

00437

1 JUDGE CAILLE: Let's go back on the record.
2 Okay. We have reconvened after our afternoon recess,
3 and we are in the process of the cross-examination of
4 Mr. Kelley, or Dr. Kelley. And Mr. Thompson, are you
5 ready to resume?

6 MR. THOMPSON: Yes, I am.

7 JUDGE CAILLE: Thank you.

8 Q. Dr. Kelley, at page 22 of your testimony,
9 lines 15 through 17, you said, Dial-around services
10 are being promoted heavily with the use of numerous
11 brands not associated with the established carriers,
12 although the use established -- excuse me. Although
13 they use established carriers -- actually, I've got a
14 -- it's written out incorrectly. Maybe you should
15 read the sentence, beginning, Dial-around services.

16 MR. CROMWELL: What page was that, again?

17 MR. THOMPSON: It's page 22, lines 15
18 through 17.

19 THE WITNESS: Dial-around services are
20 being promoted heavily with the use of numerous
21 brands not associated with the established carriers,
22 although the established carriers are providing the
23 services in many cases.

24 Q. Okay. Does WorldCom advertise its
25 dial-around services? First of all, what are

00438

1 WorldCom's dial-around services?

2 A. WorldCom has a Telecom USA affiliate, a
3 subsidiary that has these dial-around services
4 through 10-10-325, and quite honestly, I don't carry
5 those numbers around in my head.

6 Q. Okay. 10-10-220, 10-10-321, does that
7 sound right?

8 A. Could be.

9 Q. Okay. Would you agree that those numbers
10 represent brand names?

11 A. Sure.

12 Q. Okay. Do you know what portion of the dial
13 -- what share of the dial around market is controlled
14 by those WorldCom offerings?

15 A. I don't have direct knowledge. I saw a
16 number somewhere in this record of 45 percent, but I
17 don't have firsthand knowledge.

18 Q. Okay. On the topic of brand, at page 23 of
19 your testimony, at the bottom of page and then
20 carrying over, you said, There is evidence that the
21 established brand names of the major carriers are
22 becoming less important. A significant portion of
23 the advertising by AT&T, MCI WorldCom, and Sprint is
24 now devoted to products that do not carry an
25 established brand name. In addition to the new

00439

1 facilities-based entrants I described above, there
2 are literally hundreds of resellers offering service
3 under their own brand name.

4 Could I ask you, please, to take a look at
5 Exhibit C-36?

6 A. Yes.

7 Q. Okay. We asked you for -- Staff has asked
8 you for support in our data request here for the
9 portion of your statement that a significant portion
10 of the advertising of the Big Three companies is now
11 devoted to products that don't carry an established
12 brand name.

13 And as your backup for that point, you
14 supplied us the list of, I guess -- well, why don't
15 you explain what it is, I guess, since you provided
16 it?

17 A. These are data that come from this
18 Tele-trend. I believe these are the Tele-trend data,
19 or Competitrack, I'm sorry, Competitrack data, which
20 is a company that -- evidently, they have people who
21 read the newspaper and watch television and, through
22 other means, record how much advertising is going on
23 and what people are paying for it. And Charles
24 Rivers Associates, a consulting firm in Washington
25 that's working on this case for Sprint, acquired that

00440

1 data and pulled from the database the data that you
2 have here, which I relied upon.

3 Q. Okay. And I take it the point is to show
4 that some products of the Big Three carriers have
5 advertising dollars devoted to them, but they don't
6 carry an established brand name; is that right?

7 A. The established brand name of the carrier
8 -- ultimately providing the service; right.

9 Q. Okay. Can you provide a couple of
10 examples, maybe, so I can understand what you're
11 talking about?

12 A. Okay. On -- it looks like the Bates stamp
13 ends in 254, for advertiser MCI. About the middle of
14 the page, there's long distance dial-around, and it
15 gives dollars and share of their advertising in that
16 category or subcategory.

17 Q. Okay. Was that the -- do you think that
18 refers to the 10-10 offerings that we were talking
19 about earlier?

20 A. I believe they do. Dial around is when you
21 don't use your PIC carrier; you dial the 10-10 code
22 to get to another carrier.

23 Q. Okay. So they don't carry the MCI brand,
24 but --

25 A. The established brand name.

00441

1 Q. I see. Okay. But they may -- certainly,
2 they may qualify, I mean, I think you said earlier
3 that you would concede that maybe 10-10-220 is a
4 brand; right? I mean, it's just not the same brand
5 as --

6 A. Yeah, they came in and established a new
7 brand.

8 Q. Okay.

9 A. Just as Qwest came in and established a
10 brand and Bell Atlantic is now coming in and
11 establishing its brand in the West, and so yes.

12 Q. Okay. I just wanted to clarify that point.
13 Based on the totals that we see for the three
14 companies, for example, looking at the bottom line
15 for MCI WorldCom, which is on the next page, ending
16 255, are you aware of whether any of the -- what I'll
17 refer to as the emerging carriers have spent anywhere
18 near the amounts that these three companies have to
19 establish their brand names through advertising?

20 A. I'm just trying to remember whether those
21 data were extracted from this data set, and sitting
22 here now, I don't recall that they were, so --

23 Q. So in other words, you just can't make a
24 comparison based on this document, is what you're
25 saying?

00442

1 A. Right, I believe this document is MCI,
2 Sprint and AT&T.

3 Q. Right, but I guess I'm asking you, just
4 based on your knowledge of the industry, if you can
5 make any kind of a comparison of these three firms
6 compared to, say, Qwest or something?

7 A. Not to be quantitatively precise. I mean,
8 I do see ads by Qwest on the television. I think
9 I've seen some Williams ads, so they are out there
10 advertising.

11 Q. But I mean, you just don't have specific
12 knowledge of how much they're spending?

13 A. I don't. It may well be that the data we
14 supplied to you can be mined to extract that; we just
15 haven't done it.

16 Q. On page 25 of your testimony, you talked
17 about the issue, the difference between rates for
18 in-state calls versus state-to-state calls. And
19 lines 16 through 18, you said, In an intensely
20 competitive environment, firms cannot risk losing the
21 business of consumers who make a high portion of
22 in-state calls. Higher prices for in-state calls are
23 likely explained by higher access charges; correct?

24 A. Correct.

25 Q. Does Washington State have different

00443

1 intraLATA and interLATA access charges, to your
2 knowledge?

3 A. Not to my knowledge.

4 Q. Is there a major cost differential, other
5 than access charges, between intrastate interLATA and
6 intraLATA -- interLATA, intraLATA calling, other than
7 --

8 A. I think I lost your inters and intras
9 there.

10 Q. Sorry. Is there a cost differential
11 between inter and intraLATA, other than access
12 charges, because there is no access charges, is there
13 some cost differential between the two?

14 A. Between intrastate interLATA and intrastate
15 intraLATA; is that the question?

16 Q. Right.

17 A. Not that I'm aware of.

18 Q. Okay. Does MCI WorldCom offer different
19 intraLATA and interLATA rates in its MCI Everyday and
20 MCI Everyday Plus plans?

21 A. I don't know.

22 Q. Okay. Well, if I would suggest to you that
23 they did, can you explain to me why they might do
24 that?

25 A. Well, you'd have to explain to me what the

00444

1 plans are.

2 Q. Okay. Let's take a look at Exhibit 80,
3 please.

4 A. Eight-zero?

5 Q. Right.

6 A. I'm afraid I don't have it.

7 MS. HOPFENBECK: I'm going to object to the
8 question prior to getting to the document. This
9 witness has stated that he's not familiar with the
10 plans. The question calls for this witness to
11 speculate as to the reasons why there is a
12 differential in the plans. We don't have any
13 foundation established that this witness can do that.
14 In fact, he cannot do that, based on his previous
15 testimony, and I'd object to the question on that
16 basis.

17 Ms. McMahon will be able to answer this
18 question and give the Commission the relevant
19 evidence which would be the reason, in fact, that
20 there is a differential in the rate.

21 MR. THOMPSON: Well, I'd like to ask them
22 both, and I think, given the fact that the witness,
23 Dr. Kelley, is offering an opinion about why there's
24 a difference in certain rates. And particularly, I
25 guess -- well, about in-state and out of state rates,

00445

1 it certainly seems to me that, again, as an economist
2 in the field, he ought to have an opinion about the
3 subject.

4 MS. HOPFENBECK: Dr. Kelley has not
5 rendered an opinion concerning the differential rates
6 charged by any carrier between intraLATA and
7 interLATA in-state rates. The sole opinion stated in
8 his testimony is that higher prices for in-state
9 calls relative to interstate calls are likely
10 explained by higher access charges. So this is
11 beyond the scope of his testimony, as well.

12 MR. THOMPSON: I think that the witness is
13 responding to a statement by Dr. Blackmon in his
14 testimony that -- essentially indicating that there
15 might be -- essentially that the market is currently
16 on thin ice in the sense that there are structural --
17 there are flaws, there are structural flaws that
18 cause certain segments of pricing not to be driven
19 down to margin of cost, and I think this is the same
20 issue, whether it's not the identical issue.

21 JUDGE CAILLE: The objection is overruled.

22 Q. Okay. On --

23 A. I'm sorry. I don't have a copy of that
24 exhibit.

25 Q. I could just tell you, maybe, what the rate

00446

1 is. How about that?

2 A. I'd rather look at it.

3 Q. Okay.

4 JUDGE CAILLE: Could you give us the
5 reference again, Mr. Thompson?

6 MR. THOMPSON: It's Exhibit 80.

7 THE WITNESS: Okay. I have the exhibit.

8 Q. Okay. I think that most of the information
9 is on the second page of this price list, as you can
10 see from the top, MCI Telecommunications Corporation
11 Washington Price List Number Three. On the second
12 page, it sets out the applicable terms for MCI
13 Everyday Plus. And there's a heading for monthly
14 account fees of \$4.95 a month, and then an intraLATA
15 -- excuse me, interLATA rate of 11 cents and an
16 intraLATA rate of eight cents.

17 A. I see it.

18 Q. Do you see that? Okay. Do you have an
19 opinion about why MCI WorldCom might charge different
20 permanent rates for interLATA and intraLATA calls?

21 A. Well, again, I can only speculate. Let's
22 assume that access charges are the same, and I think
23 I agreed to assume that with you, and many other
24 costs are going to be similar. If that were -- both
25 those things were true, I would say that this might

00447

1 have something to do with the specific marketing
2 objective.

3 For example, I know that in many states the
4 opportunity to provide dial one intraLATA calls is a
5 fairly recent phenomena, and therefore a carrier
6 trying to take away business from US West might price
7 the intraLATA calls almost promotionally for a while
8 at a lower rate with the intention of raising them
9 later to make them equal to interLATA. That's all
10 speculation on my part.

11 Q. Do you think it might be a response to
12 greater competition, then, from US West in the
13 intraLATA segment?

14 A. No. I would say it a little bit
15 differently. It's a response to the fact that, for
16 the first time recently, IXCs have been given the
17 opportunity to compete with US West intraLATA on more
18 even footing.

19 Q. Okay. But they're trying to take away --
20 one of the reasons might be that they're trying to
21 take away customers from US West?

22 A. Sure.

23 MR. THOMPSON: Okay. That's all I have for
24 you, Dr. Kelley. Thank you.

25 JUDGE CAILLE: Excuse me, Mr. Thompson,

00448

1 were any of the exhibits -- do you have an exhibit to
2 offer?

3 MR. THOMPSON: Yeah, I think there's only
4 one exhibit that was not previously admitted that I'd
5 like to move admission of, and that's Number 109. I
6 think all the rest were responses to data requests
7 and were mentioned by Ms. Hopfenbeck yesterday as
8 part of the documents that were stipulated into the
9 record.

10 JUDGE CAILLE: Is there any objection to
11 the admission of Exhibit 109?

12 MS. HOPFENBECK: No objection.

13 MR. CROMWELL: No objection, Your Honor.

14 JUDGE CAILLE: Mr. Thompson, what about
15 Exhibit Number 30? I think -- did you reference that
16 during your cross-examination?

17 MR. THOMPSON: Oh, thanks for catching
18 that. Yes, I'd like to move for admission of that,
19 as well.

20 JUDGE CAILLE: Is there any objection to
21 the admission of Exhibit Number 30?

22 MS. HOPFENBECK: No. And Your Honor,
23 Exhibit 30 has already -- is part of the stipulated
24 exhibits.

25 JUDGE CAILLE: Oh, it is, okay.

00449

1 MR. THOMPSON: I actually didn't have it on
2 my list, but --

3 MS. HOPFENBECK: Oh, I didn't? I
4 apologize. That was one of those I left out.

5 JUDGE CAILLE: One more, Exhibit C-29. Is
6 that not offered?

7 MR. THOMPSON: I don't think we've referred
8 to that yet.

9 JUDGE CAILLE: All right.

10 MR. THOMPSON: Thank you.

11 JUDGE CAILLE: Mr. Cromwell.

12 MR. CROMWELL: Yes. If I may?

13 C R O S S - E X A M I N A T I O N

14 BY MR. CROMWELL:

15 Q. Good afternoon, Dr. Kelley.

16 A. Good afternoon, again.

17 Q. I will try to minimize repetition, if
18 possible. In your testimony, you cited to the growth
19 of the Internet as a relevant factor affecting
20 telecommunication markets, did you not?

21 A. I did.

22 Q. Are you familiar with the phrase voice over
23 IP, or VoIP?

24 A. I am.

25 Q. And are you aware of what share of the

00450

1 Washington long distance mass market is taken by VoIP
2 products?

3 A. I am not.

4 Q. Would you estimate that it is less than one
5 percent?

6 A. I don't know. I would agree it's probably
7 small at this point.

8 Q. Probably significantly less than one
9 percent?

10 A. I don't know.

11 Q. In your opinion, is voice over the Internet
12 products likely to play a price constraining role in
13 the mass market for intrastate long distance in
14 Washington during the next 12 months?

15 A. Well, again, in terms of Internet time and
16 telecommunications time, 12 months can be an
17 eternity.

18 Q. In this instance, I'm referring to the
19 literal 12 months?

20 A. The calendar years?

21 Q. Yes.

22 A. Literal 12 months and Moore's law and all
23 of that, I think I've said my expectation is it's
24 going to take some time to bring IP voice up to the
25 quality of current circuit switched voice, and it may

00451

1 well take a year, so I guess I'll agree with you.

2 Q. Okay. Would you think that likely in the
3 next two years, two calendar years?

4 A. I think much more likely, yes. Whether
5 it's likely or not now, I think it could well be a
6 factor in two years.

7 Q. Just to be clear, I'm not asking whether --
8 when, as you described it, voice over Internet
9 telephony or IP telephony is the same level of
10 quality as switched voice capability, but rather when
11 those products are likely to play a price
12 constraining role in the mass market or intrastate
13 long distance in Washington.

14 Do you believe that is likely to occur with
15 -- I suppose the assumption in my question being,
16 based upon what you've said already, that that level
17 of quality would have been reached and that it would
18 take some measurable amount of time for those
19 products to affect the market, as the foundation of
20 the question relates?

21 A. I think I lost you somewhere along the
22 line. I mean, let me say that the market -- we start
23 from a position in which the market's competitive,
24 and Dr. Blackmon agrees with that. When will
25 Internet voice be a significant choice for consumers.

00452

1 I think, you know, in the next two years, it could
2 well be. We have AOL marketing with Talk.com right
3 now, and they've acquired a lot of customers. I cite
4 that in my testimony. And AOL I can see
5 transitioning very neatly and quickly to an Internet
6 voice product with the customer base that it's
7 already built.

8 Q. Just so that I'm clear, you believe that it
9 is possible, from that time window of one year to two
10 years, well, for 24 months, that they could play a
11 role in the market?

12 A. Certainly possible.

13 Q. But you don't have an opinion on whether or
14 not that role would be a price constraining one?

15 A. Well, I mean, as I said, the market's
16 constrained by existing competition. When are these
17 guys going to be a factor in the market and start
18 taking customers away along with all the other
19 carriers who are taking customers away in significant
20 numbers, I don't know, but certainly within two
21 years, there's a feasibility.

22 Q. Let me ask perhaps a more fundamental
23 question, Dr. Kelley. In your opinion, what
24 percentage of market share would a company in the
25 market we've been discussing need to -- what percent

00453

1 of market share would need to be acquired in order to
2 constrain the pricing of AT&T and merged WorldCom,
3 who presumably will each have more than a third of
4 the market?

5 A. I don't think I can answer that question,
6 because market share is only one of the things you
7 would look at. There are lots of firms in the market
8 with -- lots of firms with capacity, and you know, in
9 theory, a firm with zero market share and a lot of
10 capacity could constrain market. That's the first
11 point I'd make.

12 The second point I'd make is, again, we
13 have to go back to the point that the market is
14 competitive already.

15 Q. So in your opinion, it's possible for a
16 company that has less than a half of one percent of
17 the market to constrain the pricing of AT&T?

18 A. I said theoretically possible. There are
19 economic models that would show you that, that I
20 wouldn't necessarily subscribe to, but there are
21 economic models that would show you that.

22 Q. Going from the realm of the theoretical to
23 the realm of what we have in Washington, what do you
24 think, in your opinion, would be likely in the actual
25 realm, rather than the theoretical one?

00454

1 A. I have to answer that in terms of the
2 elasticity of supply of other firms. You're asking
3 me, basically, to assume a counterfactual, that MCI
4 and Sprint together might be able to exercise some
5 market power, and what would it take to turn that
6 around. And it's counterfactual, because I don't
7 think they can exercise such market power.

8 Well, it would take a firm with capacity to
9 complete calls, to transport calls, to switch calls,
10 to bill calls and to market calls, and there are lots
11 of firms out there today that have that capacity.

12 Q. I have to apologize, Dr. Kelley. I'm just
13 trying to avoid duplicating some of my questions with
14 Mr. Thompson.

15 It is also your testimony, is it not, that
16 growth in the long distance transmission capacity of
17 the emerging carriers is a materially competitive
18 factor?

19 A. Yes.

20 Q. And you believe that growth in capacity has
21 allowed emerging carriers to, and I quote, attract
22 customers from the major long distance carriers, end
23 quote?

24 A. Emerging carriers, yes.

25 Q. And when you said that, who did you mean

00455

1 when you said the major long distance carriers?

2 A. Can I ask where we are here?

3 Q. Certainly. It's in your rebuttal
4 testimony, page nine, lines 12 to 23, I believe.

5 Actually, I gave you my copy of your testimony, so
6 I'm going off my notes.

7 A. Yeah, I guess the major long distance
8 carriers there, I was referring to AT&T, MCI, Sprint.

9 Q. i.e., the Big Three?

10 A. I don't like to use that word, but --

11 Q. It's common for others to use that phrase?

12 A. The biggest of the three, the biggest three
13 of the rest.

14 Q. Is it common in the industry for that term
15 to be used to reference AT&T, MCI and Sprint?

16 A. I've heard that term, certainly.

17 Q. When you also made that statement in your
18 testimony, which specific customers were you
19 referring to?

20 A. Well, I think all customers. Later on in
21 my testimony, which we talked about already, there's
22 specific data about mass market residential
23 customers, but also large business customers.

24 Q. And is it your testimony, Dr. Kelley, that
25 the growth in long distance transmission capacity is

00456

1 relevant to the decision-making of mass market
2 customers?

3 A. That the existence of capacity is -- are
4 you reading from here?

5 Q. No, it's a question.

6 A. Okay. The question is is it relevant to
7 customers that carriers have capacity, and I guess
8 the customers don't care who's carrying their calls,
9 but the fact is that the fact -- given that there's
10 capacity out there, there are carriers who can use
11 it, there are carriers who own the capacity or
12 carriers that resell the capacity that can provide
13 choices to consumers, and that's relevant to them.

14 Q. Speaking hypothetically --

15 A. Sorry I'm speaking so fast.

16 Q. I'm sorry. Speaking for a moment,
17 hypothetically, Dr. Kelley, is it economically
18 sustainable for a reseller of any type of product to
19 undercut the prices of the company from whom it is
20 purchasing that product when competing with that
21 originating company in a relevant market?

22 A. Yes.

23 Q. How would that be economically sustainable?

24 A. We're talking about a hypothetical that
25 probably doesn't have anything to do with the

00457

1 existing long distance market, but if the vertically
2 integrated carrier that is the one who has the
3 wholesale and the retail, is charging a very high
4 retail margin, then a reseller can undercut it.

5 Q. When purchasing services from that company?

6 A. Sure. If it's buying services for a dollar
7 from a company that's charging \$2, and the reseller
8 only has costs of 50 cents, it can undercut it.

9 Q. Dr. Kelley, I'd like to return a moment to
10 our prior discussion of US West and RBOC entry. Your
11 testimony also addressed competitive entry by the
12 RBOCs, did it not?

13 A. It did.

14 Q. And do you have an opinion on when US West
15 will receive its Section 271 approval from this
16 Commission and the FCC?

17 A. I was in the room yesterday when we were
18 discussing this with Mr. Porter, I believe. And if
19 my recollection is correct, I mean, it looks like not
20 in a year, but maybe in two years.

21 Q. Are you basing your testimony now upon what
22 Mr. Porter said?

23 A. Well, I don't have an exact recollection.
24 I know you had a colloquy with him about that and you
25 talked about the schedule and the fact that US West,

00458

1 you know, certainly isn't there yet. It's going to
2 take a while.

3 Q. My question was whether you had an opinion
4 on that matter. Do you have -- is that something you
5 have an opinion on?

6 A. I do, and it's based on the following. US
7 West is merging with Qwest. Qwest is a long distance
8 carrier that's building a very large nationwide
9 network, some of which it's selling off in this part
10 of the world because of the restrictions in the '96
11 Act, but Qwest has an interest in becoming a major
12 long distance player, and they are becoming a major
13 long distance player all over the country.

14 My belief is that when Joe Nacchio takes
15 over US West, he's going to explain to them that if
16 Bell Atlantic New York can do it, they can do it, and
17 they ought to do it.

18 Q. Are you familiar with Mr. Nacchio's
19 business practices?

20 A. I am.

21 Q. And do you believe he will be successful in
22 changing the corporate structure of US West
23 sufficient to make that happen?

24 A. I think the market test shows that he is a
25 very strong-willed person.

00459

1 Q. When do you believe it is likely to occur?

2 A. I don't know when the merger's going to be
3 consummated. Obviously, it will take some time for
4 the dynamic that I hypothesized here to work its way
5 out, but within that two-year framework we're talking
6 about, I think it could occur.

7 There's another thing that's happening
8 here, and that is it's taking much longer than
9 anybody thought, when the '96 Act passed, for the
10 RBOCs to get authority, but we do have Bell Atlantic
11 in New York, we have Southwest Bell in Texas, who is
12 at the FCC, but hasn't cleared the hurdles yet.
13 What's going on here is a learning experience. And
14 as the Section 271 is being administered by the 271,
15 it appears that a critical element is the ability to
16 do OSS. And once we get two or three carriers who
17 know how to do it, have learned how to do it and have
18 vendors who have helped them do it, I expect
19 something like a domino effect.

20 Q. Recognizing that you believe it to be
21 counterfactual, I think was your phrase, I would ask
22 you to express an opinion on how much market share US
23 West would need to acquire in the long distance mass
24 market to constrain pricing of AT&T and the merged
25 WorldCom?

00460

1 A. In that -- again, in the counterfactual,
2 you know, as both Dr. Blackmon and I agreed, the
3 market's competitive now. Counterfactual situation
4 that it were not, if the BOCs came in, it wouldn't
5 take long at all. The BOCs have demonstrated the
6 capacity to acquire customers very quickly.

7 Q. How long is not long at all?

8 A. Within months, and maybe even days. I
9 mean, the grant of the authority in this hypothetical
10 situation could be enough.

11 Q. Dr. Kelley, in your testimony, you state
12 that emerging carriers have captured a significant
13 share of the residential pre-subscription and
14 direct-dial long distance minutes, do you not?

15 A. Correct.

16 Q. What does significant mean in this context,
17 sir?

18 A. Well, I'm relying, I think, on FCC data on
19 this point, and I'm looking for my exhibit. But I
20 believe, as of 1998 -- maybe I should just try to
21 find it.

22 Q. I guess, just to clarify, what I'm really
23 getting at is your definition of significant in this
24 context?

25 A. Twenty percent is certainly significant,

00461

1 and they're at that range in '98, and that's a long,
2 long time ago.

3 Q. So you'd consider 20 percent significant?

4 A. Yes.

5 Q. And would 10 percent be significant?

6 A. Yes.

7 Q. Why?

8 A. If the competitors have -- again, it's an
9 elasticity of supply issue. If the competitors have
10 the capacity for transport, the switching capacity,
11 the marketing capacity and the billing capacity, yes.

12 Q. And extrapolating what appears to be your
13 opinion regarding the other factors, with capacity
14 elasticity and the others taking it down to one
15 percent or less?

16 A. Yeah, if I'm looking at elasticity of
17 supply here in this counterfactual situation.

18 Q. You stated that the established brand names
19 of major carriers are becoming less important, did
20 you not?

21 A. I did.

22 Q. And in your opinion, is this also true of
23 the long distance mass market?

24 A. It is.

25 Q. Do the companies assign value to the brand

00462

1 names?

2 A. I'm not sure I understand the question.

3 Q. Do the petitioners have names that are
4 branded?

5 A. They do.

6 Q. And do you have knowledge on whether or not
7 they ascribe monetary value to the existence of those
8 brand names?

9 A. I don't know. There's some accounting
10 issue in there. They may not.

11 Q. Do you think it's a marketing issue?

12 A. Do I think what is a marketing issue?

13 Q. The value of a brand?

14 A. The -- I mean, the question was do the
15 companies ascribe value. I don't know. If you're
16 asking me do the brands have value, I would say the
17 answer is probably yes, and I would say that events
18 in the long distance market demonstrate that other
19 companies can build valuable brands, as well.

20 Q. Let's look at the other side of that coin.
21 How do mass market customers assign value to a brand?

22 A. Brands -- I mean, looking at -- if you're
23 looking at economic theory, brands convey information
24 about, for example, quality. And one of the reasons
25 I believe that, you know, the existing brand names

00463

1 are becoming less valuable is the Internet that we
2 talked about earlier. Information is much easier to
3 acquire. The customer switching data we've all seen
4 show the customers are trying different brands.

5 MCI has tremendous churns, people going in
6 and out of their brand. So they are sampling other
7 brands and acquiring information about the brands,
8 and they can do it at fairly low cost in
9 telecommunications through dial-around, which is
10 basically zero cost or through pre-subscribing to
11 another carrier, which is obviously inherently easy
12 to do.

13 Q. Dr. Kelley, in your opinion, is the
14 residential long distance market a distinct market?

15 A. I'm trying to remember what I said. I
16 think --

17 Q. It's not keyed off your testimony. I'm
18 just asking you your opinion.

19 A. Yeah. I think we tend to think as -- it's
20 not an antitrust analysis, per se, but we tend to
21 think of residential and small business being -- I
22 mean, having a set of demand characteristics that
23 might be different than large business.

24 MR. CROMWELL: Thank you for your time, Dr.
25 Kelley. I have no further questions.

00464

1 THE WITNESS: Thank you.

2 C R O S S - E X A M I N A T I O N

3 BY MR. PASCARELLA:

4 Q. Good afternoon, Dr. Kelley. My name's Pat
5 Pascarella. I'm an attorney with SBC.

6 A. Good afternoon.

7 Q. On page 43 of your testimony, there's a
8 question, and the answer carries over onto the next
9 page. The question is, Will the merger eliminate
10 potential competition between MCI WorldCom and Sprint
11 in the local exchange market?

12 Could you define potential competition for
13 me, as you interpreted it to answer that question?

14 A. Potential competition refers to a situation
15 where there is -- a company may have the capacity, in
16 a broad sense, to serve a market, but has not yet
17 entered the market. And in economics, there is a
18 view that potential competition can constrain the
19 prices of the firms that are in the market.

20 Q. Your answer to that question in your
21 affidavit and your testimony here was no. I look
22 back a few pages, though, on page 40, and I see
23 another statement that you made, and I'm trying to
24 understand why these aren't inconsistent statements,
25 and I want to give you the opportunity to tell me

00465

1 what I'm missing.

2 You say, at the top of page 40, in
3 reference to a question that deals with broadband
4 wireless as a local exchange alternative, you say
5 that MCI WorldCom could, of course, develop an
6 independent alternative to Sprint's ION service.
7 Wouldn't that make MCI a potential competitor of
8 Sprint's?

9 A. Yes. The question on page 43 is will the
10 merger eliminate potential competition. And I don't
11 want to -- angels dancing on the head of a pin here,
12 but potential competition and a potential competitor
13 are two different things.

14 Q. Okay. So when you were answering the
15 question on page 43, what you meant was that the
16 merger won't eliminate all potential competition --
17 well, why don't you tell me what you meant? If MCI
18 WorldCom is a potential competitor of Sprint, how
19 does the merger not eliminate potential competition
20 between them?

21 A. There are a lot of broadband players out
22 there, Covad, Rhythms Net, NorthPoint, and a bunch of
23 them. Those generally compete with ION-type
24 services. And so a merger between two potential
25 competitors for that niche in the market would not

00466

1 have an anticompetitive effect.

2 Q. I'm not talking about the anticompetitive
3 effects, and you might want to look harder at the
4 question on page 43, because it says, Potential
5 competition between MCI WorldCom and Sprint.

6 A. Oh, okay.

7 Q. Taking a closer look at the question, now,
8 is your answer to that question still no?

9 A. Yes, with -- interpolated between the next
10 sentence, the point that, no, it will not eliminate
11 any competition that could potentially constrain
12 behavior in the market. Sprint could build CLEC
13 facilities, and that's what I talked about in this
14 answer on page 43 and page 44. The fact is they
15 haven't, but the fact is lots of other people have.
16 Therefore, the merger between them does not constrain
17 or eliminate potential competition.

18 MCI could be a DSL carrier or develop an
19 ION-like service, but since there are other carriers
20 out there that can do it and are doing it, it doesn't
21 eliminate potential competition.

22 Q. But MCI is a potential competitor?

23 A. Yeah.

24 Q. Let me ask you a bigger question. Longer,
25 anyway. You said you were here yesterday for some of

00467

1 Mr. Porter's testimony. And we heard from Mr. Porter
2 and from some other witnesses that this merger is
3 necessary to assure the viability in the marketplace
4 of MCI and Sprint. You used that word, viability.

5 And there's some folks that look at the
6 merger and they say, well, the result of this merger
7 is that there's some increase in concentration. I
8 won't characterize it, but some would characterize it
9 as a significant increase in concentration in some of
10 the markets. And in response to that, WorldCom and
11 Sprint say, no, the merger of these two companies and
12 any anticompetitive effects that would result from
13 that will be disciplined by this array of
14 significantly, in most cases, smaller carriers that
15 are either not yet in the market or just in the
16 process of entering the markets at issue here.

17 And I'm having trouble understanding how,
18 in a marketplace where the second and third largest
19 long distance companies in the United States have to
20 merge to remain viable, we can expect that combined
21 entity to be disciplined by much smaller companies
22 with much fewer offerings and much smaller areas of
23 geographic coverage?

24 A. Okay, sure. Let me try and think about the
25 shortest way to say this.

00468

1 Q. It was a long question. You're entitled to
2 a long answer.

3 A. MCI and Sprint and AT&T are obviously large
4 players in the mass market. They are looking in the
5 near future at the prospect for BOC entry. And in
6 the state of New York, they are incurring that entry.
7 Their view is, I would take it from the colloquys
8 that you had yesterday, that in order to be an
9 effective competitor for all of the customers in that
10 mass market, which is what they want to do, they have
11 to have a local alternative. And they view their
12 merger through the synergies that are derived,
13 particularly the MMDS and the ability to -- I'm
14 sorry, I'm going too fast.

15 They look at the merger because it provides
16 them opportunities in MMDS and through UNEs as
17 something that will help them compete with the RBOCs
18 for those mass market customers who have a strong
19 preference for bundled services.

20 I think what happens is if we get that kind
21 of entry from MCI and Sprint, and if AT&T is
22 successful -- and that's the other leg of this
23 argument. AT&T is out there developing their own
24 alternative, you're going to have three viable
25 facilities-based local companies that can provide

00469

1 bundled service. And then, the next step, and this
2 is very key, the next step is once you get
3 facilities-based competitors providing local service,
4 then you have happening in the local market,
5 hopefully, what has happened in the long distance
6 market, where MCI sells capacity to its competitors.
7 Because it thinks it's a reasonable thing to do. It
8 would rather sell that capacity to its competitors
9 than not sell its capacity to those competitors,
10 because if MCI doesn't, someone else will.

11 In the current state of the market, the
12 RBOCs don't care about selling capacity to their
13 competitors, because they know no one else will. So
14 at the end of the day, if we can get viable
15 facilities entry from MCI/Sprint -- WorldCom, I
16 guess, /Sprint, AT&T and the RBOCs, the RBOCs are
17 going to wake up one morning and say, Hey, if we
18 don't cooperate with the resellers and make available
19 to them a reasonable way to provide bundled services
20 to mass market customers, we're going to lose
21 business to WorldCom-Sprint and to AT&T, so that's
22 the dynamic I have in mind here.

23 Q. Why would, if we accept your assumption
24 that neither the RBOCs nor AT&T are interested in the
25 wholesale market, just for purposes of this

00470

1 discussion, if we accept that, why would MCI have the
2 incentive to offer wholesale product? Do they have
3 different incentive than AT&T and the RBOCs in that
4 situation?

5 A. I think you can't look at one carrier in
6 isolation there; you have to look at the market. And
7 at some point, and I hope it's three viable
8 facilities-based carriers who have sunk investment
9 dollars into the market and built capacity. At some
10 point, they're going to look around and say, Hey, if
11 I don't sell, somebody else will.

12 Q. So all these other carriers that we list in
13 here, there's one listed as being changed today from
14 59 to another number, and we identified lots of long
15 distance carriers in there.

16 A. Yes.

17 Q. What's the point of identifying all these
18 carriers if the point of your affidavit is to explain
19 why this merger is procompetitive?

20 A. I lost you there. I'm sorry.

21 Q. Okay. Either they will discipline the
22 market or they won't.

23 A. The local market.

24 Q. Well, let's talk about the long distance
25 market. Well, let me start again with you. We have

00471

1 spent, in the last two days, a great deal of time
2 talking about what some people refer to as second
3 tier carriers, but --

4 A. Emerging carriers.

5 Q. Emerging carriers. And you seem to believe
6 they have a restraining effect on some market
7 segments that are relevant, for purposes of looking
8 at this merger; is that correct?

9 A. Some, if not all.

10 Q. Okay. Which segments, which markets?

11 A. I guess we have to go back to the basics.
12 These carriers have capacity to transport calls, to
13 switch calls, to bill calls and to market to
14 customers, small and large.

15 Q. Which specific product markets are you
16 talking about? For example, are we talking about the
17 mass market long distance?

18 A. Yes.

19 Q. Okay.

20 A. And large business market.

21 Q. Long distance?

22 A. Long distance.

23 Q. Okay. Any other markets that these
24 carriers are likely to be able to restrain the price
25 of a combined WorldCom-Sprint?

00472

1 A. I think -- if you're getting at the local
2 issue, I think local competition is a big player
3 game. If you're going to play with US West in the
4 local market in Washington, other than fiber loops
5 and core areas, you're going to need to be big. And
6 I see AT&T trying to do that with cable, and I see
7 MCI and Sprint merging in order to try to do that
8 with wireless.

9 I don't necessarily see -- I was going to
10 say Qwest, but that doesn't work anymore. I don't
11 necessarily see Frontier having a leg into local mass
12 markets. Certainly they're going to build fiber
13 loops in big cities, and technology may involve in
14 wonderful ways to change that in the future. But,
15 you know, for the next few years, I see local
16 competition as a big player game.

17 Q. You're familiar with the Department of
18 Justice Merger Guidelines?

19 A. I am.

20 Q. Under the guidelines, is a merger specific
21 efficiency in Market A gained from the merger weighed
22 against an anticompetitive effect of the merger in
23 another market?

24 A. My understanding is that it would not be,
25 but my understanding is, you know, guidelines are

00473

1 guidelines. They're not necessarily what a court
2 would decide. I'd also point out this Commission has
3 a public interest test that they're looking at, which
4 would be a different test.

5 Q. What I was trying to do was focus our
6 earlier discussion a little bit -- strike that.

7 Is it your opinion that this merger is
8 necessary to the viability of MCI and Sprint --
9 WorldCom and Sprint, excuse me, in the long distance
10 markets? I can rephrase that for you. Will MCI and
11 Sprint, in your opinion, remain viable competitors in
12 the long distance market without this merger?

13 A. We're talking about a broad long distance
14 market?

15 Q. You define it, and then answer the
16 question. How's that?

17 A. Yeah, I think MCI, Sprint and others are
18 going to be viable RBOC entry, at least I hope and
19 expect that they will, and if the 271 standards are
20 applied appropriately, perhaps they will. In terms
21 of the mass market, I think that there is a concern
22 that they won't be able to compete for customers who
23 want bundles, and maybe for a lot of business
24 customers who want bundles, unless they have that
25 local entry vehicle.

00474

1 Q. Okay.

2 A. I would also point out that, you know, that
3 UNE competition, UNE loops, that's good, that's a
4 fine thing, but facilities-based competition is
5 better.

6 Q. In this marketplace, it's better to own the
7 facility than it is to be leasing someone else's?

8 A. In this marketplace, yes. In a marketplace
9 where there's a choice of local carriers, it wouldn't
10 be as important.

11 Q. Why is that?

12 A. Because the local competitors would compete
13 with each other for the business of companies who
14 want to use local facilities that they provide.

15 Q. Are you aware of any plans by WorldCom or
16 Sprint to provide voice via MMDS?

17 A. My understanding is that it was not MCI's
18 original intention to do that with MMDS, but that it
19 was Sprint's intention, beginning with ION, to do
20 that. And part of this depends on the discussion we
21 were having about Internet voice and the time it
22 takes to develop that technology to make it
23 comparable in quality to circuit switched voice.

24 Q. Do you have in mind any possible time
25 horizon for a voice offering via MMDS?

00475

1 A. That would be better directed at the
2 companies, but -- I hope I'm not making this up. I
3 thought I heard Mr. Kapka say within a year or two.

4 Q. When you talk about MMDS as a local option,
5 is that the time horizon you have in mind?

6 A. Well, MMDS, I mean, you can build it today.
7 And there are trials out there today, and I fully
8 expect the FCC to grant two-way licenses and, you
9 know, the service will go forward. And it will start
10 as a broadband offering. And then ION will be
11 developed and deployed over it, and ION has voice
12 capabilities. And I expect at some point, you know
13 -- I'm not George Gilder, I don't predict future
14 technologies, but at some point, IP voice will be
15 developed and be viable and be used.

16 Q. You used in your affidavit, for instance,
17 on page eight, the term all distance and the term
18 bundled markets. Could you tell me how you define
19 those two terms? I'm sorry, on page eight. It would
20 be on line 10 and 11.

21 A. All distance refers to the fact -- I may
22 discuss it in here later, that with technological
23 change, you will be buying a circuit to your home or
24 buying a pipeline, and you would use that pipe for
25 all of your calls, and your calls would not be priced

00476

1 separately depending on whether they happen to be
2 local or long distance, maybe some day, even
3 international.

4 A bundled market means that you're taking,
5 in today's terms, a service, like local, and
6 purchasing a package with wireless or with long
7 distance similar to this US West offering that Mr.
8 Kapka showed us earlier today, all the ways you
9 communicate in one neat little bundle. That's what a
10 bundle is.

11 Q. So you had an example of a bundled offering
12 there. Do you have any examples of all-distance
13 offerings?

14 A. I think it's the wireless players are
15 providing all distance today. You can buy from any
16 number of carriers a bucket of minutes. And it
17 doesn't matter whether those are local or long
18 distance, they count towards your bucket.

19 Q. Any other offerings? Any other
20 all-distance offerings?

21 A. Well, the Internet is an all-distance
22 offering, isn't it. Twenty dollars a month, all you
23 can eat. You can go to a web site in Moscow or you
24 can go to a web site down the street.

25 Q. Okay. Any others?

00477

1 A. That's all that come to mind right now.

2 Q. Okay. On page -- I guess it's page 14. It
3 carries over onto page 15. You're talking about the
4 investments of competing carriers, and you say the
5 investment in fiber is sunk. As an economist, what
6 is the significance to you of that fact, the fact
7 being that the investment is sunk?

8 A. Sunk investment is one which, once made,
9 can't be recouped or is difficult to recoup. And the
10 significance is that once you sink an investment, you
11 have a huge incentive to use it, as much as you can.
12 The incremental -- if you will, the incremental cost
13 is, for the sunk portion of investment, is
14 effectively zero. There's no opportunity cost.

15 Q. Would you expect that incentive to be
16 different as between, say, a company -- say Frontier
17 and Sprint, or is a sunk cost a sunk cost?

18 A. Well, it's easy to say a sunk cost is a
19 sunk cost, and you're asking me to infer how carriers
20 in a market, in different positions in a market,
21 might behave, and I want to leave open the
22 possibility that there might be differences. I
23 haven't analyzed that or seen the relevant article.

24 Q. Absent some other factor, a carrier with a
25 sunk cost in investment would have a fairly high

00478

1 incentive to sell the service that uses that
2 investment; correct?

3 A. Correct.

4 Q. Can you think offhand of any factors that
5 would chill that incentive?

6 A. If the firm had market power.

7 Q. On page 17 of your testimony, you're
8 referring to Dr. Blackmon's affidavit up at the top
9 part of the page there. And at line four, you say,
10 He bases his finding on the claim that resellers
11 cannot be expected to constrain the prices of their
12 own suppliers.

13 Do you disagree with that statement, the
14 statement being resellers cannot be expected to
15 constrain the prices of their own suppliers?

16 A. Well, we went through a hypothetical with
17 Public Counsel in which that could be. But if you're
18 asking me the reality of today's communications
19 market, long distance, they don't need to, because we
20 have a competitive situation and you can buy
21 wholesale capacity at competitive rates and retail is
22 priced at competitive rates. If you think you can
23 get into a niche and compete, you just go ahead and
24 do it.

25 Q. So a supplier of capacity cannot restrain

00479

1 -- let me try that again. A supplier of capacity --
2 one more time. It's getting late. I'll try to wrap
3 up real quick.

4 A. I'm trying to give you short answers.

5 Q. I appreciate that. Look for me, if you
6 will, on page 19. Maybe you just want to clear this
7 up, but I didn't understand. There's a question at
8 line 10 that says, How does technological change
9 impact the ability of carriers to maintain prices
10 above cost. And your answer is that, quote, All
11 customers, residential, small business, and large
12 business, have a growing number of alternatives
13 because of the emergence of new carriers with a new
14 network capacity on which they can rely and because
15 of changes in technology.

16 Then you go on to say, quote, These
17 alternatives increasingly will constrain the ability
18 of the merged MCI WorldCom-Sprint to raise prices to
19 large customers.

20 We started talking about residential, small
21 business and large customers, then we seem to have
22 limited the constraining effect of these alternatives
23 to just large customers. Was that intentional?

24 A. No. Thank you for picking that up. I
25 think it will have effect of constraining prices

00480

1 across the board.

2 Q. So your affidavit's incorrect right now
3 with regard to the answer --

4 A. Well, no, the answer is correct, but I
5 didn't mean to exclude smaller customers.

6 Q. Okay. So that's just what we might call a
7 typographical error. You just omitted smaller and --

8 A. Momentary brain spasm.

9 Q. -- residential and small business customers
10 from that sentence. On page 20, you use Winstar as
11 an example as a broadband data network that's growing
12 in importance to users, and you say that Winstar
13 serves Seattle and is competing for local long
14 distance, Internet and data traffic. Do you know
15 whether or not Winstar provides long distance and
16 data over the same network?

17 A. I don't know specifically.

18 Q. Do you know whether Winstar owns its own
19 network?

20 A. I believe they're leasing capacity from
21 others.

22 Q. Do you know who the others are?

23 A. I don't recall. I think it's on their web
24 site.

25 Q. On page 24, I think we might have another

00481

1 typo here. Did you mean to say, on lines five
2 through seven, that Bell Atlantic, GTE, SBC and US
3 West have established and will recognize brand names
4 in Washington? I know that's not a quote, but it's
5 the implication I take from that sentence.

6 A. Bell Atlantic and SBC are just entering in
7 Washington. I mean, certainly for large customers,
8 they're well-known. For smaller customers, they may
9 not be.

10 MR. PASCARELLA: I think I'd better stop
11 there. Thanks, Dr. Kelley.

12 THE WITNESS: Thank you.

13 CHAIRWOMAN SHOWALTER: Our turn?

14 JUDGE CAILLE: Yes.

15 E X A M I N A T I O N

16 BY CHAIRWOMAN SHOWALTER:

17 Q. I think my first line of inquiry has to do
18 with your testimony on page 25, lines 17 to 18. This
19 is where you said higher prices for in-state calls
20 are likely explained by higher access charges. As I
21 read the debate that's in the testimony and also in
22 the questioning today, it goes something like this.
23 Dr. Blackmon thinks there is a competitive problem in
24 this state, and your response is, Well, no, not
25 really. Differences in prices between state-to-state

00482

1 calls and in-state calls can -- are likely explained
2 by higher access charges.

3 Whereupon, Dr. Blackmon or Mr. Thompson
4 says, Well, but then what about comparing in-state
5 intraLATA and interLATA where there is no difference
6 in access charges, and yet, there is a difference in
7 WorldCom's prices, what do you say about that? And
8 I'm not sure what your answer was. But I think the
9 implicit question, and maybe the statement in Dr.
10 Blackmon's testimony is since it's not access
11 charges, because that's not different, couldn't it be
12 that there are different market pressures in the
13 intraLATA and interLATA, and that that's the
14 explanation for the difference, is that there's
15 something different going on.

16 Do you agree with that, that in addition to
17 cost, which is what access charges is about, there's
18 also, on the other side of the equation, market
19 pressures. So couldn't market pressures be part of
20 the explanation for why a company might charge a
21 different rate intraLATA, that is, a lower rate
22 intraLATA and a higher rate interLATA, in a state
23 where there's no difference in access charges?

24 A. Yes.

25 Q. Long question, short answer. That was

00483

1 good.

2 A. But let me say they are certainly different
3 in the sense that, for a long time, intraLATA was not
4 -- you didn't have equal access for intraLATA, so the
5 incumbent sort of had a leg up there. And that's
6 changed, and I speculated that -- Ms. McMahon might
7 be able to help us here. I speculated the company
8 was looking at, you know, a marketing way to try to
9 make up ground in the intraLATA market. And I guess

10 --

11 Q. Are you talking about US West or --

12 A. No, MCI WorldCom, with those rates we
13 looked at, was trying to make up ground in that
14 segment. And then we could also talk about
15 McDonald's again, where the Commissioner pointed out
16 different firms have different strategies and they
17 price bundles of service differently and elements
18 differently, maybe on the basis of demand, and the
19 economics of that, of course, are entirely correct.
20 I just -- I guess my point is, as you move towards,
21 you know, in a competitive situation, those things
22 sort themselves out and consumers have the options
23 they need at the prices that they deserve.

24 Q. Well, but then it appears, anyway, that
25 intraLATA in-state is pretty competitive, but --

00484

1 A. Well, actually --

2 Q. But what about interLATA in-state?

3 Doesn't, on the surface, anyway, doesn't it seem as
4 if it's, for some reason, less competitive than
5 intraLATA?

6 A. No, I guess -- I guess, using my logic, the
7 opposite is true, that because intraLATA is less
8 competitive, because it was historically dominated by
9 US West, you have carriers trying to build share
10 there. Just like a new store comes into town and --
11 Whole Foods came into Boulder, Colorado, and for
12 three weeks, they were selling groceries dirt cheap
13 and built up a huge clientele. People got used to
14 going there, saw that it was a nice store, clean
15 aisles and friendly salespeople, and they raised
16 their prices up to normal levels.

17 Q. So you're saying that the lower prices
18 intraLATA is an indication of a lack of competition?

19 A. Could be, in the short-run situation.
20 Economics can do wonderful things here.

21 Q. It could suggest that companies who are
22 permitted to do so, anyway, are charging lower than
23 their cost. Is that what you're suggesting?

24 A. On a promotional basis. It happens all the
25 time, yeah.

00485

1 Q. But they're competing against a company,
2 i.e., US West, that, at least in regulatory theory is
3 not supposed to be doing that, and so I suppose you'd
4 be suggesting that the nonregulated companies are
5 charging below cost in order to compete with a
6 company that maybe has different costs, but shouldn't
7 be charging the lower cost?

8 A. Yeah, you wouldn't expect to see companies
9 charging below marginal cost, but you could see them,
10 for promotional purposes, lowering rates below their
11 normal rates for marketing reasons that we discussed.

12 Q. Then, now, back in the interLATA, does the
13 fact that companies are required to -- not companies,
14 that consumers are required to purchase their
15 state-to-state provider, their services from the same
16 state-to-state provider as intrastate, interLATA
17 provider -- I probably didn't state that too well,
18 but customers have to use the same provider for both
19 state-to-state and in-state interLATA?

20 A. Right, two-PIC option.

21 Q. Wouldn't that -- isn't that a little --
22 isn't it probable that the in-state interLATA
23 business is a bit of a tail and the others a dog, and
24 that the tail isn't wagging the dog, but the in-state
25 interLATA market is part of a much larger picture;

00486

1 i.e., the national state-to-state market, and that it
2 genuinely could be the case that you're not getting
3 the same kind of competition as you would if that was
4 the universe?

5 That is, if every provider in the in-state
6 interLATA market were independent of the
7 state-to-state market in terms of what they were able
8 to provide, don't you think you would see a little
9 bit different dynamics going on?

10 A. Theoretically, yes. And your question sort
11 of raised another issue for me, in terms of how to
12 think about this, and that is, you know, the two-PIC
13 system interLATA, being interLATA, whether it's
14 intrastate or interstate, could lead -- and I'm
15 speculating here about the company and how it does
16 business, but could lead to motivations to price so
17 that their billing systems worked more efficiently.
18 So that might be a factor here.

19 But I think, to get back to your question,
20 I think there are lots of competitors out there with
21 the ability to enter and try transport and switching
22 and billing and marketing, and I would expect
23 competitive forces to send the right prices out there
24 eventually.

25 Q. Okay. Switching to a different topic, on

00487

1 page 39 of your testimony, on line 19, you say that
2 MMDS provides better propagation characteristics. I
3 don't know what that means. What does that mean?

4 A. Okay. I'll do my best to explain it, and
5 Mr. Porter could probably, with his technical
6 background, explain it better, but the higher you go
7 in the frequency range, the more likely it is that
8 you will get something called multi-path distortion,
9 which means that the signal goes out from the radio,
10 and at very high frequencies, it bounces all around.
11 And then, when you have the receiver over here, it
12 may not be able to figure out which signal it's
13 supposed to be picking up, the direct signal from the
14 tower or signals that are bouncing off buildings and
15 the ground and trees.

16 And the higher you are up in the frequency
17 range, the more that problem exists. The lower you
18 are, the less that problem exists, so that, for PCS,
19 around two gigahertz, it's not much of a problem.

20 MMDS happens to be located in a good place
21 in the spectrum, because it's just a little bit above
22 PCS, and well below the 38 gigahertz broadband. So
23 the technological challenge to get good signals out
24 of an MMDS system is not as great for other broadband
25 wireless systems. I hope I haven't told you about

00488

1 150 percent of what I know about it, but that's my
2 understanding.

3 Q. No, I think what this means to me, then, is
4 the statement here is that MMDS has some physical
5 characteristics that are advantageous to physical
6 delivery of the product?

7 A. Exactly right.

8 Q. I thought it might have to do with
9 marketing or something, so thank you for that. And
10 while we're on this topic, I am a little confused
11 about what Sprint and WorldCom think the merger will
12 do to the relationship of ION to MMDS. I understand
13 that Sprint has an ION product and I understand that
14 the companies think that they will be better poised
15 to deliver MMDS, and I'm not sure how this all adds
16 up.

17 Is it that ION is a service, it's a
18 bundling service, and if MMDS is available, then that
19 kind of service is easier to deliver, or not -- just
20 tell me what you think on that question.

21 A. Here's the way I look at it. ION is a
22 broadband service, and it doesn't care what kind of a
23 pipe it rides on. It can ride on DSL copper to a
24 home, it can ride on broadband wireless, it can ride
25 on fiber built out to a large business customer. MCI

00489

1 has extensive local facilities, certainly much more
2 extensive than Sprint in terms of big businesses in
3 metropolitan areas, and MCI does not have a product
4 comparable to ION, so that, after the merger, ION can
5 be marketed to MCI's customer base using its existing
6 fiber facilities.

7 The other, and I think more significant
8 fact, is that MCI has MMDS licenses in certain parts
9 of the country, and Sprint has MMDS licenses in
10 certain parts of the country and they don't overlap.
11 After the merger, MCI will be very -- I should be
12 saying WorldCom, but it will be very easy to use the
13 WorldCom wireless MMDS facilities that they build to
14 deploy ION more rapidly. So that's a huge advantage.

15 Then, the other thing is, when you merge --
16 I think I talk a little bit about it in the
17 testimony. When you merge their customer bases, the
18 companies have found, for example, in New York, it's
19 easier to sell a local service to an existing
20 customer than to cold call on someone who's not your
21 customer. So I think you'll be able to market these
22 broadband ION services more readily and more cheaply.

23 Q. Okay. Last line. At one point in your
24 answers to Mr. Pascarella, you posited a world in the
25 future where the RBOCs are in the game, in the long

00490

1 distance game, AT&T is in the game with its cable,
2 and Sprint and WorldCom is in the game, meaning the
3 local -- meaning the bundling game, I think, with its
4 ION MMDS.

5 And I think that this world you're drawing
6 here is a way for three different entities with three
7 different technologies or approaches or facilities to
8 compete in, and then I'm not sure -- in the
9 local/long distance or bundled, including local
10 business; is that what you meant?

11 A. All of the above.

12 Q. And by local, do you mean voice and data?

13 A. Yes. Eventually, yes.

14 Q. All right. I'm following that world, but
15 then, when I look at each of those elements, nothing
16 is actually here in front of us. The RBOCs, US West,
17 is not yet in the long distance, it has not yet
18 merged with Qwest, and that issue is actually before
19 us, and we also sit on the 271.

20 AT&T does have cable in some parts of this
21 state, but not all and not in -- doesn't have the
22 local. It has cable TV, but that's it, in some very
23 major markets, including Seattle. So it hasn't yet
24 reached this future stage you're talking about.

25 And then Sprint-WorldCom obviously have not

00491

1 yet merged, but also neither one has actually
2 produced this or is acting on, in Washington, anyway,
3 this new technology.

4 So I understand the dynamic you're laying
5 out, but you know, you have to ask the question
6 either is this vaporware that's promised at some
7 later date, or even if it is a reality at a later
8 date, what about right now?

9 And one question I have is would it make
10 sense for this Commission to impose some kind of
11 conditions on the merger, for example, in the long
12 distance area pending entry into the long distance
13 market by an RBOC, for example. I mean, that is, you
14 justify this merger based on a future that isn't
15 actually here, so even assuming we're going to get
16 there in the future, we're not there now. So is it
17 appropriate for this Commission to safeguard some of
18 these other areas, such as long distance, until
19 there's that instantaneous competition that you're
20 envisioning from US West?

21 A. I believe that we have long distance
22 competition. It's vigorous and it's vibrant, for all
23 of the reasons we've been talking about today and we
24 talk about in my testimony. And you know, the
25 biggest problem we have in telecommunications, and

00492

1 it's the same problem we've always had, is the last
2 mile. And the sooner, the quicker, and the better we
3 get last-mile competition, the better off we're all
4 going to be.

5 I would say, based on my analysis, that by
6 approving this merger, you're going to provide the
7 opportunity for WorldCom and Sprint to deploy these
8 assets more rapidly, more efficiently, to solve that
9 last mile problem. And I think that's the key issue
10 for the Commission and for the telecommunications
11 industry in general.

12 If US West isn't complying with their 1996
13 Act obligations so that they can get in the long
14 distance market, it's even more important to grant
15 this merger quickly, because you need that facilities
16 competition push on that.

17 Q. But you shifted over to the focus on the
18 local, and I'm not saying that's not an important
19 issue, but what about --

20 A. Yeah.

21 Q. -- the long distance, what about the Coeur
22 d'Alene area that will go, I think I understood, in
23 residential long distance, from three providers to
24 two major providers. Now, that, I think maybe we
25 were looking at fiber-based companies and not

00493

1 resellers at that particular point in time.

2 A. Right, right. And GTE serves Coeur
3 d'Alene. They're a market player. They may well
4 have fiber there, but I couldn't find it, so I didn't
5 count it.

6 Q. But I take it from your testimony that
7 you're just not concerned about the long distance
8 market, so the focus, from your point of view, and
9 you would urge from our point of view, be on the
10 local, and that goes in a positive direction --

11 A. Yeah.

12 Q. -- as a result of the merger. We shouldn't
13 worry too much about long distance?

14 A. I guess I don't want to be on the record as
15 being not concerned about long distance. It's an
16 important market and an essential market, but I'm not
17 concerned about market power being exercised in it.
18 And yes, focus on the biggest problem in
19 telecommunications, which is the last mile. And the
20 ability that the competitors will have to solve that
21 problem through merging their complementary assets.

22 CHAIRWOMAN SHOWALTER: Okay. Thanks.

23 E X A M I N A T I O N

24 BY COMMISSIONER HEMSTAD:

25 Q. Well, you may be covering a lot of ground

00494

1 several times here. I'll try to limit my questions
2 here. In your testimony and in your
3 cross-examination here, you put a lot of emphasis on
4 the increase in capacity, but I take it that that
5 focuses primarily on the long distance markets?

6 A. Yes.

7 Q. And I take it you don't see a significant
8 distinction in evaluating that capacity in
9 differentiating between retail and wholesale?

10 A. I think retailers are going to have access
11 to that capacity, because there's a lot of it out
12 there and companies want to use it, so I'm not
13 worried about the retail side of things.

14 Q. All right. And so whether the capacity,
15 say, is absorbed by the so-called Big Three, with
16 increase in demand, or retailers -- resellers could
17 step in, or I suppose these increasing wholesalers,
18 with their increasing capacity, could step into the
19 retail market relatively easily. All of that could
20 happen?

21 A. Right. And what we have going for us is
22 technological change, which means that fiber today
23 can be lit to carry a lot more capacity than fiber
24 five years ago.

25 Q. And from, I think, your response to a

00495

1 question under cross-examination, is it fair to say
2 you would apply the HHI to overall capacity, rather
3 than to, as Dr. Blackmon does, to revenues?

4 A. Well, it's legitimate to do both, and both
5 will provide you information. My problem with Dr.
6 Blackmon's analysis is that he stops there, and I
7 would start there. I think the Justice Department
8 uses HHI analysis as a screening device and, you
9 know, they see a high HHI, based on their guidelines,
10 they say, Oh, you better get some more information
11 here, we better look at this more carefully.

12 And as I discussed in my testimony, the
13 Department will look at factors like the ease of
14 entry and the availability of capacity to do a
15 complete analysis before they reach a decision.

16 Q. Well, is it your sense that there will, in
17 fact, be more participants, say, in a couple years
18 because of this increased capacity, or do you look at
19 it where you don't have to answer that, because it
20 offers potential competition, and that's sufficient?

21 A. Well, there's already a lot of capacity
22 built, planned and being built by a lot of firms, and
23 I would say that we don't have a problem. And I
24 would say that if problems were to emerge, capacity
25 were short, it's sort of a self-revealing thing. The

00496

1 competitors in the market have revealed they can get
2 the capital and the rights of way to build the fiber
3 that the market needs to provide services that
4 customers want.

5 Q. Well, then, the second half of this is the
6 local market, and I take it from your broad,
7 generalized testimony here that this merger is
8 important in order to have the kind of bundling
9 needed, all-distance marketing and the like, and the
10 merger is essential for that to occur?

11 A. Yeah, I guess I would start a step back
12 from that and say local competition, per se, is a
13 very good thing, with or without bundling. But given
14 that sooner or later the RBOCs are going to find
15 their way in, then it's critical that we have more
16 than one facilities-based bundle available.

17 Q. And is the capacity question relevant to
18 that at all?

19 A. Local capacity, I believe, yes. The
20 capacity I talked about most often in the testimony
21 refers to long haul fiber. I think the local fiber
22 that's going in is important and significant, but
23 that technology is not going to be there for the mass
24 market.

25 Q. Okay, all right. So essentially, the

00497

1 capacity discussion is separate from or segregated
2 from the debate going on here about local service
3 viability or separable --

4 A. Yeah, I think so. I mean, clearly, the
5 merger between WorldCom and Sprint will enable them
6 to build the capacity to serve local more effectively
7 and more rapidly, but it's not -- you're right, it's
8 not the long distance capacity argument I've been
9 talking about.

10 Q. And you see the -- well, the merger being
11 necessary to protect, say, Sprint, as -- call it the
12 weaker party here, or Sprint's viability is at risk
13 if a merger like this doesn't occur, apparently, for
14 it to be able to compete effectively in the local
15 market, or both?

16 A. Yeah, I think, as we discussed, Sprint,
17 before MMDS, had not done a lot in the local market.
18 They don't have nearly the collocations MCI has, they
19 don't have local fiber networks that MCI has. In
20 terms of their viability, I mean, part of that is --
21 what we heard from Sprint is that they didn't -- you
22 know, they think if they didn't merge with MCI,
23 somebody else less pleasant would come along, and so
24 Sprint feels that they're not viable as an
25 independent company, because somebody's going to

00498

1 acquire them for their assets, and they see a good
2 marriage with WorldCom.

3 Q. But all these other -- call them the
4 capacity new entrants currently here or potentially
5 coming, they don't have a similar kind of viability
6 risk concern, because they're in the long distance
7 market?

8 A. I think there will be a -- yes, there is an
9 all-distance, and yes, there is a bundled market
10 evolving, but there will, for some time to come, be
11 customers who want to buy separate long distance
12 services, so the risk isn't that that market will go
13 away.

14 I think the opportunity is, with this
15 merger, you're going to get local competition. And
16 then, as we discussed, with enough local capacity put
17 in and competitors in there trying to sell it, the
18 long distance companies who do not have local
19 capacity will be able to go into a local wholesale
20 market, just as some of the resellers now are going
21 into the long distance wholesale market, to get the
22 inputs they need.

23 Q. Well, I think this is a question that Mr.
24 Pascarella was getting to. And on the one hand, the
25 new entrants seem to be very aggressive and viable,

00499

1 but call them maybe nimble, but Sprint apparently is
2 not. And that's not, from your perspective, an
3 inconsistency?

4 A. No, the new entrants -- in a sense, the new
5 entrants have an advantage, in that they're building
6 new fiber and they're putting all the new whiz-bang,
7 gee-whiz technology in from the very beginning, and
8 AT&T and MCI and Sprint have to go back and retrofit.
9 I don't think that has a lot of competitive
10 significance in the long run.

11 You know, I think -- and Sprint is out
12 there as a long distance carrier, and basically the
13 same market share they've had for the last several
14 years. They've been focusing on wireless. Their
15 wireless is doing quite well. I mean, we're not
16 talking about a failing firm here we're trying to
17 acquire. We're just talking about an opportunity to
18 bring more competition and to maybe avoid a merger
19 that wouldn't be as pro-competitive in the local
20 market.

21 COMMISSIONER HEMSTAD: I guess that's as
22 much as I can pursue there. Thank you.

23 E X A M I N A T I O N

24 BY COMMISSIONER GILLIS:

25 Q. As I understand, a part of your argument is

00500

1 that the broad market trend is towards customers
2 desiring bundled products or all-distance kind of
3 products, and that the combined company being able to
4 offer such products actually enhances competition, if
5 there was another player, a very capable player that
6 can meet that customer demand. Is that -- am I
7 correct in understanding this part of your argument?

8 A. Yes.

9 Q. And to be an effective competitor in that
10 fashion, I suppose the merged company will have to
11 reposition its product offerings relative to the
12 offerings that they made as individual stand-alone
13 companies. Would that be accurate?

14 A. Yes, as they enter local markets, they will
15 undoubtedly design products for those markets.

16 Q. Well, I mean particularly if they're after
17 the markets desired -- the desired markets of
18 customers wanting bundled products and all-distance
19 type products.

20 For example, Mr. Kapka, he didn't say it
21 directly, but I thought it was implicitly said that
22 if it weren't for regulatory barriers, they'd want to
23 consider for the ION offering to be able to do
24 pricing similar to the cell phone type of pricing,
25 all-distance kind of pricing, for example. Is that

00501

1 the kind of thing you'd expect the company to want to
2 pursue if they had the opportunity?

3 A. I guess that's something they would pursue,
4 or would consider, certainly.

5 Q. Yeah. What about, for example, imposing
6 minimum usage charges on low volume customers? Would
7 that be consistent with a company that has
8 opportunities to provide and make profit from bundled
9 offerings? Is there more incentive to do that, I
10 guess relative to the stand-alone companies that are
11 engaged primarily in provision of access to the
12 network?

13 A. Well, I really don't know what the
14 incentives would be there. You know, customers who
15 build networks have capacity they'd like to fill, and
16 they can fill that capacity with a few calls from a
17 lot of customers or a lot of calls from a few
18 customers, and any way they can fill it, I think
19 they're going to be happy to do that, and they're
20 going to be in there marketing, looking at plans that
21 attract as many minutes as they can.

22 Some companies might specialize in big
23 customers and give an opportunity for other companies
24 to come in and specialize with little customers. So
25 at the end of the day, I would expect a result, you

00502

1 know, related to counter-competition drives the
2 market. I don't know if that answered your question.

3 Q. Well, I mean, I guess you were in the room
4 when Mr. Kapka and I were discussing this, and I
5 think that he -- at least I understood him to agree
6 with me that responsible economic recommendation to a
7 profit-maximizing enterprise with multiple products
8 is that you're going to want to charge the highest
9 prices you can on the inelastic segment of the market
10 and --

11 A. To the extent --

12 Q. -- access to the network is the essential
13 piece that is inelastic?

14 A. I agree with that. The key point, though,
15 is that when you have competition, you know, that
16 competition is going to discipline the market and
17 keep the overall price levels reasonable. If you
18 have, you know, if you have an unconstrained
19 monopolist, they're going to price the least elastic
20 the most and they're going to make a lot of money.
21 If you have McDonald's, they're going to do what they
22 can to recover their fixed costs, but they have to do
23 it recognizing that Burger King and the local chain
24 are out there, too. So that's another reason why
25 it's so important to have local competition.

00503

1 Q. Correct me if I'm wrong, but it's my
2 observation that, for every industry where we've gone
3 through competitive reforms that were previously
4 regulated monopolies, whether they be financial
5 industries, transportation industries, or even some
6 areas of telecommunications, that at least
7 empirically their offerings to the customers that
8 want just basic access to the service, whatever that
9 may be, and that are not big users of that service,
10 have generally had their rates raised through fees or
11 particular restrictive terms and conditions or
12 whatever. Nothing sinister; it's just how an
13 efficient market operates.

14 And why would we expect something different
15 in, I guess, the telecommunications world that we're
16 talking about here?

17 A. In a competitive market, you'd expect
18 customers to pay for the resources they use. That
19 might not always be the case in a regulated market
20 starting out because of historical and regulatory
21 considerations. So you might see those price trends
22 that you just discussed happen. But the advantage of
23 bringing competition to a local market is that the
24 overall price level is going to go down and people
25 won't be required to pay more than economic cost.

00504

1 Q. Well, I'm not arguing the advantages with
2 you or disadvantages. What I'm actually leading to
3 is to ask you if it is possible, given your earlier
4 statement that a result of the merged company is to
5 increase competition in the market segment, that
6 responding to customer demand that's bundled and,
7 what's the word, all-distance or whatever -- yeah,
8 the high end of the mass market, I guess, actually
9 may result in reduced competition in the low end of
10 the market.

11 I recall us talking about these 30 to 50
12 percent of the population that are low-end users in
13 the current economy, because the merged company's
14 going to reposition itself. So it's no longer there
15 to -- the focus is no longer to be at this lower end
16 of the market, meaning there's one less competitor on
17 that end. Is that a possible outcome of the merger?

18 A. I would not say that's a likely outcome. I
19 mean, it kind of goes back to the point that those
20 customers deliver minutes, and minutes mean revenue.
21 They mean filling up these huge pipes that they're
22 building, and they're going to want that business.

23 Q. And if you have a huge pipe, why would you
24 want to go after somebody that just wants access to
25 the network and makes five minutes of toll calls a

00505

1 month and calls the neighbors two or three times.
2 I'm talking about my parents here. Anyway, what
3 would be your possible economic incentive to want to
4 go after those people?

5 A. If you can get revenue from them. If you
6 can fill up your -- get a lot of --

7 Q. But the only revenue to be obtained is on
8 the fixed minimum usage charge?

9 A. I guess, as I said before, there are two
10 models. I mean, you can go after a few customers,
11 each of whom make a lot of calls, or you can go after
12 a lot of customers, each of whom make very few calls,
13 but at the end of the day, you're filling up your
14 network and getting revenue.

15 In terms of how WorldCom looks at this or
16 Sprint looks at this, I guess I don't know what their
17 marketing plans are or what they're doing, but you
18 know, I see out there companies offering no-fee
19 plans, competitive rates. Bell Atlantic is one of
20 them. So you know, somebody's looking out for those
21 customers.

22 In terms of repositioning as you go into a
23 bundled service market, it may well be those small
24 customers who prefer it the most. They're the ones
25 who want one bill to pay, because they don't carry

00506

1 that much. If they make three minutes or five
2 minutes of calls a month, why should they write a
3 separate check and put a stamp on it when they can
4 get it all from one supplier. Those are exactly the
5 customers who may be the biggest beneficiaries of
6 competition for those bundled services.

7 Q. Okay. Well, let me ask you about something
8 else, just quickly. Did you happen to see the
9 RUS/NTIA report on broadband deployment that came out
10 about a month ago or so?

11 A. No, I haven't seen it.

12 Q. One of the interesting aspects of that
13 report is that they had done a survey of where these
14 DSL and cable modem technologies are being deployed.
15 And in general terms, markets of 50,000 and above
16 appear to be targets, feasible targets. And you
17 know, the real problem are markets 20,000 and below.
18 And there was some discussion of deploying the MMDS
19 technology in the Yakima area, which would probably
20 be welcome, but that's one of those 50,000 and above
21 markets. I don't know whether there's DSS service
22 there now or whether there's cable modem there, but
23 certainly the national trend would suggest those
24 technologies are also feasible in such marketplaces.

25 But this is really a question for you, as

00507

1 an economist, anyway, is that do you see any magic
2 bullet in MMDS that's going to get to these
3 hard-to-reach markets, the 20,000 or below that DSL
4 and cable modems seem to be having trouble getting
5 to?

6 A. To specifically 20,000 or 30,000, something
7 like that?

8 Q. I just picked a number based on that
9 report. I mean, it could be 30,000, it could be
10 20,000, someplace.

11 A. So I don't know what the number is, but --

12 Q. But in small markets, low-density markets,
13 you have the same problem spreading fixed cost?

14 A. But the advantage of MMDS, and this is why
15 it's very good for underserved and less
16 densely-populated areas, is the technology scalable.
17 And what I mean by that is you just put up one stick.
18 You put up a tower and put a radio on it and you're
19 in business, and then you add customers, radio by
20 radio by radio, so it's very scalable.

21 Whereas for cable, for example, you have to
22 upgrade your whole plant. And you basically upgrade
23 the whole plant at great expense, and there's a fixed
24 upgrade cost, whether you get one customer or 100
25 customers. So MMDS has that advantage. And with

00508

1 respect to DSL, of course, it has a 35-mile radius,
2 and in a lot of small towns, you've got a central
3 office maybe a long way away, and you've got a lot of
4 loops that are too long for DSL, so MMDS can fill in
5 and provide broadband to those customers in those
6 kinds of areas.

7 COMMISSIONER GILLIS: Thank you.

8 E X A M I N A T I O N

9 BY CHAIRWOMAN SHOWALTER:

10 Q. Can I ask a follow-up on that? Is that one
11 stick per few customers dependent on the terrain?
12 That is, does the one stick have to be looking out
13 over a big flat area and you'd need two or three or
14 four sticks if you were in more mountainous areas,
15 even with fewer customers?

16 A. That's a good question, a good point. I
17 think hills and valleys, you might need to fill in a
18 little more. That's right.

19 (Recess taken.)

20 JUDGE CAILLE: Let's be back on the record
21 after a short break. And we are now doing redirect
22 of Mr. Kelley. Ms. Hopfenbeck -- I just blew your
23 name.

24 MS. HOPFENBECK: Hopfenbeck. It's really
25 hard at the end of the day.

00509

1 JUDGE CAILLE: Thank you. Yes, it is.

2 THE WITNESS: Sounds like a German beer.

3 MS. HOPFENBECK: Dr. Delley --

4 JUDGE CAILLE: Thank you. You did that
5 just to make me feel good.

6 MS. HOPFENBECK: I'm thinking Touch
7 America. I'm saying Delley.

8 THE WITNESS: Say Dr. Dan, for short.

9 R E D I R E C T E X A M I N A T I O N
10 BY MS. HOPFENBECK:

11 Q. Dr. Kelley, would you please turn your
12 attention to Exhibit Number 30. It's in, I believe,
13 the notebook that's lying open there, and I believe
14 it's already turned to Exhibit 30.

15 A. Yes.

16 Q. You had some discussion with Mr. Thompson
17 about this exhibit. Now, as I understand what this
18 is is you were asked to identify which of the
19 carriers that you had listed in answer to another
20 data request response, provided voice
21 telecommunication services to end user business
22 customers in each LATA. And this also identifies
23 those carriers that provide residential retail
24 services; is that correct?

25 A. That's correct.

00510

1 Q. Okay. And this is all pertaining to
2 Washington State. I'd like you to look down to
3 Teleglobe. Teleglobe, it's indicated, there's an N,
4 or no residential retail services there. Do you see
5 that?

6 A. Yes.

7 Q. Are you aware of any reseller that uses
8 Teleglobe's network to provide retail residential
9 telecommunications service in the state of
10 Washington?

11 A. Yes, I believe Excel has a relationship
12 with Teleglobe.

13 Q. Okay. Now, you also list Williams
14 Communications here. Are you aware of any carrier
15 that has a relationship with Williams that does now
16 or has announced intentions to use Williams
17 Telecommunications Network to provide services to
18 residential and small business customers in the state
19 of Washington?

20 A. Yes, I believe that would be the party
21 sitting to your left, SBC.

22 Q. And for the record --

23 MS. ENDEJAN: I don't own a phone company.

24 Q. Now, I notice that Touch America is not
25 identified on this list. Have you looked at any

00511

1 documents that would indicate whether or not Touch
2 America has a facilities-based presence in the state
3 of Washington?

4 A. They, in fact, do.

5 Q. And do you know whether Touch America is a
6 company that provides retail services to end users in
7 the state of Washington?

8 A. I believe they do.

9 Q. And do they offer those services to
10 residential and business users?

11 A. Yes, I believe they do.

12 Q. Touch America -- you also indicated that
13 Qwest has announced a commitment or an agreement with
14 Touch America to sell its network to Touch America in
15 the event that its merger with US West is
16 consummated; is that true?

17 A. I don't know if it's exactly structured
18 that way, but my understanding is that Qwest is
19 selling their network in US West states to Touch
20 America.

21 Q. And Qwest currently provides residential
22 long distance services to customers in Washington
23 State; is that right?

24 A. Yes.

25 Q. Now, I believe -- have you also looked at

00512

1 any information that would tell you whether or not
2 ELI has facilities for long distance service in the
3 state of Washington?

4 A. They do.

5 Q. Just to avoid any confusion, do you know
6 why ELI and Touch America were not included on
7 Exhibit 29 -- or excuse me, Exhibit 30?

8 A. I guess I made a mistake. They should have
9 been included.

10 Q. Now, I'd like to direct your attention now
11 to Exhibit 29 in that notebook.

12 A. Yes.

13 Q. Have you had an opportunity, prior to this
14 moment, to review this document?

15 A. Are these the work papers for Dr.
16 Blackmon's --

17 Q. On the exhibit list, that document is
18 identified as Long Distance Revenues Data, Washington
19 Telecommunications Carriers. Yes, I believe they
20 are.

21 A. I think I saw a version of this for the
22 first time last night.

23 Q. Well, actually, since you're not really
24 clear about whether it's this document, have you
25 reviewed any information that would indicate the

00513

1 number of carriers out of the 500 that you mention in
2 your testimony that are registered to do business,
3 long distance business, in the state of Washington
4 that are actually in business?

5 A. I actually -- what I saw last night, I
6 counted over 200 carriers with intrastate revenues.

7 Q. And what was the information that you
8 reviewed last night?

9 A. It was a revised exhibit by Dr. Blackmon of
10 the worksheets on which his Herfindahl indexes are
11 based.

12 Q. What was the type of information contained
13 on that document?

14 A. I believe it's intraLATA revenues of
15 carriers in the state of Washington.

16 Q. Did you mean intraLATA revenues?

17 A. I thought I said intrastate. If I said
18 intraLATA, I meant to say intrastate. Thank you.

19 Q. Thank you. Now, I'd like to direct your
20 attention to Exhibit 100.

21 A. Yes.

22 Q. You had some discussion about this document
23 with Mr. Thompson, but I'd like to ask you, does this
24 document indicate anything to you about the presence
25 of any of the carriers listed in this document in the

00514

1 long distance market in 1999?

2 A. Well, yes. In the sense that if they're
3 wholesale customers, they must be providing retail
4 services.

5 Q. And with respect to the -- is it true that
6 -- can you tell me of the companies that are listed
7 in this document, who are those companies -- what are
8 those companies identified on this page for? What
9 are the revenues that are shown here?

10 A. This is confidential.

11 Q. Yeah, I don't want you to identify the
12 specific numbers, but just generically describe what
13 is depicted on Exhibit 100.

14 A. It's the wholesale revenues that these
15 companies are paying to WorldCom for wholesale
16 services.

17 Q. So each of the companies listed on this
18 exhibit are leasing wholesale long distance services
19 from MCI WorldCom, or did in 1999; is that right?

20 A. That's my understanding.

21 Q. Okay. Dr. Kelley, do you recall looking at
22 a confidential pie chart that indicated the market
23 shares of wholesale providers --

24 A. Yes.

25 Q. -- in your cross-examination done by Mr.

00515

1 Thompson?

2 A. I do.

3 Q. And you indicated that you had something to
4 say about the significance of that document. Can you
5 tell me what that is?

6 A. Yes, and just very quickly and very simply,
7 it showed that, year over year, WorldCom's, MCI's
8 share fell, and the shares of some of the smaller
9 carriers grew very significantly in percentage terms,
10 including the carriers who we know are building
11 nationwide networks.

12 JUDGE CAILLE: Just for the record, we are
13 speaking of Exhibit C-110.

14 MS. HOPFENBECK: I had 101 down. Just
15 reflects a little dyslexia. Thank you.

16 THE WITNESS: I'm not -- was it 110? It
17 was a --

18 MR. THOMPSON: I don't think it was 110,
19 actually.

20 JUDGE CAILLE: Oh.

21 THE WITNESS: I think it was an earlier
22 number.

23 MR. THOMPSON: There was a pie chart, but

24 --

25 MS. HOPFENBECK: It is 110. Oh, no, it's

00516

1 not 110. Twenty-five.

2 MS. ENDEJAN: Which pie chart are you
3 talking about, then?

4 MR. CROMWELL: We have two votes for
5 Exhibit 25.

6 MS. HOPFENBECK: Okay. For the record, it
7 was Exhibit 25.

8 JUDGE CAILLE: Okay.

9 Q. Dr. Kelley, you were asked a number of
10 questions during your cross-examination regarding
11 incentives that carriers with sunk investment have to
12 resell the capacity associated with that investment.
13 Do you recall that cross-examination?

14 A. Yes.

15 Q. Now, I wanted to ask you, just to clarify
16 the record, whether or not, in your view, US West has
17 a different incentive vis-a-vis its sunk investment
18 in its local network than carriers with sunk
19 investment in the competitive long distance
20 facilities?

21 A. Yes, certainly, US West has many sunk
22 investments, but they also have a great deal of
23 market power, and that will be the difference.

24 Q. And I'd like you just to elaborate a little
25 bit more about that, just comparing the incentives

00517

1 that --

2 A. Companies with market power will maximize
3 their profits generally by restricting output.
4 Companies in competitive markets maximize revenues
5 and profits by selling more output. So they face
6 very different incentives and get very different
7 market results, even in the case of two markets,
8 where there are sunk costs in both.

9 Q. Now, would US West's incentive, as a
10 company with market power, change, in your view, with
11 the entry of other facilities-based carriers into
12 that market?

13 A. Yes. And with sufficient significant
14 entry, their incentives would look more like other
15 firms, and they would then become more willing to
16 search out multiple uses and multiple customers for
17 their facilities.

18 Q. And if that -- is there a difference, in
19 your view, in terms of the ascent, can you state, as
20 an economist, an opinion about whether US West's
21 incentive would be greater or the same, depending on
22 whether there were two facilities-based carriers in
23 the local exchange market or three?

24 A. Yes. It's hard to say with great
25 specificity, but the more the merrier, and certainly

00518

1 with three carriers, you're more likely to get a
2 competitive outcome. US West is more likely to see
3 the benefits of selling, reselling capacity to others
4 than with two.

5 Q. Now, you've also had discussions during the
6 course of this cross-examination about, in general,
7 whether resellers constrain prices?

8 A. Yes.

9 Q. And you seem to suggest that resellers of
10 local services may constrain prices of local services
11 to a different degree at present than resellers of
12 long distance services. Is that a fair statement of
13 your view?

14 A. Yes.

15 Q. And why do resellers of long distance
16 services constrain prices to a -- well, what is the
17 difference, first of all?

18 A. Long distance resellers have multiple
19 potential suppliers of the basic underlying capacity
20 they need to provide service. Local resellers have
21 one choice only, and that's the monopoly telephone
22 company.

23 Q. And how does the difference in choices
24 affect the ability of resellers to constrain prices
25 in one market or the other?

00519

1 A. In the case of local market, we have a
2 basic problem to begin with, and that is, in most
3 places, the resale discounts don't allow for
4 profitable entry in the first place. But in any
5 event, they're stuck with the price that US West
6 charges, whereas in the long distance business, a
7 reseller who doesn't feel like it's getting a good
8 deal from WorldCom can go to Qwest or Williams or
9 Frontier and try to cut a better deal. And so they
10 have more ability to constrain prices.

11 Q. In the long distance market, are there any
12 carriers that, to your knowledge, have entered the
13 telecommunications market with the purpose of
14 becoming a carrier's carrier?

15 A. Yes.

16 Q. And who are those carriers?

17 A. Well, I think the one example I give is
18 Williams. Now, many of them are providing carrier's
19 carriers functions, but they may also be providing
20 retail functions, like Level 3.

21 Q. Now, the last line of questions I wanted to
22 ask you is Chairwoman Showalter asked you some
23 questions about whether you thought there were any
24 conditions that this Commission might impose should
25 it be concerned about long distance market

00520

1 concentration in order to approve this merger. I
2 wanted to ask you a question about that.

3 MCI WorldCom has, in Mr. Porter's
4 testimony, suggested a condition consisting of an
5 agreement or a commitment not to increase the average
6 effective rate, per-minute rate for in-state long
7 distance services for a period of six months.

8 Now, I'll ask you, hypothetically, if this
9 Commission were to adopt such a condition as a price
10 cap, do you believe that that kind of a condition,
11 first of all, would function to address the long
12 distance market concentration concern should the
13 Commission have such a concern?

14 A. I guess I should say, first, it's a
15 theoretical concern. I don't think there's a need
16 for that concern, but certainly, you know, price cap
17 gives you some assurance or comfort or whatever it is
18 that consumers would be protected for a period of
19 time.

20 Q. Now, hypothetically, if WorldCom were
21 willing to suggest extending that kind of a condition
22 to, say, 18 months, when asked, 18 months after
23 merger closing, do you have any reason to believe
24 that even if US West is not in the market by what you
25 think would be about spring of 2002, do you have

00521

1 reason to believe that, at that point in time, this
2 Commission should continue to be concerned about long
3 distance market concentration?

4 A. No, because -- and I don't think there's a
5 concern today.

6 Q. What is your opinion about what is likely
7 to happen in the long distance market in Washington
8 State and around the nation between now and the
9 spring of 2002, in addition to RBOC entry?

10 A. In addition to RBOC entry, my analysis of
11 the capacity and the networks of the emerging carrier
12 shows that a lot of fiber is going into the ground
13 and is continuing to be lit. So there will be more
14 and more capacity as time goes on.

15 For example, I'll give you an example.
16 Level 3, everybody thinks of Level 3 as this
17 monolithic brand-new IP-based network, and it will
18 be, but in my research and in the analysis I've done
19 of where carriers have deployed fiber, I only have
20 them down for Dallas and Houston, because that's the
21 only place where I can verify they have truly lit
22 their own fiber. Everywhere else, they're leasing
23 now and they're building, they're building a lot, but
24 by 2002, they will have their network done. My
25 Exhibit ADK-2 shows that they're going to be one of

00522

1 the biggest players. Today, they're not a very big
2 player.

3 Q. I have one other question. In your
4 discussion with Commissioner Gillis, I believe you
5 were discussing DSL technology and MMDS technology,
6 and you referenced a 35-mile radius. Were you
7 referring to MMDS as having that radius or DSL?

8 A. Oh, MMDS.

9 Q. Okay, thank you. One other line. You also
10 had a discussion during the course of your
11 cross-examination with I think both Messrs. Cromwell
12 and Thompson regarding your expectations about how
13 much market share the RBOC would gain and in what
14 period of time.

15 A. Yes.

16 Q. I'll ask you this. Are you aware of a
17 joint marketing program that Qwest and US West
18 entered into in the recent past called Buyers
19 Advantage?

20 A. I am.

21 Q. Now, Buyers Advantage didn't last very
22 long, but do you know how many customers Qwest gained
23 and in what period of time that Buyers Advantage was
24 in existence?

25 A. Yes, the newspaper accounts showed that

00523

1 they had gained 130,000 customers in just three
2 weeks.

3 Q. Do you know what portion of US West's total
4 customers -- I mean, of the total US West customers
5 that would represent in the region?

6 A. US West, I believe, is around 20 to 25
7 million lines, so it would probably take me longer to
8 get my calculator out than to --

9 Q. Is it about a half a percent in three
10 weeks?

11 A. Yes.

12 MS. HOPFENBECK: I have no further
13 questions.

14 JUDGE CAILLE: Any re-cross?

15 MR. THOMPSON: I just have a couple
16 questions.

17 R E C R O S S - E X A M I N A T I O N

18 BY MR. THOMPSON:

19 Q. On Exhibit Number 30, that's the one
20 listing the various carriers in Washington State, you
21 discussed that you would --

22 A. Is it 29 or 30?

23 Q. Thirty.

24 A. Okay, 30. Thank you.

25 Q. You suggested that you would add Touch

00524

1 America to that, to the list. Do you have any idea
2 which LATAs they're in?

3 A. I believe -- I'm going on recollection
4 here. I believe they're in the Spokane LATA.
5 They're -- Touch America is Montana Power, the
6 electric utility. It's one of the things I talk
7 about in my testimony. One of the great things
8 that's going on in the industry now is that the
9 electric companies are building a lot of capacity,
10 and obviously a Montana company would be closer to
11 Spokane than to Seattle, but it's something I'm going
12 on recollection: Again, I'll look it up.

13 Q. Well, would you accept -- well --

14 MS. HOPFENBECK: Mr. Thompson, perhaps in
15 the interest of time, we could refer him to Mr.
16 Porter's Exhibit Number 2.

17 MR. THOMPSON: Okay.

18 MS. HOPFENBECK: Which has a map of Touch
19 America's facilities in the state of Washington.

20 THE WITNESS: I have it, and yes, they show
21 network in Spokane going down to Boise, and they show
22 planned network from -- it's hard to tell on this
23 copy whether it's actually planned, but they show
24 network in Seattle.

25 Q. Does that mean there's a point of presence

00525

1 in the Spokane LATA?

2 A. I would say yes. I mean, the map shows
3 clearly they have offices there.

4 Q. What about -- does Touch America, then,
5 offer residential service and retail, such as they'd
6 have a Y in that column?

7 A. I believe they do.

8 Q. Okay. What about ELI? Do you have any
9 idea which LATAs?

10 A. There's a map here. If not, I may have a
11 map.

12 MS. HOPFENBECK: Page one.

13 THE WITNESS: Electric Lightwave are listed
14 in both Seattle and Spokane. And I think I mentioned
15 in my testimony there's a local company building sort
16 of local communications facilities throughout eastern
17 Washington, and they're using -- I think they're
18 using Touch America, I'm sorry.

19 Q. Okay. Do you know if ELI sells long
20 distance services to anybody besides its own CLEC
21 customers?

22 A. I can't say for sure. I believe they do.
23 I believe that they're a long distance carrier.

24 That's something I could look into for you.

25 Q. Well, okay. We can -- I'm not sure how

00526

1 you'd look into that, but --

2 A. Look at their web site.

3 Q. Okay. I don't know if I'll have an
4 opportunity to call you back tomorrow on that, but
5 maybe if there is such an opportunity, I would ask
6 you to do that.

7 But let's turn now to -- one other subject
8 I wanted to touch on was the pie charts you made
9 reference to, and that was Exhibit 25. And it's two
10 pie charts apparently depicting wholesale revenue
11 share for 1998 and 1999. And I think you made the
12 statement that, to you, those depicted a trend of
13 gain and share by other companies and loss by the Big
14 Three. And would you acknowledge there's only two
15 years represented there?

16 A. Yes.

17 Q. And it appears to me that AT&T stayed the
18 same, Sprint stayed the same, Frontier stayed the
19 same, Level 3 changed one percent, there was -- the
20 only, I guess, large change, or I guess what might
21 pass for a large change was between Qwest and
22 WorldCom; correct?

23 A. Yeah, but that's -- I view Qwest as being
24 very significant here, because they're a company that
25 in this period is building a network.

00527

1 Q. Okay. Would you -- I don't know if this is
2 the point to talk about it, but it's interesting to
3 me, at least, the conclusion of the person writing
4 this report, which is stated in the sentence
5 underneath there, and I probably can't say it. Maybe
6 -- could I read it into the record or -- but at least
7 this person's conclusion was that, from this, was
8 that it may be difficult for MCI to capture
9 incremental share because they're already the leader.
10 Is that another conclusion you think that could
11 validly be drawn from that data?

12 A. Well, that's one conclusion. Clearly,
13 they're not getting any incremental share. They're
14 losing incremental share. If you go to the next
15 page, the analysis here says, Startups take most of
16 market growth, focusing on Qwest, Frontier and Level
17 3. And I guess, as I read this, it just gets better,
18 the last page --

19 MR. THOMPSON: Actually, that's all I have
20 for you, in the interest of time.

21 R E C R O S S - E X A M I N A T I O N

22 BY MR. CROMWELL:

23 Q. One issue, Dr. Kelley. Looking at your
24 resume, you were with the FCC as a senior economist
25 from '79 to '82; is that correct?

00528

1 A. That's correct.

2 Q. And you were with the U.S. Department of
3 Justice as a Staff economist from '72 to '79?

4 A. That's correct.

5 Q. Are you aware of any risk of
6 anticompetitive effect in the marketplace of a price
7 cap?

8 A. Yes. If you take a price cap in
9 oligopolistic market, the concern we had at the FCC
10 about FCC tariffs way back a long time ago is it
11 could become a focal point for pricing.

12 Q. In other words, to be brief, there is a
13 risk that a price cap could, in fact, become a floor?

14 A. Theoretical risk in the situation I
15 described. In this situation, I don't think you have
16 to worry about it.

17 MR. CROMWELL: Thank you.

18 MR. PASCARELLA: Two minutes, Dr. Kelley.

19 R E C R O S S - E X A M I N A T I O N

20 BY MR. PASCARELLA:

21 Q. In response to one of the Commissioners'
22 questions, you indicated that there was a group of
23 consumers in Washington that will want to buy just
24 long distance, in other words, kind of a la carte
25 long distance for some time to come. Is that

00529

1 accurate?

2 A. Yes, that's my marketing prediction.

3 Q. Okay. But you go on to say in your
4 affidavit in here that with regard to this group, we
5 shouldn't be worried about any anticompetitive
6 effects of this merger, because there are plenty of
7 emerging carriers to step up. In fact, you went
8 through, I think with MCI's counsel, a bunch of folks
9 that were either in the market or building capacity;
10 is that true?

11 A. Yes.

12 Q. Under that theory, wouldn't it also be true
13 that, I guess talking hypothetically, when eight
14 months from now, WorldCom-Sprint come to this
15 Commission and announce their intent to merge with
16 AT&T, there won't be any anticompetitive concerns for
17 that segment of the market at that time?

18 A. I disagree with that jump, and I think we
19 had some discussion about this issue as elasticity of
20 supply. And Sprint is -- whatever percent of the
21 market it is, it's less than 10. Three and a half,
22 if you believe Dr. Hausman's numbers. Seven, I think
23 I've seen seven. For a company to, you know,
24 restrict -- to exercise market power, it means it
25 restricts supply. So not all that much supply can be

00530

1 restricted with Sprint, and then, given the
2 elasticity of supply that exists because the other
3 carriers are there with transport and switching and
4 billing and marketing, they'll easily be able to come
5 in and take care of things.

6 Now, if you talk about AT&T, at 50 percent,
7 acquiring 20 percent, you know, of combined
8 MCI-Sprint, or 27, or whatever it would be, then you
9 have to have much more -- supply has to be much more
10 elastic for me not to be concerned.

11 So I'm not here to -- some companies
12 advocate a theory in economics called contestability,
13 which you can be 100 percent and entry is easy, no
14 barriers to entry, and you don't even have to worry
15 about a hundred percent firm. I'm not saying that
16 this market is contestable. I don't think there are
17 many contestable markets. What I'm saying is that
18 the elasticity of supply is such that for this
19 merger, these market shares, you don't have to worry.

20 Q. At what point, roughly -- you indicated
21 certainly 70 percent would be too high -- would the
22 elasticities in this market not be sufficient to
23 allay your concerns about the effect on competition?

24 A. I don't know if I could give you a point.
25 I mean, I'm pretty confident I'd be concerned about

00531

1 AT&T. Something less than that, I would want to sit
2 down and do an analysis.

3 MR. PASCARELLA: Thank you.

4 E X A M I N A T I O N

5 BY CHAIRWOMAN SHOWALTER:

6 Q. I just have one follow-up question on
7 Exhibit 100. This is the list of wholesale customers
8 of MCI. I'm not even sure you have to look at the --
9 go ahead.

10 A. All right.

11 Q. I thought I heard you say that one
12 inference you draw from this chart is that if these
13 people, these companies are wholesale customers of
14 MCI, then they must be involved in retail service or
15 they wouldn't be buying wholesale?

16 A. Right.

17 Q. And my only question is, is that the
18 necessary implication? Could any of these wholesale
19 customers of MCI, for whatever reason, be also
20 delivering -- turning around and delivering wholesale
21 services to someone else?

22 A. Yes, that's certainly possible. I see
23 Williams on here.

24 Q. Okay. So you can't draw the inference, 100
25 percent, anyway, that all of these wholesale

00532

1 customers mean that there is this much retail
2 business going on. Ultimately, there would be, but
3 you don't know among whom?

4 A. Yes, right. Ultimately, I think there
5 would be. By definition, it has to be retailed at
6 some point. So each minute stands for a retail
7 minute somewhere along the line. But you're right,
8 there might be buy and sell among the carriers.

9 CHAIRWOMAN SHOWALTER: Thanks.

10 JUDGE CAILLE: Any redirect? All right.
11 Mr. Kelley, you're excused. Thank you for your
12 testimony.

13 Just before we leave, I'd like to ask
14 WorldCom to supply a corrected exhibit of -- it's the
15 one where we're adding ELI and Touch America and the
16 Spokane LATA is incorrect. If you could do that,
17 plus we need a clear copy of page 10 of Exhibit 110,
18 and six copies of the FCC exhibit that you're
19 supplying. All right.

20 CHAIRWOMAN SHOWALTER: Just a comment on
21 that table. The question for that exhibit was what
22 did you base your testimony on, and of course, I
23 think you probably gave the right table, but now the
24 testimony has been changed to add in some others. I
25 think it's appropriate to add to the exhibit.

00533

1 MS. ENDEJAN: Your Honor, could I request,
2 if she's making copies, if she could make more than
3 six and provide copies to all Counsel?

4 JUDGE CAILLE: Yes.

5 MS. ENDEJAN: Thank you.

6 JUDGE CAILLE: If there's nothing further,
7 then?

8 MS. KIDDOO: Would you like to swear in Ms.
9 McMahon?

10 JUDGE CAILLE: No, I need to pick up my
11 child, so we'll do it first thing -- how about if we
12 do it at 8:20 tomorrow? Okay. Well, we're starting
13 at 8:30, and I asked -- or 8:25.

14 (Proceedings adjourned at 6:18 p.m.)

15

16

17

18

19

20

21

22

23

24

25