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October 28, 2003

Ms. Carole J. Washburn
Executive Secretary
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION
1300 S. Evergreen Park Drive S.W.
Olympia, WA 98504-7250

VIA ABC LEGAL MESSENGER

RE: In the Matter of the Petition of Qwest Corporation For Competitive Classification of Basic Business Exchange Telecommunications Services WUTC Docket No. UT-030614

Dear Ms. Washburn:

Enclosed for filing in the above-referenced docket are the original and 14 copies of WebTEC's Initial Brief. A copy of this document has also been served on all parties via the methods noted on the attached Certificate of Service.

If you have any questions, please feel free to contact our office.

Sincerely,

ATER WYNNE LLP

Susan Arellano
Secretary to Arthur A. Butler

Enclosures

cc w/encls: All Parties of Record

231495/1

The Honorable Theodora M. Mace

BEFORE THE
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

In the Matter of the: Application of Qwest Corporation's Request for Competitive Classification of Basic Business Exchange Telecommunications Services.	Docket No. UT-030614 **WEBTEC'S INITIAL BRIEF [Dated October 28, 2003]**

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I. INTRODUCTION

The Washington Electronic Business & Telecommunications Coalition (WeBTEC) submits the following brief in opposition to Qwest's petition requesting competitive classification of its basic business exchange services.

WeBTEC has two overarching concerns in this case. First, it is interested in ensuring there be sufficient competition to constrain Qwest's prices for the subject services before regulatory constraints are lifted. Premature competitive classification of Qwest's business exchange services - when Qwest still possesses significant market power - would give Qwest both the incentive and ability to exercise that market power and charge excessive prices for services WeBTEC members consider critical to their businesses. Second, WeBTEC is interested in ensuring a healthy and sustainable competitive marketplace be allowed to develop in Washington State, one that is capable of producing real consumer benefits in the form of lower prices, higher quality service, and innovation. Again, premature competitive classification of Qwest's business exchange services would create undesirable results; it would give Qwest the incentive and ability to price in a way that will both create barriers to CLEC entry and drive existing CLECs out by reducing margins below the level necessary for the CLECs to cover their costs and generate a profit.

Here, Qwest and Staff have failed to properly analyze and define the relevant market, making it virtually impossible to measure the true state of competition in a meaningful way. They have also failed to present the kind of evidence the Commission should consider in evaluating a petition like this. Moreover, the evidence that is available strongly suggests Qwest still retains and has been able to exercise significant market power over the services it now seeks to have competitively classified. Because the results of the pending Triennial Review impairment

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proceeding, Docket No. UT-033044, dealing with mass market switching and dedicated transport, could seriously undermine the foundation of Qwest's and Staff's case - the continued availability of wholesale services at TELRIC rates - and because important evidence that would be key to the proper determination of whether price constraining competition actually exists in Qwest's service territory will be developed in the Triennial Review impairment proceeding, WeBTEC respectfully requests the Commission deny Qwest's petition and direct the company to refile its petition after completion of the pending impairment proceeding. With the benefit of the relevant information that will be available, Qwest and Staff can present the kind of analysis they should have presented in this case. In that instance, the Commission will have before it the evidence and analysis needed to make a responsible decision about how Qwest's business exchange services should be regulated.

II. APPLICABLE LAW

A. Washington's Competitive Classification Statute

Soon after divestiture, and ten years before Congress passed the federal Telecommunications Act[1], the Washington legislature enacted the Regulatory Flexibility Act, 1985 Wash. Laws Ch. 450, (codified at RCW 80.36.010 *et seq.*). The Regulatory Flexibility Act was a comprehensive overhaul of [Washington's] laws regulating the telecommunications industry and was intended to facilitate competition in the local telecommunications market. *See* Sharon L. Nelson, *Washington State's New Regulatory Flexibility Act*, Public Utilities Fortnightly, January 9, 1986, at p. 29 (attached as Appendix A). Since 1911, when Washington enacted its first statutes regulating utilities, the Commission has regulated all utilities, including

[1] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (codified at 47 U.S.C. § 151 *et seq.*).

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telecommunications utilities, using the traditional "rate of return model."[2] *See* 1911 Wash. Laws Ch.117; *U S West Communications, Inc. v. Utilities and Transp. Comm'n.*, 134 Wn.2d 48, 54, 949 P.2d 1321, 1326-27 (1997)(summarizing the rate base, rate of return process). Under that system, one dominant carrier provided virtually all services in its region, and prices for telecommunications services were established by tariffs and approved by the Commission. *Id.*; *see, e.g.*, RCW 80.36.100 to RCW 80.36.140; RCW 80.04.130; RCW 80.04.150.

By 1985, the legislature recognized the Commission needed a regulatory scheme that provided it with sufficient flexibility to allow for a successful transition from monopoly to competition in local telecommunications markets.[3] *See* Nelson, at p. 29. The legislature understood some markets might be more susceptible to robust competition than others. Nelson at p. 31. Accordingly, it adopted a regulatory classification scheme that would allow the Commission to exert decreasing regulatory oversight in markets where competition had taken hold, while at the same time providing protection in markets that were not (yet) competitive. *Id.*

Specifically, Washington's "competitive classification" scheme operates in the following manner. RCW 80.36.330(1) authorizes the Commission to "classify a telecommunications service provided by a telecommunications company as a competitive telecommunications

---

[2] According to Harry Newton, *Newton's Telecom Dictionary,* CMP Books (16th ed. 2000), p. 732 (hereinafter, *Newton's)*, "rate of return" is "the percentage of net profit which a telephone company is authorized (by a regulatory commission) to earn on its rate base." The term "rate base" refers to "a regulated telephone company's plant and equipment which forms the dollar base upon which a specified rate of return can be earned." *Id.*

[3] The central goals of Washington's 1985 legislation were to "preserve affordable universal telecommunications service," ensure that customers "pay only reasonable charges for services," maintain and advance the "availability and efficiency of telecommunications services," promote "diversity in the supply" of telecommunications services, and give the Commission greater flexibility with which to achieve those goals. *See* RCW 80.36.300; Nelson, at pp. 30-31.

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service" if it finds the service is "subject to effective competition."[4] "Effective competition," in turn, means "customers of the service have reasonably available alternatives and that the service is not provided to a significant captive customer base." RCW 80.36.330(1). In determining whether a service is competitive, the Commission "shall consider" the following four factors:

> (1) The number and size of alternative providers of services;
>
> (2) The extent to which services are available from alternative providers in the relevant market;
>
> (3) The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms, and conditions; and
>
> (4) Other indicators of market power, which may include market share, growth in market share, ease of entry, and the affiliation of providers of services.

RCW 80.36.330(1).

If a party requesting competitive classification demonstrates the services for which it seeks competitive classification are subject to "effective competition," the Commission may classify the service as a competitive telecommunications service. RCW 80.36.330(1).

The "effective competition" factors set forth in RCW 80.36.330 are very similar to factors traditionally used to evaluate the "market power" of a given company for purposes of determining whether a proposed merger would increase that "market power" in violation of antitrust laws. *See* Nelson, at p. 31 ("the statute dictates certain factors, resembling those used in antitrust analysis"); *see also* U.S. Dep't of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (April 8, 1997) (hereinafter *HMG)* (Exh. 224). Indeed, the legislative history of RCW 80.36.330 reveals the test for "effective competition" is essentially an analysis of

[4] RCW 80.36.320, a parallel section, authorizes the Commission to classify a particular company as competitive if it finds all of the services it offers are subject to effective competition.

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"market power." The legislature's Joint Select Committee on Telecommunications explained the use of the term "market power" in what later became the fourth factor in RCW 80.36.320, stating: "[T]his is intended to explicitly reference the economic concept of market power, which is integral to the determination of effective competition." *See* Memorandum from Washington State Legislature, Joint Select Committee on Telecommunications, *Changes in the Seventh Draft of Regulatory Flexibility Act* (hereinafter *Legislative History of Regulatory Flexibility Act*) (February 18, 1985) at 2 (attached as Appendix B). The Senate's section-by-section analysis of SSB 3305 further provides:

> The effective competition standard has two prongs. First, the company must show that its customers have reasonably available alternatives. Second, the company must show it does not have a significant captive customer base. The Commission is given several factors to consider in determining whether a company meets these standards and should be classified as competitive. These factors essentially relate to the market power possessed by the applicant. The market power analysis essentially looks at the ability of the applicant to control entry and prices in a market.

S.B. 3305, Section by Section Analysis at pp. 2, 4 (attached as Appendix C). Thus, before the Commission can make a finding of "effective competition" under RCW 80.36.330, it must find that the entity requesting competitive classification lacks market power.

III. DEFINITION OF RELEVANT MARKET

RCW 80.36.330 authorizes the Commission to "classify a telecommunications service provided by a telecommunications company as a competitive telecommunications service" if it finds the service is "subject to effective competition." Proper definition of the relevant market for purposes of an "effective competition" analysis is critical. Relevant market definition is the fundamental building block of competition analysis because it identifies, in the first instance, the products and suppliers that can provide economically meaningful responses to an attempted

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exercise of market power by, in this case, the incumbent LEC, Qwest. Virtually all subsequent evaluations, including assessment of entry barriers, depend on its accuracy.

The relevant market has both a "product" component and a geographic component. *Id.* According to the *HMG*, market definition focuses solely on demand substitution factors; *i.e.*, possible consumer responses to increases or decreases in price. A market is defined as a product or group of products, and a geographic area in which it is sold, such that a hypothetical profit-maximizing firm, not subject to price regulation, that was the only present and future producer or seller of those products in that area, likely would impose at least a "small but significant and nontransitory" price increase. *HMG*, Sec. 1.0, at 4. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test. *Id.* As explained in the *HMG*, in determining whether a hypothetical monopolist would be in a position to exercise market power, it is necessary to evaluate the likely demand responses of consumers to a price increase. A price increase could be made unprofitable by consumers either switching to other products or to the same product produced by firms at other locations. The nature and magnitude of these two types of demand responses respectively determine the scope of the product market and the geographic market. Where the monopolist likely would discriminate in prices charged to different groups of buyers, distinguished, for example, by their uses or locations, different relevant markets corresponding to each such buyer group may be delineated. *Id.* at 4-5.

Here, Qwest and Staff have failed to properly define the relevant market. They have failed to analyze each of the services listed in Qwest's petition and determine what consumers would realistically consider to be substitutes if Qwest were to increase prices. That failure makes it virtually impossible to properly measure the relevant market shares of Qwest and its

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competitors, the market concentration, and even to properly identify the number and size of alternative providers. For this reason alone, Qwest's petition should be denied.

A. Definition of Product Market.

Qwest defines the product component of the relevant market as analog basic business exchange services. These services include analog flat and measured business exchange service, analog PBX trunks, analog centrex services, and vertical business features. Qwest's Petition, Attachment A; Reynolds Direct, Ex. 1T, at 4, lines 16-21; Tr. 111. According to Qwest, it did not include its digital switched business exchange services "because the primary focus of Qwest's Petition is competition based on the use of specific Qwest wholesale services, such as unbundled loops and UNE-P." *Id.* at 5, lines 18-20. According to Qwest, competitors "are not generally using these products to provision their digital switched services." Qwest, therefore, intends to file another case that addresses the digital switched services. *Id.* at lines 20-22; Tr. 117.

Qwest defines "analog" to mean "we deliver analog signal to the customer rather than a digital signal that's integrated into the switch and also integrated into the CPE at the customer location." Reynolds Cross, Tr. at 111. The company confirmed that both analog and digital services can be and, in some cases, are provided over digital facilities. Reynolds Cross, Tr. 112-114. Further, Mr. Reynolds testified that some of Qwest's digital exchange services have similar functionality to its analog services. Reynolds Cross, Tr. at 112. Mr. Reynolds also testified that "competitors' digital switched services are competing with Qwest PBX, Centrex, and business lines." Reynolds Cross, Tr. at 179. Qwest also asks the Commission to consider other services which it claims are substitutes, including wireless and voice over IP. Reynolds Cross, Tr. at 181-82. Nevertheless, Qwest excluded digital services from its proposed relevant market. Qwest's

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rationale is that it is proper to segment the business voice exchange market into analog and digital services because of the different types of customer premise equipment currently being used. Reynolds Cross, Tr. 180-181, 184. The degree to which a particular customer may consider digital services to be an acceptable substitute for analog services is likely to be a function of whether it has already made an investment in digital or analog CPE. Reynolds Cross, Tr. 185-86. The point is that there has not been any careful analysis of what the true substitutability is and how that should affect the definition of the relevant market for particular services.

Staff conducted no analysis of the relevant market. Instead, it merely accepted Qwest's definition of the relevant market. Wilson Cross, Tr. at 1507. Yet, in response to questions from Ms. Singer Nelson, Mr. Wilson agreed some of Qwest's business customers have switched from Qwest analog services to Qwest digital services. Wilson Cross, Tr. at 1295-96. And, Staff argues the Commission should consider alleged competitive alternatives to Qwest's analog exchange services like wireless and voice over IP. Wilson Cross, Tr. at 1296, 1324. Staff witness, Tom Wilson, in fact asks the Commission to consider a broad and flexible analysis of the market - one that Mr. Wilson characterizes as "non-traditional, cross-industry, technologically neutral analysis based on functionality of the relevant market." Wilson Direct, Ex. 201, at 27; Wilson Cross, Tr. at 1323. On redirect, he states directly: "Digital services under the theory that Longstaff recommends should be considered." Wilson Redirect, Tr. at 1512. When asked directly whether he agrees that the analog business services market is a separate market from the digital business services market, Mr. Wilson replied: "No, I have provided evidence on that market, but I haven't really - I don't make that distinction necessarily. This is a distinction that Qwest has made in its petition." Wilson Cross, Tr. at 1310-11. When asked

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whether the Commission should consider the availability of digital services in the analysis of the relevant market, Mr. Wilson responded: "That would be difficult for the Commission to do here, because there isn't adequate analysis and data in the record on digital." Wilson Cross, Tr. at 1326. When asked by Mr. Melnikoff what would be the net impact of including Qwest's and CLEC digital services in the market analysis, Mr. Wilson said: "I can't answer that, Mr. Melnikoff. There is no digital data that I have been privy to." Wilson Cross, Tr. at 1531.

WeBTEC does not know whether a proper analysis of the relevant market would result in the inclusion of both analog and digital services in a combined voice services market. The point is that the party with the burden of proof, Qwest and Staff, which has thrown its lot with Qwest notwithstanding its acknowledgment that the market has not been properly defined and the data is not available to properly analyze it, utterly failed to do what is required by RCW 80.36.330. Because the relevant market(s) were not properly defined, there is a serious question about the usability and value of the other evidence about market share, market concentration, and available alternatives.

There is an additional serious problem with the way Qwest and Staff have analyzed their proposed relevant market. Both have simply lumped all of the services listed in Qwest's petition into the same product market as if each service is a perfect substitute for all of the others. As noted above, a proper determination of the relevant product market requires each service be analyzed separately and a determination made about what services, from which providers, are really considered substitutes by consumers. As Mr. Wilson argues, basic business lines, PBX services, and centrex services are purchased by different types of customers: "I consider the basic business exchange segment of the market to be the small to medium sized customer and the PBX and Centrex customers the larger sized customers in this relevant market." Wilson Cross,

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Tr. at 1276. Assuming that is true, these services don't belong in the same product with one another. The real point is neither Staff nor Qwest has properly analyzed the issue on a service-by-service basis. A customer with a substantial sunk investment in a PBX and compatible telephone sets is certainly not going to consider a basic business line a realistic substitute for a PBX trunk. Nor would a customer that wants direct inward dialing (DID) capability to each of the stations located behind its PBX consider a centrex line as an adequate substitute for DID service. Reynolds Cross, Tr. at 334-35.

There is nothing wrong with Qwest seeking competitive classification of just its analog business exchange services and framing its request in the sort of broad terms that it has. However, the analysis required to grant that petition must be conducted in a responsible way. Each service must be analyzed separately, and all economically relevant substitutes identified in defining the relevant product market(s). Otherwise, much of the other information developed relating to the various "indicators of market power" will be misleading. Stated simply, the analysis of the relevant product market offered by Qwest and Staff is way too simplistic, deeply flawed, and obscures important aspects of the real world markets in which the various Qwest analog business exchange services covered by the petition are offered.

B. Definition of Geographic Market.

Qwest asks the Commission to consider the relevant geographic market as its entire service territory, statewide. Qwest's Petition; Reynolds Direct, Ex. 1T, at 4, lines 16-17. Staff also describes the geographic scope of the market as Qwest's statewide service territory defined at the exchange level. Wilson Direct, Ex. 201T, at 14, line 13; Wilson Cross, Tr. at 1317, lines 11-20. When asked by Mr. ffitch to explain what he meant, Mr. Wilson testified Staff was

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recommending the Commission grant the petition statewide throughout the service territory and not exchange by exchange.

The geographic scope of the relevant market recommended by Qwest and Staff is simply too large. What is involved in this case is ***local*** exchange services, i.e., wired services to specific locations. An exchange access line available from a CLEC in Spokane - whether via CLEC-owned loops, UNE-P, UNE-L, or Total Service Resale (TSR) - is simply not a substitute for an exchange access line needed at a customer location in Seattle. Nor is it a substitute for a line needed at a customer location in Chehalis, Longview, Federal Way, or any other location in the state. The most that can be said is, at least for exchange access lines provisioned using Qwest unbundled network elements, a CLEC should have access to unbundled loops extending from the wire centers where that CLEC is collocated. Maybe through dedicated transport, loops extending from neighboring wirecenters would be available; however, neither Qwest nor Staff has done any analysis, economic or otherwise, to determine what the realistic geographic reach of a CLEC collocation would be. In short, it is ridiculous to attempt to define the relevant market for business local exchange services as Qwest's statewide service territory. At best, the proper geographic scope of the relevant market would be each wirecenter, or exchange, or, with proper supporting evidence, a group of neighboring exchanges. By defining the geographic scope of the relevant market too broadly, Qwest and Staff obscure the wide variation in the state of competition in various areas of the state. See Ex. 404, 405, 414, 415. The geographic scope of the relevant market they propose is simply indefensible.

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IV. REVIEW OF STATUTORY FACTORS FOR EVALUATING EFFECTIVE COMPETITION

As discussed above, a key premise of the Washington statutory scheme for the regulation of telecommunications services is to protect against the exercise of market power by telecommunications companies. Thus, the protections of regulation are to be retained unless and until sustainable, effective competition (*i.e.,* competition sufficient to constrain the exercise of market power) develops. *See Legislative History of Regulatory Flexibility Act* (discussed *supra* at 9-10); *see also* RCW 80.36.135 (directing the Commission to consider whether an alternative form of regulation to traditional, rate of return, rate base regulation would "[p]reserve or enhance the development of effective competition and protect against the exercise of market power during its development…").

Consistent with that basic premise, the Legislature directs the Commission to evaluate petitions for competitive classification of a specific service by determining whether "customers of the service have reasonably available alternatives and that the service is not provided to a significant captive customer base." RCW 80.36.330(1). In making that determination, the Commission is directed to consider four antitrust type factors, which the Legislature has designated as "indicators of market power." *Id.* Thus, the determinations of whether customers have "reasonably available alternatives" and whether there is a significant captive customer base" are to be made in the context of whether the company providing the service is able to exercise "market power" over the service in the relevant market.

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The concept of "market power" is well-understood in antitrust analysis. According to the *HMG*, "[s]eller market power is the ability to profitably maintain prices above competitive levels for a significant period of time."[5] *HMG*, § 0.1 Purpose and Underlying Policy Assumptions.

Each of the following factors should be evaluated as an indicator of market power; that is, whether they indicate Qwest has, and with the grant of pricing flexibility, will have the ability to maintain prices above the competitive level (economic cost). Here, the evidence clearly demonstrates Qwest retains market power over the services that are listed in Qwest's petition.

A. Number and Size of Alternative Providers.

B. Extent to Which Services Are Available from Alternative Providers in the Relevant Market.

C. Ability of Alternative Providers to Make Functionally Equivalent or Substitute Services Available.

According to Qwest, its "evidence in this case is substantially based on the quantities of wholesale services purchased by alternative providers to compete with Qwest's retail basic business services. Reynolds Direct, Ex. 1T at 7-8. However, the evidence offered by Qwest and particularly Staff is a mess.

[5] See also, Landes & Posner, "Market Power in Antitrust Cases," 94 Harv. L. Rev. 937 (1981), Ex. 104 at 2, which states: "The term "market power" refers to the ability of a firm (or group of firms acting jointly) to raise price above the competitive level without losing so many sales so rapidly that the price increase is unprofitable and must be rescinded." Although stated somewhat differently, that definition is essentially identical to the definition of "market power" in the HMB. Mr. Wilson, however, proposes a substantially different and entirely novel definition of "market power" in his testimony. At Ex. 201T, page 23, lines 5-6, Mr. Wilson states: "Market power is the ability to raise and maintain price above cost without losing market share." When asked about his definition on cross-examination, Mr. Wilson first stated that his definition was the same as the HMG definition. Wilson Cross, Tr. at 1466, lines 5-12. He then acknowledged that his definition was different from the HMB definition in significant respects. Wilson Cross, Tr. at 1467, lines 14-20. When asked about the source of his proposed definition, Mr. Wilson referenced his "college education" but was unable to cite to any court case, economic text, or article as the source. Wilson Cross, Tr. at 1468. He also acknowledged that under his definition a carrier with a 100% market share that charges a price above the competitive level and loses a single customer would be considered to lack market power, even though that price were very profitable. Wilson Cross, Tr. at 1536. Mr. Wilson's proposed definition of "market power" is neither correct nor meaningful and should not be accepted by the Commission. Moreover, his opinion that Qwest lacks market power, presumably based on that definition, should be disregarded.

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First, there remains a substantial question about whether the CLEC lines reflected in Staff's aggregation really represent only analog services. Although Mr. Wilson claims to have checked with the non-party CLECs that responded to the Commission's questionnaire to ensure they were reporting only analog lines, he admitted he did not define for the responding CLECs what he meant by "analog lines." Wilson Cross, Tr. at 1293, lines 22-24. He also acknowledged some carriers couldn't break down their lines by analog v. digital, so he counted them all as analog. It is significant that the questionnaire itself mentioned nothing about analog v. digital lines and that many of the services at issue in this case can be delivered on either analog or digital lines. Thus, it is easy to see how a carrier could be confused about what Staff was really seeking. Given the fact the CLECs that are parties to the case were all confused and over-reported the number of analog lines they provide to end-users, the Commission cannot be confident that the CLEC lines reported by Staff are truly only analog lines. Thus, it is entirely possible that Qwest and Staff are really offering an apples-to-oranges comparison in this case.

Second, and more importantly, is the fact there has been no rigorous and proper definition of the relevant product market. Therefore, the Commission cannot responsibly make a determination about the composition of the real relevant market.

Third, Qwest acknowledged, while it attempted to scrub the UNE-P data to make sure the loops being provided to CLECs delivered only analog signals to business customers, it could not tell whether UNE-L loops were delivered to residential or business customers; it simply assumed they were all business customers. Reynolds Cross, Tr. at 289.

In short, even if the Commission determines it is appropriate to consider only evidence of analog exchange access lines provided by Qwest and by CLECs in evaluating a petition to competitively classify analog business exchange services - WeBTEC submits there has not been

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an adequate analysis of the real relevant market(s) to make that determination in this case - the Commission should require Qwest and Staff to go back and demonstrate clearly that the evidence of line counts really reflects what those parties claim.

1. Wholesale-Based Services (resale; UNE-P; UNE-L).

As noted above, Qwest's and Staff's cases are based primarily on the numbers of Qwest wholesale loops used by CLECs to provide services to their end-user customers. In Exhibit 53, Qwest presents a chart showing the number of TSR loops, UNE-L loops and UNE-P loops used by CLECs, the number of Qwest retail lines, and the associated market shares of the CLECs and Qwest, by individual wirecenter. Exhibit 54 arranges the data by exchange. And, Exhibit 55 shows the number of CLECs purchasing the various wholesale elements or services, with the quantity of service purchased.

The data in Exhibit 53 shows that CLECs are using UNE-P in all wirecenters except Castle Rock, Easton, Elk, Green Bluff, Pateros, Liberty Lake, and Northport. Ten or fewer UNE-P lines are being purchased in ten other exchanges. The use of UNE-L is much more limited. In fact, there are 75 wirecenters where no UNE-L loops are being purchased by CLECs. Twenty-five wirecenters have no TSR. Ten wirecenters have ten or fewer TSR lines being purchased. Thus, there are numerous communities where the use of Qwest wholesale services is minimal, and where CLECs are not providing service with their own switches. The competition in these areas, such as it is, is highly vulnerable to being eliminated by either the pending Triennial Review proceeding (Docket No. UT-033044), or the strategic exercise of pricing flexibility if Qwest's petition is granted.

Public Counsel's Exhibit 416C shows the level of UNE-L activity in Qwest's service territory on an exchange level. That exhibit shows there are 53 exchanges with no UNE-L

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activity and a 54th with only 4 UNE-L loops being used. Only six exchanges show 10% or more of the total access lines being provided with UNE-L, and no exchange with more then 15% of the total access lines being provided with UNE-L.

Data about CLEC provided PBX and centrex services was so aggregated by Staff that it is difficult to reach any conclusions about the availability of those services on a wirecenter or exchange specific basis. However, a review of Exhibit 204C reveals there are no PBX services provided by CLECs via UNE-P anywhere in the state, and no PBX services provided over UNE-L in Des Moines, Renton, and in two of Staff's aggregated community categories.[6]

Public Counsel's Exhibit 418C shows the various ways PBX and centrex services are provided by CLECs (via TSR, UNE-P, UNE-L, CLEC-owned loops) across the aggregated categories of Western Cities, Big Cities, Tier Two Western Cities, Central Cities, and Eastern Cities. In the Big Cities, PBX services are provided most frequently via UNE-L, followed by CLEC-owned loops. In the Western, Central, and Eastern Cities, PBX services are provided most frequently via UNE-P. In the Tier Two Western Cities, PBX services are provided most frequently via TSR. As noted previously, competition based on use of TSR or UNE-P is highly vulnerable to the strategic use of pricing flexibility by Qwest if its petition is granted.

Centrex services are provided most frequently via UNE-L in the Big Cities, Tier Two Western Cities, Central Cities, and Eastern Cities; whereas, they are provided most frequently via UNE-P in the Western Cities.

The lesson of this is that competition varies significantly across the state. There appear to be many communities where the competition that does exist is highly vulnerable to elimination

[6] WeBTEC was unable to decipher Staff's community codes and, therefore, is unable to be more precise about where those communities are.

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from either the Triennial Review impairment proceeding (Docket No. UT-033044), or from the strategic use of pricing flexibility by Qwest if its petition is granted.

2. CLEC-Owned Loops.

In addition to the CLEC lines being provided with TSR or with UNE-P or UNE-L, there are some CLEC-owned lines being used to provide business exchange services. Staff provided information about CLEC-owned loops in an aggregated form that largely obscures the distribution of CLEC-owned lines on an exchange basis. Ex. 203C; Ex. 232. However, even though several communities are included in an aggregated category, there are 16 categories with no CLEC-owned loops. Among those are categories covering communities as large as Aberdeen, Bellingham, Longview, Moses Lake, Port Angeles, Walla Walla, Centralia, and Port Townsend.

3. Intermodal (wireless, VoIP, Wi Fi, cable, etc.).

Both Qwest and Staff argue the relevant market is analog business exchange services, but both urge the Commission to also consider wireless services, VoIP, WiFi, and cable services as substitutes justifying competitive classification of Qwest's business exchange services. Qwest's and Staff's arguments are internally inconsistent. Either digital services, wireless, VoIP, WiFi, and cable are substitutes and should be included in the analysis of the relevant market or they are not and should be excluded. There certainly is insufficient information about these services, including information about Qwest's provision of them, for the Commission to base its decision, even in part, on their availability. In any case, the evidence is that these services are not true substitutes for wireline business exchange services; at best, some of them are complements or adjunct services.

First, cable services are not a substitute for the services involved in this case. As Mr. Wilson acknowledged on cross-examination, cable services are primarily provided to

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residential customers, not business customers, and cable infrastructure generally does not extend to business areas. Wilson Cross, Tr. at 1532. Thus, they cannot be a substitute for business exchange services.

Second, with respect to wireless services, the FCC in its recent Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, also known as the Triennial Review Order, in CC Docket Nos. 01-338, 96-98, and 98-147 ("TRO"), specifically noted CMRS continues to be primarily a complementary technology to wireline narrowband service, with only about 3% to 5% of CMRS subscribers using their service as a replacement for primary fixed voice wireline service. TRO, ¶230, at 142. Business customer use of CMRS as a replacement for wireline local exchange service is likely to be much smaller than that. In addition, the FCC notes "although promising, wireless CMRS connections in general do not yet equal traditional landline local loops in their quality, their ability to handle data traffic, and their ubiquity." *Id.* at 143. Also, wireless service is engineered to provide only roughly a 70% call completion rate while wireline call completion rates exceed 99%. *Id.* at n. 702.

Third, WiFi is a nascent technology, available only in selected "hot spots." There is no evidence that it is widely used for any-to-any voice communications.

Finally, there is no evidence in this record that VoIP services are being used as a substitute or replacement for ***local*** exchange services. The use of VoIP in corporate enterprise networks is primarily a substitute for long distance, toll calling. Williamson Cross, Tr. at 910-13. There are also security issues with VoIP services that travel over the public internet. Williamson Cross, Tr. at 914. With Vonage services, there are problems with number portability (*Id.* at 914-15), automatic directory listings (*Id.* at 915); service responsibility (*Id.* at 915-16), and E911 service (*Id.* at 918-24). And, importantly, if a business using VoIP wants people who do not have VoIP

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phones to be able to call the employees of that business or have its employees be able to call people who do not have VoIP phones, the business will still have to subscribe to local exchange services that access the public switched network. Williamson Cross, Tr. at 928-29. Thus, if VoIP services are a substitute for certain Qwest services, they are not the services that are the subject of this proceeding. The references to intermodal services by Qwest and Staff are nothing more than red herrings and should be disregarded by the Commission.

D. Other Indicators of Market Power.

1. Market Share Analysis.

The traditional starting point for appraising whether a firm has market power is its market share. A low market share will virtually preclude a finding of market power, whereas a high market share indicates the possibility that market power exists. ABA Section of Antitrust Law, Antitrust Law Developments (5th ed. 2002), at 68. *See also, Wilk v. American Med. Ass'n*, 895 F.2d 352, 360 (7th Cir.)(market share greater than 50% sufficient), *cert. denied*, 496 U.S. 927 (1990), *and cert. denied,* 498 U.S. 982 (1990); *Barret v. Fields,* 924 F. Supp. 1063, 1075 (D. Kan. 1996)(50% market share permits inference of market power). As recently noted by the 9th Circuit Court of Appeals in *MetroNet Servs. Corp. v. U S West Communs.,* 325 F.3d 1086, 2003 U.S. App. LEXIS 6007 (9th Cir. 2003); amended, *MetroNet Servs. Corp. v. U S West Communs.*, 2003 U.S. App. LEXIS 9796 (filed May 21, 2003), a market share of 65% is considered to be prima facie evidence of market power. *Id.* at *38.

As noted previously, a proper determination of market share depends critically on a proper determination of the relevant market. Because the relevant market was not properly analyzed or defined by Qwest and Staff, the market share data produced in this proceeding is also flawed. As discussed above, Qwest and Staff did not properly analyze the relevant market on a service-by-

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service basis, nor did they analyze the full range of alleged substitutes for the business services that Qwest seeks to competitively classify. Even if the Commission were to accept the definition of the relevant product market as being limited to analog business exchange services, the Commission would still have to ignore the very significant questions about whether the CLEC data really represents just analog services so that an apples-to-apples comparison with Qwest's data is made.

Moreover, both Qwest and Staff include TSR lines and lines using Qwest special access services in their market share estimates. Neither is capable of constraining Qwest's retail business exchange service prices to the competitive level; therefore, neither should be included in the market share calculations. In Docket No. UT-000883, the Commission determined that TSR services should be removed from any line-based calculation of market shares or market concentration in a competitive classification proceeding because resale does not constrain prices. Docket No. UT-000883, Seventh Supp. Order, ¶75. For that same reason, TSR lines should be removed from the market share and market concentration calculations in this case.

Business exchange services provided by CLECs over Qwest special access circuits should also be removed from the market share and market concentration calculations because the price that CLECs have to pay for those services is so high above TELRIC rates of the elements that make up the services, they cannot possibly constrain Qwest's business exchange prices to the competitive level. It is axiomatic that if the cost of the alternative element is materially greater than the cost of obtaining the corresponding element from the incumbent, the requesting carrier will not be able to provide service at prices that are competitive with the incumbent's retail prices.

Here, a comparison of Qwest's retail special access rates to the TELRIC rates that Qwest is required to charge CLECs when they purchase essentially the same facilities as unbundled

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network elements makes it clear: Qwest charges supra-competitive prices for special access circuits, and, thus, CLECs bear a significant difference in cost when they are forced to purchase a retail special access circuit in order to provide basic exchange services.

For example, the price charged for the communications path between the customer's premise and the serving wire center in Qwest's retail tariff for special access circuits is $150 per month for each DS-1 facility. Ex. 13, Sec. 6/2/11(A)(1)(a); Reynolds Cross, Tr. at 291. By comparison, Qwest only charges from $68.86 to $74.33 per month (depending on which Zone the facility is located in) for the very same DS-1 facility sold as an unbundled network element. Ex. 12, Sec. 9.2.3.3; Reynolds Cross, Tr. at 290. Thus, a competitive carrier that is forced to offer services to its end users over circuits purchased as retail Qwest special access circuits pays as much as $81.14 more per facility per month than it would if it purchased the same facilities as unbundled elements. There is a similar disparity between the retail special access circuit transport mileage rates and the unbundled transport mileage rates. For example, retail special access transport mileage rates for distances between 0 and 8 miles are between $73.86 per month (fixed) or between $2.04 (per mile)(Ex. 13, Sec. 6.2.11(A)(2)(a)), whereas the transport mileage rate for the same facility sold as unbundled elements is $33.12 per month (fixed) or $0.51 (per mile). Ex. 12, Sec. 9.6.2. In short, Qwest's special access rates are significantly higher than its unbundled element rates for the same facilities. Because any CLEC relying on Qwest special access circuits to provide basic exchange services to its customers will be forced to pay prices that are significantly above cost, it will not be able to effectively constrain Qwest's pricing to the competitive level. Therefore, special access lines, like TSR lines, should be removed from the market share and concentration analyses.

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Even without these adjustments, all of the flawed estimates of market share that have been presented show a Qwest market share high enough to warrant a presumption of market power.

2. Market Concentration Analysis.

As noted in the *HMG*, market concentration is a function of the number of firms in a market and their respective market shares. Other things being equal, "market concentration affects the likelihood that one firm, or a small group of firms, could successfully exercise market power." *HMG* at §§ 1.5, 2.0. Like the Department of Justice and the FTC, Staff and other parties used the Herfindahl Hirschman Index (HHI) to measure market concentration. The HHI is calculated by summing the squares of the individual market shares of all the participants. The HHI ranges from 10,000 (in the case of a pure monopoly) to a number approaching zero. The *HMG* divides the specturm of market concentration as measured by the HHI into three regions that can be described as unconcentrated (HHI below 1,000), moderately concentrated (HHI between 1,000 and 1,800), and highly concentrated (HHI above 1,800). *Id.* at 15.

The results of Staff's analysis showed the market concentration in all exchanges throughout the state ranged from 5,627 to 10,000. *Staff's Market Analysis*, Ex. 209C. According to the *HMG*, markets with such high HHIs would clearly be highly concentrated, and it would be presumed that a merger producing an increase in the HHI of more than 100 points will create or enhance market power or facilitate its exercise. *HMG*, at § 1.51(c). Thus, the HHIs calculated by Staff are well above the level required to classify a market as highly concentrated, which is strong evidence that Qwest retains market power throughout the state.

3. Ease of Entry.

Qwest and Staff attempt to overcome the presumption that Qwest has significant market power that flows from the high market share and market concentration data presented by arguing

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entry is easy and CLECs face no barriers to entry or expansion in the relevant market as they define it. However, neither has seriously analyzed the issue.

For example, Mr. Reynolds states that, by using Qwest's facilities, CLECs can enter the market with ease. He cites ordering procedures, installation and repair intervals, and prices that have been approved by the Commission as support. He also asserts that converting business customers from Qwest to a competitor utilizing Qwest facilities is inexpensive and fast. Reynolds Direct, Ex. 1T at 14. However, he acknowledges he did not consider the costs of "hot cuts" - which may be necessary for CLECs to be able to convert sufficient numbers of customers to have any significant impact on the market - which he admits are "expensive." *Id.* at 16. He also acknowledges he did not consider collocation costs in his analysis. *Id.* On cross-examination from Ms. Singer Nelson, Mr. Reynolds acknowledged he did not include other costs that a CLEC might have, including computer equipment, building facilities, furniture, operational support systems. Reynolds Cross, Tr. at 132. He also did not include other non-recurring charges that a CLEC might incur to provide service. Reynolds Cross, Tr. at 135-36.

In its Triennial Review Order, the FCC noted a number of factors that, depending on the circumstances, can create barriers to entry, including, among other things, sunk costs, scale economies, scope economies, absolute cost advantages, capital requirements, first-mover advantages, strategic behavior by the incumbent, long-term contracts. TRO, ¶75. The FCC also notes in its analysis of entry, the *HMG* consider economic barriers to entry, focusing on sunk costs and minimum viable scale (defined as "the smallest average annual level of sales that the committed entrant must persistently achieve for profitability at premerger prices"). When asked about various barriers to entry, Mr. Wilson testified he had considered none of them, including minimum viable scale, absolute cost advantages, first-mover advantages, long-term contracts.

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Wilson Cross, Tr. at 1471-74. He also didn't investigate whether any CLEC operating in the market today was profitable. Wilson Cross, Tr. at 1471. Nor did he consider the competitive impact of the fact that Qwest does not pay the various telecommunications excise taxes (e.g., E911, WTAP, TDD) imposed on subscriber switched access lines in this state for the lines its employees use in the business.

In short, neither Qwest nor Staff made any kind of meaningful investigation or analysis of whether there are barriers to CLEC entry or expansion. They simply cavalierly declared entry is easy. That is not sufficient. There has not been the kind of showing that should be required to overcome any presumption that Qwest has market power resulting from the high market share and market concentration numbers that have been presented here.

4. Affiliation of Providers of Service.

There is no evidence that Qwest or Staff considered this factor. Indeed, Mr. Wilson testified he counted affiliated CLECs as separate competitors. Wilson Cross, Tr. 1464-65.

5. Other.

It is well established that pricing well above competitive (cost) levels is direct evidence of market power. *See Data General Corp. v. Grumman Systems Support Corp.*, 36 F.3d 1147, 1182 n.60 (1st Cir. 1994)("supracompetitive" prices are evidence of monopoly power;" *Borden, Inc. v. Federal Trade Commission*, 674 F.2d 498, 511 (6th Cir. 1982)(noting that petitioner "consistently was able to charge a higher price and reap greater profits ... than were others marketing processed lemon juice"). Such a direct indicator of market power is largely independent of market definition and largely superior to it.

Since market power is defined in terms of the ability profitably to raise price above cost, the excess of that price over cost measures the degree of power. Here, a comparison of Qwest's

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retail analog business exchange rates to the forward-looking cost-based rates for the elements that are used to provide those services makes it clear: Qwest charges supra-competitive prices for its analog business exchange services. As Mr. Reynolds testified: "Qwest's recurring retail rates for basic business exchange services and the accompanying revenue streams associated with ancillary services exceed the wholesale UNE rates charged to CLECs by a significant margin." Reynolds Direct, Ex. 1T at 18, lines 15-17, 19; *see also,* Ex. 6C, which contains Mr. Reynold's cost/revenue comparison. Moreover, Qwest has sustained those prices for a considerable period of time, and has not used the considerable flexibility available to it to reduce those prices in response to competition. Wilson Cross, Tr. at 1522. Similarly, the CLECs have not changed their prices either, strongly suggesting they are simply price takers and do not effectively constrain Qwest's prices to the competitive level (i.e., economic cost). Thus, the conclusion is inescapable that Qwest has market power over those services, whatever the correct definition of the relevant market is. Moreover, it is clear that Qwest has been able to exercise that market power under the umbrella of regulation at least up to the level of current prices. Without the constraints of regulation, it is likely Qwest would have been able to exercise its market even more fully, with the result that prices for business exchange service might have even higher.

E. Significant Captive Customer Base.

V. OTHER ISSUES

A. Impact of Other Dockets (TRO, cost dockets, etc.).

The basic foundation of Qwest's and Staff's case for competitive classification of Qwest's business basic exchange services is the continuing availability, at current prices, of the wholesale network elements used by CLECs, including UNE-P and UNE-L. However, there is currently

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pending before the Commission a petition by Qwest to remove unbundled switching for mass market customers and dedicated transport on certain routes. Docket No. UT-033044. Should that petition be granted for some or all of Qwest's service territory in Washington State, a significant basis for Qwest's petition here would disappear. It makes no sense to proceed with the competitive classification in these circumstances. A far better course would be to deny the petition with a direction to Qwest to refile it in light of the outcome of the TRO impairment proceeding. That course of action would maintain the appropriate burdens of proof.

Moreover, given the significant questions about the reliability of the evidence presented in this case and the failure of Qwest and Staff to properly define the relevant market(s), it would be advisable to direct those parties to "do it right" next time. It will be much easier for the Commission to conduct a meaningful examination of the extent of competition and its ability to constrain Qwest's prices if it has available the kind of evidence about competitive provision of service that will be developed in the TRO proceeding.

For example, in Order No. 3, Docket No. UT-033044, the Commission notes it will be conducting a granular, fact-finding analysis in that case, which precludes masking and aggregating data, which is the source of considerable questions here. In Docket No. UT-033044, a reasonable protective order has been worked out that will provide reasonable access to and analysis of data by all parties.

Further, the bench requests issued to date will generate much evidence that will be relevant to the kind of inquiry that should have been conducted in this case. That includes information about: (1) Qwest's hot cut process; (2) average total cost per line incurred by CLECs to manage and participate in Qwest's hot cut process; (3) the volume of hot cuts that would be required to migrate UNE-P customers to UNE-L customers and connect new customers if mass

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market switching is removed from the list of UNEs; (4) problems with Qwest's hot cut process; (5) the number and location of switches used by CLECs to provide service in Washington and the areas served by them; (6) the number of voice-grade lines CLECs are providing from those switches (by type of customer); (7) average total monthly revenues earned per line; (8) average total monthly cost per line (including the costs Qwest and Staff should have investigated in expressing an opinion about barriers to entry or expansion); (9) monthly churn rates; (10) information about transport facilities; (11) and information about collocation arrangements and costs will also be produced. All of this information could be imported into the record of the new competitive classification proceeding and would be important for the Commission to be able to make an informed decision about how Qwest's business basic exchange services should be regulated.

Qwest and Staff argue the Commission need not concern itself with what happens in the TRO impairment proceeding. They contend that if the Commission finds no impairment with respect to mass market switching or dedicated transport, that is the equivalent to finding that effective competition exists for the services that use those two network elements. That argument is wrong. In its TRO, the FCC expressly states its impairment test is not the equivalent of finding that the ILEC lacks market power. TRO §§109, 111. As stated by the FCC: "The purposes of a market power analysis are not the purposes of section 251(d)(2)." TRO, §109. Thus, the Commission could find no impairment for mass market switching and dedicated transport in some or all of Qwest's service territory in Washington State but still be in a situation where the resulting competition is not sufficient to check Qwest's market power.

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B. Cost Floor.

The determination of an appropriate ***price*** floor (not cost floor) is very important in a case such as this. Here, Staff apparently believes it is not necessary to set a price floor in this case; that can await a future complaint proceeding. WeBTEC strenuously disagrees.

The uncertainty about how much discretion Qwest will have to engage in strategic pricing behavior can itself become a significant barrier to CLEC entry or expansion. It is only common sense that a firm deciding where to put its limited resources will need to know, to the maximum extent possible, what prices it can expect if it enters a market. It if cannot expect to generate revenues sufficient to cover all of its costs associated with entry, including an appropriate rate of return on invested capital given that entry could fail and sunk costs, if any, would be lost. *HMG* §3.3. Undue uncertainty about the market prices and revenues that could be expected would likely lead a firm to decide to put its resources elsewhere. This is exactly the phenomenon described by Integra's CEO, Mr. Slater. Slater Direct, Ex. 751T at 7.

When discussing an appropriate price floor for this case, it is important to keep in mind the purpose for which the price floor is being set. RCW 80.36.330(3) provides that prices for competitive services "shall cover their cost." The ***cost*** floor addressed in that provision is designed to prevent cross-subsidy. For that purpose, as Commissioner Hemstad correctly recalled (Wilson Cross, Tr. at 1492), the Commission in the past determined that the appropriate floor is TSLRIC (Total Service Long Run Incremental Cost). However, when the concern is protection of competition and prevention of price squeezes, the appropriate ***price*** floor is quite different. In that case, an appropriate price floor would cover the prices dependent competitors have to pay for essential inputs, plus the TSLRIC of non-essential inputs. Since CLECs are required to pay TELRIC rates, the price floor must at least cover TELRIC, plus the TSLRIC of non-essential

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inputs to the service at issue. But that alone is not sufficient to prevent a price squeeze. This is because TELRIC includes a contribution to cover Qwest's shared and common costs (overhead) and a cost of capital factor (profit). Retailing cost also must be covered. A CLEC paying TELRIC prices must still be able to charge enough to cover its overhead and make a sufficient contribution to profit if it is to attract capital and stay in business. Wilson Cross, Tr. at 1534; Baldwin Cross, Tr. at 792. It must also cover its retailing costs and, over an appropriate period of time, recover its sunk costs.

Obviously, the consideration of an appropriate price floor is likely to generate a considerable amount of diverse opinion. And, there simply is no adequate record here to tackle that issue. But, it is important the Commission do so in a properly conducted competitive classification case. Competitors must at least be assured that Qwest will not be able to price in a manner that will make it impossible for entry to be profitable.

C. Access Charges.

D. Proposed Conditions on Approval.

One of WeBTEC's primary concerns with Qwest's petition was its request to competitively classify DID services, including numbers. As Ms. Baldwin testified, no other feature or service encompassed in Qwest's petition can substitute for DID service; therefore, DID is in a separate product market than the other services included within the petition. Baldwin Cross, Tr. at 786. Further, no witness presented evidence that would define either the market shares of market concentration applicable to DID service. Baldwin Cross, Tr. at 787.

In Exhibit 62, which is Qwest's response to Public Counsel Data Request 05-030, Qwest stated that, under its current SGAT and current local number portability policy, non-working DID numbers are not eligible for local number portability. Thus, a business would have to be willing

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to give up its block of DID numbers to change carriers. Public Counsel's witness, Susan Baldwin, testified that the loss of unassigned, non-working DID numbers would constitute a barrier to such a business customer contemplating switching DID service from Qwest to a competitor. Baldwin Cross, Tr. at 787. No witness provided testimony that would refute this opinion.

At the conclusion of the testimony Qwest introduced Exhibit 85 into the record. That exhibit reflects a change or clarification of Qwest's local number portability policy. Under this new statement of policy, reserved numbers in a DID block that are identified to a customer service record and paid for are eligible for portability if the customer chooses to change service to a competitor.

This new statement of policy regarding reserved DID numbers addresses WeBTEC's concern. As long as that new policy remains in effect, WeBTEC does not believe a DID number portability barrier to switching carriers is presented by Qwest's petition. However, given the uncertainty about the Qwest policy and the confusion about the meaning of language in Qwest's SGAT regarding DID number portability, WeBTEC urges the Commission to require that the revised DID number portability policy set forth in Exhibit 85 be made an express condition of any approval of Qwest's petition and that the Commission order Qwest to revise its SGAT to include the new explanation.

E. Other.

VI. CONCLUSION

As discussed above, Qwest and Staff have failed to properly analyze and define the relevant market(s) for the services covered by Qwest's petition. As a result, the information developed about most of the indicators of market power that the Commission must consider in this case, including substitute services, market share, and market concentration, is not reliable or

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meaningful. In addition, significant questions remain about whether the CLEC data Staff aggregated really represent what they purport to represent. On the other hand, the evidence relating to the one direct indicator of market power - the significant margin of Qwest's retail prices over its economic costs of providing the subject services - and the facts that Qwest has been able to sustain prices well above the competitive level for a considerable period of time and has not felt compelled to exercise the considerable flexibility it has under existing law to reduce prices to respond to competition, is compelling proof that Qwest is still able to exercise market power.

WeBTEC submits that the presentations of Qwest and Staff are deeply flawed, too superficial, and inadequate to support a grant of the petition. The petition should be denied and the company directed to refile its petition after the conclusion of the pending TRO impairment proceeding, when the evidence from that proceeding will be available to import into the new competitive classification case record, and Qwest, the other parties, and the Commission can "do it right."

Notwithstanding the flaws in the record, if the Commission determines to grant Qwest's petition, in whole or in part, WeBTEC requests the Commission condition the grant on continuation of the revised DID number portability policy as expressed in Exhibit 85 and direct Qwest to revise its SGAT to reflect the revised policy explanation.

RESPECTFULLY SUBMITTED this 28th day of October, 2003.

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By

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CERTIFICATE OF SERVICE

I hereby certify that I have this 28th day of October, 2003, served the true and correct original, along with the correct number of copies, of the foregoing document upon the WUTC, via the method(s) noted below, properly addressed as follows:

Carole Washburn Executive Secretary Washington Utilities and Transportation Commission 1300 S Evergreen Park Drive SW Olympia, WA 98504-7250	_X_ Hand Delivered ___ U.S. Mail (first-class, postage prepaid) ___ Overnight Mail (UPS) ___ Facsimile (360) 586-1150 _X_ Email (records@wutc.wa.gov)

I hereby certify that I have this 28th day of October, 2003, served a true and correct copy of the foregoing document upon parties of record, via the method(s) noted below, properly addressed as follows:

On Behalf Of Qwest:

Lisa A. Anderl Qwest Corporation 1600 7th Avenue, Room 3206 Seattle WA 98091	_X_ Hand Delivered ___ U.S. Mail (first-class, postage prepaid) ___ Overnight Mail (UPS) ___ Facsimile (206) 343-4040 _X_ Email (lisa.anderl@qwest.com)

On Behalf Of Advanced TelCom:

Lon E. Blake Advanced TelCom Group, Inc. 3723 Fairview Industrial Drive SE Salem OR 97302	___ Hand Delivered ___ U.S. Mail (first-class, postage prepaid) _X_ Overnight Mail (UPS) ___ Facsimile _X_ Email (lblake@atgi.net)

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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 28th day of October, 2003, at Seattle, Washington.

Appendix A

Washington State's New Regulatory Flexibility Act

By Commissioner SHARON L. NELSON

Recognizing the importance of providing telecommunications companies opportunities for reduced regulation in competitive markets, one state legislature has given its utilities commission considerable discretion where once there existed constraints. This article describes the key provisions of legislation which recognizes the competing interests in the telecommunications market and clarifies the goals and standards which guide commission policy decisions.

The Washington state legislature in 1985 accomplished what some observers considered an impossible feat. It enacted a comprehensive overhaul of its laws regulating the telecommunications industry. It did this with only one member of the 149-member legislature voting against the bill. This event takes on additional significance when one remembers that Congress has considered similar comprehensive telecommunications legislation during the last ten years and failed to enact a bill. This article will discuss how a state legislative body, faced with a parallel number of contentious issues and parties, succeeded where Congress could not. While it remains to be seen how successful the Washington law actually will be, simply enacting the legislation is a significant step. The following discussion of Washington's Regulatory Flexibility Act may be useful to other states facing the need to restructure basic telecommunications law.

The statute, formally known as Chap 450, Laws of 1985, modified long-standing provisions of the Revised Code of Washington.[1] The statutes regulating utilities were enacted in 1911. Like many other state statutes of that vintage, the Washington code established a three-member commission to regulate natural monopoly services in the public interest. While these provisions were revised from time to time, the code made no special provisions for telecommunications as opposed to the electric or natural gas utilities. The provisions of the state's code have been construed by the courts and a considerable body of case law developed. As a result, in recent years, the state commission found itself, unlike the Federal Communications Commission, in a position of having relatively little flexibility in statutory interpretation to accommodate changes in technology and federal policy. For example, the commission could not forebear from regulation of certain carriers, streamline tariff filing requirements, or even approve banded rates.

For these reasons, the state legislature created a special committee to undertake a thorough review of the state code and recommend remedial legislation. The Joint Select Committee on Telecommunications is composed of four members from the state senate and four members from the state house of representatives. The bipartisan committee is composed of able and energetic people who spent many hours learning the nature of the industry and wrestling with the question of how to plan for a very uncertain future.

Shortly after the committee had begun its work in 1983, the Bell system divestiture occurred. See United States v. American Teleph. & Teleg. Co. (DC DC 1982)

Sharon L. Nelson has been chairman of the Washington Utilities and Transportation Commission since February, 1985. Before taking that position she served as staff coordinator of the Joint Select Committee on Telecommunications in the Washington State Legislature and was responsible for drafting the bill that is the subject of this article. She has also served as staff counsel to the U. S. Senate Committee on Commerce, Science, and Transportation. **Ms. Nelson** received her BA degree from Carleton College, an MAT degree from the University of Chicago, and a JD degree from the University of Washington.

[1]RCW 80.01.010 et seq.

48 PUR4th 227, 552 F Supp 131. Arguing that this event required immediate action, several members of the telephone industry proposed amendatory legislation to the Joint Select Committee and the parent Energy and Utility Committees in both houses. The bill authorized "detariffing" of some services and would have reduced the commission's power to scrutinize affiliated interest transactions. Known as SB 4519, the 1984 bill proved to be very controversial. It passed the Senate but was blocked in the House Energy and Utilities Committee. The controversy it engendered created a high degree of mistrust among the competing players: Pacific Northwest Bell Telephone Company, the independent telephone companies, American Telephone and Telegraph Company, GTE Sprint Communications Corporation, MCI Communications Corporation, resellers, consumer groups, and labor unions representing telecommunications workers. After the 1984 legislature adjourned sine die, the committee resumed its work in earnest and attempted to define and resolve the issues in a less confrontational manner.

Legislative Process

The committee staff proposed a draft bill which the Joint Select Committee subsequently approved. The bill, SB 3305, was introduced in the Washington state senate at the beginning of the 1985 session. The draft went through nine iterations before it was considered "massaged" and polished enough for final legislative action. The work of massaging and polishing was left largely to informal processes, such as regular meetings between committee staff and all active lobbyists. This informal process facilitated the exchange of views and the realistic appraisal by various interests of their chances to get a bill more to their liking on their own. Formal hearings also allowed for significant public comment and direction from legislators during the drafting process. All parties exercised statesmanlike qualities which made the bill's passage a practical reality. In the end, nearly all parties had some stake in seeing the bill enacted.

Although the Joint Select Committee took a rather skeptical view of the events that have occurred and policies that have been adopted at the federal level, it was the sense of the committee that federal policy trends could not be ignored. Federal Communications Commission decisions favoring the development of competition and subsequent deregulation were facts that no state could change. On the other hand, members believed that the federal regulators and federal judiciary had not undertaken the comprehensive policy analysis needed to develop rational policy prescriptions. Thus, many members of the committee expressed doubts about whether the federal policies actually would achieve their intended purposes. Also, recognizing that structural changes occurring at the interstate level were beyond the power of a state legislative body to affect, the committee narrowed its inquiry to state regulatory jurisdiction and procedures. The committee also put the telephone companies on notice that any change in the affiliated interest law would be subject to later debate.

Despite their reservations about federal policy initiatives, the committee members reasoned that the federal policy *goals* of promoting technological change and diversity in the supply of telecommunications goods and services were appropriate.[3] At least in some markets, there appeared to be a connection between reduced federal regulation and technological change, innovation and diversification in the industry. Hence, the committee recommended that another policy goal should be to "promote diversity in the supply of telecommunication services and products and the development of competition in the telecommunication markets throughout the state." The committee also stated that it thought that where competition actually, factually existed, that regulation had no rational place. Thus, the committee announced a policy of permitting pricing flexibility under certain conditions and devised a scheme that gave discretion to the commission to reduce regulation when it could make certain findings about the competitive state of relevant markets.

Policy Assumptions

The first section of the bill sets out policy goals. Significantly, the first policy goal is to preserve "affordable universal telecommunication service." This goal had never before been explicitly adopted by the legislature. It is important to note, however, that the term "universal service" is not defined. The committee understood that the term is relatively amorphous and that universal service is not synonymous with "plain old telephone service" (or POTS). With technology rapidly evolving, defining universal service to mean POTS would be shortsighted. Given the example of the FCC's computer inquiries, which were heavily dependent on technical categorization schemes and accordingly subject to rapid legal obsolescence, the committee sought to avoid excessive technological specificity.

A comparison of the bill proposed by the committee and the act finally adopted by the legislature illustrates the development of a policy consensus. For example, the committee draft did not explicitly mention the words "universal service." The committee draft had simply declared that the policy of the state should be to "maintain and advance the efficiency and availability of telecommunication service." As noted above, the primary policy goal of the bill finally enacted by the legislature

[3]See *"1984 Preliminary Report,"* Joint Select Committee on Telecommunications, especially pp. 1, 5; *"1985 Final Report,"* Joint Select Committee on Telecommunications, especially pp. 1, 2.

emphatically maintains "universal service" as the number one policy goal. Although the act does not delineate what specific market penetration rates are meant by this, the sense of the phrase is familiar and indicates a firm legislative commitment that there be no reduction in current numbers of households with telephone service.

Also, where the committee draft had recommended the "development of competition in telecommunications markets throughout the state" as a policy goal, that language was subsequently deleted. The legislature finally declared that "promoting diversity in the supply" of telecommunications services and products in telecommunication markets throughout the state was the goal. During the course of committee and floor debate, members stated that competition should be a means to an end, not an end in itself.

Many analysts believe that the goals of preserving universal service and fostering competition in the telecommunications markets are inherently contradictory. Thus, it may be the Washington State Legislature has enacted a paradox. But that paradox reflects competing interests in the policy arena. Consumer groups and some competitors felt strongly that regulatory flexibility would inevitably permit those companies retaining monopoly power to use monopoly ratepayers' revenues to "finance" unfair competitive activities. Just as vehemently, telephone companies argued that creating a "level playing field," where they would not be unduly handicapped from responding to market realities, was essential to industry health and consumer welfare. The legislature, in essence, believed there was some truth to all parties' arguments. Many members believed that some markets might be more susceptible to robust competition than others. It followed that the preferred public policy would allow competition to develop while maintaining regulatory protection for remaining monopoly ratepayers. Thus, the legislature fashioned a classification scheme which reflects this policy assumption.

Structure of the Bill

The act gives a considerable amount of discretion to the Washington Utilities and Transportation Commission (WUTC) but strives to ensure that the WUTC has clear standards to guide its actions. The guts of the bill are contained in §§ 4 and 5. Section 4 permits the commission to classify *a company* as competitive if it finds that the services it offers are subject to effective competition. Effective competition means, "the company's customers have reasonably available alternatives and the company does not have a significant captive customer base." Furthermore, the statute dictates certain factors, resembling those used in antitrust analysis, that the commission shall consider making this determination. If the commission finds that a company or a class of companies is "competitive," the commission shall permit the companies to file price lists effective on ten days' notice instead of tariffs. The commission is also given the power to waive certain statutory regulatory requirements such as transfer of property, affiliated interest, or securities filing review.

Section 5 is a parallel section which applies to companies that function as a hybrid; that is, they offer both monopoly and competitive services. For these companies, the commission is given the power to classify a specific *service* as competitive if it can find that "the service is subject to effective competition." Again, the term "effective competition" is defined as meaning "customers of the service have reasonably available alternatives and that the service is not provided to a significant captive customer base." Again, the commission is directed to take certain antitrust type factors into account. When the commission finds that a service is provided in a competitive market, the commission may allow the company to provide that service under a price list. The commission, however, is not allowed to waive other regulatory requirements for competitive services

Since § 5 allows pricing flexibility for competitive services offered by companies which also serve monopoly ratepayers, it contains a number of protections to ensure that the revenues derived from monopoly ratepayers will not be used as a "bank" to finance competitive ventures. To this end, § 5 contains a mandatory provision that requires the prices or rates charged for competitive telecommunications services to "cover their costs."

This section represents one of the key compromises in the bill. Section 5(3) states that "the commission shall determine proper cost standards to implement this section, provided that in making any assignment of costs or allocating any revenue requirement, the commission shall act to preserve affordable universal telecommunication service." Although many legislators wished to be more precise, they recognized that the legislature should not be in the business of dictating any particular costing methodology to the commission. Since this language is susceptible to many interpretations, the commission is now undertaking a notice of inquiry proceeding on costing methodologies. As most analysts are well aware, costing methodologies for telecommunications services are primitive at best. There is no unanimity on the proper approach to categorizing and accounting for joint and common costs. Section 5(3) leaves that determination to the commission, with strong direction to protect the monopoly ratepayer and universal service.

Another key provision reflecting compromise is § 4(3). As everyone involved in regulation is aware, there is a substantial body of rhetoric associated with the phrase "level playing field." The phrase usually serves to obfuscate questions about the intensity of regulation that should be applied to the former members of the Bell

system partnership and their more recent competitors. The FCC has determined that firms such as MCI and GTE Sprint have insufficient market power to warrant full regulatory scrutiny. AT&T, on the other hand, has complained bitterly at the federal level about the "intense regulation" applied to an industry it also characterizes as "intensely competitive." Given this background and given the classification scheme described above, two questions inevitably arose: Could AT&T qualify as a § 4 company and be freed to function on a price list basis? If so, when?

That question was considered at length in the bill drafting process. The authors of the bill contemplated that resellers of interexchange service, which almost everyone agrees have no market power, would be the first that might qualify as competitive companies. On the other hand, AT&T Communications, Inc., retained significant market share in interexchange transmission markets. Although analysis may argue about the percentage of AT&T's market share, future treatment of AT&T was a concern. To address this issue, the statute contains a presumption that when the equal access program ordered by Judge Greene pursuant to the modified final judgment has been implemented, the commission will review the classifications of telecommunications companies providing interexchange services between local access and transport areas (interLATA). At that time the commission is instructed to classify all interLATA interexchange companies, including AT&T, as competitive telecommunication companies unless it finds "that effective competition . . . does not then exist." This rebuttable presumption effectively shifts the burden to AT&T's competitors to show that AT&T retains market power once the major technological barriers to competition have been removed.

MCI and GTE Sprint representatives accepted this compromise because they understood that they would not be credible arguing before the legislature that they were still "little guys" and that AT&T should be handicapped for an indefinite period of time. The rebuttable presumption assures AT&T that its arguments for competitive status will be heard by the commission, and reviewed by the legislature, in a timely fashion. It assures the competitors that they will also have the opportunity to argue these points on the public record at the time that equal access is fully implemented. Obviously, even determining the threshold question of when equal access has been fully "implemented" will be a contentious matter.

Also important to passage of the bill was § 9, which contains legislative decisions that certain services may not be regulated by the commission. Notably, these include "private shared telecommunication services," which is a defined term in the act and includes "smart buildings." In a companion bill, the legislature also determined that mobile telephone and radio paging services were not to be regulated by the commission. Both of these deregulatory provisions, however, were qualified by the legislature. In the case of shared tenant services, the commission is allowed to regulate if a landlord or developer offers service such that tenants or customers have no alternative access to local exchange facilities. If a developer were to make itself a "little monopoly," then the commission retains the power to require the developer or landlord to make alternative facilities or conduit space available on reasonable terms and conditions. In the same vein, the commission may regulate mobile telephone and radio paging services when it finds that those services are the only telephone services available in a market.

Three more key provisions of the legislation should be mentioned. Section 6 gives the commission explicit authority to approve rate bands if they are in the public interest. The commission is given virtually unconstrained discretion to approve rate banding as long as the lower rate in the band is compensatory. This provision was inserted near the end of the consensus building process and was seen as merely adding to the commission's arsenal of regulatory flexibility tools. This provision replaced a very controversial provision which would have emulated a recently enacted Colorado statute permitting the Colorado Public Utilities Commission to approve special telephone company contracts with large volume users. Because of strong disagreements on the meaning of the language proposed by the Joint Select Committee, the entire provision was deleted and the banded rate provision inserted.

The implementation of the rate banding section has caused some discussion. User groups are concerned that too frequent use of § 6 could vitiate § 5, the competitive service provision, by allowing pricing flexibility for services when no competition has been shown. To date, a Pacific Northwest Bell rate banding tariff for discretionary services — speed calling, call forwarding, and intracall — is the only § 6 filing that has been approved. AT&T, however, has filed for banded message toll service rates. The AT&T filing has been suspended and should generate a vigorous debate on when rate banding is appropriate.

Section 7 of the act was inserted at the request of small business users who have begun to feel the disadvantages as well as the advantages of competition in the supply of telecommunication services. As barriers to entry are eased, many small business users fear that some fraudulent "fly-by-night" operators may enter new telecommunications markets, particularly in resale. The WUTC functioned for over seventy years with a statutory scheme that allowed initial tariffs to go into effect without prior commission approval. Although no one wished to erect significant entry barriers, such as a public convenience and necessity test, the Joint Select Committee recommended and the legislature adopted a pro-

vision that allows the commission to review newcomers for technical competence and financial soundness. The committee was very clear in its report to the legislature that this review was meant to protect *consumers* and not to protect competitors from new entrants. So far the commission's review has been thorough and fully consonant with this legislative intent. For example, although one reseller filed for registration listing as its major asset a contract with Satellite Business Systems for SBS's switched service, the commission registered that carrier once the accounting problems were worked out.

The legislature added a final section to the bill which requires an annual report by the commission on its implementation of the act, on the state of competition in intrastate markets, and on recommendations for subsequent legislative action. This section indicates that the legislature will exercise its oversight responsibilities very carefully. The act was explicitly designed to be transitional. In five years, telecommunications markets may not resemble the 1985 context in which the legislature acted. This oversight section is intended to provide the legislature with the necessary information to make adjustments to the act.

Remaining Issues

Since the July, 1985, effective date of the act, the commission staff has been diligent in drafting proposed procedural rules for implementing Chap 450. The commission received its first petition for classification as a competitive company under § 4 from Allnet Communications. We hear rumors about potential petitions under § 5, but have yet to see one materialize. In the meantime, the commission continues to engage in garden variety regulation of all telecommunication companies.

Theory continues to meet reality. Resellers in Washington state who were not heavily involved in the legislative process have expressed concern about the registration requirements authorized under § 7. Although the commission has no wish to impose undue burdens on small business, we have explained to the resellers that their quarrel appears to be with the legislature, not with the commission. They, in turn, have taken us to court on the grounds that the commission improperly adopted rules to implement § 7. Problems relating to regulation of these very small companies continue to crop up. For example, while the resellers complain about having to provide the financial and technical data required for registration, local exchange companies are apprehensive about the increasing number of bankruptcies among the small resellers. In theory, freedom of exit should be a corollary to freedom of entry. However, as these companies fail, the major creditors are often the local exchange companies or AT&T. The appropriate treatment of the uncollectible debts of bankrupt resellers owed to a local exchange company remains a thorny regulatory question.

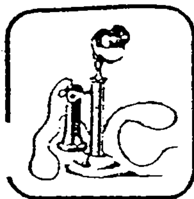
On a personal note, I remain firmly committed to the major premises of the legislation and will diligently seek to implement it consistently with the legislative intent. I cannot claim ignorance of the intent of the legislature when our oversight committees take us to task. Nevertheless, managing this enormously complex transition to a competitive market taxes the resources of a state commission and is bound to be humbling experience. The statute's emphasis on protection of the monopoly ratepayer reminds of the continuing downside risks of this transition for many ratepayers and of regulators' continuing need for intelligent, rigorous analysis of market trends, and appropriate regulatory responses. While the legislature has established the policy context, the debate deserves to be broadened and deepened.

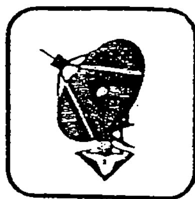
In sum, the bill represents a compromise in the best sense of that oft-maligned word. It gives the telecommunications companies the opportunity for reduced regulation in competitive markets. It gives consumers the chance to see innovation and price competition for many services. It gives the commission many needed tools to manage the transition to competitive markets. As long as *all* parties are diligent in ensuring that this political compromise does not compromise universal service and the interests of monopoly ratepayers, the Regulatory Flexibility Act may serve as an example of creative, yet pragmatic, public policy.

NATA 1986 Sourcebook Advises Telecommunications Suppliers

Learning how to market against Centrex, or in conjunction with it, is only one of dozens of subjects of particular interest to interconnect suppliers found in the North American Telecommunications Association's *1986 Telecommunications Sourcebook*. Highlights of the 396-page sourcebook include: timely articles that review changes in law and regulations affecting the telecommunications industry; tips on niche marketing; complete directories of Bell operating companies' centralized operations group centers and state and regional interconnect associations; a comprehensive directory of equipment manufacturers and vendors; and detailed product guides on industry hardware and services. The sourcebook is available through NATA, 2000 "M" Street, N. W., Suite 550, Washington, D. C. 20036.

Appendix B





WASHINGTON STATE LEGISLATURE

JOINT SELECT COMMITTEE ON TELECOMMUNICATIONS
415 Senate Office Building • Olympia, Washington 98504 • (206) 753-2521

MEMORANDUM

DATE: February 18, 1985

TO: Interested Parties

FROM: Steve McLellan SM

SUBJECT: Changes in Seventh Draft of Regulatory Flexibility Bill

The seventh draft of the regulatory flexibility bill is an attempt to address the concerns of various parties with earlier drafts. This memorandum will briefly highlight the changes made in substantive portions of the bill. All references are to cumulative line numbers or section numbers in the seventh draft. Because of coming cutoffs, we have scheduled a hearing on the proposed substitute for Thursday at 3:30 in Senate Hearing Room 4 and anticipate executive session early the next week. Senator Williams has indicated that he wishes to handle substantive amendments through a process of continuing discussion and consensus building rather than through amendments during executive session. Please see me if you have questions or comments.

Section 1 Changes

At section 1, line 51 the phrase "and the development of competition" has been deleted. This is intended to make the draft neutral on the issue of competition in local exchange markets. At line 54, a new subsection 6 has been added to explicitly state a universal policy goal.

Section 2 Changes

The definition of private telecommunication system (line 107) has been changed to reflect the intent that an entity may share a private telecommunication system with an affiliate. However, if a private telecommunication system is offered for hire, sale or resale to the general public, it would be subject to regulation as a telecommunications company.

Senator Al Williams, Chairman • Representative Seth Armstrong, Vice Chairman
Representative Pat Fiske • Senator W.H. "Bill" Fuller • Senator Dick Hemstad
Representative Ken Jacobson • Representative Darwin Nealey • Senator Dianne H. Woody

Sharon Nelson, Staff Coordinator

The definition of private shared telecommunication services (line 113) indicates that it is contemplated such services will connect to the facilities of local exchange companies. At line 115, "to a" has been deleted and replaced by "within a". At line 120, "a" has been deleted and replaced by "the facilities of a".

The definition of telecommunications company, which was formerly excessively broad, has been narrowed. At line 135 we have deleted "or using" and at line 140 after "resale" we have added "to the general public".

Section 4 Changes

For purposes of clarity the test in section 4 (line 202) has been rewritten. As changed, the broad test for declaring a company "competitive" is that the services it offers are subject to effective competition. Effective competition is further defined as having two components: customers must have reasonably available alternatives and the company must not have a significant captive customer base.

At line 223 we have replaced "competition" with "market power". This is intended to explicitly reference the economic concept of market power, which is integral to the determination of effective competition.

At line 241 we have deleted "establish procedures for providing notice to customers" and inserted "prescribe the form of notice". This is designed to make it clear that the commission may tailor the form of notice to the particular situation.

At line 265, after "effective competition" we have added ", as defined in subsection 1,". The final sentence of subsection 4 beginning with "where consistent" has been deleted. This change means that the demonstrated attainment of equal access will raise a presumption that all interLATA interexchange carriers are competitive, but that the presumption may be rebutted with any part of the effective competition test.

At line 269 we have deleted "finds it necessary to" and inserted "would". This increases the commission's discretion to adjust regulatory burdens under section 4 if required by competitive conditions.

Section 5 Changes

Section 5 (line 271) has been substantially rewritten to more closely parallel section 4. In concept, the intent is that the test for declaring a service competitive will be stricter, but that once a service is classified as competitive the pricing flexibility granted by

the commission will more closely parallel that granted under section 4. The cost standards formerly contained in Section 8(2) have been split out into a series of new subsections.

New subsection 3 indicates that prices or rates charged for competitive services shall cover their cost and that the commission may determine the proper cost standards. In making assignments of cost or allocations of residual revenue requirements, the commission is directed to act to preserve affordable universal basic telecommunication service. This change is designed to give the commission greater costing flexibility and to avoid the use of "loaded" terms such as "fully compensatory". At the same time, it is designed to give the commission direction that universal basic telecommunication service must be maintained.

New subsection 4 indicates the commission may investigate rates or prices upon complaint. The telecommunications company providing the service would bear the burden of proof in a complaint proceeding. The ability of the commission to suspend and investigate rates under section 5 has been deleted. Shifting the burden of proof in a complaint proceeding to telecommunications companies recognizes the difficulty the commission will have in policing costs where a company offers a mix of competitive and noncompetitive services.

New subsection 5 indicates the companies must provide the commission with data it deems necessary to implement the section.

New subsection 6 indicates that losses incurred by a telecommunications company which prices below cost shall be assessed against investors. It further gives the commission statutory authority to order refunds to subscribers who have paid excessive rates because of below-cost pricing. Subsection 7 contains reclassification authority.

Taken as a whole, the changes in section 5 are intended to increase the ability of companies with competitive services to price those services flexibly. The commission's power to examine prices before they go into effect has been removed. In order to balance that change, the commission's ability to investigate prices upon complaint has been strengthened.

Section 6 Changes

The entire section 6 from the sixth draft has been deleted and replaced by the commission's proposed amendment to section 6 (line 317).

Section 7 Changes

At line 341, after "customers" we have added "or order that such advances or deposits be held in escrow or trust". This change responds to concerns raised by some committee members that the requirement of a performance bond may serve as an entry barrier. The language is intended to give the commission an additional option, aside from requiring a performance bond, which would protect consumers.

Section 8 Changes

After "companies" on line 356, we have added "or associated with competitive telecommunication services". This would extend the jurisdiction of Chapter 19.86 RCW, to competitive services offered by telecommunications companies.

Section 9 Changes

At line 361, we have rewritten the exemption to clarify the authority of the commission. At line 365 we have deleted "company" and inserted "services."

Additional Changes

A number of additional changes have been made throughout the bill. In section 11 (line 424), public counsel has been added to the list of parties who may make complaint to the commission.

A new section has been added (sec. 15, line 560) for purposes of clarity to indicate that eminent domain and appropriation rights do not extend to competitive telecommunications companies, radio communication service companies, or telecommunication companies when those rights would be exercised for the purpose of providing competitive services. In section 28, language dealing with promotional rates has been deleted. In section 37 language dealing with pay telephone providers has been added and clarified. In section 42 (line 1055), language directing the commission to monitor and report on cost of service studies has been included.

SM:dc9-19

Appendix C

SECTION BY SECTION ANALYSIS

SSB 3305

Section 1.

The state's policy on telecommunications is enumerated. Policy goals include: (1) preserving affordable universal telecommunications service; (2) maintaining and advancing the efficiency and availability of telecommunications services; (3) ensuring that customers pay only reasonable charges for service; (4) ensuring that monopoly ratepayers do not subsidize competitive services; (5) promoting diversity of supply of telecommunications services and products; (6) permitting flexible regulation in competitive markets.

Section 2.

Section 2 adds definitions to Title 80 RCW and revises a number of existing definitions. New definitions include definitions of private telecommunications networks and private shared services. Private networks include networks used by companies such as Boeing to meet their telecommunications needs. Private shared services include networks offered by building managers for tenants within their buildings. Both private networks and private shared networks are essentially deregulated in a later section of the bill.

Section 3.

This section indicates that either telecommunications companies or the Commission may initiate proceedings to classify competitive telecom-

munications companies and services. Further, the Commission may require companies to appear in classification proceedings. This is designed to allow the Commission to address an entire market without engaging in multiple hearings.

Section 4.

Section 4 describes the test the Commission must use to classify a telecommunications company as competitive and the regulatory treatment it may afford the company once it has been classified as competitive.

In order to be classified as competitive, a company must demonstrate, after notice and hearing, that it is subject to effective competition. The effective competition standard has two prongs. First, the company must show that its customers have reasonably available alternatives. Second, the company must show it does not have a significant captive customer base. The Commission is given several factors to consider in determining whether a company meets these standards and should be classified as competitive. These factors essentially relate to the market power possessed by the applicant. The market power analysis essentially looks at the ability of the applicant to control entry and prices in a market.

If a company is classified as competitive, it will be subject to minimal regulation. This means that competitive companies may file price lists for their services effective on ten days notice to the

Commission and customers. The Commission may also waive other provisions of Title 80 for competitive companies. These waivers may be tailored to individual companies to provide an adequate level of regulatory protection. Certain minimal regulatory standards, including financial reporting, are set out in the bill.

The Commission is required to review the classification of all companies providing interLATA interexchange services when a company can demonstrate that the equal access requirements ordered by Judge Greene have been met. At that time, a rebuttable presumption that all such companies are competitive arises. This presumption may be rebutted by evidence that effective competition does not exist at that time.

The Commission may revoke any waivers it grants and may reclassify companies if it would protect the public interest.

Section 5.

Section 5 addresses the needs of companies which provide a mixture of monopoly and competitive services. These companies raise special concerns because of the possibility they could engage in excessive pricing in monopoly markets and funnel the proceeds to competitive ventures.

The Commission is allowed to classify a service provided by a company as competitive if it finds, after notice and hearing, the service

is subject to effective competition. The test of effective competition is parallel to that in Section 4. A company must demonstrate that the customers of the service have reasonably available alternatives and that the service is not provided to a significant captive customer base. The Commission is given a number of "market power" factors to consider in analyzing the competitiveness of the service. When a service is classified as competitive, it may be provided under a price list effective on ten days notice to the Commission and customers.

Section 5 also adopts a number of requirements to assist the Commission in protecting against cross subsidies from monopoly to competitive services. The Commission is required to implement cost standards in a manner which will preserve affordable universal telecommunications service. The Commission may investigate prices for competitive services upon complaint. In complaint proceedings initiated by the Commission, the company providing the service will bear the burden of proving that prices are appropriate. In complaint proceedings brought by competitors or customers, the complainant will bear the burden of proof. Companies providing competitive services must provide the Commission with necessary data. Losses incurred by a company in competitive sectors may not be recovered through rates for noncompetitive services and the Commission may order refunds or credits if subscribers to noncompetitive services have paid excessive rates. The Commission may reclassify services if it would protect the public interest.

Section 6.

For any service, the Commission may approve "banded rate" tariffs. A banded rate tariff is a tariff which sets a minimum and a maximum rate. For example, a banded rate tariff for toll service might say that toll will cost between 13 and 18 cents a minute. Within that band, a company may change rates upon such notice to the Commission and customers as the Commission may order. The minimum rate in the band must cover the cost of the service.

Section 7.

Section 7 sets minimal entry controls on new telecommunications providers. Companies which begin operations after January 1, 1985 must register with the Commission before beginning operations in the state. The Commission may deny registration to companies which do not possess adequate financial or technical resources to provide the proposed service. To protect ratepayers, the Commission may require either the posting of a performance bond or that any advances or deposits collected from customers be held in escrow or trust.

Section 8.

Currently, all actions of all telecommunications companies regulated by the WUTC are exempt from the Consumer Protection Act. Section 8

removes the exemption for companies which have been classified as competitive and for services which have been classified as competitive.

Section 9.

Section 9 is a deregulatory section. It sets out a number of specific areas which the Commission shall not regulate. These include: (1) one-way broadcast or cable television transmission of television or radio signals; (2) private telecommunications systems; (3) telegraph services; (4) customer premises equipment; (5) private shared telecommunications services unless customers have no alternative access to local exchange service; (6) Radio communications service companies. The language relating to radio communications service companies is identical to that in HB 281, which recently passed the House and SB 3370 which is on the Senate calendar.

Section 10 conforms existing law to new definitions.

Section 11 statutorily acknowledges the role of Public Counsel in the WUTC complaint process.

Sections 12 through 35 conform existing law to new definitions.

Section 36 recognizes customer owned pay telephones.

Sections 37 through 40 conform existing law to new definitions.

Section 41 requires an annual report to the Legislature from the Commission on the status of the Washington telecommunications industry. The report shall describe the competitiveness of markets, the availability of telecommunications services and the level of rates for local exchange and interexchange service. The Commission shall also recommend whether additional deregulation is appropriate and monitor cost studies and recommend whether cost of service ratemaking shall become a standard in Washington.

Section 41. Severability clause.

Section 43 adds sections to Chapter 80.36 RCW.

Section 44 calls for an intensive review of this act during the 1989-91 biennium.

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