BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

**QWEST PETITION FOR COMPETITIVE CLASSIFICATION
OF BUSINESS SERVICES**

DOCKET No. UT-030614

TESTIMONY OF SUSAN BALDWIN (SMB-1T)

ON BEHALF OF

PUBLIC COUNSEL

AUGUST 13, 2003

I. INTRODUCTION

Qualifications

Q: Please state your name, position, and business address.

A: My name is Susan M. Baldwin. I am an independent consultant, and my business address is 48 Franklin Street, Watertown, Massachusetts. I specialize in telecommunications economics, regulation, and public policy, and consult to public sector agencies.

Q: Please summarize your educational background and professional experience.

A. I prepared a Statement of Qualifications, which is included as Exhibit SMB-20.

Q: Have you previously testified before the Washington Utilities and Transportation Commission ("WUTC" or "Commission")?

A: Yes. In 1999, I submitted testimony regarding the proposed merger of Bell Atlantic Corporation and GTE Corporation (WUTC Docket No. UT-981367) on behalf of the Washington Attorney General Public Counsel Section ("Public Counsel").

Assignment

Q: On whose behalf is this testimony being submitted?

A: This testimony is being submitted on behalf of the Public Counsel.

Q: What is the purpose of your testimony at this time?

A: Public Counsel asked me to analyze Qwest's petition to classify business telecommunications services as competitive.

Summary of Testimony

Q: Please summarize your testimony.

A: I recommend that the Commission deny Qwest's petition for, among others, the following reasons:

- *Qwest oversimplifies the complexity of the marketplace by seeking to portray the removal of legal barriers to entry and the possibility of competition as constituting effective competition:* The Commission should rely on data that demonstrate the degree to which Qwest's market power has actually diminished. Consumers benefit from actual not potential competition.

- *The local markets that Qwest serves are highly concentrated*: HHI analyses demonstrate that although CLECs are slowly making inroads, Qwest continues to dominate local markets.

- *Qwest's grouping of diverse business products and urban and rural areas in one general statewide category masks significant market distinctions.* If the petition is approved, Qwest could raise rates in communities with few competitive alternatives and decrease rates in communities with relatively more competition. The effect of this disparate pricing would be to raise the cost of economic development and operating a business in sparsely populated areas. Similarly, Qwest could raise rates for flat line and measured business lines and lower rates for PBX trunk and Centrex services, thus causing small captive customers to bear a disproportionate share of Qwest's fixed common costs of maintaining its public switched telephone network. The petition's broad grouping of diverse product and geographic markets would allow Qwest to implement anticompetitive pricing strategies, to the detriment of consumers and the development of effective local competition.

- *A significant captive customer base remains:* Based on public data, Qwest serves approximately 95 percent of the local market either directly through its retail services or indirectly through its wholesale services.
- *The petition is not only poorly supported, but also it is premature*: An analysis of the potential for a price squeeze cannot occur until the Commission has completed its pending investigation of Qwest's costs for its unbundled loops. Furthermore, the short period of time since Qwest obtained authority to offer home-region, interLATA service is insufficient to gauge Qwest's post-271 behavior. Also, the FCC's upcoming Triennial Review Order will set in motion another state proceeding that bears directly on this one.
- *Qwest presently has the flexibility to lower its rates in order to compete:* Qwest has not demonstrated the circumstances under which it would need to *raise* rates to compete, and presently has the flexibility to decrease rates to meet competition.

Q: Should the Commission approve Qwest's petition?

A: No. Qwest fails to support its petition, and, accordingly, I recommend that the Commission deny the petition. The harm to consumers, should the petition be granted, far outweighs the purported harm to Qwest, should the petition be denied.

II. QWEST'S PETITION

Q: Please describe generally your understanding of Qwest's pending petition.

A: On May 1, 2003, Qwest Corporation ("Qwest") filed a petition for competitive classification of basic business exchange telecommunications services pursuant to RCW 80.36.330 and WAC 480-121-062. Qwest seeks competitive classification of flat and measured business local exchange service, private branch exchange (PBX) trunks, Centrex services, and discretionary features (e.g., call waiting, three-way calling), and, furthermore, seeks competitive classification for these services throughout the entire state of Washington.[1] On July 1, 2003, Qwest submitted the testimony of three witnesses in support of its petition.[2]

State law, RCW 80.36.330, allows the Commission to remove price regulation if a service is subject to effective competition where, according to the legislation, effective competition "means that customers of the service have reasonably available alternatives and that the service is not provided to a significant captive customer base." The Commission has granted pricing flexibility to large business customers served by Qwest in Seattle, Spokane, Bellevue, and Vancouver and also for all of Qwest's toll and directory assistance services. According to Qwest, its share of the business local service market in Washington is no more than 83% on a statewide average basis. Qwest serves approximately 521,000 business lines in Washington.[3]

Q: Please describe generally the evidence that Qwest provides in support of its petition.

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[1] Qwest Corporation's Petition, Request for Competitive Classification of Basic Business Exchange Telecommunications Services ("Qwest Petition"), pages 1-2 and Attachment A.
2 Direct Testimony of David L. Teitzel; Direct Testimony of Mark S. Reynolds; and Direct Testimony of Harry M. Shooshan, III.
3 *Qwest Petition*.

A: Qwest contends that "the registration of a significant number of competitive local exchange carriers (CLECs) with the Commission and their provision of business services … have promoted the diversity of supply of telecommunications services and products throughout the state."[4] In its attachments to its petition, and as exhibits to its witnesses' testimony, Qwest includes the following information:[5]

- Attachment A (Exhibit MSR-2): complete list of business services for which Qwest seeks competitive classification;
- Attachment B (Exhibit MSR-5C): Interconnection agreements and other indicators of market presence;
- Attachment C (Exhibit MSR-3): Alternative providers who purchase unbundled loops, UNE-P, and resold business services;
- Attachment D (Exhibit MSR-4) : Competitive services for business services as filed through CLEC price lists;
- Attachment E (Exhibit DLT-3C): Competitive market by geographic area, exchange and wire center for basic business access lines;
- Attachment F1 (Exhibit DLT-4C): Competitive market by exchange in alphabetical order for basic business access lines;
- Attachment F2 (Exhibit DLT-5C): Masked CLEC Resale, UNE-P and Unbundled Loops for basic business exchange access line by exchange and wire center; and
- Attachment G: Qwest Affiliates.

4 *Petition* at 3.
5 Qwest response to MCI 01-001.

Qwest also includes a comparison of wholesale and retail basic business exchange service prices (Confidential Exhibit MSR-5C) and information about the coverage of wireless carriers (Exhibit DLT-6), and voice over the Internet ("VoIP") (Exhibit DLT-7).

Q: Did you analyze the evidence that Qwest submits in purported support of its petition?

A: Yes. In Section IV of my testimony I demonstrate that the evidence that is most relevant to the Commission's evaluation of Qwest's petition supports a finding that Qwest has failed to meet its burden of proof in this proceeding. Although Qwest claims that effective competition exists for basic business telecommunications services, data about the structure of Qwest's local markets indicate that Qwest's claim is unfounded.

III. ECONOMIC AND POLICY FRAMEWORK

Q: What is your understanding of the statute that guides the Commission's evaluation of Qwest's petition?

A: Pursuant to RCW 80.36.330, the Commission *may* classify a telecommunications service provided by a telecommunications provider if the service is subject to effective competition. The statute defines "effective competition" to mean that "customers of the service have reasonably available alternatives and that the service is not provided to a significant captive customer base." Among the factors that the Commission *must* consider are the following:

- The number and size of alternative service providers;
- The extent to which the services are available from other providers in the relevant market;
- The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms and conditions; and
- Other indicators of market power, which may include market share, growth in market share, ease of entry, and the affiliation of providers of services.

The Commission may consider other factors as well.

Q: As you understand the statute, is the Commission *obliged* to classify services as competitive, where the evidence may support such a finding?

A: No. As I understand the statute, the Commission is not *required* to classify a telecommunications service as competitive. Therefore, even if there is some showing of effective competition, the Commission may decide that it is not in the public interest to classify a service as competitive. For example, as I discuss later in my testimony, it is premature for the Commission to address Qwest's petition before it resolves UNE loop costs, completes the upcoming "impairment" proceeding, and acquires more experience with Qwest's post-271 behavior. Furthermore, Qwest has the burden of demonstrating that the services for which it seeks competitive classification are subject to effective competition.[6]

Q. What are some of the regulatory implications of the Commission classifying a telecommunications service as competitive?

A. The Commission may permit the provider to provide the competitive service under a price list.[7] Also, the prices for competitive services must cover their cost, based on cost standards that the Commission is authorized to establish "provided that in making any assignment of costs or allocating any revenue requirement, the commission shall seek to preserve affordable universal telecommunications service."[8]

Q. Please describe generally your understanding of the Commission's previous orders regarding other petitions filed by Qwest for competitive classification of services?

A. Almost three years ago, the Commission granted Qwest competitive classification of services provided to business customers served on DS-1 or larger capacity circuits in the Seattle, Bellevue, Spokane, and Vancouver areas. In the same decision, the Commission rejected the petition of Qwest which had sought competitive classification of a broader group of business services in nine exchanges.[9]

In reaching its decision, the Commission stated, among other things, that "the focus of the statute, and necessarily our focus, is on the end-user, rather than other carriers, an interpretation

6 WAC 480-120-022 (Classification Proceedings).

7 As a result of a recent amendment to the statute, carriers no longer need provide ten days' notice to the Commission and to customers before changing the prices of a competitive service under a price list. RCW 80.36.330(2), amended by SSB No. 5299, effective July 27, 2003.

8 RCW 80.36.330(3).

9 Docket No. UT-000883, *In the Matter of the Petition of Qwest Corporation for Competitive Classification of Business service in Specified Wire Centers, Seventh Supplemental Order Denying Petition and Accepting Staff's Proposal,* December 18, 2000 ("Seventh Supplemental Order").

that was upheld by the Court of Appeals."[10] The Commission also declined to rely solely on the capability of carriers to provide alternative services but rather relied both the on the capability *and* the willingness of competitors to offer service.[11] Further, the Commission recognized that "[w]ith a skewed distribution of lines across customers, competitors could easily achieve an overall 40 percent market share of lines share in an exchange even if it had few or no small customers."[12]

Q: Did the Commission comment on the role of resale in the local market?

A: Yes. The Commission stated that "resale does not constrain prices."[13]

Q: Please briefly summarize your understanding of the Commission's Order in Docket No. UT-990022.

A: The Commission approved Qwest's amended petition for competitive classification of high-capacity circuits in Seattle Elliott, Seattle Main, Seattle Campus, Seattle Duwamish, Bellevue Glencourt, and Spokane. [14] The Commission observed, among other things, that competitive investment was occurring and concerns about US West's carrier-to-carrier service quality were being addressed in other Commission proceedings[15]

Q: Which portions of the Commission's Orders are most applicable to this proceeding?

A: In my opinion, the most important evidence regarding whether effective competition exists is the degree to which Qwest's market power for the relevant services has diminished. The presence

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10 *Seventh Supplemental Order*, at 17, ¶ 65, citing *US West v. WUTC,* 86 Wn. App. 719, 727-30 (1977).
11 *Seventh Supplemental Order*, at 17, ¶ 66.
12 *Id*., at 18, ¶ 68.
13 *Id*., at 20, ¶ 75.
14 Docket No. UT-9900022, *In the Matter of the Petition of US West Communications, Inc. for Competitive Classification of its High Capacity Circuits in Selected Geographic Locations, Eighth Supplemental Order Granting Amended Petition for Competitive Classification,* December 1999.
15 *Id*.,at 15.

of competitors is not, in my view, sufficient to conclude that a market is competitive. A significantly more important factor is whether Qwest's market share has eroded sufficiently so that it no longer possesses market power. The critical question is not simply whether CLECs *can* offer service in competition with Qwest, nor even whether CLECs are *willing* to compete with Qwest in a given market, but rather whether customers are subscribing to CLECs' services in sufficient quantities as to render the market effectively competitive.

Q: Does the market definition affect the Commission's analysis of the structure of the local market?

A: Yes. Qwest attempts to convince the Commission that the entire state is a single geographic market. For the purpose of displaying competitive data, Qwest also defines smaller geographic areas, which, if one were confined to establishing only nine geographic markets, might make sense, but which are overly broad for the local telecommunications market in Washington.[16] Also, Qwest's product market is excessively broad because Qwest groups Centrex, PBX service, and individual business line service in one category, which blurs important product distinctions.

In their Horizontal Merger Guidelines, the U.S. Department of Justice ("DoJ") and the Federal Trade Commission ("FTC") define a market "as a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area likely would impose at least a 'small but significant and nontransitory'

16 The nine geographic areas are Bellingham, Central/Eastern, Northeastern, Peninsula, Puget Sound, Southeastern, Spokane, Southwestern, and Tacoma. Teitzel Direct (Qwest), at 7.

increase in price, assuming the terms of sale of all other products are held constant." The DoJ and FTC explain further that a "relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test."[17]

Q. Are there any additional major economic and public policy principles that you recommend the Commission apply in its evaluation of Qwest's Petition?

A. Yes. At a minimum, I recommend that the Commission be informed by the Triennial Review Order of the Federal Communications Commission (FCC) in which the FCC is expected to direct states to apply specific operational and economic criteria in their analyses of whether CLECs are impaired absent a mandate to ILECs to offer switching to the mass market.[18]

Furthermore, Qwest's petition is premature because there is relatively little experience with Qwest's post-271 behavior. The approval of Qwest's 271 application occurred because the FCC determined that Qwest met the 14-point "checklist," and not because the FCC made a finding that that there is effective competition in Washington. Granting Qwest the enormous pricing flexibility that it seeks in this proceeding would inhibit the development of local competition that the market-opening provisions of the checklist are intended to foster.

Q. Have you applied the economic and policy framework you discuss above to the information in this proceeding?

A. Yes. I describe my analysis in the following section.

17 U.S. Department of Justice and the Federal Trade Commission, *Horizontal Merger Guidelines*, issued April 2, 1992, revised April 8, 1997 ("Horizontal Merger Guidelines"), § 1.0.
18In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, Notice of Proposed Rulemaking, *Report and Order and Further Notice of Proposed Rulemaking* (FCC 03-36), CC Docket No. 01-338 (adopted February 20, 2003).

IV. ANALYSIS OF PETITION

Number and size of alternative providers of service

Q: Please describe the information that Qwest provides regarding alternative providers of service.

A: In Confidential Exhibit DLT-5C, Qwest shows, separately by CLEC, the quantities of retail lines offered to business customers over stand-alone unbundled loops (UNE-L), UNE platforms (UNE-P), and resale to business customers. Qwest displays these data both by wire center and by exchange. According to Qwest, this "exhibit shows that CLECs are active in all but five Qwest wire centers."[19]

Q: Please comment.

A: The level of CLEC activity, as measured by the quantity of CLECs present within a market and the quantity of retail lines served by CLECs, differs among exchanges (and furthermore, even within an exchange, among wire centers). The presence of numerous competitors in Seattle is meaningless to a business consumer in Walla Walla. By grouping all exchanges within a single geographic market in its petition, Qwest ignores the disparate stages of competition that are emerging throughout the state. Also, the data that Qwest provides in support of its petition do not indicate whether the CLEC-served customers are small or big businesses. A CLEC's efforts to attract large businesses do not represent effective competition for small businesses. Furthermore, if a CLEC serves one large business (i.e., a business with a large quantity of lines or trunks) in a relatively small exchange, simply examining Qwest's market share will give a misleading impression of the level of competition that the small businesses experience in that particular exchange.

19 Teitzel Direct (Qwest), at 9.

Q: Qwest provides data regarding the presence of CLECs in local markets in Washington. Please comment on the relevance of these data to Qwest's petition.

A: As evidence of the number and size of alternative providers of services, Qwest attributes excessive significance to certain quantitative measurements which, although informative, do not prove that consumers enjoy effective competition. Mr. Teitzel and Mr. Reynolds refer to the existence of 161 CLECs on the Commission's website, 152 CLEC interconnection agreements with Qwest, and the purchase by 78 carriers of Qwest's wholesale services.[20] As I discuss below, the market shares of the vast majority of these CLECs are negligible, and even collectively are insufficient to discipline the prices and quality of Qwest's basic business telecommunications services.

Extent to which services are available from alternative providers in the relevant market

Q: Mr. Teitzel states that "[t]he open competitive market in Washington represents effective competition for Qwest's local exchange business service."[21] Do you agree?

A: No. The theoretical availability of service is an insufficient basis upon which to determine that a market has effective competition. The more important issue is whether there is price-constraining competition. I urge the Commission to examine the degree to which the CLECs are actually serving customers. By way of illustration, in Confidential Exhibit SMB-1C, I examine CLECs' entry into Spokane and, based on the data that Qwest provided, compute CLECs' individual market shares for this market. I urge the Commission to consider the number of CLECs which each have significantly less than a one percent market share.

20 Teitzel Direct (Qwest) at 6; Reynolds Direct (Qwest) at 7.
21 Teitzel Direct (Qwest) at 12.

Q: Mr. Reynolds asserts that if "indeed it is the case that the CLECs will offer service where facilities are available, and such facilities are available anywhere Qwest currently offers service, then CLEC services are available everywhere Qwest services are available."[22] Please comment.

A: Mr. Reynolds reasoning oversimplifies the complexity of the marketplace by suggesting that customers can "avail" themselves of competitive alternatives which may exist in theory only. Qwest seeks to persuade the Commission that *even in the five exchanges where Qwest is the sole provider of basic business telecommunications services, effective competition exists.* Businesses that are located in these five exchanges would likely be surprised to learn that there is local telecommunications competition in their communities. If CLECs are not actively marketing service to all business customers, and more importantly, if they are not serving business customers in sufficient quantity as to erode Qwest's market power, then the theoretical "availability" of their services is meaningless to consumers. These five exchanges provide an extreme example of why Qwest's claim of effective competition is implausible. However, throughout the 68 exchanges, small businesses lack access to meaningful competitive alternatives.

22 Reynolds Direct (Qwest) at 9.

Q: But if Qwest raised rates for its basic business services or allowed service quality to deteriorate, wouldn't this create an opportunity for CLECs to enter and successfully attract customers?

A: The theoretical opportunity would exist. However, CLECs may not choose to pursue it. In a market that is already effectively competitive, consumers' ability to migrate among suppliers provides adequate protection for consumers against monopolistic behavior by any single firm. However, adopting wishful thinking where effective competition does not yet exist is a regulatory gamble that puts consumers at risk. Qwest apparently asks the Commission to treat the theoretical possibility of competition as representing sufficient market discipline so as to prevent Qwest from exerting market power. However, CLECs have limited resources and small customers are likely not at the top of CLECs' strategic plans. There is simply no guarantee that because an opportunity may exist to compete that CLECs will offer alternatives, particularly to small business customers.

If CLECs want to compete with the prices that Qwest charges today, their presence would be detectable through market share assessments, and therefore, Qwest's contention about competition presumably relies on an expectation of entry that would occur if Qwest engaged in monopolistic behavior. However, in the unlikely scenario that CLECs enter small business and/or rural markets in the face of Qwest's high prices or poor service quality, Qwest could subsequently lower rates or improve service quality to drive away the new competition. Indeed, the knowledge that the incumbent's high prices could be transient and could decline as soon as new providers enter the market likely affects a CLEC's cost-benefit analysis of market entry. A CLEC risking limited financial resources would likely estimate potential revenues and costs associated with market entry. In its financial calculations, a CLEC would likely take into account in its assessment of pricing plans the knowledge that Qwest could lower its prices after a CLEC entered the market. After perceiving that the incumbent may not sustain its high prices, and considering other local market characteristics, CLECs may ignore some markets or only minimally serve them for the foreseeable future. Therefore, CLECs' actual entry into the local markets provides the most reliable evidence of competition.

Q: Please elaborate.

A: The mere *possibility* of transactions occurring between seller and buyer does not constitute effective competition. Qwest apparently would have the Commission believe that should Qwest engage in supracompetitive pricing in any of the areas of the state it serves, CLECs would enter and compete.[23] It is equally if not more plausible CLECs would choose not to assign their limited resources to serve businesses in these five locations. I disagree with Qwest's position that the mere existence of CLECs translates into effective competition.

Q: How much weight do you recommend the Commission afford to Qwest's testimony about the local market?

A: Not much. Qwest's petition and testimony fail to address the degree to which small customers are benefiting from competitive alternatives.[24] The presence of competitors and the existence of interconnection agreements do not reveal any information about the sizes of the customers which have migrated from Qwest to competitors, nor even whether customers are buying service from

23 Reynolds Direct (Qwest) at 9.

24 Furthermore, as I discuss later in my testimony, facilities-based competition differs significantly from competition that relies on Qwest's wholesale services. Therefore, all of the wholesale-based market share data that Qwest submitted with its petition and with its testimony should be viewed with a recognition of the limitations of wholesale-based entry.

competitors. In considering whether alternatives exist, the Commission should consider the degree to which they exist for small businesses.

Availability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms, and conditions.

Q: Please address the evidence that Qwest submits to demonstrate that there are alternative providers who can make functionally equivalent or substitute services readily available at competitive rates, terms, and conditions.

A: Qwest submits CLECs' price lists for service offerings that it asserts are comparable to Qwest's basic business local exchange services.[25] Despite Qwest's claim to the contrary, the existence of price lists and new entrants' ability to purchase Qwest's wholesale services do not constitute adequate evidence that alternative providers can readily offer basic business local exchange services to customers throughout Qwest's 68 exchanges. Carriers may not choose to purchase Qwest's wholesale services to enable them to serve certain markets. I urge the Commission to consider this criterion in the context of market share data. Where the vast majority of customers in a particular market continue to receive service from Qwest rather than a CLEC, this could be evidence of any combination of factors (all of which contribute to the lack of readily available alternatives) such as: customer inertia (caused by, for example, "brand" loyalty or the perception of high transaction costs to change providers); carriers' business plans excluding certain geographic and/or business markets; and limited CLEC resources preventing a CLEC from pursuing a statewide presence.

25 Qwest Petition, Confidential Attachment D (Exhibit MSR-4).

Other indicators demonstrate that Qwest continues to dominate the local telecommunications market in its service territory in Washington.

Q: In reaching its decision, the Commission must consider other indicators of market power in addition to those discussed above. Have you analyzed other attributes of the local market in Washington?

A: Yes. The statute requires the Commission to consider other indicators of market power which may include market share, growth in market share, ease of entry, and the affiliation of providers of service. I have considered each of these indicators as well as other indicators and show that the most fundamental weakness in Qwest's petition is its failure to demonstrate that it lacks market power.

Q: In Docket No. UT-000883, Staff conducted Herfindahl Hirschman Index (HHI) analyses to assess market concentration.[26] Briefly describe the HHI.

A: The HHI is a well-known measure of market share concentration,[27] and is computed as the sum of the squares of each firm's market share. If a single firm serves a market, the HHI is 10,000 (the highest possible HHI), and if two firms each equally serve a market the HHI of that market is 5000. The larger the HHI, the greater the concentration. Markets with HHI below 1000 are considered to be unconcentrated; those with an HHI between 1000 and 1800 to be moderately concentrated, and those with an HHI above 1800 to be highly concentrated.[28]

Q: Have you conducted an HHI analysis based on the data in this proceeding?

A: Yes. Confidential Exhibit SMB-2C shows HHI results on an exchange-specific basis and is based on the quantities of retail lines served by Qwest and by individual CLECs (exclusive of

26 *Seventh Supplemental Order*, 7-8.
27 *Horizontal Merger Guidelines*, § 1.5; F.M. Scherer, *Industrial Market Structure and Economic Performance*, Rand McNally & Company, Chicago, 1970, 50-52.
28 *Horizontal Merger Guidelines*, § 1.51.

facilities-based competitive entry). Confidential Exhibit SMB-3C provides the same analysis presented on a wire center level. I based my analysis for these two exhibits on the data that Qwest provided.[29]

Q: Please describe your analysis.

A: In Confidential Attachment F2, Qwest displays the quantities of retail lines provided by each CLEC in each wire center. In Confidential Attachment E, Qwest displays the quantities of retail lines that it provides in each wire center. In my analysis, separately for each of the exchanges (Confidential Exhibit SMB-2C) and for each of the wire centers (Confidential Exhibit SMB-3C), I compute market shares for each of the retail telecommunications providers based on the quantity of retail lines that Qwest serves and the quantities of retail lines that each of the CLECs offers.[30] Based on these provider-specific market shares, I then compute the HHI. By way of illustration of the HHI calculation, assume that Qwest serves 83 percent of a particular exchange, and each of five CLECs serve, respectively, 1 percent, 2 percent, 3 percent, 5 percent, and 6 percent of the market. The HHI is then 6964, calculated as follows:

$83^2+1^2+2^2+3^2+5^2+6^{2.}$ This HHI level indicates a highly concentrated market.

29 Because Qwest's market share is so high, minor changes to CLECs' individual market shares would not alter the HHI analysis significantly.
30 Qwest counts a business line, Centrex line, and PBX trunk equivalently. Qwest response to PC 02-012.

Q: How would your analysis change if, in your example, ten rather than five CLECs served the market?

A: The change would be negligible. Assume, for example, that ten CLECs serve the market, and assume further that seven of the CLECs each have a 1 percent market share and the remaining market share is distributed as follows: 2 percent, 3 percent, and 5 percent. The HHI would then be 6934, scarcely less concentrated than with my assumption of five CLECs: $83^2+1^2+1^{2+}1^2+1^2+1^2+1^{2+}1^2+2^2+3^2+5^2$.

Because Qwest's retail market share is so high (83 percent on a statewide basis), the actual distribution of market share among the CLECs has relatively little impact on the HHI analysis. As the Department of Justice and Federal Trade Commission observe, "Although it is desirable to include all firms in the calculation, lack of information about small firms is not critical because such firms do not affect the HHI significantly."[31] Nonetheless, I have conducted comprehensive HHI analyses in Confidential Exhibits SMB-2C and SMB-3C that are based on the CLEC-specific data provided by Qwest.

Q: The HHI analysis you have described excludes facilities-based entry. Why did you exclude this form of entry and how might the results change were you to include this mode of local entry?

A: Qwest's petition and testimony omit data on facilities-based entry because it does not possess these data. The addition of facilities-based entry affects the concentration analysis because it represents an erosion of the approximate 83 percent market share that Qwest gives as an upper estimate. Based on public data, CLECs serve approximately 5 percent of the Washington local

31 *Merger Guidelines*, footnote 17.

market (residential and business) using their own facilities.[32] This is an average percentage for all lines; the actual level of facilities-based competition varies throughout the state. Using our previous example, and assuming an average entry based on CLEC facilities of 5 percent, then Qwest, in this revised example, would serve 78 percent (rather than 83 percent) of the retail market. As a simplifying assumption, assume that this 5 percent is shared equally by the five carriers in our example. The HHI is then 6198 (rather than 6964), calculated as follows: $78^2+2^2+3^2+4^2+6^2+7^2$ Although the HHI is less than in my earlier example, a market with an HHI of 6198 is still considered highly concentrated.

Q: Now that you have explained your methodology and assumptions, please discuss the results of your exchange-specific HHI.

A: Confidential Exhibit SMB-2C summarizes the results of my analysis, using the exchange as the geographic market. Regardless of the exchange examined, the local market is highly concentrated. Confidential Exhibit SMB-3C, which uses the wire center as the relevant geographic market, yields similar results and also demonstrates that even within an exchange the level of market concentration can vary significantly among the diverse wire centers.

Q: Did you compute the statewide HHI?

A: Yes. In Confidential Exhibit SMB-2C, I include the results of my calculation, which demonstrate that, measured on a statewide basis, the local market is highly concentrated.

Q: On August 6, 2003, Staff provided aggregate CLEC data. Did you conduct an HHI analysis that incorporates any of these data?

32 FCC Industry Analysis and Technology Division, Wireline Competition Bureau, June 2003, *Local Telephone Competition: Status as of December 31, 2002* ("FCC's Local Competition Report), Tables 9 and 10.

A: Yes. The Staff-aggregated CLEC-provided data include CLEC-owned lines, and I used these data in Confidential Exhibit SMB-4C to expand my HHI analysis.

Q: Please describe Staff's aggregated data generally and how you decided which data to incorporate in your HHI analysis.

A: Staff provided aggregated data separately for three products: business line, PBX, and Centrex. With a few exceptions, the business line data are disaggregated by wire center and exchange, and the PBX and Centrex data are categorized in five geographic markets. The exchange totals do not always equal the sum of the wire centers, and therefore I decided to rely solely on the exchange totals. Unlike Qwest's data, Staff's data are not displayed separately by CLEC, apparently for reasons of confidentiality. Staff instead includes totals of all CLEC lines and also includes subtotals corresponding with resale; UNE-L, UNE-P, and CLEC-owned. However, in many instances, the total CLEC lines shown in Staff's spreadsheets do not equal (or even remotely approximate) the sum of the four subtotals. Therefore, because the accuracy and the comprehensiveness of the CLEC-provided data are questionable, I decided to limit my reliance on these CLEC-provided data for my HHI analysis. Specifically, I decided to only use the column of data corresponding with facilities-based entry, i.e., the CLEC lines that are omitted from the Qwest-provided data. Also I focused my analysis on the business line product only.

Q: Why did you focus your analysis on the business line market?

A: I decided to analyze market concentration in the business line market because: (1) Staff provided the greatest level of geographic disaggregation for this product;[33] and (2) customers of business lines are the most captive business customers.

33 Because Staff aggregates the data for these three products at different geographic levels, one cannot sum the quantities across product lines without losing significant geographic detail.

Q: Please describe your methodology.

A: I relied on the exchange-specific numbers of Qwest retail business lines (i.e., excluding Centrex and PBX) that Qwest provided in its response to PC 2-5. I also relied on Qwest's data for wholesale-based CLEC entry, provided in Confidential Exhibit DLT-3C, and as I explain in more detail in Confidential Exhibit SMB-4C, I applied an adjustment factor to these wholesale quantities to compute estimates of the quantities of wholesale-based business lines (i.e., excluding Centrex and PBX). As I explain in my exhibit, because the data that Staff reports for CLEC-owned lines likely include digital lines, I applied an adjustment factor to the numbers that Staff reported to approximate the number of CLEC-owned lines, excluding digital lines.

Furthermore, in contrast with Qwest's data, the Staff-aggregated data do not display the numbers of CLEC-owned lines separately by carrier, but rather display the total CLEC-owned lines for each exchange. Lacking access to the source data, I assumed that all CLEC-provided lines were divided equally among the CLECs identified by Qwest in Confidential Exhibit DLT-5C as serving the market through Qwest's wholesale facilities. I made this assumption because (1) as I demonstrated earlier in my testimony, changing this assumption (i.e., of even distribution among CLECs) alters the results only minimally; (2) the actual distribution of the total CLEC lines (which depends on numerous factors such as the carriers' entry strategies and the particular geographic market served), cannot be discerned from the data available. Absent more information about CLEC-owned facilities, I preferred to rely on a straightforward assumption. Were I to assume instead that lines were unevenly distributed among the CLECs, the HHI would be even higher because the market would be yet more highly concentrated.

Based on my estimates and calculations of market shares for the business line market, I then computed the HHI for each exchange for the business line market.

Q: What are the results of your analysis?

A: My analysis, which encompasses CLECs' entry using resale, UNE-P, UNE-L, and CLEC-owned facilities, shows that, defining the geographic market as the exchange and the product market as the business line, the local markets that Qwest serves throughout the state are highly concentrated.

Q: Did you conduct a similar analysis based on the total of all three products (business line, PBX, and Centrex)?

A: No, because, unlike for the business lines, the Staff's report displays Centrex and PBX quantities at an extremely aggregated level (five geographic categories), suggesting that HHI calculations might be so general as to be meaningless.

Q: How do you recommend the Commission take your various HHI analyses into consideration in this docket?

A: I recommend that the Commission afford substantial weight to these analyses because they provide irrefutable evidence that Qwest dominates the local exchange market. I urge the Commission to be informed by market concentration analyses as it considers the merits of Qwest's petition. The HHI analyses demonstrate that Qwest continues to possess market power throughout the state.

Growth in market share

Q: Have you examined the data Qwest submitted regarding CLECs' growth in market share?

A: Yes. Mr. Teitzel indicates that between December 2001 and December 2002, CLEC lines in Washington experienced a 20 percent growth, and that during the same time period, Qwest's business lines declined by 13 percent.[34] A 20 percent growth in access lines still leads to an overall market share for CLECs in Washington of only 10 percent using all modes of local entry.[35] The more important fact is that incumbent carriers continue to dominate 90 percent of the local market in Washington. The growth in CLEC lines for residence *and* business customers in this one-year period was 70,520 lines, but overshadowing this growth, is the fact that incumbents in Washington continue to serve 3,553,994 lines compared with the 406,750 lines that CLECs serve.[36] When market shares are small, growth, measured on a percentage basis, appears large and, viewed in isolation, exaggerates the level of competitive activity in Washington's local telecommunications markets. Indeed CLECs' inroads into the local markets in Washington lag behind CLECs' competitive entry nationwide, as the figure in Exhibit SMB-5 shows. Exhibit SMB-5 shows that the gap between CLECs' progress in Washington and their progress nationwide has been growing: In December 1999, CLECs' market share in Washington and nationwide was 4 percent; by contrast, as of December 2002, CLECs' market share in Washington and nationwide were 10 percent and 13 percent, respectively.

Q: Does Qwest provide data regarding growth in CLEC-served business lines?

34 Teitzel Direct (Qwest) at 4. The CLEC lines include residential and business lines.
35 *FCC Local Competition Report*, as of December 31, 2002, Table 7.
36 *FCC Local Competition Report*, as of December 31, 2002, Table 6. CLEC lines in Washington totaled 336,230 in 2001 and 406,750 in 2002. *FCC Local Competition Reports* as of December 31, 2001 and as of December 31, 2002, Table 6. Qwest's business lines were 706,000 and 615,000 for 2001 and 2002, respectively. Teitzel Direct (Qwest) at 4.

A: Yes, Mr. Reynolds estimates that the total quantity of CLEC loops served over Qwest facilities increased by 32 percent between December 2001 and December 2002, from 78,869 to 104,019.[37] I interpret these data to indicate that local competition is gradually emerging and that CLECs' inroads are critically dependent on CLECs' access to Qwest's facilities. Furthermore, it is misleading to view a 32 percent growth in CLEC-served business lines as representing effective competition when Qwest continues to: (1) dominate 83 percent of business lines on a statewide average basis; (2) dominate up to 100 percent of some geographic markets; and (3) likely dominate close to 100 percent of small business customers.

Entry based on the use of Qwest's facilities represents a weaker form of competition than does entry based on CLEC-owned facilities.

Q: Qwest estimate that it serves, at most, 83 percent of the retail market through UNE and resale. How much weight do you recommend that the Commission afford this market share estimate as an indicator of a competitive local market?

A: Not that much weight. Mr. Teitzel estimates that "CLECs have captured at least 17 percent of the basic business local exchange market in Qwest's service territory in the state, excluding any quantification of lines served via CLEC-owned facilities, wireless services, or VoIP services."[38] Regardless of the precise distribution of the remaining 17 percent of the retail market among CLECs, the HHI will nonetheless be in the vicinity of 6900, evidence of an extremely concentrated market. Further, although resale, UNE-L, and UNE-P are critical avenues toward effective local competition, they do not in and of themselves represent effective competition. CLECs confront significant transaction costs as a result of depending on Qwest's

37 Reynolds Direct (revised) (Qwest) at 13.
38 Teitzel Direct (Qwest) at 27.

facilities, which render these entry modes "less effective" in the long run than when CLECs deploy their own facilities.

The "customer-capturing" by CLECs, to which Mr. Teitzel refers, relies on the incumbent carrier's facilities, which are (1) set at wholesale prices presently in flux;[39] (2) offered at a level of service quality ultimately under the control of Qwest; and (3) vulnerable to the "re-capture" by Qwest as Qwest re-enters the home-region interLATA market. More than half of CLECs' "capturing" of customers has occurred using incumbents' facilities.[40]

Q: Please comment on the role of resale in constraining Qwest's pricing and service quality.

A: Those CLECs who base their business plans on resale incur costs that are largely beyond their control because the costs of the majority of CLECs' inputs are Qwest's resale prices. Resale provides only a limited margin within which CLECs can compete (e.g., on marketing, advertising). For these reasons, resale-based entry represents a less robust form of competition than does facilities-based competition.

Q: How much of the market does Qwest serve either directly to consumers or indirectly through its wholesale services?

A: Based on data filed with the FCC by incumbent local exchange carriers and CLECs, Qwest serves 95 percent of switched access lines with its facilities, evidence that Qwest dominates the

39 Docket No. UT-023003, In the Matter of the Review of: Unbundled Loop and Switching Rates; the Deaveraged Zone Rate Structure; and Unbundled Network Elements, Transport, and Termination.
40 *FCC Local Competition Report*, as of December 31, 2002, Table 10. (This table includes lines provided to residential and business customers by Qwest, Verizon, and CLECs, and thus provides an approximation of the distribution of lines in the small business market.)

local markets.[41] Qwest, for strategic business reasons or for reasons beyond its control may fail to meet performance standards for its wholesale services in the upcoming years, thus affecting CLECs' relationship with their customers. CLECs are particularly vulnerable, because unlike Qwest, with its long-term incumbency advantage, CLECs must overcome customer inertia and gain acceptance in order to acquire customers. If Qwest does not install a CLEC's local service in a timely manner, this delay harms CLEC's relationship with its customer, making it that much harder for them to overcome other customers' inertia.

Q: Despite these limitations on these two modes of local entry, are the exchange-specific data about UNE-based and resale-based entry nonetheless useful to the Commission as it seeks to establish an appropriate level of regulatory oversight for Qwest's local services?

A. Yes, provided that the Commission examines these data within the context that I describe above. The relative level of activity of these two modes of entry throughout the Qwest-served exchanges provides a useful "telltale" to the Commission as seeks to chart its regulatory course. Although these data do not on their own demonstrate the existence of effective competition, where there is UNE and resale activity, the market is more likely to support competitive alternatives to Qwest. Conversely, where there is little such activity, the Commission should be particularly careful about relaxing regulation. Although wholesale-based entry does not translate into effective competition, it does suggest greater prospects for such competition to develop.

41 FCC *Local Competition Order (* June 2003), Tables 9 and 10.

Q: Have you examined the data in this proceeding regarding facilities-based entry?

A: Yes. In Confidential Exhibit SMB-6C, I summarize the percentages of lines that telecommunications carriers provide to business customers over resale, UNE-P, UNE-L, CLEC-owned facilities, and Qwest's retail facilities. I rely on Qwest's data for the numbers of wholesale-based CLEC entry and for the number of Qwest retail lines. I rely on Staff's aggregated data for the number of CLEC-owned lines in Qwest's territory. Because CLEC-owned lines likely include digital lines, my calculations incorporate Qwest's estimate of its total business lines, including digital lines. The percentage of CLEC-owned lines shown in Confidential Exhibit SMB-6C provides an estimate of the level of facilities-based activity in Washington.

Many factors contribute to the decline in Qwest's business local exchange retail access line base, most of which do not erode Qwest's market dominance.

Q: Mr. Teitzel contends that "the bulk of the erosion in Qwest's access line base can be attributed to CLEC competition."[42] Please describe the "erosion" of business lines.

A: Qwest's business exchange service lines declined by five percent (from 550,329 lines to 520,635 lines) between 2002 and 2001.[43] In the same time period, including all Qwest access lines associated with business classes of services (including, for example business lines served over DS1 and above facilities that the Commission previously reclassified), the quantity decline by approximately 13 percent (from 706,000 lines to 615,000 lines).[44]

42 Teitzel Direct (Qwest) at 5.
43 Reynold Direct (Qwest) at 17, footnote 19; Teitzel Direct (Qwest) at 8.
44 Teitzel Direct (Qwest) at 4. Qwest response to PC 2-14.

Q: Has Qwest demonstrated that CLEC competition has caused the "bulk of the" erosion in its access line base?

A: No. Qwest would have the Commission believe that customers are migrating in large numbers to CLECs, cellular carriers, and VoIP, but Qwest oversimplifies the complexity of the local market and exaggerates the relevance of wireline alternatives. First, the economy has taken a downturn causing a decline in the total demand for business local exchange service.[45] Second, Qwest fails to discuss the cross-elasticity among its business products. Customers may be substituting a different Qwest product for business local access lines. Qwest indicates that it is possible that customers migrate from Qwest's business local exchange services to other Qwest products, "but it does not specifically track such migration, and thus, has no way of knowing the magnitude of such an activity."[46]

Q: Did you analyze the causes of disconnect activity for Qwest's business retail access lines?

A: Yes. In its response to PC 3-25, Qwest provided the quantities of disconnects separately by reason, for each of the following categories:

- Total disconnects (regardless of which party initiated the disconnect);
- Disconnects resulting from customers calling Qwest directly;
- Disconnects resulting from CLECs placing disconnect orders on behalf of retail customers; and
- Disconnects resulting from Qwest initiating disconnection.

45 The monthly unemployment rate in Washington state ranged between 6.7 and 7.7 in the twelve-month period spanning July 2002 through June 2003. The comparable rate for the period spanning July 1999 through June 2000 ranged between 4.6 and 5.1. www.bls.gov

46 Qwest response to PC 3-23(a). See also Qwest's response to PC 3-25, Confidential Attachment A.

Q: In what context do you recommend that the Commission examine these data?

A: I recommend that the Commission consider the reasons that customers discontinue their service with Qwest in the specific context of Qwest's assertion that competition has caused "the bulk of the erosion" in Qwest's business access lines.[47] Also, I recommend that the Commission examine specifically the aggregate data provided by Qwest in Confidential Attachment A to its response to PC 3-25, and review the quantities of disconnects associated with reasons that are likely related to the economic downturn of recent years. Confidential Exhibit SMB-7C summarizes disconnect quantities that are associated with economic reasons for the last year and compares them to the total quantities of disconnects.[48]

Q: Are there any data that suggest an *increase* in demand for Qwest's business services?

A: Yes. Throughout its territory, Qwest reported a 12.9 percent *increase* in voice-grade equivalent access lines provided to business customers.[49]

Q: Did you seek comparable data for Washington state?

A: Yes. Qwest indicates that it "is in the process of gathering the information."[50]

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47 Teitzel Direct (Qwest) at 5.
48 Qwest indicates that it does not "readily retain" these data for more than a year. Qwest response to PC 3-25.
49 Qwest's "Quarterly Report," February 19, 2003, for the fourth quarter, 2002, page 13, Attachment E. See also footnote 1 which states that "a voice-grade equivalent is the amount of capacity required to carry one telephone call" and further states that a "voice-grade equivalent is the outcome of measuring all residential and business access lines, and private line channel terminations as if they were converted to single access lines that have the ability to transmit and receive only one voice transmission at a time." [http://media.corporate-ir.net/media_files/NYS/q/reports/Q4_02Quarterly.pdf
50 Qwest response to PC 03-24.

Q: Qwest relies on E911 records as evidence of local competition. Please comment.

A: Qwest relies on the presence of 420,305 business E911 records in the Intrado database as an indicator of local competition, and adjusts it by the 51,576 unbundled loops associated with UNE-L (Qwest reports those customers served with resale or UNE-P directly to Intrado) to yield what it contends approximates the number of business records associated with CLEC-owned facilities.[51] This number likely exaggerates substantially the actual quantity of facilities-based local exchange service lines. The most recent data available from the FCC shows that for *both* Qwest and Verizon, and for *both* residence and business, there are 178,293 CLEC-owned lines.[52] The figure of 368,729 that Mr. Teitzel computes based on business E911 records is unreliable and should be ignored.[53]

Q: Why does Qwest exclude digital switched business services in its petition?

A: Qwest indicates that it has excluded digital services because CLECs "are not generally using these products to provision their digital switched services," and also states that it has excluded unbundled loops that are typically associated with provisioning digital service from the UNE quantities that Qwest provides in its petition.[54] Qwest excluded the following products from its petition: UNE-P DDS, UNE-P ISDN PRI, DS1 capable loop; ISDN PRI capable loop, xDSL capable loop, resold DDS Advanced, resold ISDN-PRI DS0 Channel, ISDN SLS, and Single Line ISDN Service.[55]

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51 Teitzel Direct (Qwest) at 10-11.
52 FCC *Local Competition Report*, Table 10.
53 The Staff-aggregated CLEC-provided data include information on CLEC-owned facilities. I discuss these data later in my testimony.
54 Reynolds Direct (Qwest) at 5.
55 Qwest response to PC 5-35.

Q: How might this exclusion of digital switched services from Qwest's petition bear on the analysis of facilities-based competition?

A: It is entirely possible that the facilities-based quantities encompassed by Staff's aggregation of CLEC-provided data *include* digital services, thus yielding numbers that are not directly comparable to those that Qwest provides in this proceeding. The effect of this data mismatch is to *overstate* the role of facilities-based competition in the relevant market.

Q: Is there other evidence that local competition is not as robust in Washington as Qwest seeks to portray?

A: Yes. I compared the status of local competition in Washington with the other twelve Qwest-served states. As Exhibit SMB-8 shows, among the seven comparably sized Qwest-served states, Washington ranks second to last, based on CLECs' market share (based on the three entry modes).[56] Among the same seven states, Washington ranks fifth based on the presence of CLEC-owned facilities.

Service is provided to a significant captive customer base.

Q: Does Qwest offer basic business telecommunications services to a significant captive customer base?

A: Yes. The services for which Qwest seeks statewide competitive classification are offered to a significant customer base, with Qwest serving, on average, 83 percent of the state, and in many exchanges well above 83 percent.[57] Furthermore, if data were available that separately identified CLECs lines offered to small businesses in Washington, the market share data would

56 I excluded the following six states from the table because they each have fewer than one million ILEC lines: Idaho, Montana, Nebraska, North Dakota, South Dakota, Wyoming. Also, with the exception of Nebraska, the FCC excludes CLEC quantities for each of these states, stating that the CLEC data are withheld to maintain firm confidentiality. *FCC Local Competition Report* as of December 31, 2002, Table 6.

57 Qwest's estimate of an 83 percent market share excludes the impact of facilities-based competition.

likely far exceed 83 percent. As the figure in Exhibit SMB-9 shows, although 80 percent of the lines that ILECs provide in Washington are to residential and small business customers, only 46 percent of CLECs' lines are provided to the mass market.[58] Qwest disproportionately serves the mass market, making small business customers particularly vulnerable to premature relaxation of regulatory oversight.

Q: Does the relative presence of small businesses vary among the geographic markets in the state?

A: Yes. In Confidential Exhibit SMB-10C, I compute the percentage of total Qwest lines that consist of those lines being provided to mass market business customers, (i.e., those with three or fewer lines per location) on a wire center and statewide basis.[59] I urge the Commission to compare the disparate percentages of small businesses in the many different local markets that Qwest serves. Those customers residing in areas that disproportionately consist of small businesses are less likely to have meaningful competitive alternatives, and therefore are relatively more "captive" than their counterparts who reside in markets with relatively lower percentages of small business customers. For example, the composition of local markets with exchanges with fewer than 1000 lines merits particular scrutiny.

58 *FCC Local Competition Report,* as of December 31, 2002, Table 11.

59 In Confidential Exhibit SMB-9, I distinguish between customers with three or fewer lines from businesses with four or more lines to correspond with the definition of the mass market that the FCC uses in its local competition report and that Qwest uses to report data to the FCC. Qwest response to PC 2-2. In contrast, for the purpose of tracking service quality, Qwest defines "small business" as those customers with four or fewer exchange access lines and "large business" as those customers with five or more exchange access lines. Qwest response to PC 5-34.

Q: Is there any other evidence that small business customers are particularly captive?

A: Yes. The prices, terms, and conditions of basic measured and basic flat rate local exchange service are identical whether offered to a large corporation or to a small neighborhood business. Even if Microsoft, Boeing, or the University of Washington can select from among competitively priced alternatives to meet their local exchange requirements, the small business likely has few such alternatives, and is thus the most vulnerable to the adverse consequences of premature reclassification of business local exchange service. Confidential Exhibit SMB-11C shows that many of Qwest's business local exchange customers have 3 or fewer lines ("mass market"), and that the average demand for the remaining customers ("small/medium") is small.[60] These small Qwest customers are not likely to attract the attention of CLECs. Comparing the total quantity of customers of Qwest's business line service (including those customers with three or fewer lines and those with four or more lines), which is shown in Confidential Exhibit SMB-11C, to the total 520,635 business lines which the petition encompasses, is further evidence that Qwest provides service to a significant captive customer base.[61]

Q: Have you analyzed the CLEC-provided data to determine the approximate average size of business that new entrants serve?

A: Yes. Based on the Staff-aggregated, CLEC-provided data, I analyzed the average size of CLECs' business customers, and provide the results of this comparative analysis in Confidential Exhibit SMB-12C. The accuracy of the results of my calculations depends, of course, on the accuracy of the data provided by CLECs as summarized by Staff.

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60 This exhibit also provides information about the distribution of PBX trunks between customers with fewer than five trunks and those with five or more trunks.
61 Teitzel Direct (Qwest) at 5.

Q: Does Qwest's proposed product and geographic market definition affect the analysis of whether customers are captive?

A: Yes. Qwest's petition is particularly weak because it relies on an excessively broad market definition that includes both Boeing and the neighborhood restaurant; both Tacoma and Walla Walla; and both Centrex and individual line basic service. By including such very different markets in a single petition, Qwest has submitted an ill-conceived petition for competitive classification. In addition to the DoJ/FTC's definition of a market, others have stated:

> The first step in any analysis of competition in a market is to properly define the product and geographic dimensions of the relevant market. If a market is defined either too broadly or too narrowly, spurious conclusions may arise.[62]

Qwest's petition defines the local market so broadly as to render support for the petition simply insufficient.

Q: Has Qwest provided any evidence of competition in the less densely populated communities that it serves?

A: Yes. Confidential Exhibit DLT-5C includes some instances of above-average CLEC activity in some small exchanges. However, I recommend that the Commission consider carefully the possible causes of these seeming anomalies. If a CLEC serves one large business in a community that is largely residential, the CLEC's presence could easily reduce Qwest's retail business market share to below the state average of 83 percent.

Q: Have you analyzed the level of competition using the exchange as the geographic market rather than the state?

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62 Martin E. Cave, Sumit K. Majumdar, and Ingo Vogelsang, Editors, *Handbook of Telecommunications Economics*, Volume 1, Elsevier: Amsterdam, 2002, David L. Kaserman and John W. Mayo, "Competition in the Long-Distance Market," p.512.

A: Yes. Confidential Exhibits SMB-13C and SMB-14C, which are based on the Qwest-provided data (i.e., wholesale-based CLEC entry), provide retail market share data at the exchange level. Confidential Exhibit SMB-13C, which ranks the exchanges by number of access lines, shows that Qwest dominates the business local exchange market. Confidential Exhibit SMB-14C provides the same market data, ranked by Qwest's market share. Finally, Confidential Exhibit SMB-15C shows the relatively low level of UNE-L activity throughout the state.

Q: Qwest defines the entire state as a single geographic market. Has Qwest supported this broad market definition?

A: No. Indeed the evidence in this proceeding certainly does not support such a finding. Competitors' inroads into Qwest's market share vary significantly among Qwest's 68 exchanges, which is further evidence of Qwest's overly broad reliance on the state as a geographic market. Furthermore, *even within an exchange*, significant disparities exist among the wire centers. By way of illustration, I examined competitive activity in the thirteen wire centers within Seattle, and provide the results of my analysis in Confidential Exhibit SMB-16C, in which I also highlight the two wire centers that, based on Qwest market share, are at the extremes of competitive activity. I urge the Commission to examine the differing levels of competitive activity in the "low" and "high" wire centers in Seattle as well as in the other areas that Qwest serves.

Q: What significance do you recommend that the Commission attach to the analysis in Confidential Exhibit SMB-16C?

A: The disparity that exists even among wire centers within a single exchange demonstrates that Qwest has failed to support its pursuit of a single statewide geographic market. Also, the following market factors may affect the level of competitive activity in a geographic area: the size of the market; the presence of small business customers; and the presence of large business customers.

Q: Why have you examined Seattle?

A: I analyzed data in Seattle to assess the types of disparities that exist among the larger exchanges. This is the type of detailed analysis that Qwest's petition lacks. Qwest does not analyze the detailed market share data that it provides but rather seemingly seeks to shift the burden to the Commission and the intervenors in this proceeding to identify those markets where there may be the beginnings of effective competition.

Q: Earlier you referred to Qwest's overly broad product market. Please elaborate.

A: Qwest groups together Centrex, PBX, and individual line service, products which attract significantly different levels of competitive interest. Qwest neglects to analyze these different markets, and instead, attempts to depict the entire group of local business telecommunications services as constituting a single product market. By contrast, on its web site where it describes its products, Qwest's home page clearly distinguishes between "small business" and "large business" customers.[63]

63 www.qwest.com, visited July 30, 2003.

Q: Does Staff summarize CLEC-provided data on PBX and Centrex lines?

A: Yes. In Confidential Exhibit SMB-17C, I summarize the data that Staff provides regarding CLEC entry into five broad geographic categories. Because the total lines that Staff reports does not equal the computed sum of the resale, UNE-L, UNE-P and CLEC-owned lines, I include two columns with totals, where one column corresponds to the total reported by Staff and the second column corresponds with the total that I compute. Although the focus of my testimony concerns the impact of Qwest's petition on small businesses, i.e., those that likely subscribe to business line service, much of my analysis pertains to the other products as well (e.g., the disparate levels of competitive entry in exchanges throughout the state).

Furthermore, although the FCC determined that Qwest satisfied the 14-point, market-opening checklist, barriers to entry for carriers serving medium and large customers also persist. For example, a business customer that migrates from Qwest to a CLEC cannot continue to have access to all direct inward dialing ("DID") numbers associated with a block of DID numbers because non-working DID numbers are ineligible for local number portability.[64] Because Qwest only ports working telephone numbers, customers with DID service may be reluctant to change local service providers. If, for example, a growing business has a block of 40 numbers, e.g., 206-123-4500 through 206-123-4539, but only 30 of the telephone numbers are working, the business would lose access to 4530 through 4539 should it decide to change its supplier of local telecommunications service. If the business continues to grow after migrating from Qwest, the business would not be able to assign consecutive numbers to future employees.

64 Qwest response to PC 5-30.

Q: You have analyzed many data that relate to an assessment of whether Qwest serves a captive customer base. Please summarize your findings on this point.

A: The Commission may classify the basic telecommunications services provided by Qwest as competitive if the services are "subject to effective competition" which "means that customers of the service have reasonably available alternatives and that the service is not provided to a significant captive customer base."[65] Qwest has failed to demonstrate that such effective competition exists. Competition is minimal for Qwest's business line product, yet these lines comprise a significant percentage of the total lines for which Qwest seeks competitive classification. Confidential Exhibit SMB-9C shows that mass market customers are disproportionately served by incumbent carriers, making them particularly vulnerable to premature reclassification of Qwest's business line service, and Confidential Exhibits SMB-11C and SMB-12C provides further evidence of this trend. Confidential Exhibits SMB-13C and 14C, which examine wholesale-based CLEC entry on an exchange basis, show that Qwest dominates the local market and Confidential Exhibit SMB-15C shows the level of UNE-L activity in Qwest's 68 exchanges. Confidential Exhibit SMB-16C shows that significant disparities exist among wire centers even within an exchange. Based on the data that I examined in these and other exhibits, I conclude that Qwest defines its markets too broadly, and that a significant customer base is captive to Qwest for basic business telecommunications services.

Entry into the local market is not easy.

Q: Have you reviewed the direct testimony of David Teitzel?

65 RSW 80.36.330(1).

A: Yes. Mr. Teitzel contends that he has presented evidence to demonstrate that "Qwest's basic business local exchange markets are open in Washington, and that competitive alternatives are readily available throughout Qwest's service territory." He further relies on the FCC's approval of Qwest's 271 application as evidence that Qwest's local markets in Washington are open to competition.[66] However, "open" is not synonymous with effectively competitive. Until consumers are actually choosing carriers other than Qwest in a quantity to constrain Qwest's behavior in the market, the market cannot be considered effectively competitive. As I discuss earlier in my testimony, the *possibility* of competition is not the same as the *existence* of effective competition.

Q: But isn't it easy to enter Qwest's local market simply by reselling Qwest's services or leasing Qwest's UNEs?

A: No. Qwest greatly oversimplifies entry costs by focusing on Qwest's requirement to offer UNEs and resale to new entrants. Entry is not costless, riskless, nor effortless. CLECs must devote resources, personnel, marketing, and technical staff to offer services in an exchange. The dwindling number of CLECs able to survive in today's marketplace underscores the difficulty of entry and furthermore of sustaining a profitable business in the local telecommunications market. More than two-thirds of the CLECs that were in operation three years ago no longer exist, and according to an industry report "even the remaining CLECs are struggling to prove themselves to Wall Street."[67] Carriers do not necessarily have the resources to expand throughout the state, nor are they necessarily interested in doing so. Not only is

66 Direct Testimony of David L. Teitzel (Qwest) at 2.
67 "The State of Local Competition: Association for Local Telecommunications Services," April 2003, www.alts.org.. The ALTS Report also describes "three years of extremely difficult market conditions, adverse regulatory decisions and scores of bankruptcies in the CLEC industry." *Id*.

ability to enter relevant, so too is willingness to enter a market. Furthermore, more meaningful than speculation about CLECs' *possible* market entry is whether they have *actually* entered the market and are actively offering service to business customers. Contestability simply means that competitors theoretically *could* enter a market if the incumbent priced the service above a competitive level. Consumers do not benefit from a possibility of competition.

Q: Earlier you referred to transaction costs. Please elaborate.

A: The use of Qwest's facilities entails the negotiation of interconnection agreements, monitoring Qwest's behavior, and initiating enforcement as needed. Where CLECs depend on Qwest's wholesale facilities in order to serve end users, they are vulnerable to Qwest's practices and pricing. The mere existence of regulatory oversight of a Bell operating company's wholesale prices and practices does not prevent anticompetitive behavior, but at best, acts as a deterrent to the most blatant anticompetitive behavior.

Q: Doesn't a comprehensive reporting system govern Qwest's relationship with its competitors?

A: Yes. Qwest submits a comprehensive QPAP report to the Commission.[68] However, even after regulators establish elaborate safeguards and reporting systems, the possibility for BOCs' anticompetitive behavior, whether inadvertent or intentional, continues. Because Qwest received its first 271 authorization less than eight months ago, there is a relatively short period of time in which to judge its ability and willingness to comply with Section 271 requirements.

Q: Didn't the FCC conclude that the performance assurance plans (PAPs) "provide

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68 In the Matter of Application by Qwest Corporations International, Inc. for Authorization to Provide In-Region, interLATA Services in the States of Colorado, Idaho, Iowa, Montana, Nebraska, North Dakota, Utah, Washington and Wyoming, *Memorandum Opinion and Order*, FCC 02-332, WC Docket No. 02-314, released December 23, 2002 ("Qwest 271 Order"), Appendix I; Qwest responses to PC 6-36 and 6-37 (re Illustrative Summary of QPAP Payments).

incentives to foster post-entry checklist compliance"?[69]

A: Yes. As I understand the FCC's order approving Qwest's 271 application, the FCC expressed confidence in the PAP's and the state commissions' ability to detect and to prevent backsliding.[70] Nonetheless, the effort required by CLECs and regulators to ensure that Qwest fulfills its 271 market-opening obligations is significant. Furthermore, in considering the complexity of this issue and Qwest's actual performance, I recommend that the Commission evaluate the post-271 Summary of QPAP payments that Qwest has submitted where Qwest has made payments because it has failed to meet some of the performance standards.[71] Also, the fact that the FCC's approval of Qwest's 271 application includes a complex set of reporting standards and regulatory safeguards – intended to encourage Qwest to provide service to CLECs on a parity basis to that it provides to itself – is itself evidence of the lack of competition in the market. Were there effective competition for these "bottleneck" elements, these regulatory safeguards for Qwest's wholesale services would be superfluous. As long as they are needed, there is not effective competition.[72]

It is premature to gauge the impact of Qwest's 271 approval on the development of local competition

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69 *Qwest 271 Order*, at ¶ 442.
70 *Id*.., ¶ 444.
71 Docket No. 030388, Monthly Payment Reports for the Performance Assurance Plan; see, e.g., Reports filed June 30, 2003 and July 29, 2003 for April and May 2003, respectively. http://www.wutc.wa.gov/rms2.nsf?Open; Qwest response to PC 7-38.
72 Qwest's "secret agreements" with CLECs are yet further evidence of its market domination. In a fully effective market, these would not likely have occurred. Qwest's ability to discriminate in the terms and conditions it offers CLECs is evidence of a non-competitive market. In February 2003, the Minnesota Public Utilities Commission issued an order assessing penalties against Qwest Corporation because of its unfiled agreements. Minnesota PUC Docket No. P-421/C-02-197, In the Matter of the Complaint of the Minnesota Department of Commerce against Qwest Corporation Regarding Unfiled Agreements, *Order Assessing Penalties*, February 28, 2003. The decision is now on appeal. The FCC also expressed dismay about Qwest's secret agreements. *Qwest 271 Order* ¶¶ 453 and 473; Statement of Commissioner Michael J. Copps.

Q Please discuss further the relationship of the FCC's approval of Qwest's long-distance bid to this proceeding.

A: In reaching a decision to allow Qwest to offer in-region long-distance services, the FCC determined that Qwest had complied with the competitive "checklist" and also determined that approval of Qwest's approval was consistent with the public interest.[73] In reaching its decision, the FCC determined that the market was open to competition but did not address whether the level of competition that has materialized in Washington represents effective competition.[74] The FCC stated that "Given an affirmative showing that the competitive checklist has been satisfied, low customer volumes or the failure of any number of companies to enter the market in and of themselves do not necessarily undermine that showing [of public interest]. As the Commission has stated in previous section 271 orders, factors beyond the control of the BOC, such as individual competitive LEC entry strategies, can explain low levels of residential competition."[75] The FCC approved Qwest's 271 application because it found that the local markets were open to competition. This finding differs substantially from a finding of effective competition.

Q: Please elaborate.

A: Compliance with the 14-point checklist is a necessary but not sufficient condition to create an effectively competitive market. Furthermore, now that Qwest has received the sought-after approval to offer long distance service, an important regulatory "carrot" has vanished, leaving regulators and competitors with a complex system of monitoring and enforcement to ensure that Qwest does not act in an anticompetitive manner.[76]

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73 *Qwest 271 Order*.
74 *Id*.
75 *Id.*, at ¶ 408.
76 Qwest Performance Results, Washington, June 2002-May 2003, Qwest's Performance Assurance Plans (PAPs), June 20, 2003. www.quest.com/wholesale/results.html

Q: Are there other ways in which the post-271 environment renders the local market more difficult to enter, and more difficult in which to compete?

A: Yes. For the first time since 1984, Qwest can now offer local and long distance services to its home-region consumers, which makes it a formidable telecommunications competitor. Qwest's pre-existing and long-term relationship with its local customers gives it an enviable position in the market for selling long distance service. Qwest's new ability to offer long distance service makes it easier for Qwest to meet the demand of those customers that seek a single supplier of multiple telecommunications services. Qwest is a first point of contact for many customers, a position it enjoys as a result of its many years as the incumbent carrier. Qwest's new ability to market and provide long distance service fundamentally alters its relationship with customers of telecommunications services in Washington, and thus fundamentally changes the local market structure. Information about Qwest's post-271 success in obtaining long distance customers would shed light on its ability to dominate the local market.

Q: Is Qwest's marketing of its long-distance service related to its marketing of its local services?

A: Yes. Qwest is clearly advertising its ability to package local and long distance service offered to its small and large business customers. Qwest describes such benefits as a "single invoice on all your Qwest services" and "combined local and long-distance billing on one easy-to-read monthly statement."[77]

Q: Did you attempt to obtain data about Qwest's post-271 success in attracting long distance customers?

77 http://www.qwest.com/pcat/small_business/product/1,1354,969_3_17,00.html, visited August 5, 2003.

A: Yes, but without success. Qwest objected to the data requests and did not provide information about the quantities of business lines and business customers that have signed up for its in-region interLATA service in Washington, nor did it provide copies of its advertisements and other marketing materials used by Qwest to markets its newly authorized long distance service.[78]

Q: Why would these data and information be useful to the Commission in this docket?

A: Qwest is uniquely positioned to offer comprehensive packages of telecommunications services to business customers. Its position is unique because (1) it is the most widely recognized provider of local service; (2) it dominates the local market; (3) it has a pre-existing and long-term relationship with its customers; and (4) it has unique access to a vast customer base. Now that it also can provide long distance service, it can indeed provide customers with bundled plans that lock them into Qwest as a provider of multiple services, including local telecommunications services.

Affiliation of other providers: BOCs' entry into the Seattle area offers evidence on the prospects for local competition

Q: Please comment on the significance of the affiliation of rival carriers in the market.

A: The affiliation of other providers of service is one of the criteria that the statute specifies as a possible indicator of Qwest's market power. I interpret this criterion to mean that if CLECs are affiliated with parent companies that have substantial resources and telecommunications expertise, potentially these CLECs can diminish the incumbent carriers' market power because, as a result of their affiliation, they are particularly well-positioned to enter the local market. Accordingly, their *actual* success in eroding Qwest's market share can shed some light on the status of and prospect for competition in the local markets that Qwest serves.

78 Qwest responses to PC 03-022(a) and (b).

Q: Does the presence of local carriers with an affiliation with larger parent companies in and of itself prove effective competition?

A: No. Having access to resources and telecommunications expertise is certainly useful to the new entrant, but it is not sufficient to translate into effective competition. The critical question is not simply whether there are carriers "in the wings" that are *capable* of serving customers. Carriers must also be *willing* to serve customers, and, most importantly, there needs to be *market share erosion* in order to determine that Qwest's market power is diminished, and that effective competition has developed. Furthermore, regulators should consider separately the level of competition that is developing for large businesses from that which is developing for small businesses.

Q: Are there providers affiliated with larger companies competing in local markets in Washington?

A: Yes. Confidential Attachment C to Qwest's petition lists alternative providers which purchase unbundled loops, UNE-P, and resold business service in Washington, and some of these carriers are clearly affiliated with larger companies.

Q: Aren't there regional Bell operating companies (RBOCs) that made public promises to enter a local market in Washington as a CLEC?

A: Yes. Both Verizon (Bell Atlantic and GTE) and SBC (SBC and Ameritech), when seeking regulatory approval for their merger applications, promised to enter Seattle as an "out-of-region" local competitor. By "out-of-region" I mean in an area where the company is not the incumbent local exchange carrier, but rather is a new entrant seeking to compete with the incumbent carrier.

Q: Please provide some general background.

A: SBC and Ameritech filed an application for approval of their merger with the FCC on July 27, 1998, and promised, if the merger were approved, that SBC would enter 30 out-of-region markets throughout the country, including the local Seattle market.[79] Bell Atlantic and GTE filed an application for approval of their merger later that year (with the FCC on October 2, 1998, and with the Washington Commission on May 11, 1999).[80] In the merger application, Verizon represented to regulators that an important public interest benefit of the merger would be that the new merged entity would enter 21 out-of-region markets, including Seattle.[81]

79 In re: Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control, FCC CC Docket No. 98-141, *Application*, filed July 27, 1998, § II.A.1.
80 FCC CC Docket No. 98-184, *In the Matter of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee, for Consent to Transfer of Control*, Application for Transfer of Control, October 2, 1998 ("FCC Application"); Joint Application of GTE Corporation and Bell Atlantic Corporation before the Washington Utilities and Transportation Commission, *In re Application of Bell Atlantic Corporation and GTE Corporation for Approval of the GTE Corporation – Bell Atlantic Corporation,* May 11, l999 ("Joint Application")
81 FCC Application, Exhibit A: Public Interest Statement, at 6-7; WUTC Docket No. UT-981367, Direct Testimony of Timothy J. McCallion On Behalf of GTE Corporation, June 18, 1999, at 17-18.

Q: Are Verizon and SBC particularly well-positioned to succeed as new entrants in the local telecommunications market?

A: Yes. As the FCC stated: "as out-of-region competitors we consider Bell Atlantic and GTE to be unusually qualified."[82] SBC and Ameritech, as multi-billion dollar companies, have vast resources. Furthermore, they each have a century of experience offering local telecommunications service; have substantial experience as incumbent carriers negotiating interconnection agreements with CLECs (which they bring to the negotiating table when they negotiate interconnection agreements as a CLEC with Qwest); have relevant technical expertise; and possess substantial brand recognition. These two carriers have a unique and formidable ability to enter local markets in Washington.

Q: In your view, how did the FCC consider Verizon's and SBC's promises to enter out-of-region markets as a CLEC?

A: In both instances, the FCC transformed the carriers' *promises* into *regulatory conditions*.[83] The fact that both Verizon's and SBC's entry into the Seattle market were among the *conditions* of the FCC's approval of the two mergers simply underscores the regulatory concern that, absent such an explicit requirement, these two carriers, despite their substantial size, resources, and expertise serving the local market, might have decided not to enter Seattle

82 In re Application of GTE Corporation, Transferor and Bell Atlantic Corporation, Transferee For Consent to Transfer Control, *Memorandum Opinion and Order*, CC Docket No. 98-184, released June 16, 2000 ("FCC Bell Atlantic/GTE Merger Order"), at ¶ 221.

83 In re: Applications of Ameritech Corp., Transferor, and SBC Communications Inc., Transferee, for Consent to Transfer Control, FCC CC Docket No. 98-141, *Memorandum Opinion and Order*, released October 8, 1999 ("SBC/Ameritech Merger Order"), Appendix C ("Conditions'), ¶ 59. The FCC's conditions specifically set forth the deployment deadlines for 30 out-of-region markets, and specified that SBC must enter Seattle with twelve months of the merger closing date. *Bell Atlantic/GTE Merger Order*, ¶ 319.

(and other out-of-region markets), once they had obtained the requisite regulatory approval to merge.

Q: Please describe the conditions on Verizon regarding its entry into local markets.

A: In its order approving the Bell Atlantic/GTE merger, issued in June 2000, the FCC directed Verizon to spend at least $500 million to provide competitive local service and "associated services" out-of-region between the merger closing date and the end of the 36th month after the closing date, that is, by June 30, 2003. The FCC defined competitive local service as including "traditional local telecommunications services that compete with like services offered by incumbent LECs, provision of advanced services to the mass market, and resale." The FCC furthered stated that Verizon's expenditures devoted toward the provision of "other telecommunications services" or information services that it offered jointly with competitive local service would count toward its $500 million commitment. The FCC stated that:

> Bell Atlantic/GTE must devote at least 50 percent of the out-of-region expenditure commitment to facilities-based competitive service, and it may allot the remaining portion to acquire customers for competitive local service in those out-of-region markets. Notwithstanding the expenditures, the merged firm will be deemed to have satisfied the out-of-region commitment if it provides service, during the 36-month period described above, over at least 250,000 customer lines that are used to provide competitive local service in out-of-region markets.[84]

Q: Has Verizon's out-of-region activity been contributing to mass market customers' competitive options for basic business services?

A: Although Verizon has been spending money in out-of-region markets, the expenditures have not necessarily enhanced competition for basic telecommunications services for the mass market.

84 *Bell Atlantic/GTE Merger Order*, ¶ 319, footnote omitted.

Verizon submitted a report to the FCC on July 23, 2003, in which it described its expansion of its efforts to sell voice and high-speed data services to apartment buildings and complexes and its expenditure of $32.3-million on synchronous optical network (SONET) and switched voice facilities in Dallas, Los Angeles, and Seattle.[85] Also, last year, Verizon submitted a report to the Commission regarding its Washington-specific ventures. I urge the Commission to examine the report submitted by Verizon last year, particularly as it pertains to the specific geographic and product markets that Verizon is actually pursuing in Washington.[86]

Q: Is Verizon obligated to provide basic telephone service out-of-region to mass market customers?

A: No. The FCC's directives in its order approving the Bell Atlantic/GTE merger, as they concerned the mass market, were solely applicable to the provision of advanced services, and not to the provision of "traditional local telecommunications services."[87] Indeed, because the FCC did not specifically require Verizon to provide basic local services to the mass market, Verizon's *voluntary* efforts to serve the mass market in Seattle with basic telecommunications services provide more realistic evidence of the prospects for local competition for small businesses than if Verizon were under a regulatory obligation to serve this market.

Q: Is there any other evidence in this proceeding regarding Verizon's actual entry in the Seattle market?

A: Yes. Confidential Attachment F2 to Qwest's petition (Qwest Exhibit DLT-5C) includes detailed CLEC-specific information about entry into local markets. Confidential Exhibit SMB-

85 *Telecommunications Report Daily*, July 25, 2003.
86 Docket No. UT-981367, In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation; *Report of Verizon to Staff and Public Counsel*, June 28, 2002, submitted to the Commission July 1, 2002.
87 *Bell Atlantic/GTE Merger Order*, ¶ 319.

18C analyzes these data, with particular reference to Verizon's entry into the Seattle market, where the entry is based on the use of Qwest's facilities. The Staff-aggregated CLEC-provided data may include facilities-based entry by Verizon in Seattle, but without access to the underlying data, I cannot comment on the specific level of Verizon's facilities-based entry in Seattle.

Q: You have discussed the significance of Verizon's presence in local markets in Washington. Please discuss further the relevance of SBC's entry into the local market in Seattle.

A: The presence of alternative providers is one of the criteria for assessing the level of competition in the local market. As is the case with Verizon's entry into the Seattle market, a closer examination of SBC's entry into Seattle illustrates the complexities of analyzing the local market. The size of a company may affect that firm's ability to raise capital and to allocate resources to local entry, but in no way alters whether management perceives entry into a new market to be profitable, and thus worthy of active pursuit. CLECs' ability *and* willingness to enter a market are both critical factors to lead to the possibility of the erosion of an incumbent's market power.[88]

Q: When SBC originally submitted its merger application, seeking regulatory approval, how was its promise to enter out-of-region markets viewed?

A: Skepticism about SBC's planned entry into out-of-region market was expressed at the time of its proposed merger with Ameritech: "SBC's fiduciary responsibilities lie with its stockholders, not its customers, and if top management subsequently determines that out-of-region markets are not likely to become profitable within a reasonable period of time, SBC may well abort or

88 *Seventh Supplemental Order*, at 17, ¶ 66.

scale back its National/Local strategy."[89] Furthermore, one of SBC's own managers recognized that local entry might not be profitable. "Mr. Kahan specifically states that the business plan for the National/Local Strategy contemplates a 'negative cash flow for nearly ten years.'"[90]

Q: Were other concerns expressed at the time of the SBC/Ameritech merger proposal that provide information about the likelihood of mass market customers benefiting from local competition?

A: Yes. The following was observed: "The Applicants' claims with respect to the benefits for residential and small business market are particularly unpersuasive. In fact, the Applications are openly disparaging of the residential and small business market."[91]

Q: Have you analyzed SBC's actual post-merger entry in the Seattle local market?

A: Yes, I have. I provide the results of my analysis in Confidential Exhibit SMB-18C, which compares SBC's and Verizon's local competitive activity in Seattle with that of other CLECs in the area.

Q: How do you recommend that the Commission take into consideration the post-merger local entry progress achieved by Verizon and SBC?

A: Presently, there are three RBOCs competing in Seattle, with vast resources and unique expertise. If the local market is as open and attractive to competition as Qwest apparently wishes the Commission to believe, one would expect the data to support such a finding. I urge

89 In re Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer Control, Federal Communications Commission CC Docket No. 98-141, Affidavit of Susan M. Baldwin and Helen E. Golding, on behalf of Indiana Utility Consumer Counselor, Michigan Attorney General, Missouri Public Counsel, Ohio Consumers' Counsel, Texas Public Utility Counsel and Utility Reform Network, filed on October 13, 1998, at ¶ 41.

90 *Id*., at footnote 65, citing James S. Kahan (SBC), at ¶ 80.
91 *Id*., at ¶ 87.

the Commission to examine the actual market share data of SBC and Verizon in Seattle, which I show in Confidential Exhibit SMB-18C, which is one of the most attractive local markets in Washington, as a way to gauge the status of local competition, particularly for small businesses, and to evaluate the merits of Qwest's petition.

Denying Qwest's petition would not prevent Qwest from competing with CLECs, yet approving Qwest's petition would harm consumers, particularly small businesses and rural businesses.

Q: Has Qwest demonstrated that approval of its petition is necessary to compete in the local market?

A: No. Qwest had failed to demonstrate that it requires additional pricing flexibility to compete effectively with CLECs. Furthermore, although it acquired pricing flexibility in Docket No. UT-990022 for certain market segments, Qwest has not yet exercised this flexibility.[92] Also, Qwest has various options for attracting and retaining business customers in the face of emerging competition. Qwest can offer new services, implement promotions (e.g., waive or reduce installation charges),[93] price within banded rates,[94] and change rates on ten-day notice.[95] Also Qwest can lower prices on ten-days' notice, which enables it to compete on the same basis as competitors to attract customers.

Q: In the face of the effective competition that Qwest contends exists, has Qwest lowered the prices for any of the services encompassed by its petition?

92 Qwest response to PC 2-8S1, part a. Qwest indicates that it has been unable to use the pricing flexibility it acquired because its billing systems cannot support different pricing structures for private lines services based on the markets established in Docket No. UT-990022. Qwest response to PC 2-8S1, part (b).
93 Qwest response to PC 2-6S1, parts a, b and Attachment A.
94 RCW 80.36.340.
95 Qwest response to PC 2-6S1, part c.

A: Yes, but for relatively few of the products, and the form of most of the rate reductions were waivers of nonrecurring charges. Qwest is unaware of any instance where the Commission has denied a request by Qwest to lower the rates for any of the services for which it seeks competitive classification.[96] Competition typically leads to *lower* prices for consumers. If local competition were as robust as Qwest claims it is, Qwest would be voluntarily lowering monthly rates for its business local exchange services more than the minimal amount that Qwest has initiated.

Q: Isn't it possible that Qwest seeks competitive classification to obtain the regulatory authority to increase rates?

A: Yes. This possibility merits particular regulatory scrutiny. Although prices can increase in an effectively competitive market, where, for example, all suppliers confront increases in the cost of their inputs, such an oil price increase, Qwest had not provided any evidence that cost increases for its inputs outweigh the cost decreases for its inputs. Furthermore, the telecommunications industry is characterized by declining costs.

Q: Did you attempt to determine those circumstances under which Qwest might increase rates for business services?

A: Yes. Public Counsel asked Qwest to indicate (assuming the petition were granted), under what circumstances it would "increase the rates for any of the services listed in Attachment A." Qwest responded that it "is not possible for Qwest to predict in advance how it might adjust its prices for services in a competitive market" and that in a competitive market "prices are raised

96 Qwest response to PC 2-6S1, parts a, b and Attachment A.

and lowered all the time in response to competitive conditions." Qwest further explains that "services will be priced to meet the varied needs of Qwest's business customers."[97]

97 Qwest Response to PC 2-20(h).

Q: Please comment.

A: By aggregating such disparate markets (rural and urban, single line business and Centrex), Qwest would have ample opportunity to raise rates for less competitive, and distinctly different markets in order to subsidize rate decreases in those markets that confront relatively greater levels of competition. Qwest has not demonstrated the circumstances under which it would need to *raise* rates in order to compete, and presently has the flexibility to decrease its rates to meet competition. According to Qwest, one could expect the raising and lowering of prices "all the time" in a competitive environment. Yet, Qwest provided relatively few instances of Qwest lowering a rate since 1999 for the services for which it seeks competitive classification, and provided no instances for the vast majority of these business telecommunications services.[98]

Q: Do the demand data for features provide any evidence about the level of competition that Qwest confronts in the local market?

A: Yes. The consumer demand for features, shown in Qwest's confidential response to PC-2-3, viewed in tandem with the rates for these services, provided on its web site demonstrates that Qwest is able to extract monopoly rents from business local exchange service customers.[99] Confidential Exhibit SMB-19C includes customer demand data for 1999 through 2002 for selected features, and also shows the change in demand for feature expressed on a per-line basis. Were there effective competition for these features, one would expect the rates to decline toward their incremental cost.

98 Qwest response to PC 2-6S1, parts a, b and Attachment A.
99 http://tariffs.uswest.com:8000/docs/TARIFFS/Washington/WAET/wa_e_t_s005p081.pdf#USW-TOC000003, visited July 30, 2003. WN U-40, Exchange and Network Services, Washington, Section 5.4.3, Custom Calling Services.

Q: Aren't the features for which Qwest seeks competitive classification discretionary, and if so, why should the Commission be concerned about the way that Qwest prices and offers them?

A: The increasing demand for these particular features suggests that they are not discretionary but rather are likely increasingly essential to businesses operations. Small businesses, who do not own PBX equipment, may rely on Qwest for the functions provided by the features. Because of the apparently integral relationship of these many features to business operations, it would be particularly harmful to consumers were Qwest to have the latitude to raise the rates for these features yet further above their cost. When first introduced, touch tone service was considered a discretionary (i.e., non-essential) service, and later became recognized as a basic telecommunications service.[100] The demand for other features may well be following the same path as touch tone service, and thus the Commission should be particularly concerned about the way in which Qwest prices these features, particularly for the smallest and most captive business customers, who likely have the fewest meaningful alternatives.

Q: Does Qwest address the relationship of its retail and wholesale rates?

A: Yes. According to Qwest, its "recurring retail rates for basic business exchange services and the accompanying revenue streams associated with ancillary services exceed the wholesale UNE rates charged to CLECs by a significant margin."[101] If local competition were as vigorous as Qwest apparently would like the Commission to believe, the market would not sustain a "significant margin" between the wholesale costs and the retail revenues. Of course, at the

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100 Massachusetts D.P.U. 89-300, *Investigation by the Department on its own motion as to the propriety of the rates and charges filed by New England Telephone and Telegraph Company*, June 29, 1990. The Department of Public Utilities stated that "…today's discretionary service may be considered to be 'plain old telephone service' tomorrow" and further stated that the "ubiquitous use of touch tone service is a case in point." *Id*., at 146.
101 Reynolds Direct (Qwest) at 18.

other extreme, a price squeeze would be anticompetitive, but Qwest, by its own admission, apparently prices at the supracompetitive end of the pricing spectrum.

Q: Please summarize briefly the major results of your analysis of Qwest's petition.

A: Based on my analysis of the data that Qwest provided and the Staff-aggregated, CLEC-provided data, my major conclusions are that:

- Qwest offers basic telecommunications customers to a significant customer base;
- Alternative services are not readily available in many exchanges, and small businesses and rural communities particularly lack functionally equivalent services;
- Qwest fails to support its overly broad market definition, and, indeed, the data show that the level of competitive activity varies significantly among geographic and product markets;
- Market share data provide the most reliable indicators of whether effective competition has emerged; and
- Qwest continues to dominate the local market and possess market power, and, therefore, absent regulatory oversight, Qwest could exert that market power to raise rates and/or allow service quality to deteriorate, particularly for small businesses.

V. RELATIONSHIP OF QWEST'S PETITION TO OTHER REGULATORY PROCEEDINGS

Q: Please describe your understanding of Qwest's position regarding the relationship of this proceeding to the FCC's Triennial Review?

A: Mr. Shooshan does not consider the FCC's Triennial Review relevant apparently because if the Commission determines in an upcoming proceeding that CLECs are impaired absent access to switching, then UNE-P will continue to be available, and thus the data that Qwest provides in support of its petition continue to be valid. Conversely, if the Commission reaches a decision that CLECs are not impaired, such a finding would be compatible with Qwest's petition to classify its business services as competitive because it would support a finding of competitive alternatives.[102]

Q: Do you concur that the FCC's Triennial Review Order is irrelevant to this proceeding?

A. No. Although this proceeding is not an impairment proceeding, *per se,* there are at least two reasons that the FCC's Order is relevant to the Commission's deliberations in this proceeding. First, the operational and economic criteria that the FCC sets forth in its Order may be appropriately applied here. The FCC, having devoted substantial time and effort to its deliberation in the Triennial Review proceeding, may identify useful ways to analyze the local market structure, which could offer guidance to the Commission's analysis in this investigation. Second, by deciding this proceeding before completing the impairment proceeding, the Commission risks ending up with contradictory conclusions about the status of competition in Washington's local markets in the two related state regulatory proceedings.

Q: Are there other reasons that this proceeding is premature?

102 Shooshan Direct (Qwest) at 16-18.

A: Yes. The outcome of the pending investigation of local loop cost directly affects the relationship between wholesale and retail rates and thus directly affects the prospects for local competition.[103] This proceeding is well underway, but until the Commission establishes UNE loop costs, the relationship between Qwest's retail and wholesale rates cannot be meaningfully examined. Also, as I discussed earlier, the passage of time since Qwest's 271 authorization became effective is too short to evaluate Qwest's ability and willingness to comply with market-opening conditions in Washington.

103 The Commission is investigating Qwest's recurring and nonrecurring loop costs in a bifurcated proceeding with briefs being filed in the recurring phase in February 2004, and briefs in the nonrecurring phase being filed in July 2004. Docket No. UT-023003, In the Matter of the Review of: Unbundled Loop and Switching Rates; the Deaveraged Zone Rate Structure; and Unbundled Network Elements, Transport, and Termination, *Twelfth Supplemental Order: Granting Motion to Compel; Revising Schedule; and Bifurcating Proceeding;*
Docket No. UT-033034,I n the Matter of the Review of: Unbundled Loop and Switching Rates; the Deaveraged Zone Rate Structure; and Unbundled Network Elements, Transport, and Termination (Non recurring Costs), *Order No. 01, Establishing Schedule of Proceedings*, August 5, 2003.

VI. RECOMMENDATION

Q: Please summarize your recommendation to the Commission.

A: There is little to be gained and much to be lost by granting Qwest's petition. The Commission should reject Qwest's petition because it is poorly supported, would adversely affect business customers (particularly the smallest and those in the most sparsely populated areas), is premature, and would impede the development of local competition.

Q: Does this conclude your testimony?

A: Yes, it does.