

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

Request for Competitive Classification of
Basic Business Exchange
Telecommunications Services

DOCKET NO. UT-030614

REBUTTAL TESTIMONY

OF

HARRY M. SHOOSHAN III

ON BEHALF OF

QWEST CORPORATION

AUGUST 29, 2003

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I. INTRODUCTION

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Q. ARE YOU THE SAME HARRY M. SHOOSHAN III WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the contentions by various intervenors that: (1) UNE-based and resale competition is not effective competition [Direct Testimony of Susan Baldwin, August 13, 2003 (“Baldwin”) at 28-29; Direct Testimony of Timothy J. Gates, August 13, 2003 (“Gates”) at 14-17; Direct Testimony of Neil Cowan, August 13, 2003 (“Cowan”) at 6]; (2) Qwest has improperly identified the relevant market [Baldwin at 37-38]; (3) the Commission should consider the financial condition of the CLEC industry as evidence that there is not effective competition [Gates at 42-50]; (4) Qwest dominates the local market (wholesale and retail) and has a “significant captive customer base” [Baldwin at 34-41; Gates at 45]; (5) high concentration ratios demonstrate that Qwest has market power [Baldwin at 19-25; Gates at 45]; (6) no effective competition exists [Gates at 42, 44]; and (7) the Commission should delay its decision in this case because of the Triennial Review [Gates at 59; Baldwin at 60-61; Cowan at 16].

Q. WOULD YOU SUMMARIZE YOUR REBUTTAL TESTIMONY?

1 A. Yes. I respond to each of the arguments made by the Intervenors listed above.
2 First, I argue that effective competition exists from the many competitive local
3 exchange carriers (CLECs) that are offering service throughout the State as well
4 as from many wireless providers. I rebut assertions that Qwest has improperly
5 defined the market, whether in regard to geography, products or customers. I also
6 rebut Mr. Gates' assertion that the CLEC industry's financial condition is relevant
7 to the actual presence and activities of competitors in Qwest's service area. Since
8 competition is for customers and not for lines, I argue that UNE-based and resale
9 competition is effective competition. It is ironic that those Intervenors who have
10 chosen to rely on unbundled elements of Qwest's network rather than to deploy
11 their own facilities (e.g., AT&T and MCI) argue in this proceeding that only
12 facilities-based competition should be considered effective competition. Second,
13 I argue that Qwest has no "captive customer base," that the retail and wholesale
14 markets should be considered separately and that the Commission's regulation of
15 Qwest's wholesale offerings is unaffected by granting the pending petition. Third,
16 I argue that concentration ratios, considered out of context, are not good indicators
17 of market power and, indeed, say nothing qualitatively about the market being
18 "measured." Finally, I reiterate what I said in my Direct Testimony that the
19 Commission should not delay a decision in this case pending the outcome of the
20 Triennial Review. I observe another irony in Intervenors, on the one hand
21 disparaging UNE-based competition and, on the other, arguing that no action be

1 taken in this proceeding until any uncertainty about the continued availability of
2 UNEs is resolved.

3 **II. EFFECTIVE COMPETITION EXISTS IN THE**
4 **MARKET FOR BUSINESS BASIC LOCAL EXCHANGE**
5 **SERVICES**

6 **Q. PUBLIC COUNSEL WITNESS BALDWIN CLAIMS THAT QWEST HAD**
7 **NOT PROPERLY SPECIFIED THE MARKET IN TERMS OF**
8 **GEOGRAPHY, PRODUCT AND CUSTOMER SIZE [BALDWIN AT 37-**
9 **38]. HOW DO YOU RESPOND?**

10 A. I believe that Ms. Baldwin is wrong and that Qwest's petition properly specifies
11 the relevant market. In the first place, it is appropriate that the relevant
12 geographic market be Qwest's entire service territory since, as Qwest and Staff
13 have shown, CLECs are competing throughout the state.¹ Second, it is
14 appropriate that the product market is all of Qwest's retail basic business
15 exchange services because competitors are able—using Qwest's network and/or
16 their own facilities—to provide all the services Qwest is providing. For example,
17 Centrex, PBX trunks and individual basic exchange lines all perform the same
18 primary function. Customers may elect one over the other based on the line of

¹ "It is interesting to note that in 2000 when Qwest filed a petition for competitive classification of certain of its business services by wire center, Public Counsel argued that *defining the market by wire center was too narrow* precisely because some customers have locations in multiple wire centers that cannot be served from a single wire center." *Docket No. UT-000883, Direct Testimony of Sarah J. Goodfriend at 35.*

1 business they are engaged in, the size of their enterprise or simply personal
2 preferences. Finally, Qwest needs the same flexibility its competitors have to
3 tailor its products and price its services appropriately for all segments of the
4 business exchange market. This is true for large businesses which have greater
5 demand and often have multiple locations throughout the state. These large
6 businesses typically seek volume discounts based on their total voice and data
7 expenditures. Small businesses tend to vary widely in how they use
8 telecommunications services. Qwest must respond to those needs with tailored
9 offerings that are not constrained by average pricing or by the “one size fits all”
10 mold of tariffed offerings or even of uniform contracts. Ms. Baldwin contends
11 that CLECs are not interested in serving small businesses and that small business
12 customers will be harmed if Qwest’s petition is granted [Baldwin at 17-18, 36].
13 The other testimony in this case does not bear out this generalization. For
14 example, Mr. Slater, Integra’s CEO, indicates that “Integra’s primary target
15 customer is the small business owner with as few as two to three employees to as
16 many as several hundred employees” [Slater at 4].

17 In addition, CLECs are in the market and have offerings suitable for small
18 businesses. The fact that some CLECs might choose to more aggressively pursue
19 large businesses which offer a greater revenue opportunity is not surprising.
20 Freeing Qwest to compete will force increased competition “down” in the
21 business market and make smaller businesses more attractive to all competitors.

1 Nationwide, CLECs have gained the loyalty of many small and medium-sized
2 businesses due to their quality of service and attention paid, according to a
3 Yankee Group survey.²

4 **Q. HOW DO YOU RESPOND TO MS. BALDWIN'S STATEMENT THAT**
5 **MERE PRESENCE AND CAPABILITY ARE NOT ENOUGH TO SERVE**
6 **AS A CHECK ON QWEST'S EXERCISE OF MARKET POWER**
7 **[BALDWIN AT 16-17]?**

8 A. In my opinion, Qwest and the Staff have presented ample evidence that
9 competitors are present and actively competing for business customers in the
10 supply of business basic exchange services. Competitors include CLECs using
11 their own facilities and/or UNEs purchased from Qwest. Not only did Staff find
12 that the CLEC share of the local exchange business market in Qwest's territory in
13 Washington is substantially greater than 17%, it found that CLECs are now
14 serving customers in all but one of Qwest's wire centers in the state [Direct
15 Testimony of Thomas L. Wilson, August 13, 2003 at 14, 20]. In addition to
16 CLEC competition, there is intermodal competition from numerous wireless

² "The Yankee Group Reports CLECs Win Decisively Over RBOCs in Small and Medium Business Customer Loyalty Ratings," Yankee Group Press Release (October 8, 2002).

1 providers and, as Mr. Teitzel discusses, from VoIP.³ Further, it is generally
2 accepted in economic literature that the ability to expand operations quickly to
3 compete is relevant to the study of a market.⁴ We are talking here not about
4 “mere presence” (e.g., a competitor which has simply collocated in a wire center)
5 but rather about firms *already in the market that are actively offering services* to
6 business customers. These firms could easily expand and extend their reach and
7 their service offerings especially if they choose to utilize the existing Qwest
8 network. Ms. Baldwin is wrong to disregard this criterion.

9 **Q. MR. GATES TESTIFIES THAT “ALL IS NOT WELL IN THE CLEC**
10 **INDUSTRY,” CITING A 92% DECLINE IN CLEC MARKET**
11 **CAPITALIZATION FROM DECEMBER 31, 1999, TO JANUARY 17, 2003**
12 **[GATES AT 47, 49]. HOW SHOULD THE COMMISSION VIEW THE**
13 **FINANCIAL CONDITION OF THE CLEC INDUSTRY?**

14 A. The Commission should view this information cautiously. Most of the CLECs in
15 Mr. Gates’ Attachment 1 had excessive debt-to-equity ratios in 1999, a sign of

³ The FCC recognizes intermodal competition coming from “other platforms such as cable and wireless” and notes that almost half of U.S. businesses have implemented PBX facilities capable of providing IP telephony. *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338; *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98; *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147. Report and Order on Remand and Further Notice of Proposed Rulemaking (Rel. August 21, 2003), at ¶ 5 and ¶ 47 (Triennial Review Order).

⁴ The economic literature requires far less stringent conditions. Consider, for example: “Groups of firms making completely non substitutable products may nevertheless be meaningful competitors if they employ essentially similar skills and equipment and if they could move quickly into each others’ product lines should the profit lure beckon.” F. M. Scherer and David Ross, *Industrial Market Structure and Economic Performance* (Houghton Mifflin, Boston 1990) at 76.

1 over-reliance on debt. Much of this debt was in the form of extremely risky junk
2 bonds. By January 2003, the financial condition of many CLECs had
3 understandably worsened as the stock market contracted and as the least efficient,
4 most highly leveraged and poorly run companies fell by the wayside. During this
5 same period, as Mr. Gates concedes, the RBOCs also experienced an extensive
6 loss—up to 49% of their market capitalization. Mr. Gates’ analysis also shows
7 that Qwest was hit as hard as the CLECs, having lost 89% of its market
8 capitalization over this same period. Further, as I noted, the entire stock market
9 experienced a downturn, related to a general economic decline (beginning with
10 the bursting of the “high technology bubble” and exacerbated by the impact of
11 September 11, 2001). During the same period measured by Mr. Gates, the Dow
12 Jones dropped roughly from 11,600 to 8,800—a loss of 25%.⁵ The point is—
13 market capitalization throughout the economy fell during this period.

14 Mr. Gates’ analysis of CLEC capitalization is misleading. Many of the firms that
15 declared bankruptcy have emerged, in most cases free of the high-cost debt that
16 dragged them down (e.g., McLeod USA, Focal). The assets of those that went out
17 of business (e.g., Teligent, Winstar, and NorthPoint) have been purchased by
18 other operators (including AT&T and MCI) and should still be considered

⁵ My estimates are from a 5 year line graph tracking the Dow Jones Industrial Index obtained from <http://finance.yahoo.com/q?s=DJI&d=c&k=c1&a=v&p=s&t=5y&l=on&z=m&q=1> (obtained August 21, 2003). Since the market as a whole reflects a wide range of industries and risks, its swings are not going to be as great as those in more volatile industries such as telecommunications.

1 productive competitive assets.⁶ The competitors that remain in the market today
2 in Washington are presumably stronger firms with a greater—not lesser—
3 likelihood of long-term survival.

4 **Q. HOW DO YOU RESPOND TO THE ASSERTIONS BY THE**
5 **INTERVENORS THAT UNE-BASED AND RESALE COMPETITION**
6 **SHOULD SOMEHOW NOT BE CONSIDERED EFFECTIVE**
7 **COMPETITION [BALDWIN AT 28-29; GATES AT 14-17]?**

8 A. I strongly disagree. The Intervenors seem to suggest that competition should be
9 gauged by which company owns the lines used to provide service. Competition
10 should not be viewed in terms of which provider actually owns the facilities. A
11 CLEC that chooses to use resale, UNE loops or UNE-P to reach a customer
12 “owns” that customer just as it would if it chose to serve the customer with its
13 own facilities. Once the CLEC obtains the customer, the CLEC has the
14 opportunity to capture all of the retail revenue associated with that customer
15 (local, toll, vertical features, etc.). The fact that Qwest owns the underlying
16 *wholesale* facilities is not relevant to the consideration of whether or not effective
17 competition exists in the *retail* market. Put another way, the question is not where
18 the money ultimately goes in the chain of production (one should calculate Nortel

⁶ The FCC takes a similar view of these events, including the continued usefulness of facilities in the ground, and does not consider the current financial status of CLECs relevant to its unbundling policies. *Triennial Review Order*, at ¶¶ 38, 500.

1 and Lucent's local exchange "market share" if that were the case) but *where the*
2 *revenues go at the level of the market being analyzed* (i.e., the retail level).

3 **Q. MR. GATES, ON BEHALF OF MCI, STATES THAT "SERVICES**
4 **THROUGH RESALE HAVE NEVER BEEN CONSIDERED TO BE**
5 **EFFECTIVE COMPETITION" [GATES AT 14]. IS HE CORRECT?**

6 A. No. In the first place, I think it is misleading to accept Mr. Gates' generalization
7 that UNE-based competition is, in effect, "resale." The theory behind unbundling
8 was, in part, that it would permit competitors to create "value-added" by
9 developing innovative offerings that the ILECs were unwilling or unable to
10 provide. Especially by combining Qwest's network elements with their own
11 facilities and software, CLECs claim that they are able to differentiate their
12 offerings from those of Qwest.⁷

13 Moreover, Mr. Gates is even wrong about the constraining effects of "pure
14 resale." The Illinois Commerce Commission, for example, has clearly considered
15 resale as a valid form of competition. The Commission, in its order establishing
16 wholesale discounts for SBC's Ameritech Illinois and Central Telephone
17 Company (acquired by Ameritech Illinois), stated its views that

18 . . . a properly established wholesale/resale market would place
19 competitive pressure on both the incumbent LECs [Ameritech Illinois

⁷ See, for example, Z-Tel's claim that its "Z-line Business[®] . . . provides innovative, integrated voice solutions for business like yours," <http://www.ztel.com/portal/ztel/learn/i/zlinebusiness.jsp> (obtained August 27, 2003).

1 and Central Telephone Company], as well as new entrants into the
2 local exchange market. This pressure would be exerted in terms of
3 price, cost, and service quality . . . pure resale competition should not
4 be written off just because it may not be as beneficial as facilities-
5 based competition. **Wholesale/retail competition will put competitive**
6 **pressure on both retail rates and quality of service.**⁸ [emphasis
7 added]

8 Further, the FCC has long recognized that competition from resellers can
9 constrain pricing by the incumbent. For example, the FCC found that allowing
10 resale of wireless services encourages competitive pricing and discourages unjust,
11 unreasonable, and unreasonably discriminatory practices of the underlying
12 carrier.⁹ The FCC additionally found that the presence of resellers positively
13 affects the growth of the market for telecommunications services.¹⁰ The resellers
14 themselves have emphasized that resale is the “quickest method of developing
15 ubiquitous competition” and that “resale will be a particularly important market
16 entry strategy for small businesses that cannot afford the investments necessary to
17 construct their own facilities or purchase unbundled network elements.”¹¹ Finally,

⁸ *AT&T Communications of Illinois, Inc., Petition for a Total Local Exchange Wholesale Service Tariff from Illinois Bell Telephone Company d/b/a Ameritech Illinois and Central Telephone Company Pursuant to § 13-505.5 of the Illinois Public Utilities Act*, Docket No. 95-0458; *LDDS Communications, Inc. d/b/a LDDS Metromedia Communications, Petition for a Total Wholesale Network Services Tariff from Illinois Bell Telephone Company d/b/a Ameritech Illinois and Central Telephone Company Pursuant to § 13-505.5 of the Illinois Public Utilities Act*, Order (June 26, 1996) at 5-6.

⁹ *In the Matter of Interconnection and Resale Obligations Pertaining to Commercial Mobile Radio Services*, CC Docket No. 94-54, First Report and Order (June 12, 1996) at ¶¶ 3, 4, 10-11. In this proceeding, the FCC relied on its experience with wireline resale to expand its wireless resale policies (“CMRS Interconnection and Resale Order”).

¹⁰ *Ibid.* at ¶ 10.

¹¹ *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order (August 1, 1996) at ¶ 881 (“Interconnection Order”).

1 the FCC's long-awaited *Triennial Review Order* does not consider competition
2 differently based on the means of providing service.¹²

3 With regard to AT&T's reclassification as "non-dominant," Mr. Gates is incorrect
4 in his claim that resale was not considered a form of competition [Gates at 46].
5 While the FCC applied a more rigorous set of standards than required in this
6 proceeding because it was finding non-dominance, it considered resellers no
7 differently from facilities-based carriers, even "pure resellers" (those that did not
8 provide any of their own distribution facilities).¹³

9 **Q. MR. GATES ASSERTS THAT WIRELESS IS NOT A CLOSE**
10 **SUBSTITUTE FOR QWEST'S BASIC EXCHANGE SERVICES [GATES**
11 **AT 18-36]. HOW DO YOU RESPOND?**

12 A. Mr. Gates makes three fundamental errors in his analysis of wireless. First, in
13 comparing wireless and wireline, he includes a number of features that are beyond
14 the scope of this proceeding. For example, this case is about basic exchange
15 services and not broadband. Thus, whether or not wireless services provide high-
16 speed Internet access (and I would reject Mr. Gates' claim that they do not) is not
17 relevant to this case. Second, Mr. Gates is wrong when he asserts that wireless
18 service does not provide a substitute for certain functions that are provided using

¹² The FCC states in the *Triennial Review Order* that the Telecommunications Act of 1996 "allow[ed] full local service competition through three types of entry," meaning resale, UNE-based and facilities-based competition [¶ 36].

¹³ *In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, FCC 95-427, Order (Rel. October 23, 1995) at ¶ 61, for example.

1 basic exchange service. Mr. Teitzel provides an extensive discussion of the
2 mistakes in Mr. Gates' analysis.¹⁴ Finally, Mr. Gates misses the fundamental
3 point that wireless offerings need not be a perfect substitute for every facet of
4 wireline service as long as those capabilities and features are available from some
5 competitor(s). For example, while mobile wireless services may not provide
6 perfect substitutes for PBX trunks and Centrex service, as staff witness
7 Williamson points out, corporate LANs or WANs can easily be configured to
8 transport voice traffic as well as data between locations [Direct Testimony of
9 Robert T. Williamson, August 13, 2003 at 8].¹⁵

10 **Q. MCI WITNESS GATES STATES THAT IN EVALUATING QWEST'S**
11 **PETITION, THE COMMISSION SHOULD ASK WHETHER**
12 **SUFFICIENT COMPETITION EXISTS TO GRANT THE PETITION AND**
13 **WHETHER THE CONSUMERS IN THE STATE WILL BE BETTER OFF**
14 **BY DEREGULATING QWEST [GATES DIRECT AT 8]. HOW DO YOU**
15 **RESPOND?**

16 A. I think that the two criteria are inextricably linked. That is, if there is sufficient, or
17 in accordance with the statute, "effective" competition, then granting Qwest's
18 Petition can be presumed to be in the public interest. Allowing an effectively

¹⁴ See Rebuttal Testimony of David L. Teitzel, August 29, 2003 at 20-27.

¹⁵ The FCC, in numerous places in its *Triennial Review Order*, describes and discusses wireless service as simply another means of providing local exchange telecommunications service. [See, for example, *Triennial Review Order* at ¶¶ 5, 53 and footnote 231, citing Justice Breyer's interest in competition from wireless carriers.]

1 competitive market, rather than regulation, to govern the service offerings and
2 prices of all providers should provide a wider array of options for consumers.

3 **Q. MR. GATES STATES THAT QWEST OFFERS NO OBJECTIVE**
4 **DEMONSTRATION THAT IT LACKS MARKET POWER OR THAT IT**
5 **NEEDS ADDITIONAL PRICING FLEXIBILITY TO RESPOND TO**
6 **COMPETITION [GATES AT 36]. HOW DO YOU RESPOND?**

7 A. The definition of market power is the ability to sustain price increases profitably
8 (that is, without losing a substantial number of customers). In this proceeding,
9 Qwest has demonstrated that effective competition exists and, therefore, that it
10 lacks market power. I note that the evidence put forth by Qwest in this proceeding
11 that shows the company is losing business customers with rates *at their current*
12 *levels*.

13 **III. QWEST DOES NOT HAVE A CAPTIVE CUSTOMER**
14 **BASE**

15 **Q. PUBLIC COUNSEL WITNESS BALDWIN ASSERTS THAT QWEST**
16 **CONTROLS “APPROXIMATELY 95 PERCENT OF THE LOCAL**
17 **MARKET DIRECTLY THROUGH ITS RETAIL SERVICES OR**
18 **INDIRECTLY THROUGH ITS WHOLESALE SERVICES” [BALDWIN**
19 **AT 3]. IS THIS AN ACCURATE REPRESENTATION OF THE**
20 **MARKET?**

1 A. No, it is not. Ms. Baldwin inappropriately combines wholesale and retail
2 markets—in this instance to produce a high number that she then asserts
3 represents “a significant captive customer base” [Baldwin at 41]. It is well-
4 accepted that there are separately distinguishable markets at each stage of
5 production/distribution of goods. Business activities at the same level of
6 production/distribution are considered "horizontally" related. Business activity at
7 different levels of production/distribution are "vertically" related and considered
8 separate markets. Vertically-related markets can be thought of as steps on a
9 ladder with each step a stage of production. The top of the ladder, in this case,
10 would be the retail market.¹⁶

11 Ms. Baldwin’s market share calculation does not reflect a properly defined market
12 from the standpoint of demand. Market share is classically calculated on the
13 demand side (i.e., share of revenues or units sold), not on the supply side, as Ms.
14 Baldwin does here. The wholesale and retail telecommunications markets in
15 Washington have different sets of customers that make different decisions and
16 purchase different products, based on their different objectives. Ms. Baldwin’s
17 calculation improperly combines those separate markets.

18 As the evidence submitted by Qwest demonstrates (and as the Staff finds), there is
19 *active retail competition* for business customers virtually throughout Qwest’s

¹⁶ These relationships are similarly described in definitions contained in *The MIT Dictionary of Modern Economics*, [David W. Pearce, ed. (4th edition, 1992), at 188, 450].

1 service territory. This competition is the basis for seeking competitive
2 classification of the retail market for basic business exchange telecommunications
3 services. Qwest is not asking the Commission to deregulate the wholesale market.
4 Thus, if, as AT&T suggests, Qwest should attempt to “manipulate” wholesale
5 prices, degrade wholesale quality, delay provisioning or “do a myriad of other bad
6 acts to destroy competition” [Cowan at 5], the Commission has the ability to deal
7 with those transgressions in the context of its regulation of the wholesale market.
8 In sum, the extent to which Qwest retains market power in the wholesale market
9 should not be an issue in this case.¹⁷

10 **Q. IN YOUR OPINION, DOES QWEST HAVE A CAPTIVE CUSTOMER**
11 **BASE IN THE RETAIL MARKET FOR BUSINESS BASIC EXCHANGE**
12 **SERVICES?**

13 A. No. As Qwest has demonstrated, business customers have a range of choices.
14 While Qwest may retain a majority of the business retail market, it cannot be said
15 to have a “captive” customer base if customers have choices.¹⁸ The fact that,
16 faced with a number of options, customers might *choose* to stay with Qwest
17 means that they are anything but captive customers. Moreover, a market may

¹⁷ In his rebuttal testimony, Mr. Reynolds discusses the safeguards, including price floors, which protect competition from possible abuses by Qwest of its position in both the wholesale and retail markets. [Rebuttal Testimony of Mark S. Reynolds, August 13, 2003, at 7-9]

¹⁸ “Captive customer” is a term of art that appears to be primarily used in utility regulation to refer to customers who have no alternative source for that service but the incumbent utility. [See, for example, the website of North Pacific, an electric utility at www.north-pacific.ca/Glossary/WebHelp/captive_customer_core_customer_core_market.html.]

1 have one or more firms with large market shares and still be considered workably
2 competitive if (as is the case here) there are well-established competitors of
3 various sizes and entry and expansion is relatively easy (in this case by firms
4 using UNEs and/or resale).¹⁹ Where CLECs already account for a substantial
5 portion of business access lines, the fact that these CLECs can easily expand and
6 extend their capacity constrains Qwest's ability to raise its prices. Under such
7 circumstances, Qwest cannot be said to have *any* "captive customer base," let
8 alone a "significant" captive customer base.

9 **Q. ARE THERE ANY OTHER PROBLEMS WITH RELYING TOO**
10 **HEAVILY ON MARKET SHARE, HOWEVER IT IS CALCULATED?**

11 A. Yes. As I discussed at page 6 of my Direct Testimony, there is a danger in relying
12 too heavily on market share in a dynamic market. This is especially true where a
13 firm begins with one hundred percent of the market as a result of the old
14 regulatory compact which "guaranteed" Qwest a monopoly in return for
15 constraints on the company's rate of return (and, thereby, on its prices).²⁰ It is
16 changes in market share over time, rather than a measure of market share at any
17 one particular point in time, that are far more indicative of a competitive market.

¹⁹ See F. M. Scherer and David Ross, *Industrial Market Structure and Economic Performance* (Houghton Mifflin, Boston: 1990) at 52-55, 76. The Staff notes that the Commission classified AT&T as a competitive telecommunications company in 1987 at a time when it retained a very large market share (75%) [Wilson at 8].

1 **IV. CONCENTRATION RATIOS, CONSIDERED OUT**
2 **OF CONTEXT, ARE NOT GOOD INDICATORS OF**
3 **MARKET POWER**

4 **Q. INTERVENORS POINT TO HIGH CONCENTRATION RATIOS AS**
5 **EVIDENCE THAT THE MARKET FOR BUSINESS BASIC EXCHANGE**
6 **SERVICES IS NOT EFFECTIVELY COMPETITIVE [BALDWIN AT 19-**
7 **25; GATES AT 45]. HOW DO YOU RESPOND?**

8 A. The Commission should be careful about relying on concentration ratios *per se*.
9 A high concentration ratio alone is not enough to demonstrate market power. One
10 needs to consider factors such as demand and supply elasticity, including ease of
11 entry).²¹ A market can “appear” to be concentrated and yet be workably
12 competitive if these other factors are taken into consideration.

13 I note that, in responding to this point in my Direct Testimony, Mr. Gates counters
14 only rhetorically that “Qwest does not want the Commission to focus on
15 concentration ratios because they would show that Qwest’s market power is not
16 diminished by resale” [Gates at 45]. Mr. Gates never directly addresses the point I

²⁰ Landes and Posner discuss the special circumstances created for firms compelled by regulation to charge uneconomic prices. They note that, in those instances where regulation requires prices to be set so low as to deter entry, a large market share (even up to 100%) may actually be a symptom of *lack* of market power. William M. Landes and Richard A. Posner, “*Market Power in Antitrust Cases*,” 94 *Harvard Law Review* 937 (1981), at 976 (*Landes and Posner*).

²¹ *Landes and Posner* also point out that a number of market considerations are excluded from market share statistics, and that their exclusion may result in an over-estimate of a firm’s market power: adequate consideration of substitutes in terms of demand elasticity; adequate consideration of substitutes in terms of production; output elasticity of fringe competitors; and ease of entry of new competitors [*Landes and Posner* at 947-950].

1 made about the pitfalls of considering concentration ratios out of context and
2 especially about ignoring factors such as ease of entry. Ms. Baldwin calculates an
3 HHI and concludes that this is irrefutable evidence that Qwest continues to
4 dominate the local exchange market. Leaving aside issues about the accuracy of
5 her calculations, I strongly disagree with her conclusion. Here, the Staff correctly
6 notes that “(b)ecause evidence suggests that market shares are changing, an HHI
7 analysis quickly becomes stale” [Wilson at 25]. As with market share
8 measurements, concentration ratio calculations are “snapshots” of moments in
9 time, when what is much more revealing is the “motion picture.” As I read the
10 case presented by the Intervenors, it is uncontroverted that Qwest’s position in the
11 market (however it is calibrated) is declining, while competitors’ positions
12 collectively are growing. This is evidence that the market is competitive.
13 Fortunately, the Commission is required to consider qualitative, as well as
14 quantitative, factors in assessing the structure of the market and the conduct of the
15 various participants.

16 **Q. IN YOUR LAST RESPONSE, YOU STATED YOU HAVE CONCERNS**
17 **ABOUT THE ACCURACY OF MS. BALDWIN’S HHI CALCULATION.**
18 **PLEASE EXPLAIN.**

19 A. On page 2 of Confidential Exhibit SMB-4C, which contains the sources and
20 assumptions for the exhibit and Ms. Baldwin’s HHI calculation, she states that she
21 applied an adjustment factor of 50% to remove digital lines from the CLEC-
22 owned line totals provided in Staff’s analysis of the Commission-requested data

1 request. This is inappropriate in light of the testimony of Staff witness Wilson [at
2 10], where he states that he verified the data in Staff's Confidential Exhibit TLW
3 C-4 represents only analog (not digital) services.

4 **VI. THE COMMISSION SHOULD NOT DELAY A**
5 **DECISION IN THIS CASE BECAUSE OF THE**
6 **TRIENNIAL REVIEW**

7 **Q. IN YOUR DIRECT TESTIMONY, YOU SUGGESTED THAT RELIEF IN**
8 **THIS CASE SHOULD NOT BE DELAYED PENDING THE OUTCOME**
9 **OF THE TRIENNIAL REVIEW [DIRECT TESTIMONY OF HARRY M.**
10 **SHOOSHAN, JULY 1, 2003 AT 18]. INTERVENORS DISAGREE,**
11 **ARGUING AMONG OTHER THINGS THAT COMPETITION MIGHT**
12 **BE ADVERSELY IMPACTED BY THAT PROCEEDING [GATES AT 60-**
13 **61; COWAN AT 16; BALDWIN AT 60-61]. HOW DO YOU RESPOND?**

14 **A.** In my opinion, the Intervenors offer no compelling reason why the pending
15 Triennial Review proceedings should cause the Commission to delay deciding this
16 case. In the first place, the Triennial Review relates to the structure of the
17 wholesale market, not the retail market that is the subject of this case. As I
18 pointed out at page 19 of my Direct Testimony, a finding of "no impairment" by
19 the Commission in its Triennial Review proceeding would only come after the
20 Commission had found that alternatives (including self-supply) are readily
21 available and that competition would not be impaired if certain UNEs were

1 removed from the list. If this Commission were to remove UNE-P from the list of
2 required unbundled network elements for business customers, the CLECs that rely
3 on UNE-P will have a 27-month transition period during which it would still be
4 available for existing business customers.²² In addition, competitors would still
5 be able to use UNE loops and resale. Mr. Reynolds has noted that in all
6 geographic areas covered by Qwest's petition, competitors today are using either
7 resale or loops or both *in addition to* UNE-P.

8 Finally, I am struck by the irony of the Intervenors arguing, on the one hand, that
9 UNE-based competition should not be considered in assessing the
10 competitiveness of the retail market for business exchange services and, on the
11 other hand, that uncertainty about the future of UNE-P should be grounds for
12 delaying the decision in the present case.

13 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

14 A. Yes, it does.

²² *Triennial Review Order* at ¶ 532.