BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

	)	
IN THE MATTER OF THE PETITION OF	)	
QWEST CORPORATION FOR	)	**DOCKET NO. UT-030614**
COMPETITIVE CLASSIFICATION	)	
OF BASIC EXCHANGE	)	
TELECOMMUNICATIONS SERVICES	)	
	)	

Direct Testimony Of Timothy J Gates

On Behalf Of

MCI, INC.

August 13, 2003

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Timothy J Gates. My business address is QSI Consulting, 917 W. Sage Sparrow Circle, Highlands Ranch, Colorado 80129.

Q. WHAT IS QSI CONSULTING, INC. AND WHAT IS YOUR POSITION WITH THE FIRM?

A. QSI Consulting, Inc. (QSI) is a consulting firm specializing in traditional and non-traditional utility industries, econometric analysis and computer aided modeling. I currently serve as Senior Vice President.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. I received a Bachelor of Science degree from Oregon State University and a Master of Management degree in Finance and Quantitative Methods from Willamette University's Atkinson Graduate School of Management. Since I received my Masters, I have taken additional graduate-level courses in statistics and econometrics. I have also attended numerous courses and seminars specific to the telecommunications industry, including both the NARUC Annual and NARUC Advanced Regulatory Studies Programs.

Prior to joining QSI, I was a Senior Executive Staff Member at MCI WorldCom, Inc. (MWCOM). I was employed by MCI and/or MWCOM for 15 years in various public policy positions. While at MWCOM I managed various functions, including tariffing, economic and financial analysis, competitive analysis, witness training and MWCOM's use of external consultants. Prior to joining MWCOM, I was employed as a Telephone Rate Analyst in the Engineering Division at the Texas Public Utility Commission and earlier as an Economic Analyst at the Oregon Public Utility Commission. I also worked at the Bonneville Power Administration (United States Department of Energy) as a Financial Analyst doing total electric use forecasts while I attended graduate school. Prior to doing my graduate work, I worked for ten years as a forester in the Pacific Northwest for multinational and government organizations. Exhibit TJG-1 to this testimony is a summary of my work experience and education.

Q. HAVE YOU EVER TESTIFIED BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION (COMMISSION)?

A. Yes. I have testified before the Commission in six different proceedings (U-88-2052-P; UT-96-0338; UT-97-0325; UT-003013; UT-023043; and, UT-021569) from 1988 to present.

I have testified more than 200 times in 42 states and filed comments with the FCC on various public policy issues ranging from costing, pricing, local entry and universal service to strategic planning, merger and network issues. As noted above, a list of proceedings in which I have filed testimony or provided comments is attached hereto as Exhibit TJG-1.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. QSI has been asked to provide an analysis of Qwest Corporation's (Qwest) request to classify its basic business exchange telecommunications services as competitive telecommunications services.[1] Mr. Mark Stacy of QSI will also be filing testimony in this case.

Q. WHAT INFORMATION HAVE YOU REVIEWED IN PREPARING THIS TESTIMONY?

A. Prior to preparing this testimony I reviewed Qwest's filing package, and Qwest responses to interrogatories. That package included, among other things, Qwest's Petition and the direct testimonies and attachments of Qwest witnesses Mr. Mark S. Reynolds, Mr. David L. Teitzel and Mr. Harry M. Shooshan III. This testimony will focus primarily on the testimony and exhibits of Mr. Teitzel.

Q. ON WHOSE BEHALF WAS THIS TESTIMONY PREPARED?

A. MCI, Inc. has retained QSI to analyze Qwest's Petition and supporting materials.

Q. WHAT ISSUES WILL YOU AND MR. STACY ADDRESS IN THIS PROCEEDING?

A. Through our testimonies, Mr. Stacy and I will show that Qwest's Petition is premature and not in the public interest. Mr. Stacy will address pricing issues and identify Qwest's incentives and ability to harm the public interest assuming Qwest is deregulated as requested. He will show that Qwest's evidence of effective competition is not compelling and that certain actions and protections are required if the services are given

[1] See Request for Competitive Classification of Basic Business Exchange Telecommunications Services, dated May 1, 2003. Hereinafter, "Qwest's Petition".

the competitive telecommunications service classification over the objections of the parties.[2]

My testimony will also address competitive issues; showing, among other things, that Qwest does not need further deregulation because it has yet to use the pricing flexibility available to it. While some competition appears to exist in Washington, it is not sufficient to justify reclassification of the service to competitive status. Indeed, I will show that certain forms of market entry to which Qwest cites, are not sufficient to eliminate Qwest's market power, that the CLEC/IXC industry is faltering, that wireless and VoIP offerings are not good substitutes for business Wireline services, that access charges need to be reduced and that other rate restructuring is required before Qwest receives any further regulatory flexibility.

III. SUMMARY OF FINDINGS AND RECOMMENDATIONS

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND STATE YOUR RECOMMENDATIONS.

A. After having reviewed the Qwest testimony and exhibits, I conclude generally that the request to classify Qwest's business local exchange and related services as "competitive" is not justified. While it appears that some level of competition exists for certain of Qwest's services, the type and extent of that competition does not warrant the competitive classification of the services. Further it makes no sense to deregulate

[2] RCW 80.36.330 allows the Commission to classify a service as a competitive telecommunications service if

Qwest when it has not utilized the pricing flexibility currently available to respond to competition.

The fundamental question to be answered in resolving this issue is whether the public interest will be better off if the Commission deregulates Qwest's business local exchange and related services. The short answer to this question is that Washington will not be better off. Qwest's customers will be worse off, and so will Qwest's dependent competitors, as well as the customers of those competitors. In fact, as each relevant party's interests are analyzed, it becomes clear that the only party who will benefit from the proposed deregulation is Qwest.

My conclusions and recommendations are as follows:

- Qwest has not shown that sufficient competition exists to warrant competitive classification of its business exchange services. Existing competition is essentially resale, and does not provide the market discipline of facilities-based competition.

- Qwest's reliance on its 271 Order is not evidence of effective competition. The FCC's 271 order finds simply that Qwest's local markets are "open" to competition.[3]

- Qwest has failed to show any evidence of its failed attempts to respond to competition.

- Wireless services – although providing a valuable service to consumers – are complements to Wireline service. Wireless is not a substitute for business landline basic local exchange service and is not effective competition.

- The CLEC/IXC industry is faltering and is not likely to pose a significant threat to Qwest in the foreseeable future.

- Competitive levels in Washington are insufficient to control Qwest's market behavior or quality of service in the absence of regulation.

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it finds that the service is subject to "effective competition."

[3] FCC **MEMORANDUM OPINION AND ORDER**, WC Docket No. 02-314; released December 23, 2002. See also the Direct Testimony of Mr. Teitzel at 2.

- Intrastate access charges are above cost and act as a barrier to effective competition.

- The Commission should initiate a proceeding to consider the establishment of an intrastate Subscriber Line Charge so that the mil levy on terminating access charges can be removed.

- The FCC's Triennial Review Order is expected any day and it may severely impact the CLECs' ability to compete with Qwest. Qwest should not be deregulated until the Commission has determined the impact of the FCC's upcoming order.

IV. QWEST'S SUPPORT FOR ITS PETITION

Q. WHAT SUPPORT DID QWEST PROVIDE FOR DEREGULATION OF ITS BUSINESS LOCAL EXCHANGE SERVICES IN WASHINGTON?

A. Qwest has brought its Petition pursuant to RCW 80.36.330 and WAC 480-121-062. Qwest's witnesses – Mr. Reynolds, Mr. Teitzel and Mr. Shooshan – have provided testimony in an attempt to show that the business market meets the standards identified in RCW 80.36.330.

Q. WHAT MUST QWEST DO TO MEET THE "COMPETITIVE" CLASSIFICATION DISCUSSED IN RCW 80.36.330?

A. In the previous Qwest proceeding seeking competitive classification, the Commission addressed the pertinent standards. The Commission summarized the requirements as follows:

> RCW 80.36.330 authorizes the Commission to "classify a telecommunications service provided by a telecommunications company as a competitive telecommunications service" if it finds that 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." RCW 80.36.330(1) enumerates four factors

> that the Commission "shall consider" in determining whether it will exercise its discretion to classify a telecommunications service as "competitive":
>
> (a) The number and size of alternative providers of services;
>
> (b) The extent to which services are available from alternative providers in the relevant market;
>
> (c) The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates terms, and conditions; and
>
> (d) Other indicators of market power, which may include market share, growth in market share, ease of entry and the affiliation of providers of services.[4]

Q. WHAT SERVICES IS QWEST SEEKING TO RECLASSIFY IN THIS PROCEEDING?

A. Qwest is asking the Commission to find that its business exchange telecommunications services are subject to effective competition and that it no longer has a captive customer base for these services. More specifically, Qwest is seeking competitive classification for Basic Business Local Exchange Service, Centrex Services, Private Branch Exchange Trunks, and Basic Business Features.[5]

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

A. Mr. Reynolds provides an overview of the Qwest case. He also offers some information on alternative providers, market share information and addresses market

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[4] See 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; Docket No. UT-000883; dated December 18, 2000; at 3. Hereinafter referred to as "Commission's 2000 Order."

[5] See Qwest Petition at 1-2. See also Exhibit MSR-2 to Mr. Reynolds' testimony.

entry issues. Finally, Mr. Reynolds suggests that Qwest's revenue streams exceed the wholesale UNE rates charged to CLECs by a significant margin, evidently in an attempt to show that a price squeeze does not currently exist. Mr. Teitzel provides some line count information, refers to Qwest's 271 Order, and suggests that wireless services are effective competition for Wireline services. While pointing out problems with VoIP services, Mr. Teitzel claims that the availability of those services show that Qwest's data is conservative.[6] Mr. Shooshan addresses market share and concentration ratios, in an attempt to show that Qwest cannot exercise market power. Both Mr. Reynolds and Mr. Shooshan argue that the Triennial Review Order should not be considered in the Commission's consideration of Qwest's Petition.

Q. WHAT GUIDANCE WOULD YOU PROVIDE TO THE COMMISSION IN EVALUATING QWEST'S EVIDENCE IN THIS CASE?

A. The statute provides the guidance necessary for the Commission to evaluate Qwest's case. The statutory criteria, when taken together, will guide the Commission to a decision that will ultimately benefit consumers and the economy. The general question this Commission should ask, however, is whether competition is sufficient to justify Qwest's request and whether the consumers in the State will be better off by deregulating Qwest. Indeed, the Commission should only approve Qwest's request if consumers and the economy will be better off under the terms suggested in Qwest's Petition. By utilizing the statutory criteria discussed below within the intent of that law,

[6] "VoIP" stands for voice over Internet protocol. VoIP technology enables transmission of phone calls via the same network that carries Internet traffic. Technical trials are ongoing for this use of the Internet protocol and network.

and by considering other public interest issues discussed herein, I am confident that the Commission will reach a decision that will benefit the public interest.

A. THE NUMBER AND SIZE OF ALTERNATIVE PROVIDERS (RCW 80.36.30(1)(a))

Q. IS THE EVIDENCE PROVIDED BY QWEST REGARDING THE NUMBER AND SIZE OF ALTERNATIVE PROVIDERS PROOF OF EFFECTIVE COMPETITION?

A. No. It appears that there is some nascent competition in certain parts of Washington. That should come as no surprise to the Commission. The mere existence of other providers in a market, however, does not mean that competition is sufficient to provide the market discipline required to govern Qwest's behavior or to protect the public interest as required by RCW 80.36.330. Qwest's control of the market, and the ability to exercise and retain control of the market demand, is not diminished by the mere presence of alternative providers, especially given Qwest's incumbency and its historical monopoly.[7]

Q. QWEST NOTES THAT 161 CLECS ARE REGISTERED WITH THE COMMISSION AND THAT THERE ARE 152 INTERCONNECTION AGREEMENTS.[8] GIVEN THE LARGE NUMBER OF ALTERNATIVE PROVIDERS, IS THAT PROOF OF EFFECTIVE COMPETITION?

[7] If there are a number of alternative providers in the market and their presence is not sufficient to control the incumbent, then one must analyze the types of services being provided. Resale and the use of Qwest's UNEs – resale of another type -- for instance, while providing a method of entry, does not provide the market discipline that would arise from the deployment of one's own facilities.

[8] See Qwest Petition at 3-4. See also Direct Testimony of Mr. Teitzel at 6.

A. No. The number and size of alternative providers are but two considerations. Indeed, this is a starting point for any consideration of competition. Qwest does not provide information on the size of these alternative providers, other than to note that two of the providers include AT&T and MCI. What is clear, however, is that Qwest – by its own calculation -- still maintains about 83 percent of the market.[9] That means that the 161 CLECs, after 7 years of trying to lure away Qwest business subscribers, share a total of about 17 percent of the Washington market. This is hardly a trend that should trouble Qwest or its shareholders.[10] Absent other information, one's *a priori* expectation would be that such a large number of alternative providers would have had a much larger impact on Qwest and its business. Since that is not the case, the Commission must continue its investigation and determine why CLEC success has been so limited. The additional criteria identified in RCW 80.36.330 provide guidelines for the Commission's further investigation.

Q. MR. TEITZEL STATES AT PAGE 6 OF HIS TESTIMONY THAT 78 OF THE 161 REGISTERED CARRIERS, INCLUDING NATIONAL CARRIERS SUCH AT AT&T AND MCI, WERE ACTIVELY PURCHASING WHOLESALE SERVICES FROM QWEST IN WASHINGTON. PLEASE COMMENT.

A. This fact shows that Qwest's reliance on the 161 registered CLECs and the 152 CLECs with approved interconnection agreements dramatically misrepresents the level

[9] Id. at 8, Table B.
[10] Indeed, now that Qwest has its 271 authority, and has begun to bundle services, I would expect the trend of supposed lost customers to dampen.

of competition. Only about half of the registered CLECs are actually purchasing services from Qwest.

Q. DOES THE FACT THAT ONLY 78 OF 161 REGISTERED CLECS ARE ACTUALLY PURCHASING WHOLESALE SERVICES CHANGE YOUR OPINION OF QWEST'S EVIDENCE?

A. No. If you divide 17 percent of the market by 78 "active" CLECs, the results are still de minimis on a carrier-specific basis. Even if you assume that AT&T and MCI together account for half of the 17 percent, the market share (4 or five percent each) is hardly threatening to Qwest. Nor is the remaining 8 percent split among the remaining 76 active CLECs (about one tenth of one percent each) in Washington.

B. THE EXTENT TO WHICH SERVICES ARE AVAILABLE FROM ALTERNATIVE PROVIDERS (RCW 80.36.330(1)(b))

Q. HOW DOES THIS INFORMATION HELP THE COMMISSION IN DETERMINING WHETHER EFFECTIVE COMPETITION EXISTS?

A. This criterion provides additional information on the activities of the alternative providers. For instance, as Qwest noted, not all registered CLECs are providing service today. If there are many providers, but they are not actually offering service to consumers, their presence should not be considered in any analysis of competition.

Q. ARE THERE PARTS OF WASHINGTON WHERE CLECS ARE NOT PROVIDING SERVICES?

A. Yes. Based on Qwest's testimony, it appears that CLECs are not offering service in Easton, Elk, Green Bluff, Liberty Lake or Northport.[11] Based on this information, Qwest cannot meet the requirements of RCW 80.36.330(1)(b) and competitive classification cannot be granted.

Q. DID THE COMMISSION MAKE A SIMILAR RULING IN ITS 2000 ORDER?

A. Yes. At paragraph 66 of the Commission's 2000 Order it considered similar arguments made by Qwest and explained:

> Qwest asks us to apply a more relaxed standard for determining effective competition. Qwest asserts that the statute is met if competitors exist in the market who are *capable* of providing ("can" provide) alternative services. We are unable to accept this standard. In our view, we must also have confidence that competitors *are* offering and *will* offer competitive services. This determination turns on the presence of competitors, their actual current availability to customers, and a judgment, from their current behavior and the current market structure, that they do, can, and will provide alternative service to end-users.

Applying this same standard to Qwest's evidence in this proceeding requires the Commission to reject Qwest's request for competitive classification of services in these exchanges.

Q. BUT QWEST ARGUES THAT CLECS ARE CAPABLE OF OFFERING SERVICE IN THESE EXCHANGES.[12] IS THAT SUFFICIENT TO JUSTIFY A COMPETITIVE CLASSIFICATION?

A. No. As the Commission noted in its 2000 Order,

[11] See Direct Testimony of Mr. Teitzel at 9-10

[12] See Direct Testimony of Mr. Teitzel at 10 and the Direct Testimony of Mr. Reynolds at 9.

> Qwest refers to the presence of switches, price lists filed with the Commission, and advertising by CLECs to show that CLECS are capable of providing or hold themselves out to provide services comparable to Qwest's business services. None of these exhibits show that competitors *in fact* are offering comparable services in the relevant geographic market. Ex. 12C, Attachment C, D, and J. Qwest's reliance on Attachment H to Exhibit 12C is also of little weight. Attachment H shows, at most, competitive presence in the thirty-one wire centers. It does not establish that those competitors are providing reasonable alternatives to Qwest's business services. Consequently, we cannot make a finding that the services in the thirty-one wire centers for which Qwest has sought competitive classification are in fact subject to effective competition at this time.[13]

Thus, in order to obtain the classification that Qwest seeks in this docket, Qwest must demonstrate that competitors currently provide reasonable alternatives to Qwest's business services. Qwest has failed to satisfy this burden.

Q. IF CLECS <u>ARE</u> PROVIDING SERVICES IN AN EXHANGE SHOULD QWEST AUTOMATICALLY RECEIVE A COMPETITIVE CLASSIFICATION?

A. No. The extent to which CLECs are offering services and whether those services are functionally equivalent and readily available at competitive rates, terms and conditions should also be considered. For instance, if CLECs have only a few lines in an exchange or if CLECs have many lines but the services are not functionally equivalent, then the Commission should reject Qwest's request for competitive classification.

C. THE ABILITY OF ALTERNATIVE PROVIDERS TO MAKE FUNCTIONALLY EQUIVALENT OR SUBSTITUTE SERVICES READILY AVAILABLE AT COMPETITIVE RATES, TERMS AND CONDITIONS (RCW 80.36.330(1)(c))

[13] See Commission's 2000 Order at paragraph 69.

Q. QWEST STATES THAT CLEC SERVICES "ARE OFFERED IN DIRECT COMPETITION WITH AND AS A COMPLETE ALTERNATIVE TO THOSE OF QWEST…" DO YOU AGREE?

A. No. I believe that the CLECs would like consumers to perceive their services are a complete alternative to those of Qwest; but generally speaking they are not.

Q. PLEASE EXPLAIN.

A. As noted in Qwest's Petition, "Qwest's competitive evidence supporting this petition is substantially based on the quantities of wholesale services purchased by alternative providers to compete with Qwest's retail basic business services. A list of competitors that purchased unbundled loops, unbundled network element platforms (UNE-P), and resold business services may be found at Confidential Attachment C."[14] While such a position would support Qwest's Petition, the Commission must seriously question whether resold or UNE-P services rise to the level of "reasonably available alternatives." Clearly they do not.

Let's discuss each of the service types upon which Qwest relies. Services through resale have never been considered to be effective competition. Resellers are more appropriately considered customers of Qwest. Resellers cannot independently produce the service they offer their customers, so they purchase services from carriers such as Qwest to provide their service to customers. The continued viability of resellers is dependent upon the maintenance of a sufficient margin between the wholesale price they pay to Qwest and the retail price they charge their customers. A reseller purchases Qwest services at the same rates, terms and conditions that Qwest offers those services, less a 14.74 percent discount.[15] The fact that the amount of business resale purchases by CLECs has dropped precipitously over time tends to indicate that the 14.74 percent discount is insufficient and that resale in general is not a viable long-term strategy.[16]

Q. BUT ISN'T RESALE ONE OF THE THREE ENTRY STRATEGIES DISCUSSED AND ANTICIPATED BY THE FCC'S *LOCAL COMPETITION ORDER*?

A. Yes. The 1996 Telecom Act and the FCC's *Local Competition Order* "…contemplates three paths of entry into the local market -- the construction of new networks, the use of unbundled elements of the incumbent's network, and resale."[17] Resale was expected to be one of the ways in which companies would gain access to the market quickly. Generally, it was thought that, over time, CLECs utilizing resale would develop the critical mass of customer density and capital to make it economically viable for them to build their own facilities and eventually diminish their reliance upon resale and/or the purchase of unbundled network elements (UNEs). Resale is generally not thought of as a long-term solution because of the reliance upon the incumbent provider and the inability to distinguish the reseller service from that of the underlying carrier. In addition, the CLEC reseller has no ability to cut its cost of

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[14] See Qwest Petition at 4. See also the Direct Testimony of Mr. Reynolds at 9-10.

[15] See Qwest Petition at 5 and the Direct Testimony of Mr. Reynolds at 10.

[16] Qwest's Petition at page 9 indicates that Business Resale from 12/31/01 to 12/31/02 dropped 41 percent. While I do not quote Qwest's Petition for the veracity of the data or calculations, on its face it seems clear that resale has not an effective competitive strategy in Washington. If it were a successful strategy, usage would be increasing, not decreasing.

[17] Before the Federal Communications Commission; *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Services Providers*; CC Docket Nos. 96-98 and 95-185; **FIRST**

telecommunications services relative to the rates of the incumbent from which it purchases services. No matter how well the CLEC manages its own business, and how efficient it becomes, it will still have the same narrow margin upon which to meet its own costs and earn a profit. Clearly the reseller has no ability to impose any competitive threat or pressure on the underlying competitor and, as such, cannot be considered effective competition.

Q. DO YOU CONSIDER CLEC USE OF UNE-P TO BE EFFECTIVE COMPETITION?

A. No. Although UNE-P has proven to be one of the most effective means of entering the local market, it is really just resale under different rates, terms and conditions.[18]

Q. PLEASE EXPLAIN.

A. UNE-P is simply the CLEC using an existing Qwest unbundled loop, transport, line port and local switching.[19] In Qwest's Wholesale Product Catalog, UNE-P is defined as:

> Qwest provides UNE-P POTS combinations as a finished service to end-users *on behalf of CLECS*. UNE-P POTS provides service similar in functionality as Qwest's retail residential and business services. (emphasis added)[20]

REPORT AND ORDER; Released August 8, 1996; hereinafter referred to as the *Local Competition Order*, at ¶ 12.

[18] On February 6, 2003, The Honorable Gary Locke, Governor of Washington, wrote to the FCC and stated, "I believe the unbundled network elements platform (UNE-P) provisions have played a vital role in promoting competition in Washington State and elsewhere, and that the incentives for competition that are contained in the Telecommunications Act of 1996 and Commission rules should be maintained."

[19] The availability of unbundled local switching will be a controversial issue in the FCC Triennial Review proceeding. As the Commission is well aware, unbundled local switching is a key component of UNE-P and the impact of not making that element available to CLECs will be the crux of the impairment analyses. This controversial issue underscores the CLEC dependence upon the ILECs for UNEs and why UNE-based competition – like more traditional resale – is not effective competition.

[20] See Qwest Wholesale Product Catalog. [Link to Qwest | Wholesale UNE-P POTS Description]

The pricing for UNE-P, however, is based upon Total Element Long Run Incremental Costs or TELRIC standards.[21] While UNE-P is an effective way for CLECs to enter markets, it still requires the CLEC to rely upon the incumbent for the underlying service. UNE-P is still a form of resale of a bundle of service elements provided by the incumbent monopoly. While the margins in some zones between the incumbent's retail rates and the CLEC's costs may be somewhat more favorable for the CLECS at Qwest's current retail prices, the CLECs still have no ability to cut their costs of services, no matter how efficient they become. Nor does the presence of the UNE-P providers in the market place constrain Qwest's ability to engage in monopolistic behavior and to adopt practices which harm telecommunications services consumers.

Q. DOES THAT SAME RATIONALE APPLY TO THE CLECS' USE OF UNE-LOOP AS WELL?

A. Yes. The CLEC purchase and use of UNE-Loop or UNE-L is just resale of Qwest's unbundled loop. Again the distinguishing difference between traditional resale and the CLEC use of UNE-P or UNE-L is the pricing standard. CLECs have generally sought to use UNEs over resale because the economics are more attractive. Again, resale does not provide effective competition for Qwest.

Q. BUT CAN'T CLECS MAKE ALTERNATIVE SERVICES "READILY AVAILABLE AT COMPETITIVE RATES, TERMS AND CONDITIONS" BY USING QWEST'S RESOLD AND UNE-BASED SERVICES?

[21] This Commission has adopted the TELRIC standards for costing proceedings. See, for instance, *In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale*, Docket No. UT-960369 et al., Eighth Supplemental Order (May 11, 1998) ("Eighth Supplemental Order"), at para. 9.

A. No. As discussed above, it is *Qwest provided service on behalf of the CLEC*. In fact, the CLECs are dependent upon Qwest for the timing of service delivery, quality of service and features. As such, it is Qwest making these alternative services "readily available", although they may be ordered and purchased by the CLECs.

Q. IF CLECS BUILD THEIR OWN FACILITIES, WOULD SERVICES OFFERED OVER THOSE FACILITIES BE CONSIDERED EFFECTIVE COMPETITION?

A. Yes, if the CLEC offered services that were comparable in terms of rates, terms and conditions. Simply overbuilding the Qwest network is not sufficient to result in effective competition unless that network can provide "competitive" alternative services.

Q. AT PAGE 12 OF MR. TEITZEL'S TESTIMONY HE STATES, "IN AN OPEN MARKET, COMPETITORS WILL REACT TO PRICE CHANGES BY ANOTHER COMPETITOR WITH CREATIVE PACKAGING, ATTRACTIVE PRICES AND ACTIVE PROMOTIONS. THE OPEN COMPETITIVE MARKET IN WASHINGTON REPRESENTS EFFECTIVE COMPETITION FOR QWEST'S LOCAL EXCHANGE BUSINESS SERVICES." DO YOU AGREE?

A. No. Mr. Teitzel is attempting to draw conclusions from its 271 approval that cannot be made. Simply because a market is open does not mean that it is effectively competitive. If that loose standard were adopted by a commission, then once entry was allowed, the incumbent would be deregulated regardless of whether alternative providers existed or offered services. This is hardly the result the legislature anticipated when it developed its criteria in RCW 80.36.330. Surely the Commission did not cede its state statutory responsibility to protect Washington consumers from anti-competitive monopoly behavior when it engaged in its advisory role on Qwest's federal 271 application under a different law and a different standard.

WIRELESS SERVICE IS NOT A SUBSTITUTE FOR WIRELINE

Q. MR. TEITZEL SPENDS CONSIDERABLE TIME IN HIS TESTIMONY ARGUING THAT WIRELESS SERVICES PROVIDE AN ALTERNATIVE TO QWEST'S WIRELINE SERVICE FOR SMALLER BUSINESSES. DO YOU AGREE?

A. No. Qwest's testimony suggests that wireless services are functionally equivalent, reasonably available and competitively priced. While I agree that wireless services may be reasonably available, I do not agree that they are functionally equivalent or competitively priced.

Q. PLEASE EXPLAIN WHY WIRELESS SERVICES ARE NOT FUNCTIONALLY EQUIVALENT TO QWEST'S BASIC LOCAL EXCHANGE SERVICES.

A. For wireless services to be functionally equivalent to landline basic exchange services, they would also have to be close substitutes. Today, wireless services are not close substitutes for landline local exchange services.

Q. WHAT DO YOU MEAN BY "CLOSE SUBSTITUTES"?

A. I am referring to the standard economic definition, which states generally that if a consumer can easily get a good substitute for a product or service they will switch to that substitute quickly if the price of their current product or service rises. A good or close substitute would be one that provides the same functionality to the consumer at the same or very similar terms and conditions. Thus, the closer the substitute, the more elastic the demand for the two products or services.[22]

Q. WHAT IS YOUR BASIS FOR CONCLUDING THE WIRELESS SERVICES ARE NOT GOOD OR CLOSE SUBSTITUTES FOR LANDLINE BASIC LOCAL EXCHANGE SERVICES?

A. When comparing services there are several characteristics to consider. For instance, in comparing services one should consider at least three characteristics – functionality, pricing and quality.

Q. PLEASE COMPARE THE FUNCTIONALITY OF LANDLINE LOCAL EXCHANGE SERVICE WITH WIRELESS SERVICE.

A. A quick and uninformed comparison of these two types of service would lead one to conclude that they do provide similar functionalities. They both provide local and long distance calling, have many of the same custom calling features, etc.[23] Those limited similarities, however, are not sufficient to conclude that the two types of services are close substitutes or, more importantly, that they are functionally equivalent.

Q. PLEASE EXPLAIN.

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[22] If the services are close substitutes, then a small change in price will result in a change in consumer purchasing patterns. In other words, when the demand is more elastic – people are more likely to change with a small change in price.

[23] Qwest notes that wireless provide the same or similar custom calling features as basic local exchange service. The availability of wireless custom calling features, however, is impacted by the calling plan selected and the handset selected. Many of the custom calling features are not available with the "free" handsets, but are available if you upgrade.

A. Comparing landline local exchange service to wireless service would be similar to comparing the functionality received from a car and a motorcycle. The car and motorcycle both provide transportation, have disk brakes, dual exhaust, halogen headlights, windshields, turn signals, stereos, seating for additional passenger, storage for belongings, and get similar mileage. One could even argue that they cost the same depending upon the model purchased and how they are equipped. Indeed, one could argue that the motorcycle even provides features and characteristics that the car does not.[24] In fact, I would have to admit that I "could" replace my car with a motorcycle; but "would" I? No.

Q. WHY IS THE DISTINCTION BETWEEN "COULD" AND "WOULD" IMPORTANT TO YOUR ANALYSIS?

A. If someone asked me if I "could" replace my car with a motorcycle, I would have to answer yes. It would be possible to sell my car and replace it with a motorcycle. Motorcycles are readily available at competitive prices, and good financing options are available if I don't have the cash. Technically, there is no reason why I could not replace my car with a motorcycle. But, because the car and motorcycle provide different kinds of transportation for different situations, I would never get rid of my car and rely solely on my motorcycle.

This is similar to the comparison of landline local exchange service and wireless service. One could technically replace landline local service with wireless service, but because wireless services provide different kinds of functionality for different situations,

[24] Motorcycles provide that "open air" experience, are more maneuverable, have a tighter turning radius, stop quicker and accelerate faster, etc.

very few businesses would actually disconnect their landline service and rely solely upon wireless service. Indeed, like the motorcycle scenario, businesses with the means to do so would likely prefer both.

Q. PLEASE EXPLAIN HOW THE FUNCTIONALITIES OF LANDLINE LOCAL SERVICE AND WIRELESS SERVICE DIFFER.

A. Landline local service is very familiar to us all. Typical local service includes, but is not limited to, the ability to: make and receive voice telephone calls, get operator assistance, make and receive long distance calls (and to select your long distance providers), connect with emergency services by dialing 911, use a fax machine to receive and send documents, get a dial-up or high-speed Internet connection, and have your number appear in the white pages of a telephone directory. While wireless service can provide many of these features, it is severely lacking in several areas. For instance, when you pick up your phone at your office you expect to receive dialtone and when the call completes you expect a high quality connection. Wireless service is famous for poor quality of service based on the technology deployed. Dropped or clipped calls are very common and service is not available in many parts of the state.[25] Further, it would be difficult or impossible for a business to replace its dial-up Internet connection on the landline with a wireless counterpart.

Q. WOULD A BUSINESS FOREGO ACCESS TO THE INTERNET (DIAL-UP OR DSL[26]), FAX CAPABILITIES OR OTHER DATA SERVICES?

[25] The manual for my wireless phone directs the customer to "move to a higher elevation, to a window or open space" when a call is dropped or you can't make a network connection. One does not have to suffer these inconveniences with a traditional landline phone.

[26] DSL refers to Digital Subscriber Line – high speed transmission technology.

A. No. The Internet is becoming a fundamental part of American business. Businesses are becoming more and more reliant on the Internet to manage investments, advertising, communications, education and training, research, and for general information and connectivity. Because of frequent and regular access to the Internet, local flat-rate calling for access to the Internet is essential.[27] Generally speaking, wireless phones cannot accept and send faxes, quickly and efficiently generate, send and receive email with attachments or allow high-speed access such as is available through landline DSL services. Further, even if such devices could send and receive data communications efficiently, connections speeds would be slow and there is no efficient way to save or print the documents or information.

Q. IS BROADBAND ALSO AN ISSUE FOR CONSUMERS AND BUSINESS?

A. Yes. At the recent Regional Oversight Committee meeting in Denver, the American Association of Retired Person (AARP) handed out copies of its Policy Book for 2003.[28] The AARP noted that many of the benefits of broadband would be valuable to older Americans. Specifically, the policy states:

> Many of the benefits of ubiquitous and affordable access to broadband networks will be of particular value to older Americans. For example, with a broadband connection to support monitoring devices and interactive video, home health care becomes a viable option for many consumers, particularly those with limited mobility or who may not be well enough to travel. A broadband connection also facilitates lifelong learning opportunities at convenient times and places, especially for

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[27] It is for this very reason that all Internet service providers offer a local access number. It is well known that consumers are not willing to make toll calls or use some other usage sensitive service to access the Internet.

[28] Regional Oversight Committee, Meetings held in Denver, Colorado on May 4th and 5th, 2003. See panel presentation entitled "The AARP Perspective on Telecommunications" from 2:15 pm to 3:00 pm on May 5, 2003.

> individuals who have jobs, disabilities or family responsibilities that make it difficult to travel to a classroom.[29]

Fast and efficient connections to the Internet are also critical for businesses since time is money. It is clear that broadband Internet access is critical to both consumers and businesses, but to date, that capability is not available via wireless services.

Q. PLEASE CONTINUE YOUR COMPARISON OF THE FUNCTIONALITIES PROVIDED BY BASIC LOCAL EXCHANGE SERVICE AND WIRELESS SERVICE.

A. Businesses require various types of alarm systems. Without a landline, ADT or other alarm companies would have no way to connect the business to its monitoring system. It is unlikely that businesses would be willing to forego their alarm system by eliminating their Wireline service and relying solely upon wireless service.

Businesses also require multiple lines. Businesses require multiple lines and roll-over (line hunting) capabilities to avoid blocking for their customers. PBXs and KSUs (key service units) in conjunction with Centrex features provide line consolidation functions which are not available with wireless services. That is, the business can save money by purchasing enough lines for its users to share without purchasing an individual line for each user. For example, a business with fifty employees with phone sets on their desks might need only 20 shared lines appearing on each of the desk sets to meet the company's daily average and peak calling needs. Can we imagine that a business would choose to pass 20 wireless phones around this medium sized office as an alternative to

[29] See 2003 AARP Policy Book at page 11-36.

its Wireline service? Wireless phones cannot provide many PBX type services that many businesses rely upon.

Businesses need additional lines. Businesses use additional lines for customer contacts, Internet access (dial-up or high speed) or fax machines. Consumers use extensions so that multiple family members can carry on conversations at the same time.[30] Teenagers, for instance, may require (or want) an additional line. It is precisely because of these consumer demands that Qwest has seen significant demand for second lines.[31]

Wireless phones do not have the capability of multiple line service. Instead, you would need multiple phones to accommodate this basic need. While there are some wireless plans that allow users to "share" minutes, there are no plans available that I am aware of, that allow multiple phones with the same number or that allow multiple lines on one wireless phone.[32] This type of convenience is only available with your landline basic local exchange service.

Another difference between landline phones and wireless phones is the ability to choose among long-distance carriers. With your landline basic local exchange service you are allowed to select different interLATA and intraLATA toll providers. Wireless

[30] Some wireless phones have a speakerphone capability, but this is not as convenient as having multiple handsets in different locations.

[31] I do not have a Qwest-specific growth percentage for second lines in Washington. Nevertheless, I think it would be fair to say that growth in requests for second lines is greater than growth in requests for new service. Line sharing is another way to enhance the capabilities of the local loop. Line sharing is not possible today with wireless technology. Regarding the impact of Line Sharing, the FCC stated, "…we are convinced that line sharing will level the competitive playing field and enable requesting carriers to accelerate the provision of voice-compatible xDSL-based services to residential and small business customers who, to date, have not had the same level of access to competitive broadband services as larger businesses." FCC Line Sharing Order at ¶ 35.

services may have limited toll options, but you are not allowed to select from among various providers for either interLATA or intraLATA toll calling. Businesses normally select their long distance providers after careful analysis of rate structures. That ability is eliminated when wireless service is purchased.

Local number portability (LNP) is another important benefit that is not yet available with wireless service. For instance, when I moved from Arvada to Highlands Ranch last year, Qwest was able to port my existing number to my new home. No such portability is available with wireless phones. While the FCC has required CMRS providers to implement LNP in the top 100 MSAs by November of this year, it is not clear whether the wireless industry will be able to make that deadline.[33]

Q. ARE THERE SAFETY ISSUES ASSOCIATED WITH SWITCHING TO A WIRELESS PHONE AND AWAY FROM YOUR LANDLINE LOCAL EXCHANGE SERVICE?

A. Yes. A critical safety feature for consumers and businesses alike is the ability to dial 911 to get emergency services. While some wireless services provide for 911 service, very few today provide for enhanced 911 service. Enhanced 911 allows emergency response units to determine precisely the location of the individual who may be within a building complex.[34]

Q. IS E-911 GENERALLY AVAILABLE TODAY FOR WIRELESS SERVICE?

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[32] The ability to have others get on other phones (extensions in the home) but on the same line to participate in a conversation is a common and expected feature of local service. Or, more accurately, it is not a feature, but an expected capability associated with having multiple outlets in the home.

[33] See FCC 03-153; CG Docket No. 02-278; **REPORT AND ORDER**; Released July 3, 2003.

[34] The AARP Policy Book states that the FCC should "…ensure that wireless carriers deploy wireless Enhanced 911 (E911) as soon as possible and should vigorously enforce the E911 Phase II completion deadline of December 31, 2005." 2003 AARP Policy Book at page 11-34.

A. No. The availability of E-911 is spotty at best, and can vary dramatically by carrier. The FCC and T-Mobile just entered into a $1.1 million Consent Decree regarding compliance with the E-911 Phase II rules.[35]

Q. DO CURRENT WIRELESS SYSTEMS HAVE TELE-TYPEWRITER CAPABILITIES?

A. Not generally. Certain digital wireless handsets are not TTY (tele-typewriter) capable. In fact, in certain locations consumers using text telephones (TTYs or TDDs (telecommunications device for the deaf)) will not be able to complete 911 calls to emergency call centers using new digital wireless services. The FCC has encouraged public safety organizations, vendors of TTY equipment for 911 call centers, TTY vendors and wireless service providers to work together to develop solutions, but for now, the problem remains.[36]

Q. ARE ALL WIRELESS PHONES HEARING AID COMPATIBLE (HAC)?

A. No. Currently only Wireline and analog wireless phones are HAC. The FCC released an order on July 10, 2003, however, requiring digital phone manufacturers to have at least two HAC models available within three years.[37] Until then, however, more than 6,000,000 Americans will not be able to use digital wireless phones.

Q. IS RADIO FREQUENCY (RF) RADIATION A CONCERN FOR WIRELESS BUT NOT WIRELINE PHONES?

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[35] See FCC Press Release Issued July 17, 2003. Phase II location requirements (X and Y location coordinates) are critical to an effective emergency response for wireless E-911 calls.

[36] See FCC Consumer Alert, "USE OF TTY DEVICES WITH DIGITAL WIRELESS PHONES", dated July 2, 2002.

[37] See FCC Order; WT Docket No. 01-309)

A. Yes. Another safety issue is the public concern with radio frequency (RF) energy from wireless handsets. The FCC requires that wireless phones sold in the United States demonstrate compliance with human exposure limits adopted by the FCC in 1996.[38]

Q. ARE THERE OTHER TECHNICAL AND QUALITY OF SERVICE ISSUES THAT DIFFERENTIATE WIRELESS PHONES FROM LANDLINE PHONES?

A. Yes. Dependability and quality of service are perhaps two of the biggest drawbacks for wireless service. I mentioned some technical issues above (E911 availability, TTY/TDD compatibility, hearing aid compatibility, inability to have multiple lines on a single phone, lack of number portability, no choice of long distance provider, etc.). Another prevalent issue unique to wireless phones is "dead zones." Anyone who has used a wireless phone has had conversations interrupted, lost or been unable to place or receive calls because of dead zones where service is unavailable. As wireless providers readily admit, there are places and times where you may not be able to complete or initiate a call due to limitations in network architecture or system capacity.

As a customer moves through an area, the cells must hand off the customer to other adjacent cells. When a carrier fails to hand off the call during a conversation, a dropped call results. If cell antennas are not optimally placed – or not placed at all -- there will also be dead zones where calls cannot be made or received because of

[38] See "CELL PHONE FACTS – CONSUMER INFORMATION ON WIRELESS PHONES", provided by the Food and Drug Administration and the Federal Communications Commission (http://www.fda.dov/cellphones/qa.html).

buildings, terrain or major highways.[39] The wireless providers frequently blame housing associations and community restrictions for "holes" in their service.[40] As such, if a consumer is relying solely on his or her wireless service, there may be times when callers cannot connect – even to leave a message on voicemail.

Wireless networks also have limited capacity. When an individual cell site has significant usage, the customer making a call will receive a fast busy or an announcement. Congestion (fast busy indicating all trunks are busy) on your local landline phone is rare.

Q. CAN INDIVIDUAL WIRELESS PHONES GO DEAD BECAUSE OF BATTERY FAILURE?

A. Yes. One obvious drawback to wireless service is the need to rely on batteries when not connected to a charger. Wireless phones vary widely in their battery life. Some phones have long standby battery life, but not very long "talk" battery life. As such, absent a charger, the business risks losing service when the battery dies. Even with a charger, batteries lose their ability to stay charged over time. This is not a problem with landline service.

Q. CAN WIRELESS USERS INCLUDE THEIR NUMBERS ON "DO NOT CALL" LISTS?

A. Technically the Telephone Consumer Protection Act of 1991 or TCPA affords the

[39] There are also "dead zones" within homes, buildings etc. For instance, my wireless phone will not work in my basement. In many commercial buildings wireless phones will not work unless you are standing at or near a window.

[40] The area where I live in Highlands Ranch, Colorado is well known by wireless providers as a "trouble" area. For instance, T-Mobile phones will not work at all in my neighborhood and AT&T Wireless phones provide only limited service.

same protections for wireless as Wireline consumers.[41] Nevertheless, it wasn't until a just released FCC Order on the TCPA that wireless users received assurances that wireless numbers could be placed on "do not call" lists.[42] Today in many states, consumers can ask the local provider of their Wireline service to place them on a no call list to prevent (or at least minimize) solicitation calls. At present, no such capability exists for wireless numbers. It appears, based on the FCC's recent TCPA Order, that wireless users may be able to use the national no call list in October of this year. If a business were to rely solely on wireless without "do not call" list capability, the marketing calls would certainly interrupt business.

Q. ARE WIRELESS HANDSET REQUIREMENTS PROBLEMATIC AS COMPARED TO WIRELINE PHONES?

A. Yes. As wireless carriers continue to evolve their networks, the handset requirements may change. For instance, AT&T Wireless is deploying its new Global System Mobile (GSM) network. This new GSM protocol is an international protocol that has been used in Europe for a long time. The new GSM network is overlaying and ultimately replacing AT&T's Time Division Multiple Access (TDMA) network. Once the GSM network is deployed, the dual mode (digital/analog) TDMA phones will no longer work.

The handset requirements are also problematic for consumers, business and for the development of competition. If a business wanted to change wireless providers, even if they use the same protocol, the business would likely have to buy new phones for its employees -- programmed for that provider. You can't take your Sprint PCS

[41] TCPA or Public Law 102-243 (1991).
[42] See FCC **REPORT AND ORDER**; CG Docket No. 02-278; Released July 3, 2003.

phone to T-Mobile, for instance, and ask them to program it for Sprint service. Further, a Cricket phone won't work on the AT&T network, and vice versa. This is a common problem and why consumers have perfectly good wireless phones laying in their junk drawers at home.

Q. WHY IS THE INCOMPATIBILITY OF WIRELESS PHONES A BARRIER TO THE DEVELOPMENT OF COMPETITION?

A. If a business decides to rely on wireless service, initiates service with a provider and purchases new wireless phones for its employees, that is a considerable sum of money. Those phones cannot be used with another carrier, and that is a sunk cost that must be considered when switching providers. This is true even if the new provider offers a "free" phone, after rebates. Such sunk costs will serve as a disincentive for businesses to move their service to another provider. It is precisely because of such disincentives that the Bell System divestiture decree, the Telecom Act of 1996 and regulatory agencies have required the ability to make inter and intraLATA "PIC" changes, implement 800 number and local number portability and other consumer friendly requirements.

Q. ARE THERE SECURITY ISSUES WITH WIRELESS PHONES THAT DO NOT OCCUR WITH A WIRELINE PHONE?

A. Yes. Security has long been an issue with wireless service. Not only are people able to listen in on conversations, but cell phone "cloning" can occur as well. Cloning occurs when an individual monitors radio wave transmissions and steals your electronic serial number and telephone number. The ESN/MIN is then used in another phone at your expense. Generally speaking, this type of insecure calling is unacceptable to businesses.

Q. DO YOU HAVE OTHER EVIDENCE THAT WIRELESS IS NOT A SUBSTITUTE FOR LANDLINE?

A. Yes, and I put this evidence in the "reality check" category. Typically consumers use one or the other of substitute products. Clearly, nearly every consumer that has a cell phone also has landline service, in other words, consumers don't use *either* wireless or landline service, they use *both*.[43] This fact refutes the contention by Qwest that wireless service is a substitute and competitive alternative for landline, because if it were, consumers would use either wireless or landline service, not both.

The reality of the matter is that wireless service is used to augment the communications needs of consumers and businesses who have landline service. These goods are not close substitutes – if they were, declining wireless prices would result in each of us bypassing the landline network and relying entirely on cellular phones (consistent with the economic definition of substitute). That has obviously not happened. Instead, wireless service is a complement to Wireline service.

Q. DOES PRICING IMPACT A PERSON'S DECISION WITH RESPECT TO THE SUBSTITUTABILITY OF WIRELESS?

A. Absolutely. Wireless pricing is confusing and anything but conventional. The variety of pricing plans was illustrated in Mr. Teitzel's testimony. He notes that "direct pricing

[43] Teenagers might be the exception to this statement. A teenager could have a wireless phone, but no landline phone. He or she would depend on the parents to provide the landline phone.

comparisons between Wireline service and wireless services are typically not straightforward…" and I certainly agree with that comment.[44]

With a landline phone you have predictability in your cost per month; that generally is not the case with wireless. Unlimited local calling is rare, so you must pick a usage plan. It may take months before a consumer or a business determines the best (most cost effective) plan for calling patterns. Further, if you oversubscribe – that is if you purchase too many minutes and you don't use them – the minutes are lost at the end of each month.[45] To make things more difficult, with wireless phones you must pay for "incoming" calls. So absent refusing all incoming calls, it is very difficult to control usage. Further, when we do go over our usage limit, high penalty rates apply.[46]

Many wireless calling plans include different rates by time of day and day or week. So you must take care in making calls during those transition periods or risk being billed for calls that you thought would be free. For instance, if you start a one hour call at 8:59 pm when your free (unlimited) "night" calling period begins at 9:00 pm, the entire 60 minutes will be deducted from your "anytime" minutes because the call started prior to the "night" period.

While some plans allow for free long-distance, you still must pay roaming charges when you are outside your local calling area. The roaming charges – initial or per day, plus per call charges – can be very expensive.[47]

[44] See Direct Testimony of Mr. Teitzel at page 18.
[45] Cingular Wireless is now offering a plan that allows a user to roll-over the "peak" minutes of use for up to one year.
[46] Penalty rates commonly range from 25 cents to 35 cents per minute.
[47] You pay additional roaming charges when making calls outside your home network, but **you do not receive calls** when you are outside your home network.

There is also the matter of initiating and terminating wireless service. If your existing wireless contract is not concluded you will need to pay a termination liability to get out of the contract. The new provider will likely require you to buy a new phone – since phones are not transferable among providers – sign a new contract, and require you to pay an "activation" fee.[48] You don't have to pay termination liabilities when you change local service providers and you don't need unique phones for each local service provider. These types of penalties and up-front charges would be terribly difficult to manage for a company.

In summary, wireless bills are never what you expect. There will be charges for roaming, incoming calls, text messages, or other features that are difficult or impossible to predict. Most businesses demand predictability in local service pricing. As such, while wireless service is a valuable and desired commodity, it is not a true substitute for landline service.

Q. CAN YOU SUMMARIZE YOUR TESTIMONY REGARDING THE SUBSTITUTIBILITY OF WIRELESS SERVICE FOR STANDARD LANDLINE SERVICE?

A. Yes. The table below provides the Commission with a partial list of differences between wireless and landline phone service. This list further clarifies and drives home the argument that wireless service is not the functional equivalent of landline service. The evidence Qwest should have presented in order to support its argument would be something along the lines of demonstrating that a minor increase in landline prices would

[48] Some providers will offer a "free" phone with activation of service for a specified period of time – usually one or two years. The free phone, however, is usually an older, outdated model and not the phone that

cause a massive shift away from local landline service to wireless service. I am skeptical that Washington businesses would scrap their existing phone systems, sacrificing each of the conveniences and necessities illustrated in the below table and "convert solely to wireless" for even significant price increases in landline service. Based on this economic reality, wireless cannot be considered a substitute or a competitive alternative to landline.

"Features" Comparison Wireline v. Wireless Service

Feature	**Basic Wireline**	**T-Mobile**	**AT&T Wireless**	**Cricket**
Quality of Service Issues:				
"Dead" Zones	No	Yes	Yes	Yes
"Dropped" Calls	No	Yes	Yes	Yes
Potential Capacity Constraint	No	Yes	Yes	Yes
Subject to Dead Battery	No	Yes	Yes	Yes
Data/Information Capabilities:				
Compatible w/ Fax Machine	Yes	No	No	No
DSL-Capable	Varies	No	No	No
Internet Access	Yes	Very Limited	Very Limited	Very Limited
Line Sharing Capable	Yes	No	No	No
Convenience/Consumer Issues:				
LNP Capable	Yes	Soon	Soon	Soon
Line Consolidation Capable	Yes	No	No	No
"Do Not Call" List Capable	Yes	Soon	Soon	Soon

most people would desire.

White Pages Listing	Yes	No	No	No
TTY/TDD Capable	Yes	Maybe	Maybe	Maybe
RF Radiation Risk	No	Maybe	Maybe	Maybe
Telephone Compatibility Issue	No	Yes	Yes	Yes
Hearing Aid Compatibility	Yes	Analog Only	Analog Only	Analog Only
Multiple Lines	Yes	No	No	No
Multiple Phones (Same Number)	Yes	No	No	No
Choice of InterLATA LD Provider	Yes	No	No	No
Choice of IntraLATA LD Provider	Yes	No	No	No
E-911 Capable	Yes	Very Limited	Very Limited	Very Limited
Secure	Yes	No	No	No
Alarm System Capable	Yes	No	No	No
Pricing Issues:				
Predictable Bill	Yes	No	No	Yes
Unlimited Minutes for $X	Yes	No	No	Yes
Same Price/Minutes Everyday	Yes	Some Plans	Some Plans	Some Plans
Contract Termination Penalty	No	$200	$175	$150
Penalty Rates for Exceeding Minutes	No	Yes	Yes	N/A
Charge for Incoming Calls	No	Yes	Yes	Yes

Q. AT PAGES 19 AND 20 OF MR.TEITZEL'S TESTIMONY HE REFERS GENERALLY TO "RESEARCH STUDIES" DONE BY QWEST IN IDAHO AND IOWA TO DETERMINE BUSINESS PERCEPTION OF THE

SUBSTITUTABILITY OF WIRELESS FOR WIRELINE. DO YOU HAVE ANY COMMENTS ON THE "STUDIES"?

A. Yes. Mr. Teitzel states "Interestingly, slightly over 30% of the business respondents in both surveys reported that they could solely rely on wireless service for the purpose of making and receiving telephone calls." As the Commission is well aware, a study is only as good as the survey instrument used to conduct the study. In this situation, Qwest limited the question to "telephone calls" and specifically eliminated the critical capability of data – Internet access. Businesses require efficient Internet access for email and data transmission and storage, even if its only dial-up access, and that capability cannot be duplicated with wireless service.

Q. ARE THERE ANY OTHER OBVIOUS FLAWS WITH QWEST'S SURVEY INSTRUMENT?

A. Yes. The question to the survey respondents reads, "….**could** they rely on wireless service…." not "….**would** they rely on wireless service." Much like my motorcycle and car example, business customers technically **could** rely solely on wireless service for telephone calls, but **would** they? I respectfully suggest that the results of Qwest's survey would have been very different had the question included Internet access and the word "would" instead of "could". If wireless service were in fact such a ready replacement for wireline business telephone service, why did Qwest have to phrase the survey in a misleadingly worded hypothetical? Qwest could just have asked how many businesses have made the substitution. That Qwest did not do so is telling.

Q. DO YOU HAVE OTHER COMMENTS ON QWEST'S STUDIES ON WIRELESS SUBSTITUTION IN IDAHO AND IOWA?

A. Yes. Qwest has not filed those studies with its testimony in Washington. The flaws that I have pointed out are obvious and based on the representations of Mr. Teitzel. There may well be other obvious and significant flaws in the studies.

VOICE OVER INTERNET PROTOCOL TELEPHONY DOES NOT PROVIDE EFFECTIVE COMPETITION

Q. MR. TEITZEL PROVIDES SEVERAL PAGES (21-27) OF TESTIMONY DESCRIBING VOIP AND HOW THAT SERVICE IS USED TODAY. DO YOU CONSIDER VOIP SERVICE TO BE EFFECTIVE COMPETITION FOR WIRELINE SERVICE?

A. No. It may be that someday VoIP services will be refined sufficiently to provide a substitute service, but today they are not. Service quality and equipment requirements make VoIP services limited in their application. The most common use of VoIP services today are by cable and Internet service providers who are trying to expand their service to include voice telephony. As Mr. Teitzel recognizes, it is difficult to compare the limited VoIP offerings to Qwest's basic business offerings.[49]

Q. DOES QWEST PROVIDE ANY EVIDENCE OF VOIP PROVIDERS ACTUALLY OFFERING SERVICES TO CONSUMERS OR BUSINESSES IN THE EXCHANGES FOR WHICH QWEST SEEKS COMPETITIVE CLASSIFICATION?

[49] See Direct Testimony of Mr. Teitzel at page 22.

A. No. At page 26 of Mr. Teitzel's testimony he states "…Qwest has no means of assessing the number of business customers served by alternative VoIP providers." Given this lack of empirical evidence, the Commission should not give any weight to the potential existence of some VoIP offerings in its deliberations. If Qwest cannot provide empirical evidence of effective competition by VoIP, it has not met its burden here. The Commission should not rely on the mere existence of VoIP technology to conclude that it has been deployed in this state and is a viable and effective competitive substitute for Qwest's business services.

D. OTHER INDICATORS OF MARKET POWER, WHICH MAY INCLUDE MARKET SHARE, GROWTH IN MARKET SHARE, EASE OF ENTRY, AND THE AFFILIATION OF PROVIDERS OF SERVICE. (RCW 80.36.330(1)(d))

Q. AT PAGE 11 OF MR. SHOOSHAN'S TESTIMONY HE STATES, "IF QWEST WERE TO RAISE ITS PRICES FOR BASIC BUSINESS EXCHANGE SERVICES IN THE CURRENT COMPETITIVE ENVIRONMENT, CLECS COULD EXPAND AND EXTEND THEIR SERVICE OFFERINGS."[50] DO YOU AGREE?

A. There is no evidence in the record to show that CLECs would expand and extend their service offerings if Qwest raised its retail rates. More importantly, there is no evidence in the record that Qwest has attempted to respond to competitive entry by reducing rates. In fact, Qwest offers no objective demonstration that it lacks market power or that it needs additional pricing flexibility to respond to competition.

[50] See also, the Direct Testimony of Mr. Teitzel at page 12.

Q. WHY IS QWEST'S RESPONSE TO COMPETITION, OR LACK THEREOF, PERTINENT TO QWEST'S REQUEST TO CLASSIFY ITS SERVICES AS COMPETITIVE?

A. Qwest's statements about market power and effective competition are interesting, but its actions speak louder than its words. Qwest just identified the number of certificated carriers and the number of lines "lost" to competition. It did not show any instance in which Qwest's competitor took its business, even after Qwest utilized its available pricing flexibility.

Indeed, Qwest has provided no evidence of how it has responded to this supposed competition. As noted in the Commission's 2000 Order, "Qwest can use banded rate tariffs, offer business services through a competitive affiliate, offer promotions, offer win back incentives, and lower prices in response to competition."[51] It appears that Qwest has not taken advantage of its existing pricing flexibility to respond to the limited competition it faces today. As such, until Qwest proves that its current flexibility is insufficient to respond to competition, and until effective, price constraining competition exists as required under RCW 80.36.330, Qwest's request for competitive classification should be denied.

Q. HOW DO YOU DEFINE MARKET POWER?

A. A company has market power if it is profitably able to charge supracompetitive prices. In short, market power allows the company to set prices profitably above competitive levels.

Q. AS DISCUSSED IN A PREVIOUS PORTION OF THIS TESTIMONY,

QWEST HAS IDENTIFIED NUMEROUS CLECS OPERATING IN ITS SERVICE TERRITORY. ARE YOU SUGGESTING THAT QWEST HAS MARKET POWER EVEN IN THE FACE OF ALL THESE ALTERNATIVE PROVIDERS?

A. Yes. As discussed above, the evidence Qwest has provided in this case is substantially based on the quantities of wholesale services purchased by CLECs – unbundled loops, UNE-P and resold business services. This "resale" competition – which leaves alternative providers dependent upon Qwest and its services -- is not sufficient to reclassify Qwest's business services. Further, even after 7 years of attempts to lure away Qwest business customers, the 161 registered CLECs evidently only have about 17 percent of the market by Qwest's own calculations.

Q. HAS QWEST ARGUED THAT IT IS HINDERED BY THE EXISTING REGULATION OF ITS BUSINESS SERVICES?

A. Not to my knowledge. Since we know that Qwest is not hindered from reducing rates, this complaint can only be seen for what it is – a not so hidden agenda to gain deregulation so that it can suppress the growth of real competition and ultimately increase rates. Again, this is not the type of response one would expect from a competitive provider. Instead, it is what you would expect from a monopoly provider with sufficient market power to raise rates without fear of a negative financial result.

Q. MR. TEITZEL SAYS "WERE QWEST TO INCREASE ITS BUSINESS RATES IN WASHINGTON, WHERE CLEC-BASED COMPETITION IS VIRTUALLY UBIQUITOUS, CUSTOMERS WOULD BE INCENTED TO

[51] See Commission's 2000 Order at page 8, paragraph 23 and at page 20, paragraph 70.

MOVE FROM QWEST TO AN ALTERNATIVE PROVIDER."[52] DOESN'T THAT STATEMENT SEEM TO INDICATE THAT QWEST IS CONCERNED WITH ITS PRICE LEVELS?

A. A simple reading of the testimony would seem to indicate that Qwest wants flexibility to reduce rates. But Qwest's actions speak louder than its words. Qwest has had the opportunity to reduce rates and it chose not to. If Qwest really believed the statement by Mr. Teitzel, then it would have responded to those few new entrants who have priced services below those of Qwest. Given Qwest's logic above, if Qwest would have reduced rates in response to the alternative offerings, it could have regained the lost access lines or at least have stopped the loss of those lines. Again, Qwest chose to do nothing.

Q. THIS CRITERION SUGGESTS THAT MARKET SHARE IS RELEVANT FOR THE COMMISSION'S CONSIDERATION IN DETERMINING WHETHER QWEST'S SERVICES SHOULD BE CLASSIFIED AS COMPETITIVE. PLEASE ADDRESS QWEST'S EVIDENCE ON MARKET SHARE.

A. It is important to note that the only information that Qwest provided in this docket relating to market share is based on resold services. Qwest provides number of CLEC lines served by resale, UNE-P and UNE-L. As discussed above, all of these services are various forms of Qwest resale. As such, they offer no proof of effective competition for Qwest. Qwest estimates a CLEC market share of about 17 percent.[53] Qwest did

[52] See Direct Testimony of Mr. Teitzel at page 12.
[53] See Direct Testimony of Mr. Teitzel at 8.

not provide an estimate of CLEC-owned lines.

Q. MR. SHOOSHAN REFERS TO MEASURES OF MARKET SHARE AND EASE OF ENTRY AS DETERMINANTS OF MARKET STRUCTURE.[54] HOW WOULD YOU DEFINE THE MARKET STRUCTURE IN WASHINGTON?

A. The market structure in Washington is characterized by an existing incumbent provider providing various forms of resale to new entrants. The new entrants are building facilities, but at a very slow rate due to limited financial resources and limited success in the resale market. This is not an effectively competitive market because the new entrants are still dependent upon the incumbent for the resold services.

Mr. Shooshan refers to certain economic texts for descriptions of markets, but those references are to effective and/or workable competition. Without facilities-based competition we have no effective or workable competition in Washington. Instead, we have primarily resale competition, which means that Qwest is still the underlying carrier.

Q. WHY DIDN'T QWEST PROVIDE EVIDENCE OF CLEC-OWNED LINES?

A. Qwest states that it "…does not have direct knowledge of the total number of access lines served by CLECs via CLEC-owned facilities."[55] The Commission, however, pursuant to RCW 80.36.330(5) did solicit line information from CLECs.[56] The Staff of the Commission reviewed and organized the data received from the CLECs and then distributed the information to the parties. Unfortunately, the information was not

[54] See Direct Testimony of Mr. Shooshan at 6.
[55] Id. a page 3.
[56] See ORDER REQUIRING DISCLOSURE OF INFORMATION; ORDER NO. 06; Docket No. UT-030614; dated June 30, 2003.

received in time to allow a complete review and analysis for inclusion in this testimony. Once Staff files the data in its testimony, with an explanation of the assumptions, I will review that information and provide comments in the next round of testimony.

Q. PLEASE COMMENT ON QWEST'S MARKET SHARE INFORMATION.

A. Qwest's market share estimate of 17 percent misrepresents the CLEC presence in the market. Qwest is profiting from each of the 104,019 lines it has identified as lines Qwest has lost to CLECs. For instance, if a customer in Seattle chooses to change his business service from Qwest to Integra, then Qwest simply replaces its retail revenue stream with a wholesale revenue stream. It is true that the revenue stream is reduced, but all of Qwest's costs are covered and profits are generated. Consequently Qwest's claims of lost lines and market share, when put in the proper light, are really complaints about reduced profits.

Q. AREN'T THE REDUCED PROFITS RESULTING RESALE COMPETITION JUSTIFICATION FOR COMPETITIVE CLASSIFICATION OF QWEST'S SERVICES?

A. No. There is no criterion in the statute referring to reduced profits. A reduction in market share implies lost revenues and profits, but not from resale. Qwest is still providing the underlying service, controlling the service quality and the cost of service for its dependent competitors. Qwest maintains market power because it is the underlying carrier with control over facilities, quality of service, speed to market, and all other important aspects of service provisioning. Resale is not the type of competition that would ultimately reduce Qwest's market power.

Q. RCW 80.36.330(1)(d) ALSO IDENTIFIES GROWTH IN MARKET SHARE AS A CONSIDERATION IN DETERMINING WHETHER EFFECTIVE COMPETITION EXISTS. DID QWEST PROVIDE EVIDENCE ON THAT ISSUE?

A. Yes. Not surprisingly, Qwest has focused on this measure. If you have a small number and double it, you still have a small number despite the 100 percent increase. Qwest has calculation growth in CLEC market share of about 32 percent from December 31, 2001 through December 31, 2002.[57]

Q. DO YOU FIND QWEST'S GROWTH IN CLEC MARKET SHARE TO BE EVIDENCE OF EFFECTIVE COMPETITION?

A. No. Again, we must remember that we are talking about resold Qwest services, not CLEC-owned services. Indeed, even a growth rate of 32 percent for CLEC owned loops would likely result in a very small total percent of the market.

Q. MR. SHOOSHAN SAYS THAT THE COMMISSION "…SHOULD NOT RELY ON CONCENTRATION RATIOS…."[58] PLEASE COMMENT.

A. Qwest does not want the Commission to focus on concentration ratios because they would show that Qwest's market power is not diminished by resale. Indeed, with the new found flexibility the competitive classification would provide, the potential for Qwest's to successfully exercise its market power would increase.

Q. WHAT IS YOUR RECOMMENDATION TO THE COMMISSION REGARDING QWEST'S EVIDENCE ON MARKET SHARE AND

[57] See Direct Testimony of Mr. Reynolds at page 13.
[58] See the Direct Testimony of Mr. Shooshan at page 8.

GROWTH IN MARKET SHARE?

A. The Commission should find that the Qwest calculated market shares – based on resold Qwest services – is not sufficient to show that effective competition exists for Qwest's business services at issue in this case. It is clear that Qwest is still the underlying carrier for all the "lost" lines to CLECs and, as such, the customers, while being ostensibly served by a CLEC, are captive customers of Qwest.

Q. ASSUMING STAFF FILES THE CLEC-OWNED LINE INFORMATION, SHOULD THE COMMISSION CONSIDER THOSE LINES TO BE COMPETITION FOR QWEST?

A. Yes. Where CLECs have provisioned their own lines, Qwest is no longer the underlying carrier. In those situations Qwest does lose its entire revenue stream and the CLEC, not Qwest, controls the quality of service, speed to market and other provisioning issues.

Q. IS CLEC-OWNED LINE COMPETITION THE TYPE OF COMPETITION THAT SHOULD BE CONSIDERED WHEN ADDRESSING THE CRITERIA IN RCW 80.36.330?

A. Yes.

Q. PLEASE COMMENT ON QWEST'S EVIDENCE OF "EASE OF ENTRY" INTO THE LOCAL MARKET.

A. Mr. Reynolds provides his opinion on the ease of entry. Indeed, he says "By using Qwest's facilities, CLECs can enter the market with ease."[59] Again, Qwest is relying on a "resale" standard for competition instead of a "facilities-based" standard. If

AT&T had been allowed to rely upon a "resale" standard for deregulation, it would have been declared non-dominant in the mid 1980s instead of the mid 1990s. Assuming Qwest's numbers, CLECs have only gained about 17 percent of the market with resale in 7 years. The CLEC-owned line market share is obviously much less. Entry into the local market is anything but easy as the next portion of this testimony will show.

V. MARKET FORCES ARE NOT SUFFICIENT TO CURTAIL QWEST'S MARKET POWER

Q. QWEST'S WITNESSES HAVE PAINTED A PICTURE OF A VIBRANT CLEC INDUSTRY TAKING MARKET SHARE AND GROWING DRAMATICALLY. IS THAT YOUR IMPRESSION OF THE CLEC INDUSTRY?

A. No. There were some heady days just after the 1996 Telecom Act was passed. The industry was excited at the prospect of opening the entire market to competition and that excitement extended to Wall Street. But after a few years of very limited success in trying to break into the local market, intense scrutiny of companies and business plans took the glow off the CLEC industry. The CLEC industry imploded in 2000, and the entire telecommunications sector suffered with it. The CLEC industry has still not recovered.

Q. HAVE YOU PERFORMED A FINANCIAL ANALYSIS THAT MAY ILLUSTRATE THAT THE COMPETITIVE INDUSTRY IS NOT NEARLY AS VIBRANT AS QWEST WOULD HAVE THE COMMISSION BELIEVE?

[59] See the Direct Testimony of Mr. Reynolds at page 14.

A. Yes. Attached to this testimony is an analysis that calculates the dramatic change in market value of the CLEC industry over the period of December 31, 1999 through January 17, 2003 based on the value of the common shares held by investors. For the major IXCs, the total decline in market capitalization over this period is a devastating 92 percent. The total decline in market capitalization for the CLECs and wholesale suppliers during that same period was a staggering 86 percent.[60] The RBOCs had a decline in market capitalization over the same period of 49 percent.

Q. PLEASE DESCRIBE IN MORE DETAIL HOW YOU CALCULATED THE CHANGE IN MARKET CAPITALIZATION.

A. As noted, this change in value was determined from December 31, 1999 to January 17, 2003. QSI created an analysis of 44 companies that comprise the vast majority of publicly traded CLECs and the four RBOCs to demonstrate the disparate financial strength of new entrants versus incumbent carriers. Market capitalization as of December 31, 1999 was used as the baseline value in this analysis for two primary reasons: (1) this point in time was still within the bull market period before the first significant market correction took place in the first quarter of 2000; and (2) the components necessary to calculate market capitalization, common shares outstanding and market price, were both readily available from publicly available sources such as websites that provide current and historical price quotes and Securities Exchange Commission ("SEC") filings.

[60] Attachment II lists the companies for which the change in market capitalization has been calculated.

The companies included in the analysis were classified into three categories:

(1) CLECs & Wholesale Suppliers
This category includes CLECs and wholesale suppliers. Not included are the CLEC divisions of the major IXCs – they are included in the third category described below. (The companies included in this category are identified in Attachment 1.)

(2) RBOCs
This category includes the four RBOCs: Qwest, SBC, BellSouth, and Verizon.

***(3) Major IXCs* – CLECs and Carrier's Carriers**
This category includes the major IXCs: Williams Communications, Level 3 Communications, Global Crossing, Sprint, WorldCom, and AT&T.

The Debt to Equity ratio was also determined for each company over the same time period to measure changes in relative financial strength based on the amount of debt used to fund operations versus stockholder's equity. Large ratios or ratios that increase over time indicate declining financial strength as debt becomes a larger component of the firm's capital structure. This can be attributed to a greater use of debt as equity markets dry up, declining stockholder's equity as a result of accumulated operating deficits, or a combination of both.

Q. PLEASE DISCUSS THE RESULTS OF YOUR ANALYSIS.

A. Of the 40 companies comprising the CLEC and IXC categories (Categories 1 and 3), 18 have filed for bankruptcy protection since December 31, 1999 with seven of these filings occurring in the last six months.[61] A few of the carriers that initially filed for protection have since closed down their operations and sold off their assets to competitors. The number of CLECs and IXCs that have reported negative

[61] See detailed listing of bankruptcy filing dates on Attachment II.

stockholders' equity due to accumulated operating deficits increased to 28 as of January 17, 2003 compared to eight as of December 31, 1999.[62]

The analysis demonstrates that the competitive carriers have suffered serious financial setbacks over the last two and one-half years. The capital markets have dried up for these providers and expanding operations is becoming more difficult. A more detailed breakdown of the decline in market capitalization for these three categories of carriers is found in Attachment 1.

Q. IN VIEW OF THE NATIONAL DECLINE IN THE CLEC INDUSTRY, SHOULD THE COMMISSION BE CAUTIOUS IN GRANTING QWEST'S REQUEST BASED ON RESALE COMPETITION?

A. Yes. Contrary to Qwest's claims, all is not well in the CLEC industry. Moreover, as discussed further below, the FCC is poised to change the rules for the ILECs' unbundling obligations, which may further hinder the development of competition and create additional uncertainty for CLEC business plans. This means that the Commission cannot rely on the CLEC industry to protect the ratepayers from Qwest's efforts to raise prices. Further, the Commission should recognize that carriers operating in Washington are not insulated from the financial difficulties of the CLEC industry and that for the foreseeable future most CLECs will remain dependent on Qwest for UNEs, access, and interconnection services. As discussed at length by Mr. Stacy, this dependency makes the CLECs extremely vulnerable to anti-competitive pricing strategies that Qwest could employ under its deregulation proposal. To be sure, if the

[62] The 28 carriers with Stockholder's Deficits as of August 28, 2002 include carriers that have filed for bankruptcy since December 31, 1999.

Commission approves Qwest's proposal, then the long-term viability of CLECs that use Qwest's UNEs is seriously impaired.

Q. IF THE COMMISSION CLASSIFIES QWEST'S BUSINESS SERVICES AS COMPETITIVE, SHOULD IT ASSUME THAT COMPETITION IS SUFFICIENT NOT ONLY TO CONTROL PRICES BUT ALSO TO CONTROL QUALITY OF SERVICE?

A. Yes. This is another way to determine whether effective competition exists in the marketplace. If the services are fully competitive then the Commission could forebear from enforcing quality of service rules. In other words, if the services in question are fully competitive then the market forces are sufficient to ensure quality service to consumers at reasonable rates. If the Commission is not willing to deregulate Qwest with respect to quality of service, it should also not deregulate Qwest's prices, terms and conditions for those services.

Q. ARE YOU RECOMMENDING THAT IF QWEST RECEIVES COMPETITIVE CLASSIFICATION THAT IT SHOULD BE RELIEVED OF ALL ITS QUALITY OF SERVICE REQUIREMENTS?

A. No. The point of the answer above is that when effective competition is present, that the market forces will ensure quality services at competitive rates. I certainly do not believe that effective competition exists today for Qwest's services. As such, the Commission must continue to regulate quality of service and other aspect of service delivery; not only to consumers, but to dependent competitors.

VI. ACCESS CHARGES MUST BE REDUCED TO COST-BASED LEVELS

Q. ASSUMING QWEST'S SERVICES ARE CLASSIFIED AS COMPETITIVE AS REQUESTED, WOULD THERE BE ANY ECONOMIC OR REGULATORY BARRIERS TO ENTRY FOR ALTERNATIVE PROVIDERS?

A. Yes. The fact remains that Qwest is the incumbent provider of the last mile and that alternative toll providers must still pay Qwest for access. Those access rates are not priced at TELRIC[63] levels and include significant contribution with which Qwest can subsidize its local and long distance competitive offerings.

Q. HOW DO YOU KNOW THAT QWEST'S ACCESS CHARGES ARE PRICED ABOVE TELRIC LEVELS?

A. Commission rule WAC 480-120-540 identifies the structure for access charges. That structure includes costs that are not TELRIC compliant – the Interim Terminating Access Charge or ITAC. The ITAC is really a universal service surcharge and should not be included in the access charge structure.

Q. ARE QWEST'S ACCESS CHARGES DESIGNED TO SUBSIDIZE LOCAL RATES?

A. Yes. In the just released Commission Order in the AT&T Access Complaint proceeding, it notes:

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[63] TELRIC stands for Total Element Long Run Incremental Cost. The FCC defines TELRIC as, the forward-looking cost over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element, calculated taking as a given the incumbent LEC's provision of other elements. (47 C.F.R. Section 51.505(b))

> Historically, access charges have provided a substantial portion of local exchange company revenues and have assisted, along with averaging of rates across high-cost and low-cost locations, in keeping rates for local exchange service lower than might be otherwise necessary.[64]

This is not unusual, since other states have also allocated the cost of the loop to other services. It is time, however, to rationalize the rate structure and make all subsidies explicit and portable.

Q. HAS THE FCC ALSO RECOGNIZED THAT ACCESS CHARGES AND OTHER RATES HAVE SUBSIDIZED LOCAL OFFERINGS?

A. Yes. In the FCC's First Report and Order in CC Docket 96-45 the FCC stated:

> States have maintained low residential basic service rates through, among other things, a combination of geographic rate averaging, high rates for business customers, high intrastate access rates, high rates for intrastate toll service and high rates for vertical features and services such as call waiting and call forwarding.[65]

The intrastate access charges cause market distortions by virtue of the excessive contribution they provide to Qwest. Access charge reform must be completed before Qwest is deregulated.

Q. DID THE COMMISSION RECOGNIZE THE NEED TO RESTRUCTURE ACCESS CHARGES IN THE VERIZON ACCESS CHARGE CASE?

A. Yes. At page 12 of that Order it states:

> It is clear that competitive circumstances have changed radically since the Commission's orders in U-85-23. The level and the structure of access charges that were permissible and competitively neutral when first adopted are now impermissible. And the record is also clear that

[64] See ELEVENTH SUPPLEMENTAL ORDER; ORDER SUSTAINING COMPLAINT, DIRECTING FILING OF REVISED ACCESS CHARGE RATES; Docket No. UT-020406; Released August 12, 2003; at pages 11-12. Hereinafter "Verizon Access Charge Order".

[65] Before the Federal Communications Commission; In the Matter of Federal State Joint Board on Universal Service; CC Docket No. 96-45; **REPORT AND ORDER**; dated May 8, 1997; at ¶ 14.

an activity countenanced in one rule may—inadvertently or not—act to stifle competition, and therefore violate another rule or law.

Q. IF QWEST IS DEREGULATED WILL IT HAVE ANY INCENTIVE TO REDUCE OR RESTRUCTURE INTRASTATE ACCESS CHARGES?

A. No. Access is a monopoly offering that provides significant contribution for Qwest. From a shareholder perspective, Qwest would be remiss to voluntarily reduce such rates. Nevertheless, the public interest requires Qwest to rationalize its rate structure and make the implicit subsidies within access charges explicit.

The industry is moving toward more and more bundled offerings. MCI's "The Neighborhood" offering combines local, long distance and other features into one flat-rate package. Qwest is offering similar "bundled" services. Assuming the best possible outcome – that Qwest does reduce service prices instead of raising them – then the services will be priced closer to cost. The margins for those services will be reduced thereby providing benefits to consumers. Qwest, however, will be able to use the subsidies inherent in access charges to subsidize its competitive offerings to the detriment of its competitors. In effect, Qwest can subsidize its competitive offerings with profits from its competitors. Mr. Stacy discusses this phenomenon in his testimony.

Q. DOES THE STATUTE PROHIBIT THE KIND OF ANTICOMPETITIVE CROSS-SUBSIDY YOU MENTION ABOVE?

A. Yes. RCW 80.36.186 requires that carriers offering noncompetitive services provide rates and access that are not unduly discriminatory and are not preferential or causing competitive disadvantage.[66] The Commission found in the Verizon Access Charge Order that "By maintaining high access charge rates, Verizon provides a preference to itself and a disadvantage to its competitors in interexchange service within Verizon's territory."[67]

Q. WHY IS ACCESS CHARGE REFORM REQUIRED PRIOR TO CLASSIFYING QWEST'S SERVICE AS COMPETITIVE?

A. The industry has recognized that implicit subsidies must be removed for the market to work efficiently. The FCC noted:

> It is widely recognized that, because a competitive market drives prices to cost, a system of charges which includes non-cost based components is inherently unstable and unsustainable. It also well-recognized that access charge reform is intensely interrelated with the local competition rules of section 251 and the reform of universal service.[68]

In its access charge reform proceeding, the FCC reiterated the benefits of moving access charges to cost:

> Restructuring rates to reflect more accurately cost-causation will promote competition, reduce per-minute charges, stimulate long-distance usage, and improve overall efficiency of the rate structure.[69]

The FCC also encouraged the states to identify intrastate implicit subsidies:

> Congress intended that states, acting pursuant to sections 254(f) of the Communications Act, must in the first instance be responsible for identifying intrastate implicit universal service support. Indeed, by our decisions in this Order and in our companion *Universal Service Order,*

[66] See Verizon Access Charge Order at page 13.
[67] Id. at 14.
[68] See *Local Competition Order*, at ¶ 8.
[69] Before the Federal Communications Commission; In the Matter of Access Charge Reform; Price Cap Performance /Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges; CC Docket Nos. 96-262, 94-1, 91-213, 95-72; **FIRST REPORT AND ORDER**; Released May 16, 1997; at ¶ 131.

> we strongly encourage states to take such steps.[70] (emphasis in original)

The FCC has made considerable progress in moving interstate access charges towards cost. The CALLS[71] and MAG[72] Orders issued in 2000 and 2001 respectively have reduced interstate access rates significantly and rationalized the rate structures. The introduction to the CALLS Order states:

> By simultaneously removing implicit subsidies from the interstate access charge system and replacing them with a new interstate access universal service support mechanism that supplies portable support to competitors, this Order allows us to provide more equal footing for competitors in both the local and long-distance markets, while still keeping rates in higher cost areas affordable and reasonably comparable with those in lower cost areas.[73]

As discussed above, the FCC has recognized that the implicit subsidies in access charges must be removed. It is imperative that those subsidies be removed **before** Qwest receives additional pricing flexibility. With those subsidies from access charges, Qwest will be able to cross-subsidize its competitive offerings on the backs of its competitors.

Q. INTERSTATE RATES ARE LOW, AT LEAST IN PART, BECAUSE COSTS HAVE BEEN MADE EXPLICIT AND RECOVERED THROUGH SUBSCRIBER LINE CHARGES AND A UNIVERSAL SERVICE FUND.

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[70] Id. at ¶ 11.
[71] CALLS stands for the Coalition for Affordable Local and Long Distance Service.
[72] The Multi-Association Group (MAG) Plan was put into place for rate of return carriers at the federal level. The Order (FCC 01-304) was released on November 8, 2001.
[73] Before the Federal Communications Commission; In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service; CC Docket Nos. 96-262, 94-1, 99-249, 96-45; **SIXTH REPORT AND ORDER IN CC DOCKET NOS. 96-262 AND 94-1; REPORT AND ORDER IN CC DOCKET NO. 99-249; ELEVENTH REPORT AND ORDER IN CC DOCKET NO. 96-45;** Released May 31, 2000; hereinafter referred to as the "CALLS Order", at ¶ 3.

ARE THOSE MECHANISMS IN PLACE IN WASHINGTON ON AN INTRASTATE BASIS?

A. No. There is no Washington universal service fund or an intrastate subscriber line charge in Washington. As such, many of the implicit subsidies still remain in Washington's intrastate access charges.

Q. ARE YOU AWARE OF ANY STATES THAT HAVE ATTEMPTED TO RATIONALIZE THE ACCESS RATE STRUCTURE IN THE MANNER YOU SUGGEST?

A. Yes. Last summer in Colorado the parties signed a stipulation that would have restructured intrastate access charges in much the same manner as I propose above. Intrastate access charges would have been reduced to interstate levels and an intrastate subscriber line charge (SLC) would have been put into place. The access restructuring was revenue neutral to Qwest and the proposed intrastate SLC was less than $2 per month per line. The Colorado Commission ultimately rejected the proposal, but it is important to note that Qwest, AT&T, MCI, Sprint and the Colorado Telecommunications Association supported the proposal. I have attached the stipulation for the Commission's consideration.

Q. IS THE LEVEL OF ACCESS CHARGES SOMETHING THAT THIS COMMISSION CAN RESOLVE IN THIS PROCEEDING?

A. Perhaps not. But until access charges are reduced to cost-based levels, Qwest will enjoy an artificial cost advantage in the market place – in both the local and long-distance markets -- that it can leverage into other markets. Allowing Qwest to charge its dependent competitors above cost rates puts those competitors at a distinct competitive disadvantage. Qwest will have every incentive to use those excessive profits against the competitors in the market. Mr. Stacy addresses these incentives and abilities in his testimony.

Q. WHAT IS YOUR RECOMMENDATION TO THE COMMISSION REGARDING INTRASTATE ACCESS CHARGES?

A. I recommend that the Commission specifically recognize that the current level of Qwest's intrastate access charges is far above economic cost, is not conducive to an efficient market and that the implicit subsidies in those access charges cause distortions in the market and hamper the development of competition. I further recommend that the Commission initiate a proceeding or rulemaking in which the rules surrounding the pricing of access and mechanisms for eliminating the implicit subsidies could be considered.

Specifically, I recommend that the Commission initiate a proceeding whereby three important issues could be considered:

1) The complete elimination of the Interim Terminating Access Charge;

2) The refinement of Qwest's access rates so that access charges reflect their economic cost and the rate structure reflects cost causation;

3) Development of an intrastate Universal Service Fund to ensure reasonable and affordable rates for all consumers in Washington.

Q. ARE YOU RECOMMENDING THAT THE COMMISSION RESOLVE THESE ISSUES BEFORE IT CONSIDERS FURTHER DEREGULATION OF QWEST?

A. Yes. First of all, Qwest has failed to show a need for additional pricing flexibility in this proceeding. Second, if Qwest were deregulated under these conditions – the lack of effective competition and access charges far above cost – the public interest would be harmed. The Commission should observe how Qwest behaves now that it has received 271 authority, encourage Qwest to use the pricing flexibility it currently has, fix the remaining rate distortions, and then – if necessary – consider granting Qwest additional pricing flexibility.

VII. TRIENNIAL REVIEW ISSUES WILL DRAMATICALLY IMPACT THE INDUSTRY

Q. WILL THE FCC'S TRIENNIAL REVIEW ORDER IMPACT THE INDUSTRY?

A. There is no question that the order to be released by the FCC sometime this year will dramatically impact the industry, the status of competition and the ability of CLECs to compete going forward. The press briefing on February 20, 2003, gave us an overview of what the FCC might do on key issues associated with the unbundling obligations of ILECs. The FCC has found that "…switching – a key UNE-P element – for business customers served by high-capacity loops such as DS-1 will no longer be unbundled based on a presumptive finding of no impairment."[74]

[74] See FCC Press Release entitled "FCC ADOPTS NEW RULES FOR NETWORK UNBUNDLING OBLIGATIONS OF INCUMBENT LOCAL PHONE CARRIERS", dated February 20, 2003, at page 2.

Q. MIGHT THE FCC'S ORDER IMPACT THE EVIDENCE IN THIS CASE?

A. Yes. Although the evidence in its current state is insufficient to justify the requested competitive classification, there is no question that if UNE-P is no longer available in its current form that the ability of CLECs to compete in the local market – even on a resale basis -- will be significantly impaired. UNE-P is the only resale pricing that permits switchless carriers or carriers who do not have facilities in a given area to accumulate customers on the basis of TELRIC costs of the platform elements. It is a primary market entry strategy for competitors who wish ultimately to become effective competitors to monopoly services.

Q. DO THE DEPARTMENT OF JUSTICE HORIZONTAL MERGER GUIDELINES ADDRESS THE POTENTIAL FOR CHANGING MARKET CONDITIONS?

A. Yes. Section 1.521 of those guidelines discuss changing market conditions and the impact of those changes on the firm's competitive significance. For instance, if the Triennial Review Order takes away UNE-P or somehow changes the availability or cost of services currently available to CLECs, that would change the relative strength of Qwest's position in the market. The guidelines state, "However, recent or ongoing changes in the market may indicate that the current market share of a particular firm either understates or overstates the firm's future competitive significance."

Q. WHAT IS YOUR RECOMMENDATION TO THE COMMISSION REGARDING THE POTENTIAL FCC ORDER?

A. I suggest that this is yet one more reason why the Commission should not grant Qwest's request for competitive classification of its business services at this time. Instead, the Commission should deny Qwest's Petition based on the current record and observe Qwest in the existing market.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.