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

REBUTTAL TESTIMONY OF DON J. WOOD
On Behalf Of Advanced TelCom, Inc.
and
MetroNet Services Corporation

October 6, 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.

Q. ARE YOU THE SAME DON J. WOOD WHO PRESENTED DIRECT TESTIMONY IN THIS PROCEEDING ON SEPTEMBER 18, 2000?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the testimony of Dr. Glenn Blackmon on behalf of the WUTC Staff.

In his testimony, Dr. Blackmon makes a number of factual observations, and then reaches certain conclusions based on those facts. He then makes both a primary and a secondary (what he refers to as an "alternative") recommendation to the Commission. While I agree with the factual conclusions reached by Dr. Blackmon, I must disagree that these facts support the adoption of his secondary, or "alternative," recommendation.

Q. WHAT IS YOUR UNDERSTANDING OF THE FACTUAL CONCLUSIONS UPON WHICH DR. BLACKMON RELIES WHEN MAKING HIS RECOMMENDATIONS?

A. Dr. Blackmon appears to base his recommendations on the following facts: (1) Qwest currently has access to tools that it can use to become more competitive, (2) the Commission need not grant the requested pricing flexibility in order to correct any perceived regulatory inequities, (3) the viability of each form of market entry available to competitors varies based on geography, customer size, and availability, and (4) UNEs, including UNE-P, are an important entry vehicle for competitors seeking to offer service to small business customers, and limitations in the availability of UNEs to date has limited the ability of competitors to serve these small business customers.[1] I will explain the importance of each of these conclusions below, and then explain why I believe that his alternative recommendation is not supported by these facts.

[1] Small business customers are defined for the purpose of this discussion as those whose telecommunications needs are insufficient to efficiently use a T-1 circuit.

Q. AT PAGES 4–7 OF HIS TESTIMONY, DR. BLACKMON EXPLAINS WHY HE BELIEVES THAT QWEST CAN ACT TODAY, WITHOUT THE REQUESTED PRICING FLEXIBILITY, TO BECOME A MORE EFFECTIVE COMPETITOR. DO YOU AGREE WITH HIS OBSERVATIONS?

A. Yes. Dr. Blackmon concludes that, contrary to Mr. Teitzel's assertions, Qwest's hands are not tied in the current regulatory framework but that it actually has "many tools at its disposal that it could be using to be more competitive with other providers of local exchange service." Specifically, Dr. Blackmon notes that Qwest can introduce new services; offer promotions on a 10 day notice; offer winback incentives; use banded rates (within which price changes can be made on 10 days notice); lower prices in response to competition; or offer business services through a competitive (but structurally separate) affiliate.

Q. AT PAGES 7-8 DR. BLACKMON STATES THAT THE COMMISSION SHOULD NOT GRANT QWEST'S PETITION IN ORDER TO ADDRESS A PERCEIVED REGULATORY INEQUITY, NAMELY QWEST'S CURRENTLY RESTRICTION AGAINST OFFERING INTERLATA SERVICES. DO YOU AGREE WITH HIS OBSERVATIONS?

A. Yes. As Dr. Blackmon correctly points out at page 7, Qwest controls its destiny in this regard: "Qwest can get into the long-distance business as soon as it demonstrates that it has opened its local network to competition." Dr. Blackmon goes on to point out the irony in Qwest's position, noting that the standard to be met is essentially the same in each case: Qwest must open its local network to competition in order to receive the pricing flexibility that it seeks in this proceeding and to gain the ability to offer interLATA services in its 271 proceeding. Given this fact, it is nonsense for Qwest to argue that it should be granted pricing flexibility because it does not yet have interLATA authority, just as it would be nonsense for Qwest to argue that it should be granted interLATA authority because it does not yet have pricing flexibility.

Q. AT PAGES 10-12, DR. BLACKMON DESCRIBES THE STRUCTURE OF THE LOCAL MARKET AND THE FORMS OF COMPETITIVE ENTRY AVAILABLE TO COMPETITORS. DO YOU AGREE WITH HIS OBSERVATIONS?

A. Yes. Dr. Blackmon notes that competitors can attempt to enter the market for business local exchange services by building their own fiber facilities, purchasing special access

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facilities from Qwest, purchasing unbundled loops from Qwest, purchasing UNE-P from Qwest, or by reselling Qwest's retail services. As Dr. Blackmon correctly points out, however, "the viability of each method of competition varies based on geography, customer size, and availability." In fact, when small business customers are specifically considered, Dr. Blackmon concludes that "there is no evidence to suggest that small business customers have any viable alternative to Qwest's business exchange service, because none of the methods I just listed are reasonably available and financially viable to that market segment."

Q. AT PAGES 12-15, DR. BLACKMON DESCRIBES THE CURRENT AVAILABILITY OF UNES, INCLUDING UNE-P. DO YOU AGREE WITH HIS ASSESSMENT?

A. Yes. Dr. Blackmon correctly notes that the use of UNEs and UNE-P by potential competitors of Qwest's business services can lead to a form of competition that can constrain Qwest's prices. He specifically concludes that this can be the case if the facilities that the competitor acquires from Qwest are "priced independently" of Qwest's retail service and are "readily available" to competitors. Unfortunately, his first condition does not apply to resale, and his second condition does not yet apply to UNEs or UNE-P.

Dr. Blackmon explains that while there are numerous performance metrics that could be considered, "one very basic measure suggests that competitors are not yet getting comparable service," and that specifically the installation interval and repair time for unbundled loops exceeds the comparable time for Qwest's own retail business services. As Dr. Blackmon correctly points out, "unbundled network elements are not yet a proven commercial product."

Q. WHAT IS YOUR UNDERSTANDING REGARDING STAFF'S PRIMARY RECOMMENDATION IN THIS PROCEEDING?

A. It is my understanding that, based at least in part on the factual conclusions described above, Staff's primary recommendation is to limit Qwest's pricing flexibility to the Seattle, Bellevue, Spokane, and Vancouver exchanges, and to limit the flexibility to services provided via a DS-1 or larger circuit. Dr. Blackmon states at page 10 of his

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testimony that this conclusion was based on a finding that for large business customers served by these four exchanges, there was not a significant captive customer base and that "Qwest's local exchange service is subject to effective competition *in these geographic areas* and *for this set of customers*" (emphasis added).

Conversely, it my understanding that Staff did find captive customers, and did not find effective competition, for those customers that are not large enough to receive service provided via a DS-1 or larger circuit (Blackmon pp. 3, 9, 11, 12, 13, 15).

Q. WHAT IS YOUR UNDERSTANDING REGARDING STAFF'S SECONDARY, OR ALTERNATIVE, RECOMMENDATION IN THIS PROCEEDING?

A. Dr. Blackmon first reiterates the limitations that competitors currently face when attempting to compete with Qwest utilizing UNEs: "the key problem with competition in the low end of the business market is that it relies on service using unbundled loops, which are a promising but still unproven source of competition for Qwest's retail service." As Dr. Blackmon had previously pointed out in his testimony, resale competition, in which the price of the network access is tied to the price of the retail service, cannot be relied upon to constrain prices.

In spite of the fact that he had reached (and fully documented) these factual conclusions in his testimony, Dr. Blackmon goes on at pages 20-21 to offer an alternative recommendation that would grant Qwest pricing flexibility for **all** customer segments of the business services market, including the small business market (defined as any business customer too small to efficiently utilize a full T-1)—markets that he had concluded currently have captive segments and for which effective competition does not now exist.

Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE BASIS FOR DR. BLACKMON'S ALTERNATIVE RECOMMENDATION.

A. Dr. Blackmon's alternative recommendation is based on two assumptions: (1) that the availability of UNEs and UNE-P will improve significantly, and (2) that the three constraints that he lists at page 21 of his testimony will adequately protect consumers in

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these markets. I must disagree with both of these assumptions.

First, Dr. Blackmon states at page 20 that "since there is some reason to believe that this [UNE] alternative will become more viable over time, particularly with the development of UNE-P, the WUTC could consider granting the pricing flexibility for all customer segments with limitations imposed on Qwest's discretion with regard to small business service." While there is always hope that the availability of UNEs, offered in a timely and reliable manner, will improve, such an improvement has not yet happened. As Dr. Blackmon correctly points out at page 13 of his testimony: "the WUTC must decide this case based on the facts as they exist now. The current situation is that unbundled loops and the UNE-P are not readily available for serving the mass market small business customer segment. They cannot be counted on to constrain Qwest from raising prices."[2]

Until UNEs and UNE-P are readily available, it is premature for the Commission to grant a level of pricing flexibility that relies in part on the availability of UNEs to constrain Qwest's prices. Dr. Blackmon is correct that they "cannot be counted on" to do so now. In addition, the Commission should not give away one of its two "carrots" too quickly. Qwest's motivation to provide UNEs and UNE-P is generated by the desire to achieve interLATA authority and to be granted pricing flexibility. If either of these outcomes desired by Qwest is granted before it has actually begun to provide UNEs in a timely and reliable manner, it becomes less likely that it will do so.

Second, Dr. Blackmon states at page 9 that inherent in Staff's alternative recommendation is the requirement that Qwest "agree to stringent conditions that would protect smaller customers until Qwest has fully opened its network to competition." Unfortunately, the conditions contained in the alternative recommendation (as set forth on page 21) are not sufficiently stringent to protect the smaller customers that Staff expresses concern about. Even with the three conditions included in the alternative recommendation, Qwest would be able to:

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[2] At page 15 of his testimony, Dr. Blackmon also describes the problem with the nonrecurring charges associated with UNE-P, and the need for this problem to be resolved in order for UNE-P to be a viable competitive option.

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1. Engage in a price squeeze of resellers by offering a discount to a customer that is greater than the resale discount (and by failing to make the discounted price available as the new resale price);
2. Offer discounts to customers who currently have competitive alternatives, while denying those discounts to customers in the same wire center area without existing alternatives;
3. Discourage competitive entry by efficient competitors into these exchanges through the ability to engage in strategic and geographically limited price reductions; and
4. Effectively "redline" the geographic area in these exchanges by freezing in place the number and location of customers who have competitive alternatives and those who do not.

The three conditions proposed by Staff in its alternative recommendation are insufficient to prevent these outcomes.

Q. IS ADOPTION OF THE STAFF'S ALTERNATIVE RECOMMENDATION NECESSARY IN ORDER FOR QWEST TO HAVE A MEASURE OF PRICING FLEXIBILITY FOR ITS SERVICES OFFERED TO SMALL BUSINESS CUSTOMERS?

A. No. As Dr. Blackmon points out at page 5 of his testimony, Qwest can utilize banded rates, with a rate floor at cost and a rate ceiling at the current tariffed rate. As Dr. Blackmon explains, "Qwest can set the floor at its cost, and surely it would not want to price below its cost. Qwest can set the ceiling at the current tariff price for existing services, and surely it would not need to raise prices to respond to competition."

The only difference then between Qwest's existing authority to price within rate bands and the flexibility that would be granted to Qwest under the Staff's alternative proposal is Qwest's ability to charge discriminatory prices. Under Staff's alternative proposal, Qwest could take advantage of the geographic over-inclusiveness of its chosen market definition (the entire area served by a given wire center) in order to selectively make attractive offers (at cost, if necessary) to those customers with existing competitive alternatives, while continuing to charge existing prices to customers with no existing alternatives. The ability of Qwest to selectively decrease prices means that it can make attractive offers, including term contracts, to retail customers based on what it knows about its competitors' plans to collocate and/or obtained UNEs. Qwest currently has the ability to change its prices to the degree that would be permitted by the Staff's alternative

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proposal; what it currently lacks – and what it would gain – is the ability to engage in discriminatory pricing strategies to the detriment of both customers and the further development of competition.

Q. DO YOU HAVE ANY REASON TO BELIEVE THAT CENTREX RESELLERS, SUCH AS ATG AND METRONET, WOULD BE ADVERSELY IMPACT BY THE ADOPTION OF THE STAFF'S ALTERNATIVE RECOMMENDATION?

A. Yes. In response to Data Requests, Qwest provided a 1996 Memorandum entitled "Centrex Resale Competition in Washington." The first paragraph of the memo states that "the purposes of this memo are to provide you with an update on the competitive situation we face in Washington from resold Centrex service and to further discussions around specific actions we can take to address it as soon as possible." The document outlines a number of strategies, including the attempt to grandfather Centrex Plus service and to engage in strategies whose objective would be "to make it difficult to directly compare resold Centrex to 1FB/FL service." If Qwest is granted the pricing flexibility that it seeks, or even the flexibility inherent in the Staff's alternative recommendation, Qwest would be able to add a further strategy to this memo: price squeeze competitors out of market.

Q. AT PAGE 21 OF HIS TESTIMONY, DR. BLACKMON STATES THAT QWEST SHOULD HAVE UNCONDITIONED PRICING FLEXIBILITY OF ITS BUSINESS LOCAL EXCHANGE SERVICE UPON APPROVAL BY THE FCC OF ITS 271 APPLICATION. DO YOU AGREE?

A. No, for two reasons. First, the requirements of section 271 of the Act are applied on a fundamentally different scale than the requirements of RCW 80.36.330. In order to be granted interLATA authority, Qwest must prove to the Commission and the FCC that it has complied with each item on the 14 point checklist. The analysis performed by both the Commission and the FCC to determine Qwest's compliance may be performed at the relatively large scale of Qwest's service territory within the state. In contrast, RCW 80.36.330 requires the Commission to perform its analysis at the much more discreet level of individual markets (defined in terms of services and geography). A decision to grant Qwest interLATA authority pursuant to section 271 would not automatically initiate

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pricing flexibility for Qwest's services, and would not eliminate the requirement that any application for pricing flexibility be evaluated at the level of specific markets.

Second, in order to prevent "backsliding" once interLATA authority is granted, it will be even more important for the Commission to watch the development of competition in the local exchange markets and place constraints on Qwest as necessary. Once all the carrots are gone, it will be even more important that the Commission carry a stick to be used when necessary.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.

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