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	)	

Rebuttal Testimony of Mark L. Stacy

On Behalf Of

MCI, INC.

August 29, 2003

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I. INTRODUCTION

Q. ARE YOU THE SAME MARK L. STACY WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

II. PURPOSE OF REBUTTAL TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. My rebuttal testimony focuses on the direct testimony of Staff in this proceeding. Staff has performed a valuable service in this proceeding in gathering data that is helpful to the decision makers in this case. Unfortunately, Staff has drawn conclusions that are not supported by the data they have gathered.

Q. WHAT IS YOUR OVERALL REACTION TO STAFF'S TESTIMONY IN THIS PROCEEDING?

A. I have identified three major flaws in the testimony of Staff in this proceeding.

- First, Staff witness Thomas Wilson has drawn conclusions relating to market share that are not supported by the raw data available. This has resulted in Staff recommendations that are not consistent with the Commission's obligation to determine whether effective competition exists in Washington.
- Secondly, Staff appears to assume that CLECs are a single entity, acting in lockstep, and that CLECs are indifferent to the actions and activities of one another. This assumption is inaccurate, and invalidates Staff's conclusions.

- Finally, Staff, in its testimony, equates the mere presence of competitors with effective competition. As I have explained in my direct testimony, and will expand upon here, this is improper.

Q. HAS STAFF'S TESTIMONY GIVEN YOU ANY REASON TO CHANGE YOUR ANALYSIS REGARDING QWEST'S CONTINUED MARKET DOMINANCE IN THE STATE OF WASHINGTON, OR YOUR RECOMMENDATION THAT THE COMMISSION DENY QWEST'S APPLICATION?

A. No. In fact the additional analysis conducted by Staff in this proceeding has re-enforced the conclusions I reached in my direct testimony regarding Qwest's continued dominance of the marketplace, and the inappropriate timing of Qwest's petition for deregulation. My recommendation remains that the Commission deny Qwest's petition for competitive classification of basic business local exchange telecommunications services (Petition Services).

III. REBUTTAL OF STAFF TESTIMONY

a. Market Share

Q. DO YOU AGREE WITH STAFF'S CONCLUSIONS CONCERNING THE RELATIVE MARKET SHARE OF CLECS AND QWEST IN WASHINGTON?

A. No. The data provided by Staff does not support its recommendation to the Commission that Qwest's Petition be approved. In fact, based on an analysis which combines the data initially provided by Qwest in this docket with the additional data gathered by Staff, and eliminating CLEC lines provided via UNE-P and resale from the analysis, this data provides support for my recommendation to deny Qwest's Petition.

Q. WHY HAVE YOU ELIMINATED FROM YOUR MARKET SHARE CALCULATION ALL RESALE AND UNE-P CLEC SERVICES?

A. I eliminated lines used to provide services via these media because it is appropriate to do so in a market share/market concentration analysis. It is important to remember, and, I believe important to consider, that there are two markets that directly impact retail competition in Washington, that is, the retail market and the wholesale market. As noted in my direct testimony, Qwest is the sole supplier of wholesale inputs for CLECs providing retail service via UNE-P and/or resale, and, therefore, as the monopoly provider to captive CLEC customers of Qwest, Qwest is in the position to dictate what services end-use customers may choose from and at what price. Qwest is the underlying carrier of these lines to CLECs and, as such, the retail customers, while ostensibly served by a CLEC, remain captive customers of Qwest. Because of Qwest's complete monopoly in the wholesale market, it is not appropriate to include services offered by CLECs though resale or UNE-P in any market share analysis. To do so would skew the results of the analysis and understate Qwest's presence in the marketplace.[1]

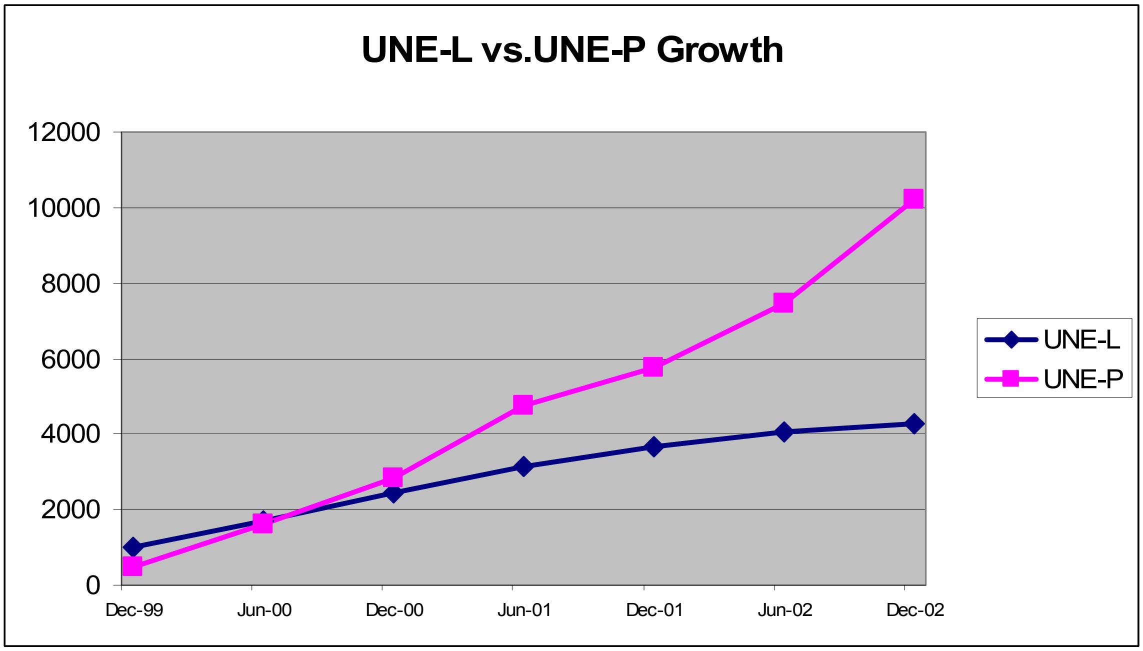
[1] In his rebuttal testimony, Mr. Gates offers additional support for the elimination of resale and UNE-P lines from this market share analysis.

Q. DOES THE PRESENCE OF ALTERNATIVE PROVIDERS USING RESALE OR UNE-P ACCOUNT FOR ANYTHING?

A. Certainly. Alternative carriers offering service via resale or through UNE-P is indicative of a market that is in its competitive infancy. The first stages of market development can be predicted to include carriers trying to get a toe-hold in the market place without the full commitment to market entry required by investing in facilities. Entry into the market via UNE-P or resale offer avenues for first stage entry for alternative carriers seeking to develop a customer base. However, the "milestone" referred to by Mr. Wilson at page 2 of his testimony is yet to be achieved.

Q. STAFF NOTES THAT UNE-P BASED COMPETITION REPRESENTS ONLY ABOUT A QUARTER OF THE CLEC LOOPS IN THE RELEVANT MARKET. IS THERE REASON TO BELIEVE THAT CLEC RELIANCE ON UNE-P MAY BE UNDERSTATED BY THIS STATEMENT?

A. Yes. According to the most recent release of the FCC's Industry Analysis and Technology Division's Trends in Telephone Service, CLECs offering service relying on UNE-P have increased faster than CLECs offering UNE loops (UNE-L). This trend can be seen in the chart below which compares the growth of UNE-P and UNE-L loops over the time frame tracked by the FCC.



If this national trend is mirrored in Washington, it can be expected that Qwest's unchallenged dominance of the wholesale (and thus retail) market will continue.

Q. AFTER ELIMINATING LINES PROVIDED VIA RESALE AND UNE-P FROM YOUR MARKET SHARE CALCULATIONS, WHAT DOES STAFF'S DATA SHOW?

A. The data is quite revealing. I have performed an analysis, which incorporates and relies upon the data used by Staff in the development of Staff Exhibits TLW-C-5 (including the additional CLEC lines discovered by Staff), and TLW-C-9. My analysis is illustrated in Exhibit No. MLS_Reb_1. After eliminating Qwest monopoly wholesale lines from the analysis, Staff's data shows that all CLECs in Washington combined, occupy only 16% of the share of the market on a statewide-average basis. Further, the analysis shows that CLECs have less than a 5% market share in 52 of the 66 exchanges in Washington. In other words, Qwest enjoys a market share exceeding 95% in more than three-quarters of the exchanges in Washington. Qwest's market share is greater than originally reported by Qwest and Staff. Moreover, as illustrated in this analysis, effective competition cannot be considered to be present in Washington.

Q. WHAT DOES STAFF'S CORRECTED DATA SHOW IN TERMS OF MARKET CONCENTRATION?

A. In terms of market concentration, based on the Hirschman-Herfindahl Index (HHI), the data show that of the 66 exchanges in Washington, 28 would have an HHI value of 10,000. The United States Department of Justice regards an HHI of 10,000 as representing a "pure monopoly".[2] This evidence demonstrates that the local market for the Petition Services is not subject to effective competition at this time. To the contrary, the figures indicate that Qwest continues to maintain a dominant position in the marketplace.

Q. DO YOU HAVE ANY ADDITIONAL THOUGHTS ON STAFF'S EVIDENCE REGARDING MARKET SHARE?

A. Yes. After acknowledging that its HHI analysis indicates a high market concentration, (evidence that is diametrically opposed to its ultimate recommendations), Staff downplays the significance of the results of the analysis, noting that the data relied upon would overestimate Qwest market shares, and that the analysis is static. Because, as I have indicated, data used by Staff in its market concentration calculations includes data that should not be included (which would tend to underestimate Qwest's market share), the Staff's first criticism of its market concentration analysis should be disregarded. Additionally, I would note that the results I obtained in my analysis account for the additional facilities-based lines Staff uncovered through the discovery process. In spite of these newly discovered lines, the fact remains that the 28 of the 66 exchanges in Washington have an HHI indicating a complete Qwest monopoly, and Qwest enjoys a 95% market share in more than 75% of Washington exchanges. In those other exchanges, the HHI ranges from 5,327 to 9,993, indicating an extremely concentrated market.

Q. CAN YOU COMMENT ON STAFF'S ASSERTION THAT THE MARKET CONCENTRATION ANALYSIS IS STATIC?

A. It is a valid point. This is a primary reason that it was not a major part of our initial analysis. However, Staff fails to mention that *any* market share analysis (including the analysis offered by Staff in support of Qwest's Petition) suffers from the potential of rapidly becoming stale. This is because should Qwest receive the relief sought in this proceeding, market dynamics will undoubtedly change dramatically, and likely in favor of Qwest. After all, Qwest seeks deregulation here presumably to improve its opportunity to win back market share that it has lost over the past nine years. Therefore, while it is true that market share data today will likely not be valid 12 or 18 months from now, it is very unlikely that the results of a market share/market concentration analysis performed in the future would show results that are more in line with Staff and

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[2] U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines.

Qwest's recommendations today. Future analysis would, more likely, show an increase in Qwest's market share. In other words, even if the Commission were to conclude that the market share analyses performed in this docket would support granting Qwest's Petition, (which I clearly do not believe they do), that information in and of itself would be insufficient to grant Qwest's Petition because of the negative impact on the public interest on a going forward basis. I note that the United States Department of Justice, the agency which authors the standards and principles of which the HHI is part, considers that if the result of proposed market modifications would elevate the HHI by 100 or more points, it is a matter of significant concern. Staff's observations about current competitor market share project from the present retail price regulated service into a non-price regulated future without accounting for the radical change in the competitive environment which would result from retail deregulation of Qwest. There is no basis in evidence for Staff's conclusion that competitor market share would be maintained into the future, much less grow in the new environment, and much reason for concern that Qwest's new and virtually unfettered pricing opportunity would produce quite the opposite result, resulting in a more concentrated market.

b. CLECs' De Minimum Market Share

Q. IS THERE ANOTHER ISSUE RELATED TO THE QWEST/STAFF DISCUSSION OF MARKET SHARE THAT YOU WOULD LIKE TO ADDRESS?

A. Yes. Implicit in the Qwest/Staff discussion of market share in this proceeding is the assumption that CLECs represent a unified force that competes as a single entity against Qwest. This is simply not the case. CLECs present in the marketplace must be cognizant not only of Qwest, but also of the other CLECs that are competing for the same customers. Implicit in the discussion by Qwest/Staff in this proceeding, is that CLECs are indifferent as to which carrier succeeds in winning customers so long as it is not Qwest. In fact, individual CLECs (with their *de minimus* market shares) battle not only Qwest, but also one another. In short, the statement by Staff that Qwest maintains a 75.5% market share should not be interpreted to mean that CLECs enjoy the market power of a single firm with 24.5% market share.

Q. EARLIER, YOU DESCRIBE INDIVIDUAL CLEC MARKET SHARES AS *DE MINIMUS*. WHY DID YOU USE THAT DESCRIPTION?

A. Because individual CLEC market shares in Washington are insignificant in comparison to Qwest's dominant market position. Over the past nine years, the majority of CLECs present in the local exchange market have been able to achieve only inconsequential market penetration.

Q. CAN YOU PROVIDE SUPPORT FOR YOUR ASSERTION THAT CLEC MARKET SHARES ARE *DE MINIMUS*?

A. Yes. Based on wire center data provided by Staff in Staff Exhibit TLW-C9, the average CLEC market share in any given wire center in Washington is 1.5%.

Even more illuminating is the fact that the median CLEC market share in the State is 0.3%.[3] These numbers demonstrate the relative insignificance of CLECs in the local market. The following table illustrates the comparison between Qwest market share and that of CLECs in Washington.

MARKET SHARE COMPARISON		
MEAN CLEC MARKET SHARE	MEDIAN CLEC MARKET SHARE	QWEST MARKET SHARE
1.5%	**0.3%**	**75.5%**

Q. IN DEVELOPING THIS INDIVIDUAL CLEC MARKET SHARE INFORMATION, DID YOU ELIMINATE ALL RESALE AND UNE-P LINES AS YOU DID IN YOUR PREVIOUS ANALYSIS?

A. No. Obviously, making that adjustment would reduce the CLEC market share values to even lower levels.

Q. IN YOUR OPINION, COULD THE AVERAGE CLEC CONSTITUTE ANY KIND OF MAJOR THREAT TO QWEST IN WASHINGTON?

A. No. And, should Qwest receive the relief it seeks for the Petition Services, individual CLECs would be extremely vulnerable to Qwest targeting strategies. The data clearly show that individual CLECs have a tiny fraction of the customer base enjoyed by Qwest. As the carrier with significant dominance in the market,

[3] The median market share represents the market share for which one-half of the values are lower and one-half of the values are higher.

if its services were deregulated, Qwest would pose a serious threat to these vulnerable alternative carriers.

c. Presence of Competitors

Q. IN SUPPORT OF ITS RECOMMENDATIONS, STAFF REPEATEDLY NOTES THAT "AT LEAST ONE TO THREE CLECS OFFER BASIC BUSINESS SERVICE IN EVERY QWEST EXCHANGE IN WASHINGTON EXCEPT ELK".[4] IS THIS AN INDICATION THAT EFFECTIVE COMPETITION EXISTS IN WASHINGTON?

A. No. As I alluded to in my direct testimony, even though certain Washington consumers have the ability to choose a provider for the Petition Services other than Qwest, the mere presence of alternative providers (as tenuous as it is) developed during a time in which Qwest was regulated and thereby, hindered in its ability to threaten CLECs' continued existence in the marketplace. Equating the presence of alternative providers to effective competition would inappropriately relax the standard for determining whether effective competition exists. I discussed this issue in my direct testimony, and this Commission addressed it in Docket UT-000883 when it found that Qwest failed to provide the Commission with sufficient confidence that competitors *are* offering and *will* offer competitive services (original emphasis).[5]

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[4] For Example, Testimony of Thomas L. Wilson, Jr., at page 4.
[5] Before the Washington Utilities and Transportation Commission, Docket UT-000883, Seventh Supplemental Order.

Q. ARE THERE OTHER REASONS THE COMMISSION SHOULD NOT EQUATE THE PRESENCE OF "AT LEAST ONE TO THREE CLECS OFFER BASIC BUSINESS SERVICE IN EVERY QWEST EXCHANGE IN WASHINGTON EXCEPT ELK" WITH EFFECTIVE COMPETITION?

A. Yes. Reaching such a conclusion would be subject to the criticism leveled by Staff regarding its conclusion related to the HHI results generated by the raw market share data, in that it is based on a "static" analysis. While it may be true that *currently*, there are one to three CLECs present in each Washington exchange, this data may quickly grow stale should Qwest receive relief in this docket. This is of particular concern given the *de minimus* individual CLEC market shares I discussed previously. Given the tenuous toe-hold many CLECs currently have in the market, (while Qwest is subject to this Commission's oversight), it is likely that the number of CLECs present in each exchange would decrease, if not be entirely eliminated. In short, I continue to believe that the Commission's determination that it is not only critical to examine whether alternative carriers *are* offering competitive services, but also to examine whether carriers *will* continue to offer competitive services, is the appropriate standard for determining whether effective competition exists.

d. Additional Rebuttal of Staff

Q. CAN YOU COMMENT ON STAFF'S CONCLUSIONS REGARDING QWEST'S "BREAK-EVEN" ANALYSIS?

A. Yes. Staff has concluded that because Qwest is able to achieve sufficient revenue in every wire center to pass an imputation test, "competitors can, too".[6] Unfortunately, this observation is meaningless in terms of assisting the Commission in its decision regarding whether sustainable, effective competition is present in Washington. This is because once again, this conclusion is based on static analysis which does not take account of the dramatic changes to the competitive market which would result from granting Qwest's Petition. As I noted in my direct testimony, one of the major threats to the competitive market, should Qwest's Petition be approved, is Qwest's ability to engage in price squeeze tactics, including setting prices that do not pass a break-even test. Therefore, the concern is not so much whether Qwest is passing such a test at this point in time, but rather, whether if Qwest will have the essentially unrestrained opportunity to engage in pricing tactics in the future that would result in Qwest's failing the test. Passing a break-even analysis test now – prior to deregulation – should be of little comfort to the Commission on a going forward basis. I would also note that Qwest, to date, has given the Commission no assurance that it will set prices which would pass a break even test in the future, or that it will set prices that cover costs, as required by RCW 80.36.330(3).

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

[6] Testimony of Thomas L. Wilson, Jr., at page 22.