

BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of)
)
QWEST CORPORATION)
) DOCKET NO. UT-033044
To Initiate a Mass-Market Switching)
And Dedicated Transport Case)
Pursuant to the Triennial Review)
Order)

REBUTTAL TESTIMONY

OF

WILLIAM H. LEHR

AND

LEE L. SELWYN

ON BEHALF OF

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC.,
AT&T LOCAL SERVICES ON BEHALF OF TCG SEATTLE, AND TCG OREGON
(COLLECTIVELY "AT&T")

ECONOMIC CONSIDERATIONS

February 20, 2004

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1 **Q. PLEASE STATE YOUR NAMES AND BUSINESS ADDRESSES.**

2 A. Our names are William H. Lehr and Lee L. Selwyn. We previously filed both direct and
3 responsive testimony in this docket.

4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY AT THIS TIME?**

5 A. The purpose of our rebuttal testimony is to comment on the additional testimony filed by Qwest
6 relating to its claim that CLECs would not be impaired without access to unbundled switching.
7 Specifically, we will comment on the testimony of Qwest witnesses Harry M. Shooshan,¹ Peter
8 B. Copeland,² and Mark S. Reynolds,³ and WUTC Staff witness Thomas L. Spinks.⁴

9 **I. OUR POSITION ON ISSUES RAISED BY MR. SHOOSHAN**

10 **Q. DO YOU AGREE WITH MR. SHOOSHAN'S COMMENTS REGARDING WHAT THE**
11 **WUTC SHOULD REGARD AS ITS TASK IN THIS PROCEEDING?**

12 A. No. Mr. Shooshan disregards the evidence demonstrating the limited viability of actual and
13 potential CLEC-switch-based competition in Washington, in a clearly biased attempt to
14 persuade this body to find non-impairment regardless of the evidence. As we explained in our
15 Response Testimony, there is now ample evidence before the Commission to confirm the
16 Federal Communications Commission's ("FCC's") national finding of impairment.

¹ *Response Testimony of Harry M. Shooshan III on Behalf of Qwest Corporation, Petition of Qwest Corporation to Initiate a Mass-Market Switching and Dedicated Transport Case Pursuant to the Triennial Review Order*, WUTC Docket No. UT-033044, February 2, 2004 (hereafter "Shooshan Response").

² *Response Testimony of Peter B. Copeland on Behalf of Qwest Corporation, Petition of Qwest Corporation to Initiate a Mass-Market Switching and Dedicated Transport Case Pursuant to the Triennial Review Order*, WUTC Docket No. UT-033044, February 2, 2004 (hereafter "Copeland Response").

³ *Response Testimony of Mark S. Reynolds on Behalf of Qwest Corporation, Petition of Qwest Corporation to Initiate a Mass-Market Switching and Dedicated Transport Case Pursuant to the Triennial Review Order*, WUTC Docket No. UT-033044, February 2, 2004 (hereafter "Reynolds Response").

⁴ *Response Testimony of Thomas L. Spinks on Behalf of WUTC Staff, Petition of Qwest Corporation to Initiate a Mass-Market Switching and Dedicated Transport Case Pursuant to the Triennial Review Order*, WUTC Docket No. UT-033044, February 2, 2004 (hereafter "Spinks Response").

1 In his efforts to block consideration of this evidence, Mr. Shooshan (1) suggests that the
2 WUTC blindly limit its consideration by ignoring all but a few sections of the TRO that are
3 taken out of context;⁵ (2) cautions the WUTC “not to replicate the FCC’s analysis by
4 developing their [sic] own framework,”⁶ warning that if it does so, it risks FCC pre-emption;⁷
5 and (3) argues that the “FCC has already decided in the TRO that unbundled
6 switching...should be eliminated.”⁸

7 The TRO defines the “impair standard” as follows: “A requesting carrier is impaired when lack
8 of access to an incumbent LEC network element poses a barrier or barriers to entry, including
9 operational and economic barriers, that are likely to make entry into a market uneconomic,”⁹
10 and explicitly finds that “[a]ctual marketplace evidence is the most persuasive and useful
11 evidence [of impairment].”¹⁰ By contrast, Mr. Shooshan’s pseudo-legal constructionist
12 “analysis” of what the FCC did and did not mean would have this Commission ignore “actual
13 marketplace evidence” and instead convert the entire process into nothing more than a
14 mechanical counting exercise: “One, two, three – poof! Competition is gone.” That is exactly
15 what Qwest would like for this Commission to do. Count to three and end consumer choice,
16 end lower prices, put CLECs out of business, decrease jobs – the list of ill-effects goes on, not
17 the least of which is violating the spirit and the text of the *Telecommunications Act of 1996* (the
18 “1996 Act”) and the TRO.

19 Whether the trigger or the business case analysis is used, the analysis needs to accurately reflect
20 the “actual marketplace evidence” upon which the question of impairment will be resolved.

21 The TRO makes this clear:

⁵ *Id.*, at 4.

⁶ *Id.*

⁷ *Id.*, at 3.

⁸ *Id.*, at 5.

⁹ TRO, ¶ 7.

¹⁰ *Id.*

1 93. As we anticipated in the *Triennial Review NPRM*, we agree with commenters that
2 argue that actual marketplace evidence is the most persuasive and useful kind of evidence
3 submitted. In particular, we are most interested in granular evidence that new entrants are
4 providing retail services in the relevant market using non-incumbent LEC facilities, for
5 two main reasons. First, it is faithful to the Supreme Court's admonition that we consider
6 "the availability of elements outside the incumbent's network" as we apply the "impair"
7 standard. Second, *this kind of evidence demonstrates better than any other kind what*
8 *business decisions actual market participants have made regarding whether it is feasible*
9 *to provide service without relying on the incumbent LEC.* Specifically, this evidence
10 shows us whether *new entrants*, as a practical matter, have surmounted barriers to entry in
11 the relevant market.¹¹

12 **Q. WHAT IS THE PURPOSE OF THE "TRIGGER" APPROACH IN THE ANALYSIS OF**
13 **CLEC VIABILITY?**

14 The purpose of the trigger approach is to provide an evidentiary shortcut instead of a more
15 detailed examination of "actual marketplace evidence," not to short-change the analysis of
16 granular data on actual competition. If multiple firms are present and actively providing
17 service to mass market customers using self-provisioned switching and ILEC-provided UNE-
18 Ls throughout the defined geographic market, one can reasonably *infer* the economic viability
19 of a UNE-L business model *in that market*. In interpreting and applying the triggers, there
20 must be some basis to support such an inference. That inference requires more than merely
21 counting to three. Qwest contends that the switching trigger is satisfied if three CLECs are
22 each serving one business or residential customer anywhere in the MSA via UNE-L. There is
23 no basis for any inference of economic viability based solely upon that kind of "actual
24 marketplace evidence," and any reading of the TRO to that effect is utter nonsense. The
25 simplistic and reductionist interpretation advocated by Qwest is obviously inconsistent with the
26 TRO's impairment standard and the 1996 Act.

¹¹ *Id.*, ¶ 93, emphasis supplied, footnotes omitted.

1 Similarly, if the business case analysis of potential competition is forced to include arbitrary
2 and patently unrealistic assumptions (such as the assumption that prices and revenue per line
3 will remain constant over the entire time frame of the business case analysis), it would render
4 the model meaningless in assessing the “operational and economic barriers, that are likely to
5 make entry into a market uneconomic.”¹² Use of such arbitrary and economically irrational
6 rules (as Mr. Copeland argues should be applied) would force an economically irrational and
7 erroneous conclusion.

8 The TRO clearly directs states to conduct an economic investigation of actual (trigger tests) and
9 potential deployment (business case analysis) competition using granular, local data as part of a
10 fact-intensive investigation in order to confirm its national findings with respect to
11 impairment.¹³ In earlier decisions, the Courts did not fault the FCC for mandating UNEs under
12 the Act, but only for doing so without adequate consideration of local data regarding the
13 economic need for UNEs.¹⁴ The FCC's trigger test provides a mechanism for finding non-
14 impairment only when the evidence of actual competition, properly interpreted, demonstrates
15 that there is sufficient competition to reasonably infer that entry barriers to facilities-based
16 CLEC entry do not exist. In that case, it is no longer necessary to consider whether entry is
17 potentially viable since the actual evidence demonstrates that it presumptively is. Applying the
18 triggers as the overly simplistic and self-serving counting exercise recommended by Qwest is
19 completely inconsistent with the economic logic of the impairment standard¹⁵ and inconsistent
20 with the mandates of the TRO.

¹² *Id.*, at ¶¶ 7, 56, 84, 164, and 782.

¹³ *Id.*, at ¶¶ 10 and 190.

¹⁴ See AT&T's Prehearing Brief Rebutting Legal Positions Raised by Qwest Witness Harry M. Shooshan

¹⁵ In our Response Testimony at pp. 19-24, we described a hypothetical, albeit perhaps extreme, situation for which, under Qwest's “count to three” approach, a “no impairment” conclusion would be indicated. That result, however, is clearly inconsistent with the goal of determining whether CLECs would face economic barriers to entry without access to unbundled switching.

1 **Q. DOES THE FCC'S ERRATA MODIFYING THE LANGUAGE IN ¶499 OF THE TRO**
2 **SUPPORT MR. SHOOSHAN'S "COUNT TO THREE" INTERPRETATION OF HOW**
3 **THE TRIGGERS SHOULD BE APPLIED BY DELETING THE ORIGINAL "TOTAL**
4 **DEMAND" REQUIREMENT?**

5 A. No, it does not. The FCC's errata modifying the language in ¶499 does not alter the
6 requirement that to qualify as a triggering firm, the CLEC must be actively providing service
7 via UNE-L and its own switching *throughout the market*. The original version of TRO ¶499
8 included language that could have been misinterpreted to mean that the *only* CLECs that could
9 qualify as triggering firms under the self-provisioning trigger would be CLECs that
10 individually had the capacity in place to serve *all* demand in the relevant market.¹⁶ That is
11 obviously not what the FCC had in mind since such an interpretation would clearly be
12 inconsistent with the 1996 Act's goal of promoting efficient competition. If each CLEC had
13 capacity in place sufficient to serve the entire market demand, there would necessarily be
14 excess industry capacity that would be neither desirable nor sustainable as an economic matter.
15 As modified, the TRO continues to be clear in requiring that triggering firms be "actively
16 providing voice services to mass market customers *in the market* [emphasis added]."¹⁷ It would
17 be inconsistent with a reasonable economic interpretation of the TRO's impairment standard as
18 set forth in our direct testimony to read "in the market" as referring only to incidental
19 competition. Competition that is localized in only a small geographic or customer subset of the
20 mass "market," as defined, does not provide an economic basis for the necessary inference that
21 CLEC competition is viable generally.

¹⁶ In a subsequent errata statement, the FCC eliminated a sentence in ¶ 499 of the TRO that said that CLECs qualifying for the self-provisioning trigger need to be "operationally ready and willing to provide service to all customers in the designated market."

¹⁷ See TRO, ¶ 499.

1 Consequently, in order to qualify as a “triggering firm,” a CLEC must be actively serving mass
2 market customers via UNE-L in a significant part of the geographic area included within the
3 market, not just in a nominal portion such as the area encompassed by a few wire centers.
4 Furthermore, for those wire centers for which the CLEC is utilizing UNE-L, a legitimate trigger
5 candidate should serve more than just a subset of that CLEC’s mass market customer base
6 within a particular wire center.

7 **Q. PLEASE COMMENT ON MR. SHOOSHAN'S DISCUSSION OF HOW THE WUTC**
8 **SHOULD MAKE “CLOSE CALLS” IN THIS PROCEEDING.**

9 A. This proceeding is not about whether UNEs are desirable or whether Qwest has or is able to
10 abuse market power, but rather *which* UNEs are needed by CLECs to make additional entry
11 economically viable.¹⁸ The TRO has already made a national finding that CLECs *are* impaired
12 without access to unbundled switching.¹⁹ While the TRO establishes criteria and a framework
13 for analyzing economic data on local entry conditions to confirm this finding or – *if* the
14 evidence supports an opposite conclusion -- of rebutting the national finding – it is simply
15 incorrect and grossly misleading to characterize the TRO or the role of the WUTC in this
16 proceeding as seeking to find “non-impairment” whenever there are “close calls.”²⁰

17 In any case, the evidence is clear that there are no “close calls” that need to be made here. The
18 evidence of entry conditions (both actual and potential) demonstrates that CLECs face entry
19 barriers and therefore are impaired without access to unbundled switching to serve mass market
20 customers.

¹⁸ See e.g., TRO, ¶ 419.

¹⁹ *Id.*

²⁰ See Shooshan Response, p. 7; see also Shooshan Direct, p.26

1 **Q. PLEASE COMMENT ON MR. SHOOSHAN'S ATTACKS ON UNE-BASED**
2 **COMPETITION.**

3 A. Contrary to the Act,²¹ Mr. Shooshan does not believe UNE competition is desirable. Although
4 he argues that any discussion of the desirability of UNES is “irrelevant,” he goes to great
5 lengths to attack the benefits of UNES.²² We have already explained in our direct and response
6 testimony why Mr. Shooshan's critique is incorrect as a matter of economics.²³ He argues
7 incorrectly that the optimal/preferred mode of competition in telecommunications is for each
8 competitor to be an integrated, facilities-based carrier, regardless of how much such a strategy
9 would cost and whether it would be economically viable.²⁴

10 Mr. Shooshan has a problem here, because each of the BOCs – including his client – make
11 extensive use of resale as the basis for their own long distance service offerings. He attempts to
12 rationalize this by suggesting that the “resale arrangements that the RBOCs have entered into to
13 provide long-distance services following removal of the line-of-business restrictions are
14 *voluntary* agreements at *negotiated* rates and terms. The terms of long-distance resale are not
15 compelled by regulation and long-distance resale is not primarily an arbitrage opportunity.”²⁵
16 Of course, the reason that “the terms of long-distance resale are not compelled by regulation” is
17 simply because, unlike the case with local network services, there is extensive facilities-based
18 competition in long distance at a level that is more than sufficient to induce carriers to
19 voluntarily provide services for resale as a means for expanding their overall market share.²⁶

²¹ For the most recent Supreme Court interpretation on what the Act requires see *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, ___ U.S. ___, 124 S.Ct. 872, 877-78 (2004).

²² See Shooshan Response, p. 11, 28-33.

²³ AT&T's Prehearing Brief Rebutting Legal Positions Raised by Qwest Witness Harry M. Shooshan also appears to argue why such a proposition is incorrect as a matter of law.

²⁴ Shooshan Direct, p. 16,32; see also Shooshan Response, p. 28-30.

²⁵ Shooshan Response, p. 34, emphasis in original.

²⁶ The transition to facilities-based competition in long distance services was much easier because long distance services are less capital intensive than local access services, and facilities that are geographically distant can compete as viable substitutes along long haul routes (*e.g.*, a route from New York to Los Angeles that goes via Chicago may be a viable

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1 Additionally, the long distance carriers that provide a resale opportunity eventually embraced
2 their competitors' resale business as making economic sense, a realization that continues to
3 elude the RBOCs in the local market.

4 Mr. Shooshan is correct in noting that resale in long distance services has delivered important
5 benefits in terms of expanded competition and enhanced consumer choice, but he errs in failing
6 to recognize that resale plays an analogous and beneficial role with respect to facilitating the
7 emergence and vibrancy of local competition.

8 Strong facilities-based competition in the long distance market has been present for nearly
9 fifteen years, yet resale persists and (with the entry of the BOCs) has actually become a far
10 more important market factor today than it was just a few years ago. Today, more than a third
11 all retail long distance services are being provided by resellers – the largest of which are the
12 BOCs themselves!²⁷ If Mr. Shooshan is somehow seeking to portray long distance resale as
13 merely a “transitional step” toward facilities-based long distance competition, then Mr.
14 Shooshan is clearly wrong. Replication of a nationwide *local* network would require
15 enormously greater amounts of capital and time, and would result in vast amounts of wasteful
16 duplication of existing ILEC facilities that already have more than sufficient capacity to meet
17 total demand. *It is precisely for that reason that Congress provided the means for new entrants*
18 *to access incumbent network facilities, and to do so on a permanent basis.* The notion that
19 CLEC access to UNEs and to resale ILEC services is supposed to be “transitional” and to be

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substitute for a route that goes via Dallas; however, local facilities have to go to the customer location). Moreover, even in long distance services, facilities-based competition did not emerge overnight. AT&T was only deregulated as a dominant carrier in 1995, more than ten years after divestiture and after its market share had fallen below 55 percent.

²⁷ According to the FCC, AT&T, Sprint, and MCI accounted for 64.1% of toll service revenues in 2001 which is the last year for which the FCC reports long distance market shares (see Table 9.8 in *Trends in Telephone Service*, Federal Communications Commission, August 2003). Verizon recently reported that, as of the end of 2003, it had signed up some 16.6-million long distance subscribers spread across sixteen states, with penetration rates as high as 61% (in New York, where Verizon has been offering long distance service for four years). See **Exhibit WHL-8**. All of Verizon's long distance offerings are provided via resale of services obtained from other, facilities-based carriers.

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1 discouraged in favor of full facilities-based entry – a misconception that lies at the core of Mr.
2 Shooshan’s position – cannot be squared with either the economics of the local
3 telecommunications business or with the purposes and goals of the 1996 Act.

4 **Q. PLEASE COMMENT ON MR. SHOOSHAN'S CRITIQUE OF LATAS AS THE**
5 **RELEVANT MARKET.**

6 A. Mr. Shooshan argues against defining the relevant market as a single wire center because this is
7 too small to allow a CLEC to realize necessary scale and scope economies.²⁸ The exact same
8 reasoning explains why the MSA is also too small a geographic area. Neither the wire center
9 nor the MSA are large enough to coincide with the scale and scope that would be necessary in
10 order to support economically viable entry to serve mass market customers throughout the
11 defined market.

12 Defining the market as the MSA is less practical and less consistent with CLEC-entry
13 economics than would be defining the market as the LATA. MSA boundaries do not
14 correspond to how CLECs actually compete, to the areas over which costs are shared/incurred,
15 or to how telecom-specific data is collected. The LATA is the natural geographic area that
16 coincides with how telecom data is collected and thus provides both a CLEC and this
17 Commission with the necessary information for assessing the economics of mass market entry.
18 In making this assessment, it is necessary to consider the total costs of entry, which are not
19 limited to either retail-level or network-level costs but include both categories as is clear in the
20 cost-model and business case analysis testimony submitted by AT&T.²⁹

²⁸ Shooshan Response, p. 13-14.

²⁹ Mr. Shooshan mischaracterizes the AT&T testimony as focusing on economies of scale related only to retail functions (*see* Shooshan Response, p. 11).

1 **Q. PLEASE COMMENT ON MR. SHOOSHAN'S RECOMMENDATION REGARDING**
2 **GEOGRAPHIC MARKET DEFINITION.**

3 A. Mr. Shooshan persists in trying to portray the trigger analysis as nothing more than a simple
4 counting exercise. However, his argument that defining the geographic market as the MSA is
5 more “conservative” than defining the relevant market as the collection of MSAs actually
6 serves to demonstrate the error of his position.³⁰ The result of the impairment analysis should
7 not be contingent on the choice of the geographic market. Instead, the choice of the geographic
8 market should facilitate the impairment analysis. The TRO indicates that “while a more
9 granular analysis is generally preferable, states should not define the market so narrowly that a
10 competitor serving that market alone would not be able to take advantage of the scale and scope
11 economies from serving a wider market.”³¹ While defining the market as the wire center
12 certainly would make it easier to determine which CLECs should qualify as trigger firms, it
13 would make analysis of potential competition and reaching economically rational findings with
14 respect to impairment more difficult. Although we believe that defining the geographic market
15 area as the LATA is appropriate, a broader geographic market definition should not be used so
16 as to trivialize the economic analysis of actual competition that provides a central component to
17 the impairment analysis and that is critical for proper application of the triggers.

18 When determining impairment, it is necessary to ensure that CLEC competition would not be
19 impaired without access to UNEs “throughout” the market. The fact that competition is
20 geographically localized and not distributed throughout even the MSA markets identified by
21 Qwest demonstrates that entry economics are *not* uniform even across an area as small as an
22 MSA. The fact that entry economics differ across wire centers within an MSA, and by

³⁰ Shooshan Response, p. 15-16. In our Response Testimony, we described a hypothetical example that is completely consistent with Qwest's application of the triggers that demonstrates why it is nonsensical and incorrect.

³¹ TRO ¶ 495.

1 extension, across a LATA, does not provide a basis for limiting the market definition to a
2 smaller area (*i.e.*, not to either a collection of wire centers nor to an MSA).

3 **Q. DO YOU AGREE WITH MR. SHOOSHAN'S CONTENTION THAT AN EFFICIENT**
4 **CLEC MAY CHOOSE TO SERVE CUSTOMERS THAT ARE NOT PROFITABLE?**

5 A. No. Mr. Shooshan's claim that a profit-maximizing CLEC might choose to serve customers in
6 some wire centers that are not "incrementally profitable"³² makes no economic sense, except
7 perhaps at an extremely incidental level. An efficient CLEC will want to provide service
8 throughout an area no smaller than that covered by local mass media (radio, TV, newspapers)
9 to avoid the potentially negative impact on its brand image if a more limited market entry were
10 perceived by potential customers as "redlining." The inability to enter economically with a
11 suitably large market footprint (not just with respect to geographic coverage, but also with
12 respect to classes of customers served) may make entry of all kinds more expensive and hence
13 less likely to occur. As we explained in our Direct Testimony, UNEs complement facilities-
14 based entry by allowing a CLEC to offer service throughout the market and thereby avoid
15 precisely the sort of "redlining" issues that Mr. Shooshan alludes to. However, with or without
16 UNEs, if it is not incrementally profitable to serve a class of customers, a profit-maximizing
17 CLEC will not serve those customers.

³² Shooshan Response, p. 18. Note, to be clear, an efficient CLEC is profit-maximizing by definition.

1 **II. OUR POSITION ON THE ECONOMIC MODEL TESTIMONY PROFFERED BY MR.**
2 **COPELAND**

3 **Q. MR. COPELAND CHALLENGES THE 4.6% CHURN RATE USED IN THE AT&T**
4 **BCAT MODEL, CONTENDING THAT HIS USE OF A 3% CHURN RATE FOR CLEC**
5 **MASS MARKET CUSTOMERS IS SUPPORTED BY THE REPORTED EXPERIENCE**
6 **OF SEVEN SPECIFIED CLECS.³³ DOES THE EXPERIENCE OF THOSE CLECS**
7 **SUPPORT HIS CLAIM?**

8 A. No. Most of the CLECs cited by Mr. Copeland do not offer mass market services; hence, the
9 churn rates they report are not representative of mass market conditions. Allegiance, Choice
10 One, Focal, Mpower, and US LEC have not in the past served the residential market at all, and
11 there is no publicly available information to indicate that they serve businesses with fewer than
12 four lines (i.e., mass market customers) except perhaps on an entirely incidental basis.³⁴ Unlike
13 mass market services, enterprise services are often provided under term contracts that
14 effectively prevent the customer from switching carriers. Even where the service is provided
15 on a month-to-month basis, the relative complexity and “mission critical” nature of enterprise
16 services creates far greater customer inertia – and hence far less churn – than is characteristic of
17 mass market services.

18 Additionally, in several cases the churn rates actually being reported by the CLECs that Mr.
19 Copeland specifically cites are much higher than what he claims.³⁵ For example, Mr. Copeland
20 reports that Focal Communications has experienced monthly churn rates of 0.8%. However,
21 Focal’s First Quarter 2003 10-K reports that it lost 67,157 lines over the first quarter, while it

³³ Copeland Response, p. 26.

³⁴ Indeed, McLeod and Z-Tel, which do serve mass market customers, report significantly higher churn rates than the other enterprise-focused CLECs.

³⁵ See **Exhibit WHL-9**.

1 began the period with 586,981 line.³⁶ That translates into a total churn rate for the quarter of
2 11.44% (i.e., 67,157/586,981), or a monthly churn rate of 3.81%. Mr. Copeland has similarly
3 overstated the churn experiences of McLeodUSA and Z-Tel.³⁷ In fact, McLeod and Z-Tel are
4 the only CLECs selling services to the mass market and they exhibit churn ratios of 4.02% and
5 3.20%-6.40%, respectively, although these figures represent the churn rates for mass market
6 and enterprise customers combined. The sole mass market only figure presented by Mr.
7 Copeland is for Mpower, with a range of 4.30%-4.80%, which is entirely consistent with the
8 4.6% used in the BCAT.

9 **Q. MR. COPELAND ARGUES THAT FOR TRACK 2 BUSINESS CASE MODELLING**
10 **PURPOSES, REVENUE PER LINE SHOULD BE ASSUMED TO REMAIN**
11 **UNCHANGED OVER THE ENTIRE TIMEFRAME OF THE ANALYSIS. PLEASE**
12 **COMMENT.**

13 A. Mr. Copeland is wrong for several reasons. First, and as we have stated in our Response
14 Testimony, the FCC directs state commission to “consider prices and revenues prevailing at the
15 time of their analyses,” nowhere does the FCC suggest that “prevailing” prices be considered to
16 the exclusion of all other relevant information.³⁸ Second, and again as we addressed in our
17 Response Testimony, there is a widespread consensus among industry analysts that competition

³⁶Focal Communications Corp., First Quarter 2003 10Q Report filed with the US Securities and Exchange Commission, May 14, 2003.

³⁷McLeodUSA reports in its 3rd quarter 2003 10Q (filed with the US Securities and Exchange Commission, 11/14/03) that the decrease in revenue was primarily due to a decline in customers, of which approximately 50,000 resulted from our drive to eliminate non-profitable business. The same report also states that McLeodUSA had 414,767 total competitive customers at the beginning of the quarter. Therefore a conservative monthly churn rate for McLeodUSA would be $((50,000/414,767)/3)$ 4.02%. Mr. Copeland, however, reports that McLeod exhibits a monthly churn rate of 0.80%. Z-Tel, according to its 3rd quarter 2003 10Q (filed with the US Securities and Exchange Commission 11/14/03) reported a reduction of 25,000 lines to 237,000 at September 30, 2003. Therefore, at a minimum, Z-Tel's monthly churn was $((25,000/262,000)/3)$ 3.2%. However, it is not unreasonable to assume that gross line losses were double the net losses, raising the churn rate as high as 6.4% per month.

³⁸ See Lehr & Selwyn Response Testimony, p. 60.

1 will drive down prices and revenues over time.³⁹ Mr. Copeland’s suggestion that such revenue
2 losses would somehow be offset by “the creation and adoption of new services and revenue
3 opportunities” is without basis and entirely unjustified. Mr. Copeland fails to explain precisely
4 what these services might be and, moreover, fails to note that some of the likely candidates may
5 not even be possible for CLECs to provide. For example, the TRO specifically *does not* require
6 ILECs to provide “advanced services” such as DSL and broadband as UNEs.⁴⁰

7 Finally, while Mr. Copeland describes the ““process of forecasting the dynamics of price
8 changes and the availability and adoption of new services going forward in time”“ as
9 “contentious and highly speculative,” assuming that the going-in (i.e., current prevailing) prices
10 will remain unchanged over a time frame as long as ten or (in the case of CPRO) twenty-five
11 years is certainly no less “contentious and highly speculative” – and, moreover, is almost
12 certainly wrong.

13 **Q. MR. COPELAND ALSO CHALLENGES THE USE OF “AVERAGE” REVENUE IN**
14 **THE BUSINESS CASE MODEL, ARGUING THAT CLECS TARGET HIGH-**
15 **REVENUE CUSTOMERS. PLEASE COMMENT.**

16 A. We addressed this question in some detail in our Response Testimony, and will not repeat these
17 arguments here.⁴¹ However, it is worth noting again that even if CLECs are successful initially
18 in attracting a higher-value customer base, as CLEC shares increase (an assumption common to
19 both the Qwest and AT&T models), their ability to selectively target only high-revenue

³⁹ *Id.*, p. 61.

⁴⁰ TRO, at ¶ 7. While CLECs may offer certain of these services, such as ADSL, over UNE loops that are configured entirely using copper (*i.e.*, with no DLC or fiber segments), more than 21% of Qwest’s Washington loops are not copper end-to-end (*see Exhibit WHL-10*). Even in the largest and most densely populated MSAs – Seattle and Tacoma – some 14% and 24% of all loops, respectively, fall in this category. Not only will such additional revenue sources not be available to CLECs, their inability to offer such services may also affect consumer demand for CLEC-provided conventional voice (POTS) services, particularly where the basic service is packaged with DSL or other advanced service offering.

⁴¹ *See Lehr & Selwyn Response*, p. 42-47.

1 customers will diminish and their average revenue per customer will fall while the costs of
2 customer acquisition will likely rise.⁴² Moreover, to the extent that CLECs may be unable to
3 offer advanced services, there is a strong possibility that those very same high-revenue CLEC
4 customers will actually migrate back to Qwest. We would also observe that Mr. Copeland's
5 revenue figure for "the average revenue per line per month of residential customers and small
6 business customers leaving Qwest in 2003" does *not* include interLATA toll revenues being
7 captured by Qwest's long distance affiliate. Qwest does not report its affiliates' revenues to the
8 WUTC for regulatory purposes, and does not include interLATA long distance revenues and
9 earnings in determining its revenue requirement under rate-of-return regulation. To maintain
10 competitive neutrality, CLECs should similarly not be required to include interLATA toll
11 revenues in assessing the overall economic viability of their business model.

12 **III. OUR POSITION ON THE WUTC STAFF RECOMMENDATION**

13 **Q. MR. SPINKS FOR THE WUTC STAFF RECOMMENDS THAT MASS MARKET**
14 **BUSINESS AND RESIDENTIAL SERVICES BE CONSIDERED AS SEPARATE**
15 **MARKETS, AND THAT URBAN AND RURAL AREAS ALSO BE SEPARATED INTO**
16 **DISTINCT MARKETS FOR PURPOSES OF APPLYING THE TRIGGER TESTS AND**
17 **FOR BUSINESS CASE ANALYSIS PURPOSES. DO YOU AGREE?**

18 A. No. Markets are defined with respect to both *demand* and *supply* conditions. The demand-
19 based distinctions that Mr. Spinks proposes ignore the fact that CLECs do not provide services
20 in isolated, community-specific "islands" but rather require a minimal scale and scope of
21 operations in order to profitably supply their services.

⁴² For example, Mr. Copeland cites the average revenue for customers who have left Qwest for a CLEC as being above the average for the Qwest population overall. Copeland Response, p. 22-23.

1 Exhibit WRE-3C identifies some BEGIN CONFIDENTIAL << [REDACTED] >> END
2 CONFIDENTIAL UNE-loops spread across BEGIN CONFIDENTIAL << [REDACTED] >> END
3 CONFIDENTIAL wire centers in all three of the MSAs for which a “no impairment” finding is
4 being sought. Only about BEGIN HIGHLY CONFIDENTIAL << [REDACTED] >>
5 END HIGHLY CONFIDENTIAL of these are associated (apparently) with mass market
6 services.⁴³ Citing CLECs’ responses to bench request 45, Mr. Spinks indicates that virtually
7 all of these mass market UNE-Loops are being used for *business* services.⁴⁴ Applying
8 essentially the same mechanical counting approach that is being used by Qwest, Mr. Spinks
9 then concludes that, at least with respect to small business customers, the trigger test is
10 satisfied, at least in the three markets that Mr. Spinks identifies.⁴⁵ As AT&T witness John
11 Finnegan explains, the trigger test is not satisfied even for mass market business services
12 viewed on a stand-alone basis.

13 The basis for Mr. Spinks’ recommendations appears to be the same mechanical interpretation
14 of the trigger test as was adopted by Mr. Shooshan – i.e., count to three. Mr. Spinks is
15 absolutely correct in his conclusion that neither the trigger nor the business case analysis is
16 satisfied with respect to residential service,⁴⁶ but his solution of carving out the small business
17 segment into a stand-alone market serves more to highlight the fundamental fallacy in the
18 Qwest view of the trigger application than in resolving Mr. Spinks’ specific concerns with
19 respect to residential and rural customers. The provision of mass market business and
20 residential services involves *common* network and organizational resources. There is no basis
21 to conclude that either segment could be economically viable on a pure stand-alone basis.
22 Indeed, neither the Qwest nor the AT&T business case models divide the market into separate

⁴³ See Exhibit MSR-6HC.

⁴⁴ Spinks Response, p. 19.

⁴⁵ *Id.*, p. 19.

⁴⁶ *Id.*, p. 19-20.

1 residential and business segments because to do so would reduce economic viability. The TRO
2 specifies that “states should not define the market so narrowly that a competitor serving that
3 market alone would not be able to take advantage of available scale and scope economies from
4 serving a wider market”⁴⁷ The granularity with which Mr. Spinks proposes to split separate
5 customer categories directly violates this requirement.

6 **IV. OUR POSITION ON MR. REYNOLDS TRIGGER REBUTTAL TESTIMONY**

7 **Q. PLEASE EXPLAIN WHY MR. REYNOLDS IS INCORRECT IN RECOMMENDING**
8 **THAT CABLE TELEPHONY PROVIDERS BE COUNTED TOWARDS THE**
9 **TRIGGERS IN WASHINGTON.**

10 A. Mr. Reynolds claims that the TRO specifies that cable telephony providers should be counted
11 toward the self-provisioning triggers in Washington, basing his argument – like Shooshan – on
12 a partial and biased reading of selected passages in the TRO.⁴⁸ As we explain in our Response
13 Testimony, cable telephony services are still too new and experience with them is still too
14 limited to ensure that they offer a viable substitute for Qwest's services (*i.e.*, of equivalent
15 quality and maturity⁴⁹). Moreover, the "cable telephony" approach is not economically viable
16 for other CLECs (because cable companies are *not* required to make network elements
17 available), nor is it viable even for a cable carrier seeking to provide service outside of its
18 existing footprint, which typically embraces only a subset of the defined market area.⁵⁰

⁴⁷ TRO, at ¶ 495.

⁴⁸ See Reynolds Response, p. 2-12.

⁴⁹ See TRO ¶ 499, footnote 1549. Mr. Reynold's attempt to limit the import of the discussion in this footnote to wireless providers because that is the example cited in the TRO following the footnote represents just another example of Mr. Reynold's selective reading (see Reynolds Response Testimony, pages 3-4). The wireless example is even more clear than the cable telephony example but the footnote clearly applies to both or the FCC could have been explicit. Moreover and more importantly, we cite this example only as the clearest example of the TRO's position with respect to how intermodal competition ought to be evaluated. The core of our analysis, however, relies on an economic interpretation of the TRO's impairment standard which is based on reading the entire TRO and what has gone before.

⁵⁰ See Lehr & Selwyn Response, p. 20.

1 Certainly, the Commission ought to *consider* evidence of actual competition from all sources,
2 including intermodal competition. After all, an important outcome of these proceedings will be
3 a more accurate snapshot of the extent of current competition. However, as with the need to
4 qualify traditional CLECs, this does *not* mean that any firm offering any kind of service to
5 consumers should immediately be counted toward meeting the triggers. The fact that a cable
6 carrier may be offering services that compete with Qwest's telephone services *may* help
7 discipline Qwest's market power and benefit consumers, but as we noted before, that is not the
8 purpose of this proceeding, and it is certainly not the intent of the trigger test, which is intended
9 to assess whether evidence of actual competition provides adequate support for inferring that
10 additional efficient CLEC entry is viable. The presence of cable telephony in no way
11 demonstrates that to be the case, due to the specialized nature of the cable telephony business
12 model. Seeking to count cable telephony providers is just another example of Qwest's attempt
13 to induce this Commission to adopt a "One, Two, Three and away with competition" ruling.

14 **Q. PLEASE COMMENT ON MR. COPELAND'S ALLEGATION THAT AT&T'S**
15 **BUSINESS CASE ANALYSIS FAILS TO MEET THE REQUIREMENTS OF THE**
16 **TRO.**

17 A. Mr. Copeland mischaracterizes AT&T's analysis of potential competition as summarized in Mr.
18 Baranowki's testimony regarding the BCAT model and in Mr. Denney's testimony regarding
19 the DS0 Analysis Tool that provides critical inputs to the BCAT.⁵¹ While there are numerous
20 ways in which Mr. Copeland's critique of the AT&T analysis is flawed, others will respond to
21 most of those. There is no single way to formulate or present the results of a business case.
22 Mr. Copeland's critique that AT&T failed to provide a "revenue/cost business case analysis
23 required by the FCC that examines potential discounted cash flows of a business decision" is

⁵¹ See Copeland Response, p. 2, 10.

1 superficial and without foundation. His criticism has no more merit than if had had chastised
2 AT&T for printing its tables in landscape format in a font he dislikes, instead of using portrait
3 format. Mr. Reynolds' comment is simply meaningless. The calculations remain the same.

4 Indeed, the AT&T analysis is conservative insofar as it does not fully account for the fact that
5 cash flows are likely to be significantly negative in the early ramp-up years, requiring financing
6 that would only decrease the economic viability of CLEC facilities-based entry. Since the
7 analysis presented by AT&T demonstrates that facilities-based entry to serve the mass market
8 is not economic without UNEs in any case, excluding these costs reduces the complexity of the
9 model and enhances transparency, while supporting an identical finding of impairment.

10 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

11 A. Yes, it does.