BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

IN THE MATTER OF THE PETITION OF U S WEST COMMUNICATIONS, INC. FOR COMPETITIVE CLASSIFICATION	Docket No. UT-000883

NON-CONFIDENTIAL VERSION

TESTIMONY OF DON J. WOOD

On Behalf Of Advanced TelCom, Inc.
and
MetroNet Services Corporation

September 18, 2000

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Don J. Wood. My business address is 4625 Alexander Drive, Suite 125, Alpharetta, Georgia 30022. I am a principal in the firm of Wood &Wood, an economic and financial consulting firm. I provide regulatory and cost analysis of the telecommunications and related "convergence" industries, with an emphasis on economic policy, development of competitive markets, and cost of service issues.

Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.

A. I received a BBA in Finance with distinction from Emory University and an MBA with concentrations in Finance and Microeconomics from the College of William and Mary. My telecommunications experience includes employment at both a Regional Bell Operating Company ("RBOC") and an Interexchange Carrier ("IXC").

I was employed in the local exchange industry by BellSouth Services, Inc. in its Pricing and Economics, Service Cost Division. My responsibilities included performing cost analyses of new and existing services, preparing documentation for filings with state regulatory commissions and the Federal Communications Commission ("FCC"), developing methodology and computer models for use by other analysts, and performing special assembly cost studies. I was also employed in the interexchange industry by MCI Telecommunications Corporation, as Manager of Regulatory Analysis for the Southern Division. In this capacity I was responsible for the development and implementation of regulatory policy for operations in the southern U. S. I then served as a Manager in the Economic Analysis and Regulatory Affairs Organization, where I participated in the development of regulatory policy for national issues.

Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY BEFORE STATE REGULATORS?

A. Yes. I have testified on telecommunications issues before the regulatory commissions of twenty-eight states, Puerto Rico, and the District of Columbia. This testimony has addressed a wide range of issues, including the competitive classification of services and the safeguards necessary to permit efficient competition to develop in those markets previously characterized by monopoly supply. I have also presented testimony regarding

interconnection and cost of service issues in state, federal, and overseas courts, before arbitration panels, and have presented comments to the FCC. A listing of my previous testimony is attached as Exhibit DJW-2.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been asked by MetroNet Services Corporation ("MetroNet") and Advanced TelCom Group, Inc. ("ATG") to review Qwest Corporation ("Qwest's") Request for Competitive Classification of Business Services in Specific Wire Centers in Washington ("Request") dated June 7, 2000. Specifically, I have reviewed the company's Petition, the supporting documentation that accompanied the Petition, the testimony of Qwest witnesses in support of the Petition, and the company's responses to discovery of the parties. Qwest continues to provide responses to certain of ATG and MetroNet's discovery, and my analysis of the information contained in these later responses is ongoing.

When examining this material, I have attempted to determine whether the competitive classification of business services sought by Qwest would support the continued development of competition to the benefit of Washington subscribers of business telecommunications services, and further whether such competitive classification should be more limited in scope than requested by Qwest and whether specific safeguards should accompany such a competitive classification.

Q. HOW SHOULD THE COMMISSION ADDRESS THE QUESTION BEFORE IT IN THIS PROCEEDING?

A. The standard to be applied by the Commission is set forth in RCW 80.36.330. The methodology for evaluating the available evidence -- and the Commission's decision regarding what to do once that evidence has been examined -- is far from a lock-step process, however, and the Commission has significant flexibility in its implementation of this section.[1]

<u>The Commission can conclude that the requirements of RCW 80.36.330 have</u>

[1] Like Qwest witnesses Jensen and Teitzel, I am not an attorney. My conclusions regarding the requirements of the applicable law are based on my experience applying state and federal legal requirements to the facts at hand in a particular proceeding.

been met, and still elect not to permit the competitive classification of Qwest's services. RCW 80.36.330 (1) states in part that "[t]he Commission *may* classify a telecommunications service provided by a telecommunications company as a competitive telecommunications service if the service is subject to effective competition" (emphasis added). Clearly, the Commission is not compelled to grant Qwest's Request in this proceeding regardless of the conclusion the Commission reaches regarding the adequacy of Qwest's factual demonstration. As explained in more detail below, the impact of the Request on Washington end user subscribers to the business services in question should be the Commission's primary consideration. The concerns and desires of competing carriers, including Qwest, ATG, and MetroNet, should be considered in the context of the broader public interest. Such a focus does not, as it should not, require the Commission to protect any individual competitor, but it does require the Commission to act proactively to protect the ongoing development of competitive markets.

The Commission can determine the geographic scope of the markets at issue when evaluating competitive alternatives. In order to determine whether effective competition exists – pursuant to the definition set forth in RCW 80.36.330 or any other definition – it is necessary to first define the scope of the market to be evaluated. The scope of a market must be defined in terms of both the geographic area and the products or services being offered. In this case, the Commission can exercise its judgment regarding whether Qwest has properly identified the scope of the relevant markets for business services.

As I will explain in detail later in my testimony, the Request is overly broad in terms of both products and geographic areas. If the Commission determines that it is in the interest of the customers of business telecommunications services to grant Qwest additional competitive classification of its services, it will be necessary to limit the scope of that classification in order to ensure that (1) customers who currently have competitive alternatives will continue to have those alternatives, and (2) that customers who current have limited or no alternatives do not lose the opportunity to have such alternatives in the future. In addition, it is essential that the Commission act to prevent those customers who currently have no competitive alternatives from experiencing immediate and significant price increases. If the competitive classification granted is too broad in terms of either products or geography, Qwest will have the ability and incentive to increase prices to

these customers in order to pay for the deep discounts that it can offer to those customers who currently do have competitive alternatives.

The Commission must determine the cost standard to be used to establish price floors for competitive services. RCW 80.36.330 is clear that the pricing flexibility for services classified as competitive is constrained by a lower bound based on cost. RCW 80.36.330 (3) states in part that "[p]rices or rates charged for competitive telecommunications services shall cover their cost. The Commission shall determine proper cost standards to implement this section." As a result, the Commission must evaluate the likely impacts of the requested competitive classification and determine what cost-based price floor should be implemented. The cost standard adopted by the Commission can, and should, reflect the fact that Qwest remains the monopoly provider of essential network services in many areas and for many customers, making it necessary to impute the price of these essential network services in the price floor calculated.

The importance of implementing the necessary safeguards *before* Qwest is granted any of the additional pricing flexibility that it is seeking cannot be overstated. Once Qwest has the ability to exercise this additional flexibility in the marketplace, it will be difficult, if not impossible, for the Commission to "unscramble the egg" and retroactively enforce competitive safeguards. In my experience, such efforts invariably fail because in most cases the damage has already been done and no remedy exists for the affected carriers that does not cause significant disruption to customers. As a result, it is essential for the Commission to carefully consider the safeguards that may be necessary to protect both the short and long term interests of consumers, and to implement those safeguards prior to, or concurrent with, any additional pricing flexibility for Qwest.

The Commission may elect not to waive the "unreasonable preference" and "rate discrimination" requirements of RCW 80.36.170 and 180. RCW 80.36.330 (8) states that "[t]he Commission *may* waive the requirements of RCW 80.36.170 and 80.36.180 in whole or in part for a service classified as competitive *if* it finds that competition will serve the same purpose and protect the public interest" (emphasis added). It is my understanding that the Commission may only waive 80.36.170 and 180 if it concludes that "competition will serve the same purpose and protect the public interest," and may still elect not to waive any portion of 80.36.170 and 180 even if it makes such a finding.

Clearly, the Commission can retain certain prohibitions against "unreasonable preference" and "rate discrimination" if it chooses to do so.

The language of 80.36.170 and 180 appears to treat customer contracts differently than generally available rates. It is not unusual for business services to be provided pursuant to such a contract, and the services provided to higher volume business customers are almost exclusively provided pursuant to such a term contract. It will be necessary, therefore, for the Commission to specifically address any safeguards applicable to the pricing of services provided via a customer-specific contract.

The Commission can investigate prices for competitive services in order to determine if they are fair, just, and reasonable. RCW 80.36.330 (4) states that "[t]he Commission may investigate prices for competitive telecommunications services upon complaint. In any complaint proceeding initiated by the Commission, the telecommunications company providing the service shall bear the burden of proving that the prices charged cover cost, and are fair, just, and reasonable." There can be little serious debate that an ongoing process of regulation-by-complaint is unlikely to be an effective or efficient use of Commission or Staff resources. Since the Commission has the clear authority to hold prices for competitive services to a fair, just, and reasonable standard once the service is declared to be competitive, it seems prudent for the Commission to act at the time a given service is classified as competitive to define the fair, just, and reasonable standard and put into place self-enforcing mechanisms – to the extent possible – to ensure that future rate changes meet this standard.

The Commission can apply additional considerations, including an assessment of the public interest, when deciding whether to permit the classification of services as competitive. RCW 80.36.330 (1) states that the factors that the Commission may consider when determining whether to grant competitive classification include, but are not limited to, those listed in the section. The Commission can, and should, consider the impact of any requested competitive classification on the development of competition and the customers of telecommunications services. In addition, RCW 80.36.330 (7) explicitly allows the Commission to reclassify a service previously classified as competitive if such a reclassification "would protect the public interest." If the Commission has the undisputed authority to reclassify a service based on public interest concerns that day

after the service is classified as competitive, then it seems eminently reasonable for the Commission to consider the broader public interest when making its initial decision to permit a service to be classified as competitive.

RCW 80.36.300 (5) states that it is the policy of the state to "[p]romote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state." It is no secret that in order to successfully accomplish this objective, the flexibility afforded the incumbent former monopoly provider must be timed correctly. If the incumbent is granted too much flexibility too soon, it will be able to eliminate existing competition and create an effective barrier to further competitive entry. If flexibility for the incumbent is delayed unnecessarily, there may be one fewer competitor in the market for some services. While an additional competitor may provide some marginal consumer benefit, its presence is not necessary in order for consumers to receive the benefits of lower prices and quality service. This observation is not intended to be disparaging in any way of Qwest and its services, but the inescapable fact remains that if Qwest's claims in its petition are valid – that effective competition currently exists for all business services for all customers served by the 31 identified wire centers – the presence of one additional competitor will not provide a material incremental benefit to consumers. That is because in a market characterized by effective competition, no provider can increase its price without suffering a loss of market share. It is a matter of economic definition that prices in such a market are at competitive levels, and would not be reduced by the presence of an additional carrier.[2] The Commission should, as the statute permits, allow Qwest to exercise additional pricing flexibility over time as competitive conditions make it possible for Qwest to exercise such flexibility without harming consumers or the development of competition. The Commission should time the implementation of such flexibility as precisely as it can, because doing so will provide the greatest benefit to both consumers and competing carriers (including Qwest). When in doubt, however, the Commission should err on the side of caution: allowing flexibility too early will create a scenario of substantial harm to consumers, benefit to Qwest, and

[2] A possible exception to such a scenario would be a potential new entrant that sought to enter the market by utilizing a new, more efficient (and therefore lower cost) technology. This would not be case for Qwest, who would provide service using an existing network that its own witnesses have characterized as less technologically advanced than that of its competitors.

harm to its competitors. If flexibility is delayed longer than necessary consumers will be unaffected, Qwest will suffer some harm, and its competitors will be unaffected.

To be clear, I am not suggesting that the Commission should act in a way that will create undue harm to Qwest. To the extent possible, the Commission should time the implementation of pricing flexibility as precisely as possible so that the interests of consumers are protected while the interests of all competing carriers, including Qwest, are preserved. The policy declarations of RCW 80.36.300 (3), (4), and (5) clearly indicate, however, that it is the customers who purchase the services in question – not the carriers that provide those services – that are to be protected.

For each of these reasons, the application of RCW 80.36.330 is not simply a checklist exercise, but instead has ample room for the Commission to exercise its judgment. While RCW 80.36.330 sets forth the mechanism by which Qwest's Request will be considered, it appears that the Commission has the flexibility to consider the broader impact that granting the Request would be likely to have and to impose requirements or restrictions to ensure that the outcome of any competitive classification will serve the public interest. I urge the Commission to do so in this proceeding.

Q. QWEST WITNESSES JENSEN AND TEITZEL STATE THAT QWEST IS ASKING FOR "PARITY" WITH ITS COMPETITORS. DO YOU AGREE WITH THIS CHARACTERIZATION?

A. Not at all. The inescapable truth is that no regulator, including this Commission, can create such a level of parity between an incumbent LEC and its competitors.

At pp. 16-17, Ms. Jensen argues that "all competitors, including Qwest, must be given parity in regulatory treatment." Mr. Teitzel similarly refers to putting Qwest on "an equal footing" (p. 3) and requests neutral treatment of competitors by the Commission (p. 23). Such treatment, he argues, will give Qwest the ability – at long last – "to respond to the competitive business market *under the same conditions currently enjoyed by its competitors*" (emphasis added).

In reality, it is highly unlikely that Qwest really wants to experience the same conditions as its competitors. In order to do so, Qwest would have to:

<u>Rely on its competitors to provision network facilities essential to Qwest's services in a timely manner.</u> Qwest would be subject having its orders for network

functions essential to its ability to offer service as promised to a customer "held" (i.e. not provided when due) by its competitors, sometimes for several months. Qwest would then be in the position of explaining to the effected customer why the service was not provided when promised, and why the delay is outside of Qwest's control and the fault of another carrier. During the time that the order was held, the carrier upon which Qwest relied would, of course, be free to attempt to win back the customer in part by holding itself out as a more reliable provider.

Rely on its competitors to maintain and operate their networks so that Qwest's service to its customers would not be interrupted. Qwest would be in the position of having service to its customers interrupted because of network problems experienced by the carrier upon which it relied. The other carrier would be relied upon to minimize the frequency and duration of such outages, even though the outages impacted the retail services of a competitor.

Rely on its competitors to make collocation space available in their central offices. Qwest would be required to secure space from a competitor in order to place its equipment. The placement of Qwest's equipment would be delayed through the negotiation process and would be subject to additional delays caused by the competitor's negotiations with other carriers.

Rely on its competitors to take reasonable steps to plan for Qwest's needs when planning their own network deployment. When Qwest is able to secure collocation space, its ability to use that space will be subject to the availability of essentials, such as electric power, in the competitor's building. Even though the competitor will have known for some time that Qwest would be utilizing the space and would require such power, it may not factor those needs into its planning process. As a result, Qwest's use of its collocation space may be further delayed until the competitor installs the necessary power capacity.

In addition, Qwest's ability to obtain unbundled elements from its competitor may likewise be delayed because the competitor has not considered the needs of Qwest in its network planning and deployment efforts.

Rely in each of these ways on competitors who can unilaterally dictate how services will be provided. Parity would also require Qwest to experience the frustration

of requesting network facilities from its competitor for a particular purpose, incur the time, effort and expense to obtain those facilities, and then be told by the competitor that the facilities in question cannot be used for the intended purpose. Qwest would then have to incur additional time, effort, and expense to acquire different network facilities from the competitor, subject to the limitations described above.

Of course, if Qwest were to actually experience these same conditions currently "enjoyed" by its competitors, it could avoid each of the problems described above. In order to do so, Qwest need only (1) begin to compete with no network facilities in place, (2) obtain the capital necessary to build a ubiquitous network even though no revenue base exists at the time to support such investment, and (3) build out such a ubiquitous network overnight.

Q. ARE THERE ANY OTHER REASONS WHY IT IS IMPOSSIBLE FOR "PARITY" TO EXIST BETWEEN QWEST AND ITS COMPETITORS?

A. Yes. Qwest's filing in support of its Request illustrates a very real problem with any efforts to create the superficial appearance of "parity" simply by granting Qwest pricing flexibility comparable to that of CLECs. According to Ms. Jensen, Attachment H to the Request contains detailed carrier-specific information, by wire center location, regarding the activities of Qwest's competitors. The fact that Qwest was able to develop Attachment H (and the summary version of that information, Attachment G) represents a *prima facie* case that the state of "parity" described by the Qwest witnesses is impossible.

In its role as a "wholesale" provider of network functionality that is essential to its competitors' ability to provide service, Qwest receives collocation applications, facility needs forecasts, and UNE orders from the competitors of its retail operations. Such information is to be utilized by Qwest solely for network planning purposes, and is not to be disclosed. While Qwest has apparently gone to some effort to mask the identity of the individual carrier information presented in Attachment H, such "protection" of this information from public disclosure in this proceeding entirely misses the point: Qwest's retail operations have been given access to this information, and Qwest as a provider of competing retail business services has knowledge about its competitors that give it a significant advantage in the marketplace. In addition to the marketing advantage, Qwest apparently has no qualms about using this proprietary information about is competitors –

gathered for other purposes -- in order to support a request for retail pricing flexibility.

The creation by Qwest of Attachments G and H makes abundantly clear two facts that are relevant to the decision to be made by the Commission in this proceeding. First, Qwest is in the unique position of having advanced knowledge of each of its competitor's network deployment and marketing plans. Qwest, as a wholesale provider of network functions essential to its competitors, knows when one of those competitors is attempting to expand into a given geographic market. If the competitor is utilizing UNEs, Qwest has access to both the current orders and the forecasted needs of that competitor. A competitor that is placing its own facilities, instead of or in conjunction with UNEs, must request collocation space in a given Qwest central office months (if not years) in advance of actually offering retail services utilizing those facilities.

Second, Qwest has demonstrated in this proceeding the willingness to utilize that information about its competitors for purposes other than those for which it is intended. Qwest receives information regarding the forecasted needs of its competitors in order to better manage its network and to ensure that the facilities needed by both it and its competitors are available without undue delays.[3] Qwest has used that information to advance its competitive interests in this proceeding. Qwest could (and may currently be doing so) utilize this information in order to target competitive offerings. If granted the requested pricing flexibility, Qwest would be able to engage in a series of successful "pre-emptive strikes" against its competitors by targeting customers in the geographic areas that the competitor seeks to enter and locking up those customers with term contracts before the competitor has the ability to actually offer the service. Qwest would be in the unique position of being able to focus these offers on a very narrow basis, limiting them to only the customers in a specific geographic area and only the customers of services that are likely to be provided utilizing the specific facilities ordered or forecasted by the competitor.

Such a strategy, if allowed to be implemented, would result in two immediate and devastating consequences for the consumers of business telecommunications services. In the short term, customers would effectively be "redlined" by Qwest: those customers who

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[3] In practice, Qwest has not effectively utilized the information that it has been given for this purpose. Instead, significant delays in the provisioning of collocation space and UNEs have occurred and continue to occur.

either have competitive alternatives or are likely to have competitive alternatives (based on what Qwest knows in advance about CLEC market entry plans – the "detailed carrier specific information" touted by Ms. Jensen) will receive extremely attractive rates, at least initially. Those customers with no competitive alternatives, especially those served by wire centers for which Qwest is granted competitive classification for its services,[4] will experience rate increases of a magnitude limited only by Qwest's needs for cash. No competitive market forces exist to protect these customers, and Qwest's prices will be unconstrained in the upward direction.

Over the longer term, the degree of competitive entry will either be frozen or reduced. If a competitor considering expansion into a business service market in Washington[5] knows that it must notify Qwest of those plans well in advance by requesting collocation, ordering UNEs, and worse – providing forecasts of future UNE needs – it will also be aware that Qwest can engage in a pre-emptive strike by targeting customers in that new market before the competitor's arrival. *The ability of Qwest to engage in such a strategy is a highly effective barrier to entry*, and comparable in its effect to a refusal by Qwest to comply with the requirements of sections 251 and 252 of the Act.

Q. IF QWEST IS TRULY SEEKING "PARITY" WITH ITS COMPETITORS, HOW CAN THIS BE ACCOMPLISHED?

A. The closest approximation of "parity" would be to implement a structural separation between Qwest's network and retail operations, and to rigorously enforce a comprehensive set of non-discrimination requirements. Ultimately, however, experience indicates that even structural separation will not be a fully effective means of allowing Qwest's retail operation to "experience the same conditions currently enjoyed by its competitors," at least initially. Even after The Great Structural Separation of January 1, 1984, AT&T continued to enjoy significant advantages over its competitors through the use of shared network facility arrangements, or "SNFAs." Regulatory oversight and

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[4] As I will describe later in my testimony, Qwest's decision to define the relevant geographic market at the level of the wire center is overly broad, and invariably includes within its scope both customers who currently do, and do not, have competitive alternatives for the services in question.

[5] Such an expansion could be represented by the offering of a new service or the offering of existing services in a new geographic area.

enforcement mechanisms of the time proved inadequate to make even structural separation a fully effective means of preventing discrimination in the use and pricing of monopoly local network facilities.

To be clear, I am not advocating structural separation of Qwest's operations in this proceeding. If Qwest truly seeks to experience the same conditions currently "enjoyed" by its competitors, however, then structural separation is a minimum first step.

Q. IF STRUCTURAL SEPARATION IS NOT THE PREFERRED STRATEGY, WHAT IS?

A. The correct strategy is to focus on the both the short and long term interests of the customers of the services at issue. In order to do so, the Commission must endeavor to devise – within the flexibility inherent in the existing statute – a mechanism that will best serve the interests of customers over time, but which may or may not serve the stated interests of any given carrier. The Commission should not impose unnecessary limits on any carrier, but at the same time it must recognize that Qwest is, and will continue to be for the foreseeable future, in a fundamentally different position than its competitors. Fair and sustainable competition cannot be created or maintained by allowing superficial measures of equity such as those requested by Qwest in this proceeding. Instead, constraints designed to mitigate Qwest's unique position and abilities will continue to be necessary.

Q. QWEST STATES THAT IT IS SUBJECT TO BOTH FACILITIES-BASED COMPETITION BASED ON UNES AND RESALE COMPETITION. PLEASE EXPLAIN THE LIMITATIONS OF EACH OF THESE TYPES OF COMPETITION AND WHY THOSE LIMITATIONS ARE RELEVANT TO THE TASK BEFORE THE COMMISSION IN THIS PROCEEDING.

A. Qwest has presented claims regarding the level of both types of competition in support of its filing, particularly in Attachments G and H.

While competitors can economically serve the largest business customers located in a concentrated business district by utilizing their own facilities, UNEs continue to be an important and often essential means of expanding the scope of competitive alternatives beyond this limited number of customers. In order to utilize UNEs, however, a competitor must rely on Qwest for timely provisioning on UNEs and collocation and for a

level of service quality that will meet the demands of customers. Delays in provisioning have the obvious detrimental effects, but also introduce a more subtle suggestion to the customer that the competitor lacks the necessary reliability. Similarly, service outages caused by outages on Qwest's network cause customer concerns regarding service reliability, even when the affected customers are made aware that Qwest was the cause of the outage.

In addition, the existing degree of UNE geographic deaveraging limits the pricing of CLEC services. It is my understanding that UNE loops are currently deaveraged based on five zones, and that each Qwest wire center falls into one of those zones. As a result, competitors utilizing UNE loops can deaverage their retail prices at the level of the wire center in order to reflect differences in the cost of providing the service. They cannot deaverage within the area served by a given wire center, however, because their primary network costs – UNE loops – are fixed at that level. There is little dispute, however, that the cost to Qwest of providing loops varies significantly within the area served by a given wire center. If Qwest is granted the flexibility, constrained only by a calculation of its cost, to charge deaveraged prices within a wire center area, its competitors will immediately be frozen out of the market for all customers with lower than average loop costs for that zone.

Finally, the degree of difficulty currently being experienced by competitors is plainly illustrated by the limited number of UNE loops currently being provided in Washington. For example, earlier this year Qwest stated it was providing just 6,526 UNE loops in the entire state of Washington.[6] Moreover, 3,755 of these loops are being provided to data CLECs, or "DLECs."[7] The limited use of these facilities to date reflects the existing rates for UNE loops and the ability of competitors to provide a competitively priced service to consumers when faced with a network cost of that magnitude.[8] The limited use of these facilities to date reflects the existing rates for UNE loops and the ability of competitors to provide a competitively priced service to consumers when faced

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[6] Rebuttal Testimony of Mark S. Reynolds, 15, Docket UT-991358 (Feb. 22, 2000).
[7] Id.
[8] Although Qwest may be providing more UNE loops in Washington now than it was earlier this year, I have used the data from the merger docket because it is not designated confidential and can be used publicly. The data is current enough to reflect the limitations on the ability of competitors to use UNEs.

with a network cost of that magnitude. An increase in the price of UNE loops will certainly make them a viable option in fewer situations.[9]

Competition based on the resale of Qwest retail services suffers from additional limitations, yet this is the only form of competitive alternative available for the majority of customers identified by Qwest in Attachments G and H. Like UNE-based competition, competitors must rely on Qwest for timely provisioning and service of acceptable quality. Resellers are further constrained by their inability to offer features and functions beyond those already offered by Qwest.

Most importantly for Washington consumers of business telecommunications services, however, resale competition offers no protection against excessive prices. When a service is being resold, the competitive market constraints that would otherwise control prices simply do not exist. Unlike facilities-based competition, Qwest will not lose market share to a reseller as a result of increasing prices. If Qwest offers a service to a retail customer at $100 per month, for example, a reseller can offer that service at $100 minus the resale discount. At a resale discount of 15%, the competitor could offer the service at $85 if it has retail-related costs no higher than Qwest's and at slightly less than $85 if it is more efficient than Qwest at performing retail functions. If Qwest elects to double the price to $200 per month, however, the reseller cannot continue to offer the service at $85 but instead has no choice but to make a comparable price increase to its retail customer. Because a reseller's cost of providing service is tied directly to the retail price of the incumbent, the reseller can exert no price discipline in the market to prevent Qwest from charging excessive prices to customers. For this reason alone, the resale competition data provided by Qwest in this proceeding, even if verified, should not be used by the Commission in any way. *While it illustrates the existence of a specific category of competitor, it does not represent the existence of competitive market forces that provide price protection to retail consumers.* The presence of resale data in a proceeding such as this one is especially dangerous because it creates the illusion of

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[9] Ms. Jensen states at page 7 of her testimony that most competitors utilizing ported telephone numbers are not doing so over unbundled loops. If this statement is correct, it indicates that facilities-based competition is currently limited to those customers who are located in an area of high enough line density that competitors can serve them utilizing their own high volume facilities, and is further limited to the customers in those areas with a demand for a large number of telephone lines.

consumer protections that, in reality, do not exist.

The testimony of the Qwest witnesses exhibits significant confusion on this point. Mr. Teitzel, for example, argues at page 8 that "the market will determine efficient prices. Qwest will lose market share if it attempts to sustain such prices that are not market-based." When asked in discovery to describe the market forces assumed in this statement, Qwest replied that "[t]he market force that will determine 'efficient prices' is competition...Qwest will lose market share if it cannot compete at the same terms and conditions as its competitors, and if it cannot price its services based on the market direction." Qwest went on in that same response to indicate that it expected market forces to act "in the same manner" when resold services are specifically considered. Ms. Jensen goes on to take an even more aggressive view that resale constitutes "effective competition," and states in response to a data request that "[t]here is nothing unique about resellers [sic] ability to protect a customer from increased prices."[10]

As described above, such assertions are simply factually incorrect. The resale of Qwest services does not, and cannot, exert price discipline in the market for that service. By the act of setting its retail price, Qwest establishes the cost of its competitors at that level (minus only a resale discount that is intended to represent the avoided costs of each carrier). Competitors cannot "hold the line" against Qwest price increases for the retail service, because their costs increase in lockstep with the Qwest retail price increase. As long as they receive Qwest's best price as the resale price, competitors are not directly harmed until Qwest prices the service at such a level that total market demand decreases. The consumers of the retail service in question are not so lucky, however: they will experience price increases regardless of which carrier (Qwest or a resale competitor) provides its service. If the Request is granted, these price increases will be limited only by the whims of Qwest.

Resale competition suffers from one additional limitation: resellers are especially vulnerable to a price squeeze (intentional or unintentional) by the incumbent. The resale

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[10] Qwest response to ATG/MSC 02-002. It is perhaps worth noting that Ms. Jensen provided the responses to the questions directed to both her testimony and that of Mr. Teitzel. When giving her views regarding the operation of competitive markets and what she refers to as "the natural course of competition," Ms. Jensen states that she "did not rely on economic texts, articles, papers, or other published sources," but rather "upon her 28 years of experience" working for a regulated monopoly.

of the incumbent's services can serve two objectives: (1) in and of itself, it provides alternative sources of supply (though not price protection) for consumers, and (2) perhaps more importantly in the long run, it allows competitors to establish a presence in a market, begin to establish customer relationships, and initiate a revenue stream before facilities are placed. For this reason, the ability of Qwest to exert a price squeeze on resale competitors can have an adverse impact on both resale and facilities-based competition.

If granted the unconstrained upward and constrained-only-by-cost downward pricing flexibility inherent in the Request, Qwest would have the ability to squeeze many resellers out of the market. Resellers are themselves captive customers of Qwest, though on a wholesale rather than retail basis. If another facilities-based carrier is operating in the same geographic area as the reseller, that facilities-based carrier must offer a service for resale with the features and functions required for the reseller's service in order to be a viable option. Even then, section 251 of the Act does not require facilities-based carriers other than the incumbent LEC to make services available for resale at a discount.

As a result, Centrex resellers such as ATG and MetroNet must obtain the underlying service from Qwest, and the pricing of ATG's and MetroNet's retail services must remain tied to the price charged by Qwest for Centrex Plus. Qwest, however, would control (if the Request is granted) both ends of the equation: it would be able to increase the rates for Centrex Plus, and would be able to reduce the rates for its retail business services that compete against ATG's and MetroNet's services.

Q. YOU STATED PREVIOUSLY THAT QWEST HAS DEFINED THE RELEVANT MARKETS FOR BUSINESS SERVICES IN WASHINGTON TOO BROADLY. PLEASE EXPLAIN WHY THIS IS THE CASE.

A. Qwest's market definition for the services that it asserts are subject to effective competition is overly broad for at least three reasons: Qwest has included too many specific geographic areas (wire centers) in its petition, Qwest has included too many services within each geographic area, and Qwest has chosen to define the relevant geographic market area as the area served by a given wire center, which is too large to accurately portray the competitive alternatives available to customers.

Q. PLEASE EXPLAIN WHY YOU BELIEVE QWEST HAS INCLUDED TOO MANY WIRE CENTERS IN ITS PETITION.

A. Attachment G indicates that Qwest is seeking competitive classification of its business services in 31 wire centers. The degree of competitive entry experienced to date varies widely in the identified wire centers, however. Assuming that the information provided by Qwest is correct and verifiable, competitors have ported more than 10% of the telephone numbers in only {****PROPRIETARY****} of the 31 wire centers. According to Qwest, resellers have a market share of greater than 10% in only {****PROPRIETARY****} of 31 wire centers subject to competitive classification. While Attachment G (and the underlying Attachment H) shows that competitive entry has occurred to some degree in each of the 31 wire centers, it does not demonstrate that effective competition exists in any of those areas. To the contrary, Attachment G portrays a situation characterized by widely varying levels of competitive entry and – even in the examples most favorable to Qwest – low market shares for Qwest's competitors.

At page 7 of her testimony, Ms. Jensen describes two wire centers, Bellevue Sherwood and Seattle Elliott, that she contends represent "an excellent example of the diversity of carrier selection in how this geographic market area is approached" by competitors. She goes on to tout that 14 competitors have "approached" the Bellevue Sherwood area, while 17 competitors have "approached" the Seattle Elliott area. What Ms. Jensen fails to mention is that, even in the areas she has chosen to illustrate "excellent examples of the diversity of carrier selections," those competitors have made on slight competitive inroads to date. According to Qwest's data, resellers have only {****PROPRIETARY****}% of the business lines in Bellevue Sherwood, while facilities-based competitors have ported only {****PROPRIETARY****}% of the lines. If market shares are roughly evenly divided, this means that the 5 resellers each have about {****PROPRIETARY****}% of the business lines in the area, while the 10 facilities-based carriers each have about {****PROPRIETARY****}% of the telephone numbers. Similarly, in the Seattle Elliott area resellers have only {****PROPRIETARY****}% of the business lines and facilities-based carriers have managed to port only {****PROPRIETARY****}% of the numbers to date. If market shares are roughly evenly divided, this means that the 9 resellers each have about {****PROPRIETARY****}% of the business lines in the area, while the 12 facilities-based carriers each have about

{**PROPRIETARY**}% of the telephone numbers.

Even with these quite low levels of market penetration, Qwest attempts to portray these wire centers as representative of the 31 at issue, but that is simply not the case. In 21 of the 31 wire centers resellers have a lower market share than in Bellevue Sherwood, and in 23 of the 31 a lower market share than in Seattle Elliot. Facilities-based carriers who port telephone numbers have a lower percentage of the numbers in 8 of the 31 wire centers than in Bellevue Sherwood, and in 21 of the 31 a lower percentage than in Seattle Elliott. Qwest has not demonstrated the presence of effective competition in the illustrative wire centers chosen by Ms. Jensen, and certainly has not done so for the significant number of wire centers that exhibit lower levels of competitive entry than the illustrative areas. To the contrary, Qwest's data indicates that, to date, even when a given geographic area is "approached" by a significant number of competitors (14 in the Bellevue Sherwood wire center and 17 in the Seattle Elliott wire center according to Ms. Jensen), those competitors have still been unable to win away significant market share from Qwest.

Q. PLEASE EXPLAIN WHY YOU BELIEVE THAT QWEST HAS BEEN OVER-INCLUSIVE IN THE LIST OF SERVICES FOR WHICH IT IS REQUESTING COMPETITIVE CLASSIFICATION.

A. Qwest has been over-inclusive in the list of services included in its Request in two ways: by including services that rely on forms of network access not yet readily and reliably available to its competitors, and by including services not offered by its competitors.

The list of services presented in Attachment A consists of services that, in most instances, are efficiently provisioned utilizing low volume network access arrangements. In order to provide Business Basic Measured on Business Flat Line services, for example, even a competitor with a fiber ring through a downtown area is likely to need to utilize unbundled loops obtained from Qwest. It is rarely cost efficient to serve a customer who need only a few lines with a high volume facility. Qwest's data indicates that competitors are having difficulty provisioning services to customers of this size utilizing unbundled loops. According to Ms. Jensen (page 7), 14 competitive carriers have managed to have only 808 unbundled loops provisioned in the Bellevue Sherwood wire center, and 17 competitors have managed to have only 585 unbundled loops provisioned in the Seattle

Elliott wire center. These are extremely low counts by any measure, and clearly indicate a problem with either the price, availability, or reliability of UNE loops provided by Qwest.

Qwest has also chosen to request competitive classification for services that it readily admits are not offered by its competitors. At page 11 of her testimony, Ms. Jensen makes the sweeping claim that "business customers in these geographic areas have access to the full spectrum of business services without relying on Qwest for said services."[11] Mr. Teitzel makes a similar statement at page 15: "Today, in every one of the thirty one wire centers, customers can go to the well-advertised and widely available competitors of Qwest to purchase equivalent service offerings." As Mr. Teitzel later points out at pages 17-18, however, neither of these claims is actually true. In fact, Qwest has included services in the Request that it readily concedes are *not* being offered by its competitors today. Instead, Qwest has included services that it has unilaterally determined that its competitors *ought* to be offering, even though they are not yet actually doing so. As Mr. Teitzel explains, "Qwest has compared its list of its services to services or features available from the various switch manufacturers utilized by its competitors. If the switch manufacturer utilized by the CLEC offered the feature or service, Qwest included the product in its list of competitive services."

Such an approach completely ignores the fact that the manufacturers of these switches expect to be paid for these features, and that the cost to a carrier of providing a given service extends well beyond the simple cost of acquiring the needed underlying feature from an equipment vendor. In this new height of arrogance, Qwest has determined that it, and not the obviously uninformed and misguided CLEC, is in the best position to determine what the CLEC market entry strategies ought to be and how these carriers should spend their limited investment funds.

Fortunately, the Commission need not put Qwest in the position of managing the CLECs at this time. RCW 80.36.330 plainly states that a telecommunications service may be classified as competitive if "customers of the service have reasonably available alternatives." It does not state that a service can be classified as competitive if "Qwest

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[11] In Qwest's response to ATG/MSC 02-013, Ms. Jensen defines "full spectrum of business services" as "the services at issue in this proceeding.

thinks that customers of the services ought to have reasonably available alternatives," nor does it state that a service can be classified as competitive "if a CLEC fully controlled by Qwest would have chosen to deploy its resources differently and would have made an alternative available by now." Contrary to Qwest's assertions, not all of the services for which it is requesting competitive classification have reasonably available alternatives, and captive customers for these services do exist in the geographic areas identified by Qwest.

Q. PLEASE EXPLAIN WHY QWEST'S CHOICE TO IDENTIFY THE RELEVANT MARKETS AT THE LEVEL OF THE WIRE CENTER IS OVERLY INCLUSIVE.

A. As I described previously in my testimony, a market must be properly defined in terms of both products or services (specifically whether such offerings are substitutes for one another) and geography (the scope of the offering of the product or service). The geographic scope of the relevant market used to identify competitive offerings is not specified by RCW 80.36.330, however, and the Commission has the flexibility to define the geographic scope of the markets in question. For the purposes of consideration of the Request and all supporting documentation, Qwest has made the decision regarding geographic market definition to be applied in this proceeding.

It is clear that Qwest's choice to define markets at the level of the geographic area served by a given wire center was not made based on a review of available information regarding competitors. It is reasonable to expect that when making such a decision, one would collect and review data regarding the geographic scope of competitive alternatives, and, based on that data, propose a market definition based on the geographic areas that currently experience reasonably available alternatives. Such a market could be defined as broadly as the entire state or as narrowly as individual city blocks or buildings.

Qwest has actually done just the opposite, as explained by Mr. Teitzel at page 6 of his testimony: "Qwest has chosen wire centers as its relevant market for competitive classification purposes for ease of measurement and implementation. Evidence supporting the existence of competition has been gathered on a wire center basis and was submitted in that fashion in Qwest's Petition." The fact that Qwest has chosen to take such an approach is unfortunate for several reasons. First, while it may be true that it

would be easiest for Qwest to collect data at the level of the entire wire center area and to implement price changes at this level, "easy collection and implementation" is simply not a substitute for a determination of where "reasonably available alternatives" actually exist. Second, because Qwest defined the market as the area served by a given wire center *before* collecting data, it has no information that is at a more discrete, and potentially more useful, level. As Ms. Jensen points out in response to ATG/MSC 02-015, "Qwest did not identify specific market segments" within the area served by a given wire center. As a result, while data at a finer, more discrete level may have been sufficient to provide the Commission with a basis for permitting competitive classification for some services for an area smaller than a wire center, no such data is available.

The problem, of course, amply illustrated by the network maps provided by Qwest as Attachment K, is that not all customers served by a given wire center are similarly positioned with respect to their access to competitive alternatives. Some customers served by a given wire center, especially those located on or very near a competitive carrier's fiber route, may have reasonably available competitive alternatives for a given business service. Other customers served by that same wire center, however, may have no alternatives at all. Unfortunately for this second group of customers, Qwest is asking for competitive classification – and the commensurate upward and downward pricing flexibility -- for the service for the entire wire center area.

If the Request is granted, customers who currently have no competitive alternatives will be subject to price increases, and the funds generated can be used by Qwest to fund the offering of services to customers who do have competitive alternatives at the cost floor. In contrast, if the market area were to be defined correctly to include only those customers who truly have reasonable alternatives today, customers with no current alternatives will continue to have some measure of protection, and Qwest will have (marginally) fewer funds available to offset losses associated with providing service to a given customer at cost in order to underprice a competitor.

Q. BOTH MR. TEITZEL AND MS. JENSEN RELY PRIMARILY ON THE INFORMATION CONTAINED IN ATTACHMENT G (AND THE UNDERLYING ATTACHMENT H) TO SUPPORT THEIR ASSERTIONS REGARDING THE AVAILABILITY OF COMPETITIVE ALTERNATIVES TO QWEST'S BUSINESS SERVICES. PLEASE EXPLAIN IN DETAIL WHAT ATTACHMENT G ACTUALLY SHOWS AND DOES NOT SHOW IN TERMS OF THESE CLAIMS.

A. Attachments G and H show that competitive alternatives, provided either through resale, a competitor's facilities, or a competitor's use of Qwest unbundled facilities, exist *for some customers* in the identified wire centers. This information is a snapshot of the facts as they exist today, with no consideration of how the identified competitive alternatives may change if the Request is granted. Attachments G and H also illustrate the fundamental shortcoming of Qwest's presentation in this proceeding: all of the data presented assumes that the area served by a given wire center is the relevant geographic definition of the market (i.e. that *all* customers of business telecommunications services served by a given wire center have access to competitive alternatives), and as a result no data was collected or presented for geographic areas smaller than the total area served by a given wire center.

It is also important to note that, in contrast to the claims made by Ms. Jensen and Mr. Teitzel, Attachments G and H do not support certain assertions. These unsupported assertions can be summarized as follows:

<u>The Qwest data does not show the level of competitive coverage within the defined market area</u>. Mr. Teitzel claims at page 4 that the data presented by Qwest "unequivocally demonstrates that competition for Qwest's basic business services exists in Washington," and at page 15 that "[t]oday, in every one of the thirty one wire centers, customers can go to the well-advertised and widely available competitors of Qwest to purchase equivalent service offerings." His statements may be true for some customers in Washington today, but it is certainly not true for all customers and not true for all of the customers served by each of the 31 wire centers. Qwest has presented data that is not geographically precise enough to show which customers have readily available alternatives and which do not.

<u>The Qwest data does not show a "conservative" estimate of Qwest's competitive losses.</u> At pages 4 and 6 of her testimony, Ms. Jensen suggests that the data collected by Qwest is incomplete and "does not fully capture the total competitive loss experienced by

Qwest." The rationale for this claim is that when a large customer switches from Qwest to a competitor, it hypothetically can choose to retain (have ported) only those phone numbers used for external communications, and may be willing to change all of the phone numbers associated with internal communication. Qwest offers no theory why the customer in question would consider a disruption in internal communications to be acceptable, while a disruption in external communications would not be. In response to ATG/MSC 02-009, Qwest could not offer a single example of such an occurrence. As a result, there is no factual basis for the Commission to conclude that Qwest's measurement of ported numbers significantly understates the market share of its competitors.

The information presented in Attachment G should not be considered to be a "conservative" measure for one additional reason. When presenting the average percentage of resold business lines and average percentage of CLEC ported numbers for the 31 wire centers at the bottom of the chart, the spreadsheet is constructed in such a way that it produces misleading results. Rather than calculate these percentages directly from the data on the chart, the Qwest spreadhseet takes an average of the percentages for the individual offices (in effect, creating an "unweighted average"). This spreadsheet flaw has a significant impact on certain of the results: instead of the average percentage of CLEC ported numbers of {**Proprietary**}% that appears on the chart, Qwest should have reported a value of only {**Proprietary**}%.[12]

The Qwest data does not show that no barriers to entry exist or would exist if the Request is granted. Qwest witnesses are quick to assert that the existence of competitors in a given market area demonstrates that barriers to entry do not exist. Mr. Teitzel argues at page 13, for example, that the presence of a threshold number of facilities-based providers operating in a given wire center area "clearly indicates no barrier to entry and extensive competitive alternatives." Ms. Jensen goes beyond merely claiming that barriers do not exist, and claims (p. 11) that competitors' "ease of entry" has no limitations. As a factual of matter, the mere presence of competitors in a given area says essentially nothing about the existence of existing barriers to entry, and absolutely

[12] {**PROPRIETARY**} ported numbers divided by {**PROPRIETARY**} Qwest business lines equals {**PROPRIETARY**}, and not {**PROPRIETARY**} as reported on Attachment G.

nothing about the barrier that would exist of the Request is granted.

From an economic standpoint, barriers to entry are more accurately described as "barriers to effective entry." A barrier may exist that prevents a potential competitor from entering a market at all, but a more subtle – but from the viewpoint of customer benefit, equally effective – barrier may exist that prevents a carrier that is otherwise capable of successfully competing[13] from doing do. The relatively modest success of competing providers in the majority of the 31 wire centers at issue suggests the existence of this second, more subtle barrier.

<u>The Qwest data does not show that Qwests lacks market power for the services in question.</u> To the contrary, the market share data in Attachment G indicates that Qwest retains significant market power. In response to ATG/MSC 02-031, Qwest asserts that the data it has provided "demonstrate that market share is dispersed among several providers in the wire centers. In short, no one competitor has market power but rather that all are competing for a share of the business customers." I agree with Qwest that the dispersion of market share in the 31 wire centers is an important consideration: in the market areas in question, one carrier currently has between {**PROPRIETARY**} and {**PROPRIETARY**} of the lines subject to resale (with an average of {**PROPRIETARY**}%) and between {**PROPRIETARY**}% and {**PROPRIETARY**}% of the telephone numbers subject to being ported (with an average of approximately {**PROPRIETARY**}. Assuming that Qwest's data is correct and verifiable, the following chart summarizes the current typical degree of market share dispersion for the 31 wire centers:[14]

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[13] In this context I am referring to a competitor that has the marketing, management, and operational expertise to offer a product that is desirable to customers, and the financial resources to implement such an offering.

[14] CLEC percentages are derived directly from the data in Attachment G, and assume that the total CLEC market share is divided evenly among individual CLECs.

Resale:

	Competitor	Share of Lines
	CLEC 1	{**Proprietary**}%
	CLEC 2	{**Proprietary**}%
	CLEC 3	{**Proprietary**}%
	CLEC 4	{**Proprietary**}%
	CLEC 5	{**Proprietary**}%
	CLEC 6	{**Proprietary**}%
{**Proprietary**}%	Qwest	

Facilities-based:

	Competitor	Share of Lines
	CLEC 1	{**Proprietary**}%
	CLEC 2	{**Proprietary**%
	CLEC 3	{**Proprietary**}%
	CLEC 4	{**Proprietary**}%
	CLEC 5	{**Proprietary**}%
{**Proprietary**}%	CLEC 6	
{**Proprietary**}%	CLEC 7	
{**Proprietary**}%	Qwest	

According to Qwest's data from Attachment G, in a typical scenario an average of {**Proprietary**} resellers will share less than {**Proprietary**}% of the market, while Qwest retains almost {**Proprietary**}% of the lines. Similarly, the Qwest data indicates that in a typical scenario an average of {**Proprietary**} CLECs will share a number of ported numbers equal to less than {**Proprietary**}% of the total business numbers, while Qwest retains the remaining {**Proprietary**}% of the numbers. Such a dramatic difference in the market share of Qwest and its competitors demonstrates

that—even if its data is correct—Qwest enjoys substantial market power and will continue to do so in the foreseeable future.

The Qwest data does not show that market forces exist to protect business customers from price increases. Qwest relies heavily on the existence of resellers to create the impression of significant competitive entry. Unfortunately for the consumers of business telecommunications services, resale competition offers no protection against price increases. Even when considering the facilities-based competition that exists in some areas, a mis-match exists between the geographic coverage of the competitive alternatives and the area within which Qwest would be granted pricing flexibility. For those customers that are located within the area served by one of the 31 wire centers but outside of the area that actually has access to facilities-based competitive alternatives, no protection would exist.

The Qwest data does not show that there are no captive customers in the identified market areas. Since Qwest decided to define the relevant market area as the area served by a given wire center and then collected data at that level of aggregation, there is no evidence in this proceeding that will allow the Commission to determine which customers in those areas actually have reasonably available competitive alternatives. Attachment K illustrates the limits of geographic coverage of the CLECs' facilities, but is incomplete and cannot be used to determine the level of actual competitive coverage in the 31 wire centers at issue.

Q. HOW DOES QWEST ATTEMPT TO JUSTIFY THE REQUEST BEYOND THE DATA PROVIDED IN THE ATTACHMENTS TO THE PETITION?

A. Qwest attempts to justify the Request in part through assertions that its competitors have significant and important freedoms while its hands remain unnecessarily tied. Specifically, Mr. Teitzel argues that Qwest's competitor's can (1) change prices with only 10 days notice, (2) charge prices below the level of the statewide average, (3) offer a broader array of services (including interLATA services) than Qwest, and (4) offer services that are more technologically advanced than Qwest. For these reasons, he argues, the Commission should grant Qwest the pricing flexibility that it is seeking in this

proceeding. Each of Mr. Teitzel's observations fails to justify what Qwest is asking for, however.

Mr. Teitzel is correct that competitors can change prices with 10 days notice. As he concedes at pages 8-9 of his testimony, however, so can Qwest: it need only keep the rates within a band previously approved by the Commission. Mr. Teitzel laments that that banded tariffs "still require a price floor and a price ceiling." The price floor would not change, however: Qwest would still have to price the service in question above its cost. What Qwest would gain if the Request is granted is relief from the approved price ceilings. While it would have no greater downward pricing flexibility, Qwest would have complete upward flexibility in its pricing. If Qwest is right that effective competition currently exists for every customer of every business service within the 31 wire centers, then this upward flexibility will be of no benefit, because competitive market forces will render it moot. If Qwest has overstated the scope of effective competition, however, a significant group of Washington consumers will have no protection from price increases for business telecommunications services.

Mr. Teitzel is also correct that competitors can price a service below the level of a statewide average rate, but he fails to recognize the limitations in that flexibility. Resellers can deaverage at a level no greater than the level rate deaveraging by Qwest. Facilities-based competitors that rely on UNEs can deaverage only to the level of the five zones for deaveraged loops; within a given wire center, all loops cost a competitor the same amount. In reality, the degree of geographic deaveraging for Qwest's retail service available for resale and the UNEs it provides determines the level of potential price deaveraging for its competitors. While competitors can offer high volume business services utilizing their own facilities (in the areas in which they have facilities in place) and deaverage to a greater degree, Qwest also has the ability to deaverage these high volume services.[15] The services that are subject to the immediate petition are provided to business customers with fewer lines than those previously considered by the Commission in Docket UT-990022.

Mr. Teitzel is also right that many of Qwest's competitors can and do offer

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[15] The competitive classification of these services was granted in Docket No.UT-99022.

interLATA services that Qwest is currently prohibited from providing. Of course, Qwest can gain the ability to offer such services by complying with the checklist items in section 271 of the Act; it controls its own destiny in this regard. The pricing flexibility being requested in this proceeding is completely unrelated and the granting of the Request would not address Mr. Teitzel's concern. Qwest concedes in response to ATG/MSC 02-028 that Qwest is not seeking to address this issue in this proceeding.

Finally, I agree with Mr. Teitzel that competitors may offer services that are more technologically advanced than those offered by Qwest, although the ability of competitors to offer these services is largely limited to areas in which they have deployed their own facilities and relates to high volume services that are not the subject of this proceeding. Qwest readily acknowledges, however, that the classification of business services as competitive will not make Qwest's services "'more advanced' than the current offerings." I agree. Of course, while the pricing flexibility it seeks will not give Qwest a technological advantage or overcome any technical shortcomings, the ability to engage in price squeezes of resellers or pre-emptive strikes against potential facilities-based carriers may reduce or eliminate the need for Qwest to invest in new facilities.

In summary, the problems that Mr. Teitzel asserts that Qwest is having in the marketplace – the inability to change prices with a ten day notice, the inability to charge prices at a level of disaggregation less than the statewide average, the inability to offer interLATA services, and the inability to offer services that are as technologically advanced as its competitors – either do not exist or will not be addressed if the Request is granted. Qwest can obtain 10-day pricing flexibility by filing proposed rate bands and can charge rates that are more deaveraged than simply a statewide average rate. The additional pricing flexibility that Qwest is seeking will not give it interLATA authority, however, and is no substitute for network investment.

Q. IS QWEST ALREADY ACTIVELY ENGAGED IN COMPETITIVE EFFORTS TO RETAIN AND WIN BACK CUSTOMERS WITH ITS EXISTING DEGREE OF PRICING FLEXIBILITY?

A. Yes. Qwest indicates that it is actively involved in such competitive efforts. Other than the largely irrelevant claims of Mr. Teitzel described above, Qwest has provided no evidence in this proceeding that it cannot successfully compete within the existing set of

constraints, or, put more finely, that any shortcomings in its efforts to successfully compete are caused by circumstances not already directly under the company's control.

Proprietary documents provided in response to ATG/MSC 44-46 and 48 indicate that Qwest has a fully developed plan in place {**PROPRIETARY**}. Qwest can and should engage in this type of competitive effort, but does not need the additional pricing flexibility inherent in the Request in order to do so.

Q. WHAT WILL BE THE IMPACT ON COMPETITION FOR BUSINESS SERVICES IN WASHINGTON IF THE REQUEST IS GRANTED?

A. The granting of Qwest's petition will have a number of immediate effects to the detriment of both consumers and competitors of Qwest business services:

<u>Qwest will be able to able to limit or eliminate the presence of resellers in these markets by engaging in targeted price squeezes.</u> Mr. Teitzel states at page 10 of his testimony that "Qwest will not be able to price in a manner that will result in a price squeeze," but simply making the statement does not make it a fact. By controlling both ends of the resale equation – the cost incurred by the reseller and the price for the retail service that it must compete against – Qwest can effectively squeeze resellers out of the market. Contrary to Mr. Teitzel's assertion, the ability to engage in a price squeeze does not require Qwest to be able to price the competing retail service below cost. The cost-based price floor that currently constrains Qwest will not change if the Request is granted, but Qwest will be granted unlimited upward pricing flexibility. Resellers remain captive customers at the wholesale level and, along with the retail customers that are located within the identified market areas but which do not currently have a reasonably available facilities-based competitive option, will be at Qwest's mercy.

Qwest has recently produced a cost study of Centrex Plus service, which is resold by ATG, MetroNet, and other resale competitors of Qwest. While I have had the time to conduct only a limited review of the study in advance of preparing this testimony, it appears that there is little room for price reductions to the service. The only reason for Qwest to include Centrex Plus in the Request, therefore, is to gain *upward* pricing flexibility for the service.

<u>Market entry will be frozen in terms of both geographic area and services.</u> Mr. Teitzel argues at pages 19-20 that "[c]ompetitive classification will not slow the

distribution of market share among the various providers of service." This is unlikely to prove true, however. The flexibility requested will permit Qwest to eliminate resale in many instances, both by those competitors that focus on resale and by potential facilities-based carriers utilizing resale to establish a competitive presence and customer relationships prior to beginning to offer service in the area utilizing their own facilities.

Equally importantly, facilities-based competition will be unable to develop in new areas (either in terms of new geographic areas or new services in geographic areas that already have competitive alternatives for other services). Competitors that are aware that Qwest can engage in a pre-emptive strike to lock up customers before they can begin to offer their own service simply will not invest the resources for entry into new markets. Because of its unique position as the incumbent monopoly provider of essential facilities to its competitors (collocation and UNEs), Qwest knows in advance the plans of potential competitors and can control the speed of their competitive entry through its control of the provisioning intervals for collocation and UNEs. During the inherent lag between the time that Qwest learns of its competitor's entry plans and the time that competitor has the opportunity to implement those plans, Qwest can act with relative precision to take away the potential market. The pricing flexibility sought in this proceeding will enhance Qwest's ability to engage in such a strategy.

My concern in this regard is increased when reviewing the documents provided by Qwest in response to ATG/MSC 44-46 and 48. In these documents, Qwest sets forth various projections of the share of business service revenues that it and its competitors will receive in the future. In the scenarios in which Qwest is successful in obtaining the pricing flexibility being sought in the proceeding, Qwest's projected market share in the year 2005 is {**PROPRIETARY**} to its market share today. In direct contrast to Mr. Teitzel's assertion that "[c]ompetitive classification will not slow the distribution of market share among the various providers of service," Qwest's own internal projections are {**PROPRIETARY**}.

<u>Granting the Request would freeze the business customer "haves" and "have nots," and effectively allow Qwest to redline competition.</u> Customers with existing facilities-based competitive alternatives could be offered rates that Qwest's competitors will be unable to match, while customers that are located within the area served by the 31

wire centers but which currently do not have facilities-based competitive alternatives will be the victims of Qwest's new unlimited upward pricing flexibility. Qwest's ability to engage in pre-emptive strikes before a competitor can successfully enter the market will ensure that the current "have nots" do not receive rate relief.

Qwest would have the unfettered incentive and ability to focus on individual customers of its competitors and to offer them prices that can't be matched. The combination of upward and downward pricing flexibility will permit Qwest to offer targeted prices to CLEC customers that recover only the direct costs of providing the service while recovering all other costs of doing business from the unfortunate business customers who are located within one of the identified market areas but do not have a reasonably available competitive alternative. Qwest's competitors have no such captive customers from which to extract the recovery of these costs, however. As a result, they can meet Qwest's price floor offering and lose money, or attempt to recover their costs and lose the customer.

Qwest will have the unfettered incentive and ability to focus on individual customers who do not have facilities-based competitive alternatives and to increase the prices that they must pay. Mr. Teitzel argues at page 8 that "Qwest will lose market share if it attempts to sustain prices that are not market-based." Such a statement can only be true, however, with regard to those customers who have facilities-based competitive alternatives. For those customers that have been included in a flexible pricing area simply because of Qwest's overly broad market definition, Qwest faces no threat of lost market share.

Q. GIVEN THE ADVERSE CONSEQUENCES FOR BOTH CUSTOMERS AND COMPETITORS IF THE COMMISSION GRANTS THE REQUEST, WHAT IS YOUR RECOMMENDATION?

A. My recommendation is that the Commission reject Qwest's Petition. Qwest was well aware of the requirements of RCW 80.36.330, yet elected to define the relevant markets in an overly inclusive way that made the required factual demonstration impossible.

It would be difficult and dangerous to attempt to fix an inherently flawed application without competitive data at the necessary degree of disaggregation to do so in this proceeding, particularly given the very short time frame in this docket due to the

statutory deadline for Commission action. Instead, the Commission should deny the current petition and make it clear that in any future petition that Qwest might desire to file, it must file supporting data with the petition that is specific to those areas – to the extent that they exist – in which Qwest currently faces facilities-based competition for the services in question. Services included in such a petition should, of course, be limited to those services that are actually being offered by competitors, so that the "reasonably available alternatives" required by RCW 80.36.330 can be demonstrated.

If the Commission elects to grant a portion of Qwest's petition in this proceeding, however, it should do so only if *each* of the following restrictions is imposed:

<u>Competitive classification should be granted only for those wire centers within which Qwest faces significant facilities-based competition for the services to be classified.</u> Since resale competition cannot constrain price increases, even a minimum level of consumer protection requires that upward pricing flexibility be granted only in those areas in which facilities-based alternatives can serve to provide price discipline. Care should also be taken to match the services classified as competitive with the type of facilities in place; the presence of high volume facilities that can only be economically used to provide service to customers with a large number of lines should not be used to justify competitive classification of business services that are targeted to customers with fewer lines. In order to classify these lower volume business services as competitive, the existence (not just potential) of properly priced and reliable unbundled loops – provisioned in a timely manner – must be demonstrated.

<u>All competitive offerings made to a business customer served by a given wire center must be made to all customers served by that wire center.</u> As explained previously, one of the fundamental problems with the Request is that the market areas are over inclusive: Qwest is asking for pricing flexibility for areas within which some customers may have reasonably available competitive alternatives, but other customers will not. The ability of Qwest to perpetuate the current status of "haves" and "have nots" is created by its ability to charge different prices within the market area that it has identified. One of the following sets of facts must be true, however: (1) Qwest is incorrect regarding the geographic coverage of competitive alternatives within the area served by a given wire center (as I have suggested), and granting it upward pricing

flexibility at this time would have a significant adverse impact on many of the business customers in the identified areas, *or* (2) Qwest is correct in its assertion that all business customers in served by each of the 31 wire centers currently has access to reasonably available competitive alternatives (e. g. effective competition exists for these services for the entire market area identified by Qwest), in which case market forces will prevent it from exercising the flexibility that it is seeking.

Put simply, if Qwest's claims of effective competition are overstated the Commission should not grant the pricing flexibility sought, and if Qwest's claims of effective competition are correct, market forces will require it to offer the lowest price to all customers of a given service served by a given wire center. As a result, Qwest should not oppose a requirement that it make all offerings available to all customers of the service served by the wire center in question, because a refusal to do so would prove that it has overstated its claims regarding the geographic scope of effective competition.

Such a requirement has clear benefits, however. If Qwest must make its offerings available on a market-wide (in this case wire center-wide) basis, it will need to carefully analyze any such offering in order to determine if the price makes sense as a long term competitive strategy that will permit cost recovery. This will require Qwest to act as a rational competitor would act and will limit its ability to engage in predatory pricing strategies.

<u>The ability of Qwest to deaverage its prices must be limited to the ability of a competitor utilizing UNEs to deaverage.</u> The current zone pricing of UNE loops means that the facilities-based competitors of Qwest's business services experience costs that are averaged at the wire center level, and differ only by wire center depending on the zone in which it falls. Under no circumstances should Qwest's ability to deaverage its retail prices exceed the ability of its competitors to deaverage their costs. Qwest is free to propose further deaveraging of UNE loops in the future, and once that level of UNE deaveraging is in place it will be appropriate to permit Qwest to deaverage retail prices to that level. Until such time, Qwest must be required to meet a price floor for all relevant retail prices based on the imputed rates of UNEs specific to the wire center in question.

<u>Specific requirements should be applied to ensure that resale remains available as a source of competitive alternatives for consumers and as an entry vehicle for</u>

competitors. While I am not advocating that the Commission adopt requirements specifically to protect any particular carrier, I strongly advocate the adoption of measures necessary to protect the viability of resale as a form of limited competition and as a vehicle for competitive entry. Resale viability can be maintained with the adoption of two important requirements. First, the ability of Qwest to engage in a price squeeze must be contained and minimized. Upward pricing flexibility for resold services must be limited to reflect the fact that resellers remain captive customers. For services such as Centrex Plus, an initial review of Qwest's cost data suggests that little downward flexibility is possible, and that the only effect of the requested pricing flexibility will be price increases to specific customers of Qwest's choosing. A service with these characteristics, especially a service that serves as a primary vehicle for resellers to provide business services, should be excluded from any competitive classification.

Second, any new offering by Qwest within one of the market areas that it has identified must become the new resale price for the service (minus the appropriate resale discount). If Qwest is right that effective competition exists throughout the entire area served by a given wire center, then customers throughout that market area will be demanding competitive rates. A new offering by Qwest will reset the market price against which resellers must compete, and they will be unable to do so if they do not have the opportunity to meet that price. In order for this mechanism to be effective, both customer contracts – and offer sheets to potential customers – must be defined as offerings subject to resale. Without such a requirement, Qwest will always be able to underprice a competing reseller.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.