BEFORE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Merger of the Parent	)	DOCKET NO. UT-991358
Corporations of Qwest Communications	)	
Corporation, LCI International Telecom	)	
Corp., USLD Communications, Inc.,	)	
Phoenix Networks, Inc. and U S WEST	)	
Communications, Inc.		)

DIRECT TESTIMONY

OF

DR. BRIDGER M. MITCHELL

MCLEODUSA TELECOMMUNICATIONS SERVICES, INC.

February 1, 2000

1 Direct Testimony of
2 Bridger M. Mitchell
3 Docket No UT-991358
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5
6
7 **A. Would you please state your name, address, and position?**

8 A. My name is Bridger M. Mitchell. I am a vice president of Charles River Associates
9 Incorporated, an economics, finance and business consulting firm with offices in Boston,
10 Massachusetts and six other cities. I am the director of the Palo Alto office, which is
11 located at 285 Hamilton Avenue, Palo Alto, California.

12 **Q. Would you please briefly describe your professional qualifications?**

13 A. I received an A.B. with a major in economics from Stanford University in 1962 and a
14 Ph.D. in economics from M.I.T. in 1970. I was an assistant professor in the Department
15 of Economics at Stanford University from 1966 to 1971, and have subsequently taught
16 economics courses at Stanford as an acting associate professor and at UCLA as a lecturer
17 in economics. In 1971 and 1972, I was an economics policy fellow at the Brookings
18 Institution and the Department of Health, Education and Welfare. From 1972 to 1994, I
19 was a senior economist at the RAND Corporation in Santa Monica, CA. I am a member

1 of the American Economics Association and the International Telecommunications
2 Society.

3 My fields of specialization within economics are industrial organization,
4 regulation, and microeconomics. I have co-authored five books and written a large of
5 number of articles published in professional journals and books. In the
6 telecommunications industries I have conducted studies of telecommunications
7 competition, incremental costs of local telephone networks, interconnection of
8 telecommunications networks, demand for telephone services, pricing of
9 telecommunications services, cable television regulation and the allocation of spectrum
10 resources. I have provided expert consultation and testimony in telecommunications
11 cases, as listed in my curriculum vita.

12 **Q. Q. What is the purpose of your testimony in this proceeding?**

13 A. I have been asked by McLeodUSA to evaluate the likely effects of the proposed merger of
14 Qwest and U S WEST on competition and consumers in the state of Washington. This
15 testimony reports the conclusions of my analysis.

1 **Q. Q. In your testimony how will you refer to the various parties to this**
2 **proceeding?**

3 A. I will use "Applicants" to mean the merging parties and I will not distinguish between a
4 company and its wholly owned affiliates (e.g., references to "Qwest" include LCI, UCSD,
5 Phoenix, etc.) The terms "in-region" and "out-of-region" refer to the region of the United
6 States served by U S WEST. The term "ILEC" refers to both pre-merger U S WEST and
7 to the ILEC part of post-merger Qwest. Similarly, "Qwest" refers to both pre-merger
8 Qwest and the corresponding part of post-merger Qwest.

9 **Q. Would the merger be detrimental to the public interest in any way?**

10 A. Yes. The merger would increase the ILEC's incentive and ability to circumvent
11 regulation, it would increase the ILEC's incentive and ability to degrade the quality of
12 service provided to consumers and other telecommunications carriers in the state of
13 Washington, and it would reduce actual or potential competition in the markets for local
14 exchange, high-speed data access, and long-distance services.

15 **Q. How would the ILEC try to circumvent regulation?**

1 A. The asymmetry of information between regulators and regulated firms is a fact of life that
2 almost certainly cannot be avoided, and surely not without spending extravagant (and
3 inefficient) amounts of resources. This asymmetry provides the ILEC two main avenues
4 by which it can attempt to circumvent regulatory obstacles to its exploitation of monopoly
5 power. First, the ILEC can try to misinform regulators about its cost structure in order to
6 obtain higher price ceilings or lower quality floors for its regulated services. Second, it
7 can try to misinform regulators about the actual quality of its regulated services and thus
8 save on the expenses and investments necessary to achieve quality levels specified by
9 regulation.

10 The relative strength of these two strategies (cost misinformation and quality
11 misinformation) will depend on the structure of regulation. For example, the incentives
12 for quality degradation are stronger under price-cap regulation than under rate-of-return
13 regulation.[1] It should be noted, however, that regulation is almost always of a hybrid
14 form[2] and that the ILEC will have incentives to pursue both strategies.

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[1] For a simple formal model showing that a monopolist subject to price-cap regulation will provide sub-optimal quality levels, see M. Armstrong, S. Cowan and J. Vickers, *Regulatory Reform: Economic Analysis and British Experience*, The MIT Press, Cambridge, MA, 1994, p. 173.

1 [2] On the one hand, cost-based regulation maintains some flexibility in the choice of costs that are allowed into the
2 rate base and regulated rates are not adjusted instantly, thus acting as short-term price caps. On the other hand, price
3 caps and X-factors under incentive regulation are not set once-and-for-all and information about realized profits is

1 Since total profits can be assessed with some precision from accounting data and
2 market valuations (for example, stock prices) and since these data convey information
3 about the firm's cost structure and expenses, a particularly effective form of
4 misinformation is to divert resources from regulated to unregulated divisions within the
5 company. The ILEC can accomplish this diversion directly by reducing investments in its
6 regulated division or indirectly by distorting the allocation of common costs. In some
7 cases the ILEC might even have an incentive to adopt inefficient technologies with high
8 common costs over more efficient (but more "transparent") technologies with smaller
9 common costs.

10 The projects necessary to increase quality of service are likely to suffer the most
11 from reduced investments in the ILEC's regulated division, mainly because the costs and
12 benefits of quality of service investments are hard for regulators to evaluate. In the case of
13 the quality of services provided to CLECs, this problem is particularly severe because
14 regulatory pressure is essentially the only motivation for the ILEC to provide such
15 services.

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1 invariably used in their update. See Armstrong et al., cited above, or D. E. M. Sappington and D. L. Weisman,
2 *Designing Incentive Regulation for the Telecommunications Industry*, The MIT Press, Cambridge, MA, 1996 for a
3 more detailed comparison of cost-based and incentive regulation.

1 Regulators' experiences with U S WEST have demonstrated that U S WEST has
2 not only the incentives but also considerable ability to manipulate the quality of its
3 services. Carriers, such as McLeodUSA and AT&T, that measure the quality of services
4 they purchase from ILECs have found that U S WEST's performance is inferior to service
5 obtained from out-of-region ILECs.

6 As described in the prepared testimony of Stacey Stewart, Vice President – ILEC
7 Relations of McLeodUSA, U S WEST has denied McLeodUSA access to necessary
8 facilities and engaged in a variety of behaviors that prevent McLeodUSA from receiving
9 timely wholesale services.

10 I understand that McLeodUSA compiles monthly performance indicators on
11 services provided by the ILECs in the states in which it offers services. For provisioning
12 of facilities used by McLeodUSA for the resale of Centrex services the measured
13 performance by U S WEST has been inferior to the performance of Ameritech. For
14 example, during the first 10 months of 1999, in the case of U S WEST 47% of all
15 reported out-of-service conditions exceeded 24 hours as compared with 25% for
16 Ameritech-supplied service. The average time required to restore service was 45 hours
17 from U S WEST, compared with 35 hours needed by Ameritech. And U S WEST

1 confirmed only 22% of firm orders within 48 hours, as compared with 54% for
2 Ameritech.[3] In Washington, AT&T states that U S WEST failed to meet Customer
3 Desired Due Date commitments for DS-1 facilities more than 39% of the time in May,
4 June, and July of 1999 and was the poorest performing RBOC for provisioning of access
5 services.[4]

6 AT&T's reported experience with U S WEST is based on a uniform set of direct
7 measures of quality (DMOQs) for access services that it purchases from the RBOCs. U S
8 WEST's performance on these measures in 1999 "is last or second to last among all
9 RBOCs for each of the DMOQs." For example, across the U S WEST region in 1999, U
10 S WEST's percentage of new DS1 services that were provisioned not later than the
11 customer desired due date was less than 60%, and the percentage for new DS0 services
12 was less than 78%; this compares to the best-in-class RBOC performance of 98%-100%.[5]
13

14 The ILEC also has the ability to selectively degrade service quality to other

1 [3] See Direct Testimony of Stacey Stewart on Behalf of McLeodUSA, dated February 1, 2000.
1 [4] AT&T, "Complaint and Request for Expedited Treatment,", Washington Utilities and Transportation Commission,
2 p. 13.
1 [5] AT&T, "Complaint and Request for Expedited Treatment,", Washington Utilities and Transportation Commission,
2 pp. 8-9.

1 carriers and discriminate in favor of its own services and those of its affiliates.
2 McLeodUSA reports that U S WEST has attempted to withdraw Centrex service,
3 imposed discriminatory charges for Centrex, database, and other services, and limited
4 changes in Centrex service.[6]

5 AT&T complains that U S WEST provides its affiliates, such as its data network
6 affiliate U S WEST !nterprise, with access to blocking information, network locations
7 where its facilities are at or near capacity, and which central offices are selected for
8 expansion, but refuses to provide such information to AT&T.[7]

9 Very substantial deficiencies in the quality of service provided to U S WEST's
10 retail consumers are apparent in the FCC's recent tabulation of LEC quality of service
11 provided by the seven RBOC holding companies, GTE, and Sprint.[8] In 1998, complaints
12 to federal and state regulators rose to 722 per million U S WEST residential access lines
13 from the 532 per million lines of the previous year, greatly exceeding the next-highest

1 [6] See Stewart's testimony, cited above.
1 [7] AT&T, "Complaint and Request for Expedited Treatment,", Washington Utilities and Transportation Commission,
2 p. 14.
1 [8] J. Kraushaar, "Quality of Service of the Local Operating Companies Aggregated to the Holding Company Level,
2 1996 – 1998," FCC, Industry Analysis Division, Common Carrier Bureau, released December 1, 1999. Statistics in
3 the text are from Tables 2(a) and 3(a).

1 number of complaints, 245 per million NYNEX residential lines in 1998. In 1998, U S
2 WEST's business customers also complained at more than three times the rate of the LEC
3 with the next-highest number of complaints. More than one-third of all troubles reported
4 to U S WEST result in a repeat trouble report, compared with fewer than 21% for the
5 next-highest LEC. And unscheduled U S WEST switch outages caused an average loss of
6 service of 9.9 minutes per access line during 1998, compared with 3.5 minutes for the
7 next-highest LEC.

8 The relatively low quality of U S WEST's service does not appear to be due to
9 structural backwardness, nor to problems specific to U S WEST's territory: according to
10 AT&T, "prior to 1993, U S WEST often performed at or near the top in some DMOQs
11 compared to the other RBOCs." [9] The decline in service quality appears to coincide with
12 U S WEST's expansion in the market for advanced telecommunication services and this is

1 [9] AT&T, "Complaint and Request for Expedited Treatment,", Washington Utilities and Transportation Commission,
2 p. 8. According to a 1999 article by Stuart Steers, "In 1992, the [Colorado] PUC logged 2,500 complaints against
3 the company [U S WEST]; last year they numbered more than 6,000. (Most of the other states in U S WEST's
4 territory — which extends from Oregon to Iowa — reported similar experiences.)" See "Liars on the Line," *Denver*
5 *westword.com*, November 11-17, 1999, available at http://www.westword.com/issues/1999-11-
6 11/feature.html).

1 suggestive of a revenue diversion strategy.[10]

2 The unsatisfactory quality of U S WEST's service has been acknowledged by the
3 company's CEO who stated that "A portion of our customers aren't getting the level of
4 service they expect to receive." The company set year-end 1999 goals to make a 30%
5 improvement in the number of held orders and to repair 65% of out-of-service trouble
6 reports within 24 hours. Spending for service improvements in 1999 are announced to
7 increase by more than $1 billion more than spent in 1998.[11]

8 **Q. Why would the merger increase the ILEC's ability to circumvent regulation?**

9 A. The merger would greatly and suddenly increase the scope and size of the ILEC's
10 operations in markets and services that are not currently regulated at the state level.
11 Qwest's current operations in collocation and remote access, internet access and web
12 hosting services, wireless and video services, and out-of-region long distance services
13 would be added to U S WEST's current in-region operations. Overall, the merger would

1 [10] The article by Stuart Steers mentioned in the previous footnote also provides information on lawsuits that have
2 been filed against U S WEST precisely for allegedly diverting money from necessary network investments to other
3 lines of business.
1 [11] "Sol Trujillo Commits U S WEST to Improved Service," News Release, Oct. 25, 1999 at
2 http://www.uswest.com/news/102599.html.

1 increase the firm's total assets from $18.4 billion (pre-merger U S WEST) to $27.5
2 billion post-merger in terms of book-value[12] and from $36.5 billion (pre-merger U S
3 WEST) to $65 billion post-merger in terms of stock-market valuation.[13]

4 This abrupt expansion in size and scope of the regulated firm would
5 correspondingly increase the extent of informational asymmetries between regulators and
6 the ILEC and, more generally, the complexity of the tasks faced by regulators. It is
7 unlikely that it would be optimal for regulators to spend enough additional resources (in
8 monitoring and evaluating the ILEC's behavior) to bring complexity and informational
9 asymmetries back to pre-merger levels.[14] It is even less likely that it would be optimal, or
10 even feasible, for the regulators to adjust immediately to the sudden change caused by the
11 merger.

12 As a consequence, at least for some time, regulators may lack the experience and

1 [12] The data are from U S WEST's and Qwest's 1998 Annual Reports as posted on their websites at
2 http://www.uswest.com/is/annuals/annual98/index.html and
3 http://www.qwest.com/annual_report98/index.html
1 [13] U S WEST's merger presentation, at http://www.qwest.net/qwest/index.html.
1 [14] It would probably be optimal to spend *some* additional resources. Another regulatory response to the decreased
2 precision of information about the ILEC's cost structure would be to rely more heavily on incentive regulation and,
3 especially if the loss of precision comes with an expanded range of possible outcomes, leave more informational
4 rents to the firm. For a formal analysis, see J.J. Laffont and J. Tirole, *A Theory of Incentives in Procurement and*
5 *Regulation*, The MIT Press, Cambridge, MA, 1993, especially Appendix A1.6 (pp. 123-124), Section 12.3.1 (pp.
6 519-524) and Section 12.4.1 (pp. 528-529).

1 resources necessary to evaluate the potential synergies between the new or greatly
2 expanded activities and the regulated parts of the ILEC's business. During this period the
3 ILEC would gain greater leeway to impute disproportionate amounts of its total costs to
4 its regulated activities and thereby obtain undue increases in its profits. Where the ILEC
5 is regulated on a cost basis, the ILEC would realize this increased return directly, and in
6 jurisdictions where it is subject to incentive regulation the increased returns would be
7 reaped via increases in price-caps or decreases in X-factors. For the same reasons, the
8 merger would also increase the ILEC's ability to bias its choice of technologies towards
9 those that have high synergies with the (new) unregulated activities.

10 As an example of the difficulties that regulators have faced in enforcing regulatory
11 policies when U S WEST operates unregulated affiliates and can transfer assets between
12 regulated and unregulated activities, consider the experience with directory publishing
13 operations. Prior to 1984, U S WEST's directory publishing operations were provided on
14 an integrated basis with its local exchange services and the revenues from its publishing
15 operations, including the profits from its yellow pages advertising, were included in its
16 rate base in an effort to keep local telephone rates low.

17 At divestiture, Pacific Northwest Bell ("PNB"), the U S WEST local telephone

1 service provider in Washington state, transferred its yellow pages assets to an
2 independent subsidiary, Landmark Publishing Company, which later transferred them to
3 the unregulated entity U S WEST Direct. U S WEST Direct then paid an annual
4 publishing fee to PNB, but only until 1988. In the following years, the Washington
5 Utilities and Transportation Commission imputed yellow pages advertising profits to U S
6 WEST (the successor to PNB) for ratemaking purposes.[15] In 1989, regulators from several
7 states in the U S WEST region filed documents in the ongoing proceeding designed to
8 enforce the Modification of Final Judgment ("MFJ"). In its "Advice to the Court," the
9 state commissioners attacked "The U S WEST policy to offer no revenue support from U
10 S WEST Direct to the telephone operations of the company. . . as a blatant subversion of
11 the stated objectives of the [MFJ] Court's orders in this proceeding."[16] An attachment to
12 the filing documented state regulators' efforts to require U S WEST to meet its regulatory
13 responsibilities. For example, the Minnesota Public Utilities Commission voided the
14 agreement transferring Northwestern Bell's directory operations, but the decision was

1 [15] See T. Sweeney, "Brief regulatory history of U S WEST yellow pages," December 18, 1996 available at the
2 Commission's web site http://www.wutc.wa.gov.
1 [16] U.S. v. Western Elec. Co., Inc., Civil Action No. 82-0192, "Advice to the Court by the Western Conference of
2 Public Service Commissioners Amici Curiae Regarding the Enforcement of the Order on Modification of Final
3 Judgement Dated August 11, 1982," at p. 5, no. 8 (filed Oct. 23, 1989).

1 reversed by the Minnesota Court of Appeals in 1985.[17] The Minnesota Commission
2 noted that in December 1988 Northwestern Bell declared it would no longer receive
3 payments from U S WEST Direct and that the Commission was unsure whether it had the
4 legal authority to compel the continuation of payments.[18] More recently, U S WEST's
5 mounted several (unsuccessful) legal challenges against the imputation of directory
6 publishing profit mandated by the Washington Utilities and Transportation
7 Commission.[19]

8 Regardless of the merits in this specific matter, it is a clear illustration that determining
9 and *enforcing* the appropriate boundaries between regulated and unregulated activities can be
10 problematic even for cases as apparently simple as directory publishing. The proposed merger
11 would confront regulators with much harder cases.

12 **Q. Why would the merger increase the ILEC's incentive to divert resources?**

13 A. The main reason why the merger would increase the ILEC's incentive to divert resources

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1 [17] See Court of Appeals of Minnesota, Nos. C4-84-1872, C8-84-1888, May 14, 1985.
1 [18] Advice to the Court, App. A, p. 4.
1 [19] The matter reached the Supreme Court in the state of Washington and the Ninth Circuit Federal Court of Appeal.
2 Both ruled against U S WEST. See Supreme Court of Washington, No. 64822-1, 134 Wash. 2d 74; 949 P.2d 1337,
3 filed December 24, 1997; United States Court of Appeals for the Ninth Circuit, No. 97-35551, 146 F.3d 718, filed
4 June 16, 1998.

1 is that the merger would make it easier for the ILEC to invest in Qwest's projects.

2 The incentive to invest in Qwest-like projects (instead of investing, say, in
3 projects that enhance ILEC service quality) is arguably present even without the merger.
4 If there were Qwest-like projects available to the ILEC in the market,[20] and the ILEC had
5 a comparative advantage in financing them, it would have invested in those projects
6 instead of paying cash dividends to its shareholders.[21] Therefore, either the ILEC had no
7 comparative advantage in financing those Qwest-like projects or such projects were not
8 available.

9 The merger would make such projects available to the ILEC. Moreover, by
10 eliminating the boundaries between the two firms, the merger may reduce the agency
11 costs associated with financing those projects with the ILEC's revenues.[22] This could lead
12 to an inefficient diversion of resources from regulated to unregulated investments.

1 [20] That is, those not legally proscribed. Section 271 of the Telecommunications Act of 1996 makes significant
2 investments in companies that provide in-region long-distance service unavailable to RBOCs.
1 [21] U S WEST paid out dividends for $4.1 billion in the years 1995-1998 as computed from historical dividend
2 information in U S WEST's web site at http://www.uswest.com/is/dividends/information.html.
1 [22] In a competitive environment this would count as an efficiency benefit of the merger, but the ILEC's environment
2 is one of market power and regulation. In this second-best context, the agency costs of outside financing may be a
3 compensating factor for the divergence between the private and social value of the ILEC's investments.

1 This diversion of resources is all the more likely because Qwest is placing great
2 importance on the opportunity to use U S WEST's financial resources after the merger.
3 The Applicants have announced that the merged firm would aggressively pursue a
4 strategy of diverting U S WEST's revenues (mainly from regulated activities) to finance
5 Qwest's investments (mainly into unregulated activities). They plan to slash the annual
6 dividend on U S WEST's stock from more than two dollars per share to a nickel per share
7 after the merger closes -- a sharp departure from industry practice.[23] The companies
8 estimate that this reduction in the dividend, along with certain "capital expenditure
9 synergies," will free up $7.5 billion for future investment. Qwest explained the theory of
10 the deal as follows:

11 "We believe we will be able to redeploy our capital in the years 2000
12 through 2005 in the aggregate amount of approximately $7.5 billion
13 toward new investment in Internet applications and hosting, out-of-region

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1 [23]Compare Qwest Communications International Inc. Form S-4 (Qwest S-4), filed with the Securities and Exchange
2 Commission on August 13, 1999, at 75 (listing historic dividends paid on U S WEST shares) with id. at 72 (stating
3 that the quarterly dividend on the stock after the merger will be $0.0125, or five cents per year). Other major ILECs
4 have paid out dividends of the same order of magnitude as those paid by U S WEST. For example, as of January 29,
5 2000, the stock yields (i.e., the last dividend per share divided by the share price) of the RBOCs and GTE were:
6 1.69% for Bell South, 2.50% for SBC, 2.64% for Bell Atlantic, 2.74% for GTE and 3.24% for U S WEST (data
7 from Yahoo!Finance at http://finance.yahoo.com/).

1 facilities based competitive local exchange service, out-of-region
2 broadband access and Internet services, wireless expansion and video
3 entertainment. We believe we can fund this redeployment of capital with
4 approximately $5.3 billion of savings from the reduction in the dividends
5 currently paid by U S WEST and $2.2 billion of savings from capital
6 expenditure synergies."[24]

7 The plan to stop paying almost all dividends and invest them in Qwest's business
8 is a signal that the merger will not be neutral with respect to the budgeting and capital
9 structure decisions of the merging parties. It also suggests that the Applicants will go
10 further than simply stopping the payment of dividends and actually redirect some of the
11 funds that would have been invested in U S WEST's in-region local network towards
12 Qwest's (mainly out-of-region) network.

13 Moreover, when exceptional or unexpected problems in the local network occur
14 the availability of liquid funds enables an ILEC to take prompt remedial actions. As a
15 consequence of the merger the commitment of U S WEST's liquidity to Qwest's projects

1 [24] See Qwest S-4 at 28.

1 would eliminate an important financial buffer and reduce the ILEC's incentives to cope
2 with rare, but eventually inevitable events.

3 **Q. Why would the merger increase the ILEC's incentive to degrade service**
4 **quality?**

5 A. The most straightforward reason why the merger would increase the ILEC's incentive to
6 degrade service quality is that it would increase the ILEC's incentive to divert resources
7 from quality-enhancing investments to Qwest's high-speed data projects. I have discussed
8 this incentive is my answer to the previous question. There are, in addition, other more
9 subtle reasons that are related to the ILEC's increased incentive to raise rivals' costs. [25]

10 For example, consider the quality of access service the ILEC provides to IXCs on
11 calls terminating in U S WEST's region. Pre-merger, the ILEC's incentive to provide good
12 service quality to IXCs depends essentially on the maximum access charges that the ILEC
13 can levy on IXCs and on the elasticity of the IXCs' demand for access. If regulation keeps
14 access charges close to the cost of providing access, the ILEC will provide a sub-optimal

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1 [25] See J.A. Ordover and G. Saloner, "Predation, Monopolization, and Antitrust" in *Handbook of Industrial*
2 *Organization*, Vol. I, pp. 565-570 (R. Schmalensee and R.D. Willig, eds., 1989) for a review of the literature on this
3 topic.

1 level of service quality and the degradation in quality will be larger if access demand is
2 relatively inelastic. However, pre-merger the ILEC does not have any incentive to
3 discriminate against any particular IXC, nor to spend resources (either directly, or in
4 terms of increasing the probability of being fined by regulators for failing to meet quality
5 standards) to actively degrade interconnection quality with IXCs.

6 After the merger, Qwest's out-of-region interLATA operations will become a
7 division of the ILEC. The profits of this IXC division will generally increase if its
8 competitors' costs of providing quality service rise. For these competitors the costs of
9 providing quality service depend in part on the quality of access service provided them by
10 the ILEC for calls terminating in its own region. These anticompetitive incentives would
11 be effective in the state of Washington, as in other states reached by Qwest's network.
12 Therefore, the merger will increase the incentive to degrade quality of access to
13 competing IXCs.[26] In turn, this will translate into higher prices for out-of-region
14 consumers and lower quality for all consumers on inter-regional calls.[27]

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1 [26] The merger would also induce the ILEC to provide better service quality to its own IXC division (i.e., pre-merger
2 Qwest), but the net effect of the distortion on consumers' welfare will be negative.

1 [27] For a formal model along these lines, see D. Reiffen, "A Regulated Firm's Incentive to Discriminate: A
2 Reevaluation and Extension of Weisman's Result," in Journal of Regulatory Economics, vol. 14, n. 1, July 1998, pp.
3 79-86. Reiffen makes the reasonable assumption that the provision of high service quality to downstream
4 competitors (e.g., IXCs) is costly to the ILEC. Several other papers have studied whether the incentive to degrade

1 The ILECs' incentives to discriminate when terminating calls from competing
2 IXCs has been taken very seriously by the FCC in its recent decision about the merger of
3 SBC and Ameritech -- even though neither ILEC had any significant long-distance
4 operations at the time of the merger. In the case of the Qwest/U S WEST merger, the
5 merged entity would already own substantial (out-of-region) long-distance operations. As
6 a result, this anticompetitive effect would not have to wait for the ILEC to obtain
7 interLATA relief according to Section 271 of the Telecommunications Act of 1996 -- it
8 would be operative immediately.

9 The harm to in-region consumers, however, may be even higher. The ILEC must
10 take care that the lower quality of service provided to in-region consumers (because of
11 decreased investments and degraded access to downstream competitors) does not induce
12 them to switch to competing CLECs. Possibly the cheapest way to retain these customers
13 is to reduce the competitiveness of in-region CLECs by degrading the quality of their
14 interconnection with the ILEC. This would further harm all in-region consumers, but

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1 the quality of service to competitors extends to the case in which this form of non-price discrimination is costly to the
2 ILEC. In his comprehensive survey of this literature ("Killing the Goose that May Have Laid the Golden Egg: Only
3 the Data Know whether Sabotage Pays," forthcoming in the *Journal of Regulatory Economics*), David M. Mandy
4 shows that the answers to this question cannot be obtained on theoretical grounds alone. Mandy claims that existing
5 data sources do not allow a clear empirical answer either. However, he reports some back-of-the-envelope
6 calculations suggesting that the incentive to discriminate is present in the U.S. telecommunications industry.

1 would disproportionately harm the CLECs' customers.[28] Thus, the ILEC's customers
2 would be unwilling to switch to a CLEC in spite of the ILEC's low quality of service -
3 indeed, partly because of it![29]

4 In sum, the ILEC's increased incentives to divert resources to unregulated
5 businesses and to discriminate against IXCs who compete with Qwest out-of-region have
6 the further effect of increasing the ILEC's incentive to strengthen its power in the market
7 for in-region local calls. These incentives all work to decrease the overall quality of
8 service enjoyed by consumers in the ILEC's region.

9 Note that, although the preceding discussion is cast in terms of local and long-
10 distance calls, the same argument would apply *a fortiori* to the in-region provision of
11 800-number services and private line services or to the in-region provision of any
12 advanced service that require use of the ILEC's network (e.g., DSL service, now offered

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1 [28] Because the ILEC has a much larger market share than all other CLECs combined most of the calls made by the
2 ILEC's consumers are made to other consumers that are served by the ILEC and are unaffected by the quality
3 degradation. On the contrary, most of the calls from CLECs' consumers would suffer the quality degradation
4 precisely because they are directed to ILEC's consumers and depend on the quality of interconnection. For a formal
5 model, see the technical appendices of J. Crémer, P. Rey and J. Tirole, "The degradation of quality and the
6 domination of the Internet," mimeo, 1998, prepared for counsel of GTE in the matter of MCI-WorldCom merger.
1 [29] The CLEC could decrease its reliance on the ILEC's services by reaching more consumers directly with its own
2 new facilities. But this would often involve inefficient duplication of facilities, higher costs and ultimately higher
3 prices that would dissuade consumers from switching.

1 predominantly by U S WEST, and high-speed broadband Internet access service, offered
2 by Qwest), where the ILEC's influence on rivals' costs is even greater.

3 **A.Would the merger increase the ILEC's incentives to obtain interLATA relief?**

4 A. In their filings at the FCC, the Applicants have claimed that the merger itself would
5 increase the ILEC's incentives to open its markets to competition because it would
6 increase the incentives to obtain relief from the interLATA restrictions in Section 271 of
7 the Telecommunications Act of 1996.[30] The arguments they adduce, however, are
8 unconvincing. First, even if the incentive to obtain interLATA relief were to *increase*
9 with the proposed merger, it would not follow that the ILEC would have *sufficient*
10 incentives to open up its markets to competition and/or to spend resources to accelerate
11 such opening. Post-merger, the ILEC may still find that it is profit maximizing to do as
12 little as possible to open its markets to competition. Second, as I have explained in my
13 answer to the previous question, the merger would strengthen some of the ILEC's
14 incentives to foreclose entry in the local exchange market and thus reduce the ILEC's
15 incentive to take the measures necessary to obtain interLATA relief.

1 [30] See the Applicants' "Response to Comments on Applications for Transfer of Control" filed on October 18, 1999 in
2 FCC CC Docket No. 99-272) and, in particular, the declaration by Bruce Owen (attachment B).

1 The reasons for increased incentives to obtain interLATA relief mentioned by the
2 Applicants do not seem sufficiently strong to reverse the negative effects mentioned
3 above. Bruce Owen, in his declaration accompanying the Applicants' Response
4 Comments, states that the merger would increase the ILEC's profits from satisfying
5 Section 271 because

6 "First, and probably most important, the combined company will already have a
7 nationwide network with substantial capacity, while U S WEST entering on its
8 own would have to obtain national network capacity at prevailing market prices or
9 through new construction. […] In considering the profitability of attracting long
10 distance traffic, the combined company would not take into account the cost of the
11 capacity, because that cost is already sunk." (p. 9; italics in the original)

12 But, although Qwest's capacity may be sunk in the ground, its cost is *not* sunk
13 because that capacity can be used without linking it to U S WEST's assets. The
14 opportunity cost of that capacity is its value in the best alternative use, i.e., its market
15 value. This market value would enter the combined company's calculations of the
16 profitability of attracting long distance traffic. Dr. Owen's argument implicitly assumes

1 that the merger would reduce the market price of capacity to zero.[31] The Applicants,
2 however, have not provided any reason why the merger would decrease the market value
3 of Qwest's network at all.[32]

4 **Q. Federal antitrust authorities have decided not to challenge this merger. Why should**
5 **the Washington Utilities and Transportation Commission consider the merger's**
6 **effects on competition?**

7 A. The lack of opposition to this merger on the part of the Department of Justice does not
8 imply that the merger would have no anticompetitive effects. It only implies that the
9 Department of Justice has determined that, at the national level, any such anticompetitive
10 effects do not sufficiently outweigh potential benefits of the merger to trigger action by
11 the federal antitrust authorities. The Washington Utilities and Transportation
12 Commission, however, will evaluate this merger according to a different and more

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1 [31] Alternatively, Owen may have assumed that (pre-merger) U S WEST can buy capacity at market prices, but (post-
2 merger) Qwest cannot sell it. This assumption could be justified only if U S WEST was the only potential buyer of
3 Qwest's capacity, i.e., if Qwest's capacity could be of use only to U S WEST. There is no evidence to suggest that
4 this is the case.

1 [32] On the contrary, the analysis in M. H. Riordan, "Anticompetitive Vertical Integration by a Dominant Firm" in
2 *American Economic Review*, vol. 88, no. 5 (December 1998), pp. 1232-1248, suggests that the price change is likely
3 to be small and positive. The merger would prevent the ILEC's use of Qwest's network for interLATA transport until
4 interLATA relief is obtained, but this does not affect the argument of this section.

1 comprehesnsive standard. In analyzing the effects of the merger on the public interest in
2 the state of Washington, this Commission should consider all aspects of the merger.

3 Moreover, this Commission and other regulatory authorities are in a better
4 position than antitrust authorities to impose and administer appropriate conditions for
5 merger approval. While it may be advisable not to oppose a merger if the alternatives are
6 either preventing the merger or imposing excessively crude divestiture conditions,
7 conditioning the same merger on more finely-tuned remedies that can be effectively
8 monitored and enforced may well be in the public interest.

9 **Q. Would the merger reduce competition in the LEC market?**

10 A. The Applicants have argued that Qwest should not be considered a significant potential
11 entrant in U S WEST's LEC market because it faces competition from a large number of
12 actual and potential CLECs.[33] The questions relevant to assessing potential competition,
13 however, are different. First, would Qwest be likely to enter the local exchange market if
14 the merger does not go through? Second, does the merger negatively affect the probability

1 33 Carlton and Sider, pp. 15-16 (attachment A to Applicants' "Response to Comments on Applications for Transfer of
2 Control," filed on October 18, 1999 in FCC CC Docket No. 99-272).

1 that some other firms would enter the market or the timeliness of their entry?[34]

2 Qwest claims to be active and interested in out-of-region local exchange markets
3 even without the merger:

4 "Qwest *already* is active outside the U S WEST region, and its ability to
5 draw on U S WEST local exchange expertise will simply accelerate that
6 process."[35]

7 "[Qwest] plans to construct or acquire local network facilities in 25 markets
8 across the country" and expects "to provide the full range of local services in those
9 markets."[36]

10
11 However, Qwest has recently retreated from U S WEST's in-region local
12 exchange markets. What special characteristics of the state of Washington (and, more
13 generally, of U S WEST's region) would cause Qwest not to enter these local exchange

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1 34 Of course, establishing whether there are other firms that could consider entering the market is a necessary step to
2 answering this question, but not a sufficient one.
1 35 Applicants' "Response to Comments on Applications for Transfer of Control," filed on October 18, 1999 in FCC
2 CC Docket No. 99-272, p. 16 (italics in the original).
1 36 Qwest's "Response to Staff Request for Information and Documents," filed on November 24, 1999, CC Docket
2 No. 99-272 ("Response to Staff Request"), p. 15.

1 markets when it is actively pursuing local markets elsewhere in the U.S.? Apparently,
2 none. Qwest has stated that "in the absence of the merger, Qwest's future plans might
3 have included locations within the U S WEST region."[37] Indeed, Qwest's plans did
4 include at least one such location, namely Seattle, and "[as] a result of the announced
5 merger, Seattle was dropped from the announced list [of cities Qwest targeted for local
6 facilities-based market entry]."[38]
7 It may be suspected that Qwest's recent withdrawal from U S WEST's region was
8 a purely tactical move to ease merger approval. Clearly, after the merger, Qwest would
9 not need to enter the market: it would simply be the dominant firm in the market.

10 Apart from the potential entry of Qwest into the in-region local exchange market,
11 the merger may also deter some other firm from entering the market. The Applicants
12 stress the beneficial effects of having a "national identity," providing service on a
13 nationwide basis, etc.[39] If this is an important competitive factor,[40] then firms that are able
14 to offer nationwide services would have an advantage in competing against U S WEST

1 [37] Qwest's Response to Staff Request, p. 16.
1 [38] Qwest's Response to Staff Request, p. 16.
1 [39] See pp. 18-19 of the Applicants' "Response to Comments on Applications for Transfer of Control," filed on
2 October 18, 1999 in FCC CC Docket No. 99-272.
1 [40] As I discuss below, the Applicants have not provided sufficient evidence to support this (or other) claim of merger-
2 related efficiencies.

1 for the in-region local market, and could thus at least partially compensate U S WEST's
2 incumbency advantage. But if, as a result of the merger, the incumbent also has a
3 nationwide presence this countervailing force would be missing and competitive entry
4 would be less likely.

5 **Q. Would the merger reduce competition in markets for high-speed data access?**

6 A. U S WEST is the dominant supplier of high-speed data access services in its region. It
7 has been aggressively deploying such services in urban areas throughout its 14-state
8 service territory. Nationwide, U S WEST is the leading supplier of DSL. It provides
9 DSL services in 40 cities and accounts for about 40 percent of all DSL customers in the
10 U.S.[41]

11 U S WEST has deployed high-speed data switches across its region, including
12 approximately 420 frame relay switches and 130 ATM switches. [42] U S WEST's
13 broadband network includes 7,000 metro fiber rings.[43]

14 Qwest is an important actual and potential competitor to U S WEST in high-speed

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1 [41] Qwest/U S WEST Application for Transfer of Control, August 19, 1999, pp. 15-16.
1 [42] Qwest/U S WEST Application for Transfer of Control, August 19, 1999, p. 16.
1 [43] U S WEST's merger presentation, at http://www.qwest.net/qwest/index.html.

1 data access services. A central component of Qwest's announced business strategy is "to
2 offer customers broadband connectivity on an end-to-end basis."[44] Qwest has pursued
3 this strategy in major urban markets across the U.S. by entering the market for high-speed
4 data access service in several ways. Qwest is constructing its own metropolitan fiber-
5 optic facilities. It has made strategic investments in fixed wireless access providers. And
6 it is reselling high-speed access services and DSL services.

7 As of February, 1999 Qwest had completed metropolitan area networks in 10
8 major cities, including Seattle, and planned to have networks completed in an additional
9 nine major markets by the end of 1999.[45] Qwest's metropolitan area networks provide
10 high-speed access to large businesses and enable them to connect directly to the Qwest
11 nationwide network. In October 1999, Qwest stated that by the end of 2001 it plans to
12 have operational local fiber networks in more than 25 major metropolitan areas.[46]

13 During 1999 Qwest has begun to enter local data access markets in metropolitan
14 areas across the country. Qwest is supplying DSL services by reselling the services of
15 Covad Communications Group and Rhythms NetConnections. Through Covad, Qwest

1 44 Qwest press release, February 24, 1999.
1 45 Qwest press release, February 24, 1999.
1 46 Qwest press release, October 21, 1999.

1 plans access in 22 metropolitan markets, including Seattle, by the end of 1999.[47] Through
2 Rhythms, Qwest plans to provide DSL access in major markets including Phoenix and
3 Portland, also by the end of 1999.[48] Altogether, Qwest has announced plans to provide
4 high-speed local access in more than 35 markets that reach 50 percent of U.S.
5 businesses.[49] In August 1999, the company announced that it was then providing DSL
6 service in 13 markets, including Seattle, and planned service in more than 30 major
7 markets by the end of 1999, including Denver, Milwaukee, Minneapolis, Phoenix,
8 Portland, and Salt Lake City.[50] The company "plans to expand into other markets through
9 its own construction and additional strategic alliances." [51]

10 Through its investment in Advanced Radio Telecom (ART), Qwest provides
11 broadband fixed wireless access in the in-region cities of Seattle, Portland and Phoenix.
12 ART holds 38 GHz wireless licenses covering 210 US markets[52] and plans to construct
13 networks in 40 of the top 50 U.S. markets over two years. [53]

1 47 Qwest press release, January 19, 1999.
1 48 Qwest press release, April 7, 1999.
1 49 Qwest press release, April 7, 1999.
1 50 Qwest press release, August 4, 1999.
1 51 Qwest press release, August 4, 1999.
1 52 National License Map, at http://www.artelecom.com/content/services/licensemap.html.
1 53 Qwest press release, June 1, 1999.

1 ART is authorized to provide service in 12 of the 14 U S WEST states – all but South Dakota
2 and Wyoming.[54]

3 Qwest and U S WEST are actual competitors for high-speed data access
4 customers in several metropolitan markets. Prior to the merger, Qwest had announced
5 plans to expand DSL service and metropolitan fiber access networks in a number of
6 major cities in the U S WEST region. Out of region Qwest is actively expanding its local
7 high-speed access services into additional markets across the U.S. Extending high-speed
8 access via DSL, metropolitan fiber networks, and fixed wireless networks within the U S
9 WEST region would be consistent with Qwest's stated strategy of providing customers
10 with end-to-end high-speed connectivity throughout the U.S. But for the merger, Qwest
11 is an actual potential competitor in high-speed data access services in a large number of
12 additional markets in U S WEST territory.

13 The merger of Qwest and U S WEST would reduce both actual and potential
14 competition in the supply of high-speed data access services in states in the U S WEST
15 region.

1 [54] National License Map, at http://www.artelecom.com/content/services/licensemap.html.

1 **Q. Would the merger reduce competition in long-distance markets?**

2 A. Yes, to some extent.

3 In order to comply with Section 271 of the Telecommunications Act Qwest would
4 have to stop offering in-region long-distance voice and data services. Qwest has already
5 announced (in its reply comments to the FCC) that it does not intend to sell its in-region
6 facilities, so the merger will reduce the number of carriers offering long-distance services
7 over their own facilities.

8 **Q. Would the merger have countervailing efficiency benefits?**

9 A. The Applicants have not provided sufficient information to properly evaluate their
10 efficiency claims. Indeed, according to the declaration of Dennis W. Carlton and Hal S.
11 Sider submitted to the FCC on behalf of the Applicants,[55] "the companies have not yet
12 fully determined exactly how such opportunities [to realize a variety of efficiencies] are to
13 be pursued" (page 8). Carlton and Sider apparently only claim that "the transaction
14 creates possibilities for efficiencies that otherwise would not exist" (page 8). They do not

1 55 Attachment A to the Applicants' "Response to Comments on Applications for Transfer of Control," filed on
2 October 18, 1999 in FCC CC Docket No. 99-272.

1 explain, however, *why* some of the most important among such "possibilities" could not
2 be realized without the merger. For example, Carlton and Sider mention that the merger
3 would put together "complementary physical assets" such as Qwest's high-speed
4 broadband network and U S WEST's DSL capabilities. High-speed networks and DSL
5 service are indeed complementary goods, but complementarity (in production and/or
6 consumption) is not sufficient ground for claiming merger efficiencies. The Applicants
7 should show that the complementarity could not be exploited by contractual means. As
8 far as we know, U S WEST's DSL equipment has no specific complementarity with
9 Qwest's network and could be connected equally well to the networks managed by
10 Qwest's competitors such as AT&T, MCI/Worldcom, Sprint or GlobalCrossing/Frontier.
11 Similarly, Qwest's network could be connected with the DSL equipment of other carriers.
12 In other words, although the relevant assets are complementary, they are not "specific" in
13 the sense of Williamson.[56] Therefore the merger would not provide any opportunities for
14 achieving efficiencies in this regard.

15 Moreover, even if some efficiencies could be realized by joining the two kinds of

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1 [56] See O. E. Williamson, "Transaction Cost Economics," in *Handbook of Industrial Organization*, Vol. I, pp. 135-
2 182, (R. Schmalensee and R.D. Willig, eds.), 1989.

1 assets under the same ownership, the main beneficiaries would be consumers outside U S
2 WEST's region, because Section 271 would not allow Qwest to offer interLATA data
3 (Internet) transport to in-region consumers.[57]

4 Carlton and Sider also claim that the merger would enable Qwest to "take
5 advantage of U S WEST's large in-region customer base." I am afraid that is true. And it
6 would not be to the advantage of those consumers, who would benefit much more if
7 Qwest had to compete fairly with its competitors for their demand. The Applicants have
8 not demonstrated that they need to merge in order for Qwest to provide its services to U S
9 WEST's customers, as they could do so by contract or joint venture. To the extent that
10 the merged firm would take advantage of U S WEST's customer base to obtain and use
11 customer proprietary information to deploy services it would enable U S WEST to
12 disadvantage competing suppliers of applications services.

13 In sum, the Applicants have not provided any clear evidence that the merger
14 would have significant efficiency benefits. Moreover, the mere potential for any genuine
15 merger-related efficiencies vanishes when one takes into account the restrictions that

1 57 Carlton and Sider recognize that in-region consumers could only benefit if U S WEST gains interLATA authority
2 under Section 271 (see page 9, n. 25 of their declaration).

1 Section 271 would impose on the merged entity.[58]

2 **Q. Can you suggest ways to reduce the negative effects of the merger?**

3 A. The preceding analysis shows that the proposed Qwest/U S WEST merger would increase
4 both the payoffs from circumventing regulation and the probability that the merged entity
5 would be successful in doing so. As a consequence, the merged entity will be more likely
6 to divert investments from the ILEC's to Qwest's businesses and to increase the ILEC's
7 anticompetitive exploitation of its dominant position. Both kinds of actions would lead to
8 the degradation of the quality of services provided to consumers (because of decreased
9 investments in the ILEC's network) and to competitors (because of anticompetitive
10 conduct as well as decreased investments), thus harming consumers both directly and
11 indirectly.

12 These adverse effects could be countered by a combination of two classes of
13 remedies: (1) separation of the ILEC into two or more separate entities, and (2) increased
14 monitoring of service quality levels (to end-users and to other carriers) and/or higher

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1 [58] Indeed, the Applicants themselves have admitted as much in their merger application to the FCC: "The entire
2 rationale of this transaction depends on interLATA relief." See Qwest/U S WEST Application for Transfer of
3 Control, August 19, 1999, p. 17.

penalties for non-compliance with (possibly enhanced) regulated quality standards.

Separation is a matter of degree, both in its intensity (ranging from mere accounting separation to the creation of separate legal entities under different ownership) and in its extension, i.e., in the way in which the ILEC would be partitioned.[59] If separation is to have any significant effect, it must be sufficiently intense to remove the commonality of interests between the separated entities. Mere accounting separation would not be effective and the Washington Utilities and Transportation Commission should consider strong forms of structural separation.

Determining the most appropriate extension of the separation, i.e., the most appropriate way to partition the original ILEC, is a delicate task.[60] On one hand, an extensive separation removes a larger number of potentially anticompetitive incentives. On the other hand, it may also eliminate some asset ownership structures aimed at reducing transaction costs.

[59] In principle, every element of the ILEC's network could be assigned to a different owner – even though, in practice, this would not be an efficient ownership structure.

[60] See FCC Memorandum Opinion and Order Adopted October 6, 1999, CC Docket No. 98-141, henceforth Opinion and Order.

1 Possibly the least intrusive boundary for structural separation is the one between
2 the ILEC's wholesale and retail activities. It would eliminate, almost by definition, the
3 wholesale ILEC's incentive to discriminate against CLECs and in favor of the ILEC's
4 retail division. However, it would not fully eliminate the wholesale ILEC's incentives to
5 discriminate against CLECs engaged in facilities-based competition, nor against
6 competing IXCs.

7 Even the most complete form of structural separation would not fully eliminate
8 the ILEC's incentives to supply a sub-optimal quality level. Therefore, it is important that
9 the Commission also consider the adoption of an effective quality monitoring plan.

10 Designing an adequate monitoring and penalty structure is another difficult task,
11 but fortunately it is not a task that needs to be approached from scratch. The Washington
12 Utilities and Transportation Commission can make use of the performance
13 measurements, benchmarks, and statistical methods developed in collaborative regulatory
14 processes in Texas and California. These procedures, with further modifications, have
15 been adopted by the FCC as conditions for approving the SBC/Ameritech merger.[61]

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1 [61] FCC Memorandum Opinion and Order adopted on October 6, 1999, CC Docket No. 98-141. In spite of their
2 differences, both the SBC/Ameritech and the Qwest/U S WEST mergers pose similar issues of increased anti-
3 competitive conduct on the part of the ILEC. The conditions imposed on the SBC/Ameritech merger can thus serve

1 Where the ILEC provides a CLEC with a service that has a retail analog, the performance
2 the ILEC provides its own retail operations will be compared with the performance
3 provided to the CLEC, and parity is required. Where there is no retail analog, the ILEC
4 performance will be compared to a benchmark. Assessment of parity or benchmark
5 performance is based on generally accepted statistical analysis. The performance
6 measurements adopted for the SBC/Ameritech merger include several of those currently
7 used by McLeodUSA and U S WEST to monitor quality of services purchased by
8 McLeodUSA.

9 The Carrier-to-Carrier Performance Plan adopted by the FCC in approving the
10 merger of SBC and Ameritech has two elements. First, it requires the ILEC to report, on
11 a monthly basis in each state, the ILEC's performance in 20 measurement categories that
12 may have a direct effect on local competitors and their customers and to make this
13 information available to regulatory commissions and CLECs. Second, the plan obligates
14 the ILEC to make substantial payments over 3 years based on its performance in the 20
15 measurement categories.

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1 as a useful benchmark in the Qwest/U S WEST case, too.

1 The Plan focuses on preventing discrimination against CLECs because its basic
2 goal is to improve the competitiveness of local exchange markets and thus allow market
3 forces to provide consumers with services of appropriate quality and price. It must be
4 recognized, however, that competition may not spread rapidly to some areas.[62] Since, as I
5 argued above, the merger of U S WEST and Qwest poses a serious threat of diverting
6 resources to the (unregulated) "advanced services" lines of business, consumers in those
7 areas may suffer deterioration of the quality of service they get from the merged entity
8 and remain without recourse to alternative providers. Therefore, I believe that it would be
9 advisable to disapprove the merger unless the Applicants commit not only to a plan to
10 improve the competitiveness of local exchange markets like the Carrier-to-Carrier
11 Performance Plan mentioned above, but also to a similar plan to ensure good performance
12 to end-users.

13 The conditions required by the FCC in approving the SBC/Ameritech merger
14 include the obligation to provide quarterly reports on retail service quality on a state-by-
15 state basis in accordance with the recommendations of the NARUC Technology Policy

1 [62] Especially in rural areas, widespread competition is unlikely before a competitively neutral mechanism of
2 universal service subsidization becomes fully operative.

1 Subgroup "Service Quality White Paper" (November 1998)[63] and with the ARMIS Report
2 No. 43-05.[64] The Applicants should commit to a similar reporting requirement and to a
3 system of enforceable penalties for any failing to meet a set of given performance goals.[65]
4 The performance goals could be set on the basis of the performance of other ILECs as
5 recorded, for example, in the ARMIS database. I refer to my joint declaration with Prof.
6 Joseph Farrell in the SBC/Ameritech merger case for a discussion of alternative ways to
7 structure this kind of relative performance evaluation mechanism.[66]

8 **Q. Does this conclude your testimony?**

9 A. Yes.

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1 63 FCC Memorandum Opinion and Order adopted on October 6, 1999, CC Docket No. 98-141, at 403, pp. 168-169.
1 64 FCC Memorandum Opinion and Order adopted on October 6, 1999, CC Docket No. 98-141, at 404, p. 169.
1 65 Similar requirements are part of U S WEST's "Modified Alternative Form of Regulation Plan for the State of
2 Minnesota" filed on January 11, 1999.
1 66 "Benchmarking and the Effects of ILEC Mergers," Declaration of Joseph Farrell and Bridger M. Mitchell, October
2 14, 1998, CC Docket No. 98-141.