

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

Request for Competitive Classification of Basic
Business Exchange Telecommunications
Services

DOCKET NO. UT- 030614

**DIRECT TESTIMONY
OF
HARRY M. SHOOSHAN III
ON BEHALF OF
QWEST CORPORATION**

JULY 1, 2003

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE AND ADDRESS.

- A. My name is Harry M. Shooshan III. I am a principal and co-founder of Strategic Policy Research, Inc. ("SPR"), a public policy and economics consulting firm located at 7979 Old Georgetown Road, Suite 700, Bethesda, Maryland, 20814.

Q. PLEASE REVIEW YOUR WORK EXPERIENCE, PRESENT RESPONSIBILITIES AND EDUCATION.

- A. Before co-founding Strategic Policy Research, Inc. ("SPR"), I served for eleven years on Capitol Hill. I was chief counsel and staff director of what is now the Subcommittee on Telecommunications and the Internet of the U.S. House of Representatives during the period of time when telecommunications markets were first being opened to competition. As a private attorney, I appeared before Judge Harold Greene in his review of the consent decree that broke up the old Bell System. As a consultant, I have specialized in communications public policy analysis, regulatory reform and the impact of new technology and competition. I have also advised firms on business strategies and market opportunities.

I have testified before several Congressional committees, the Federal Communications Commission ("FCC"), the Canadian Radio-television and Telecommunications Commission, and numerous state commissions, including those in Arizona, Idaho, Illinois, Indiana, Louisiana, Nebraska, New Jersey, New York, Pennsylvania, and Tennessee.

My testimony before state commissions has addressed topics related to price regulation, the growth of competition and the reclassification of services. I also served as an advisor to the Iowa Utilities Board and to the staff of the Arizona Corporation Commission where my work included the development of alternative regulation/price regulation plans and implementation of the Telecommunications Act of 1996. I have also been involved in our firm's work with OFTEL, the telecommunications regulatory body in the United Kingdom that adopted the first price regulation plan for an incumbent provider in 1983.¹ OFTEL has since gradually withdrawn from regulating retail prices, including prices for business services, as competition has developed. I have also actively participated in the Triennial Review rulemaking process at the FCC.

I am a graduate of Harvard University (B.A.) and of the Georgetown University Law Center (J.D.). From 1978 to 1991, I was an adjunct professor of law at Georgetown University Law Center, teaching regulation and communications law.

A copy of my complete curriculum vitae is appended to this testimony as Exhibit HMS-2.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION (“THE COMMISSION”)?

A. No.

¹ OFTEL, “A Brief History of Recent U.K. Telecoms and OfTel,” www.oftel.gov.uk/about/history.htm#1

II. PURPOSE AND BACKGROUND

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

- A. The purpose of my testimony is to discuss the evidence put forth by Qwest Corporation in support of its petition for competitive classification of basic business exchange services throughout the state of Washington. In particular, I discuss the appropriate role of evidence such as market share or concentration ratios in this proceeding.

Competitors have achieved a significant share of the market. Coupled with the trends over time and the ease of entry/expansion, there is ample evidence of effective competition. However, the Commission should be careful in applying in this docket tools such as concentration ratios developed by enforcers of antitrust laws to analyze mergers and acquisitions.

Next, I discuss the national trends as they relate to competition from other “platforms” such as wireless. This “intermodal” competition demonstrates that the evidence of competition provided thus far by Qwest in this case is conservative and very likely understates the actual level of competition in Washington.

Finally, I discuss the relationship between the anticipated Triennial Review proceeding and this proceeding, and conclude that the resolution of the issues raised in the former should not cause the Commission to delay granting Qwest's petition for competitive classification.

Q. WHAT RELIEF IS QWEST SEEKING IN THIS PROCEEDING?

A. In this proceeding, Qwest seeks the competitive classification of its basic business exchange services, consisting of business access lines [flat rate, measured service, private branch exchange ("PBX") trunks, and Centrex] and discretionary features that enhance those business lines or trunks.

III. CLECS' PRESENCE IS EXTENSIVE AND CONTINUES TO GROW IN QWEST'S SERVICE AREA

Q. WHAT EVIDENCE HAS QWEST PROVIDED IN SUPPORT OF ITS PETITION?

A. Qwest has provided a variety of evidence of the extensive presence of competitive local exchange carriers ("CLECs") throughout its Washington state service area in its Petition and in the direct testimonies of Mr. Teitzel and Mr. Reynolds in this proceeding. For example, Qwest provided the number of CLEC business lines served by resale, UNE loops and UNE-P in each of nine geographic regions of Washington that Qwest serves. These CLEC lines are about 17 percent of total lines (Qwest + these CLEC lines) for the total state. As I discuss subsequently, this is a conservative estimate since it does not

account for business lines served by CLEC loop facilities or competition from wireless or VoIP (“voice over Internet protocol”) providers.

Additionally, substitution of usage is not captured by any line-based measures of CLEC activity. For example, many businesses are making and receiving an increasing number of voice calls on mobile wireless networks. As a result, these businesses may drop existing—or not add new—Qwest lines (e.g., PBX trunks) even though they may remain “connected” to the Qwest network. The fact that a business customer can easily shift usage to a wireless connection also constrains Qwest’s pricing ability.

Q. HOW SHOULD THESE ESTIMATES OF CURRENT CLEC PENETRATION BE CONSIDERED?

A. Economists typically look at a variety of factors that relate to structure, conduct and performance in a market to determine whether there is effective or workable

competition.² It is important to examine all three dimensions when analyzing a market (in this case, the market for basic business exchange services). My reading of the Washington statute (RCW 80.36.330) suggests that the Legislature incorporated all three elements in the standard it set for the Commission to apply in competitive classification proceedings. For example, by determining the number and size of the firms in the market as well as considering the ease of entry/expansion, the Commission is asked to look at the structure of the market. The Commission is also asked to consider how firms in the market are acting by looking at what type of services are actually being offered by those firms; that is, how the firms in the market are conducting themselves. The statute also asks the Commission to consider whether the services being offered are readily available at competitive rates. This is a measure of the performance of the market. The point is that all three dimensions should be considered, without placing undue weight on any one of them.

Estimates of “market share,” while showing substantial inroads by competitors in the business services market in Washington, provide a static view of competitive

² See, for example, F.M. Scherer and David Ross, “The Welfare Economics of Competition and Monopoly,” *Industrial Market Structure and Economic Performance* (Houghton Mifflin Company, Boston: 1990) at 52-55 (hereinafter “Scherer and Ross”), for an enumeration of the characteristics of “workable competition” (as “effective competition” is often called in economic literature). These criteria do not require that no one firm have a large market share. Economists have long recognized that workable competition provides a more realistic description of most markets today, as the theoretical model of perfect competition is so rare. See J.M. Clark, “Toward a Concept of Workable Competition,” *The American Economic Review*, Vol. XXX, No. 2, June 1940.

conditions in the state. They are a summary statistic that helps describe market or industry structure.³ As the Legislature made clear in the competitive classification statute (RCW 80.36.330), it is also relevant to examine changes in the rate of CLEC penetration to determine the extent of competition in Qwest service areas. This implies a dynamic (as opposed to static) view of the market.

In this proceeding, we are examining a market in which one firm originally provided basic business exchange service (and thus started with close to 100 percent of the market). As competition has taken hold, the share of the basic business exchange market served by competitors—and by Qwest—can be expected to change over time. These changes in market share over time are highly indicative of a competitive market and are as telling as (if not more telling than) an examination of market share at any one particular point in time.

Mr. Reynolds and Mr. Teitzel both testify to significant CLEC growth in market share over the past few years in Washington. Mr. Reynolds, for example, cites data showing 36% market share growth (based on UNE-P, unbundled loop and resale competition) between December 2001 and December 2002. The fact that CLEC penetration overall has been increasing is indicative of a competitive market. However, especially because Qwest started with a high market share, reliance on market share data alone can be

³ The economic interpretation of market shares depends on the specific conditions that produce them. For example, most people would consider the restaurant business as fairly competitive in other than sparsely populated areas. In the typical setting, where a restaurant possesses a substantial market share and has a long line of patrons waiting for tables, this would normally be interpreted as evidence of good rather than poor economic performance in terms of delivering value for money to consumers. In contrast, when a firm in a closed market has a large market share, it is not likely to connote good performance. Of course, it does not

misleading. Qwest may still have a large market share, but (as is the case here) be unable to exercise market power as a result of the existence of well-established competitors of various sizes and the relative ease of entry and expansion by firms using UNEs and/or resale.⁴ Where, as here, CLECs already account for *at least* 17 percent of business access lines, the fact that these CLECs can easily expand and extend their capacity serves to constrain Qwest's ability to raise its prices. Under such circumstances, Qwest cannot be said to have *any* "captive customer base," let alone a "significant" captive customer base.

**Q. IN WHAT CONTEXT SHOULD THE COMMISSION CONSIDER
CONCENTRATION RATIOS IN THIS PROCEEDING?**

A. I understand that at the open public hearing held on May 28, 2003, Commission Staff raised concern about concentration ratios as one reason to suspend this matter and set it for hearing.

The Commission should not rely on concentration ratios *per se* because they, by themselves, are not enough to demonstrate market power. If one views concentration ratios in isolation (apart from considerations of market demand and

necessarily connote poor performance—suppose the firm was effectively regulated. The point is that market share can be seen as both "cause" and "consequence."

⁴ A market may have one or more firms with large market shares and still be competitive under the criteria of workable competition. *See* Scherer and Ross, footnote 2, *supra*.

supply elasticity, including ease of entry), they will almost certainly provide the wrong answer to the question of whether a market is workably competitive.⁵ For example, in reviewing a merger, antitrust authorities examine a variety of factors *in addition to* structure (or concentration). The *Merger Guidelines* require an examination of “the ease of entry by new firms into the markets.”⁶

It is important to note that, in this proceeding, Qwest is seeking competitive classification in order to obtain the flexibility it needs for its business services to enable it *to respond to growing competition*. Focusing on market concentration (or even on static market share data) can be counterproductive in this situation. Such a focus suggests that Qwest should stop competing until its share falls or the market reaches an “acceptable” level of concentration in order to win its freedom to compete. It is difficult to see how this result benefits business customers in Washington.

What matters for market power is the ability to restrict market output profitably -- in this case, in the market for basic business exchange services. Thus, one has to assess the actual and potential supply capabilities of competing firms; that is, their capacity. Here, by

⁵ Professor Landes and Judge Posner discuss “pitfalls in mechanically using” such tools to measure market power. See William M. Landes and Richard A. Posner, “Market Power in Antitrust Cases,” 94 *Harvard Law Review* 937 (1981), at 937-996.

⁶ U.S. Department of Justice & Federal Trade Commission, *Horizontal Merger Guidelines*, reprinted in 4 Trade Reg. Rep. (CCH) & 13,104.

virtue of the universal availability of UNEs and resale, competitors have the ability to expand output and extend capacity throughout Qwest's local market.⁷

Q. WHAT ARE THE COSTS AND TIME FRAMES FACING A CLEC THAT CHOOSES TO USE QWEST'S NETWORK AS A MEANS OF ENTERING THE MARKET OR EXPANDING/EXTENDING ITS REACH IN THAT MARKET?

A. Mr. Reynolds and Mr. Teitzel discuss at length in their direct testimonies that CLECs incur very small up-front costs and very short time frames when switching Qwest customers. They also discuss the Commission's findings that Qwest's operations support systems ("OSS") meet performance standards and are nondiscriminatory.

Q. WHAT IS THE SIGNIFICANCE OF COMPETITORS' ABILITY TO PURCHASE FACILITIES OR SERVICES FROM QWEST AT LOW COSTS AND IN SHORT TIME FRAMES?

A. The significance of competitors' ease of entry is twofold. First, the rapid growth in CLEC penetration and the significant levels achieved by CLECs in the local exchange market indicate that the provisioning process is working. Second, Qwest must be aware of the

⁷ This is in addition to the ability to expand and extend their own facilities or obtain facilities from a provider other than Qwest.

ease of additional entry and further expansion by CLECs as it makes its retail pricing decisions throughout its service territory.⁸

The ability of CLECs to expand their capacity by leasing facilities from Qwest limits Qwest's ability to exercise market power. Market power is defined as the ability to *profitably* raise prices without fear of competitive losses. If Qwest were to raise its prices for basic business exchange services in the current competitive environment, CLECs could expand and extend their service offerings. Qwest would then risk losing additional business customers to its competitors. If enough business customers have alternatives (which they clearly do), their ability to switch providers will discipline the market in the absence of retail price regulation. It is difficult to justify continued regulation of retail prices in a market with such conditions.

IV. THE EVIDENCE OF COMPETITION OFFERED BY QWEST IN THIS CASE IS CONSERVATIVE.

Q. BASED ON YOUR EXPERIENCE ELSEWHERE, HOW WOULD YOU CHARACTERIZE THE EVIDENCE OF COMPETITION OFFERED BY QWEST IN THIS CASE?

A. Local competition takes a number of forms. One type is "intermodal" or "platform" competition and involves competitors using facilities other than wireline telephone

⁸ Economists call a market with such relative ease of entry (and exit) a "contestable market." See, for example, William J. Baumol, John Panzar and Robert Willig, *Contestable Markets and the Theory of Industry Structure* (New York: Harcourt Brace Jovanovich) (1982) in which the theory is developed.

networks. Another form of local competition (often referred to as “intramodal”) comes from wireline telephone networks deployed by competitors and typically involves use of parts of the network of incumbent local exchange companies (“ILECs”) such as Qwest’s UNEs and/or resale of Qwest’s local service offerings. Intramodal competitors include CLECs and, in some cases, independent ILECs “overbuilding” parts of an adjacent Bell Operating Company’s (“BOC’s”) service territory. Qwest primarily relies on this latter form of competition in this case. As a result, Qwest makes a conservative and understated showing.

Q. WILL YOU ELABORATE ON THE EXTENT TO WHICH THERE IS INTERMODAL COMPETITION FOR BUSINESS CUSTOMERS IN PARTICULAR?

A. Yes. The growth of wireless services and substitution of wireless service and usage for wireline service and usage, while not specifically quantified by Qwest in its analyses here, is significant nationwide. Given the number of major wireless providers offering service in Washington and the wide variety of offerings they provide (*see* Mr. Teitzel’s Direct Testimony), I can say that the trends I have observed elsewhere apply to Washington.

I have found that wireless provides an especially good substitute for the wireline voice services used by many small businesses. As an increasing amount of usage is diverted to mobile phones (for both incoming and outgoing calling at business locations), these businesses rely less and less on the basic business exchange services offered by companies like Qwest. For example, the demand for PBX trunks is directly affected if

employees of a business make and receive a large number of calls on their wireless phones at their workplace. Customer surveys, customer interviews and focus groups I have conducted or am familiar with elsewhere confirm this substitution.⁹

Indeed, mobile wireless operators are competing vigorously for business users who spend \$70 per month, compared to non-business consumers who spend \$45 per month.

Additionally, business users generate twice the usage that consumers do.¹⁰

In addition to mobile wireless offerings for businesses, new wireless applications are emerging all the time. For example, one firm, Spectralink, has deployed a Wi-Fi voice communications system with many functions for Lowe's home improvement stores, and may add Internet access to its capabilities.¹¹

Recent research by In-Stat Group determined that 47 percent of all U.S. workers have access to wireless services. Companies with less than 100 employees account for the

⁹ Among the surveys I have directed and presented as a witness is one in New Jersey in which 38 percent of business customers said that more than half the calls they make on wireless phones would have been made on their business' wireline phone. *See* Affidavit of Harry M. Shooshan III, before the Board of Public Utilities in New Jersey, BPU Docket No. TO99120934, Attachment 4, Part 2 (May 17, 2000). In Illinois, the survey I directed found that 41-52 percent of business customers (results were presented by strata of business size and region in Ameritech's Illinois service area) said that, if they did not have wireless service, they would make more calls using their wireline service. *See* Direct Testimony of Harry M. Shooshan III, Schedule 4, Docket No. 98-0860 (March 12, 1999). Also, in a more recent survey of business customers sponsored by Qwest in Idaho, 31 percent of respondents said that they could solely rely on cell phone service for the purpose of making and receiving local calls. *See* Direct Testimony of Dr. Douglas J. Lincoln, Ph.D., *In the Matter of the Application of Qwest Corporation for Price Deregulation of Basic Local Services*, Case No. QWE-T-02-25 (December 17, 2002), Exhibit 10 at 2-3.

¹⁰ In-Stat MDR Market Alert, "Battle for Business Cellular Users Rages on" (January 1, 2003).

¹¹ Max Smetann, "Voice over Wi-Fi Gaining Momentum," (June 24, 2003), from www.allnetdevices.com/wireless/news/2003/06/24/voice_over.html.

largest group of business users “working wirelessly.” U.S. businesses are expected to spend about \$74 billion for wireless technology by 2005.¹²

Additionally, customers may choose VoIP technology as an alternative to Qwest’s basic business exchange services. Mr. Teitzel discusses VoIP options in detail in his direct testimony.

**V. THE UPCOMING TRIENNIAL REVIEW PROCEEDING NEED
NOT AFFECT THE COMMISSION’S DECISION IN THIS
PROCEEDING**

**Q. ARE YOU AWARE OF THE TRIENNIAL REVIEW PROCEEDING AND THE
IMPACT IT MIGHT HAVE ON THE CONTINUED AVAILABILITY OF
UNEs AND UNE-P?**

A. Yes. I have been actively involved in the FCC’s rulemaking on behalf of Qwest and have also helped analyze the issues for other clients of our firm, including OFTEL, the U.K. telecommunications regulatory office.

**Q. WOULD YOU PLEASE ELABORATE ON YOUR INVOLVEMENT WITH
THESE ISSUES?**

A. Yes. My firm filed with the FCC two studies that assessed the impact of unbundling on telecommunications markets and investment, both of which I helped to prepare. The first

¹² “Wireless in the Trenches,” *Computer Edge Magazine* (October 28, 2002) as posted on the NReach website at http://www.nreach.biz/press_releases/coputeredge102802.pdf.

study examined the affects of unbundling obligations on carriers' incentives to deploy broadband technologies.¹³ In this study, we examined the disincentives for investment that result from the regulatory application of "old" network policies to "new" network technologies. The second study consisted of a critique of an econometric study filed by Dr. Robert D. Willig on behalf of AT&T in that proceeding and SPR's own econometric study that showed that unbundling requirements negatively affect ILEC incentives to make discretionary investments over and above what are needed to maintain their networks.¹⁴ I contributed to another study in that proceeding authored by two of my colleagues on behalf of the High-Tech Broadband Coalition, that also examined the costs and disadvantages of extending unbundling requirements to broadband technologies.¹⁵ As a result, I am very familiar with the legislative history, the FCC and court decisions and the previous round of findings by the various state commissions that are implicated in the Triennial Review.

¹³ John Haring and Harry M. Shooshan III, *ILEC Non-Dominance in the Provision of Retail Broadband Services*, before the FCC, *In the Matter of Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, Attachment A to Comments of Qwest Communications International Inc., March 1, 2002.

¹⁴ John Haring, Margaret L. Rettle, Jeffrey H. Rohlf, and Harry M. Shooshan III, *UNE Prices and ILEC Investment*, before the FCC, *In the Matter of Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, Attachment to Comments of Qwest Communications International Inc., July 17, 2002.

¹⁵ John Haring and Jeffrey H. Rohlf, *The Disincentives for Broadband Deployment Afforded by the FCC's Unbundling Policies*, prepared for the High-Tech Broadband Coalition for submission before the FCC, *In the Matter of Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket No. 01-337, April 4, 2002.

I have also contributed to briefings and memoranda our firm has prepared for OFTEL that have explained the U.S. unbundling regime and have compared and contrasted it with the facilities-based model of local competition favored by OFTEL.

Q. HOW SHOULD THE NEXT ROUND IN THE TRIENNIAL REVIEW PROCEEDING AFFECT THE COMMISSION'S DECISION-MAKING IN THIS CASE?

A. The Commission should grant Qwest's petition in this proceeding without delay. There is no reason to believe that the Triennial Review proceeding and this proceeding will be at odds with each other. For example, if the Commission were to find that removing unbundled switching from the list of required UNEs in Washington would not impair competition, it will be because the Commission itself has determined that there are competitively supplied alternatives readily available. While it is impossible to know in advance of the *Order* being released by the FCC precisely what criteria the Commission will have to apply or how any transition involving UNE-P will be handled, it is clear that the decision is this Commission's to make. The process the FCC is expected to establish will leave existing UNEs (including UNE-P) in place during the pendency of the various state proceedings. As the FCC's Press Release describes it:

Unbundled Network Element Platform (UNE-P) Issue – The Commission finds that switching – a key UNE-P element – for business customers served by high-capacity loops such as DS-1 will no longer be unbundled based on a presumptive finding of no impairment. Under this framework, states will have 90 days to rebut the national finding. For mass market customers, the Commission sets out specific criteria that states shall apply to determine, on a granular basis, whether

economic and operational impairment exists in a particular market. State Commissions must complete such proceedings within 9 months. Upon a state finding of impairment, the Commission sets forth a 3 year period for carriers to transition off of UNE-P.¹⁶

A finding of “no impairment” by the Commission would presumably be predicated on evidence that alternatives are readily available and that competition will not be harmed if CLECs have to rely upon them. And even if this Commission were to remove UNE-P from the list of required unbundled network elements for business customers, the CLECs that rely on UNE-P will have a transition period during which it would still be available for existing business customers. In addition, competitors could still use UNE loops and resale. In fact, as Mr. Reynolds points out, competitors *today* are using all three means of serving business customers (i.e., business loops, resold business lines, and business UNE-P). In all geographic areas covered by Qwest’s petition, competitors are using either resale or loops or both *in addition to* UNE-P.

And, of course, competitors can also rely more on their own facilities. For example, one prominent financial analyst has already indicated a view that a lack of unbundled switching (and, thus, UNE-P) will not drive AT&T out of the local service market.¹⁷ That analyst

¹⁶ “FCC Adopts New Rules for Network Unbundling Obligations of Incumbent Local Exchange Carriers,” (FCC Press Release, February 20, 2003) at 1.

¹⁷ Bear, Sterns and Company, Inc. “Company Report – February 6, 2003: AT&T Corp. Ticker: T,” report number 7210143, at 5.

notes that AT&T has 165 5E switches of its own or could rely on other carriers' switches in the event that unbundled switching is no longer available.¹⁸

Q. WHAT WOULD BE LOST IF THE COMMISSION WERE, FOR ANY REASON, NOT TO GRANT THE COMPETITIVE CLASSIFICATION SOUGHT BY QWEST IN THIS CASE?

A. In my opinion, business customers would be adversely affected by the Commission's failure to grant Qwest the relief it is seeking. As I understand it, the effect of the competitive classification of basic business exchanges services would be to afford Qwest many of the same freedoms its competitors enjoy. Qwest will thus have the ability to price and package its full range of business services to meet and respond to the offerings of its competitors. In turn, this will enable business customers to enjoy the full benefits of local competition sooner rather than later.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

¹⁸ *Ibid.*