Exhibit No. ___ -THC (TLW-1THC)
Docket No. UT-050814
Witness: Thomas L. Wilson
REDACTED VERSION

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Application of **VERIZON COMMUNICATIONS, INC. and MCI, INC.** **For Approval of Agreement and Plan of Merger**	**DOCKET NO. UT-050814**

TESTIMONY OF

THOMAS L. WILSON

STAFF OF
WASHINGTON UTILITIES
AND TRANSPORTATION COMMISSION

September 9, 2005

REDACTED VERSION

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Thomas L. Wilson, Jr., and my business address is 1300 South Evergreen Park Drive Southwest, P.O. Box 47250, Olympia, Washington, 98504. My business e-mail address is twilson@wutc.wa.gov.

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission (Commission) as a Telecommunications Analyst.

Q. What are your education and experience qualifications?

A. I have been a Telecommunications Analyst on Staff at the Commission since January 1986. Please see Exhibit No. ___ (TLW-2) for a complete description of my educational background and job experience.

II. PURPOSE OF TESTIMONY AND SUMMARY

Q. What is the purpose of your testimony in this case?

A. The purpose of my testimony is to provide market share and market concentration analysis of the proposed merger of Verizon and MCI.

Q. Please summarize your testimony.

A. My testimony provides market share and market concentration analysis based upon the economic theory of industrial organization and also upon my experience in analyzing the competitive status of the telecommunications industry.

First, I define the relevant geographic market for purposes of my testimony as the historic incumbent operating territory wire centers served by Verizon in Washington. I define the relevant service market as the market for local exchange lines (residential and business local exchange service) and the market for private line and special access channels (intrastate and interstate).

In the main part of my analysis, I provide information about the market status of existing competitors, including market share details, and market concentration analysis within the relevant geographic and service markets as I have identified them. I provide analysis of Verizon's market power over the time period 2003 – 2004. I also estimate how Verizon's market power might change across its wire centers if the merger is allowed

by assuming that all of the lines and channels served by MCI would be served instead by Verizon.

III. RELEVANT MARKET DEFINITION

Q. Please define the relevant geographic markets for purposes of your testimony.

A. The relevant geographic market for purposes of my testimony is defined as the wire centers served by Verizon in Washington. I recognize that the Applicants provide services all over the state. However, because neither Staff nor any other party surveyed all of the other providers in the entire state, I used historical wire center level retail and wholesale data that Staff gained through discovery from Verizon. Therefore, my analysis does not focus on areas outside of Verizon's 103 historic incumbent local exchange operating areas in Washington.[1]

[1] Verizon provided relevant data for several additional wire centers, or data categories, which are included, when relevant, in my analyses: STTLWACH – NOOFWA, STTLWAWB- SEATTLE UNIV OF WA VIRTUAL, and SEATTLE UNIV OF WASHINGTON. Note that STTLWAWB- SEATTLE UNIV OF WA VIRTUAL, and SEATTLE UNIV OF WASHINGTON are in fact, outside of Verizon's historical incumbent local exchange operating territory.

Q. Please describe the relevant service market for purposes of your testimony.

A. There are a variety of ways to define the relevant service market. When customers consider one service as a substitute for the other, those services are in the same relevant market. For example, to the extent that cellular, wi fi, voice over internet protocol (VOIP) and wireless networking solutions are seen as functional equivalents to a basic business exchange, PBX or centrex service from Verizon, they are in the same relevant market. Some customers may choose to fill their needs with several "plain old telephone service" basic business exchange lines from Verizon, or they may choose to network the lines through customer premises equipment that allows for various applications including voice, data or fax. Some customers choose to upgrade analog voice systems with digital substitutes, getting more for their dollar, or satisfying other tastes and preferences or specific or unique needs.

Current theoretical discussion and case study of the communications sector, with attention to the role of regulation when competition exists, indicates that non-traditional, cross-industry, technology-neutral analysis based on functionality of the relevant market may be appropriate. Much more activity is occurring in the relevant market than appears under direct Commission oversight. For example, intermodal offerings of analog and

digital services via wire and non-wireline transmission technologies are often presented as competitive alternatives in part or in whole to what Verizon currently offers in the relevant market. However, a survey of all other providers of services in the relevant markets involved in this case has not been performed. Therefore, the Verizon data obtained through Staff's discovery represents only a sub-set of all of the choices facing consumers in the relevant market, and it does not include facilities-based or intermodal competition.

For purposes of my testimony, the relevant service markets are the market for local exchange lines (residential and business local exchange service) and the market for private line and special access channels (intrastate and interstate). I will also provide testimony concerning Competitive Local Exchange Carrier (CLEC) collocations and the long distance markets served by the Applicants.

Q. Why do you define the relevant service market the way that you do, rather than in terms of mass and enterprise markets?

A. My definition of the service market allows very clear assembly and analysis of the available data in a meaningful way. By analyzing the residential and

business markets in terms of local exchange line data, I can effectively analyze CLEC and Verizon market data in an "apples-to-apples" comparison. In the space of my study for this case, adequate and accurate data about CLECs is limited to the information obtainable from the Applicants. Without a survey of all carriers in the relevant market, I cannot accurately make many inferences about mass market or enterprise market services.

CLECs purchase various Unbundled Network Elements (UNEs) and wholesale services as inputs to competitive service offerings in the market for local exchange lines. Although I have a very accurate picture of what CLECs are purchasing from Verizon, it is not possible to guess what the CLECs are doing with many of those inputs, and I did not consider it necessary to go behind the Verizon data to achieve the level of analysis needed for this case. This is because the data reveals that Verizon enjoys consistently strong market power in the residential and business markets for local exchange lines. I believe that for purposes of considering the overall effects of the merger on the relevant market, the approach that I have taken yields reliable and reasonable results.

IV. MARKET CONCENTRATION ANALYSIS

Q. How do you analyze the data for private line and special access services?

A. I analyze the market for private line and special access services on a per-channel basis because private lines and special access lines come in different "sizes," i.e., DS0, DS1, DS3 and OC-3. By converting all of these circuits to a channelized basis (i.e., to the number of voice grade equivalent channels that can be carried over each type of circuit), I can compare all of the data at once, in an "apples-to-apples" comparison, while still taking size and volume into account. Customers can multiplex channels into larger and larger circuits or demultiplex them into smaller chunks. Therefore, it makes sense to analyze the market for private line and special access services on the basis of channels. I term this market an "access" market because I am comparing Verizon to CLECs and Interexchange Carriers (IXCs), who use private line and special access channels to provide access.

By analyzing the market for intrastate and interstate private line and special access channels together, I believe that I am reflecting the way that these services are used by CLECs and IXCs today. From a functional standpoint, private line channels and special access channels are the same thing. They both connect point A to point B with a dedicated pathway. It is

my impression that CLECs, IXCs and Verizon are all deploying these channels with diminishing regard for distinctions between what is "private line" and what is "special access" and distinctions between what is "intrastate" and what is "interstate." I think this is fair to say, particularly in light of the blurring distinctions between regulated telecommunications and Internet-based communications. It is my understanding that CLECs can and often do use interstate special access as a substitute for intrastate private line service or UNE loops. This is because of the FCC's "ten percent rule," which holds that if ten percent or more of the traffic on a facility is interstate, then the whole facility may be tariffed at the federal level. My understanding is that special access is sometimes used in lieu of local interconnection services by CLECs in order to achieve parity with incumbent operations. The extent to which competitors utilize special access as a transport mechanism is not relevant to customers who are only interested in functionality and satisfaction, with transmission and other technology methods being transparent to the end user.

Q. Please address how you fit into your analysis the market study of facilities –based competition, and intermodal services and functionally equivalent services not subject to the WUTC's jurisdiction?

A. The Applicants both compete with VOIP/Internet, cable TV companies, wireless (wi fi, wi max, microwave, low-earth-orbit satellite), public utility districts (PUDs), Noanet, municipal networks and private/public partnerships, and broadband over power line (BPL), to name a few unregulated alternatives. I do not dispute that intermodal competition should be an important element of the analysis, but it is, after all, a rather nascent form of competition. Also, public data of sufficient detail on intermodal competition in the relevant markets is very difficult to come by. Suffice it to say that my estimates of Verizon market power in the relevant market are conservative because I do not have the ability to include intermodal and facilities-based competition data in this case.

Q. Please describe your analysis of market concentration.

A. To begin, I analyzed two years' worth of data. I analyzed data effective December 31, 2003, and data effective December 31, 2004. It has been my experience in the past that incumbent local exchange carriers have little or no

information about facilities-based competition, so I did not attempt to collect that information via discovery. However, I subsequently noticed that Public Counsel did obtain some information about facilities-based CLEC lines effective March 2005, and I have included that information. I realize that the most antiseptic analysis would exclude the March 2005 data as inconsistent with December 31, 2004, data because it is from a different time period. However, in the interest of bringing forth as much relevant data as possible, I have decided to use both data together, and to make my assumption known.

Exhibit No. ___ HC (TLW-3HC) provides overall summary detail about the service markets in Washington where Verizon operates as the incumbent local exchange company (ILEC). It shows the total number of local exchange lines and access channels for Verizon, CLECs and IXCs and MCI. The change in the number of lines and channels from 2003 and for 2004 is provided in nominal and percent terms.

Exhibit No. ___ HC (TLW-3HC) shows that Verizon's local exchange business and the number of private line and special access channels diminished during 2003-2004, but CLECs and IXCs increased their presence. During the same period, MCI grew substantially, especially in the local exchange market. Overall, the market decreased slightly in size.

Having compiled this data, I then did an analysis of market concentration using the Herfindahl-Hirschman Index (HHI). A single snapshot of HHI analysis does not provide the best representation of what is going on in the market. That is why I also studied HHI trends over time.

Q. What do HHI calculation figures represent?

A. The HHI index, described in the Department of Justice's Horizontal Merger Guidelines, is calculated by summing the squares of the individual market shares of all the participating firms in the relevant market. The Horizontal Merger Guidelines are used by the Department of Justice and the Federal Trade Commission to determine the effects of a merger on competition. According to the Horizontal Merger Guidelines, an HHI under 1,000 indicates an unconcentrated market. An HHI between 1,000 and 1,800 indicates a moderately concentrated market. An HHI over 1,800 indicates a highly concentrated market. An HHI of 10,000 indicates a 100 percent pure monopoly market.

The HHI can range from zero in a perfectly competitive market to 10,000 in a perfect monopoly market. The HHI would equal 1,667 in a market with six firms of equal size, 2,000 in a market with five firms of equal size,

2,500 with four firms of equal size, 3,333 with three firms of equal size, and 5,000 with two firms of equal size. Staff chooses a threshold of 5,000 for determining when market concentration indicates market power but acknowledges that different levels of market concentration would be acceptable with different market structures.

Q. What data did you consider in your analysis of the market for local exchange lines?

A. First, I think it is important to note that as of December 31, 2003, Verizon had 96 approved and effective interconnection agreements with CLECs in Washington. One year later, it had 86. These figures indicate that Verizon faces a large number of competitors in many of the relevant markets.

Next, I analyze the residential and business markets individually at the wire center level. The data for the residential market for local exchange lines on the CLEC side includes:

1. Self-Provisioned CLEC Lines (obtained via responses to Public Counsel discovery) ;
2. UNEP Lines;[2]
3. UNE-POTS Lines (analog loops);

[2] UNEP figures include all UNE-P volumes provided under Section 251 of the Act as well as substitutes provided under commercial agreements.

4. UNE-DS0 Channels (Digital, BRI and DSL lines); and
5. Resale Lines.

The residential market for residential local exchange lines is defined on the Verizon side as including POTS Lines Retailed by Verizon.

For the business market for local exchange lines, I analyzed the following CLEC data:

1. Self-Provisioned Multi-Lines;
2. UNEP Lines;
3. UNE-POTS Lines;
4. UNE-DS0 Channels;
5. UNE-DS1 Channels;
6. UNE-DS3 Channels;
7. UNE DS1 EELS; and
8. Resale Lines.

For the business market for local exchange lines, I analyzed the following Verizon data:

1. POTS Lines;
2. Centrex-Type Lines;
3. DS0 Loops (ISBN-BRI) ; and
4. DS1 Loops (ISBN-PRI).

Q. Please describe your analysis of the residential market for local exchange lines.

A. Exhibit No. ___ HC (TLW-4HC) provides details about Verizon's residential local exchange lines, market share and market power by wire center. Exhibit

No. ___ HC (TLW-5HC) provides details about CLEC residential local exchange lines, market share and the number of wire centers served.

There were 103 wire centers and [redacted] lines in 2004 in the relevant market for residential local exchange lines. Verizon competes with 36 CLECs in 86 wire centers and enjoys an average 98.5 percent market share that varies from a high of 100 percent to a low of 96.5 percent with a standard deviation of one percent. This means that there is not very much variation in Verizon's market share for residential local exchange lines across its 103 wire centers. Verizon has very high market power for residential local exchange lines. There are virtually no facilities-based competitive residential local exchange lines.

Q. Please discuss MCI's status in the market for residential local exchange lines.

A. MCI is Verizon's [redacted] competitor with [redacted] percent market share and virtually no market power. MCI serves about [redacted] residential local exchange lines in the relevant market than the [redacted]. MCI's growth in residential local exchange lines has been [redacted] from 2003-2004.

Q. Please present your analysis of the business market for local exchange lines.

A. Exhibit No. ___ HC (TLW-6HC) provides a wire center level view of Verizon's business local exchange lines before the merger in 2004, market share and market power. Exhibit No. ___ HC (TLW-7HC) lists business local exchange lines for 38 CLECs competing against Verizon, their 2004 business local exchange line count, market share, and the number of wire centers each CLEC served. Exhibit No. ___ HC (TLW-8HC) provides an analysis of the effect of the merger on Verizon's line count, market share and market power by assuming that all of MCI's lines and channels are provided by Verizon.

Verizon provided [redacted] business local exchange lines in 104 wire centers in 2004.[3] The average number of business local exchange lines that Verizon serves in a wire center is [redacted]. The maximum number of business local exchange lines served by Verizon in 2004 in any wire center was [redacted], and the minimum is [redacted] Verizon's maximum wire center market share for business local exchange lines was 100 percent, and the minimum was 24.9

[3] This is one more wire center than the number of wire centers where Verizon provides residential local exchange lines because Verizon provides business services in an additional wire center in Seattle, which is served by Qwest Corporation.

percent. Verizon's average market share for business local exchange service was 69.7 percent. Verizon enjoys very high overall market power as measured by the HHI.

Thirty-eight CLECs provide business local exchange services in 89 Verizon wire centers. The average CLEC provides 2,488 business local exchange lines across Verizon territory, the largest provides [redacted], and the smallest provides one line. The most wire centers that any CLEC is in competition to provide business local exchange lines is 60, and the largest market share for any CLEC is [redacted] percent. The average market share for a CLEC providing business local exchange services in Verizon territory is 0.8 percent, and the average CLEC serves 18 wire centers. MCI is the [redacted] CLEC, selling business local exchange services to [redacted] percent of the lines.

Based on my analysis, after the merger, Verizon's market power will increase in two wire centers from below 5,000 to above 5,000, and Verizon's market share will increase [redacted] percent.

Q. Please present analysis of the market for intrastate and interstate private lines and special access.

A. Exhibit No. ___ HC (TLW-9HC) provides the number of intrastate and interstate private line and special access channels for Verizon, assuming the merger added the MCI channels to Verizon as of December 31, 2005. Verizon would serve [redacted] channels in 106 wire centers.[4] Assuming the addition of the MCI lines to Verizon, Verizon's overall market share using December 31, 2004, channel counts would be 43.4 percent, with an average of 52.8 percent in each wire center, a maximum of 100 percent and a minimum of two percent. Verizon has an overall HHI before the merger that is below 5,000, and it will increase slightly but will still be below 5,000 after the merger. Verizon's HHI will go from below 5,000 to above 5,000 in six wire centers; however, Verizon will only gain market power over 0.3 percent of all intrastate and interstate private lines and special access lines as a result of the merger.

[4] This is two more wire centers than I reported in my analysis of the business local exchange market because Verizon counts a virtual wire center in Seattle and a wire center called "ORPHWAAN, Unknown Location" as extra. Verizon also counts an extra wire center called NOOFWA, but neither Verizon nor any CLEC or IXC provide intrastate or interstate private line or special access channels in the Malden wire center.

Exhibit No. ___ HC (TLW-10HC) shows that 58 CLECs and IXCs are providing intrastate and interstate private line and access channels across 96 wire centers. Overall CLEC market share in 2004 for intrastate and interstate private line and access channels was 58.9 percent, ranging from a maximum of 23.6 percent to a minimum of zero percent. The average CLEC market share was one percent. The average CLEC serves 15 wire centers, the largest CLEC serves 85 wire centers, and the smallest CLEC serves one wire center.

Q. Please provide information about CLEC collocations.

A. [redacted] CLECs in [redacted] wire centers had [redacted] collocations in 2003, and [redacted] collocations in 2004. [redacted] of the CLECs account[s] for all of the new collocations in 2004. The average number of CLEC collocations in the [redacted] wire centers affected was 2.3 in 2003, and it went up to 2.4 in 2004. The maximum number of CLECs collocating in any given wire center during the study period is [redacted], and the maximum number of collocations held by any CLEC in any of the [redacted] wire centers during the study period was [redacted] for both years.

Q. Please provide information about the market for long distance services.

A. The number of long distance customers presubscribed to MCI or MCI affiliates as of December 31, 2003, was [redacted] residential subscribers, and [redacted] business customers. In 2004, the number of residential long distance customers presubscribed to MCI or MCI affiliates [redacted], and business numbers went down to [redacted].

Verizon provided long distance service to [redacted] presubscribed residential subscribers in 2003 and to [redacted] presubscribed business customers that year. In 2004, Verizon's long distance market [redacted] presubscribed residential customers and [redacted] business customers.

Based on the data I presented on the numbers of residential and business local exchange customers in 2004 in Exhibit No. ___ HC (TLW-5HC) and Exhibit No. ___ HC (TLW-7HC), MCI and Verizon residential long distance market shares are approximately [redacted] percent and [redacted] percent respectively. For the business market MCI and Verizon market shares would be approximately [redacted] percent and [redacted] percent respectively.

Q. Does this conclude your direct testimony?

A. Yes.