Commission's website represents those CLECs that
10 have met all the requirements (approved certification, tariffs and interconnection
11 agreements) of providing service. Similarly, the presence of a CLEC in the white pages
12 indicates that CLEC is interested in providing service in an area. Neither source indicates
13 the CLEC is actually providing service. Without additional exchange specific evidence,
14 this information is of little use.

15 **Q. Please summarize your recommendation for a finding of effective**
16 **competition.**

17 A. Based on an analysis of all evidence presented, Staff continues to support
18 effective competition for SBC's business access line and line-related services in the
19 exchanges of St. Louis and Kansas City, and additionally recommends the Commission
20 support SBC's request for a finding of effective competition for the business access lines
21 and access line-related services in the 17 exchanges of Farley, Harvester, Fenton,
22 Chesterfield, Springfield, Greenwood, Valley Park, Manchester, St. Charles, Grain
23 Valley, Marionville, Pond, Smithville, Eureka, Imperial, High Ridge, Maxville.

Rebuttal Testimony of
Bill Peters

1 Staff continues to support effective competition for the residential access lines
2 and access line-related services in the Harvester and St. Charles exchanges. Staff does
3 not support SBC's request for a finding of effective competition for any other residential
4 access lines or access-line related services.

5 **Q. Does this conclude your Rebuttal Testimony?**

6 **A. Yes it does.**

No Supplement to this
tariff will be issued
except for the purpose
of canceling this tariff.

General Exchange Tariff
Section 17
8th Revised Sheet 12.01
Replacing 7th Revised Sheet 12.01

RULES AND REGULATIONS APPLYING TO ALL CUSTOMERS' CONTRACTS

17.6 PAYMENTS FOR SERVICE

17.6.1 Payment for Service

A. Residence Service

The customer is responsible for payment of all charges for services furnished the customer, authorized users, and any other charges for which the customer has agreed to be responsible, including but not limited to charges for services originated or charges accepted at the customer's telephone for exchange service; intrastate or interstate long distance service charges billed by the Telephone Company; any FCC-approved end user charge; any charges transferred to the customer's account from terminated accounts billed to the same customer; and any charges pursuant to Paragraph 17.4, preceding, where the customer has executed a Contract of Guaranty. A customer shall have at least 21 days from the rendition of a bill to pay the charges stated.

A Late Payment Charge of \$1.60 will be applied to accounts which have charges greater than \$5.00 carried over to the next monthly bill. When the balance carried over is in dispute, the Late Payment Charge may be applied and adjusted later, if appropriate, based on the resolution of the claim.

(AT)

Effective October 25, 2004, residential customers in the Harvester and St. Charles exchanges will have a Late Payment Charge of \$5.00 applied to accounts which have charges greater than \$5.00 carried over to the next monthly bill. When the balance carried over is in dispute, the Late Payment Charge may be applied and adjusted later, if appropriate, based on the resolution of the claim.

(AT)

If the customer notifies the Company before the next bill is generated, the Company will exempt the disputed portion of the bill from the Late Payment Charge until the claim is resolved. If the claim is resolved in favor of the Company, the Late Payment Charge will be applied if appropriate.

(MT)

(MT)

Issued: September 2, 2004

Effective: September 12, 2004

By CINDY BRINKLEY, President-SBC Missouri
Southwestern Bell Telephone, L.P., d/b/a SBC Missouri
St. Louis, Missouri

Schedule 1

FILED
MO PSC

**SCHEDULE 2 IS DEEMED
HIGHLY CONFIDENTIAL IN ITS ENTIRETY**

**SCHEDULE 3 IS DEEMED
HIGHLY CONFIDENTIAL IN ITS ENTIRETY**

**SCHEDULE 4 IS DEEMED
HIGHLY CONFIDENTIAL IN ITS ENTIRETY**

Q. PLEASE PROVIDE THE SOURCE DATA USED TO GENERATE THE VISUAL REPRESENTATIONS IN CRAIG UNRUH SCHEDULES 15, 16, AND 17 FROM HIS DIRECT TESTIMONY.

A. The data sources used to generate Unruh Schedule 15 are publicly available Internet websites searched by zip code for service plan comparisons for multiple wireless providers; and, Internet websites for service plan areas for individual wireless providers. Service Plan Comparisons by Zip Codes were identified at: www.letstalk.com for: T-Mobile, Verizon Wireless, Nextel, Cellular-One, U.S. Cellular. This website also identified Cingular and AT&T Wireless, which were excluded from Unruh Schedule 15. Verification for service coverage information for some exchanges and/or zip codes, was performed at www.foncentral.com, and www.wirelessadvisor.com.

Distinct websites searches by service plan area with and without zip code identification were performed for:

Alltel Wireless – www.alltel.com/news_information/maps

Chariton Valley Wireless – www.cvalley.net

U.S. Cellular – www.uscc.com

Sprint PCS – www.sprintpcs.com

Western Wireless – www.wwireless.com and www.cellularonewest.com

Cellular One – www.celloneusa.com

Mid-Missouri Cellular – www.mydigital.com

T-Mobile – www.t-mobile.com

Verizon Wireless – www.verizonwireless.com

Nextel – www.nextel.com

For the following SBC Missouri Exchanges, a search for “Cell Phone Service Providers” was performed at the Yellow Pages listing by city: East Prairie, Paynesville, Meta and Armstrong. These cell phone providers were then contacted by telephone and asked if they provided service to these locations. At least one provider was identified for each of these exchanges. However, as noted on Unruh Schedule 15, no wireless providers were found for Stanberry.

For Unruh Schedules 16 and 17 the source data is a combination of public information such as press releases, advertising, etc., information purchased from Nielson Communications and Geographic Data Technologies and some internal

Missouri Case No. TO-2005-0035
PSC Staff
Request No. 5
RFI No. 5-39
Page 3 of 3

SBC data. This information resides in a data base that interfaces graphically with mapping software to produce the maps. Spreadsheets and other typical types of source data are not created in this process. Generally the information purchased from outside sources contains data for the United States, not just Missouri.

Responsible Person: Donna T. Halwe
Area Manager-Regulatory
One SBC Center, Room 3506
St. Louis, MO 63101

Jessica Willis
Associate Director- GIS Infrastructure
105 Auditorium Cr., Room 11-M-06
San Antonio, TX 78205

- Q. PLEASE PROVIDE ANY DOCUMENTATION, INCLUDING BUSINESS PLANS, PRESENTATIONS AND INTERNAL MEMOS, THAT DISCUSS AND/OR DETAIL ANY PRICE AND/OR SERVICE CHANGES (I.E. COMPETITIVE RESPONSE PLANS) THAT SBC MISSOURI CONTEMPLATES IT WOULD IMPLEMENT IF IT WERE TO HAVE COMPETITIVE CLASSIFICATION FOR ANY OR ALL OF ITS SERVICES IN ANY OF OR ALL OF ITS MISSOURI EXCHANGES.
- A. SBC Missouri has not determined what marketing programs it would initiate as a result of an expansion of competitive classification. Analysis needs to be performed to determine how customers desires can be better served with new flexibility.

Responsible Person: Sylvia Acosta Fernandez
Director-Voice Package Simplification
530 McCullough, Room 6-M-06
San Antonio, TX 78215

Elizabeth Stoia
Director-Core Services
530 McCullough, Room 09-K-06
San Antonio, TX 78215



The world's networking company™

News Release

FOR RELEASE THURSDAY, JULY 22, 2004

AT&T Announces Second-Quarter 2004 Earnings, Company to Stop Investing in Traditional Consumer Services; Concentrate Efforts on Business Markets

- Second-quarter earnings per diluted share of \$0.14
- Consolidated revenue of \$7.6 billion
- Operating income of \$348 million
- Second-quarter cash from operating activities of \$1.1 billion

BEDMINSTER, N.J. — AT&T (NYSE: T) today reported net income of \$108 million, or earnings per diluted share of \$0.14, for the second quarter of 2004. This compares to net income of \$536 million, or earnings per diluted share of \$0.68, in the second quarter of 2003.

The company also announced that it is shifting its focus away from traditional consumer services such as wireline residential telephone services, and concentrating its growth efforts going forward on business markets and emerging technologies, such as Voice over Internet Protocol (VoIP), that can serve businesses as well as consumers. The shift plays to AT&T's strength as an innovator in communications and a leader in serving the complex networking and technology needs of businesses.

"AT&T is the leading provider of communications services to business customers, offering a full range of leading-edge networking and communications solutions on a global basis," said David W. Dorman, AT&T's Chairman and CEO, who noted that nearly 75% of AT&T's revenue is now generated by AT&T Business. "We intend to widen the gap between AT&T and our competitors in the business market, while also improving our industry-leading cost structure and financial strength."

As a result of recent changes in regulatory policy governing local telephone service, AT&T will no longer be competing for residential local and standalone long distance (LD) customers. The company stressed that existing residential customers will continue to receive the quality service they expect from AT&T; however, the company will no longer be investing to acquire new customers in this segment.

"This decision means that AT&T will focus on lines of business where we are a clear leader, where we control our own destiny and where we have distinct competitive advantages," said Dorman. "Despite the near-term challenges associated with a difficult industry environment, we are confident that AT&T's cost structure, customer base, strong balance sheet and cash flow give us the flexibility to continue investing for success in the long run."

AT&T reported second-quarter 2004 consolidated revenue of \$7.6 billion, which included \$5.6 billion from AT&T Business and \$2.0 billion from AT&T Consumer. Consolidated revenue declined 13.2 percent versus the second quarter of 2003, primarily due to continued declines in LD voice revenue.

AT&T's second-quarter 2004 operating income totaled \$348 million, resulting in a consolidated operating margin of 4.6 percent. Operating income included \$54 million of net restructuring and other charges taken during the quarter primarily related to employee separations. This quarter the company also reported that it generated \$1.1 billion in cash from operations while spending \$0.5 billion on capital expenditures.

AT&T UNIT HIGHLIGHTS

AT&T Business

- Revenue was \$5.6 billion, a decline of 12.7 percent from the prior-year second quarter. Pricing pressure and mix shift from retail to wholesale negatively affected the unit's revenue performance.
- Long distance voice revenue decreased 17.6 percent from the prior-year second quarter, driven by continued pricing pressure as well as a continued mix shift in volume from retail to wholesale. Volumes were flat on a quarter-over-quarter basis, with growth in wholesale volumes offset by a decline in retail volumes.
- Local voice revenue grew 5.0 percent from the prior-year second quarter. Local access lines totaled more than 4.6 million at the end of the current period, representing an increase of over 85,000 lines from the end of the first quarter of 2004.
- Data revenue declined 10.4 percent from the prior-year second quarter. Revenue was negatively affected by pricing pressure, weak demand and technology migration.

Schedule 7-1

- IP&E-services revenue grew 2.3 percent over the prior-year second quarter. The quarter-over-quarter growth was primarily driven by strength in advanced services, including Enhanced Virtual Private Network and IP-enabled frame.
- Outsourcing, professional services and other revenue declined 18.9 percent from the prior-year second quarter, due to customers reducing scope and terminating outsourcing contracts.
- Operating income totaled \$152 million in the period, yielding an operating margin of 2.7 percent. Second-quarter 2004 operating income included net restructuring and other charges of \$52 million related to employee separations. The operating margin declined from the prior-year second quarter, reflecting the ongoing mix shift from retail LD products toward advanced and wholesale services.
- *The sequential increase in second-quarter operating margin was primarily driven by favorable access settlements. In the second half of 2004, we expect the operating margin to be eroded by continuing pricing pressure in the enterprise segment, RBOC share gains in the small and medium business markets and the customary impact of seasonality.*
- Capital expenditures were \$463 million as AT&T Business continued to invest in its network and systems to drive continued cost efficiencies and expand its customer-focused networking capabilities.
- AT&T Business showed an improvement in market share trends at the high end of the market, consistent with its strategy of keeping and building its enterprise customer base.
- During the second quarter, a number of sizable customer wins and contract extensions were signed with companies including Lockheed Martin, Deutsche Bank and Providea, as well as The United States Army and The Internal Revenue Service, among many others.

AT&T Consumer

- Revenue was \$2.0 billion, a decline of 14.6 percent versus the prior-year second quarter, driven by lower standalone LD voice revenue as a result of the continued impact of competition, wireless and Internet substitution and customer migration to lower-priced products and calling plans, partially offset by targeted price increases.
- Operating income totaled \$240 million, yielding an operating margin of 11.9 percent. The margin decline from the prior-year second quarter was largely due to ongoing substitution and competition. In addition, increased spending for marketing and new initiatives such as VoIP contributed to the margin decline. Such declines were partially offset by the effects of pricing actions.
- According to industry estimates, more than 40% of American households have now migrated to some combination of bundled communications services. Recent regulatory decisions make it financially infeasible for AT&T to offer a competitive bundle of services to consumers. AT&T has determined that it cannot effectively compete against bundled competition by selling only standalone LD.
- As of June 30, 2004 AT&T Consumer offered its residential VoIP AT&T CallVantageSM Service in 72 major markets throughout the U.S. Recently, the company expanded the availability of its offer to 100 major markets in 32 states and Washington D.C.

OTHER CONSOLIDATED FINANCIAL HIGHLIGHTS

- Free cash flow was \$0.6 billion for the quarter. Free cash flow is defined as cash flow provided by operating activities of \$1.1 billion less cash used for capital expenditures and other additions of \$0.5 billion.
- AT&T ended the quarter with net debt of \$7.9 billion, a \$0.5 billion decrease from the end of the first quarter of 2004. Net debt is defined as total debt of \$11.2 billion less cash of \$2.5 billion, restricted cash of \$0.5 billion and net foreign debt fluctuations of \$0.3 billion.

DEFINITIONS and NOTES

AT&T Business

LD Voice - includes all of AT&T's domestic and international LD revenue, including Intralata toll when purchased as part of an LD calling plan.

Local Voice - includes all local calling and feature revenue, Intralata toll when purchased as part of a local calling plan, as well as inter-carrier local revenue.

Data Services - includes bandwidth services (dedicated private line services through high-capacity optical transport), frame relay and asynchronous transfer mode (ATM) revenue for LD and local, as well as revenue for managed data services.

Internet Protocol & Enhanced Services (IP&E-services) - includes all services that ride on the IP common backbone or that use IP technology, including managed IP services, as well as application services (e.g., hosting, security).

Outsourcing, Professional Services & Other - includes complex bundled solutions primarily in the wide area/local area network space, AT&T's professional services revenue associated with the company's federal government customers, as well as all other Business revenue (and eliminations) not previously defined.

Data, IP&E-Services - Percent Managed - managed services refers to AT&T's management of a client's network or network and applications including applications that extend to the customer premise equipment.

Data, IP&E-Services - Percent International - a data service that either originates or terminates outside of the United States, or an IP&E-service installed or wholly delivered outside the United States.

AT&T Consumer

Schedule 7-2

Bundled Services - includes any customer with a local relationship as a starting point, and all other AT&T subscription-based voice products provided to that customer.

Standalone LD, Transactional & Other Services - includes any customer with solely a long distance relationship, non-voice products, or a non subscription-based relationship.

Local Customers - residential customers that subscribe to AT&T local service.

Other Definitions and Notes

Restricted cash - \$0.5 billion of cash that collateralizes a portion of private debt and is included in "other current assets" on the balance sheet.

Foreign currency fluctuations - represents mark-to-market adjustments, net of cash collateral collected, that increased the debt balance by approximately \$0.3 billion at June 30, 2004, on non-U.S. denominated debt of about \$1.8 billion. AT&T has entered into foreign exchange hedges that substantially offset the fluctuations in the debt balance. The offsetting mark-to-market adjustments of the hedges are included in "other current assets" and "other assets" on the balance sheet.

-
- 2Q04 Income Statement (PDF)
 - 2Q04 Quarterly Income Statements (PDF)
 - 2Q04 Historical Segment Data (PDF)
 - 2Q04 Balance Sheet (PDF)
 - 2Q04 Cash Flow (PDF)
 - 2Q04 Reconciliation of Non-GAAP Measures (PDF)

The foregoing contains "forward-looking statements" which are based on management's beliefs as well as on a number of assumptions concerning future events made by and information currently available to management. Readers are cautioned not to put undue reliance on such forward-looking statements, which are not a guarantee of performance and are subject to a number of uncertainties and other factors, many of which are outside AT&T's control, that could cause actual results to differ materially from such statements. These risk factors include the impact of increasing competition, continued capacity oversupply, regulatory uncertainty and the effects of technological substitution, among other risks. For a more detailed description of the factors that could cause such a difference, please see AT&T's 10-K, 10-Q, 8-K and other filings with the Securities and Exchange Commission. AT&T disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. This information is presented solely to provide additional information to further understand the results of AT&T.

About AT&T

For more than 125 years, AT&T (NYSE 'T') has been known for unparalleled quality and reliability in communications. Backed by the research and development capabilities of AT&T Labs, the company is a global leader in local, long distance, Internet and transaction-based voice and data services.

AT&T 'Safe Harbor'

The foregoing contains 'forward-looking statements' which are based on management's beliefs as well as on a number of assumptions concerning future events made by and information currently available to management. Readers are cautioned not to put undue reliance on such forward-looking statements, which are not a guarantee of performance and are subject to a number of uncertainties and other factors, many of which are outside AT&T's control, that could cause actual results to differ materially from such statements. These risk factors include the impact of increasing competition, continued capacity oversupply, regulatory uncertainty and the effects of technological substitution, among other risks. For a more detailed description of the factors that could cause such a difference, please see AT&T's 10-K, 10-Q, 8-K and other filings with the Securities and Exchange Commission. AT&T disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. This information is presented solely to provide additional information to further understand the results of AT&T.

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Schedule 7-3

MCI Reacts To Triennial Review Ruling

BACKGROUND: The U.S. Court of Appeals for the District of Columbia Circuit today released its ruling on the Federal Communications Commission's (FCC) "Triennial Review" local telephone competition order. This order established the framework under which competitors can access the Bell-controlled public phone network. MCI and other competitive local exchange carriers joined with the FCC in defending portions of the order that ensure consumer choice in the local telephone market.

The court sharply restricted the ability of MCI and other companies to offer local phone service to residential customers by denying competitors the right to lease the facilities still controlled by local Bell monopolies. Without access to those facilities, MCI and others simply cannot continue to offer lower prices and better residential services. The D.C. Circuit also denied competitors the ability to provide innovative broadband services on fiber facilities. If the Court's opinion is not stayed, consumers will be impacted in as few as 60 days.

The following statement should be attributed to Stasia Kelly, MCI general counsel:
"Congress had envisioned that the Telecom Act would open local markets to competition and ensure that consumers have freedom of choice when it comes to local residential service. Yet, eight years later, local phone competition is still under attack.

"Eliminating the FCC's local competition rules scraps the significant progress we have made to deliver consumers lower rates and innovative service. Three and a half million consumers have chosen MCI for local service over the Bells, and more than 19 million households now use a local phone provider other than the Bells. Additionally, local competition has spurred network investment and created tens of thousands of jobs.

"The D.C. Circuit's decision leaves us with little choice but to seek an emergency stay and full review from the U.S. Supreme Court.

"It is imperative that the FCC continue the fight to preserve competition, by taking this case to the Supreme Court for a definitive decision. Millions of Americans will pay the price if the FCC does not act to protect their interests."

- 2 March, 2004

PR Contact:

Name: Peter Lucht
Tel: (800) 644-NEWS

PR Contact:

Name: Sudie Nolan
Tel: 703-886-7311

Source:

<http://global.mci.com/about/news/news2.xml?newsid=9910&mode=long&lang=en&width=530&root=/about/&langlinks=off>

**SCHEDULE 9 IS DEEMED
HIGHLY CONFIDENTIAL IN ITS ENTIRETY**

**SCHEDULE 10 IS DEEMED
HIGHLY CONFIDENTIAL IN ITS ENTIRETY**

NP

**SCHEDULE 11 IS DEEMED
HIGHLY CONFIDENTIAL IN ITS ENTIRETY**

NP