Exhibit No. ___ (HEW-1T)
Docket No. UT-023003

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Review of Unbundled Loop and Switching Rates; the Deaveraged Zone Rate Structure; and Unbundled Network Elements, Transport, and Termination	)))))	DOCKET NO. UT-023003

DIRECT TESTIMONY OF HAROLD E. WEST III ON BEHALF OF VERIZON NORTHWEST INC.

COMPETITION

June 26, 2003
PUBLIC

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I. INTRODUCTION

Q. MR. WEST, PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND EMPLOYER.

A. My name is Harold E. West, III. My business address is 540 Broad Street, Newark, New Jersey. I am employed by Verizon Communications as Director — Regulatory Support. I am sponsoring testimony on behalf of Verizon Northwest Inc. ("Verizon NW") in this proceeding.

Q. MR. WEST, PLEASE DESCRIBE THOSE ASPECTS OF YOUR PROFESSIONAL BACKGROUND MOST PERTINENT TO YOUR TESTIMONY.

A. I graduated from Princeton University in 1980 with a Bachelor of Sciences degree in engineering. In 1991, I completed an Executive Masters program at the University of Pennsylvania and received a Master of Sciences degree in engineering.

I began working for New Jersey Bell (now Verizon-New Jersey Inc.) in 1980 as a central office equipment engineer. I then held positions of increasing responsibility in Service Costs, Rates, Product Management and Sales. I assumed my current position in December 1994. I have provided testimony before public utility commissions in Delaware, Maryland, Massachusetts, New Jersey, New York, Pennsylvania, Virginia, and Washington, D.C. on various marketing, policy, and pricing issues associated with competitive entry into telecommunications markets. I have also participated in interconnection agreement arbitration proceedings in Delaware, Maryland, New Jersey, and Pennsylvania.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will testify about the general state of competition in the local exchange market in the parts of Washington served by Verizon Northwest Inc. ("Verizon NW").

II. COMPETITION IN WASHINGTON

Q. PLEASE SUMMARIZE THE STATE OF COMPETITION IN VERIZON NW'S SERVICE AREAS IN WASHINGTON.

A. Competition is growing not only in Washington generally, but also in Verizon NW's service areas there. This competition is coming not only from competitive local exchange carriers ("CLECs"), which have already made significant investments in facilities in the high-revenue, high-growth areas of Verizon NW's territory in Washington, but also from wireless services, Internet-based services, cable television company networks, and government-owned networks.

With respect to the state of Washington generally, the FCC's June 2003 Local Competition status report ("FCC Report"), which shows data through December 2002, reveals that competition not only is substantial, but also has shown rapid expansion. According to the FCC Report, by EOY-2002, CLECs reported that they were serving 10% of all switched local access lines in Washington. Of the 406,750 end-user access lines that CLECs reported serving in Washington, 178,293 (or 44%) of these lines are served over the CLECs' own facilities, 118,203 (or 29%) over UNEs, and 110,253 (or 27%) via resale.[1/] For

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[1/] "Local Telephone Competition: Status as of December 31, 2002," Industry Analysis and Technology Division, Wireline Competition Bureau at Table 10 (June 2003) ("FCC Report").

the total access lines served over both the CLECs' own facilities and served over UNEs, the above figures represent an increase of over 18% from the period ending December 2001. It is likely that these figures significantly understate the actual level of CLEC competition, as CLECs serving fewer than 10,000 lines are exempted by the FCC from reporting. Indeed, the FCC data is based on reporting from only 11 CLECs, while Verizon NW is aware of at least 26 CLECs operating in its territory alone.

With respect to the areas of Washington served by Qwest Corporation ("Qwest"), the FCC found in its Section 271 approval order that AT&T, Rainier Cable, Time Warner Telecom, and XO Washington each provide facilities-based competition, and "represent 'actual commercial alternatives' to Qwest."[2/] After first targeting the urban markets in a state, it is very common for CLECs to then target the neighboring high-growth suburban areas. Washington is no exception to this rule — competition is rapidly expanding in Verizon NW's service areas. As noted above, at least 26 CLECs are now actively providing local service in Verizon NW's Washington territory. As of the end of March 2003, CLECs had 59 collocation arrangements in place, covering approximately **[BEGIN VERIZON NW PROPRIETARY]** XXXX **[END VERIZON NW PROPRIETARY]** of the access lines served by Verizon NW in Washington. From December 2001 to February 2003, the number of UNE lines served by CLECs grew by almost 62%. In

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2/ Memorandum Opinion and Order, Application by Qwest Commun. Internat'l, Inc. for Authorization to Provide In-Region, InterLATA Services in the States of Colorado, Idaho, Iowa, Montana, Nebraska, North Dakota, Utah, Washington, and Wyoming, WC Docket No. 02-314, FCC 02-332 ¶ 29 (2002) (internal citations omitted).

contrast, while Verizon NW was *adding* nearly 2,300 lines per month in 1999, by 2002 it was *losing* almost 2,600 lines per month.

CLECs' substantial investment in collocation facilities signals their serious commitment to competing in the most populous regions served by Verizon NW. CLECs have targeted the most densely populated areas in Verizon NW's Washington territory, including Everett, Kirkland, Redmond, Bothell, Woodenville, Mount Vernon, Pullman, Richland, Kennewick, and Wenatchee, as these locales offer the greatest growth and revenue opportunities. The Seattle-Bellevue-Everett area is especially attractive to CLECs, because 54% of Verizon NW's market in that area consists of multi-dwelling units. Multi-dwelling units are attractive targets for competitors because they can economically offer residents of multi-dwelling units a complete bundle of local exchange, cable TV, high-speed Internet, and wireless services without incurring the large investment costs associated with the typical residential customer.

CLECs are actively offering highly competitive bundled local and long distance calling plans in Verizon NW's service areas. For example, MCI offers "The Neighborhood" plan in Verizon NW's Washington territory, which includes unlimited local and long distance calling, as well as add-on features such as voicemail, call waiting, caller ID, speed dial, and three-way calling for a flat monthly rate.[3/] Allegiance Telecom offers businesses a complete package of

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[3/] *See* The Neighborhood, Residential Local Service at http://www.theneighborhood.com/res_local_service/jsps/default.jsp (visited on June 20, 2003).

telecommunications, including local, long distance, international calling, high-speed data transmission and Internet services.[4/]

Q. PLEASE DESCRIBE THE COMPETITION FROM GOVERNMENT NETWORKS.

A. Verizon NW is also facing competition from the Bonneville Power Administration ("BPA"), Public Utility Districts ("PUDs"), and at least one city.[5/]

In the center of the state (Chelan, Douglas and Grant counties), PUDs have built significant fiber-optic networks and continue to expand these facilities. The PUDs have captured significant local government, educational and health care customers, which in these smaller markets tend to be the "anchor customers" for a telephone company, and to provide a significant portion of revenues. They have also targeted other business customers. In addition, Grant PUD is building extensively to residential customers.[6/] PUDs in the Tri-Cities

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[4/] *See* Allegiance in the News, "Allegiance Telecom Introduces Service in the Seattle Area" at http://www.algx.com/about/2000/seattle_office.jsp ("Allegiance brings competition to the local marketplace, providing an economical single source for these business telecommunication requirements, all consolidated on one bill.") (visited on June 20, 2003).

[5/] *See* "Dot-Com Goes Rural," Seattle Times (Nov. 15, 1999) (describing BPA's offer to Washington public utility districts to lease capacity on high-capacity fiber-optic cables laid by the BPA); *see also*, "PUD Mulls Fiber Optics Role," Bellingham Herald (Sep. 5, 2000) ("BPA is letting PUDs market the cable capacity wholesale to potential users in their service areas. That potentially includes telephone and cable television companies, Internet service providers and local governments and school districts.").

[6/] *See* Zipp, Grant County Public Utility District, Fiber Optic Network at http://www.gcpud.org/zipp/thezippnetwork.htm (visited June 20, 2003).

area are also becoming active in such ventures, and PUDs in the northwest corner of the state are pursuing similar projects.

Many of the state's PUDs have formed a corporation called NOANet, which, at preferential rates, leases bandwidth on an extensive fiber-optic network built by BPA.[7/] These BPA facilities form an interexchange network to which the PUDs connect their new local networks. The effect is to almost completely bypass the existing networks of Verizon NW and other ILECs — also of CLECs and interexchange carriers.

The City of Mount Vernon has overbuilt Verizon NW's — and the cable company's — fiber rings and is capturing government, educational, health care, and business customers.[8/]

In municipal government and "public power" circles, such ventures are highly touted under rationales ranging from economic development to public revenue enhancement, and there is no sign this momentum will diminish. Such competition is significant not only because it may take business away from Verizon NW as does competition from the other sources I have discussed, but because it is invariably funded with tax money, revenues from other utility operations, and government grants — sources unavailable to Verizon NW. In

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7/ *See* CMON, Columbia Mountain Open Network, Bringing Broadband Communications to the Columbian Basin at http://www.sparwood.bc.ca/speed/cmon_background.htm (visited June 20, 2003).

8/ *See* "Rural Areas Gamble on Fiber-Optic Future," Puget Sound Business Journal (April 13, 2001) ("the city of Mount Vernon is spending approximately $2 million installing a fiber-optic network that will connect government offices, schools, hospitals and businesses.").

addition, government competitors are not subject to all of the taxes that apply to private firms (most notably, federal income tax), and, as government-financed entities, are not necessarily constrained by the requirement of obtaining a full return on their investment.

Q. PLEASE DISCUSS COMPETITION FROM WIRELESS PROVIDERS.

A. Wireless providers are also serious competitors to Verizon NW's wireline service. The FCC found that wireless subscriptions increased 25% in Washington from December 2000 to December 2002, to a total of over 2.8 million subscribers.[9/] Wireless subscriptions are thus rapidly approaching the nearly 4 million access lines that wireline providers serve in Washington. Approximately twelve competitors are providing wireless services in Verizon NW's Washington markets.

Wireless is rapidly becoming an increasingly attractive alternative to wireline service. Wireless carriers' share of total telecommunications revenues is growing strongly nationwide, while the share of ILECs' is dropping. A Yankee Group study has found that, "26 percent of the mobile users' minutes are already being displaced from wireline to wireless and 45 percent of mobile users indicated at least some substitution."[10/] The study predicts that, by 2006, U.S. mobile subscribers will increase by 50 percent and will "dominate personal calling

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9/ FCC Report at Table 13.

10/ *Wireless Use to Nearly Double by 2006 — Study*, Reuters (Sept. 16, 2002) (quoting Yankee Group study).

and severely cannibalize landline minutes of use."[11/] In addition, in its most recent report on wireless competition, the FCC cited a study finding that 20 percent of residential customers had replaced some wireline phone usage with wireless, and that 11 percent had replaced a "significant percentage."[12/] The FCC also cited a USA Today/CNN/Gallop poll finding that almost one in five mobile telephony users regard their wireless phone as their primary phone,[13/] as well as a study estimating that, by the end of 2001, wireless had displaced 10 million access lines, "primarily by consumers choosing wireless over installing additional access lines."[14/]

Q. PLEASE DESCRIBE THE COMPETITION PROVIDED BY CABLE TELEPHONY IN VERIZON NW'S WASHINGTON SERVICE AREA.

Verizon NW also faces competition for local voice and data service from Comcast, the nation's largest cable provider, which provides facilities-based competition over its cable network in Washington. Indeed, Comcast is already offering local and long-distance bundled plans customers in Verizon NW's

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[11/] Yankee Group News Release, *Consumers Abandon Landlines and Increase Mobile Call Volumes, Creating Strong Growth in the Wireless Market, Reports Yankee Group* (Sept. 16, 2002).

[12/] Seventh Report, *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, at 33 (2002) (citing *Carriers Said to Need New Tactics to Combat LD Substitution*, Communications Daily, Mar. 15, 2002 (citing Yankee Group analyst Knox Bricken).

[13/] *Id.* (citing Michelle Kessler, *18% See Cellphones as Their Main Phone*, USA Today, Feb 1, 2002).

[14/] *Id.* (citing *It's a Wireless Boom as More People Cut the Cord*, News Release, International Data Corp., Jan. 8, 2002).

Washington region.[15] Even before its acquisition by Comcast, AT&T offered cable telephony to more than seven million households nationwide, and served more than 1.5 million lines, including customers in the Seattle area.[16] Comcast has viewed its merger with AT&T as an opportunity to "accelerate its entry into this market" by combining Comcast's "financial and management strengths" with AT&T's "extensive experience and expertise in the design, roll-out, provisioning, operations, and marketing of cable telephony."[17] Following the merger, Comcast has reported that it is conducting trials of IP phone service on its cable network which it plans to begin offering this year and that it expects to substantially complete the upgrade and rebuild of its newly acquired systems by the end of 2004 for a total cost of $2.2 billion to $2.5 billion.[18] Thus, competition from an established and well-financed cable operator in Verizon NW's Washington territory is both substantial and rapidly growing.

Q. PLEASE DESCRIBE THE COMPETITION VERIZON NW IS FACING FROM INTERNET-BASED SERVICES.

A. Internet-based services are providing a number of alternatives that are eroding Verizon NW's business. As with wireless services, email is displacing significant

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15/ *See* Comcast, My Membership at http://www.comcast.com/Products/Telephony/Packages.ashx? LocResult&Zip=98201 (visited June 20, 2003).

16/ Applications and Public Interest Statement, *Applications for Consent to the Transfer of Control of Licenses, Comcast Corporation and AT&T Corp, Transferors, to AT&T Comcast Corporation, Transferee*, at 3.

17/ *Id.* at 3, 38

18/ Comcast 2002 Form 10K at 25.

volumes of wireline voice traffic, especially toll traffic, in both the business and the residence service markets. Even where this Internet traffic uses Verizon NW's network to some extent, the company's revenues are negatively impacted. Verizon NW receives only the flat monthly charge for the underlying basic telephone service, and receives no access charges for this traffic. In fact, increased Internet traffic makes investment demands on ILECs without generating any additional revenue to cover these new costs.

Voice-over-the-Internet ("VOIP") services are also beginning to displace Verizon NW's wireline services.

Q. HOW ARE COMPETITORS ABLE TO USE INTERNET-BASED SERVICES TO COMPETE WITH VERIZON NW?

In addition to email, competing firms take business from Verizon NW's wireline network using packet switch technology and Internet Protocol telephony to route voice communications over DSL or other data networks. So-called "softswitches" operate over broadband connections and can be used to route voice and data using Internet Protocol ("IP"). More advanced softswitches, known as "virtual central offices," even provide additional services such as call forwarding and voice messaging. In addition, softswitches remove the geographic constraints on conventional voice switching because calls can be routed to the Internet without passing through the switched telephone network to a central office.[19/] "The

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19/ Vicky Uhland, *Switchin' to Go*, Interactive Week, Jan. 15, 2001 ("A company can own one softswitch and 10 to 15 voice gateways and be able to access the entire country. Gone is the need for a central office.") at ZDNet, News, ZDNet Biztech Library at www.zdnet.com/intweek/stories/ news/ 0,4164,2674861,00.html.

economics of an IP packet-based platform are compelling. While a circuit switch network's price performance doubles every 80 months, that of an IP network doubles in about a quarter of that time, or every 20 months. Providing voice and data services over a single network is an economically attractive proposition. Carrying voice traffic on a packet platform saves up to 70% in operating costs, by [Bank of America] estimates."[20/]

The number of deployed high-speed lines used for Internet access in the United States has more than quadrupled between June 2000 and December 2002.[21/] While local exchange companies provide DSL service, cable companies

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20/ Wall St. Transcript Corp., Investext Rpt. No. 2003080, Analyst Interview: Telecommunications – Industry Report at *3-*4 (Sept. 22, 2000) (quoting Trent Spiridellis, Principal and Senior Equity Research Analyst, Banc of America Securities). *See also* A. Lindstrom, *Talkin' 'Bout Next-Generation Telcos*, Bus. Comm. Rev., May 1, 2001, at 14 (quoting P. William Bane, vice president of Mercer Management Consulting: "New business models based on the use of IP-oriented switches have an infinitely better value proposition for carriers. . . . They'll enable gross margins in the 60 percent-plus range and the ability to provide differentiated offerings.").

See also E.R. Jackson, U.S. Bancorp Piper Jaffray Inc., Investext Rpt. No. 2267558, Sonus Networks Inc.: Initiating Coverage – Company Report (Aug. 21, 2000):

> Packet switching takes advantage of very favorable technology trends. Currently, packet telephony offers potential reductions of up to 50% in switch per-port costs. This difference is very likely to increase due to the performance capabilities of data components doubling every 18 months due to the effects of Moore's law while the performance capability of voice components is only doubling every 10 years. . . . Faster, cheaper, smaller, and more versatile switching equipment is transforming the central office. The use of packet telephony infrastructures can result in a reduction of up to 90% in equipment space requirements. This important point is amplified as Central Office space is a very finite resource and is some of the most costly real estate worldwide.

21/ High-Speed Services for Internet Access: Status as of December 31, 2002, Table 7, Industry Analysis and Technology Division, Wireline Competition Bureau, June 2003; See also Status as of June 30, 2001, Table 7, issued February 2002.

are serving far more Internet access users with their cable modem technology. In Washington, cable companies retain the majority of residential and small business high-speed lines.[22/]

III. CONCLUSION

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING THE LEVEL OF COMPETITION IN WASHINGTON.

A. Data from the FCC and Verizon NW demonstrate that the Verizon NW's Washington market is becoming increasingly competitive across a broad range of technologies, particularly in the areas of concentrated service and growth, that these developments are placing increasing pressure on the company's service volumes and revenues, and that recent trends indicate that those pressures will only be increasing further in the foreseeable future.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

22/ *Id.* Tables 7 and 11.