BEFORE THE

WASHINGTON STATE UTILTIES AND TRANSPORTATION COMMISSION

IN THE MATTER OF THE INVESTIGATION INTO QWEST CORPORATION'S COMPLIANCE WITH SECTION 271 OF THE TELECOMMUNICATIONS ACT OF 1996	DOCKET NO. UT-003022

DIRECT TESTIMONY

OF

MARK N. COOPER

ON BEHALF OF

THE PUBLIC COUNSEL SECTION OF

THE WASHINGTON STATE ATTORNEY GENERAL'S OFFICE

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

I. INTRODUCTION

A. STATEMENT OF QUALIFICATIONS

Q. Please state your name and address.

A. My name is Mark N. Cooper. I am Director of Research of the Consumer Federation of America (CFA). I am also President of Citizens Research.

Q. Please describe your experience.

A. Prior to founding Citizens Research, a consulting firm specializing in economic, regulatory and policy analysis, I spent four years as Director of Research at the Consumer Energy Council of America. Prior to that I was an Assistant Professor at Northeastern University teaching courses in Business and Society in the College of Arts and Sciences and the School of Business. I have also been a Lecturer at the Washington College of Law of the American University co-teaching a course in Public Utility Regulation.

I have testified on various aspects of telephone and electricity rate making before the Public Service Commissions of Arkansas, California, Colorado, Connecticut, Delaware, the District of Columbia, Florida, Georgia, Hawaii, Illinois, Indiana, Iowa, Kentucky, Manitoba, Maryland, Missouri, New Jersey, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, Tennessee, Texas, Vermont, Virginia, and Washington, as well as the Federal Communications Commission (FCC), the Canadian Radio-Television, Telephone Commission (CRTC) and a number of state legislatures.

For a decade and a half I have specialized in analyzing regulatory reform and market structure issues in a variety of industries including telecommunications, railroads, airlines, natural gas, electricity, medical services and cable television. This

includes approximately 200 pieces of testimony split fairly evenly among state regulatory bodies, federal legislative bodies, and federal administrative bodies.

I have participated in several section 271 proceedings. For the Consumer Federation of America I have filed comments at the Federal Communications Commission (FCC) in the Ameritech-Michigan, BellSouth South Carolina and Louisiana, SBC Texas, and Bell Atlantic-New York. I have also participated as an expert witness on behalf of others in several section 271 and related proceedings. I was an expert witness for the Oklahoma Attorney General in the early arbitrations in that state and I assisted that office in its preparations for the second section 271 proceeding in that state. I was an expert witness for the Texas Office of Public Utility Counsel in the section 271 proceeding in that state.

B. OVERVIEW AND OUTLINE OF THE TESTIMONY

Q. What is the purpose of your testimony?

A. I have been asked by the Public Counsel section of the Washington Attorney General's Office to respond to the public interest questions posed by the Washington Utilities and Transportation Commission (WUTC) in its Interpretive and Policy Statement of March 15, 2000 and to analyze the public interest issues raised by Qwest witnesses.

Q. What is your overall view of Mr. Teitzel's discussion?

A. Mr. Teitzel's testimony inverts the logic of the Telecommunications Act of 1996 (the 1996 Act or the Act), the process of section 271 evaluation, and the economic reality of telecommunications markets.[1]

Q. What are your concerns about Mr. Teitzel's approach to the section 271 process?

[1] "Direct Testimony of David L. Teitzel on Behalf of Qwest Corporation, Re: Public Interest and Track A," May 16, 2001 (hereafter, Teitzel).

A. Mr. Teitzel takes an approach that implies the FCC has prescribed what the WUTC can and can not do. He walks through a long litany of things the FCC has said about how it evaluates section 271 applications, as if the WUTC is not allowed to exercise independent judgment on these matters. If the Congress had intended for the FCC to decide these matters in the "top-down" manner that Mr. Teitzel outlines, it would not have bothered to give states and the Department of Justice the opportunity to participate in the process.

The WUTC can use independent judgment and standards to decide whether to support a Qwest application for entry into long distance. The New York prefiling statement and collaborative process, which created the first, and by far the most successful road map, to section 271 entry was developed largely without FCC input. It is certainly reasonable for the WUTC to press for a model similar to New York.

In fact, the FCC has never approved an RBOC application without the support of the state utility commission. Although no RBOC has brought an application over the objection of the state, Ameritech's Michigan application did not have the full support of the Commission, and it was rejected. Obviously, the WUTC must exercise reasonable judgment in determining whether Qwest has opened its market to competition, but there is considerable leeway, particularly in light of the fact that, unlike SBC and Verizon, Qwest has yet to demonstrate a model that satisfies any regulator, state or federal.

In my discussion below, I review the basic decisions through which the states, the DOJ and the FCC defined the section 271 process.[2] These decisions gave rise to

[2] The framework was substantially defined in the rejection of the first two applications, as discussed below including Michigan Public Service Commission, In the Matter of the Commission's Own Motion to Consider Ameritech Michigan's Compliance with the Competitive Check List in Section 271 of the Telecommunications Act of 1996, Case No. U-11104; Federal Communications Commission, In the Matter of Application by Ameritech Michigan to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Service in Michigan, CC Docket 97-1; Federal Communications Commission, Memorandum Opinion

the rigorous standards applied in New York. They support the WUTC's ability to adhere to such a rigorous standard.

Q. What are your concerns about Mr. Teitzel's approach to the key substantive elements in the section 271 public interest review?

A. Mr. Teitzel has incorrectly and inappropriately tried to narrow the scope of the public interest review and the competitive market assessment.

Qwest seemingly seeks to reduce the public interest standard to simply evaluating the competitive checklist. (DLT-1T, Exh _____, p. 44) That was clearly not the intention of the Act. The public interest test is largely undefined in the 1996 Act and the accompanying report. The only mention is to require the FCC to make a public interest determination. Further, the Department of Justice is given broad latitude in its evaluation of the request for entry. The Conference report mentions specifically (1) the House standard, (2) the standard included in the AT&T consent decree, "or (3) any other standard the Attorney General deems appropriate." Conference Report, p. 149.

---

and Order In the Matter of Application by Ameritech Michigan to Section 271 of the Telecommunications Act of 1934, as amended, to Provide In-Region, InterLATA Service in Michigan, CC Docket 97-137, August 19, 1997 (hereafter FCC Michigan). Oklahoma Corporation Commission, Cause NO. PUD 97-64, Federal Communications Commission, In the Matter of Application of SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Oklahoma, CC Docket No. 97-121.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

Although some have sought to downplay the importance of the public interest test, that approach is not supported by the law or the legislative history.[3] The fact that Congress added a broad public interest standard to the 1996 Act is seen by the Department of Justice as an important step.[4] The FCC took this view as well as outlined in their order rejecting Ameritech's Michigan application:

---

[3] Turetsky, David, "Bell Operating Company InterLATA Entry Under Section 271 of the Telecommunications Act of 1996: Some Thoughts," before the Communications Committee of the National Association of Regulatory Commissioners, July 22, 1996.

> In view of this history and Congressional policy it is especially curious that, since enactment of the new law, it has been suggested in certain quarters that the public interest requirement might be less significant in section 271 than in other context and that it may be just some sort of gratuitous restatement of the competitive checklist, presumed to be satisfied whenever the checklist is. I would like to put that notion to rest...
>
> The equally critical importance of the public interest requirement is unmistakable. Its importance is not only reflected in the express terms of the statute itself, where the requirement is given co-equal billing with the checklist and the other requirements that the Bells must establish that they satisfy. It is also indicated time after time in the legislative history. Members whose support was absolutely essential to the new law's passage made it clear that an independent public interest requirement, of at least the breadth that public interest requirements - and with emphasis on its competition component -- generally have before commissions such as the FCC, was essential to their support. It was also an important consideration for President Clinton in signing the new law. Turetsky at pp. 19-20.

[4] As the DOJ said:

> The "public interest" standard under the Communications Act is well understood as giving the Commission the authority to consider a broad range of factors and the courts have repeatedly recognized that competition is an important aspect of the standard under federal telecommunications law.

"Evaluation of the United States Department of Justice, Federal Communications Commission, In the Matter of Application of SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Oklahoma, CC Docket No. 97-121, May 16, 1997 (hereafter, DOJ, SBC), p. 39.

> As discussed below, we believe that section 271 grants the commission broad discretion to identify and weigh all relevant factors in determining whether BOC entry into a particular in-region, interLATA market is consistent with the public interest. Before making a determination of whether the grant of a particular section 271 application is consistent with the public interest, we are required to consult with the Attorney General, and to give substantial weight to the Attorney General's evaluation...
>
> The Communications Act is replete with provisions requiring the Commission, in fulfilling its statutory obligation to regulate interstate and foreign communications by wire and radio, to assess whether particular actions are consistent with the public interest, convenience, and necessity. Courts have long held that the Commission has broad discretion in undertaking such public interest analyses...
>
> The legislative history of the public interest requirement in section 271 indicates that Congress intended the Commission, in evaluating section 271 applications, to perform its traditionally broad public interest analysis of whether a proposed action or authorization would further the purposes of the Communications Act. We also conclude that Congress granted the Commission broad discretion under the public interest requirement in section 271 to consider factors relevant to the achievement of the goals and objectives of the 1996 Act. Moreover, requiring petitioning BOCs to satisfy the public interest prior to obtaining in-region, interLATA authority demonstrates, in our view, that Congress did not repeal the MFJ in order to allow checklist compliance alone to be sufficient to obtain in-region, interLATA authority...

FCC Michigan, paras. 383, 384, 385.

The public interest standard is, of course a flexible one. Therefore, in its consultative role, the state should express its view of how the public interest should be defined. The WUTC has asked for **"A description of factors that should be considered in assessing whether U.S. West's entry into the long distance market would be in the public interest."** My first response is that the WUTC can define the public interest broadly. Below, I will offer other specific recommendations about how to define the public interest.

The Department of Justice has underscored the important role that independent review of the facts of the case by each entity charged with review of the application has in the section 271 process. This is reflected in its criticism of the Oklahoma Corporations Commission's compilation of evidence and reading of the law.

> In this case, however, the OCC majority did not adopt detailed factual findings concerning the checklist compliance issues, and their conclusions appear to rest, in large part, on what we believe to be an incorrect legal interpretation of the checklist.

DOJ, SBC, p. 26.

RBOC efforts to restrict the nature of the hearings at the state level have been vigorous. If the states fail to build a full evidentiary record, then the Department of Justice and the FCC will have to build a record of its own. The Attorney's General have echoed this concern.[5] The FCC has expressed similar concerns. The FCC defined

---

[5] "Reply Comments of the Attorneys General of Delaware, Florida, Iowa, Maryland, Massachusetts, Mississippi, Missouri, New York, North Dakota, Oklahoma, Utah, West Virginia and Wisconsin, In the Matter of Application of SBC Communications, Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance for Provision of In-Region InterLATA Services in Oklahoma, Federal Communications Commission, CC Docket No. 97-121 (hereafter, Attorneys General), p. 3.

> The Commission must also consider the extent to which it can rely upon the consultation provided by the Oklahoma Corporation Commission in this proceeding. If the Oklahoma Commission has fallen short in its review of SBC's compliance with the competitive checklist set forth in section 271(c)(2)(B) of the 1996 Act, it is incumbent upon the Commission to say so. Otherwise, the Commission runs the risk of undermining the work of public utility commissions (PUCs) in other States that, often with the assistance of the State's Attorney General's office, have undertaken or will undertake thoroughgoing reviews of their local BOC's compliance with the requirements of section 271. A Commission decision that appears to sanction Oklahoma's level of scrutiny will endanger PUC efforts in other States to conduct more detailed reviews.

the standard to be applied as a preponderance of sworn evidence in the record. FCC Michigan, paras. 45, 47, 152.

The most critical manifestation of Qwest's misreading of the Act, is Mr. Teitzel's repeated citation of FCC statements that say that an application will not be turned down because competition has failed to reach a specific market share or to demonstrate a specific level of geographic spread. As described below, the extent of competition is probative, not dispositive, in the process. Further, the fact that the FCC declines to specify a level of market share loss or geographic spread necessary to justify approval does not mean that a near total lack of competition would be permissible. I will address the role and importance of the competitive assessment at greater length later in my testimony.

Q. How has Qwest inverted the intent of the public policy element of the Act?

A. The Qwest presentation of the public interest standard also gets the public policy concerns of the 1996 Act backwards. In Qwest's view, the incumbent local telephone company with a market share of 98 percent in the residential market becomes disadvantaged vis-à-vis the long distance companies, even though the long distance companies generally have much smaller market shares in their primary markets and have made little headway in the local market. Qwest argues that the problem is a lack of competition in long distance, which is substantially more competitive than local, rather than the much more sparse competition in local markets. Qwest blames the competitors for choosing not to compete in local markets, dismissing the possibility

that there are barriers to competition. Qwest is the source of those barriers; barriers only Qwest can remove.

Given this backwards view of the statute and the economic reality, Qwest has gotten the public interest arithmetic backwards. Qwest emphasizes the benefits of allowing it to sell bundles of services, ignoring the larger benefit of price competition in both local and long distance service.

The WUTC has asked for comment on **"the potential benefits to the public interest and to consumers specifically that U. S. West foresees from its entry into the long distance market."** Making one stop shopping available to less than one third of the consumers in the state is the only unique benefit Mr. Teitzel offers. See DLT-1T, Exh _____ pp. 54-6. There is one vague and non-specific suggestion that price competition might occur Id., at p. 57. I believe that applying a strict standard for entry, as occurred in New York, can produce significant price competition. This includes a firm commitment to genuine parity of Operational Support Systems, strict military style testing at commercial scale of operations, and a Performance Assurance Plan with penalties that effectively elicit the desired behaviors.

Qwest asserts that local competition will come after it is allowed into long distance, when the evidence is that premature entry, with competition at the meager levels observed in Washington, will do exactly the opposite - stifling both local and long distance competition. The remainder of my testimony addresses the substantive flaws in Mr. Teitzel's discussion.

II. THE COMPETITION POLICY IN THE TELECOMMUNICATIONS ACT

Q. What is the public policy thrust of the 1996 Act?

A. Because the Qwest position turns the logic of the 1996 on its head, it is important to recall the Act and the framework that federal and state authorities established for evaluating section 271 applications.

In the 1996 Act, Congress set a broad goal of "opening all telecommunications markets to competition." It recognized that different markets posed different problems. Because local markets would be particularly difficult, it imposed special conditions on local service companies. In sections 251 and 252 of the 1996 Act, it imposed a series of requirements on all local exchange companies, as well as specific requirements on incumbent local exchange companies.

The Department of Justice has succinctly summarized the public policy balance that Congress struck in the 1996 Act when it addressed the issue of RBOC entry into in-region long distance.

> InterLATA markets remain highly concentrated and imperfectly competitive, however, and it is reasonable to conclude that additional entry, particularly by firms with the competitive assets of the BOCs, is likely to provide additional competitive benefits.
>
> But Section 271 reflects Congressional judgements about the importance of opening local telecommunications markets to competition as well. The incumbent local exchange carriers (LECs), broadly viewed, still have virtual monopolies in local exchange service and switched access, and dominate other local markets as well. Taken together, the BOCs have some three-quarters of all local revenues nationwide, and their revenues in their local markets are twice as large as the net interLATA market revenues in their service areas. Accordingly, more considerable benefits could be realized by fully opening the local market to competition.

DOJ, SBC, p. 4.

In short, Congress recognized that opening the local monopoly to competition was far more important than adding more competition in the long distance market.

Reflecting the more highly developed level of competition in the long distance industry segments and the fact that local exchange markets are a bottleneck input for long distance markets, Congress placed its emphasis on ensuring that local markets would be competitive. While the long distance oligopoly could be expected to perform better if greater competitive forces were brought to bear in it, the crucial barrier to competition in the telecommunications industry is the local monopoly.

> Section 271 reflects Congress' recognition that the BOCs' cooperation would be necessary, at least in the short run, to the development of meaningful local exchange competition, and that so long as a BOC continued to control local exchange markets, it would have the natural economic incentive to withhold such cooperation and to discriminate against its competitors. Accordingly, Congress conditioned BOC entry on completion of a variety of steps designed to facilitate entry and foster competition in local markets.

DOJ, SBC, pp. 4-6.

Q. Did the FCC take this view?

A. The FCC took the opportunity in its first section 271 decision to outline in detail the competitive advantage the incumbent local companies have in entering the long distance market compared to other companies entering the local market.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

The most crucial observation is to recognize, as the Antitrust court did, the power inherent in the incumbent monopoly status of the local exchange companies.[6] These advantages include,

- a history of legal barriers,
- economic and operational barriers,
- the fully deployed, ubiquitous network of the incumbents which lowers heir incremental cost of entering other markets, and
- the need for interconnection.[7]

Not only do the incumbent local exchange companies have an advantage in the market power they posses in the local market, but entry into the long distance market

---

[6] The court found that, if the BOCs were permitted to compete in the interexchange market, they would have "substantial incentives" and opportunity, through their control of local exchange and exchange access facilities and services, to discriminate against their interchange rivals and to cross subsidize their inter-exchange ventures. FCC Michigan, para. 10.

[7] For many years the provision of local exchange service was even more effectively cordoned off from competition than the long distance market. Regulators viewed local telecommunications markets as natural monopolies, and local telephone companies, the BOCs and other incumbent local exchange carriers, often held exclusive franchises to serve their territories. Moreover, even where competitors legally could enter local telecommunications markets, economic and operational barriers to entry effectively precluded such forays to any substantial degree...

These economic and operational barriers largely are the result of the historical development of the local exchange markets and the economics of local networks. An incumbent LEC's ubiquitous network, financed over the years by the returns on investment under rate of return regulation, enables an incumbent LEC to serve new customers at a much lower incremental cost than a facilities based entrant that must install its own network components. Congress recognized that duplicating the incumbents local networks on a ubiquitous scale would be enormously expensive. It also recognized that no competitor could provide a viable, broad-based local telecommunications service without inter-connecting with the incumbent LEC in order to complete calls to subscribers served by the incumbent LECs network. FCC Michigan, paras. 11-12.

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

will be relatively easy for them because of the more competitive structure of that market.[8] The ease of entry stems from a number of factors including,

- brand recognition,
- a fully deployed network, and
- a mature market where switching and resale are common.

Q. Did the Act reflect the Congress' concern about the local market in establishing the market opening requirements of section 271?

A. With this understanding of the advantages of the local incumbents, the provisions of section 271 seek to redress the imbalance of market power between local companies and their potential competitors. The FCC notes that it was this competitive imbalance that Congress sought to address in section 271.

---

[8] Indeed given the BOCs strong brand recognition and other significant advantages from incumbency, advantages that will particularly rebound in the broad-based provision of bundled local and long distance services, we expect that the BOCs will be formidable competitors in the long distance market and, in particular, in the market will bundled local and long distance services. ...

Significantly, however, the 1996 act seeks not merely to enhance competition in the long distance market, but also to introduce competition to local telecommunications markets. Many of the new entrants, including the major inter-exchange carriers, and the BOCs, should they enter each other's territories, enjoy significant advantages that make them potentially formidable local exchange competitors. Unlike BOC entry into long distance, however, the competing carriers entry into the local market is handicapped by the unique circumstance that their success in competing for BOC customers depends upon the BOCs' cooperation. Moreover BOCs will have access to a mature, vibrant market in the resale of long distance capacity that will facilitate their rapid entry into long distance and, consequently, their provision of bundled long distance and local service. Additionally, switching customers from one long distance company to another is now a time tested, quick, efficient, and inexpensive process. New entrants into the local market, on the other hand, do not have available a ready, mature market for the resale of local service or for the purchase of unbundled network elements, and the process for switching customers for local service from the incumbent to the new entrant are novel, complex and still largely untested. For these reasons, BOC entry into long distance market is likely to be much easier than entry by potential BOC competitors into the local market, a factor that may work to BOC advantage in competing to provide bundled service. FCC Michigan, para 15, 17.

1 By requiring BOCs to demonstrate that they have opened their local markets to competition before they are authorized to enter into the in-region long distance market, the 1996 Act enhances competition in both the local and long distance markets.

> If the local market is not open to competition, the incumbent will not face serious competitive pressure from new entrants, such as the major interexchange carriers. In other words, the situation would be largely unchanged from what prevailed before the 1996 act. That is why we must ensure that, as required by the Act, a BOC has fully complied with the competitive checklist. Through the competitive checklist and the other requirements of section 271, Congress has prescribed a mechanism by which the BOC may enter the in-region long distance market. This mechanism replaces the structural approach that was contained in the MFJ by which BOCs were precluded from participating in that market.

FCC Michigan, paras 15, 18.

Without section 271, there was little in the Act to give the BOCs incentives to open their markets.[9]

Having identified the basic conditions for local competition, the Congress turned to the question of entry by RBOCs into in-region, interLATA long distance. Unsatisfied that the general requirements placed on the RBOCs to open their networks to competition would be effective, the Congress required additional conditions and oversight by other agencies before the RBOCs would be allowed to sell in-region long distance See Attachment 1, MNK-2, Exh. _______. The Congress required the FCC to

[9] A salient feature of these market-opening provisions is that a competitor's success in capturing local market share from the BOCs is dependent, to a significant degree, upon the BOCs' cooperation in the non-discriminatory provision of interconnection, unbundled network elements and resold services pursuant to the pricing standards established in the statute. Because the BOCs, however, have little, if any, incentive to assist new entrants in their efforts to secure a share of the BOCs' markets, the Communications Act contains various measures to provide this incentive, including section 271. Through these statutory provisions, Congress required BOCs to demonstrate that they have opened their local telecommunications markets to competition before they are authorized to provide in-region long distance services. Section 271 creates a critically important incentive for BOCs to cooperate in introducing competition in their historical monopoly local telecommunications markets. FCC Michigan, para 14.

1 make findings in four areas before RBOCs were to be allowed into in-region long
2 distance services. These findings were to be made in consultation with the states and
3 the Department of Justice (whose advice was to be given substantial weight).[10]
4 The exhaustive, detailed and overlapping requirements placed on the RBOCs
5 and the multiple review by federal and state agencies with differing expertise make it
6 clear that Congress intended a vigorous and rigorous regulatory process before RBOCs
7 were to be authorized to sell in-region long distance services. The DOJ points out that
8 Congress contemplated delay in RBOC entry.

9 Congress carefully structured the four, interrelated prerequisites for BOC entry to ensure both (1) that the BOCs would have appropriate incentives to cooperate with competitors who wished to enter local markets and (2) the BOC entry into interLATA markets would not be held hostage indefinitely to the business decisions of the BOCs' competitors. Thus, rather than allowing for immediate entry or entry at a date certain, Congress chose to accept some delay in achieving the benefits of BOC interLATA entry in order to achieve the more important opening of local markets to competition.

DOJ, SBC, p. 7.

The four critical subsections of section 271 identify a subset of requirements. In section 271 [c](1) Congress required that there be a facilities-based competitor actually competing in the service territory of the RBOC for residential and business customers

[10] Section 271 establishes four basic requirements for long distance entry. The first three such requirements -- satisfaction of Section 271 [c] (1) (A) (Track A) or Section 271 [c](1)(B)(Track B), the competitive checklist, and Section 272 -- establish specific, minimum criteria that a BOC must satisfy in all cases before an application may be granted. In addition, Congress imposed a fourth requirement, calling for the exercise of discretion of the Department of Justice and the Commission. The Department is to perform competitive evaluation of the application. "Using <u>any standard</u> the Attorney General considers appropriate." And, in order to approve the application, the Commission must find that "the requested authorization is consistent with the public interest. In reaching its conclusion on a particular application, the Commission is required to give "substantial weight to the Attorney General's evaluation." DOJ, SBC, pp. 7-8.

using predominantly its own facilities. Only under limited circumstances did Congress anticipate allowing RBOCs to sell long distance in region without being subject to facilities-based competition (See Attachment 1, Column 1).

In section 271 [c](2) Congress provided a more detailed list of specific actions that the RBOC had to take to open its network (see Attachment 1, Column 2). These referred back to the conditions identified in sections 251 and 252 and expanded on them in considerable detail. These conditions have come to be known as the 14 point check list, since there are 14 items on the list.

Congress added requirements in section 272 for separation between the local and long distance arms of the RBOCs and regulation of affiliate transactions between local and long distance companies (see Attachment 1, Column 3). It also added safeguards to ensure that affiliates would not receive favorable treatment. These protections refer back to section 251 and expand and elaborate on them.

Finally, in section 271[d], the Congress added a broad public interest finding to the decision making process (see Attachment 1, Column 4).

While some have complained about the heavy, regulatory approach to review of requests for in-region sale of long distance services, even a quick review of the major areas in which Congress imposed conditions on RBOC entry into the long distance market suggests the careful scrutiny that Congress desired. The FCC argues that this structure was necessary to respond to an important public policy problem.

> Although Congress replaced the MFJ's structural approach, Congress nonetheless acknowledged the principles underlying that approach -- that BOC entry into long distance would be

> anti-competitive unless the BOC market power in the local market was first demonstrably eroded by eliminating barriers to local competition. This is clear from the structure of the statute which requires BOCs to prove that their markets are opened to competition before they are authorized to provide in-region long distance services. We acknowledge that requiring businesses to take steps to share their market is an unusual, arguably unprecedented act by Congress. But similarly, it is a rare step for Congress to overrule a consent decree, especially one that has forced major advances in technology, promoted competitive entry, and developed substantial capacity in the long distance market. Congress plainly intended this to be a serious step. In order to effectuate Congress' intent, we must make certain that the BOCs have taken real, significant and irreversible steps to open their market.
>
> The requirements of section 271 are neither punitive nor draconian. They reflect the historical development of the telecommunications industry and the economic realities of fostering true local competition so that all telecommunications markets can be opened to effective, sustained competition. Complying with the competitive checklist, ensuring that entry is consistent with the public interest, and meeting the other requirements of section 271 are realistic, necessary goals.

FCC Michigan, paras 18, 23.

III. THE COMPETITIVE ASSESSMENT

Q. What is the role of the competitive assessment of local markets.

A. Competitive assessment plays a key role in the section 271 review. The Department of Justice underscored the fundamental competition analysis which must be the basis of any ultimate finding on authorization of RBOC entry. The Department of Justice stresses the distinction between the minimum conditions set out in parts of section 271 and the broader public interest test. DOJ concludes that Congress clearly made a distinction between threshold conditions and an overall reading of the public interest.

> Congress supplemented the threshold requirements of Section 271, discussed in Parts II and III above, with a further requirement of pragmatic, real world assessments of the competitive circumstances by the Department of Justice and the

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24 25

> Commission. Section 271 contemplates a substantial competitive analysis by the Department, "using any standards the Attorney General considers appropriate. The Commission, in turn, must find before approving an application that "the requested authorization is consistent with the public interest, convenience, and necessity," and, in so doing, must "give substantial weight to the Attorney General's evaluation." The Commission's "public interest" inquiry and the Department's evaluation thus serve to complement the other statutory minimum requirements, but are not limited by them.
>
> In vesting the Department and the Commission with additional discretionary authority, Congress addressed the significant concern that the statutory entry tracks and competitive checklist could prove inadequate to open fully the local telecommunications markets. (emphasis added)

DOJ, SBC, p. 38.

Without specifying a precise standard, DOJ concludes that competition must be meaningful, real, nontrivial, substantial, and irreversible. At the key point in its response, DOJ uses the term "substantial competition."[11] In other places, the DOJ and its experts refer to "meaningful competition" and "real competition." DOJ, SBC, p. 51.

---

[11] The public interest in opening local telecommunications markets to competition also requires that the Commission deny SBC's interLATA entry application. SBC does not presently face substantial local competition in Oklahoma, despite the potential for such competition and the expressed desire of numerous providers, including some with their own facilities, to enter the local market... SBC's failure to provide adequate facilities, service and capabilities for local competition is in large part responsible for the absence of substantial competitive entry. If SBC were to be permitted interLATA entry at this time, its incentives to cooperate in removing the remaining obstacles to entry would be sharply diminished, thereby undermining the objectives of the 1996 Act.

In performing its competitive analysis, the Department seeks to determine whether the BOC has demonstrated that the local market has been irreversibly open to competition. To satisfy this standard, a BOC must establish that the local markets in the relevant states are fully and irreversibly open to the various types of competition contemplated by the 1996 Act -- the construction of new networks, the use of unbundled elements of the BOC's network, and resale of BOC services... In applying this standard, the Department will look first to the extent to which competitors are entering the market. The presence of commercial competition at a nontrivial scale both (1) suggests that the market is open; and (2) provides an opportunity to benchmark the BOC's performance so that regulation will be more effective. DOJ, SBC, pp. 41-42.

Thus, we have a series of adjectives far beyond the simple condition set out in section 271 [c](1).

The Department of Justice's analysis focuses primarily on the behavior of competitors. Are they actually entering and at what scale? If competition is real or meaningful, it must be affecting incumbent behavior in a number of areas. Entry, on which the Department of Justice focuses, is only one indicator of the competitive status of the market.

> It is premature to reward Ameritech Michigan with long distance entry under Sec 271 because the local bottleneck has not yet been broken pursuant to Sec. 251. If the local Michigan market were competitive, relevant indicators suggest that customers would be switching to other providers; historic monopoly rates would be going down; innovations, expanded services options and service quality would be increased. Instead it is clear that the local bottleneck has not been broken.

DOJ, Michigan, pp. 32, 33.

It appears at least arguable that the service quality improvements seen in Washington state are the result of conditions, and potential penalties, associated with the WUTC's approval of the merger of US West and Qwest; rather than a consequence of competition.

The Department of Justice has pointed out the failure of competition to spread beyond a very small number of select markets.

> The local competitive entry to date is primarily located in the largest urban areas, Grand Rapids and Detroit, but competitors have facilities in several other communities, including Lansing, Ann Arbor, and Traverse City.
>
> Ameritech remains, however, by far the dominant provider of local exchange services, with a near monopoly in its service areas. Most parts of Michigan still have no local competition, save possibly on a resale-

1 basis, since such CLEC competition as exists in Michigan is overwhelmingly concentrated in parts of the cities of Grand Rapids and
2 Detroit and is primarily focused on business customers.

3 Given this level of competition, we cannot presume that no barriers to entry exist. At the same time, given the successful
4 small-scale entry that have occurred using all three paths, we cannot presume that the local markets necessarily remain closed
5 either.

6 DOJ, Michigan, pp. 32-33.

7 The FCC used a similar string of adjectives and offered a long series of
8 examples of evidence that indicated the goals of the Act to promote competition are
9 being met. FCC Michigan, paras. 391-402.

10 State and federal authorities commenting on competition analysis have taken the
11 view that it is a good indicator, but not the only indicator, of the openness of the
12 market. For example, the Wisconsin Public Service Commission argued as follows:

13 The best way to make this showing would be through proof that broad-based competitive entry into local exchange markets has
14 been successful in the State. If broad-based entry into local exchange markets has not occurred in the State, that would not
15 foreclose the possibility of approval of a section 271 application if the BOC can otherwise prove that there are no significant
16 impediments to such entry.[12]

17 The FCC takes a similar view. For example, in its order rejecting Ameritech's
18 Michigan application the FCC stated:

19 The most probative evidence that all entry strategies are
20 available would be that new entrants are actually offering competitive local telecommunications services to different
21 classes of customers (residential and business) through a variety of arrangements (that is, through resale, unbundled elements,
22 interconnection with the incumbent network, or some

23 [12] "Finding of Fact, Conclusions of Law and Second Order," Matters Relating to Satisfaction of
24 Conditions for Offering InterLATA Service (Wisconsin Bell, Inc. D/b/a/ Ameritech Wisconsin), Public Service Commission of Wisconsin (hereafter Wisconsin), p. 5.

25

> combination thereof), in different geographic regions (urban, suburban, and rural) in the relevant state, and at different scales of operation (small and large). We emphasize, however, that we do not construe the 1996 Act to require that a BOC lose a specific percentage of its market share, or that there be competitive entry in different regions, at different scales, or through different arrangements, before we would conclude that BOC entry is consistent with the public interest.
>
> Evidence that the lack of broad-based competition is not the result of a BOC's failure to cooperate in opening local markets could include a showing by the BOC that it is ready, willing, and able to provide each type of interconnection arrangement on a commercial scale throughout the state if requested.

FCC Michigan, paras. 391-392.

To put the matter in simple terms, Qwest has the opportunity to prove that "I opened my market and nobody came." However, because the goal of the Act is to have actual competition, when competition is lacking, the incumbents should bear a heavy burden of showing that its market has been opened for a sufficiently long time to allow meaningful entry. Only then can we conclude that barriers to entry were the not cause of the problem.

Q. If the competitive assessment raises questions about the status of competition, where do regulators look to understand the cause of the lack of competition?

A. At this point, we enter into the items of the 14 point checklist. Here we ask whether there are specific problems with checklist-item implementation that may be creating a barrier to entry.

The fundamental question is, what does full implementation on a non-discriminatory basis of the 14 point competitive checklist mean?

> Full implementation means that final rules are in place implementing equal quality service at fully commercial scale,

with mechanisms in place to detect discrimination and enforce penalties to correct abuses.[13]

The Department of Justice is particularly concerned about the ability of RBOCs to provide wholesale functionality -- fully loaded functioning. As with competitive standards, regulators at the state and federal level have come to focus on actual provision of service under conditions of competition.[14] The FCC's order in the

[13] The Department of Justice stated this position as follows:

> By the same token, an agreement that does not set forth complete rates and terms of a checklist item, but merely invites further negotiations at some later time, falls short of "providing" the item as required by Section 271, as does a mere "paper commitment" to provide a checklist item, i.e. one unaccompanied by a showing of the actual ability to provide items on demand... In sum, a BOC is "providing" a checklist item only if it has a concrete and specific legal obligation to provide it, is presently ready to furnish it, and makes it available as a practical, as well as formal matter. DOJ, SBC, pp. 23-24.
>
> The Oklahoma Attorney General reached a similar conclusion:
>
>> The requirement that SBC must be "providing" access and interconnection demonstrates Congress' intent that such unaffiliated competing provider must be operational. "Operational" means "able to function or be used." AG Oklahoma, p. 4.

[14] Accordingly, the Commission finds that to meet its stated "tested and operational" requirement, Ameritech must provide access to each of the following interfaces: pre-ordering, ordering, provisioning, repair and maintenance, and billing. That access must be non-discriminatory, meaning in substantially the same time and manner that an incumbent LEC provides OSS functions to itself. Access to the necessary design and operating specifications must be provided to enable CLECs to use the interfaces. The burden of proof is upon Ameritech to show that these requirements have been fulfilled. That burden of proof has not been met. Wisconsin, p.17.

Or, as stated by the Attorney's General commenting on SBC's Oklahoma application:

> CLECs need smooth and effective communications with the BOCs' databases in order to enable effective local exchange competition. If a BOC's OSS do not function well or break down, this will impede the CLEC's ability to service its customers and the customer will blame the CLEC rather than the BOC...

Ameritech Michigan petition sought to elaborate and give specificity to the concept of fully loaded functioning. FCC Michigan, summary at para. 22. The principles it adopted were as follows.

- Elements must be available subject to concrete and specific legal obligations embodied in a state-approved agreement that sets the price, terms and conditions of service.
- Rates must be based on forward looking costs, and the FCC intends to use its TELRIC methodology to determine if they are anticompetitive.
- Competitors must have access to all processes, including interface and legacy systems (systems embedded within the incumbent's operating structure that support its services) to accomplish all phases of a transaction - - pre-order, order, provisioning, repair and maintenance, billing.
- In order to meet the requirements of the Act, the elements have to be operationally ready and sufficiently available to meet the likely demand in volume and in a manner that does not discriminate against or place competitors at a disadvantage.

A BOC's OSS capability should be required to pass at least two tests before they are deemed to satisfy the competitive checklist. First, the BOC must demonstrate that the systems incorporate sufficient capacity to be able to handle the volumes of service reasonably anticipated when local competition has reached a mature state. Second, the BOC's OSS capabilities must be proven adequate in fact to handle the burdens place upon them as local competition first takes root. Testing of the systems by the BOC is not enough to provide reasonable assurance that they will function as planned with the system of CLECs. It will require some experience with the systems on a day-to-day basis under conditions of local competition in order to asses their adequacy on this measure.

Finally, some record of experience under conditions of local competition is necessary to reveal whether a BOC will engage in unfair or discriminatory practices to inhibit entry into local exchange service markets. As a provider of essential bottleneck facilities, BOCs retain considerable market power in local exchange markets. The importance of OSS is just one example of the BOCs' competitive significance in these markets. BOC promises of compliance with statutory prohibitions against unfair and discriminatory practices must be confirmed in the course of confronting real and effective competition in the marketplace. Attorneys General, pp. 8-9.

- The ongoing performance of the BOC in supplying the elements should be subject to monitoring and enforcement to ensure the availability of elements at all phases of the interaction with competitors.

FCC Michigan, paras. 110, 288-290, 135, 136, and 140 respectively with data requirements described in paras. 164, 205, 206 and 212.

The performance review of the BOCs became a central issue in the Ameritech proceeding. Once companies begin to compete, their success will be largely determined by their ability to deliver service. Since they are significantly dependent on the BOCs to initiate and maintain service, their fate can be determined by a difference in service quality.

The Department of Justice has concluded that it is critical to provide entrants with a higher degree of certainty.[15] Faced with uncertainty, competitors find it extremely difficult to make major commitments to invest in local competition. Without certainty, they cannot make the commitments necessary for large-scale entry into local markets. Moreover, uncertainty inhibits entry in those markets where margins are lowest.

[15] Even if the issue related to SBC's support processes were adequately addressed, there could still be other obstacles to competitive entry in Oklahoma, which competitors would have to confront if they are ever able to cross the initial thresholds. For example, SBC has failed to show that its rates for unbundled elements, as established in the AT&T arbitration and as used in its SGAT, are consistent with underlying costs. The Oklahoma Corporation Commission (OCC) has never found SBC's SGAT rates for unbundled elements and interconnection, or its interim arbitrated rates from which they were derived, to be cost-based... The OCC's proceeding to examine SBC's costs and set final prices will not even commence until later this summer, and it is not clear when this proceeding will be completed. Since it is not yet known what the final Oklahoma prices will be or how they will be determined, the provision for a true-up is hardly sufficient assurance that competitors will in fact be charged cost-based prices now or later. DOJ, SBC, pp. 61-62.

IV. THE IMPACT OF PREMATURE ENTRY

Q. Do you agree with Mr. Teitzel's statement that long distance entry should come first, to stimulate local competition?

A. I disagree entirely and believe that the Act precludes this approach. More importantly, I believe that the experience in New York, compared to other states, supports the conclusion that premature entry by RBOCs can be disastrous for competition.

Prematurely allowing incumbent local companies into the in-region long distance market undermines the prospects for competition. The WUTC seeks information about **"the likely impact on the local and long distance markets if U. S. West enters the long distance market."** If the incumbents are allowed into long distance markets before their local markets are irreversibly open, local competition will not develop and long distance competition will not be vigorous. The incumbents can capture long distance customers without having to compete on price because barriers have not been removed. They face little real local competition and their hold on the local market is reinforced by their unique ability to offer a bundle of services.

The WUTC has asked, **"Will there be a 'first mover' advantage associated with the ability to offer integrated service, and if so, how significant will that advantage be?"** There will be a significant advantage. The risk that arises from a rush to approve a section 271 application is that the incumbent can exploit the anticompetitive conditions, or "competitive imbalance," in the critical early days of the bundled telecommunications market. It can then rapidly capture long distance customers by bundling local and long distance service, while competitors are unable to respond with a competitively priced bundle.

The two key conditions for competition, Operating Support Systems (OSS) that treat competitors at parity and prices for unbundled network elements (UNEs) are not

in place and/or are uncertain in Washington. Operationally, while audits and tests of operating support systems are being conducted, the ability to treat competitors at parity at full commercial scale over a sustained period of time has not been demonstrated. Moreover, even if it could be shown that current Operating Support Systems are adequate, the market opening conditions are not irreversible. The performance assurance plan (PAP), which is the key to ensuring ongoing treatment of competitors at parity, is still under development. Similarly, the prices charged for UNEs must be based on rigorous TELRIC costs, that are permanent and in place for a sufficient period of time for competitors to establish their business models in the state. UNE pricing is still under development in Washington state. Therefore, by definition, these key conditions are not yet irreversible.

The WUTC has asked for information on **"the likely competitive impact on the local and long distance markets if U. S. West enters the long distance market."** Allowing premature entry will cause the CLEC industry to shrink, as RBOCs capture long distance market share. The incentive to open local market will be eliminated. Although the more competitive long distance market will gain some additional competition, the larger impact will be on the local market which will suffer from premature entry.

Q. How do you interpret the results in New York?

A. The root cause of the success in New York is not, as Mr. Teitzel argues, the mere entry by incumbents into long distance. Mr. Teitzel argues that competitors entered New York, not because the conditions for a truly competitive local market were put in place, but because the competitors thought the New York Public Service Commission was going to approve entry. To the contrary, the cause of the success in New York is the irreversible market opening that took place prior to allowing the company entry into

long distance. Prematurely allowing incumbent local companies into the in-region long distance market undermines the prospects for competition. Again, what is required is a firm commitment to genuine OSS parity, strict military style testing at a commercial scale of operations, and a PAP with sufficient penalties to elicit the desired behaviors by Qwest.

Q. How does competition in Washington compare to New York?

A. In the residential sector, it is virtually non-existent. The WUTC has asked about **"the present state of competition in the provision of both local and long distance services."** I answer that question in the context of a comparison to New York, now and at the time of entry. Qwest's claims about competition after entry are intended to obscure the fundamental point that residential competition is nowhere nearly as well developed in Washington as in New York at the time of its application there.

Table 1 below summarizes the distribution of competition between the business and residential classes in New York and Washington, both today and at the point when the New York application was approved. I include Connecticut for purposes of comparison. Not only is Connecticut a neighbor of New York, but it is also one of only two states whose customers are overwhelmingly served by a non-Bell company. This means that entry into long distance was not subject to the requirements of irreversible opening. As the figures suggest, with respect to local competition, the results for consumers are disastrous.

TABLE 1: EXTENT OF RESIDENTIAL COMPETITION[16]

	CLEC SHARE OF MARKET (in Percent)		
	NEW YORK	WASHINGTON	CONNECTICUT
DECEMBER 2000	19%	3%	3%
JUNE 2000	15	1	1
UPON APPLICATION	7	n/a	0

Compared to New York at the time of entry, Washington has virtually no competition. The lack of competition for residential customers is reflected in a very different geographic spread of competition. Although data is available only for the current geographic distribution of competition, it shows a sharp difference between the two states, as Table 2 shows.

TABLE 2: GEOGRAPHIC SPREAD OF COMPETITION

	PERCENT OF ZIP CODES					
	NY		**WA.**		**CONN.**	
	6/00	12/00	6/00	12/00	6/00	12/00
NO CLEC	12%	7%	37%	29%	5%	1%
1 TO 3 CLECS	28	38	45	40	92	94
4 TO 5	18	16	14	23	3	4
6 OR MORE	42	49	4	7	0	0

Id.

The WUTC also asks **"Will the entry of U. S. West into the interLATA market affect the incentives of long distance companies to expand local service?"** If the entry is premature, the long distance companies may exit the local market. Washington looks a lot more like Connecticut than New York and the likely impact of

[16]See Industry Analysis Division, *Local Telephone Competition: Status as of December 31, 2000* (Federal Communications Commission, May 21, 2001).

premature entry is likely to be a complete absence of competition for local residential service.

Unfortunately, similar data for the geographic distribution of competition by zip codes was not compiled for New York at the time of its approval, a year and a half ago. However, the substantial difference in residential competition leads us to suspect that it had more widespread geographic competition. The analysis of market structure in Washington suggests that there is not a base of competition to support it in the long term. This indicates that the underlying conditions for competition have not been established.

Q. What is your recommendation for how the Commission proceed from this point?

A. Based upon the information Qwest has provided and that which is publicly available, I believe that the presently undeveloped state of competition in Washington stems from the absence of a stable set of market opening conditions available on a long-term basis. The Commission should continue to press the company to put those conditions – particularly OSS parity and cost-based UNEs – in place. Further, the company should also be required to have a fully developed performance assurance plan in place and to be in statistical compliance with that plan (i.e. no significant fines or violations) for one fiscal quarter (90 days) before the Commission supports Qwest's application for entry into the in-region long distance market. The ROC OSS and PAP processes are not yet complete and the WUTC and the parties to the Washington proceeding have not yet had an opportunity to review the OSS and PAP on the record in Washington. Until these necessary elements are finished, and until a meaningful review is available for parties

not participating in the ROC OSS and PAP process, any opinion of whether Qwest's entry in the InterLATA long distance market is in the public interest must be conditional.

At that point, once these conditions are in place, I do not believe we will be forced into the debate over the extent of competition because competitors will enter where markets are truly open. Of course, at that time, the WUTC should look carefully at the actual status of competition and define the public interest standard broadly in conducting its review.

V. THE IMPORTANCE OF GETTING THE UNBUNDLED NETWORK ELEMENT APPROACH RIGHT

Q. Why do you believe the UNE approach is so important?

A. The New York model demonstrates that the state Commission's approach to UNE pricing can deliver substantial benefits. It is also appears that other approaches are not likely to have a substantial impact in the near term.

Q. How has price competition unfolded in New York?

A. In New York, new entrants offered statewide local rates at a substantial discount. The price of MCI's competing local service was about 5 percent less than the incumbent's. When bought in combination with long distance (any plan) an additional $5 was taken off the bill. Given the rates in New York, this constituted an additional discount off of the typical local bill of 10 to 15 percent. Customers who wanted bundled local and long distance services could save between 15 and 20 percent off their local bill.[17]

[17] Comments Of The Consumer Federation Of America, In the Matter of Application of New York Telephone Company (d/b/a/ Bell Atlantic – New York) Bell Atlantic Communications, Inc. NYNEX Long Distance Company and Bell Atlantic Global Networks, Inc., for Authorization To Provide In-Region, InterLATA

In New York, the potential savings represent about three-quarters of the long-term potential gains from competition, as estimated by the FCC's own Synthesis Proxy Cost Model. Id. In New York, there would appear to be about $10.50 of inefficiencies, misallocated costs, etc., embedded in local service costs that could be weeded out by vigorous competition. Of this, about $7.85 is recoverable in the intrastate jurisdiction. The savings of $6 per month described above would capture three-quarters of that for the residential ratepayer.

In the long distance market, Verizon entered with a range of competitive offerings, anchored by an anytime, anywhere rate of $.10 per minute. Compared to the products in the market at the time, this was about a 50 percent savings for low volume customers. Other products offered by Verizon were attractive as well.[18]

As a result of genuinely open markets, consumers in New York have switched companies in droves (2.7 million local and over 1.5 million long distance). Companies have engaged in "tit-for-tat" competition, matching each other's offers. Prices for both local and long distance service have dropped substantially (approximately 20 percent for those who shop).[19]

The key to this outcome is to ensure that the local market is effectively open to competition prior to granting approval for the incumbent BOC to enter the interLATA long distance market. If the local market is not open, long distance companies cannot compete to deliver bundled services. Moreover, the incumbent BOCs do not have to

---

Services in New York, Before the Federal Communications Commission CC Docket No. 99-295, November 8, 1999.

[18] The Telecommunications Research and Action Center, *A Study of Telephone Competition in New York*, September 6, 2000.

[19] Id.; Consumer Federation of America and Consumer's Union, *Lessons From 1996 Telecommunications Act: Deregulation Before Meaningful Competition Spells Consumer Disaster*, February 2001.

compete vigorously to win market share in the interLATA long distance market. The BOCs just bundle local and long distance and use their name recognition to gain market share. This is exactly what happened when companies like Southern New England Telephone and GTE were allowed to enter the long distance markets in the states of Connecticut and Hawaii before they opened their local markets to consumers. In those markets they offered un-competitive long distance rates and consumers got virtually no benefits. There was no local competition whatsoever.

Q. Is New York a relevant comparison for Washington?

A. There is no reason why OSS cannot be made to work at parity across all companies. The results of the FCC's Hybrid Proxy Cost Model show that cost difference between Washington and New York are not that great.

Q. Why do you think UNE-based competition is so important for residential consumers?

A. It does not appear that other means of entry will provide substantial competition for the incumbent monopolists any time soon.

The failure of new entrants to break the monopoly of the incumbents is reinforced by the failure of incumbents to compete against one another, just as in cable. It was hoped that the large incumbent local monopoly companies might attack their neighbors' service areas, as they are the best situated to do so. But such competition has not happened.[20] The incumbent local exchange carriers (ILECs) have not yet tried to enter each other's service territories in any significant way. In fact, they have done quite the opposite. Rather than compete, they have merged. Before the 1996 Act was

[20] Reply Comments Of The Consumer Federation Of America, Consumers Union, And AARP, before The Federal Communications Commission, Proposed Transfer Of Control SBC And Ameritech, CC Docket No. 98-141, November 16, 1998); Citizen Action of Indiana, et al., *The Consumer Case Against the SBC-Ameritech Merger* (January 20, 1999).

passed, the largest four ILECs owned less than half (48%) of all the lines in the country.[21] Today, the largest four local telephone companies own about 85% of all the lines in the country.[22]

The WUTC has asked, **"Whether the public interest requires the presence of viable local competition in at least the major markets in Washington. Whether such competition should be available to both business and residential customers. If viable competition is not required, whether as an alternative, any other level or standard or test of competition must be met in order to establish that the applications is in the public interest."** I believe viable competition is required in the residential market to meet the public interest standard. No lesser standard is acceptable. Until Qwest can demonstrate that it has operationally provided an irreversibly open market, as measured by the 14 point checklist, for a substantial period of time, at least 90 days, the commission should not consider any lesser standard. 90 days is a commercially reasonable period and provides for collection of three months of OSS data for the possible application of PAP penalties. Because the PAP is still under formulation it is still uncertain what the precise penalty structure would be. It is my understanding that under the current Qwest PAP proposal certain penalties could be held in abeyance or not imposed depending upon subsequent month(s) compliance or non-compliance. 90 days of review provides an adequate basis for the WUTC to make an informed judgement on the application of the final PAP it approves to the fully functioning OSS Qwest will have to have in place at that time.

Q. What about competition from coaxial cable providers?

[21] FCC, *Statistics of Common Carriers, 1995/1996,* Tables 1 and 2.5.
[22] Id., adjusted for Bell Atlantic/GTE merger and CLEC line count.

A. Wire-to-wire competition has been a failure in another very evident way. Throughout October 2000, AT&T conducted a flurry of board meetings, press conferences and conference calls with Wall Street analysts to explain its decision to break itself up into four companies.[23] The admission that its business strategy had failed was obviously bad news for AT&T stockholders, but it was even worse news for telephone consumers. It signaled the failure of the federal Telecommunications Act of 1996 to deliver local phone competition.

AT&T justified its purchases of cable TV companies to regulators and bankers by claiming that local telephone competition over cable wires could be provided only as part of an integrated package of voice, video and data services.[24] It promised to use the tens of millions of cable lines it was buying to compete for local telephone service.[25] Now AT&T is going in the opposite direction. The company is splitting the cable business from its telephone and wireless businesses, and creating a separate tracking stock for its consumer long distance business.

The difficulties of providing switched telephone service over cable networks appear to render such activity uneconomic.[26] It appears that two separate networks,

---

[23] Cooper, Mark, "Picking Up the Public Policy Pieces of Failed Business and Regulatory Models," presented at *Setting The Telecommunications Agenda,* Columbia Institute For Tele-Information, (November 3, 2000).

[24] *Application for Consent to Transfer of Control of Licenses and Section 214 Authorization from Telecommunications, Inc., Transferor, to AT&T Corp., Transferee, Public Interest Statement,* Federal Communications Commission, CS Docket No. 98-178; *Application for Consent to Transfer of Control of Licenses and Section 214 Authorization from MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee, Public Interest Statement,* Federal Communications Commission, CS Docket No. 99-251.

[25] This was always a dubious proposition, see Consumers Union, Consumer Federation of America and Media Access Project, *Breaking the Rules: AT&T's Attempt to Buy a National Monopoly in Cable TV and Broadband Internet Services* (August 17, 1999).

[26] The local exchange companies recognized the difficulty that cable companies would have in providing telephone service. Bell Atlantic described the problems in detail in its aborted attempt to purchase TCI. (See Bell Atlantic's Request for an Expedited Waiver Relating to Out-of-Region Interexchange Services and Satellite Programming Transport, *United States of America v. Western Electric Company, Inc., and American Telephone and Telegraph Company*, Civil No. 82-0192 (HHG) January 20, 1994. The request consists of six parts, the request itself and five affidavits (Affidavits in Support of Bell Atlantic's Request for an Expedited Waiver

each optimized around very different functionalities, make perfect economic sense, for three legitimate reasons.[27] One, functional specialization is a sound economic principle, especially when there are diseconomies of integration between switched and non-switched services. It costs too much to make one network do very different things. Two, "One-stop-shopping" sounded like a good idea but it was not compelling when one-click shopping is available for almost anything. Consumers are not clamoring for one huge package of voice, video and data services. Three, planning, setting, and achieving goals is much more difficult for these multi-service, integrated firms. It is much more challenging to sell three distinct services to very different kinds of customers.

Specialized networks that do not compete directly for their core businesses pose a problem for policymakers. Without wire-to-wire competition, the plain old problem of monopoly power in cable TV and local telephone networks fails to subside.[28]

Q. What about competition from wireless providers?

A. Wireless telephone service technologies have not solved the problem of a lack of competition for local service and will not solve it any time soon. Cellular phones have

---

Relating to Out-of-Region Interexchange Services and Satellite Programming Transport, January 20, 1994. Individual affidavits include Alfred E. Kahn and William E. Taylor; Gary S. Becker; Robert W. Crandall; Robert G. Harris; and Brian D. Oliver. Ironically, prior AT&T management apparently reached the same conclusion. However, current AT&T management confesses to being unaware of these analyses (Cauley, Leslie, "Armstrong's Vision of AT&T Cable Empire Unravels on the Ground," *Wall Street Journal,* October 18, 2000). At least one cable company has publicly admitted that it cannot pursue a typical telephone service (circuit switched telephony) and will have to try to provide Internet telephony, although there are no guarantees when, or whether, this approach will be viable for basic telephone service (Comments of Joe Waz at Setting The Telecommunications Agenda, Columbia Institute For Tele-Information, November 3, 2000).

[27] It was always a dubious proposition. See Cooper Mark, *Expanding the Information Age in the 1990s: A Pragmatic Consumer Analysis* (Consumer Federation of America and American Association of Retired Persons, January 1999); *Developing the Information Age in the 1990s: A Pragmatic Consumer View* (Consumer Federation of America, June 8, 1992)

[28] Consumer Federation of America and Consumer Action, *Transforming the Information Superhighway into a Private Toll Road* (, September 1999), looks at problems in both the cable TV and the telephone industries from the point of view of advanced services.

become popular, but this service has not emerged as a substitute for basic telephone service for several reasons. Even though the price of wireless has come down, for the average consumer wireless costs about five times as much as local service.[29] The average flat rate telephone is in use for local calling about 1300 minutes per month.[30] The average monthly charge is about $20 per month. Thus average cost per minute of use for wireline service is $.015 per minute ($20/1300). Assuming half the usage is outgoing, the cost per minute of a call made is $.03 ($20/650). This is much less than average cost of cellular calling plans, which run in the range of $.10 to $.15 per minute (e.g. 1500 minutes for $150). Cellular service is measured service; local exchange service is generally flat rate. Cellular service does not allow multiple phone hookups on the same phone number, in contrast to wireline service. Cellular charges not only for outgoing calls, but also for incoming calls, which is never the case with wireline service.

The proof that wireless and basic wireline services occupy different product spaces can be seen in the numbers of consumers subscribing to each. Both wireless and wireline have been growing at strong rates. In fact, since the 1996 Act was passed, the number of local access lines has grown faster than at any time since the 1984 break-up of the AT&T system. Local exchange revenues have been growing twice as fast as other wireline revenues, and faster than they had in the in the first half of the 1990s.[31] Thus, although cellular has achieved a high market penetration, it does not represent an economic substitute for wireline local telephone service. It is a different commodity that provides different functionality.

---

[29] Comments of the Consumer Federation of America.

[30] Industry Analysis Division, *Trends in Telephone Service*, December 2000.

[31] Federal Communications Commission, *Trends in Telephone Service, 2000* (March 2000); Federal Communications Commission, *Statistics of Common Carriers* (various issues).

1 The fact that wireless has failed to become cost competitive with wireline, while
2 it was moving from twenty million subscribers to over 100 million subscribers bodes ill
3 for future competition. The economies of scale have been substantially exploited and
4 wireless is clearly not a substitute for basic telephone service.

5 **Q. What about the competition provided by the competitors cited by Mr. Teitzel in**
6 **his testimony?**

7 A. The CLEC industry has suffered tremendously since last year, when most of the data
8 relied upon by Mr. Teitzel appears to have been gathered. I have addressed several of
9 the competitors previously in my testimony and provide a brief review of the current
10 market status of those identified by Mr. Teitzel below.

11 **Electric Lightwave, Inc.** On April 2, 2001, Electric Lightwave received a
12 letter from The NASDAQ Stock Market Inc., informing it that if the bid price for ELI's
13 Class A Common Stock is not at least $5.00 for 10 consecutive days prior to July 2,
14 2001, ELI's stock will be delisted and transferred to the NASDAQ Small Cap Market.
15 From January 1, 2001, to May 25, 2001, ELI's market capitalization has fallen roughly
16 51%, from $168 million to $82 million. The stock price has fallen from $3.31 to $1.61.
17 While the company reported first quarter 2001 revenues of $62.6 million, a 10 percent
18 increase over that of the same period a year ago, it is still operating at a loss – $37.7
19 million in Q1 2001. *Business Wire, May 8, 2001; MSN Investor (market capitalization*
20 *and stock price data).*

21 **Eschelon Telecom, Inc.** Privately held Eschelon announced in February that it
22 has acquired Salt Lake City-based Rocky Mountain Telephone Company, a telephone
23 systems provider serving Utah businesses. Eschelon plans to use this acquisition to
24 expand its presence in the Salt Lake City market. *Business Wire, February 14, 2001.* In
25 April Eschelon announced that it added $10 million to its debt facility in order to install

a switch in its Reno, Nevada market and to expand its investment in its operations support systems. The additional financing expanded the company's bank facility from $135 million to $145 million. *Business Wire, April 5, 2001.*

Allegiance Telecom, Inc. Allegiance announced a record first quarter in 2001 with revenues of $105.9 million. This represents an increase of 11% over the prior quarter and 124% from the same period a year ago. Lines sold increased 9%. The company still operates at a loss, however, and its market capitalization has fallen roughly 24.7%, from $2.51 billion to $1.89 billion, during the period from January 1, 2001, to May 25, 2001. The stock price in that period has fallen from $22.27 to $16.8. The company estimates that it will be operationally profitable by 2002. *PRNewswire, April 24, 2001; MSN Investor (market capitalization and stock price data).*

Sprint FON Group. Sprint announced first quarter 2001 revenues of $4.36 billion, down 1% compared to the same period a year ago. Net income was $315 million, down 41% compared to $445 million in the same period last year (excluding a $675 million gain from the sale of Global One in 2000). The CEO indicated that Sprint was shifting its focus from a predominantly wireline voice business to the higher growth areas of data, wireless, and broadband services. *PRNewswire, April 17, 2001.* Sprint's market capitalization and stock price, despite interim fluctuations, were largely unchanged from the period beginning January 1, 2001, to May 25, 2001. Both increased roughly .3%, with the market cap now at $16.28 billion and the stock trading at $20.37. *MSN Investor.*

WorldCom. WorldCom announced first quarter 2001 revenues in its MCI Group, the division that handles long distance and local services, of $3.6 billion, down 14% from $4.2 billion in the same period a year ago. The company noted that while MCI was actually seeing an increase in long distance and local revenue, it was being

offset by reduced revenues from calling card services as they are being replaced by wireless services. *PRNewswire, April 26, 2001.* WorldCom's market capitalization and stock price have risen roughly 29% to $52.4 billion and $18.15, respectively, during the period beginning January 1, 2001 to May 25, 2001. *MSN Investor.*

Teligent, Inc. On May 21st Teligent announced that it filed for Chapter 11 bankruptcy. Its shares last traded on the NASDAQ on May 10th, closing at 56 cents. *Bloomberg, May 21, 2001; Reuters, May 25, 2001.*

XO Communications. XO reported first quarter 2001 revenues of $277.3 million, a 10% increase over the prior quarter, and a 162% increase over the first quarter of 2000. However, net income for the period was a loss of $443.5 million, compared to a gain of $43.2 million in the same quarter last year. The company estimates that it has sufficient funding to last through the first half of 2003. *Business Wire, April 26, 2001.* From January 1, 2001, to May 25, 2001, XO's market capitalization and stock price have fallen roughly 81%. Its market cap fell from approximately $6.54 billion to $1.26 billion, and the stock price fell from $17.81 to $3.43. *MSN Investor.*

In sum, this is an industry undergoing massive consolidations, restructuring, and failures. The next year or two will be critical in determining whether the competitive telecommunications market the Congress envisioned will come to be. Premature entry by Qwest or any BOC into the long distance markets is one of the few, discrete market events which can be clearly identified as seriously damaging, if not damning to that vision.

Q. Please summarize your testimony.

A. It is critically important for the Commission to recognize that in its role as the state agency overseeing the market opening process, it should define the public interest

standards for evaluating a section 271 application broadly, to reflect Washington goals and objectives. I believe viable competition is required in the residential market to meet the public interest standard. The FCC will pay heed to the desires of the Washington State Commission. Insisting upon a rigorous market opening process that mirrors the approach taken in New York can have a substantial pay-off for the citizens and consumers of Washington. A vibrantly competitive telecommunications marketplace, as the one which has developed in New York, is a goal worth striving for.

The steps necessary to accomplish that goal are clear. Operating support systems that do not discriminate against competitors must be in place and fully operating at commercial scale. UNE prices must be based on a rigorous TELRIC analysis. The PAP must contain a penalty structure that will elicit the desired pro-competitive behaviors from Qwest. These conditions, which will bring forth vigorous competition, must be in place for a substantial period before Qwest is allowed to enter into long distance. If entry is premature, the incumbent will not be forced to compete for local service. With an advantage in bundling, name recognition and the other trappings of incumbency, incumbents will squelch competition.

The current status of competition in Washington reflects the fact that the basic market opening conditions do not yet appear to be in place in the state. Competition in the residential market is negligible. The collaborative process, of which this proceeding is a part, is intended to create the necessary market opening conditions. When Qwest finally does open its local markets, I have no doubt that competition will grow and entry into long distance will be justified.

Q. Does this conclude your testimony?

A. Yes.