

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of)	
)	
AT&T COMMUNICATIONS OF THE)	
PACIFIC NORTHWEST, INC.)	
)	Docket No.
to Remove Conditions on Its Competitive)	
Classification and Waive Additional)	
Requirements)	

DECLARATION OF RICHARD CABE, Ph.D.

1. My name is Richard Cabe. I am an economist in private practice, specializing in economic analysis of the telecommunications industry. My current resume is attached to this Declaration as **Attachment 1**.

PURPOSE OF DECLARATION & EXPERIENCE

2. The purpose of this Declaration is to address certain conditions placed upon AT&T Communications of the Pacific Northwest, Inc.'s ("AT&T") competitive classification in the State of Washington. For the reasons set forth here, I conclude that the Commission should remove the conditions it placed upon AT&T over sixteen years ago. Competition in the interexchange industry has proceeded more or less as might have been projected when the conditions were imposed, completely removing any vestiges of market power that may have persisted at that time. In short, I conclude that there is no longer any reason to impose different regulatory restrictions on AT&T than on other interexchange companies.

3. Briefly, my experience is as follows: I have presented testimony in matters concerning competition in the telecommunications industry to the public utility commissions of Alabama, Arizona, Colorado, Florida, Georgia, Iowa, Kentucky, Louisiana, Minnesota, Mississippi, Nevada, New Mexico, North Carolina, Oregon, South Carolina, Tennessee, Texas, Utah and to this Commission. I have also prepared sworn declarations and assisted in preparation of comments filed before the FCC.

4. Until May of 1999, I was employed as Associate Professor of Economics and International Business at New Mexico State University. In that position, I taught graduate and undergraduate economics courses and arranged the telecommunications curriculum for conferences sponsored by the Center for Public Utilities.

5. My experience with telecommunications regulation began in January of 1985 when I was employed by the Washington Utilities and Transportation Commission. During my employment at the Washington Commission, I served as a staff member to the Federal - State Joint Board in CC Docket No. 86-297. When I left this Commission's staff to complete my doctoral degree, my title was Telecommunications Regulatory Flexibility Manager. My consulting clients since that time have included aspiring new entrants into the local telecommunications market, state commissions, and consumer advocates.

HISTORY OF THE CONDITIONS PLACED UPON AT&T

6. In 1987, as a member of the Washington Commission's Staff, I concluded that AT&T was subject to effective competition except for certain diminishing "vestiges of market power" based on events stemming from what was then a recent structural change in the industry: the break-up of the vertically integrated Bell system in which AT&T's

interexchange business, operating in increasingly competitive markets, divested the local exchange monopolies held by the Bell Operating Companies ("BOCs"). I concluded that AT&T could no longer operate as anything but "just another long distance company."

7. In 1987, I testified on behalf of Staff in Docket No. U-86-113. In that proceeding the Commission classified AT&T as a competitive telecommunications company. Based on the statutory tests for classification as a competitive telecommunications company, I recommended that AT&T should be classified as a competitive company, but that at least one restriction not applied to other carriers was appropriate for a limited time because of "vestiges of market power." My testimony expressed the belief that, with the passage of time, these "vestiges of market power" would be effectively removed by the forces of competition, eliminating the need for the restriction after January 1, 1989.

8. The conditions the Commission placed upon AT&T were as follows:

- (1) AT&T shall continue charging geographically uniform rates;
- (2) AT&T shall continue providing service in all areas of the state;
- (3) AT&T shall be restricted in its ability to charge prices charged to customers using one hour of long distance service per month relative to the prices charged to customers using ten hours of long distance service per month, (In applying this restriction, reference should be made to Mr. Cabe's testimony, Exhibit T-40, pages 38-40); and
- (4) AT&T shall be restricted from placing prohibitions or surcharges for resale or shared use of any interexchange service or facility.¹

¹ *In re Petition of AT&T for Classification as a Competitive Telecommunications Company*, Docket No. U-86-113, Fourth Supp. Order at 19-20 & 24 (June 5, 1987) ("U-86-113 Order").

9. AT&T asked me to revisit my 1987 analysis and reach a conclusion as to whether any “vestiges of market power” still remain and whether any reason remains to restrict AT&T’s market activities in ways that do not apply to other interexchange carriers. In revisiting my earlier analysis I examined data similar in character to the data I relied on in my 1987 testimony that has become available in the subsequent 16 years. I have also relied on my knowledge of events in the industry that could not have been anticipated 16 years ago.

**EXAMINATION & ANALYSIS OF MARKET SHARE
AND INDUSTRY TRENDS SINCE 1987**

10. My 1987 conclusion, that AT&T was subject to effective competition except for certain diminishing vestiges of market power, was based on a recent structural change in the industry: the break-up of the vertically integrated Bell system in which AT&T’s interexchange business, operating in increasingly competitive markets, divested the local exchange monopolies held by the BOCs. At that time I concluded that AT&T could no longer operate as anything but “just another long distance company.” The “diminishing vestiges of market power,” which motivated my recommendation for a limited-duration additional condition on AT&T’s market behavior, concerned the availability of market information to low-volume customers using AT&T as a “default” long distance provider.

11. My conclusions regarding these effects of divestiture rested primarily on two types of evidence: (a) the current level of AT&T’s market share and evidence that AT&T’s market share was declining rapidly and (b) evidence regarding the implementation of “equal access.” In the years since 1987, the decline of AT&T’s market share has continued, and AT&T’s market share now approximates half its level of

that period. Furthermore, implementation of “equal access” has long since been completed.²

A. Current Market Share & Evidence of Continuing Decline

12. The level and change through time of AT&T’s market share is shown graphically in Chart A1.2 of the Federal Communications Commission’s (“FCC’s”) last *Long Distance Market Shares* report,³ which shows several indicators of AT&T’s market share for the years 1984 through 1998. The relentless decline of AT&T’s market share appears in all indicators. While the FCC’s *Long Distance Market Shares* report was discontinued after the report for the fourth quarter of 1998, similar information contained in broader subsequent reports shows a continuation of the decline of AT&T’s share of the long distance market. The FCC’s May, 2002 *Trends in Telephone Service* (attached as **Attachment 3**) reports certain measures of AT&T market share, and discusses differences among measures that are relevant to the Commission’s deliberations regarding regulation of AT&T in Washington State at this time.

² Unable to find documentary evidence of completion of equal access in the state, I called Western Wahkiakum Telephone Company and Inland Telephone Company – the companies apparently last operating non-equal access exchanges. I found respondents eager to assure me that the company had been providing equal access “for years,” and to read a long list of available long distance companies.

³ *Long Distance Market Shares, Fourth Quarter 1998*, attached as **Attachment 2**. This report was produced quarterly by the FCC through the report for the fourth quarter of 1998. This Commission relied on earlier editions in reports to the legislature submitted in 1989 and 1991. (WUTC Reports on the Status of the Washington Telecommunications Industry, submitted to the Legislature January 27, 1989 and February 15, 1991) My 1987 testimony and the Commission’s report to the legislature submitted January 12, 1987 relied exclusively on Washington-specific measures. Some of these measures were peculiar to that early period in the development of interexchange competition (e.g., measures based on equal access balloting), and other measures required extensive follow-up on underlying data and were thus difficult and expensive to calculate. The Commission’s 1991 Report to the Legislature discontinued calculation of Washington-specific volume-based market shares because the effort was no longer justified at a time of diminishing concern with AT&T’s market share and easy availability of FCC reports of national market shares, which, as the 1991 Report observed (at pages 53 and 54), correlated closely with intrastate measures. Since preparation of the initial draft of this declaration, the FCC has issued another report, *Statistics of the Long Distance Telecommunications Industry, May 2003*, which reports some more recent data bearing on issues considered here. The data of this new report are not incorporated into this declaration, but are entirely consistent with the qualitative conclusions reported here.

13. The only measure reported in the FCC's most recent *Trends in Telephone Service* at the state level, market share based on residential direct-dial minutes, shows AT&T's market share for Washington at 43.1 % for the year 2000, the most recent period reported. See Table 10.11. At the national level, AT&T's market share based on toll service revenues for the year 2000 was reported at 37.9 % of the toll service revenues of long distance carriers only, or 34.8 % of toll service revenues of all long distance toll providers, including local exchange carriers.

14. The distinction between these two measures (yielding 37.9 % or 34.8 %) reflects two effects that are now changing in ways that work to reduce AT&T's market share. First, insofar as local exchange carriers provide inter-LATA service, revenues from such services should be included in calculation of AT&T's market share, reducing the share calculated for AT&T.⁴ Second, as BOCs, such as Qwest,⁵ receive authority under Section 271 of the Telecommunications Act, the distinction between inter-LATA and intra-LATA long distance service simply disappears, and long distance market share calculations should include intra-LATA toll service revenues, again reducing the share calculated for AT&T.⁶ Increasingly, correct long distance market share calculations should include long distance toll revenues of local exchange carriers, and the lower

⁴ Exclusion of toll service revenues of local exchange companies was a matter of no consequence at the time of my 1987 testimony, but has become increasingly important in subsequent years. With passage of the telecommunications act of 1996, the major local exchange company GTE was released from a prohibition on the provision of inter-LATA long distance service, promptly began offering that service, and subsequently had substantial long distance revenue that represented direct competition to AT&T. Other non-Bell local exchange companies have also increasingly offered inter-LATA service to their local exchange customers, in direct competition with AT&T.

⁵ Qwest Corporation ("Qwest") received Section 271 relief for the State of Washington in December of 2002.

⁶ The distinction between inter-LATA and intra-LATA long distance service continues for the purposes of Section 272 of the Act, but becomes irrelevant for the purpose of defining the relevant market in which to assess AT&T's market share or market power.

market share for AT&T (34.8 % rather than 37.9 % in 2000) becomes conceptually more correct.

15. AT&T's market share has continued to decline in each of the last 5 years reported, for both of the overall market share indicators and for all 3 of the residential market share indicators reported in the current *Trends in Telephone Service* Tables 10.8, 10.9, and 10.10. Over these 5 years, AT&T's average decline in market share was 2.78 percentage points per year in market share of toll service revenues of long distance carriers only, and 2.02 percentage points per year in market share of toll revenues of all long distance toll providers. In residential markets, AT&T's share declined by an average of 4.26 percentage points per year for access lines, 4.02 percentage points per year for toll revenues, and 4.96 percentage points per year for direct dial minutes.

Extrapolating AT&T's Washington State share of 43.1 % of direct dial minutes for 2000 to 2002, on the basis of the average decline in national market share of residential direct dial minutes over the last five years reported, yields an estimated Washington market share of direct dial minutes for 2002 of 33.18 %.

B. Implementation of Equal Access

16. At the time of my 1987 recommendation and the Commission's consideration of AT&T's application for classification as a competitive telecommunications company, AT&T's divestiture of the BOCs' local exchange monopolies was less than four years old. This history of affiliation with local exchange monopolies was the only source of AT&T's monopoly power at the time of divestiture.⁷ At the time of my 1987 testimony,

⁷ For a discussion of the historical advantages of patent monopolies for the telephone instrument and long distance transmission technologies, the influence of economies of scale, and the role of denial of interconnection, either to the local exchange network or the long distance network, see Gerald W. Brock,

the acronym "OCC" still required no explanation.⁸ AT&T's control of the local exchange monopolies was broken as a legal matter by divestiture. The technically superior access by which AT&T reached its customers was remedied through the process of equal access implementation.⁹ The marketing advantage AT&T enjoyed by virtue of customers associating its name, by default,¹⁰ with the concept of "long distance company" may have decayed more slowly. My 1987 recommendation to the Commission to treat AT&T differently than other interexchange companies was motivated by an abundance of caution to protect consumers – especially those without equal access and those with limited incentives to seek out information about alternatives – from the exercise of any vestiges of market power that may have survived AT&T's January, 1984 divestiture of control over local exchange monopolies.¹¹ There is no

The Telecommunications Industry: The Dynamics of Market Structure, 1981, Harvard University Press, Cambridge, MA

⁸ See 1987 Testimony at 15. The acronym "OCC" abbreviated "Other Common Carrier," meaning "other than AT&T." The acronym fell out of use after the FCC adopted explicitly different regimes of regulation for "dominant" and "non-dominant" common carriers, and the usefulness of the acronym was completely overtaken by changes in the industry when the FCC classified AT&T as a non-dominant carrier in 1995.

⁹ The 1985 Act of the Washington Legislature that provided for the competitive company classification that was the subject of Cause No. U-86-113 recognized the importance of equal access implementation by establishing, at §4(3), a presumption that all companies providing inter-LATA interexchange service would be subject to effective competition when equal access requirements of the MFJ were met. As my Testimony indicated, at 7, this requirement applied only to Qwest's predecessor once removed, Pacific Northwest Bell, and had been satisfied at the time of filing of my 1987 Testimony. It may appear strange today that a presumption in AT&T's favor would be contingent on the actions of Qwest's predecessor Pacific Northwest Bell, but the requirements of equal access were agreed to by the parent company when AT&T and Pacific Northwest Bell were sister companies in the Bell System.

¹⁰ My 1987 Testimony mentions, at 36, the two applicable senses of the word "default." The equal access balloting sense of the word is explained in the Commission's 1987 Report to the Legislature, Appendix S, third paragraph. Neither of the two senses is relevant today.

¹¹ See 1987 Testimony at 9, lines 3-11 & 36, lines 18-23. The Commission's Fourth Supplemental Order in Docket No. U-86-113 granting AT&T's competitive classification mentions concern for rural customers (at 19) and the 1989 Report to the Legislature (at 74) notes conditions imposed on AT&T "to protect the public, particularly rural customers who may not yet have competitive choices." The Commission's 1987 Report to the Legislature, Appendix S, discusses the extension of equal access requirements beyond the Bell Operating Companies to Independent local exchange companies, and, as I note elsewhere, equal access has now become a reality throughout the state, bringing competitive long distance choices to all customers, even the most remotely located customers of independent local exchange companies.

longer any basis to recommend or continue different regulatory treatments for AT&T versus and other interexchange companies.

17. In 1987, implementation of equal access requirements and AT&T's historical control of the local exchange monopoly were still issues. Today they are not. AT&T has long since become "just another long distance company," as a legal matter, as a technical matter, and in the minds of consumers of long distance services.

CONSIDERATIONS NOT ANTICIPATED IN 1987

18. The market for interexchange telecommunications services in Washington is very different today than it was in 1987, in part due to changes flowing from divestiture that could have been more or less anticipated, and from considerations that could not have been anticipated at the time. Today, a very substantial portion of interexchange traffic is carried by wireless providers, mostly under rate structures that do not even recognize the distinctions between exchange traffic and interexchange traffic. The invasion of wireless carriers into the competitive landscape for interexchange traffic has injected even more reason to do away with the conditions imposed upon AT&T because it faces difficult competition from a less heavily regulated wireless industry and its ability to respond to such competition should not be burdened by unnecessary conditions.

19. As is further discussed below, the presence of dominant local exchange providers in the long distance market could not have been anticipated in the early years after divestiture; after all, the point of divestiture was to allow competition to develop where it could, such as in markets for long distance services, without the problem of a competitor with monopoly control of a vertically related segment of the industry in the local

exchange. Today, Qwest, as well as the majority of other local exchange companies in Washington, has an affiliate competing in the interexchange market.

20. As I indicated above, AT&T's only source of monopoly power in the long distance market at the time of divestiture was its history of control over the local exchange facilities necessary for access to end user customers. The bulk of that monopoly power was destroyed more than nineteen years ago through divestiture of AT&T's local exchange assets, and the resulting effective competition justified my recommendation and the Commission's granting of competitive classification. My recommendation more than sixteen years ago regarding the imposition of restrictions on AT&T was predicated on the existence of "vestiges" of monopoly power that may have remained in 1987, but were clearly decaying in the wake of the structural change of divestiture. Now, another structural change has taken place in the long distance industry that raises some of the same concerns that were present before divestiture, but AT&T is no longer the company implicated in the potential for exercise of market power. Qwest's recently approved Section 271 authority to provide long distance service creates new considerations that must enter into any analysis of the long distance industry.

21. First, because of Qwest's authorization to provide inter-LATA service, the distinction between inter-LATA and intra-LATA markets no longer has any significance for the purpose of defining the relevant market. Now, evaluation of any market power that AT&T might possess must be undertaken in the relevant market defined without reference to LATAs. Ceasing to define AT&T's relevant market as inter-LATA results in an immediate reduction of calculated market share.

22. Next, Qwest's authorization to provide inter-LATA services introduces a new competitor for AT&T's traditional customers. While there is no shortage of competitive entry in the long distance business, Qwest has the advantage of incumbency as the State's major local exchange provider. Most of the effect of BOC entry into in-region inter-LATA long distance markets is not captured by market share estimates discussed above. The most recent market share figures reported in the FCC reports relied on, and discussed above, are for the year 2000, during which Verizon had Section 271 approval for New York for the entire year and SBC had approval for Texas for approximately half the year. Thus, examination of the trend of market shares through 2000 – even including local exchange carriers' long distance revenues – probably underestimates the rate of decline of AT&T's market share.

23. Finally, while regulatory constraints on the exercise of such incentives are now much more firmly established, Qwest's incentives as a vertically integrated provider of local exchange services and long distance services will be very similar to those of the vertically integrated AT&T before divestiture. The competition in the local exchange market that exists today exists only by virtue of regulatory mandates. The "equality" of equal access provided by a post-divestiture vertically integrated provider of both local exchange services and long distance services, as Qwest is today remains to be tested in Washington and elsewhere. Concerns arose at the time of AT&T's competitive classification concerning equal access and AT&T's history of affiliation with the State's dominant local exchange provider, and these concerns were addressed by imposition of conditions on AT&T's market behavior that were not imposed on other interexchange

companies. These concerns no longer apply to AT&T. Insofar as these concerns have any relevance today, they apply much more directly to Qwest than to AT&T.

CONCLUSION

24. After examining the most recent data available and relevant to the considerations that entered into my recommendation to the Commission in my 1987 testimony on behalf of Staff, and considering events that could not have been anticipated at the time of AT&T's application for classification as a competitive telecommunications company, I conclude that the "vestiges of market power" that existed shortly after divestiture have long since dissipated, and I see no reason to impose different regulatory requirements on AT&T than on other interexchange carriers. As I expected at the time of that testimony, the vestiges of AT&T's market power have disappeared through operation of the competitive process and the passage of time. The Commission's order granting AT&T's competitive classification contemplated the removal of those conditions after March 1, 1990, and I see no reason for maintaining those conditions at this time.

25. This concludes my Declaration.

Respectfully submitted this 22nd day of July, 2003.

By:

companies. These concerns no longer apply to AT&T. Insofar as these concerns have any relevance today, they apply much more directly to Qwest than to AT&T.

CONCLUSION

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