BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Investigation into	**)**	
U S WEST COMMUNICATIONS, INC.'S	**)**	**DOCKET NO. UT-003022**
	)	
Compliance with Section 271 of the	**)**	
Telecommunications Act of 1996	**)**	

DIRECT TESTIMONY OF

DON PRICE

RE: PUBLIC INTEREST

WORLDCOM, INC.

JUNE 7, 2001

DIRECT TESTIMONY OF DON PRICE

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Don Price. My business address is 701 Brazos, Suite 600, Austin, Texas 78701.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by WorldCom in the Western Region Public Policy group as Senior Regional Manager, Competition Policy. In that capacity, I have broad responsibilities in the development and coordination of MCI's regulatory and public policy initiatives in a number of states including the Qwest states, the Southwestern Bell states, California (Pacific Bell), Nevada (Nevada Bell), and the Ameritech states.

Q. HAVE YOU PREVIOUSLY TESTIFIED?

A. Yes, I have. I have not, however, previously testified before the Washington Commission.

Q. HAVE YOU PREPARED A SCHEDULE OF YOUR PROFESSIONAL AND ACADEMIC QUALIFICATIONS?

A. Yes. Attached to this testimony as Exhibit DP-2 is a schedule providing my academic background, work experience, and the proceedings in which I have previously presented testimony. As detailed in that attachment, my experience in telecommunications spans more than 22 years, including five years in the employ of an incumbent local exchange carrier, three years on the staff of the Public Utility Commission of Texas, and more than 14 years with WorldCom (by way of MCI). Beginning in 1993 with MCI's acquisition of Western Union Access Transmission Services, my responsibilities in the state regulatory department have focused on public policy issues relating to competition in local exchange telecommunications markets. Until the passage by Congress of the 1996 Act, I was closely involved with MCI's advocacy in the states urging the elimination of legal and economic barriers to entry into local telecommunications markets. Subsequent to passage of the Act, my responsibilities have included direct participation in the development and implementation of the company's policy positions on key topics such as interconnection and unbundled network elements, both as to terms and conditions and pricing. I have testified on related public policy issues in arbitration proceedings in Texas, North Carolina, Florida, Georgia, California, Louisiana, and Tennessee.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to present to the Commission a discussion of the public interest issues raised by Qwest's request to be permitted entry into the Washington long distance market. First, I will discuss the concept of the "public interest" and explain its importance in this context. Second, my testimony will discuss why the state is in a preferred position to assess the public interest in the context of a 271 application. Third, I will discuss why pricing issues under §252(d)(1) of the Act represent a critical component of a public interest consideration. Fourth, I will present evidence that Qwest continues to behave as a monopoly and to demonstrate a monopoly mindset, and will discuss the implications of such behavior on this Commission's consideration of the public interest. Fifth, my testimony discusses the inherent problems in attempting to regulate good behavior and why structural separation of Qwest's monopoly and competitive components is ideally suited to the task of preventing abuses of monopoly power as Qwest is permitted to operate in competitive markets. Sixth, I discuss some of the key regulatory tools the Commission absolutely must "get right" if it chooses a regulatory over a structural approach to dealing with continuing monopoly power.

I. The Public Interest

Q. WHAT IS THE PUBLIC INTEREST?

A. The public interest is the balance that regulators seek to achieve between the various interests as they decide complex public policy issues. For example, an electric utility may have a need to augment transmission capacity to a given area requiring additional high-voltage transmission lines into that area. The various private interests here would include the economic interests of the property owners whose property would be impacted by the transmission line, the economic interest of the utility in trying to route the new transmission line without undue expense, the aesthetic interest of persons who would see the transmission facility, and the health and safety issues associated with the proximity of the transmission line to schools, parks, libraries, hospitals, and other such public locations. As this example shows, there is no formula for quantifying the public interest. Rather, the public interest requires the decision-maker to qualitatively assess the pros and cons from varying perspectives in an effort to achieve a balance among the varying interests. The balancing of even more complex issues is required as regulators grapple with competitive issues such as are presented today in the telecommunications industry.[1]

Q. IS ACHIEVING THE PUBLIC INTEREST THE BASIS FOR REGULATION OF CERTAIN FIRMS?

[1] As Chairman Levinson noted in her dissent in the MCImetro complaint, "[a]s we leave monopoly regulation's safe and familiar ground, we lose many tools upon which we traditionally have relied. I believe it is, therefore, all the more essential to the performance of our duties that we exercise forcefully the powers we do have, including the penalty power." Docket No. UT-971063, Order issued February, 1999, at ¶ 289.

A. Yes. Our society is one that typically prefers free markets over centrally-controlled markets such as existed in the Soviet Union. There are good reasons for such a preference. Competitive markets are much better at allocating society's resources and in meeting consumers' needs. This is because firms in competitive markets strive to distinguish themselves from their competitors so as to earn a higher profit for their investors relative to the rest of the firms operating in that market. Such efforts typically take one of two forms. One is for the firm to introduce efficiencies in the means of production, yielding cost savings it can pass on to customers in the form of lower prices.[2] The second way in which a firm may seek to distinguish itself from its competitors is by introducing innovative products or services which differentiate the firm from others in that market. In either case, the motive of obtaining greater profits for the firm's investors is the stimulus for innovation.

A firm that operates without competition has no such incentive to seek cost savings in production, because there are no constraints on the prices it can charge for its products. Market forces by definition cannot restrain the firm's profits. Likewise, such a firm -- whether it operates only in retail markets, wholesale markets, or both -- has no incentive to introduce innovative products or services to stimulate profits, because it

[2] The advantage from the introduction of such efficiencies is typically short-lived, as other firms seek to erase or minimize the temporary disadvantage by following the market leader.

has no need to differentiate itself in a market where it stands alone.[3] Economists refer to this type of situation as a "market failure." It is only in such instances that our society has imposed regulation of such a firm as a government imposed reaction to this "failure" of the market to deliver goods and services to consumers.

Our belief in free markets over centrally-controlled markets was articulated succinctly by President Bush's recent appointment to the Federal Energy Regulatory Commission, Pat Wood, who stated:

> On our best days as regulators, we cannot deliver benefits to customers as well as a functional market can. But the market must work right first.[4]

Unlike the markets for consumer products such as toothpaste, apparel, consumer electronics, automobile tires, and so on, there is no "functional market" for local telecommunications goods and services.[5] Rather, the telecommunications market in the U.S. has been a monopoly for virtually all of the more than 130 years since the telephone was introduced. It has been only during the past 17 years that competition has

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[3] For example, prior to the introduction of competition for customer premises equipment in telecommunications, consumers had few choices in terms of style, colors, or features in their telephone sets. Because it would not have increased earnings, the Bell System had no incentive to introduce new styles or colors of phones. Similarly, consumer features were introduced on a timetable which suited Bell System's management, rather than the desires of consumers. It is widely recognized that the pace of such introduction by monopolies is far slower than the pace in competitive markets where firms have an obvious profit motive to be the first to market with such innovations.

[4] "Two Named to Energy Panel; Bush Picks Texan, Pennsylvanian to Fill FERC Vacancies," Washington Post, March 28, 2001.

[5] As discussed in more detail below, vibrant competition exists in other telecommunications markets, such as interLATA long distance and customer premises equipment.

begun to exist for certain telecommunications services. The competition that does exist today is due almost entirely to the 1984 divestiture which resolved the U.S. government's massive antitrust case against the Bell System.

Policy-makers have limited options in the absence of a "functional market." One option is simply to accept the fact of a market failure and engage in traditional regulation. That option is not consistent with the public policy exemplified in the 1996 Act, however, which is to encourage the historic local telecommunications monopolies -- including Qwest -- to open their local markets to competition in exchange for the legal right to enter the competitive long distance market in their service territories. This policy, however, presents a number of difficult and complex issues to regulators. As relates to the public interest, regulators must not only assess the competing private interests of incumbent providers and would-be market entrants, they must craft regulations designed to create conditions where competition in local telecommunications markets can flourish, and existing competition in the long distance markets is not diminished.

Q. YOU HAVE STATED THAT REGULATION EXISTS WHERE THERE IS A MARKET FAILURE. HOW DO REGULATORS CREATE CONDITIONS WHERE COMPETITION CAN FLOURISH WHEN BY DEFINITION

THERE CAN BE NO "FUNCTIONAL MARKET" ABSENT REGULATION?

A. In the broadest terms, regulators should enact pro-competitive measures to both encourage good behavior and discourage anticompetitive behavior by Qwest. Such measures should seek both to neutralize the enormous advantages that Qwest possesses in the local market by virtue of its market power, and to ensure that Qwest does not use that market power to monopolize downstream markets such as broadband and long distance.

Q. WHAT DO YOU MEAN BY THE PHRASE "MARKET POWER?"

A. By the term "market power," I mean that Qwest has the ability with respect to various telecommunications services to control the market prices for those services. Also, Qwest has the ability to foreclose competitive entry by other firms for the provision of competing services.[6] In its service territories in Washington, Qwest's undeniable market power exists by virtue of its control of local bottleneck facilities. Qwest has enjoyed a preferred status as a provider of telecommunications services in Washington. For most of its existence, it has operated with the protection

[6] As the Court noted in its landmark opinion approving the consent decree presented to resolve the Justice Department's antitrust action against AT&T, "as defined by the Supreme Court, monopoly power is "the power to control prices or exclude competition."" *US v. American Tel & Tel*, 552 F. Supp. 131 (1982), at 171, citing *US v. Grinnell Corp*, and *US v. duPont & Co.* In my testimony, I will use the term "market power" to mean the same thing.

of a state-authorized monopoly, such that no competitor could even obtain the legal right to operate in competition with Qwest. In addition, Qwest enjoyed the prerogative of financing the construction of its ubiquitous network over a period of decades with captive ratepayer funds.[7]

Q. YOU STATED ABOVE THAT THE COMMISSION SHOULD ENACT REGULATIONS WHICH PROVIDE INCENTIVES FOR QWEST TO BEHAVE IN WAYS THAT FACILITATE COMPETITION IN THE WASHINGTON TELECOMMUNICATIONS MARKETS. WOULD YOU ELABORATE ON THE RELATIONSHIP OF THIS GOAL TO THE PUBLIC INTEREST?

A. Yes. As previously noted, our society is predicated on a preference for free markets over centrally controlled markets. But as Pat Wood's earlier statement notes, the market must first "work right." With this in mind, we can examine what reasonably would be expected of Qwest in terms of its behavior in a "free" market. Like any for-profit concern, Qwest possesses a natural incentive to manage its operations in a way that provides the highest financial return to its investors. But because of its control of bottleneck facilities on which its would-be competitors in both the local and long distance markets must rely, it has both the incentive and the

[7] I will address below in more detail why Qwest's situation -- with an already-constructed, ubiquitous network worth billions of dollars funded with virtually no risk to its shareholders -- provides it a huge competitive advantage over its potential CLEC competitors.

ability to exploit such control, always ensuring a competitive advantage over its competitors. If Qwest were allowed to act on this normal incentive and exploit its undeniable market power, the competitive process would suffer irreversible damage. Such a result would not be in the public interest.

Adopting regulations to limit Qwest's ability to exercise its market power to the detriment of the competitive process likely would trigger a claim by Qwest that it is harmed by such regulations. In such a situation, the Commission must consider whether the public interest is better served by facilitating the development of competition in Washington's telecommunications markets even though Qwest's private business interest is diminished. That is, the Commission must prioritize the pros and cons of the potential benefits to consumers of a more competitive marketplace versus alleged harm to Qwest. The fundamental public interest challenge is how to weigh the competing private interests of incumbent versus would-be competitor in the larger context of the overall benefits to the competitive process which is the best way to ensure that customers obtain the best possible services at the lowest prices.

Q. WHY IS IT NOT A REASONABLE PUBLIC POLICY MEASURE TO SIMPLY ELIMINATE ALL REGULATION OF ALL PROVIDERS AND LET THE MARKET DECIDE THE WINNERS AND LOSERS?

A. As noted above, regulation is exercised in instances where one provider has market power and the market cannot "self regulate." The market power Qwest possesses in the local telecommunications market means that the market simply cannot "work right," and elimination of all regulations would simply free Qwest to exercise its market power to the detriment of both consumers and the competitive process. The public interest considerations the Commission is making in this proceeding involve two different but related questions. One is whether the market for local telecommunications services has been sufficiently open to permit new entrants (CLECs) a meaningful opportunity to compete for both traditional voice services and emerging broadband offerings. The other is what is the likely impact of Qwest's entry into a market for long distance telecommunications services that is already subject to robust competition.

II. States and the Public Interest

Q. ARE STATE REGULATORS UNIQUELY POSITIONED TO CONSIDER PUBLIC INTEREST ISSUES?

A. Yes, they are. This fact was recognized by Congress in passing the Communications Act of 1934, and underscored in the 1996 amendments to the Act. For example, Section 251(d) of the Act contains limitations on the FCC's authority to preclude certain state regulations, orders, or policies that are consistent with the Act's requirements. Even more directly related to the purpose of this proceeding, the Act specifically requires the FCC to consult with the State in considering a Bell Company's application pursuant to §271 of the Act for authority to provide long distances services within its service territory.

The states are uniquely positioned to consider public interest issues because this is where the proverbial rubber meets the road. This Commission has not merely observed from afar the implementation of the Act's market-opening provisions, but actively has been involved at every step of the process. From reviewing negotiated interconnection agreements, to arbitrating complex policy issues on which the CLEC and Qwest could not reach agreement, establishing prices for unbundled network elements, and resolving disputes over interpretations of language in interconnection agreements, the Commission regularly has grappled with difficult issues of importance to the consumers of Washington. Such extensive "on-the-job training" establishes this Commission as the most qualified body to consider issues of the public interest as it impacts Washington users of telecommunications services.

Perhaps even more importantly, in recent comments before an American Bar Association antitrust enforcement panel, the Chair of the FCC signaled that he will not be as aggressive in enforcing the public interest standard, which is part of the FCC's review of ILECs' 271 applications before that agency.[8] This Commission must therefore satisfy itself that Qwest's entry into the long distance market serves the public interest in this State. Contrary to the recommendations of Qwest witness Teitzel that this Commission should limit its deliberations to those elements considered in the FCC's public interest reviews, I urge the Commission to consider any and all evidence it deems pertinent to its public interest findings.[9]

Q. WHAT IS THE KEY ISSUE FOR THE COMMISSION TO CONSIDER IN ASSESSING THE PUBLIC INTEREST IMPLICATIONS OF QWEST'S ENTRY INTO THE WASHINGTON LONG DISTANCE MARKET?

A. It is the question of timing of that entry. Obviously, there are risks associated with allowing Qwest into the long distance market either too early or too late. As I discuss throughout my testimony, there are a number of reasons why the risk to the public interest is immeasurably greater if Qwest is permitted into the long distance market earlier rather than later.

Q. WHAT POLICY RESULT IS INDICATED BY THE REWARD STRUCTURE SET OUT IN THE ACT?

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[8] Wall Street Journal, May 1, 2001, "Politics & Policy: Powell Quickly Marks Agency as His Own" by Yochi J. Dreazen

[9] Direct testimony of David L. Teitzel, filed May 16, 2001, in WA Docket No. UT-003022, at 43.

A. Congress clearly recognized the inherent risk to consumers and to competition if Qwest is allowed to enter the long distance market prematurely; i.e., before Qwest's local market is irreversibly open to competition.

Q. WHAT ARE THE RISKS TO WASHINGTON CONSUMERS IF THE COMMISSION GETS THE TIMING WRONG?

A. The history of telecommunications regulation in the U.S. in the 20th Century reveals the undeniable difficulties associated with opening up previously monopolized markets to competition. At the turn of the century, the Bell System refused to interconnect its long distance facilities with the local networks operated by the independent (i.e., non-Bell affiliate) companies until threatened with prosecution under the nation's antitrust laws. The threat of anti-trust action led to a commitment by the Bell System to interconnect its long distance network with both unaffiliated and affiliated local telephone companies; a commitment known as the Kingsbury Commitment, which was entered in 1913. A subsequent anti-trust suit brought by the Justice Department in 1949[10] ended with the entry of a meaningless consent decree that did not correct the alleged

[10] The government's complaint alleged that the Bell System "had monopolized and conspired to restrain trade in the manufacture, distribution, sale, and installation of telephones, telephone apparatus, equipment, materials, and supplies, in violation of sections 1, 2, and 3 of the Sherman Act…." *US v. American Tel. and Tel.*, 552 F. Supp. 131 (1982) (hereinafter referenced as "*AT&T*"), at 135-136.

anti-competitive activities. The effectiveness of that resolution and the FCC's later efforts to deal with anticompetitive actions by the Bell System in the 1970s was described by Judge Harold Greene[11] as follows:

> The efforts of various arms of government to introduce true competition into the telecommunications industry have been … feeble. The anti-trust suit brought by the Department of Justice in 1949 ended in 1956 with a consent decree which imposed injunctive relief that was patently inadequate. It took from 1968 when the *Carterfone* decision was handed down by the FCC to 1978 when the United States Court of Appeals decided *Execunet II* to establish even the very principle of competition so that it was beyond dispute by [the Bell System].[12]

Because Qwest continues to possess market power,[13] and for the reasons discussed below, there is significant risk that Qwest could exercise its market power in such a way as to re-monopolize certain telecommunications markets. The significant barriers to entry in the consumer market should be of particular concern to the Commission. As the FCC noted:

> …BOC entry into the long distance market would be anticompetitive unless the BOCs' market power in the local

[11] Judge Greene oversaw the anti-trust action brought by the Justice Department against the Bell System in 1974 which was resolved by the 1984 divestiture of the Bell Operating Companies from AT&T.

[12] *AT&T* at 170

[13] The source of Qwest's market power is its control over a ubiquitous telecommunications network throughout its operating territory. As noted in the FCC's Local Competition Order, "An incumbent LEC's existing infrastructure enables it to serve new customers at a much lower incremental cost than a facilities-based entrant that must install its own switches trunking and loops to serve its customers." (FCC Order 96-325 in CC Docket 96-98, released August 8, 1996, at ¶ 10)

> market was first demonstrably eroded by eliminating barriers to local competition.[14]

Q. IS IT TRUE THEN THAT THIS COMMISSION'S ONLY TASK IS TO ASSESS THE CURRENT STATE OF QWEST'S EFFORTS TO OPEN ITS LOCAL MARKETS TO COMPETITION?

A. No. The public interest requires that the Commission look not only at Qwest's prior actions, but also must make every effort to anticipate the impact of those actions in the future. This notion was described by the FCC in the following manner:

> While BOC entry into the long distance market could have procompetitive effects, whether such benefits are sustainable will depend on whether the BOC's local telecommunications market remains open after BOC interLATA entry. Consequently, we believe that we must consider whether conditions are such that the local market will remain open as part of our public interest analysis. [15]

This passage underscores the fact that there is a forward-looking aspect of the public interest review.

Q. WHAT SORTS OF PROSPECTS FOR FUTURE COMPETITION EXIST THAT THE COMMISSION MIGHT ANTICIPATE AS IT WEIGHS THE

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[14] *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services In Michigan*, Memorandum Opinion and Order in CC Docket No. 97-137, Order FCC 97-298, released August 19, 1997, at 18.

[15] Id., at 390.

PUBLIC INTEREST ASPECTS OF QWEST'S ENTRY INTO THE WASHINGTON LONG DISTANCE MARKET?

A. There are several facts indicating that the prospects for a vibrant competitive marketplace for a variety of telecommunications services in Washington are shaky, at best.

First, the Commission need look only to the speed with which Verizon and SBC have captured long distance market share in New York and Texas. In less than one year, both Bell Companies were able to vault from the position of new entrant to that of second-largest carrier in their respective states.[16] While such a result might be taken as indicative of their marketing prowess, I believe it demonstrates something quite different. One must remember that it took ten years following the implementation of "equal access"[17] for MCI to achieve a 20% share of the long distance market. The fact that the Verizon and SBC Bell Companies were able to capture long distance market share so quickly reveals a critical difference between the long distance and the local markets for telecommunications services; namely, that it is far easier for a provider of

[16] See, e.g., Telecommunications Reports Daily, April 17, 2001, quoting Maura Breen, president of Verizon Long Distance, on the fact that Verizon captured 20% of the New York long distance market within 12 months. See also, SBC press release dated April 23, 2001, noting that it had won 2.2 million long distance customers in Texas, Oklahoma, and Kansas in less than one year; www.sbc.com/news_center/.

[17] "Equal access" is a term describing the network interconnections non-AT&T long distance companies were finally able to obtain as a condition of the consent decree settling the government's 1974 anti-trust case against the Bell System. The term means network interconnection equal in quality to the interconnections the Bell Companies had historically

ubiquitous local services to garner long distance market share than for a provider of long distance services to capture local market share. The reason for this is easy to see. Qwest almost instantly can change a customer's long distance provider using electronic processes triggered with a few keystrokes on a computer terminal. On the other hand, converting a customer's local service from one carrier to another requires numerous steps by both carriers, which steps must be coordinated and which because the ILECs have not implemented electronic means of handling such processes, require significantly more than a few seconds to execute. For example, the intervals offered by ILECs such as Qwest to accomplish a simple single-line conversion is between 3-5 days. Until the ILECs implement electronic processes to accomplish local conversions, their ability rapidly to capture long distance market share will be immeasurably greater than IXCs' ability to capture local market share. It is quite clear from Mr. Teitzel's testimony that he and I have very different interpretations of why Verizon and SBC have been so successful upon entering the LD markets in New York and Texas, respectively. Notwithstanding the existence in those states of three large facilities based interexchange carriers who have competed head-to-head for years, as well as numerous resellers, and undisputable evidence that consumers pay much less for LD service than in the past, Mr. Teitzel draws the

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provided to AT&T. Equal access was implemented on a phased basis beginning in 1984, and unsupportable conclusion that those states' LD markets were not competitive until one more carrier entered the market.

Second, the Commission can open the business section of the newspaper on any given day and read about yet another CLEC that has declared bankruptcy or is otherwise in dire financial straits. A recent report on the status of local competition by the Association for Local Telecommunications Services (ALTS)[18] described the CLECs' dismal financial picture. Of the 36 publicly traded CLECs tracked for the report, three-fourths of the CLECs (27) saw their market capitalization drop by more than 70% in the year ending February 2001. Equally stunning is the fact that only ***one*** of the CLECs actually experienced a ***positive*** 52-week change in its market capitalization. Quite simply, it is ludicrous to portray the CLEC industry as comprising significant competitive challenges to Qwest's monopoly in the provision of local services in the broad consumer market over the long term. According to its most recent ARMIS report to the FCC, Qwest's Washington revenues for 2000 totaled $1.55 Billion.[19] The enormous revenue stream Qwest obtains from consumers captured as part of its historic monopoly provides it with a huge advantage over its would-be competitors, most of whom are reeling under massive debt

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was largely completed by 1986.

[18] *The State of Local Competition 2001*, ALTS report issued February 2001, at 22.

[19] See ARMIS 43-01 report, Table 1: Cost and Revenue table. The intrastate portion of Qwest's revenues was reported at $1.07 Billion.

loads. Closely related to the problems facing the CLECs is the decline in the financial standing of the major long-distance companies. Concerns over shrinkage in the traditional voice long distance business has caused the shares of AT&T, Sprint, and WorldCom to drop significantly. Indeed, all three companies have lost between 55% and 69% of their market capitalization over the past year. The financial picture for the Bell Companies is quite rosy by comparison. Even though the overall stock market anxiety has impacted their share prices, the reduction is nowhere as pronounced as the CLECs and IXCs. As the chart on Exhibit DP-3 shows, compared to the share prices of AT&T, Sprint, and WorldCom which as discussed above are only about one-half year ago price levels, Qwest's shares are virtually even with year ago levels.

Third, there is a tremendous difference in the situation facing a new entrant in the Washington local telecommunications market and the situation Qwest historically experienced. By virtue of its government-protected monopoly, Qwest entered the market free from any competitive threat. Perhaps even more important is that Qwest was assured the recovery of its costs and a return on its invested capital. Qwest's situation can be likened to that of an army occupying a town that has been vacated by the enemy, whereas a CLEC faces what could charitably be described as "fierce opposition" by an entrenched enemy who has no incentive or intention of giving up even a single building -- much less the entire town.

As the Commission gazes into its crystal ball and seeks to anticipate the future of telecommunications competition in Washington, it should take into account this sharp disparity between the circumstances of the new market entrants and Qwest as the established local service provider. Recognizing the extent of this disparity also provides insight to the question of why more competition has not yet developed in Washington, because unlike the historic monopoly, entrants can scarcely afford to enter markets unprofitably.

Fourth, the evidence is clear that the Commission should not look to other Bell Companies as a likely source of broad-based competition for Qwest. Rather than competing with each other, the Bell Companies have merely acted to consolidate their geographic monopolies. Bell Atlantic acquired the New York/New England Bell Company known as NYNEX, and then swallowed up GTE to become Verizon. Southwestern Bell acquired Pacific Bell and Nevada Bell to become SBC, and then gobbled up Ameritech -- the Bell Company serving the mid-west. In the case of SBC's acquisition of Ameritech, SBC committed to entering a number of local telecommunications markets outside of its service territories. Notwithstanding the big splash SBC made in the press when it announced entry into several out-of-region markets, recent reports reveal that SBC is significantly scaling back its efforts to compete with its sister Bell Companies such as Qwest. An article in the San Antonio Express-News on March 8, 2001 reported confirmation by an SBC spokeswoman that SBC had "laid off an unspecified number of workers in the seven markets into which [SBC] already expanded," and had "shuttered a 400-employee call center in Tampa, Fl." A Network World article dated March 5, 2001 noted that "in New York and Long Island, where SBC says it turned up CLEC service against Verizon late last year, large companies with sister offices in SBC's native territories -- exactly the type of businesses the carrier said it would go after -- remain unaware of SBC's market entry." The article further states that "users and independent competitive local exchange carriers call SBC's effort virtually invisible." By virtue of their decades of experience in providing local services, the ILECs represent the most formidable potential competitors to each other. Given this, the Commission should take careful note that the ILECs expressly have chosen not to compete in each others' territory, but rather have focused their attention on their own territories where they have the ability to exploit their market power.[20]

Fifth, the Commission should take note of the regulatory tools at its disposal to check competitive abuses and/or exercise of market power in the Washington consumer market for telecommunications. So-called pricing flexibility plans have had the result of effectively deregulating

[20] See, "Sitting Pretty: How Baby Bells May Conquer Their World," New York Times, April 22, 2001, by Seth Schiesel. "Some experts had thought that the Bells would invade one another's territories. That did not happen because the Bells knew better than anyone that profits rested on network ownership, and they do not own significant networks in the other companies' territories."

Qwest before any competitive alternatives in the market could act as a check on its market power. Thus, consumers face the prospect of having neither regulatory protection from, nor competitive alternatives to, the monopoly provider of local telecommunications services.

Q. GIVEN THE ABOVE, WHAT IMAGE IS THE COMMISSION LIKELY TO SEE IN ITS CRYSTAL BALL?

A. The image that is likely to be observed is the same image that existed in the 1970s, when the Washington market for broad-based consumer telecommunications services was dominated by a single, vertically integrated firm providing both local and long-distance telecommunications services. Unlike the situation that existed in the 1970s, however, such a provider will be subject to, at best, minimal regulatory oversight. Perhaps even more distressing is the likely prospect that Qwest will have leveraged its monopoly over last-mile facilities to become the dominant provider of broadband services in the consumer market. Said differently, a likely scenario is that of a market where consumers have only one choice: an unregulated, integrated firm providing local, long-distance, and broadband/internet services. The strong likelihood of this scenario should be of grave concern as this Commission assesses the public interest implications of Qwest's proposal to enter the long distance market in Washington.

III. Pricing of Network Elements and the Public Interest

Q. EXPLAIN HOW THE PRICING OF NETWORK ELEMENTS RELATES TO THE COMMISSION'S CONSIDERATION OF THE PUBLIC INTEREST?

A. The significance of the pricing of network elements was explained by the FCC in its Local Competition Order,[21] as follows:

> …the removal of statutory and regulatory barriers to entry into the local exchange and exchange access markets, while a necessary precondition to competition, is not sufficient to ensure that competition will supplant monopolies. An incumbent LEC's existing infrastructure enables it to serve new customers at a much lower incremental cost than a facilities-based entrant that must install its own switches, trunking and loops to serve its customers. […] Because an incumbent LEC currently serves virtually all subscribers in its local serving area, an incumbent LEC has little economic incentive to assist new entrants in their efforts to secure a greater share of that market. An incumbent LEC also has the ability to act on its incentive to discourage entry and robust competition by not interconnecting its network with the new entrant's network or by insisting on supracompetitive prices or other unreasonable conditions for terminating calls from the entrant's customers to the incumbent LEC's subscribers.[22]

> Congress addressed these problems in the 1996 Act by mandating that the most significant economic impediments to efficient entry into the monopolized local market must be removed. <u>The incumbent LECs have economies of density, connectivity, and scale; traditionally, these have been viewed as</u>

[21] In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order in CC Docket No. 96-98, FCC Order No. 96-325, released August 8, 1996.

[22] <u>Id.</u>, at § 10.

> creating a natural monopoly. As we pointed out in the NPRM, the local competition provisions of the Act require that these economies be shared with entrants. We believe they should be shared in such a way that permits the incumbent LECs to maintain operating efficiency to further fair competition, and to enable the entrants to share the economic benefits of that efficiency in the form of cost-based prices.[23]

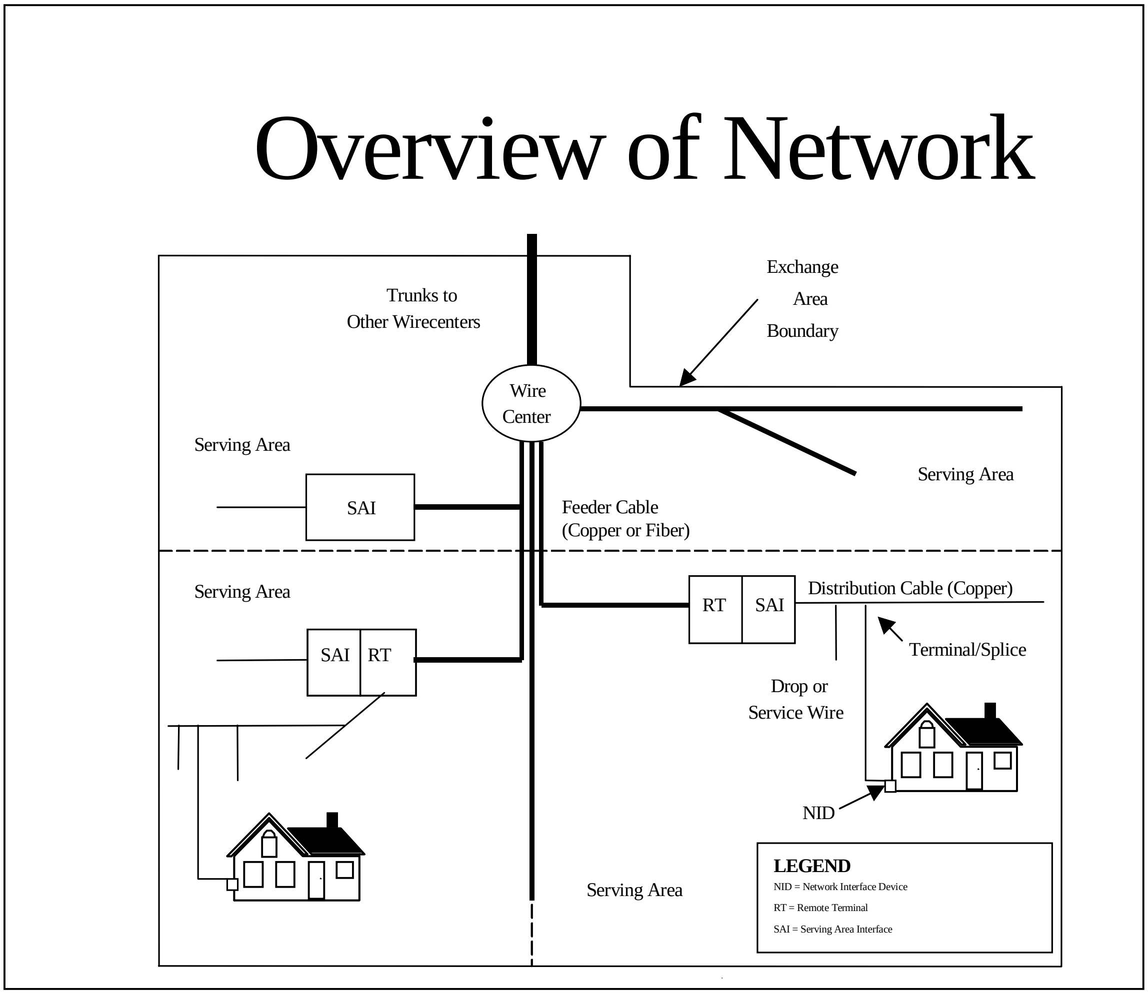
Thus, a significant barrier to entry into the local telecommunications market would exist absent the CLECs' legal and practical ability to lease components of the incumbents' networks at prices based on forward-looking economic costs.

Q. PLEASE ELABORATE.

A. To explain the relationship between UNE prices and the public interest, I must first provide an overview of telecommunications networks and the related economics.

At the most simplistic level, telecommunications networks are comprised of 1) loop plant that is used to connect customers' premises with 2) switches which are joined together by 3) interoffice transport. The diagram below depicts a typical "exchange" served by a single switch where the loop plant connects the various buildings to the "wire center" -- which is where the switch is typically located. The "trunks" represent the connections to other wire centers/switches.

[23] Id., at § 11. Emphasis added.



As discussed above, as a result of its historic monopoly in the provision of local telecommunications services, Qwest operates a loop network connecting virtually ***every home and building*** in its service territory. The fact of this existing, ubiquitous network represents a strategic asset of enormous competitive value.

A CLEC wishing to compete with Qwest for local telecommunications services on a broad scale -- or an IXC competing with

Qwest in the long distance market -- must have an ability to quickly connect subscribers to its network regardless of where the subscriber's premises are located. The CLEC's choice is either to construct its own facilities or lease facilities from Qwest.[24] A CLEC opting for the first choice faces a massively expensive and lengthy task of obtaining financial backing, obtaining municipal franchise authority, securing rights-of-way, and ordering and placing such facilities in the ground. Although this process can be described in a few words, each of the aforementioned steps represents a massive undertaking in and of itself. An example would be the matter of obtaining capital funding. Based on the most recent ARMIS report to the FCC, Qwest's loop plant in Washington represents a $3,100,000,000.00 asset. Should a CLEC attempt to replicate Qwest's ubiquitous loop plant at today's materials and labor cost, the amount of necessary investment would likely be far greater. There is the significant question of how the CLEC could obtain such massive funding given that it will have to compete head-to-head with Qwest for each and every customer -- unlike Qwest whose network was constructed while it had a protected monopoly.[25]

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[24] Similarly, the choice for the IXC is to try and find an alternative provider of local facilities or to lease facilities from Qwest.

[25] Recall the earlier military analogy in which the CLEC is in the role of trying to "take" the market on a building by building basis, in contrast with Qwest who simply marched in and occupied the market without opposition.

I discussed above how the process of converting local customers from one carrier to another is much more difficult than changing a customer's long distance carrier. That fact is of critical importance in this context, as the Commission should note that it took nearly ten years for MCI to gain 20% of the long distance market from AT&T following divestiture in 1984. In short, investors understandably would be quite hesitant to fund a total replication of Qwest's loop plant if the best a CLEC could hope to achieve over a ten year period was a 15% market share. Such hesitation easily can be explained. Assuming the CLEC requires an investment equal to Qwest's $3.1 Billion, the investor must assess the CLEC's ability to finance that massive debt load (as well as the CLEC's internal operations) with only a fraction of Qwest's customer base. The math simply doesn't work. Economists refer to such a scenario as a barrier to entry, because of the fact that entry into the market would require enormous sunk costs.[26] And even assuming the CLEC could vault such a massive financial hurdle, the CLEC could not possibly complete the other tasks of obtaining franchise authority and rights-of-way in every city, town, and village, securing the necessary materials and equipment, and performing such a Herculean construction job in less than ten years.[27]

[26] Economists use the term "sunk costs" to refer to costs that, once they are incurred, cannot be recovered. The costs to a CLEC of installing "last mile" facilities to reach thousands of customers would be "sunk," because such facilities could not be moved elsewhere when demand fails to materialize.

[27] The Commission should recall that Qwest's construction activities in any given year impact only a mere fraction of its total loop plant, unlike the task the CLEC would face. Also, the Commission

The CLEC's other option is to lease loop facilities from Qwest as unbundled network elements pursuant to §251(c)(3) of the Act. Unlike the construction option described above, this option presents the obvious advantage of being immediately available, and does not require the CLEC to prove up an impossible financial picture to obtain investment capital. Nonetheless, the lease option presents a variety of undesirable prospects to the CLEC, the foremost of which is that the CLEC is dependent upon its main competitor for a key input to the services it wishes to offer to customers. Understandably, no CLEC wishes to place its ability to meet its customers' needs in the hands of its chief competitor.[28] The lease option places the CLEC at the mercy of its main competitor both for the price it must pay to utilize the facilities and for the terms and conditions under which it has access to and can utilize the leased facilities. Without question, Qwest has no incentive to price such facilities in a manner that would permit the CLEC to pose a real competitive threat to Qwest, particularly because Qwest knows full well that construction of a duplicative network is not a viable alternative to the CLEC.

should not lose sight of the fact that during the entire period of CLEC construction, Qwest would continue to enjoy the inflow of copious revenues from its still-captive customer base.

[28] See below discussion of Qwest's performance in providing special access to WorldCom.

Q. DID CONGRESS RECOGNIZE THE EXISTENCE OF HIGH ENTRY BARRIERS INTO THE LOCAL TELECOMMUNICATIONS MARKET IN THE 1996 AMENDMENTS TO THE ACT?

A. Yes. Congress noted that competitors could not possibly enter markets rapidly if they were forced to build duplicative networks "because the investment necessary is so significant."[29] It further recognized that the overall pro-competitive objectives of the Act would be frustrated if the rates the Bell Companies were allowed to charge for the use of their existing network (unbundled elements) were not set appropriately, and therefore required that rates for the leasing of network elements be "just, reasonable, and nondiscriminatory" and "based on the cost … of providing" the network element.[30] Congress clearly recognized the incentive and the ability of the incumbent Bell Companies to preclude market entry by manipulating the prices charged for the use of portions of their existing, ubiquitous networks.

A strong indication of the incentives discussed above is the fact that the incumbent Bell Companies have mounted every possible legal challenge to the implementation of reasonable cost-based prices. Those challenges have taken the form of appeals of both the FCC's and of virtually every state's pricing rulings at federal district courts across the

[29] H.R. Conf. Rep. No. 104-458, at 148 (1996)

[30] 47 U.S.C. §§251(c)(3), 252(d)(1).

nation. The rulings by some of these district courts have been taken up by at least two of the U.S. Courts of Appeals, and the question of the FCC's pricing rules for unbundled network elements is pending before the U.S. Supreme Court.

In short, Qwest and its sister Bell Companies have attacked the notion of reasonable, nondiscriminatory, cost-based pricing of the components of its network in every possible venue.[31] Notwithstanding its activist stance in attempting to foreclose competitive entry by CLECs through the use of unbundled network elements, Qwest now shamelessly argues that CLECs' entry strategies are "beyond its control."[32]

Q. HOW DOES THIS RELATE TO THE QUESTION OF THIS COMMISSION'S CONSIDERATION OF THE PUBLIC INTEREST?

A. This Commission represents the judge and jury as to whether Qwest will be permitted to require its would-be competitors to pay unreasonable prices for components of its network necessary to provide competitive alternatives to Qwest's local services in Washington, or conversely, whether the rates Qwest charges for the use of those components will stimulate broad-based entry and provide true competitive alternatives to

[31] In Washington, although Qwest has so far not indicated that it will appeal the Commission's final pricing decision in Docket No. 960369, it has over the years appealed all the way to the Ninth Circuit Court of Appeals many of this Commission's pro-competitive arbitration decisions, including the decisions entered in both MFS's and MCI Metro's arbitrations.

[32] Rebuttal Testimony of David L. Teitzel in AZ docket T-00000B-97-238, filed May 29, 2001, at 4.

the State's consumers. As WorldCom witness Bobeczko previously testified before this Commission:

> …Qwest's proposed UNE-P recurring and nonrecurring rates are so high relative to the prices of its retail product offerings, that if a CLEC sold local service to a residential customer for the same price as Qwest, it would not even make enough money to pay for the cost of the elements it leases to provide that service.[33]

Q. HOW CAN THE COMMISSION ENSURE THAT THE PRICES FOR UNBUNDLED ELEMENTS OF QUEST'S NETWORK HAVE THE INTENDED PRO-COMPETITIVE EFFECTS?

A. There is no simple answer to this, in large part because of the fact that costing proceedings typically produce widely differing recommendations as to what constitutes the "right answer" for any given element. Most of such differing recommendations arise out of the fact that numerous assumptions are required to estimate the "cost" of any network element. In the area of switching equipment for example, Qwest is able to obtain a sizeable discount off its vendors' "list prices" as a result of the substantial buying power it has as a purchaser of switches across its 14-state region. The magnitude of that discount has an obvious impact on the accuracy of estimations of the cost of various switching components, and Qwest has two significant reasons to not disclose the actual amount of its vendor discount. One reason is the competitive sensitivity of such information.

The second is the incentive described previously; i.e., that Qwest has absolutely no reason to reveal the size of that discount to this Commission and its competitors because such information would compromise Qwest's competitive advantage relative to the CLECs.

Another example of the difficulty in discovering the "right answer" is in the area of what are termed "fill factors" for loop facilities. As a brief explanation, fill factors are required in estimating the cost of loop facilities because of the way such facilities are engineered and constructed. The costing of loop facilities must take into account both demand and what is called "breakage."[34] As with the vendor discount described relative to estimating the cost of switching, Qwest's obvious incentive is to estimate loop costs with the lowest possible fill factor. As an example, we will assume that Qwest's loop costs are based on a fill factor of 50% -- a figure I consider excessively low. This means that for every pair the CLEC leases, Qwest is compensated for engineering and construction of 2 pairs. Qwest would effectively then have a "free" copper pair for every pair the CLEC purchases, and that "free" pair can be used to generate revenues from services sold to its retail customers. These examples demonstrate that the Commission's decisions on seemingly arcane issues

[33] Direct testimony of Paul G. Bobeczko, filed December 20, 2000, in WA Docket No. UT-003013, at 8.

[34] Breakage is the term used to describe the likelihood that a given copper pair in a cable will be unusable. Because of breakage, loop facilities are engineered for a greater number of pairs than is required to serve the demand.

can have a significant impact on the development of competition in Washington's telecommunications markets.

Q. ARE THERE OTHER EXAMPLES OF FACTORS FOR WHICH EXPERTS WILL LIKELY OFFER WIDELY DIFFERING RECOMMENDATIONS?

A. Yes. The above examples relate to the first step in the estimation of costs; the investment per unit of plant. Once that investment figure has been determined, there are numerous factors such as labor rates, the cost of capital, and depreciation rates, all of which are needed to transform the investment figure into a monthly cost. Each of these factors, as well as many others, such as trench sharing and placement costs, can be manipulated by Qwest to its competitive advantage.

Q. WITH ALL OF THE ABOVE IN MIND, HOW SHOULD THE COMMISSION ASSESS SUCH A WIDE RANGE OF RECOMMENDATIONS IN SETTING PRICES FOR NETWORK ELEMENTS?

A. First and foremost the Commission must remember that Congress' intent in allowing CLECs to lease components of the incumbents' networks at reasonable and cost-based rates was to remove the huge barrier to entry represented by the massive capital costs necessary to replicate ILECs' networks I discussed above. Congress expected that CLECs would lease facilities in order to compete with the incumbents, and the likelihood of such competition with the incumbent is increased as UNE rates are lower.[35] Thus, a principled basis for the setting of UNE rates is that such rates must be no higher than necessary to compensate the incumbent for the function it is providing and earn a return on its investment. Anything above such a minimum price will frustrate Congress' intent by creating rather than removing a barrier to entry because the Act is pro-competition rather than pro-competitor.

Q. DO YOU HAVE FURTHER COMMENTS ON THE IMPORTANCE OF UNE PRICING?

A. The pricing of UNEs is one of the most important tools available to regulators to effectively open the ILECs' local markets for competitive entry.[36] Access to UNEs at cost-based prices that encourage entry is the best way the Commission can neutralize the barrier to entry that exists by virtue of Qwest's ubiquitous, pre-existing network already paid for by its captive ratepayers. Beyond the issue of UNE pricing is another price-related issue this Commission should consider in its public interest analysis; namely, the Qwest's ability to engage in an anticompetitive price

[35] Recall that CLECs simply cannot enter markets unprofitably.

[36] Of course, even the best pricing decision can be neutralized by allowing the ILEC to impose anti-competitive terms and conditions on CLECs for the use of the UNE(s).

squeeze against other long distance carriers unless its switched and special access charges are reduced to levels reflecting their economic costs. The issue is simple. When Qwest is permitted to compete for customers' long distance services, it will provide those services using the same components of its network used by other carriers. The cost to Qwest for the use of its network is its economic cost.[37] But the cost to other carriers is the access rates charged by Qwest. To the extent that Qwest's access rates exceed the economic costs of the network components, Qwest will enjoy an artificial, but powerful, price advantage over other long distance carriers. Such an advantage would operate to the detriment of Washington consumers and the competitive process because Qwest could compete with other carriers on price even if it were the less efficient service provider.

IV. Qwest's Behavior Indicates a Continuing Monopoly Mind-Set

Q. WHAT ARE THE PUBLIC INTEREST IMPLICATIONS OF QWEST'S BEHAVIOR TOWARD CLECS SEEKING TO ENTER LOCAL MARKETS?

[37] This is true even if Qwest were required to "impute" its switched or special access rates to its retail long distance pricing. An imputation requirement simply results in a "right-pocket, left-pocket" transaction within the corporate family without real financial significance, and thus does nothing to prevent an anticompetitive price squeeze.

A. As noted earlier in my testimony, Qwest is a for profit entity and by virtue of that fact it possesses a natural incentive to manage its operations in a way which provides the highest financial return to its investors. After all, Qwest's management has a fiduciary obligation to do so. But because it controls bottleneck facilities on which its competitors must rely, Qwest has both the incentive and the ability to exploit such control in a way that provides it with a competitive advantage over its competitors. Allowing Qwest to act on this normal incentive and exploit its undeniable market power would cause irreversible damage to the competitive process to the detriment of Washington consumers and to the public interest. Evidence of Qwest's treatment of its would-be competitors in the market for local telecommunications services is of critical relevance as this Commission considers the public interest implications of Qwest's entry into the Washington long distance market.

Q. WHAT IS QWEST'S "TRACK RECORD" IN DEALING FAIRLY WITH OTHER CARRIERS?

A. The track record amassed over the years since the passage of the 1996 Act is of a Qwest which continues to behave as a monopoly and exhibit a monopoly mindset. This monopoly mindset was satirized a number of years ago by Lilly Tomlin's famous telephone operator character, who stated: "we don't care. We don't have to. We're the Phone Company."

As discussed above, when a firm is "the only game in town," its profitability is not contingent on its successes in meeting (much less, exceeding) customers' expectations. As a result, it has no incentive to distinguish itself in the wholesale market by such acts as providing innovative services, superior customer service, or reducing costs so as to be price competitive. The question is whether Qwest is a firm which, by its actions, demonstrates to its customers that it recognizes them as valued customers, or whether it is a firm with a "we don't care; we don't have to" attitude.

Q. WHAT EXAMPLES EXIST OF QWEST'S CONTINUING MONOPOLY MINDSET?

A. Some examples include a Qwest which:

- ignores critical planning information provided by CLECs that Qwest itself has demanded that CLECs furnish
- unreasonably discriminates against other carriers by giving preference to its retail operations
- dictates new processes and procedures to its carrier customers rather than consulting with them
- fails to recognize terms and conditions in existing interconnection agreements

Even though many of the examples below were ultimately resolved, the fact that Qwest took such positions required WorldCom and other CLECs to expend management and regulatory resources to achieve resolution.

Such behavior by Qwest has the effect of raising the CLECs' costs of entry -- contrary to Congress intent to lower legal and economic barriers to entry in passing the Act. Furthermore, Qwest's behavior indicates the difficulty of anticipating each and every possible way Qwest might act to thwart competitors' efforts to enter its local markets.[38]

Q. PLEASE EXPLAIN WHAT YOU MEAN BY QWEST IGNORING CRITICAL PLANNING INFORMATION THAT QWEST HAS DEMANDED BE PROVIDED BY CLECS.

A. Qwest has consistently required CLECs to furnish forecasts of future interconnection trunk demand levels even before CLECs had historical information on which to base such forecasts. As this Commission determined in a complaint filed by WorldCom against Qwest, Qwest routinely ignored the very forecast information it demanded that CLECs furnish.[39] The result of ignoring the required forecast information was a Qwest facilities shortage which limited WorldCom's ability to obtain interconnection trunks on a timely basis but which had little if any impact

[38] See discussion below in Section V of my testimony regarding the historic difficulties regulators have experienced trying to prevent discriminatory and anticompetitive acts by the Bell System.

[39] See, *MCImetro Access Transmission Services, Inc. v. U S West Communications Inc.,* Washington Utilities and Transportation Commission Docket No. UT-971063, Commission Decision and Final Order Denying Petition to Reopen, Modifying Initial Order, in Part, and Affirming, in Part, issued February, 1999, Finding of Fact 205: "US West failed to disclose that its processes did not accept CLEC forecasts at the same time that it required MCImetro to submit forecasts as a precondition to provisioning facilities."

on Qwest's retail operations.[40] While Qwest has withdrawn many of its forecasting requirements in its SGAT in Arizona, Colorado and Washington on the basis that forecasts are not useful in network planning, Qwest continues to justify poor wholesale provisioning performance on the lack of forecasts. Just a few weeks ago in a Minnesota proceeding to address the need for Qwest wholesale service quality standards, Qwest objected to the Minnesota Commission imposing standards for timely installations of unbundled loops and other local facilities, absent CLEC forecasts.[41] WorldCom and the other CLEC participants testified that they do routinely provide forecasts to Qwest for collocations and for unbundled and line-shared loops in the "hopes that it will provide Qwest with the data to improve their performance."[42] CLEC concerns over Qwest's forecasting requirement relate to Qwest's ability to "game the system" by unilaterally determining what level of forecast is adequate. CLECs testified that they do provide forecasts, but forecasts should not be a condition of standards and remedies for Qwest's performance.[43] WorldCom and the other participating CLECs also objected to Qwest's forecasting requirement as discriminatory, since Qwest's retail tariffs do

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[40] Id., Finding of Fact 244: "Capacity problems at local tandem switches have a relatively minimal impact on US West."

[41] The Facilitation in the Matter of Qwest Wholesale Service Quality Standards, Minnesota PUC Docket No. P-421/M-00-849, TR at Vol 1-25-29.

[42] TR at Vol 1- 165.

[43] Id., at 154-179.

not require customers to forecast demand before they are entitled to service at a "standard interval" or one interval over another.[44] In direct contradiction to its argument that forecasting should be required before imposition of standards and penalties, in response to questions posed by the Minnesota Commission staff, Qwest admitted that CLECs that provide forecasts do not get better performance from Qwest.[45] Qwest routinely disregards their forecasts.[46]

The effect of Qwest's behavior was to "[subject] MCImetro to an undue disadvantage and [grant] to itself an unreasonable preference,"[47] the textbook definition of anticompetitive behavior. Qwest's actions requiring CLECs to furnish information that it then failed to use in its planning processes had the effect of driving up CLECs' costs to compete with Qwest in the local telecommunications marketplace.[48] Whether or not Qwest's purpose in imposing the forecast requirement was to drive up its competitors' cost, the effect was the same.

In Minnesota, Qwest continues to routinely request forecasts from competitive carriers for unbundled loops and other services. Qwest uses

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[44] TR at Vol 2-59. A "standard interval" is the length of time within which Qwest commits to complete an installation for a given service or facility pursuant to tariff or contract.

[45] Id., at 248-49.

[46] TR at Vol 1-162-165.

[47] Washington Order, Conclusion of Law 265.

[48] This effect was achieved because Qwest's requirements meant that CLECs had to utilize their personnel in ways that had nothing to do with providing service to their customers, but had everything to do with filling out meaningless forms for Qwest.

the absence of forecasts as a reason to excuse reporting to the Minnesota Public Utilities Commission on its provisioning performance for non-forecasting carriers. Such reporting and payment of penalties for poor performance are required under Qwest's merger agreement in Minnesota.

Q. IS THIS WHAT YOU MEANT WHEN YOU STATED EARLIER THAT QWEST HAS UNREASONABLY DISCRIMINATED AGAINST OTHER CARRIERS BY GIVING PREFERENCE TO ITS RETAIL OPERATIONS?

A. The interconnection facilities situation in Washington to which I referred above is one example. Other examples were found by the Minnesota Public Utilities Commission, which concluded that US West had "discriminated (vis a vis itself) against MCIm[etro]" in several areas, including network capacity and forecasting, provisioning intervals and delivery of facilities, denying MCImetro's request to have certain test orders worked, and US West's performance in working requests for interim number portability for MCImetro's customers.[49]

Yet another example of such treatment can be found in Qwest's efforts to prevent its intra-LATA toll customers in Colorado from freely changing carriers when intra-LATA pre-subscription was rolled out. Qwest

[49] See, *In the Matter of a Complaint of MCImetro Access Transmission Services, Inc. Against U S West Communications, Inc. for Anticompetitive Conduct*, Minnesota PUC Docket No. P-421/C-97-1348.

unilaterally, and without notice, instituted "PIC freezes"[50] on more than 208,000 customers, requiring that Qwest's IXC competitors go through additional and unnecessary steps before they could win customers away from Qwest in what had previously been Qwest's monopoly intraLATA toll market. The Colorado Public Utilities Commission found that implementation of these unilateral PIC freezes was anti-competitive.[51]

Q. PLEASE EXPLAIN WHAT YOU MEAN BY QWEST DICTATING NEW PROCESSES AND PROCEDURES TO ITS CARRIER CUSTOMERS RATHER THAN CONSULTING WITH THEM.

A. Qwest's practice in issuing policy letters is effectively a dictatorial process rather than one that evidences a spirit of cooperation with its wholesale customers. As opposed to demonstrating an attitude that its customers can provide valuable input to Qwest's development of new procedures and processes, its practice demonstrates the sort of "we don't care; we don't have to" mindset noted above. In competitive markets, providers may seek to distinguish themselves from other providers by focusing on customer services closely tailored to their customers' specific needs.

[50] The term "PIC" refers to a given customer's "primary interexchange carrier," i.e., the carrier whose network is reached when the customer places long distance calls by dialing 1+the area code and number. By "PIC freeze," I mean an indication on the customer's service order record for Qwest to refuse an interexchange carrier's request to have the PIC change worked via the normal automated processes.

[51] See, MCIWorldCom vs. U S WEST, Decision No. C00-513, in Colorado Docket No. 99K-193T, at para. B.4, adopted April 26, 2000.

Qwest's policy letters practice show an inability either to grasp the concept of a true service orientation or to recognize the potential value of its wholesale customers' input into its processes.

This failure by Qwest to grasp the integral nature of its role as both a wholesale supplier to other carriers and a retail provider in the telecommunications market was highlighted by Qwest's comments in a recent Colorado workshop on UNE loops. During the workshop, one CLEC noted that Qwest had not been at all helpful in exploring unbundled network alternatives, stating:

> I want you to know though that through numerous meetings with Qwest and mediation and negotiation and lawsuits, we have indicated to them that we needed 6,000 - 6.500 lines in our switch to be at a break even -- to even make it. And yet we've talked about that fact over and over again, yet we've never been offered any other alternatives to get these unbundled loops ported over.[52]

Another CLEC representative, agreeing that Qwest could be more helpful in explaining alternative that are available to CLECs, stated:

> What I'm saying when I walk into Nordstrom's, I'm their customer. When I call your account representative, I'm your customer.[53]

In response, Qwest's attorney replied:

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[52] Comments of Mr. Potter of Sunwest in Colorado 271 workshop, April 17, 2001; Transcript at 232.

[53] Id., at 246-247.

That is a retail customer.[54]

This exchange clearly demonstrates a Qwest whose mindset is that it is appropriate to treat retail customers differently than the way it treats its wholesale customers. So long as Qwest continues its tradition of placing on its wholesale customers unreasonable demands for information from its wholesale customers that it willfully ignores to its customers' detriment in the market, and providing preferential treatment to its retail operations, it constitutes strong evidence of a continuing monopoly mindset by Qwest and a disdain of the value of its wholesale customers as partners.

Q. PLEASE EXPLAIN WHAT YOU MEAN BY YOUR STATEMENT THAT QWEST FAILS TO RECOGNIZE TERMS AND CONDITIONS IN EXISTING INTERCONNECTION AGREEMENTS.

A. Over the past year, Qwest has mounted an aggressive campaign to obtain regulatory endorsement of statements of generally available terms and conditions ("SGATs") in each of the states where it operates. Notwithstanding the fact that several states have allowed such SGATs to go into effect, WorldCom's recent experiences with Qwest personnel indicate that the terms and conditions of its SGAT, as opposed to our existing interconnection agreement, governs its obligations toward WorldCom. Said differently, Qwest has transmitted "product notifications"

[54] Id..

to WorldCom which appear to contradict and to take precedence over the terms and conditions of our interconnection agreements in the various states. Such attempts to force a "one size fits all" process on its wholesale customers means that Qwest is ignoring terms and conditions negotiated in good faith and/or imposed through a lawful arbitration process in the state, evidencing a monopoly mindset.

In Washington, until only a few days before this testimony was filed,[55] Qwest had refused to honor the term approved by this Commission in WorldCom's interconnection agreement for the right to interconnect "at any technically feasible point.[56] Notwithstanding this clear statement by the Commission, it has taken more than 5 months of pressure by WorldCom to obtain Qwest's "agreement" that it would process interconnection orders for our Tacoma switch. Qwest personnel repeatedly balked at working the orders on the basis that Tacoma and Seattle are separate local calling areas -- a factor that under our interconnection agreements has no relevance. Further, Qwest personnel asserted in discussions with WorldCom personnel that the only way for WorldCom to obtain the requested interconnection was to utilize a new "product" termed by Qwest its "Single Point of Presence (SPOP) in the LATA" product. But the terms of the "SPOP product" are such that using

[55] Based on a telephone conference call on June 1, 2001, it appears that Qwest has finally recognized its obligation and will proceed with processing of WorldCom's orders.

it to accomplish the interconnection requested by WorldCom would have required a complete reworking of the existing interconnection between the companies in the Puget Sound area. Such a "tail wagging the dog" result serves no public policy purpose, and makes absolutely no sense from the standpoint of either company's networks. This is yet another example of a Qwest which manifests a monopoly mindset and seems unable to respond to the needs of its wholesale customers.

Q. YOU HAVE REPEATEDLY REFERRED TO QWEST'S MONOPOLY MINDSET. WHAT IS THE SIGNIFICANCE OF SUCH A MINDSET TO THE PUBLIC INTEREST ISSUE BEING CONSIDERED IN THIS PROCEEDING?

A. I stated early in my testimony that addressing the public interest requires regulators essentially to look into a crystal ball and seek to anticipate the future based on the facts before them. Qwest's historic pattern of treating its wholesale customers as second class citizens can hardly be reconciled with the notion that Qwest's local telecommunications market in Washington is irreversibly open to competition. The image that appears in the crystal ball is of a Qwest continuing to exercise a tight grip on the Washington local telecommunications market. Furthermore, it is an image of a Qwest that will utilize its market power in local

[56] Commission Decision and Final Order Denying Petition to Reopen, Modifying Initial Order, In

telecommunications to disadvantage competitors in both the emerging broadband market and in the already competitive long distance market.

For Quest to demonstrate to this Commission that its market is open, it must do so on the basis of more than mere promises that future behavior will be different than in the past. Indeed, the Commission should require strict proof by Qwest that it has fulfilled any and all such promises.

When Southwestern Bell was before the Public Utility Commission of Texas seeking its endorsement of 271 relief, that Commission explicitly recognized the value of having more than mere promises as evidence of whether its market was open to competition. The Texas Commission's June 1, 1998 recommendation stated in pertinent part that:

> - SWBT needs to show this Commission and participants during the collaborative process by its actions that its corporate attitude has changed and that it has begun to treat CLECs like its customers;
>
> - SWBT needs to establish better communication between its upper management, including its policy group, and its account representatives. As a first step, SWBT shall develop policy manuals for its account representatives and put in place a system, such as email notifications, to communication decisions by the policy group to account representatives and questions or comments back to the policy group;
>
> - SWBT needs to establish consistent policies used by all SWBT employees in responding to issues raised by CLECs. Toward that end SWBT shall establish an interdepartmental group whose responsibility is trouble-shooting for CLECs engaged in interconnection, purchase of UNEs, and resale.

Part, and Affirming, In Part, WA Docket No. UT-971063, issued February, 1999, at ¶ 121.

This group shall be headed by an executive of SWBT with the final decision making power;

- SWBT needs to establish a system for providing financial or other incentives to [Local Service Center] personnel based upon CLEC satisfaction;

- SWBT needs to commit to resolving problem issues with CLECs in a manner that will give CLECs a meaningful opportunity to compete;

- SWBT shall draft a comprehensive manual for CLECs to ensure the timely provision of all aspects of interconnection, provision of UNEs and resale. The manual shall be written in a fashion that clearly delineates parties' responsibilities, the procedures for obtaining technical and other practical information, and the timelines for accomplishing the various steps in interconnection, purchase of UNEs, and resale. The manual should also set forth SWBT's policy with regard to a CLEC's ability to adopt an approved interconnection agreement pursuant to Section 252(i) (this process will be referred to as the "MFN" process);

- SWBT needs to treat CLECs at parity with the way it treats itself or its unregulated affiliates;

- SWBT needs to show proof that it has made all the changes it agreed to make during the process of the Commission's 271 hearing, all of which have been detailed in the record;

- SWBT needs to establish that its interconnection agreements are binding and are available on a nondiscriminatory basis to all CLECs;

- SWBT needs to establish that it is following all Commission orders referenced in this recommendation and that it intends to follow future directives of this Commission;

- SWBT needs to establish its commitment to offering the terms of current interconnection agreements during any period of renegotiation, even if the negotiations extend beyond the original term of the interconnection agreements;

- Commission staff, SWBT, and the participants need to establish adequate performance monitoring (including performance standards, reporting requirements, and enforcement mechanisms) during the collaborative process that will allow self-policing of the interconnection agreements after SWBT has been allowed to enter the long distance market; and

- SWBT shall not use customer proprietary network information to "winback" customers lost to competitors.

Q. HAS QWEST PROVIDED EVIDENCE THAT IT IS EVEN REMOTELY CLOSE TO MEETING ALL OF THE PUBLIC INTEREST OBLIGATIONS SET OUT BY THE PUC OF TEXAS?

A. No. Absent a strong stance by this Commission, Qwest has no incentive to promise anything beyond a bare minimum set of commitments toward opening its markets. Like SWBT,

- Qwest must demonstrate in the collaborative process by its actions that its corporate attitude has changed and that it will treat CLECs like its customers and not unilaterally change documents referenced in its SGAT and that its behavior does not reflect the statements of its attorney that it need not treat wholesale customers like retail customers;

- Qwest needs to establish better communication between its upper management, including its policy group, and its account representatives as is evidenced by the testimony of numerous CLECs about the lack of knowledge Qwest account teams have about Qwest "new" policies and the inability of account team representatives to adequately address CLEC problems and Qwest's habit of issuing product notifications that contradict interconnection agreements and even provisions in Qwest's proposed SGAT. Only recently has Qwest agreed to communicate its legal obligations to all appropriate personnel so that account teams and other internal personnel know what Qwest is obligated to perform for wholesale customers under its SGAT.

- Qwest should establish an interdepartmental group whose responsibility is trouble-shooting for CLECs engaged in interconnection, purchase of UNEs, and resale. This group should be headed by an executive of Qwest with the final decision making power;

- Qwest needs to establish a system for providing financial or other incentives to Local Service Center personnel based upon CLEC satisfaction;

- Qwest needs to commit to resolving problem issues with CLECs in a manner that will give CLECs a meaningful opportunity to compete. Qwest must recognize that its wholesale customers are as important as retail customers;

- Qwest needs to establish that it is following all Commission orders referenced in this recommendation and that it intends to follow future directives of this Commission; and

- Qwest should not be permitted to attempt to "winback" customers lost to competitors when a CLEC customer inadvertently or mistakenly calls Qwest.

I see this as very much akin to what a young child does at the dinner table when she wants to jump directly to dessert without having to eat her broccoli. Most of us can relate to the situation where the child says to the parent "how about if I eat 2 more bites?" Obviously, the notion is to get the reward with the least amount of undesirable effort. Whether the goal is avoiding having to eat an undesirable vegetable or avoiding having to open up a previously monopolized market, the incentive is clear: do absolutely no more than is required to get to dessert. Moreover, even if Qwest makes promises, mere promises are insufficient to demonstrate that Qwest will meet its public interest obligations.

Q. YOU HAVE MENTIONED SEVERAL EXAMPLES OF BEHAVIOR BY QWEST THAT SHOULD BE INTERPRETED AS EVIDENCE THAT ITS MARKETS ARE NOT YET IRREVERSIBLY OPEN. IS THERE OTHER EVIDENCE THIS COMMISSION SHOULD CONSIDER AS IT TRIES TO ANTICIPATE QWEST'S FUTURE BEHAVIOR IF IT WERE ALLOWED INTO THE LONG DISTANCE MARKET?

A. Yes. Timely and accurate special access provisioning by Qwest is absolutely vital to the long-term viability of competitors in Washington. As shown below, Qwest's provisioning of special access services to CLECs and IXCs should be examined by this Commission as an indicator of what is to come when Qwest enters the long distance market.

Q. PLEASE EXPLAIN WHAT YOU MEAN BY "SPECIAL ACCESS" AND WHY THAT IS RELEVANT TO THE SUBJECT OF THIS PROCEEDING?

A. Special access is a service Qwest historically has provided to IXCs, which involves the use of Qwest's last mile loop and transport facilities for direct connections between an IXC's network and its customer's premises.[57] Special access facilities allow Washington business customers with large

[57] CLECs also sometimes use special access rather than unbundled elements for use in connecting their customers' premises with their local switches, for a variety of reasons. For purposes of this testimony, however, my focus will be on the traditional usage of special access because of its importance to the question of Qwest's ability to discriminate against other long distance carriers once it has obtained the legal right to provide retail long distance services within its service territories.

call volumes to bypass the switched network and move their traffic, including high-speed data and broadband traffic, directly from their location to their long-distance carrier's point of presence ("POP"). Thus, when WorldCom wins a new business long-distance customer, it offers as part of its service the connection between WorldCom's POP and the customer's building. WorldCom and other IXCs are dependent on Qwest to provide special access facilities for connections to Washington business customers. Critically, however, once Qwest is allowed to compete for the customers' retail long distance business, it will not only be WorldCom's retail competitor, but also WorldCom's wholesale supplier.[58]

Q. WHAT HAS BEEN WORLDCOM'S EXPERIENCE WITH QWEST AS A WHOLESALE SUPPLIER OF SPECIAL ACCESS?

A. Qwest's performance in provisioning special access to competitive carriers was extremely poor in 2000. This has had serious impacts on not just WorldCom and other IXCs who depend on access services furnished by Qwest, but more importantly, also the end user customers served by

[58] As the FCC has frequently recognized, when an incumbent carrier is a retail competitor as well as a wholesale supplier of the inputs other carriers need to provide their own retail service, the incumbent has the "incentive and the potential ability to unfairly act to the detriment of their . . . competitors and to act in other anticompetitive ways." *In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996,* Report and Order, 11 F.C.C.Rcd.20,541, paragraph 14; see also, *In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996,* First Report and Order, 11 F.C.C.R. 15499, paragraph 307 (1996) (explaining that "incumbent LECs have little incentive to . . . provision unbundled elements in a manner that would provide efficient competitors with a meaningful opportunity to compete").

the IXCs. Qwest's poor performance reflects an obvious shift in corporate focus away from access services it provides as a wholesaler to the retail (and thus higher revenue) data and broadband services. Its performance also indicates Qwest's apparent recognition that its wholesale customers lack alternative suppliers for these services, and its seeming disregard for the needs of its wholesale purchasers. Absent a demonstrated change in its behavior, Qwest's performance as a provider of special access strongly suggests that allowing Qwest to compete for customers' long distance business in Washington would not be in the public interest. Rather, the public interest will only be served if the Commission addresses special access as part of its 271 public interest analysis and seeks to ensure that Qwest does not utilize its control over such last mile facilities to its competitive and strategic advantage.[59]

Q. YOU HAVE STATED THAT QWEST'S POOR PROVISIONING RECORD DEMONSTRATES A MONOPOLISTIC MINDSET. AREN'T THERE COMPETITIVE, ALTERNATIVE PROVIDERS FROM WHICH WHOLESALE CUSTOMERS CAN PURCHASE SPECIAL ACCESS?

[59] Including special access facilities in a performance assurance plan would be one way to provide appropriate incentives preventing Qwest from exercising control over its network in such an anticompetitive manner. See, e.g., *The Facilitation in the Matter of Qwest Wholesale Standards,* Minnesota PUC Docket No. P-421/M-00-849 (proceeding to develop Qwest wholesale service quality standards)

A. For the most part, no. WorldCom and other long-distance carriers rely almost totally on Qwest to provide special access services for the connections between the IXCs and their long distance customers. An excellent example of this can be seen by examining the development of facilities competition in the Los Angeles area -- surely one of the largest and most competitive markets. Even taking into account the massive capital outlays by competitive carriers over the past decade, SBC submitted to the FCC information showing that competitive carriers ***in the aggregate*** have constructed transport facilities to only slightly more than 1/5th of the ILECs' wire centers in the Los Angeles MSA.[60] Competitive alternatives to the ILECs' special access services are quite clearly limited, and IXCs must therefore in the vast majority of instances rely on the ILECs for such services to reach their customers.

WorldCom alone pays millions of dollars per year to Qwest for access services in Washington. Thus, when Qwest's performance is poor, that fact provides a strong incentive for WorldCom to obtain access facilities from alternate providers. And in fact, on any given customer order, WorldCom first looks to provide service over "on-net" facilities in its own network, and then searches for facilities owned by a competitive access provider ("CAP") whose rates are significantly lower than Qwest

[60] See, Letter from Jeffry A. Brueggeman, Senior Counsel, SBC, to Ms. Magalie R. Salas, Secretary, FCC, March 6, 2001, Ameritech Operating Companies, Pacific Bell Telephone Company and Southwestern Bell Telephone Company Petitions for Pricing Flexibility, CCG/DPD File Nos. 00-26, 00-23, and 00-25, Appendix C, Page 6 of 7.

and whose performance indicates that they are anxious for WorldCom's business. Despite WorldCom's systematic attempts to find alternate facilities, however, it almost certainly must rely on Qwest to provision any given request for special access, because even those competitive carriers that have the greatest access to "lit buildings" do not reach the vast majority of business customers in this State.

Q. IN WHAT WAYS DOES QWEST'S SPECIAL ACCESS PROVISIONING FAIL TO ACCOUNT FOR THE NEEDS OF WHOLESALE CUSTOMERS?

A. Although some improvements have been observed recently, Qwest's performance in completing access orders generally has been unreasonably slow, and the information on the status of such orders Qwest provides to WorldCom and other wholesale customers is often unreasonably late and unreliable. Qwest does not appear to provide wholesale services in the manner of a business with competitive concerns. The most serious problems WorldCom has experienced are Qwest's extremely poor percent on-time performance and its practice of amassing "held" orders. In WorldCom's experience, Qwest *frequently* misses the target date for installation that it specifies in its Firm Order Confirmation or "FOC." Qwest's target date in its FOC is not the customer requested date, but the date Qwest commits to provide service.

Recently, pursuant to an order of the Minnesota Public Utilities Commission, Qwest provided performance reports in a Minnesota public proceeding.[61] Although the reports are misleading and flawed, at best they demonstrate that Qwest misses its own committed installation date on over 20% of WorldCom's orders, by at least two to three weeks. Missing one out of every five orders is unacceptably bad performance. Based on the reports provided to the Minnesota Commission, Qwest's performance is worse than appears on the face of those reports. This primarily is due to the fact that the reports Qwest provided in Minnesota failed to comply with the explicit order of the Minnesota Commission. For instance, the Minnesota Commission ordered Qwest to report on the ***total*** number of orders submitted to Qwest for DS0, DS1 and DS3 dedicated access during the reporting period (six months of data). The Missed Order Report with which Qwest responded contains a column for "Number of Orders" for each reported month. In response to data requests from WorldCom, however, Qwest acknowledged that it ignored the Minnesota Commission's order and only reported on the number of orders it ***completed*** during the reported month. What about the orders it did not complete? The report does not say anything about those orders, and thus

[61] See, In the Matter of the Complaint of AT&T Communications of the Midwest, Inc. Against U S West Communications, Inc. Regarding Access Service, Minnesota PUC Docket No. P-421/C-99-1183, 2000 Min. PUC LEXIS 53 (August 15, 2000) (Qwest ordered to provide specific reporting regarding AT&T orders; later ordered to provide same reports with respect to WorldCom in consolidated proceeding).

neither complied with the Commission's order nor provided an accurate picture of Qwest's performance. The Missed Order Reports, contrary to the Minnesota Commission's Order, do not show the backlogged orders or those orders "held" by Qwest on the ground that it lacks sufficient "facilities" or "funding" to build facilities. Qwest still has not provided complete data on these, but if the held order information it did provide is factored in, Qwest's 80% on-time performance goes down to around 69% for the first reported month of 2000 (September). This means that in that month, almost one-third of WorldCom's pending orders were delayed by Qwest. Some were delayed by days, some weeks, some months. Some are still pending. Of the orders it has completed, Qwest reported to the Minnesota Commission an average delay of 2 to 3 weeks past the dates Qwest committed to completing the installations before installation was actually accomplished. This ***excludes*** all orders Qwest has put into "held order" status, which orders are not assigned an installation date. Such orders can sit for months, and are not reflected on Qwest's reports to the Minnesota Commission regarding provisioning of special access for WorldCom. Qwest's historic lack of facilities and resulting held orders is also an issue this Commission is familiar with in Washington.

In any industry where true wholesale competition exists, suppliers bend over backward to provide on-time service, and to accurately report on orders delayed for any reason, with an estimated delivery date.

Qwest's practices reflect an attitude toward its wholesale customers that is diametrically opposite such a customer-focused approach.

Q. WHY DOES QWEST DESIGNATE ORDERS AS "HELD," AND WHAT HAPPENS TO THESE ORDERS?

A. Qwest puts an order in "held" status when it determines that it does not have sufficient facilities in place to provision the order at the requested customer location, and Qwest has not allocated funds to augment its facilities at the requested location. Qwest surveys its network and makes decisions regarding which orders to relegate to "held order" status without consulting with its IXC customers. It decides whether it wants to invest in facilities (and where), as well as how much it chooses to invest. As already discussed, it ignores competitive carrier forecasts about where facilities may be required.

There may have been good reason for such unilateral decision-making in the past. However, it is not appropriate for Qwest to unilaterally make such decisions regarding the need for new network facilities when it seeks to compete with the very carriers that rely on Qwest to provision facilities for their retail services. There are inherent and anti-competitive problems with Qwest dictating where new facilities will go. And not only does Qwest make unilateral decisions to either increase facilities or hold orders, it fails to provide to its wholesale customers prompt and accurate information about held orders. On some held orders, Qwest will provide an FOC with a committed install date and when the day arrives, only then inform WorldCom that the order has been "held." This practice wreaks havoc with WorldCom's customer relations and adversely affects consumers. On other held orders, Qwest provides no FOC, and the held orders simply accumulate until WorldCom demands an accounting of them. Qwest held orders were a serious problem for WorldCom during 2000. Notwithstanding recent efforts by Qwest to reduce the number of held orders, problems remain when WorldCom's customers require service at a location where Qwest unilaterally determines that it has no business interest in adding capacity to its facilities.

Q. WHAT IS THE EFFECT ON WHOLESALE CUSTOMERS AND THEIR CUSTOMERS OF QWEST'S LATE PROVISIONING AND HELD ORDERS?

A. Qwest's failures to meet its own target intervals for special access, and its practice of holding orders for lack of funding or facilities, leave customers waiting days, weeks and even months for service. This impedes the ability of the Washington businesses WorldCom serves to do business, leading to potential and real losses in their revenues. It certainly hurts WorldCom's revenues. To add insult to injury, customers blame WorldCom for Qwest's failures. Customers need to know when they can expect installation of facilities needed to turn up their service. When they choose WorldCom as their carrier, they expect WorldCom to give them installation dates and to meet them. If WorldCom cannot do that for weeks or months after the promised date, the customers blame WorldCom, not Qwest. This affects WorldCom's reputation as a provider of telecommunications services of all types. When WorldCom and other wholesale customers cannot provide acceptable service because of Qwest constraints, that threatens the viability and development of a competitive market in Washington, and thereby compromises the ability of Washington consumers to enjoy the benefits of a vibrant competitive market for a variety of telecommunications services.

Q. WHAT IS THE PROSPECT FOR ACCESS PROVISIONING PERFORMANCE WHEN QWEST ENTERS THE LONG DISTANCE MARKET?

A. Qwest's performance is likely to get much worse when Qwest is not only the dominant provider of special access, but is also competing against its wholesale customers to provide inter-LATA interstate long distance services. It appears that the degradation of wholesale service quality over the past few years came as Qwest was further positioning itself to enter the inter-LATA, inter-state long-distance market, and to focus on faster-growing revenue opportunities in data and broadband services. Given the critical nature of access services, the necessary dependence of wholesale customers on Qwest and Qwest's poor provisioning record, this Commission should insist that Qwest demonstrate substantial improvement in its provisioning of special access. Absent such demonstrated improvements, allowing Qwest into the long distance market at this time would not be in the public interest.

Q. DOES WORLDCOM HAVE ANY RECOMMENDATIONS REGARDING SPECIAL ACCESS PROVISIONING?

A. Yes. The above discussion highlights two important issues in the context of this proceeding. One is the difficulty of obtaining accurate information on Qwest's performance as a wholesale provider to other carriers who depend on Qwest's facilities to provide services to Washington consumers. Because it controls the information necessary to evaluate its performance, the fact that Qwest provided suspect information in reports ordered by a state regulatory commission raises serious questions about how much weight this Commission should attribute to information Qwest provides. The second issue is the absolutely critical nature of performance measures -- with microscopically specific rules as to what is measured and how it is measured. For these reasons, Qwest's performance assurance plan should include performance measures or performance indicator definitions ("PIDs") that address special access in a manner similar to the PIDs that relate to the provisioning of local wholesale services. This is precisely the conclusion reached by the Texas PUC in considering this same issue relating to Southwestern Bell Telephone.[62] Those performance measures should also result in the payment of penalties to incent Qwest to improve the provisioning of special access and elimination of held orders, much like the proposed Qwest performance assurance plan is intended to incent Qwest to adequately provide local wholesale services.

V. Regulatory versus Structural Tools for Dealing with Market Power

Q. PLEASE EXPLAIN WHAT YOU MEAN BY THE TERMS REGULATORY TOOLS AND WHY YOU CONTRAST SUCH TOOLS WITH STRUCTURAL TOOLS.

A. Regulatory tools typically take the form of an order by a government agency requiring some action or proscribing certain behavior. As such, regulatory tools are essentially the same as what attorneys refer to as injunctive relief. Another way to look at regulatory tools is that they are "thou shalts" and "thou shalt nots." A regulator establishes certain parameters for reasonable behavior with the hope and anticipation that

[62] The Texas Commission issued an oral ruling on May 23, 2001, but its written order has not yet been issued.

the firm will act in accordance with the rules. Should the firm not do so, the question then becomes whether the regulator effectively can enforce its rules and regulations.[63]

Structural tools are vastly different. Structural tools seek to eliminate the incentive for the firm to act in a given manner, and thus get at the ***cause*** for the undesirable behavior. Throughout my testimony I have noted the natural incentive that exists in a for-profit entity such as Qwest to maximize its shareholders' return. Regulatory tools would seek to identify all the means by which Qwest could act in anticompetitive and discriminatory ways to ensure a higher return for its shareholders. Conversely, structural tools would seek to remove incentives for such behavior.

The best example of a structural remedy in modern telecommunications is the divestiture of the Bell Operating Companies by AT&T in 1984.[64] The concept underlying that structural remedy was to eliminate AT&T's ability to engage in anticompetitive actions using its control over the local bottleneck facilities operated by the Bell Companies. Thus, AT&T divested itself of the Bell Companies so that it no longer had

[63] FCC Chairman Powell has publicly stated a desire to increase that agency's ability to levy meaningful fines on carriers, seeking an increase in the statutory limit from $1.2 million to $10 million per violation of the local competition provisions of the Act. See, www.gcc.gov/Bureaus/Common_Carrier/News_Releases/2001/nrcc0116.html.

[64] Other examples include the Section 272 requirements of the Act and the concessions obtained by the FCC in the merger proceedings between SBC and Ameritech, and between Bell Atlantic and GTE, to provide advanced services through separate affiliates.

control over the local bottleneck facilities and no financial incentive to use such facilities in anticompetitive ways. As a result of that divestiture, AT&T had to obtain use of those bottleneck facilities on an arms-length basis, in the same manner, and at the same price, as its competitors in the long distance market.

Instead of continuing the ineffective attempts to enjoin anticompetitive behavior by AT&T, the Justice Department argued for a structural solution where AT&T no longer had an incentive or ability to abuse its monopoly in the local telecommunications market to disadvantage competitors in the upstream long distance services market. In comparing the likely benefits of such a structural approach with an injunctive, or regulatory, approach, the MFJ Court stated:

> It would be difficult to formulate an order that would effectively deal with all of the different kinds of anticompetitive behavior that are claimed to have occurred over a considerable period of time, in various geographical areas, and with respect to many different subjects. There is evidence which suggests that [the Bell System's] pattern during the last thirty years has been to shift from one anticompetitive activity to another, as various alternatives were foreclosed through the action of regulators or the courts or as a result of technological development. In view of this background, it is unlikely that, realistically, an injunction could be drafted that would be both sufficiently detailed to bar specific anticompetitive conduct yet sufficiently broad to prevent the various conceivable kinds of behavior that [the Bell System] might employ in the future.
>
> An even more formidable obstacle is presented by the question of enforcement. Two former chiefs of the FCC's Common Carrier Bureau, the agency charged with regulating [the Bell System], testified that the Commission is not and never has been capable of effective enforcement of the laws governing

> [the Bell System's] behavior. In their view, this inability was due to structural, budgetary, and financial deficiencies within the FCC as well as to the difficulty in obtaining information from [the Bell System]. Whatever the true cause, it seems clear that the problems of supervision by a relatively poorly-financed, poorly-staffed government agency over a gigantic corporation with almost unlimited resources in funds and gifted personnel are no more likely to be overcome in the future than they were in the past.[65]

What this passage suggests is that, unless this Commission can impose on Qwest regulations "that would be both sufficiently detailed to bar specific anticompetitive conduct yet sufficiently broad to prevent the various conceivable kinds of behavior that [Qwest] might employ in the future," Washington consumers will be denied the benefits of a vibrant competitive market for telecommunications services of all types.

Q. OVER THE HISTORY OF THE U.S. TELECOMMUNICATIONS INDUSTRY, CAN IT BE SAID THAT THE REGULATORY APPROACH HAS BEEN A SUCCESS?

A. Regulation of utilities has proved successful only where competitive issues were absent; i.e., where the monopoly of the utility remained intact. In such instances, the focus of regulation has been to protect consumers from monopoly abuses, largely through rate-of-return regulation of retail rates and by enforcing terms and conditions in the utility's retail tariffs. When regulation has attempted to deal with market power in the context

[65] *AT&T* at 168. (footnotes omitted.)

of emerging competition on the other hand, it has enjoyed marginal success, at best. This point was made explicitly in the Court's decision in the AT&T case:

> The evidence adduced during the A*T & T* trial indicates that the Bell System has been neither effectively regulated nor fully subjected to true competition. The FCC officials themselves acknowledge that their regulation has been woefully inadequate to cope with a company of *AT & T*'s scope, wealth, and power.[66]

Q. DO YOU HAVE EXAMPLES OF FAILURES OF THE REGULATORY APPROACH?

A. Yes. The regulatory approach had proven "woefully inadequate" to restrain discrimination by the Bell System in the areas of manufacturing and sale of customer premises equipment and the provision of long distance services. The complete inability of regulatory approaches to inject competition into these markets stands in stark contrast with the veritable explosion of customer choices that occurred following divestiture, in both of the CPE markets and long distance services. Quite simply, the pre-divestiture Bell System was able to successfully block regulatory attempts to proscribe discriminatory and anti-competitive actions -- and thus to spur competition -- in those key markets for more than a decade.

A more recent telecommunications example is the complete failure of the FCC's Open Network Architecture ("ONA") concept. Until the

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[66] *AT&T* at 170.

FCC's adoption of its Computer II decision, federal rules required that the ILECs provide information services only through structurally separated affiliates. With its ONA decision, the FCC eliminated the structural separation requirement on the condition that the ILECs implement certain non-structural -- i.e., regulatory -- safeguards. The centerpiece of these safeguards was the requirement that the ILECs must provide to ISPs access to the same network capabilities the ILECs utilize in providing retail information services on a non-discriminatory basis. Unfortunately, the FCC's attempt to encourage non-discriminatory behavior via the non-structural ONA obligations was a total failure. The only beneficiary of ONA was the ILECs, who quickly accomplished their objective of marketing information services on an integrated basis with their other telecommunications offerings. The intended beneficiaries of the FCC's ONA approach -- the ISPs -- soon found that ONA was of no benefit whatsoever. The ISPs were forced to look to second- and third-best choices for the services they needed. Proof of the failure of the ONA concept is that the ILECs projected only $25 million in ONA-related revenues in their 2000 tariff review plans, or only 2/100ths of 1 percent of their revenues. The ONA example demonstrates yet another way in which the Bell Companies have been able to thwart the effectiveness of regulatory tools designed to foster competition in markets involving their local networks.

Q. ARE THERE EXAMPLES INDICATING THE SUPERIORITY OF THE STRUCTURAL APPROACH IN DEALING WITH COMPETITIVE ISSUES IN THE PRESENCE OF MARKET POWER?

A. The most obvious examples are in the customer premises equipment (CPE) and long distance service markets. The Bell System's historic stranglehold in those markets gave rise to an old joke that a person could have any type of telephone she desired, so long as it was a black, rotary-dial phone. For years, the Bell System frustrated attempts to compete in the CPE and long distance markets, using its bottleneck control over the local telecommunications networks. Regarding the ability of government regulators to resolve the problems in both the CPE and long distance markets, the MFJ Court reasoned as follows:

> The key to the Bell System's power to impede competition has been its control of local telephone service. The local telephone network functions as the gateway to individual telephone subscribers. It must be used by long-distance carriers seeking to connect one caller to another. […] The enormous cost of the wires, cables, switches, and other transmission facilities which comprise that network has completely insulated it from competition. Thus, access to [the Bell System's] local network is crucial if long distance carriers … are to be viable competitors.
>
> [The Bell System] has allegedly used its control of this local monopoly to disadvantage these competitors in two principal ways. First, it has attempted to prevent competing long distance carriers and competing equipment manufacturers from gaining access to the local network, or to delay that access, thus placing them in an inferior position vis-à-vis [the Bell System's] own services. Second, it has supposedly used profits earned from the monopoly local telephone operations to subsidize its long

> distance and equipment businesses in which it was competing with others.
>
> For a great many years, the Federal Communications Commission has struggled, largely without success, to stop practices of this type through the regulatory tools at its command. A lawsuit the Department of Justice brought in 1949 to curb similar practices ended in an ineffectual consent decree. Some other remedy is plainly required; hence the divestiture of the local Operating Companies from the Bell System. This divestiture will sever the relationship between this local monopoly and the other, competitive segments of *AT & T*, and it will thus ensure -- certainly better than could any other type of relief -- that the practices which allegedly have lain heavy on the telecommunications industry will not recur.[67]

As opposed to the tight grip that the pre-divestiture Bell System had on the CPE market, there has been an explosion in types and styles of CPE since the structural separation implemented by divestiture. Customers are able to purchase phones from simple, almost disposable, devices to sophisticated, reasonably priced devices combining such auxiliary capabilities as Caller ID and voice mail. Once a structural, rather than a regulatory, approach toward competition was implemented, the number of choices available to consumers exploded, and prices shifted dramatically in consumers' favor.

Similarly, the number of competitive choices available to consumer for long distance services has increased to levels unimaginable at the time of divestiture. Literally hundreds of companies provide long distance services in the U.S. Prices for consumer long distance services have

[67] Id., at 222-223

declined rapidly since divestiture, and the FCC's latest report indicates AT&T's market share -- estimated at about 90% of all domestic toll revenues at the time of divestiture -- has declined to about 41%. In contrast with the total inability of regulation to restrain anti-competitive behavior from the pre-divestiture Bell System, the effects of divestiture stand as glittering examples of how structural separation can resolve the aforementioned incentive of carriers such as Qwest to exploit its bottleneck facilities to its own private gain and to the detriment of the competitive process and the public interest.

Q. WHAT IS THE RELEVANCE OF THIS HISTORY TO THE EXAMPLES OF QWEST'S CONTINUING MONOPOLY MINDSET PRESENTED IN THE PREVIOUS SECTION OF YOUR TESTIMONY?

A. Those examples demonstrate the strength of Qwest's incentives to exploit its bottleneck control over its ubiquitous network to its own competitive advantage. Indeed, the history of the pre-divestiture Bell System instructs that such incentives simply are too powerful to be overcome or neutralized by regulatory tools, precisely the concern voiced by the Chairman of the House Judiciary Committee who, writing to Speaker Hastert in regard to H.R. 1542, cautioned as follows:

> The new § 251(j) contains an exemption that would eliminate [the RBOCs'] obligation to provide unbundled network elements and resale at wholesale rates for high speed data service. These obligations on incumbent local exchange carriers allow

> competitors the ability to provide competing local service. In short, this provision allows the incumbents effectively to leverage their monopoly control over the local exchange and exclude competition in high speed data service. That is troublesome enough, but taken together with the broad definition of high speed data service -- which could include voice as well as data -- it represents the potential remonopolization of the industry.[68]

Q. TAKING ALL OF THE ABOVE INTO ACCOUNT, WHAT YOU HAVE DESCRIBED SOUNDS LIKE A VERY INTENSIVE REGULATORY PROCESS. AREN'T YOU IN EFFECT ASKING THIS COMMISSION TO ENGAGE IN EVEN MORE REGULATION IN THE FACE OF WHAT IS SUPPOSED TO BE A TREND TOWARD A MORE DE-REGULATORY ENVIRONMENT?

A. Quite the opposite. My testimony suggests a much more radical ***de-regulatory*** approach than this Commission has previously considered. By imposing an appropriate incentive structure on Qwest's wholesale operation, Qwest's ***retail*** operation could be freed of virtually all traditional regulations very quickly. That is because Qwest's retail operation would have to deal with the wholesale arm in precisely the same manner as would other CLECs. It would pay the same rates for use of the underlying network as other CLECs, and would be subject to the same terms and conditions for use of that network as other CLECs. Such an approach would 1) ensure that Qwest's retail operation has no artificial competitive

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[68] Letter from F. James Sensenbrenner, Jr. to Speaker Hastert dated May 1, 2001, at 8

advantage over other CLECs seeking to compete in the Washington local telecommunications market, and 2) rapidly eliminate the need for regulation of Qwest's retail operation. If Qwest's true objective is to avoid unnecessary regulations, the approach outlined herein provides it with an opportunity to achieve rapid deregulation of its retail operations.

VI. Strong, Self- Enforcing Measures to Prevent Backsliding are Mandatory in the Absence of Structural Remedies

Q. IF THE COMMISSION CHOOSES NOT TO ENDORSE THE USE OF STRUCTURAL TOOLS TO ACCOMPLISH ITS PRO-COMPETITIVE PUBLIC INTEREST OBJECTIVES, CAN YOU DESCRIBE THE TYPES OF TOOLS THAT WOULD BE A SECOND-BEST APPROACH?

A. Yes. In addition to the critical issue of pricing for unbundled network elements discussed at length in section III, above, the Commission must also ensure that 1) the terms and conditions for CLECs' access to UNEs and UNE combinations permit economically viable access to those elements, 2) operational support systems (OSSs) are available to CLECs that are fully functional, stress-tested, and integratable, and 3) there exist self-executing and behavior-modifying remedies for violations of the competitive "rules of engagement" established by this Commission.[69]

[69] Obviously these tools do not replace the need to ensure Quest's compliance with the "checklist items" required by the Act

Q. IS IT YOUR UNDERSTANDING THAT THE OSS ISSUES ARE BEING ADDRESSED IN A SEPARATE PHASE OF THIS PROCEEDING?

A. Yes. My point here was to provide to the Commission a complete list of the necessary regulatory tools. i do not mean to suggest that this workshop is the place to consider issues related to Qwest's OSS. It is my understanding that this Commission will be considering the results of the ROC OSS test and other performance issues in a subsequent phase of this proceeding Moreover, I also understand that this Commission is participating in the ROC collaborative's consideration of Qwest's proposed "anti-backsliding" performance assurance plan and will be addressing the results of the ROCs work in a later phase of this proceeding.

Q. PLEASE EXPLAIN WHAT YOU MEAN BY "SELF-EXECUTING AND BEHAVIOR-MODIFYING REMEDIES FOR VIOLATIONS OF THE COMPETITIVE 'RULES OF ENGAGEMENT' ESTABLISHED BY THIS COMMISSION."

A. Simply stated, the performance assurance plan the Commission adopts must have the effect of encouraging Qwest to "do the right thing" relative to its wholesale customers. To be effective, such a plan must contain financial penalties at a level sufficient for Qwest to view them as something other than a cost of doing business, much as FCC Chairman

Powell is seeking to ensure by requesting authority to levy higher penalties for non-compliance. Looking at this as a "carrot and stick" process, an effective plan must contain a sufficient "stick" such that Qwest's a financial incentives are clear -- it must treat its competitors in a non-discriminatory manner that is at parity with how it deals with its own retail operations.

Q. THERE ARE OTHER REMEDIES AVAILABLE TO CARRIERS WHO BELIEVE THEY ARE BEING TREATED IN AN ANTICOMPETITIVE AND UNLAWFULLY DISCRIMINATORY MANNER. ARE YOU SAYING THAT THOSE REMEDIES ARE INSUFFICIENT?

A. Depending on the particular remedy, it may or may not provide a sufficient incentive to encourage "good behavior" by Qwest. I've already alluded to the recent statement by FCC Chairman Powell wherein he mentions the need for higher penalties for non-compliance by the ILECs. Other remedies that are available include the filing of an enforcement action at the FCC and the pursuit of anti-trust relief in the courts.[70] Petitions to the FCC for enforcement have taken significant time for decision in the past. The fact that a "speedy trial" is unlikely, coupled with the absence of potentially behavior modifying penalties, renders FCC enforcement action a less-than optimal means of ensuring compliant behavior by Qwest. The threat of anti-trust action is certainly a possible remedy available to a CLEC. However, the high cost of prosecuting such a case, combined with the fact that Qwest would likely continue to receive more than $100 Million in revenues each month during the pendency of the case (in Washington alone), means that Qwest would be far better situated than most, if not all, CLECs to survive such a war of attrition.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

[70] These examples are mentioned in the previously noted AZ rebuttal testimony of Qwest witness Mr. Teitzel, at 7.