

WASHINGTON LOCAL TELECOMMUNICATIONS COMPETITIVE ENVIRONMENT

Qwest's Local Exchange Base

As competitive local exchange alternatives have grown in Washington, Qwest's local exchange access line base has steadily declined. Local exchange customers virtually throughout Qwest's service territory in Washington now have the option of subscribing to local service from CLECs using either their own switches and network facilities or wholesale network elements purchased from Qwest. The following table summarizes the change in Qwest's residential and business retail access line base in Washington from June 2000, when the SQPP was initiated, to March 2004:

Qwest Retail Lines in Service ¹	June 2000	March 2004	Difference	% Change
Residence	1,773,563	1,520,473	(253,090)	(14.2)%
Business	756,632	563,876	(192,756)	(25.4)%
Total	2,530,195	2,084,349	(445,846)	(19.0)%

While various factors have contributed to these trends, including the general economic malaise and some displacement of non-primary lines by DSL service, it is indisputable that Qwest's access line base has declined dramatically and that much of this decline is driven by the increase in the number of competitive alternatives to Qwest service. These alternatives include CLEC options as well as the availability of wireless and VoIP services, which are discussed in the following sections.

CLEC Competitive Trends

A wide range of CLECs are now competing with Qwest in the local exchange market in Washington, and contrary to the mistaken belief that the CLEC industry has undergone a "meltdown" over the last two years, the aggregate number of lines served by CLECs in the state has continued to grow. A total of 139 CLECs are now listed as competitive providers regulated

¹ Excludes Public Coin and Qwest Official Company Service (OCS) access lines.

by the WUTC on the Commission's current web site,² and a number of facilities-based CLECs including Advanced TelCom Group (ATG), Allegiance/XO, Comcast, Eschelon, Integra, MCI Metro, McLeodUSA, Rainier Connect, SBC and others have price lists on file with the Commission indicating that they are currently providing local exchange services within Qwest's service territory in Washington. Additional CLECs are now competing with Qwest in Washington via resale of Qwest's retail services or by the use of wholesale network elements purchased from Qwest.

The following table summarizes the change in volume in various categories of wholesale services purchased by CLECs from Qwest since the advent of the SQPP rules associated with the Qwest merger:

Qwest Wholesale Service	June 2000	March 2004	Difference	% Change
UNE Loops	7,749	64,604	56,855	733.7%
UNE-Platform	0	129,944	129,944	n/a
UNE-Platform Directory Listings				
Residence	0	65,445	65,445	n/a
Business	0	64,811	64,811	n/a
Resold Lines				
Residence	3,612	3,108	(504)	(13.9)%
Business	29,698	5,454	(24,244)	(81.6)%
Local Interconnection Service (LIS) Trunks	119,009	207,316	88,307	74.2%

In regard to UNE loops, this metric shows that a significant number of lines are being served by CLECs using their own switches in combination with stand-alone UNE loops purchased from Qwest to deliver service to the end user. It is important to note that the quantity of UNE loops in service does not capture any data for end users served by CLECs using CLEC-owned switches coupled to CLEC-owned loops. The evidence from Qwest Basic Business Services Competitive Class Proceedings, Docket UT-030614, indicate a significant quantity of CLEC-owned loop based services in the state. For example, end user lines served by cable

² www.wutc.wa.gov

telephony providers such as Comcast and Rainier Connect are not reflected in these totals, nor are end user lines served by CLECs such as AT&T or MCI to the extent they utilize their own fiber networks to deliver local service to a proportion of their customer base. These totals also do not include customers in Qwest territory served by Verizon, by wireless carriers, or by VoIP companies.

Local Interconnection Service (LIS) trunks are network facilities that enable the exchange of traffic between Qwest and CLEC switches. As the number of end user lines served by CLECs increases, the number of LIS trunks in service must be increased to minimize blockage of calls from CLEC customers to customers served by Qwest. LIS trunks are used by CLECs using their own loop network facilities as well as those that use unbundled loops purchased from Qwest and are therefore a good barometer of the growth in the overall customer access line base served by facilities-based CLECs. It is noteworthy that the number of LIS trunks used by facilities-based CLECs has nearly doubled since the Qwest merger was completed in June 2000 as these CLECs resized their networks to accommodate their growing customer base.

Since resale of Qwest's existing retail services represents a non-capital intensive means for CLECs to enter the market and build a core customer base, albeit with profit margin potential lower than that available via delivery of service via CLEC-owned facilities or wholesale network facilities leased from Qwest, it is not surprising that CLECs have largely moved away from resale toward other forms of local exchange service delivery. The trend in Washington is consistent with national trends as CLECs seek greater efficiencies and margins. However, especially for new market entrants, resale remains a viable option as a means to quickly and with little investment enter a local market to attract a customer base of sufficient size to justify further investment in CLEC-owned switches and facilities.

The Unbundled Network Element-Platform (UNE-P) product was available to CLECs in June 2000, but no CLEC was purchasing the product then. Much has changed since that time with respect to UNE-P. This service has now been embraced by a number of CLECs, including AT&T, MCI, Sprint, Z-Tel and others as a means of efficiently delivering service to residential and small business customers in Washington, and these carriers are all now actively promoting UNE-P based services as evidenced by the significant (and ever-increasing) number of UNE-P lines in service shown in the table above. In addition, the quantity of residential and business directory listings in the Qwest listings database associated with UNE-P lines in service in March 2004 is shown in the table. While the number of directory listings will never precisely match the number of lines in service, since some telephone numbers do not appear in the directory while others have multiple directory listings, it is noteworthy that the number of UNE-P directory listings is roughly the same for the residential and business categories and shows that CLECs utilizing UNE-P to deliver local service have a strong focus on the residential market as well as the business market.

While developing a precise calculation of overall CLEC market share within Qwest service territory is difficult, as Qwest does not have access to proprietary customer information held strictly by the CLECs, an estimate can be developed using the white pages listings counts associated with CLEC access lines that are retained in Qwest's listings database. Since many access lines are not listed due to privacy concerns and other reasons, the number of white pages listings will not correspond to the total number of lines in service. For example, approximately 26% of Qwest's residential and business retail lines are not published in the white pages directory. In March 2004, there were a total of 227,474 CLEC white pages listings in the directory database. If that number is increased by 26% to account for non-published numbers (assuming the ratio of non-published numbers for CLEC customers is comparable to that of Qwest customers), a proxy for total CLEC access lines in service as of March 2004 would be 307,397. Since the number of Qwest retail lines in service as of March 2004 was 2,084,349 as

shown in the first table in this section, the total number of retail lines (Qwest and CLEC combined) is 2,391,746 and the overall CLEC market share as of March 2004 in Washington can be estimated as follows:

$$307,397 / 2,391,746 = \underline{12.9\%}$$

In Table 6 of the FCC's Local Telephone Competition Report, released December 22, 2003, the FCC reported an overall CLEC market share in Washington of 10% based on a data vintage of June 30, 2003. However, these data are statewide totals and include counts in Independent Telephone Company operating territory, and carriers with 10,000 or fewer access lines were not required to report. These data also represent a timeframe 9 months prior to the March 2004 data reported above. When market growth is considered, the FCC's data shows that the CLEC share estimate based on white pages listings as shown above is very reasonable.

It is also important to note that these "share" estimates do not contemplate intermodal telephone service substitutes, such as wireless and VoIP services, now available to customers within Qwest's service territory in Washington. These intermodal service alternatives are discussed in the sections that follow.

Wireless Service

In its most recent Local Telephone Competition report, the FCC showed a total of 3,102,750 wireless subscribers in Washington as of June 2003.³ In the same report, the FCC showed a total of 3,452,669 ILEC (Qwest and Independents combined) access lines in service for the same month. In other words, the number of wireless subscribers is nearly equal to the total number of ILEC switched access lines in service. Wireless phones are now widely accepted by business and residential consumers for voice telephony. In addition, wireless providers are now augmenting their services with data applications such as dial-up wireless internet access, text messaging and image transmission to bring additional functionality to their services to attract and retain customers. While it would be an overstatement to assert that all Qwest customers view

³ FCC Local Telephone Competition Report, Table 13, December 22, 2003.

wireless service as a complete substitute for Qwest local exchange service, a segment of the Qwest customer base certainly does view wireless service as a good alternative to primary or additional wireline access lines, and this segment has contributed to the decline in Qwest's retail access line base. For example, in August 2002, Qwest began tracking residential access lines reported by the customer as being disconnected in lieu of wireless service. In many instances, the customer refuses to provide a reason for the disconnect and the "disconnect reason" tracking therefore understates total disconnects. However, Qwest has tracked over 12,000⁴ disconnected residential lines for which customers have reported they are substituting wireless service in Washington.

A wide range of wireless providers are now offering service within Qwest territory in Washington, including Nextel, U S Cellular, AT&T Wireless, Cingular, Sprint, T-Mobile, Verizon Wireless, Inland Cellular Telephone and CellularOne. Service is available from at least one of these carriers in virtually every Qwest exchange in Washington. Each of these carriers has significant scale and scope and is actively promoting the availability of its service to customers in the state.

On November 24, 2003, wireless number portability was implemented in response to an FCC mandate. Wireless number portability not only enables wireless subscribers to retain a preexisting wireless telephone number when changing wireless service providers, it also enables customers to retain a preexisting wireline telephone number when the customer elects to disconnect the wireline service entirely and rely solely on wireless service as the customer's primary telecommunications service. This event removes a barrier that may have prevented some wireline customers from "cutting the cord" and substituting wireless service for traditional Qwest wireline telephone service. Research released in January 2004 by Advanis⁵ assessed the

⁴ August 2002 through February 2004 disconnect tracking data.

⁵ Mobile Metrics: Wireline to Wireless Displacement Study (Advanis: January 2004). This research was a telephone survey of 1,000 residential households in the top 100 MSAs and was conducted in November and December 2003.

impact of wireless number portability on the proportion of residential wireline customers willing to completely substitute wireless service for traditional wireline local exchange service.

Advanis found that, assuming availability of a wireless plan priced at \$40/month and containing 600 plan minutes, 6.4% of the respondents reported a willingness to completely substitute wireless for wireline service without number portability. When the respondent was informed of the availability of wireless number portability, the percentage of respondents willing to "cut the cord" increased to 11.5%. On a nationwide basis, Advanis projects that wireless service will erode the wireline telephone base at an increasing rate and predicts that 6 million wireline telephone lines will be displaced by 2007 and 14 million by 2009.

Wireless companies offer a variety of plans - local plans, regional plans, and national plans – with varying amounts of minutes included. Generally, wireless packages including long distance and features start as low as \$20.00 per month. As a point of comparison, consider that in Washington Qwest’s flat-rated local exchange residence line is priced at \$18.60 (\$12.50 basic rate plus the \$6.10 Subscriber Line Charge), excluding any charges for features or intraLATA long distance. The comparable Qwest business rate is \$32.99. **T-Mobile** offers customers within its service territory a \$19.99 per month plan which includes 60 “whenever” minutes, 500 weekend minutes, VoiceMail with paging, Caller ID, Conference Calling, Call Waiting, Call Hold, and no long distance or roaming charges.⁶ **Cricket** offers unlimited local calls to Spokane consumers for \$29.99 per month. Customers have the option of adding features and unlimited toll for additional charges per month.⁷ **Cingular** Wireless’s Nation 250 plan, priced at \$29.99 per month, includes 250 “anytime” minutes, 1000 nights/weekend minutes, nationwide long distance, Call Waiting, Caller ID, Enhanced Voice Mail, and Three-Way Calling.⁸ **Nextel** offers a “National 1000” plan that includes 1000 anytime minutes, unlimited night and weekend minutes, nationwide long distance, unlimited “Direct Connect” (walkie-talkie) minutes, voice

⁶ www.t-mobile.com, visited 5-4-04.

⁷ www.cricketcommunications.com, visited 5-4-04

⁸ www.cingular.com, visited 5-4-04.

mail, Three-Way Calling, Call Hold, Call Waiting, and Caller for \$54.99 per month.⁹ **Sprint** recently introduced a similar service, PCS ReadyLink, that allows quick, two-way walkie-talkie style communications over its nationwide PCS network.¹⁰ In addition, Sprint offers several wireless calling plans, such as the PCS Free & Clear – Area-wide plan which includes 1000 “anytime” minutes, unlimited night and weekend minutes, nationwide long distance calling, Voice Mail, Caller ID, Call Waiting, numeric paging, and Three-Way Calling for \$45.00 per month. **AT&T Wireless** offers a “GSM America Local Plan” which includes 600 anytime minutes, unlimited night and weekend calling, and “free” nationwide long distance for \$39.99 per month.¹¹ Alternatively, consumers may choose from a wide array of national and local wireless plans from **Verizon Wireless**, including the America’s Choice 400 plan. This plan, priced at \$39.99 per month, includes 400 home airtime minutes per month, free in-network plus unlimited night and weekend home airtime minutes, Three-Way Calling, Call Forwarding, Caller ID, No Answer/Busy Transfer, Text Messaging, and Voice Mail.¹²

These examples represent only a very small number of the wireless plans and services that are available to Washington consumers. For small business and residence customers that find value in the service attributes offered by the wireless carriers, a few of which are shown in the above examples, wireless service is clearly an attractive alternative to Qwest’s wireline service.

Voice over Internet Protocol (VoIP) Telephony

Voice over Internet Protocol (VoIP) service is quickly evolving as a direct substitute for Qwest wireline telephone service, and the service functions in a manner very similar to standard telephone service familiar to Qwest's customers. For example, the VoIP customer utilizes a standard telephone set to originate and receive telephone calls, and the dialing patterns are

⁹ www.nextel.com, visited 5-4-04.

¹⁰ www.sprint.com, visited 5-4-04.

¹¹ www.attwireless.com/personal/plans, visited 5-4-04.

¹² www.verizonwireless.com, visited 5-4-04.

identical to standard wireline telephone service. The customer's telephone set is simply plugged into an interface device that enables the telephone call to be processed over a broadband connection via the Internet. Currently, VoIP providers do not pay Switched Access charges for this type of traffic, enabling VoIP providers to offer very low long distance rates.¹³ For example, Vonage offers free long distance within the continental United States and Canada, and international long distance rates from the U.S. are priced as low as \$0.02 per minute. Typically, long distance carriers charge \$0.30 per minute or more for the same call.

Qwest is aware of at least seven vendors now offering VoIP telephony applications to consumers in Washington. AT&T offers a “suite” of VoIP products for business customers and is in the process of rolling out its residential service entitled "CallVantage." While not yet available in Washington, the company plans to offer CallVantage in 100 major markets by the end of 2004.¹⁴ Five Star Telecom is also a provider of VoIP products and services, offering service under the “earthphone” trade name. In addition, Vonage, Packet8, VoicePulse,¹⁵ BroadVoice, and Zipglobal offer telephony services utilizing VoIP technology.

VoIP services are priced competitively with Qwest wireline services, especially for customers with existing broadband internet access. Vonage offers a “Residential Premium Unlimited Plan” priced at \$34.99 per month that includes unlimited local and long distance calling within the U.S. and Canada, free Call Waiting, Voice Mail, Call Forwarding, Repeat Dialing, Call Transfer, Caller ID, and Three-Way Calling. Alternatively, residential customers may subscribe to Vonage’s “Unlimited Local/Regional Plus Plan” and receive unlimited local and regional service plus 500 nationwide and Canada long distance minutes, as well as all of the features included in the Premium Unlimited Plan for \$24.99 per month. Vonage’s “Small Business Unlimited” plan, priced at \$49.99 per month, provides unlimited local and long

¹³ Qwest recently announced it is eliminating connection fees carriers pay when their customers make Internet-based phone calls to Qwest local-telephone customers in a move to promote true VoIP services.

¹⁴ *AT&T will offer Internet phone calls in selected markets*, Wall Street Journal, March 31, 2004.

¹⁵ VoicePulse service is available anywhere in the country where broadband Internet access is available, however, it is currently not offering numbers within Washington area codes.

distance calling within the U.S., as well as a free fax line, free Call Waiting, Voice Mail, Call Forwarding, Repeat Dialing, Call Transfer, and Caller ID Blocking. The “Small Business Basic Plan” provides all the same free features as the Small Business Unlimited Plan, with 1500 local and long distance minutes for \$39.99 per month. In addition, Vonage allows its customers to select the area code they would like assigned to them. For example, a Vonage customer doing significant business volumes with Los Angeles customers may elect a Los Angeles area code. By so doing, all calls from Los Angeles customers to the Vonage customer are toll-free. Consumers subscribing to Vonage’s service may also elect to keep their current phone number.

Another example of a VoIP service provider is Packet8. This VoIP provider offers its “Freedom Unlimited” residential plan for \$19.95 per month. This plan provides several features and unlimited calling to anyone in the 50 states and Canada and Packet8 subscribers worldwide. Packet8’s “Virtual Office” plan, priced at \$39.95 per month, also includes business class voice mail, an auto-attendant to answer calls, conference call bridge service, hold music, three-digit dialing, as well as unlimited calling plans to the United States and Canada. Similar to the Vonage offering, Packet8 allows the customer to select the geographic “rate center,” which allows incoming calls from customers in that geographic area to call the Packet8 customer toll-free. Calls between Packet8 customers anywhere in the world are always free.

As stated previously, Qwest’s stand-alone basic exchange rate, including the Subscriber Line Charge but excluding features and long distance, is \$18.60 for residence and \$32.99 for business. For Qwest’s residential and business customers with access to a broadband Internet connection and who use calling features and make long distance calls, these services represent a viable and price-competitive alternative to traditional local exchange service.

It is clear that the competitive paradigm is changing in the local exchange market. Recently, there have been a number of public announcements made, demonstrating that carriers are now very serious about utilizing this alternative technology to capture and retain customers. Qwest became the first regional Bell operating company to offer residential telephone service

using VoIP technology, with a roll-out of the service in Minnesota in early December 2003. Also, within the past several months carriers such as Verizon Communications, SBC, BellSouth, and Time Warner announced plans to begin offering or broaden existing VoIP offerings. Vonage announced that it is moving its service into hundreds of Circuit City stores across the country.¹⁶ Packet8 just announced that it is interconnecting its VoIP network with FreeWorld Dialup, the world's leading free Internet Telephony community.¹⁷ This will allow subscribers to Packet8's service to call or be called by FreeWorld Dialup subscribers. "The interconnection of voice over IP networks is a trend that will continue as more and more people incorporate VoIP calling into their lives," according to Bryan R. Martin, Chairman and Chief Executive Officers of 8 x 8, Inc. "We expect to see much more activity in this area in the near-term, as VoIP telecommunication service providers like Packet8 endeavor to lower the call routing costs for their customers even further. VoIP interconnects also improve the voice quality over that possible on switched networks, so consumers will finally start to hear what they have been missing on the legacy telephone network," Mr. Martin concluded.¹⁸ InfoTech, a research and consulting firm, projects that over two-thirds of U.S. Small and Mid-Sized Business Centrex users will convert to IP Telephony by the year 2008.¹⁹

While empirical evidence of competition for Qwest's local exchange services has in the past focused primarily on traditional wireline CLEC-based competition, the growing presence of VoIP services, as well as wireless services, is a further indication that the competitive paradigm is changing and additional local retail service options for Washington consumers are now available.

¹⁶ *Internet Phone Service Slowly Enters Mainstream*, San Jose Mercury News, April 6, 2004.

¹⁷ *Packet8 and FreeWorld Dialup Now Offer Free Unlimited Calling Between Subscribers*, PR Newswire, March 30, 2004.

¹⁸ *Id.*

¹⁹ *Small Businesses Set to Abandon Centrex – InfoTech Sees Broad SMB Shift to IP Telephony*, Market Wire, Incorporated, April 30, 2004.

