Introduction and Qualifications

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Glenn Blackmon, Ph.D. My business address is 1300 S Evergreen Park Drive SW, Olympia, Washington, 98504. My e-mail address is ***blackmon@wutc.wa.gov.***

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Washington Utilities and Transportation Commission ("WUTC" or "Commission") as Assistant Director-Telecommunications.

Q. PLEASE STATE YOUR QUALIFICATIONS TO PROVIDE TESTIMONY IN THIS PROCEEDING.

A. I hold Ph.D. and master’s degrees in public policy from Harvard University and a bachelor’s degree in economics from Louisiana State University. I have been employed at the Commission since August 1995 and assumed my current position in April 1996. I previously served as the Commission’s economics advisor in the interconnection case, Docket UT-941464, and the major U S WEST general rate case, Docket UT-950200.

In my current position, I have testified before the Commission in various proceedings, including U S WEST's most recent general rate case (Docket UT-970766), the GTE/Bell Atlantic merger case (Docket UT-981367), the Qwest/U S WEST merger case (Docket UT-991358), and the generic cost and price case (Docket UT-960369).

Prior to working at the Commission, I was a consultant in private practice, where my clients included both regulated companies and consumer advocates, and I was an analyst for the Washington State Senate Energy and Utilities Committee. In addition to the telecommunications cases that I mentioned earlier, I have presented testimony as an expert witness before this Commission in electric and natural gas cases, as well as before the Illinois and Idaho commissions.

I am the author of a book, *Incentive Regulation and the Regulation of Incentives* (Boston: Kluwer Academic Publishers, 1994). I have authored or co-authored articles on utility regulation and economic theory published in *American Economic Review*, *Journal of Regulatory Economics*, *Yale Journal on Regulation*, *Journal of Risk and Uncertainty*, and *Public Utilities Fortnightly*.

Q. PLEASE DESCRIBE YOUR WORK AT THE WUTC AS IT SPECIFICALLY RELATES TO ISSUES OF COMPETITION AND REGULATION IN THE LONG-DISTANCE MARKET.

A. Under my direction the Staff has undertaken a broad-based and successful effort to increase competition in the state's long-distance business and to reform the regulatory treatment of long-distance services to match the increased competition. This effort included working with GTE-Northwest to allow customers to choose their 1-plus carrier for local toll calls (UT-960728), after which the Staff initiated a case in which the WUTC classified GTE-Northwest's toll service as competitive (UT-970767). Staff then brought a complaint case against U S WEST Communications to require that it open local toll service to competition (UT-980340). After prevailing in that case, Staff joined with U S WEST in a competitive classification process that permitted the company to begin pricing flexibly on the same day that consumers began having 1-plus choice (UT-990021). More recently, Staff undertook, again on its own initiative, a project to classify almost 150 long-distance and operator service companies as competitive (UT-990985, et seq.). The purpose of this effort was to reduce the level of regulation based on the presence of effective competition in the long-distance market. Finally, Staff has worked to ensure that long-distance carriers are not unreasonably hindered from market exit, specifically by supporting U S WEST's effort to exit certain local toll markets this year (UT-990976).

In addition, I have been directly involved in various efforts to protect the long-distance market from anti-competitive acts and practices, notably the effort by U S West and Qwest in 1998 to establish a joint marketing arrangement and the inadequate disclosure by national carriers of in-state rates that are tied to highly advertised state-to-state calling plans.

Summary

Q. WHAT ACTION DOES STAFF RECOMMEND THAT THE COMMISSION TAKE WITH RESPECT TO THIS MERGER?

A. Staff recommends that the Commission issue an order finding that the proposed merger would harm the public interest and denying the merger petition. The Commission should then give the applicants an opportunity to develop and submit an alternative proposal, in which either the transaction itself is restructured to remove the combination of the companies' long-distance and wireline local services or significant consumer protection conditions are offered.

Q. PLEASE EXPLAIN WHY STAFF IS RECOMMENDING THAT THE MERGER BE DENIED.

A. Staff has conducted a thorough review of the proposed merger, and based on the legal standards established by State law and prior Commission decisions, Staff has concluded that the merger, as proposed, is not consistent with the public interest. MCI WorldCom and Sprint are the No. 2 and No. 3 providers of long-distance service to Washington state consumers. The merger of these two companies would reduce consumer choice and competition. The long-distance market already offers consumers few alternatives, particularly after WorldCom and MCI merged in 1997. Indeed, there are today only three well-established "brand name" long-distance companies – AT&T, MCI WorldCom, and Sprint. The combination of two of those three companies can reasonably be expected to result in higher prices and reduced innovation, which would unambiguously harm consumers and the public interest.

Description of Washington State Long-Distance Market

Q. PLEASE DESCRIBE THE CURRENT STATE OF COMPETITION IN THE LONG-DISTANCE MARKET IN THIS STATE.

A. Most of the residential and business consumers in this state subscribe to one of three companies for interLATA long-distance service: AT&T, MCI WorldCom, and Sprint.[1] For intraLATA service, most consumers have chosen either their local exchange provider, e.g., U S WEST or GTE-Northwest, or one of the three big national long-distance companies.

Q. IS THIS CHARACTERIZATION OF THE MARKET BASED ON DETAILED STATISTICS REPORTED TO THE WUTC?

A. No. The WUTC does not require that long-distance companies file detailed reports on their market share or customer base. The companies report their annual intrastate revenues, which are our best indicator of the volume of business they provide in this state. The revenue statistics provide a rough measure of market presence, but they do not permit easy differentiation of important market segments, particularly between intraLATA and interLATA and between residential and business..

Q. WHAT DO THE INTRASTATE REVENUE STATISTICS INDICATE ABOUT THE CURRENT INDUSTRY STRUCTURE?

[1]"LATA" means local access and transport area and is a geographic designation created at the time of AT&T's divestiture of the Bell operating companies. In-state calls in Washington state are divided roughly evenly between interLATA and intraLATA (FCC Statistics of Communication Carriers, Table 2.6). The LATA distinction has no significance to most consumers, but it affects the state long-distance market because (1) customers can make separate choices for their 1-plus intraLATA carrier and their 1-plus interLATA carrier and (2) U S WEST is prohibited by law from providing interLATA service until it opens its local network to competition pursuant to 47 U.S.C. 271.

A. The market structure has over recent years become less concentrated, but the current proposed merger of MCI WorldCom and Sprint threatens to set that trend back several years. The most commonly used measure of market concentration is the Herfindahl-Hirschman Index (HHI). This index can range from zero in a perfectly competitive market to 10,000 in a perfect monopoly. The federal government's horizontal merger guidelines characterize a market as "highly concentrated" if the HHI value exceeds 1,800. The cutoff for "highly concentrated" is closer to the bottom of the range than the top because the HHI scale is not linear. The HHI would equal 1,667 in a market with six firms of equal size, 2,000 in a market with five firms of equal size, 2,500 with four firms of equal size, 3,333 with three firms of equal size, and 5,000 with two firms of equal size.[2]

As shown in Exhibit _____ (GB-1), the HHI for the Washington intrastate long-distance market is in the range of 2,100 to 2,800 for 1998, the most recent year for which revenue data are available. The higher value indicated in Exhibit ___ (GB-1) excludes the two predominantly intraLATA firms, incumbent local exchange companies U S WEST and GTE, because intraLATA and interLATA services are distinct (though closely related) market segments. The lower value indicated in Exhibit ___ (GB-2) includes U S WEST and GTE in the calculation of a single statewide figure. This statewide figure understates the current level of market concentration, because it incorrectly assumes that

[2]The formula for these calculations is $n*(100*1/n)^2$, where *n* is the number of firms in the market.

U S WEST's provision of intraLATA service could constrain the prices of AT&T, MCI WorldCom, and Sprint for interLATA service. However, I believe it is useful to consider the statewide value, because it shows that even if the existing distinctions between interLATA and intraLATA segments were to be erased, the market would still be classified as highly concentrated.

The more realistic HHI values (without GTE and U S WEST) show a decline in market concentration from 1994 to 1998. Even with Worldcom's acquisition of MCI, the HHI dropped from about 4,000 to about 2,800 over four years.

Exhibit _____ (GB-1) also shows the effect of the proposed merger of MCI WorldCom and Sprint on the industry concentration index. The merger would increase the HHI by about 440 points, to about 3,200. Under the federal government's horizontal merger guidelines, a merger that increases the HHI of an already highly concentrated industry by even 100 points is "presumed ... likely to create or enhance market power or facilitate its exercise."

Q. PLEASE DESCRIBE THE EASE WITH WHICH CUSTOMERS CAN SWITCH FROM ONE LONG-DISTANCE COMPANY TO ANOTHER IF THEY CHOOSE TO DO SO.

A. A customer could switch long-distance companies by authorizing the chosen company to initiate his service. The long-distance company submits the change order to the local telephone company, which charges the customer a fee. The fee ranges from $5 for U S WEST and GTE to as much as $13.52 for some of the smaller independent companies.

This is a relatively straightforward process, though it is complicated by the problem of "slamming." A customer is slammed when a long-distance company submits a change order without the customer's authorization. Because slamming has become a significant problem for consumers, it has become more common for consumers to "freeze" their accounts. The freeze protects against unauthorized changes, but it also makes it more difficult to make authorized changes. When a freeze is in place, the customer has to contact both the chosen long-distance company and the local telephone company.

Q. IS IT PRACTICAL FOR CUSTOMERS TO SWITCH FROM ONE LONG-DISTANCE COMPANY TO ANOTHER ON A CALL-BY-CALL BASIS?

A. There is a limited opportunity to use different carriers for different calls, though it typically involves off-brand carriers. These can be accessed by dialing an extra seven digits, such as "1010288" or "1010333." The WUTC has in the past determined (UT-980340) that these dial-around services are not an effective competitive substitute for 1-plus presubscribed service. Moreover, dial-around is not a viable method of switching among the three name-brand carriers, AT&T, MCI WorldCom, and Sprint, because these carriers do not offer their best prices to dial-around callers.

Q. WHAT IS THE ROLE OF RESELLERS IN THE LONG-DISTANCE MARKET?

A. Washington state has hundreds of long-distance companies registered to provide telecommunications service, including long-distance service. These companies typically purchase long-distance minutes from one of a few facilities-based wholesale providers, including AT&T, MCI WorldCom, and Sprint, and sell those minutes to end-use customers. In the aggregate, their share of the market is in the range of 10-15 percent. Even this small market share likely overstates these companies' effect on market prices, since they cannot be expected to constrain the prices of their own suppliers.

Q. IS LONG-DISTANCE SERVICE COMPETITIVE IN WASHINGTON STATE?

A. The long-distance market is, at this time, subject to effective competition. The WUTC has examined the state of competition in the long-distance market and determined, for every carrier in the market today, that effective competition exists. The presence of large, brand-name carriers like AT&T, MCI WorldCom, and Sprint, smaller facilities-based carriers like Frontier and Qwest, and resellers like Excel serves to provide consumers with reasonably available alternatives and prevent any one company from maintaining a captive customer base.

Q. ARE THERE ANY CONCERNS ABOUT THE CURRENT LEVEL OF COMPETITION IN THE LONG-DISTANCE MARKET IN THIS STATE?

A. Yes. While subject to effective competition, the market is by no means perfectly competitive. The state long-distance market is characterized by a relatively small number of providers. Moreover, the artificial division of the market into interLATA and intraLATA components restricts the effectiveness of competition. The WUTC had, even before this merger was announced, been particularly concerned about the paucity of competition in the interLATA market segment. In this market segment, customers are not permitted to make separate choices of carriers for in-state calls and state-to-state calls, and yet the long-distance companies are permitted to charge different prices for the two types of calls. This disparity in choice leaves customers somewhat at the mercy of the long-distance companies, and this is reflected in a tendency of the companies to price in-state interLATA calls higher than in-state intraLATA calls or state-to-state interLATA calls. Because the market has relatively few competitors already and has this structural problem, Staff believes that any significant industry consolidation raises serious concern about the competitive status of the entire market.

Q. COULD THE ANTI-COMPETITIVE EFFECTS ON THE LONG-DISTANCE MARKET BE ADDRESSED BY INCREASING THE WUTC'S REGULATION OF THE POST-MERGER LONG-DISTANCE COMPANY?

A. No, that is not a reasonable way of mitigating the negative effects of the merger. Certainly, if the long-distance market were to become less competitive because of some technological change or the exit of key firms, the WUTC would need to reconsider its current policy of very light regulation. However, the WUTC should understand that regulation of long-distance rates and services is an extremely poor substitute for effective competition. Innovation, efficiency, and consumer benefits are all greater with effective competition than with regulation, even the very good regulation that we do at the WUTC.

The fact is that the WUTC counts on long-distance competition to protect consumers, and it often bases policy decisions on the existence of effective competition. For example, the WUTC has at times reduced access charges, and it has counted on effective competition to ensure that those reductions are passed through to end user long-distance rates. Further access charge reductions can be anticipated, particularly when the state implements a universal service program, and the success of those reductions will depend on effective competition in the long-distance market.

Analysis of the Purported Merger Benefits

Q. WHAT BENEFITS DO THE APPLICANTS CLAIM WILL RESULT FROM THE MERGER?

A. MCI WorldCom witness David N. Porter claims five benefits: (1) better use of long-distance facilities through aggregation, (2) better economics for construction of local access facilities to bypass incumbents' networks, (3) more efficient deployment of Sprint's ION service using MCI's collocation space and local transport, (4) greater customer base for marketing of local services, and (5) greater deployment of fixed wireless service.

Q. PLEASE PROVIDE YOUR EVALUATION OF THESE CLAIMED BENEFITS.

A. The purported benefits do not justify the loss of competition in the long-distance market that would result from this merger. The first two reasons amount to nothing more than a claim that "bigger is better" in the long-distance market. I do not dispute that, from a technical or engineering perspective, a more "efficient" network could be constructed by aggregating all the long-distance traffic on a single network. If one carries that argument to its logical conclusion, we would revert to a monopoly industry structure. Moreover, these scale economies that MCI WorldCom is now arguing in favor of its merger should have prevented MCI from entering the market in competition with AT&T two decades ago. They were invalid then and are invalid now.

Regarding the deployment of Sprint's digital subscriber line service, ION, using MCI's collocation space and local transport, the purported gains appear to be based on speculation alone. MCI WorldCom and Sprint have not determined whether the technology behind ION is compatible with MCI WorldCom's overall plans, nor has this service proven itself in the market. If there are other collocation problems, Sprint should bring those to the WUTC for resolution, but that should not be a basis for merging two major long-distance competitors. At that time, the WUTC can ensure that Sprint has sufficient collocation space to deploy ION.

The assertion that the merged company can enter the local market more quickly than could either company alone also is not backed up by any specific plans. Staff has been unable to find any indication that either company was, on its own, planning to offer facilities-based local service to the mass market in the foreseeable future, and the companies have offered no specific plans for post-merger entry into this market. Even as a theoretical proposition, there is no basis to support the notion that the combined company could enter more quickly. The big obstacle to local entry is not the lack of a marketing base – each company already has more customers for long-distance and wireless service than it could possibly hope to serve with local service. Rather, the big obstacle to local entry is the lack of integration of operating systems between the incumbents and the entrants. The merger would do nothing to solve that problem; indeed, it could exacerbate it by diverting the companies' attentions as they integrate their own systems internally.

Finally, the promise of deployment of fixed-wireless service, MMDS, should not justify reducing consumer choices in the long-distance market. Both companies concede that technical and regulatory barriers remain before their fixed wireless plans can be implemented. Even if the problems are solved and the service becomes viable, any benefits would not outweigh the competitive harm to the long-distance market and in any case could likely be obtained in less harmful ways than a merger of two out of the big three long-distance carriers.

Q. CAN THE MERGER BE JUSTIFIED BY THE ABSENCE OF A MOBILE WIRELESS (CELLULAR OR PCS) SERVICE IN MCI WORLDCOM'S CURRENT PORTFOLIO OF SERVICES?

A. No. I do not disagree with MCI WorldCom's desire to seek to round out its portfolio of long-distance, data, Internet, and local services by adding a mobile wireless service. Except for a paging service, MCI WorldCom cannot offer its customers a branded mobile wireless service today. However, Sprint PCS is already part of the package of Sprint name-brand services. If bundling is good when it applies to MCI WorldCom, then surely the *unbundling* of Sprint's package of wireless and wireline services must be considered a negative result. Thus, the "bundling" argument nets to zero, and in any event, there are alternatives to merging that MCI WorldCom could pursue on the wireless front.

Q. WHAT ALTERNATIVES TO THE ACQUISITION OF SPRINT WOULD MCI WORLDCOM HAVE IF IT IS TO ADD MOBILE WIRELESS SERVICE TO ITS PORTFOLIO OF OFFERINGS?

A. The most desirable outcome would be for MCI WorldCom to develop a new mobile wireless service that would give consumers an additional choice. Even assuming that this approach is not feasible, MCI WorldCom would appear to have other alternatives. VoiceStream, for example, is developing a national PCS service and is as-yet unaffiliated with any wireline local or long-distance company. Nextel is another example of a national wireless provider that is not already integrated with a larger telecommunications company. If MCI WorldCom were to take this approach, consumers could end up with both MCI WorldCom and Sprint as competing providers of a full range of local, long-distance, and wireless telecommunications services.

Even if those alternatives would for some reason not fill MCI WorldCom's needs, there remains the alternative of acquiring Sprint's wireless assets without merging the wireline businesses of Sprint and MCI WorldCom. Indeed, a year before this merger agreement, Sprint restructured itself and created separate stocks for its wireless (PCS) and wireline (FON) businesses. The market capitalization of Sprint is now spread roughly half and half between the two stocks.

Q. HOW DO YOU EVALUATE THE "MEGA-BELL" CLAIM, I.E., THAT MCI WORLDCOM AND SPRINT NEED TO COMBINE IN ORDER TO BECOME BIG ENOUGH TO REMAIN COMPETITIVE WITH OTHER TELECOMMUNICATIONS COMPANIES SUCH AS AT&T, BELL ATLANTIC, AND SBC?

A. I am skeptical of that claim, particularly given the size of MCI WorldCom already. The applicants have not explained exactly why they need to get bigger in order to be competitive. Under the theory being advanced by the applicants, "big enough" is defined by the size – perhaps they would take it even farther and say the potential size – of other firms in the industry. It is hard to see how this theory reconciles with the notion of a competitive industry structure, since it leads inexorably to a highly concentrated structure.

By any objective standard, MCI WorldCom and Sprint, with annual revenues of $37 billion and $17 billion, respectively, would already seem to have the financial wherewithal to operate a telecommunications business. Moreover, if MCI WorldCom's motivation were simply to increase the scale of the firm, that objective could be met in ways more consistent with the public interest than a merger with a direct competitor. Sprint can add virtually nothing to MCI WorldCom's capabilities to offer long-distance telephone service. A merger partner with more international presence, more data capabilities, or a larger local telephone business would seem to contribute more business diversity. Whatever desire MCI WorldCom may have to become larger, it is not a reasonable or acceptable approach to enlarge by acquiring one of its major long-distance competitors.

Q. WOULD IT BE REASONABLE TO ALLOW THIS MERGER BASED ON AN EXPECTED REDUCTION IN "CHURN" OR TURNOVER IN EACH COMPANY'S CUSTOMER BASE?

A. No. I have no doubt that churn is seen by each company as a problem and an expense. MCI WorldCom and Sprint frequently lose customers, often to each other. Customers switch based on various offers, promotions, and advertisements; they leave when they get a better offer elsewhere. While both MCI WorldCom and Sprint attempt to win business from the other name-brand carrier, AT&T, the reality is that they often win customers from each other. However, what the companies may think of as a bother, an expense, and a business risk – customers switching from one long-distance carrier to another – is better known as customers exercising choice. Customers leave because they perceive that another carrier’s service or price is better. If Sprint and MCI WorldCom succeed in reducing “churn” by merging, they will simply have reduced customers’ opportunities to get a better price or better service by switching carriers. If churn is a problem for the long-distance companies – Sprint and MCI WorldCom in particular – they should work harder to retain their customers rather than attempting to reduce customer choice through a merger.

Role of Brand Names in the Proposed Merger

Q. WHY IS THIS MERGER VIEWED AS NOT IN THE PUBLIC INTEREST, WHEN THERE APPARENTLY WAS NO OBJECTION BY THE WUTC TO THE MERGER OF MCI AND WORLDCOM IN 1997?

A. The market was more concentrated after MCI and WorldCom combined than it was beforehand, and as the market becomes more concentrated the standard should be higher for future mergers. At the time of the MCI/WorldCom merger, MCI was the No. 2 long-distance carrier and WorldCom was the No. 4 long-distance carrier. MCI WorldCom today has a larger market share than did MCI in 1997, and even more significantly, Sprint today has a larger market share than did WorldCom in 1997.

Moreover, Sprint and WorldCom are qualitatively different companies. Sprint is a brand-name long-distance company that is a direct substitute for MCI's brand-name service, while WorldCom was a largely unknown company that provided more generic long-distance service that did not as directly compete with MCI.

Q. PLEASE EXPLAIN WHY SPRINT IS A "BRAND-NAME" SERVICE AND WORLDCOM WAS NOT.

A. According to *Advertising Age (7/12/99)*, MCI WorldCom and Sprint are today among the top 10 among all “megabrands” in the entire U.S. economy – not just within long-distance or even telecommunications generally. That is in sharp contrast to the MCI/WorldCom merger. At that time, MCI was a high-ranking brand name, but

WorldCom did not rank even among the top 200 names. MCI's advertising budget was $475 million at the time it was acquired by WorldCom, while WorldCom's own advertising budget was $10 million.[3] The most recent statistics show that MCI WorldCom has an advertising budget of $948 million, and the advertising budget of its acquisition target, Sprint, is $672 million.[4] In short, the MCI/WorldCom deal did not eliminate an independent name-brand long-distance service, while the MCI WorldCom/Sprint deal would do exactly that.

Q. PLEASE EXPLAIN THE SIGNIFICANCE OF SPRINT AS A "BRAND NAME" CARRIER, VERSUS WORLDCOM AS A "GENERIC" CARRIER.

A. Economists and marketing experts have long recognized that name brands are important to consumers. A company's brand name provides a signal to consumers about the quality and reputation of a product. Consumers face less uncertainty about a product's characteristics if it has a brand name. A brand name can be expensive to build and maintain, but it can allow a product to command a higher price. Competing unbranded products, even those of equal quality by any objective measure, typically must be priced lower in order to attract customers. If one company acquires a major competitor's brand name, that reduces competition and consumer choice as surely as would the acquisition of a competitor's production capacity.

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[3] "Marketing savvy tops WorldCom's bid for MCI," *Advertising Age*, October 1997.

[4] http://www.adage.com/dataplace/lna/index.html

Q. IS STAFF'S CONCERN ABOUT THE MERGER SIMPLY THAT THE SPRINT NAME WILL BE LOST AS AN INDEPENDENT BRAND NAME?

A. No. The concern is that the vast majority of consumers for whom brand name is an important product component will have substantially fewer choices of independent, alternative providers of long-distance service. MCI WorldCom might well maintain the Sprint brand name and use it to target particular market segments, much as General Motors uses various brand names in the automotive business. The problem is that consumers, most of whom do not perceive no-name services to be a viable choice, will lose the benefits that they currently enjoy from having three carriers, AT&T, MCI WorldCom, and Sprint, compete for their business.

Q. BUT DON'T ALL THE LONG-DISTANCE COMPANIES OFFER ESSENTIALLY THE SAME COMMODITY, SO THAT TWO BRANDED CARRIERS AND A VARIETY OF UNBRANDED RESELLERS ARE SUFFICIENT TO CONSTRAIN PRICES?

A. No. It's true that, at some technical network level, the services of major branded and unbranded providers are essentially the same, with some differences in how they transport the calls between the local exchange company switches at each end of the call. However, there are very real differences in how the competing companies approach key consumer issues such as price and customer service.

Both Sprint and MCI have, at various times in their history, introduced pricing plans that offered new opportunities for consumers. For example, earlier this year, after this Commission had criticized the big three companies for their failure to include in-state calls in the highly advertising state-to-state pricing plans, Sprint broke ranks with its competitors and offered the Sprint Sense Anywhere plan. AT&T quickly followed suit, though MCI WorldCom was at last report still considering its options. It seems most unlikely that Sprint would have come forward with that in-state pricing plan had the company been controlled by MCI WorldCom, and consumers would have fewer choices. Another, even more recent example is Sprint 1000 Weekends plan, which offers customers up to 1,000 minutes of state-to-state or in-state calling for a flat monthly fee.

Q. DO BRAND NAMES CONTRIBUTE TO CUSTOMER SERVICE?

A. Yes. Consumers make inferences about service quality based on brand name. Brands allow consumers to extrapolate from their experience with one product or service to the experience they are likely to have with another product or service that carries the same brand name. Both Sprint and MCI WorldCom have recognized the paramount importance of protecting their brand names and their reputation, because each has expressed concern that a poorly handled deployment of local exchange service could damage their brand name in other markets, such as long-distance service.

Role of Fiber Backbone Providers in the Long-Distance Market

Q. DOES THE EXISTENCE OF NEW PROVIDERS WITH LARGE INTERCITY FIBER BACKBONES ELIMINATE THE ANTI-COMPETITIVE EFFECTS OF THIS MERGER?

A. No. Interoffice transport, such as fiber and microwave radio, is simply one input to retail long-distance service. As the cost of these networks decreases, it becomes increasingly less significant as an input. There certainly are multiple providers of that transport between major cities. This reduces one potential barrier to entry and helps make the long-distance market more competitive, but it does not in any way eliminate the market power that AT&T, MCI WorldCom, and Sprint have through their heavy national advertising and branding.

Customer Service Issues

Q. YOU ALSO MENTIONED CUSTOMER SERVICE AS A DIFFERENTIATING CHARACTERISTIC OF THE THREE BRANDED COMPANIES. DOES THE PROPOSED MERGER THREATEN TO REDUCE CONSUMER OPTIONS IN THIS AREA AS WELL?

A. Yes. Customer service is a qualitative factor that cannot be readily measured, and all three branded competitors would almost certainly claim to compete based on the quality of their customer service. Yet customer service, at least as it is measured by the number of consumer complaints received by the WUTC, differs markedly among the three carriers. In 1999 the WUTC received 409 informal complaints from MCI WorldCom's customers - more than four times the 89 it received from Sprint's customers. About half that difference could be explained by MCI WorldCom's greater size. However, on a size-adjusted basis MCI WorldCom is twice as likely as Sprint to generate a consumer complaint. While there is certainly some room for companies to differentiate themselves on every dimension, including customer service, this merger would likely deprive consumers of the opportunity to choose Sprint's package of price and service.

Q. YOU HAVE USED 1999 STATISTICS IN THIS ANALYSIS. HAS MCI WORLDCOM'S RECORD BEEN IMPROVING IN 2000?

A. No. MCI WorldCom customers filed more informal complaints in January and February of 2000 than they did in the same two months of 1999. So far this year, MCI WorldCom's complaints are up 30% this year over last year.

Q. IS IT POSSIBLE THAT MCI WORLDCOM'S CUSTOMER SERVICE COULD IMPROVE AS A RESULT OF ITS ACQUISITION OF SPRINT?

A. Anything is possible, but I do not believe the WUTC should count on the merged company looking more like Sprint than like MCI WorldCom. MCI WorldCom has been constructed from various smaller long-distance companies, such as MCI, LDDS, Wiltel, and TTI National, but they have all been integrated into a single customer service operation. It would appear most likely that Sprint's customers would eventually be rolled into the same operation. Moreover, customer complaints are a function of more than how the customer is treated by a company's customer service staff. Complaints often start with a company's marketing and pricing practices, and Sprint's marketing and pricing will almost certainly be subsumed by MCI WorldCom's own practices.

<u>Potential Competition from U S WEST</u>

Q. DOES THE POTENTIAL ENTRY OF U S WEST INTO THE LONG-DISTANCE BUSINESS REMEDY THE LOSS OF SPRINT AS AN INDEPENDENT BRANDED PROVIDER?

A. No, it does not. I do not take issue with the notion that U S WEST represents an eventual name-brand competitor in the long-distance market. Indeed, the attempt by U S WEST and Qwest in 1997 to steer U S WEST customers to Qwest's long-distance service was driven, at least in part, by the fact that U S WEST had a stronger brand name than Qwest but could not itself offer long-distance service. While that particular joint marketing effort was opposed by this Commission and struck down by the courts, the same motivations likely resurfaced last year in the two companies' decision to merge.

Nonetheless, the Commission should not allow MCI WorldCom to swallow Sprint based on the prospect of U S WEST's entry into the long-distance market. That entry is far from certain at this point, because even assuming Qwest successfully acquires U S WEST, it may yet decide that the costs of obtaining approval for long-distance entry outweigh the benefits of being in that business. Moreover, there is no reason to believe that U S WEST would engage in the type of price-constraining competition that Sprint presently contributes to the market. U S WEST would more likely compete directly against AT&T for the legacy base of Ma Bell customers and would not necessarily offer the aggressive pricing plans that would constrain MCI WorldCom.

Finally, to substitute U S WEST for Sprint in the long-distance market would deprive consumers of one of the key benefits that was to have accrued from the Telecommunications Act of 1996. The fundamental point of that act was that competition should increase in both the local market and the long-distance market. Local competition would increase because legal and operational barriers to competitive entry would be eliminated. Long-distance competition would increase because the Bell operating companies would, after opening their local markets, be allowed into the long-distance business. If U S WEST simply substitutes for Sprint, consumers will get, at best, the same level of long-distance competition as they could have expected in the absence of the Telecom Act, when they had every reason to believe that the act would provide them with increased competition.

<u>Effect of Proposed Merger on Sprint's Incumbent Local Exchange Customers</u>

Q. DOES STAFF HAVE ANY CONCERNS ABOUT THE EFFECT OF THIS MERGER ON THE CUSTOMERS OF SPRINT'S INCUMBENT LOCAL EXCHANGE OPERATION?

A. Yes. Staff has two concerns. One is that the costs of the merger, whether those be one-time costs of the transaction itself or ongoing costs caused by the merger, should not be charged to the captive customers of Sprint's incumbent local telephone business. The applicants have said that they are committed to insulating customers from these costs, but Staff believes this commitment should be made explicit. The other concern relates to Sprint's decisions regarding deployment of advanced services. MCI WorldCom claims that it can help speed Sprint's planned deployment of its ION service in Seattle, and yet there are no plans to offer any form of ADSL service to Sprint's existing ILEC customers.

Conclusion

Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A. Yes.