BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of Petition of **Qwest Corporation** **For Competitive Classification of Basic Business Exchange Telecommunications Services.**	**DOCKET NO. UT - 030614** **MCI'S OPENING BRIEF**

WorldCom, Inc., (n/k/a/ "MCI"), on behalf of its regulated subsidiaries in Washington, hereby presents its opening brief in this matter.

I. INTRODUCTION

The request to classify Qwest's business local exchange and related services, as "competitive" is not justified. While it appears that some level of competition exists for certain of Qwest's services, the type and extent of that competition does not warrant the competitive classification of the services. Further, it makes no sense to deregulate Qwest when it has not utilized the pricing flexibility currently available to respond to competition.

The fundamental question to be answered in resolving this issue is whether the public interest will be better off if the Commission deregulates Qwest's business local exchange and related services. The short answer to this question is that Washington will not be better off. Qwest's customers will be worse off, and so will Qwest's dependent competitors, as well as the customers of those competitors. In fact, as each relevant party's interests are analyzed, it becomes clear that the only party that will benefit from the proposed deregulation is Qwest.

The anecdotal, historical evidence presented by Qwest in this proceeding is of little

value to the Commission in that none of the areas Qwest points to as evidence that the market is fully competitive would even exist absent the regulatory oversight of the Commission. The state of the local exchange market today is not the result of the competitive market reaching maturity, to the point that Qwest no longer poses a threat to the continued development and sustainability of competition, but due to the continued careful oversight of the Commission, which has precluded Qwest from acting on its incentive and ability to resist and/or eliminate all competition from the marketplace.

The first stages of competition should not be mistaken for a marketplace that is effectively competitive and able to take the place of regulation of the dominant carrier. This Commission has actively overseen the first stages of such development, but Qwest has both the ability and the incentive to take back the gains that the limited competitive market has made in Washington.

The criteria established in RCW 80.36.330 have not been satisfied. Qwest has neither provided assurances that effective competition currently exists, nor that effective competition would be sustained under the classification Qwest seeks. For all the reasons that follow, the Commission should reject Qwest's Petition.

II. APPLICABLE LAW

RCW 80.36.330 authorizes the Commission to "classify a telecommunications service provided by a telecommunications company as a competitive telecommunications service" if it finds that the service is "subject to effective competition." The statute defines "effective competition" to mean "that customers of the service have reasonably available alternatives and that the service is not provided to a significant captive customer base." RCW 80.36.330(1) enumerates four factors that the Commission "shall consider"

1 in determining whether it will exercise its discretion to classify a telecommunications

2 service as "competitive:"

3

4 (a) The number and size of alternative providers of services;

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6 (b) The extent to which services are available from alternative
7 providers in the relevant market;

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9 (c) The ability of alternative providers to make functionally
10 equivalent or substitute services readily available at
11 competitive rates terms, and conditions; and

12

13 (d) Other indicators of market power, which may include market
14 share, growth in market share, ease of entry and the affiliation
15 of providers of services.[1]

16

17 The statute then continues, describing the relaxed regulatory requirements for

18 competitively classified services:

19 (2) When the commission finds that a telecommunications company
20 has demonstrated that a telecommunications service is competitive,
21 the commission may permit the service to be provided under a
22 price list effective on ten days notice to the commission and
23 customers. The commission shall prescribe the form of notice. The
24 commission may adopt procedural rules necessary to implement
25 this section.

26

27 (3) Prices or rates charged for competitive telecommunications
28 services shall cover their cost. The commission shall determine
29 proper cost standards to implement this section, provided that in
30 making any assignment of costs or allocating any revenue
31 requirement, the commission shall act to preserve affordable
32 universal telecommunications service.

33

34 (4) The commission may investigate prices for competitive
35 telecommunications services upon complaint. In any complaint
36 proceeding initiated by the commission, the telecommunications
37 company providing the service shall bear the burden of proving
38 that the prices charged cover cost, and are fair, just, and
39 reasonable.

40

[1] See In the Matter of the Petition of Qwest Corporation for Competitive Classification of Business Service in Specified Wire Centers; SEVENTH SUPPLEMENTAL ORDER DENYING PETITION AND ACCEPTING STAFF'S PROPOSAL; Docket No. UT-000883; dated December 18, 2000; at 3. Hereinafter referred to as "Commission's 2000 Order."

(5) Telecommunications companies shall provide the commission with all data it deems necessary to implement this section.

(6) No losses incurred by a telecommunications company in the provision of competitive services may be recovered through rates for noncompetitive services. The commission may order refunds or credits to any class of subscribers to a noncompetitive telecommunications service, which has paid excessive rates because of below cost pricing of competitive telecommunications services.

(7) The commission may reclassify any competitive telecommunications service if reclassification would protect the public interest.

(8) The commission may waive the requirements of RCW 80.36.170 and 80.36.180 in whole or in part for a service classified as competitive if it finds that competition will serve the same purpose and protect the public interest.

The burden lies with Qwest to demonstrate that it faces effective competition in the relevant market.[2] Qwest must meet the statutory criteria by showing the number of customers served by competitors. It is insufficient for Qwest to rely on the percentage of lines being served by competitors as evidence of effective competition. A small minority of business customers may purchase a majority of the lines.[3]

IV. REVIEW OF STATUTORY FACTORS FOR EVALUATING EFFECTIVE COMPETITION

A. Number and size of alternative providers

The mere existence of other providers in a market does not mean that competition is sufficient to provide the market discipline required to govern Qwest's behavior or to protect the public interest as required by RCW 80.36.330. Qwest's control of the market, and the ability to exercise and retain control of the market demand, is not diminished by the mere presence of alternative providers, especially given Qwest's incumbency and its historical monopoly.

[2] WAC 480-120-022(7); Commission's 2000 Order at p. 3.
[3] Commission's 2000 Order at p. 18.

1 Qwest notes that 161 CLECs are registered with the Commission and 152
2 interconnection agreements exist between Qwest and competitors here in Washington.[4]
3 That, however, is not proof that effective competition exists. The number and size of
4 alternative providers are but two considerations. Indeed, this is a starting point for any
5 consideration of competition. Qwest does not provide information on the size of these
6 alternative providers, other than to note that two of the providers include AT&T and
7 MCI. What is clear, however, is that Qwest – by its own calculation in its Petition and
8 direct testimony -- still maintains about 84 percent of the market.[5] That means that the
9 161 CLECs, after 7 years of trying to lure away Qwest business subscribers, share a total
10 of about 16 percent of the Washington market. Moreover, only about half of the
11 registered CLECs are actually purchasing services from Qwest.[6]

12 Dividing 16 percent of the market by the 78 "active" CLECs, results in de
13 minimis market shares on a carrier-specific basis. Even if you assume that AT&T and
14 MCI together account for half of the 16 percent, the market share (4 percent each) is
15 hardly threatening to Qwest. Nor is the remaining 8 percent split among the remaining
16 76 active CLECs (about 0.1 percent each) in Washington.[7]

17 Even utilizing the market share data reported by Staff, which MCI and other
18 intervenors have shown significantly overstates CLEC market share, the fact is that
19 CLECs hold, on average, only 1.5% market share, and even more illuminating, the mean
20 market share for individual CLECs is a mere 0.3%. This de minimis market penetration
21 by CLECs in Washington stands in sharp contrast to Qwest's market domination of
22 nearly 84 percent.

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[4] See Qwest's Petition at pp. 3-4.
[5] Id. at 8, Table B.
[6] Direct Testimony of Timothy Gates, Exhibit 501T at pp. 9-10.
[7] See Exhibit 501T at p. 11.

1 The existence of competitors in a market does not, in and of itself, translate to an 2 effectively competitive marketplace. While it is obvious that some consumers of business 3 telecommunications services in Washington currently enjoy the ability to select service from 4 an alternative choose from a provider, it is critical to stop and consider the environment in 5 which such conditions developed. In Washington, since the passage of the 6 Telecommunications Act of 1996, CLECs have had some *limited* success in making inroads 7 into a market that continues to be dominated by Qwest. What is critical to bear in mind is 8 that this relatively inconsequential progress took place while Qwest was fully regulated. 9 The question then becomes, *will progress be sustained in a completely different* 10 *environment, where the dominant provider is no longer regulated*?[8]

11 **B. Extent to which services are available from alternative providers in the**
12 **relevant market**
13
14 This criterion provides additional information on the activities of the alternative 15 providers. For instance, as Qwest noted, not all registered CLECs are providing service 16 today. If there are many providers, but they are not actually offering service to 17 consumers, their presence should not be considered in any analysis of competition.

18 Based on Qwest's Petition and direct testimony, it appears that CLECs are not 19 offering service in Easton, Elk, Green Bluff, Liberty Lake or Northport.[9] Staff's 20 investigation concluded that CLECs offer services in all Qwest exchanges except Elk.

21 At paragraph 66 of the Commission's 2000 Order, this Commission held:

> 22 Qwest asserts that the statute is met if competitors exist in the market that
> 23 are *capable* of providing ("can" provide) alternative services. We are
> 24 unable to accept this standard. In our view, we must also have confidence
> 25 that competitors *are* offering and *will* offer competitive services. This
> 26 determination turns on the presence of competitors, their actual current
> 27 availability to customers, and a judgment, from their current behavior and

[8] See Direct Testimony of Mark Stacy, Exhibit 601T at pp. 10-11.
[9] See Exhibit 51 at 9-10

> the current market structure, that they do, can, and will provide alternative service to end-users.

Applying this same standard to Qwest's evidence in this proceeding requires the Commission to reject Qwest's request for competitive classification of services, at a minimum, in the exchanges where no competitor is offering services.

The Commission should also reject Qwest's argument that effective competition exists because CLECs are "capable" of offering services in particular exchanges. As the Commission noted in its 2000 Order,

> Qwest refers to the presence of switches, price lists filed with the Commission, and advertising by CLECs to show that CLECS are capable of providing or hold themselves out to provide services comparable to Qwest's business services. None of these exhibits show that competitors *in fact* are offering comparable services in the relevant geographic market. Ex. 12C, Attachment C, D, and J. Qwest's reliance on Attachment H to Exhibit 12C is also of little weight. Attachment H shows, at most, competitive presence in the thirty-one wire centers. It does not establish that those competitors are providing reasonable alternatives to Qwest's business services. Consequently, we cannot make a finding that the services in the thirty-one wire centers for which Qwest has sought competitive classification are in fact subject to effective competition at this time.[10]

Thus, the analysis here is not complete simply if Qwest is able to show that a CLEC is present in a particular exchange. The extent to which CLECs are offering services and whether those services are functionally equivalent and readily available at competitive rates, terms and conditions must also be considered. For instance, if CLECs have only a few lines in an exchange or if CLECs have many lines but the services offered in that exchange are not functionally equivalent, then the Commission should reject Qwest's request for competitive classification.

Even if Qwest is able to demonstrate that alternative providers exist in its territory in

[10] See Commission's 2000 Order at paragraph 69.

1 the state, the benefits of competition that Washington consumers have enjoyed to date have
2 all occurred during a time when Qwest was regulated by the Commission and in an
3 environment where the Petitioned Services were not classified as competitive. In fact, the
4 benefits experienced by Washington's consumers are directly tied to the steps taken by the
5 Commission exercising its statutory authority to protect the competitive market and the
6 public interest.[11]

7 If the Commission gives up all or part of such authority, and essentially hands over
8 the responsibility to protect the public interest to Qwest, the minimal competitive gains will
9 be lost and the development of competition will stop. This is because the Commission has
10 an interest in promoting a competitive market and ensuring that CLECs have the ability to
11 compete on even footing with the incumbent (Qwest). Such competition promotes
12 consumer welfare, and is in the public interest. Qwest, on the other hand, has no such
13 interest. In fact, Qwest's interests are diametrically opposed to the Commission's obligation
14 to ensure that Washington consumers have a choice of providers. While the Commission's
15 oversight of the development of the market in Washington has been driven by public interest
16 objectives, Qwest's unregulated participation would be driven by financial objectives.
17 Unfortunately the optimization of Qwest's financial objectives does not include the presence
18 of real competitors or the protection of the public interest in a developing competitive
19 market. In fact, Qwest can come closer to reaching its financial objectives by weakening its
20 competitors and reducing consumer choice. The conclusion of that exercise would be when
21 Qwest had eliminated its competition entirely.[12]

22 While competitive carriers have the same financial incentives, CLECs are generally
23 constrained in the retail pricing of their services by the cost of the services and elements,

[11] Exhibit 601T at p. 16.
[12] Exhibit 601T at p. 17.

which they must purchase from Qwest. Qwest obviously does not face the same obstacles. This unequal footing is a critical point that should be weighed heavily by the Commission in its decision in this case.[13]

C. Ability of alternative providers to make functionally equivalent or substitute services available

1. Wholesale-based services (resale; UNE-P; UNE-L)

As noted in Qwest's Petition, "Qwest's competitive evidence supporting this petition is substantially based on the quantities of wholesale services purchased by alternative providers to compete with Qwest's retail basic business services. A list of competitors that purchased unbundled loops, unbundled network element platforms (UNE-P), and resold business services may be found at Confidential Attachment C."[14] While such a position may ostensibly support Qwest's Petition, the Commission must seriously question whether resold or UNE-P services rise to the level of "reasonably available alternatives." MCI believes that they do not.

Services through resale have never been considered to be effective competition. Resellers are more appropriately considered customers of Qwest. Resellers cannot independently produce the service they offer their customers, so they purchase services from carriers such as Qwest to provide their service to customers. The continued viability of resellers is dependent upon the maintenance of a sufficient margin between the wholesale price they pay to Qwest and the retail price they charge their customers. A reseller purchases Qwest services at the same rates, terms and conditions that Qwest offers those services, less a 14.74 percent discount.[15] The fact that the amount of business resale purchases by CLECs has dropped precipitously over time tends to

[13] Exhibit 601T at p. 18.
[14] See Qwest Petition at 4. See also the Exhibit 1T at 9-10.
[15] See Qwest Petition at 5 and Exhibit 1T at 10.

1 indicate that the 14.74 percent discount is insufficient and that resale in general is not a
2 viable long-term strategy.[16]

3 The 1996 Telecom Act and the FCC's *Local Competition Order* "…contemplates
4 three paths of entry into the local market -- the construction of new networks, the use of
5 unbundled elements of the incumbent's network, and resale."[17] Resale was expected to
6 be one of the ways in which companies would gain access to the market quickly.
7 Generally, it was thought that, over time, CLECs utilizing resale would develop the
8 critical mass of customer density and capital to make it economically viable for them to
9 build their own facilities and eventually diminish their reliance upon resale and/or the
10 purchase of unbundled network elements ("UNEs"). Resale is generally not thought of as
11 a long-term solution because of the reliance upon the incumbent provider and the
12 inability to distinguish the reseller service from that of the underlying carrier. In
13 addition, the CLEC reseller has no ability to cut its cost of telecommunications services
14 relative to the rates of the incumbent from which it purchases services. No matter how
15 well the CLEC manages its own business, and how efficient it becomes, it will still have
16 the same narrow margin upon which to meet its own costs and earn a profit. Clearly the
17 reseller has no ability to impose any competitive threat or pressure on the underlying
18 competitor and, as such, cannot be considered effective competition.[18] This Commission

[16] Qwest's Petition at page 9 indicates that Business Resale from 12/31/01 to 12/31/02 dropped 41 percent. On its face it seems clear that resale has not an effective competitive strategy in Washington. If it were a successful strategy, usage would be increasing, not decreasing; Exhibit 501T at p. 14.

[17] Before the Federal Communications Commission; *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Services Providers*; CC Docket Nos. 96-98 and 95-185; **FIRST REPORT AND ORDER;** Released August 8, 1996; hereinafter referred to as the *Local Competition Order,* at ¶ 12.

[18] Exhibit 501T at pp. 14-15.

1 recognized this characteristic of resale competition in its consideration of Qwest's
2 previous request for competitive classification of its business services.[19]

3 Although UNE-P has proven to be one of the most effective means of entering the
4 local market, it is the resale of Qwest's retail services under different rates, terms and
5 conditions than total services resale.[20] UNE-P is simply the CLEC using an existing
6 Qwest unbundled loop, transport, line port and local switching.[21] Even Staff agreed, in
7 response to MCI Data Request No. 15, that Qwest's UNE-P offering does not represent
8 facilities-based competition.[22]

9 In Qwest's Wholesale Product Catalog, UNE-P is defined as:

10 Qwest provides UNE-P POTS combinations as a finished service to end-
11 users *on behalf of CLECS*. UNE-P POTS provides service similar in
12 functionality as Qwest's retail residential and business services. (emphasis
13 added)[23]
14
15 The pricing for UNE-P, however, is based upon Total Element Long Run
16 Incremental Costs or TELRIC standards.[24] While UNE-P is an effective way for CLECs
17 to enter markets, it still requires the CLEC to rely upon the incumbent for the underlying
18 service. UNE-P is simply resale of a bundle of service elements provided by the
19 incumbent monopoly. While the margins in some zones between the incumbent's retail
20 rates and the CLEC's costs may be somewhat more favorable for the CLECs at Qwest's

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[19] Commission's 2000 Order at p. 20.

[20] On February 6, 2003, The Honorable Gary Locke, Governor of Washington, wrote to the FCC and stated, "I believe the unbundled network elements platform (UNE-P) provisions have played a vital role in promoting competition in Washington State and elsewhere, and that the incentives for competition that are contained in the Telecommunications Act of 1996 and Commission rules should be maintained."

[21] The availability of unbundled local switching will be a controversial issue in the FCC Triennial Review proceeding. As the Commission is well aware, unbundled local switching is a key component of UNE-P and the impact of not making that element available to CLECs will be the crux of the impairment analyses. This controversial issue underscores the CLEC dependence upon the ILECs for UNEs and why UNE-based competition – like more traditional resale – is not effective competition.

[22] Exhibit 213.

[23] See Qwest Wholesale Product Catalog. Link to Qwest | Wholesale UNE-P POTS Description

[24] This Commission has adopted the TELRIC standards for costing proceedings. See, for instance, *In the Matter of the Pricing Proceeding for Interconnection, Unbundled Elements, Transport and Termination, and Resale*, Docket No. UT-960369 et al., Eighth Supplemental Order (May 11, 1998) ("Eighth Supplemental Order"), at Para. 9.

current retail prices, the CLECs still have no ability to cut their costs of services, no matter how efficient they become. Nor does the presence of the UNE-P providers in the market place constrain Qwest's ability to engage in monopolistic behavior and to adopt practices, which harm telecommunications services consumers.[25]

The CLEC purchase and use of UNE-Loop or UNE-L is resale of Qwest's unbundled loop. This form of competition is more significant since it does require the use of the CLEC switch. Nevertheless, the distinguishing difference between total service resale and the CLEC use of UNE-P or UNE-L is the pricing standard. CLECs have generally sought to use UNEs over resale because the economics are more attractive. Again, resale does not provide effective competition for Qwest.[26]

For all three of these CLEC local service methods, it is *Qwest providing service on behalf of the CLEC*. In fact, the CLECs are dependent upon Qwest for the timing of service delivery, quality of service and features. As such, it is Qwest making these alternative services "readily available", although they may be ordered and purchased by the CLECs.

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

Wireless. Qwest's testimony suggests that wireless services are functionally equivalent, reasonably available and competitively priced to Qwest's business wireline services. While wireless services may be reasonably available, they are not functionally equivalent or competitively priced. For wireless services to be functionally equivalent to landline basic exchange services, they would also have to be close substitutes. Today, wireless services are not close substitutes for landline local exchange services.[27]

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[25] Exhibit 501T at pp. 16-17.
[26] Exhibit 501T at p. 17.
[27] See Order No. 29360, Idaho Public Utilities Commission, Case No. Qwe-T-02-25 (October 20, 2003) (hereafter the "Idaho Qwest Order").

1 Generally if a consumer can easily get a good substitute for a product or service, it
2 will switch to that substitute quickly if the price of their current product or service rises. A
3 good or close substitute would be one that provides the same functionality to the consumer
4 at the same or very similar terms and conditions. Thus, the closer the substitute, the more
5 elastic the demand for the two products or services. If the services are close substitutes, then
6 a small change in price will result in a change in consumer purchasing patterns. In other
7 words, when the demand is more elastic, people are more likely to change with a small
8 change in price.[28] When comparing services, there are several characteristics to consider:
9 functionality, quality and pricing.

10 **Functionality.** A quick and uninformed comparison of wireless and wireline local
11 service would lead one to conclude that they provide similar functionalities. They both
12 provide local calling and have many of the same custom calling features. Those limited
13 similarities, however, are not sufficient to conclude that the two types of services are close
14 substitutes or, more importantly, that they are functionally equivalent.

15 As noted in Mr. Gates' testimony, comparing landline local exchange service to
16 wireless service would be similar to comparing the functionality received from a car and a
17 motorcycle. The car and motorcycle both provide transportation, have disk brakes, dual
18 exhaust, halogen headlights, windshields, turn signals, stereos, seating for additional
19 passenger, storage for belongings, and get similar mileage. One could even argue that they
20 cost the same depending upon the model purchased and how they are equipped. Indeed, one
21 could argue that the motorcycle even provides features and characteristics that the car does
22 not. Technically, there is no reason why one could not replace his/her second car with a
23 motorcycle. But, because the car and motorcycle provide different kinds of transportation

[28] Exhibit 501T at pp. 19-20.

1 for different situations, one would not as likely get rid of a car and rely solely on a
2 motorcycle.[29]

3 This is similar to the comparison of landline local exchange service and wireless
4 service. One could technically replace landline local service with wireless service, but
5 because wireless services provide different kinds of functionality for different situations,
6 very few businesses would actually disconnect their landline service and rely solely upon
7 wireless service. Indeed, like the motorcycle scenario, businesses with the means to do so
8 would likely prefer both.[30]

9 Landline local service is very familiar to us all. Typical local service includes, but is
10 not limited to, the ability to: make and receive voice telephone calls, get operator assistance,
11 make and receive long distance calls (and to select long distance providers), connect with
12 emergency services by dialing 911, use a fax machine to receive and send documents, get a
13 dial-up or high-speed Internet connection, and have the number appear in the white pages of
14 a telephone directory. While wireless service can provide many of these features, it is
15 severely lacking in several areas.

16 Generally speaking, wireless phones cannot accept and send faxes, quickly and
17 efficiently generate, send and receive email with attachments or allow high-speed access
18 such as is available through landline DSL services. Further, even if such devices could
19 send and receive data communications efficiently, connections speeds would be slow and
20 there is no efficient way to save or print the documents or information.[31]

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[29] Exhibit 501T at pp. 20-21.
[30] Exhibit 501T at p. 21.
[31] Exhibit 501T at p. 22.

1 At the recent Regional Oversight Committee meeting in Denver, the American
2 Association of Retired Person (AARP) handed out copies of its Policy Book for 2003.[32]
3 The AARP noted that many of the benefits of broadband would be valuable to older
4 Americans. Specifically, the policy states:

5 Many of the benefits of ubiquitous and affordable access to broadband
6 networks will be of particular value to older Americans. For example,
7 with a broadband connection to support monitoring devices and interactive
8 video, home health care becomes a viable option for many consumers,
9 particularly those with limited mobility or who may not be well enough to
10 travel. A broadband connection also facilitates lifelong learning
11 opportunities at convenient times and places, especially for individuals
12 who have jobs, disabilities or family responsibilities that make it difficult
13 to travel to a classroom.[33]
14
15 Fast and efficient connections to the Internet are also critical for businesses since time is
16 money. It is clear that broadband Internet access is critical to both consumers and
17 businesses, but to date, that capability is not available via wireless services.[34]

18 Businesses also require various types of alarm systems. Without a landline, ADT
19 or other alarm companies would have no way to connect the business to its monitoring
20 system. In addition, businesses require multiple lines and roll-over (line hunting)
21 capabilities to avoid blocking for their customers. PBXs and KSUs (key service units) in
22 conjunction with Centrex features provide line consolidation functions that are not
23 available with wireless services. Businesses need additional lines as well. Businesses
24 use additional lines for customer contacts, Internet access (dial-up or high speed) or fax
25 machines. Wireless phones do not have the capability of multiple line service. Instead, a
26 business would need multiple phones to accommodate this basic need. While there are
27 some wireless plans that allow users to "share" minutes, there are no plans available, that

[32] Regional Oversight Committee, Meetings held in Denver, Colorado on May 4th and 5th, 2003. See panel presentation entitled "The AARP Perspective on Telecommunications" from 2:15 pm to 3:00 pm on May 5, 2003.
[33] See 2003 AARP Policy Book at page 11-36.
[34] Exhibit 501T at p. 23.

1 allow multiple phones with the same number or that allow multiple lines on one wireless
2 phone.[35] These types of conveniences are only available with landline basic local
3 exchange service.[36]

4 Another difference between landline phones and wireless phones is the ability to
5 choose among long-distance carriers. With landline basic local exchange service the
6 customer is allowed to select different interLATA and intraLATA toll providers.
7 Wireless services may have limited toll options, but the customer is not allowed to select
8 from among various providers for either interLATA or intraLATA toll calling.
9 Businesses normally select their long distance providers after careful analysis of rate
10 structures. That ability is eliminated when wireless service is purchased.[37]

11 Local number portability (LNP) is another important benefit that is not yet
12 available with wireless service. While the FCC has required CMRS providers to
13 implement LNP in the top 100 MSAs by November of this year, it is not clear whether
14 the wireless industry will be able to make that deadline.[38]

15 A critical safety feature for consumers and businesses alike is the ability to dial
16 911 to get emergency services. While some wireless services provide for 911 services,
17 very few today provide for enhanced 911 service. Enhanced 911 allows emergency
18 response units to determine precisely the location of the individual who may be within a
19 building complex.[39] The availability of E-911 is spotty at best, and can vary dramatically

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[35] The ability to have others get on other phones (extensions in the home) but on the same line to participate in a conversation is a common and expected feature of local service. Or, more accurately, it is not a feature, but an expected capability associated with having multiple outlets in the home.
[36] Exhibit 501T at pp. 23-25.
[37] Exhibit 501T at p. 25.
[38] See FCC 03-153; CG Docket No. 02-278; **REPORT AND ORDER**; Released July 3, 2003; Exhibit 501T at 25.
[39] The AARP Policy Book states that the FCC should "…ensure that wireless carriers deploy wireless Enhanced 911 (E911) as soon as possible and should vigorously enforce the E911 Phase II completion deadline of December 31, 2005." 2003 AARP Policy Book at page 11-34; Exhibit 501T at p. 26.

1 by carrier. The FCC and T-Mobile just entered into a $1.1 million Consent Decree
2 regarding compliance with the E-911 Phase II rules.[40]

3 Certain digital wireless handsets are also not TTY (tele-typewriter) capable. In
4 fact, in certain locations consumers using text telephones (TTYs or TDDs
5 (telecommunications device for the deaf)) will not be able to complete 911 calls to
6 emergency call centers using new digital wireless services. The FCC has encouraged
7 public safety organizations, vendors of TTY equipment for 911 call centers, TTY vendors
8 and wireless service providers to work together to develop solutions, but for now, the
9 problem remains.[41]

10 Currently only wireline and analog wireless phones are usable for persons with
11 hearing impairments. The FCC released an order on July 10, 2003, however, requiring
12 digital phone manufacturers to have at least two HAC models available within three
13 years.[42] Until then, however, more than 6,000,000 Americans will not be able to use
14 digital wireless phones.[43]

15 Technically the Telephone Consumer Protection Act of 1991 or TCPA affords the
16 same protections for wireless as wireline consumers.[44] Nevertheless, it wasn't until a just
17 released FCC Order on the TCPA that wireless users received assurances that wireless
18 numbers could be placed on "do not call" lists.[45] Today in many states, consumers can ask
19 the local provider of their wireline service to place them on a no call list to prevent (or at
20 least minimize) solicitation calls. At present, no such capability exists for wireless numbers.

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[40] See FCC Press Release Issued July 17, 2003. Phase II location requirements (X and Y location coordinates) are critical to an effective emergency response for wireless E-911 calls.
[41] See FCC Consumer Alert, "USE OF TTY DEVICES WITH DIGITAL WIRELESS PHONES", dated July 2, 2002; Exhibit 501T at pp. 26-27.
[42] See FCC Order; WT Docket No. 01-309.
[43] Exhibit 501T at p. 27.
[44] TCPA or Public Law 102-243 (1991).
[45] See FCC **REPORT AND ORDER**; CG Docket No. 02-278; Released July 3, 2003.

1 It appears, based on the FCC's recent TCPA Order, that wireless users may be able to use
2 the national no call list in October of this year. If a business were to rely solely on wireless
3 without "do not call" list capability, the marketing calls would certainly interrupt business.[46]

4 The handset requirements are also problematic for consumers, business and for
5 the development of competition. If a business wanted to change wireless providers, even
6 if they use the same protocol, the business would likely have to buy new phones for its
7 employees -- programmed for that provider. A customer can't take its Sprint PCS phone
8 to T-Mobile, for instance, and ask them to program it for Sprint service. Further, a
9 Cricket phone won't work on the AT&T network, and vice versa. This is a common
10 problem and why consumers have perfectly good wireless phones laying in their junk
11 drawers at home.[47]

12 **Quality.** Dependability and quality of service are perhaps two of the biggest
13 drawbacks for wireless service. Anyone who has used a wireless phone has had
14 conversations interrupted, lost or been unable to place or receive calls because of dead zones
15 where service is unavailable. As wireless providers readily admit, there are places and
16 times where the customer may not be able to complete or initiate a call due to limitations in
17 network architecture or system capacity. As such, if a business is relying solely on its
18 wireless service, there may be times when callers cannot connect – even to leave a message
19 on voicemail.[48]

20 Wireless networks also have limited capacity. When an individual cell site has
21 significant usage, the customer making a call will receive a fast busy or an announcement.
22 Congestion (fast busy indicating all trunks are busy) on the local landline phone is rare.[49]

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[46] Exhibit 501T at p. 29.
[47] Exhibit 501T at pp. 29-30.
[48] Exhibit 501T at p. 28.
[49] Exhibit 501T at p. 28.

1 Another obvious drawback to wireless service is the need to rely on batteries when
2 not connected to a charger. Wireless phones vary widely in their battery life. As such,
3 absent a charger, the business risks losing service when the battery dies. Even with a
4 charger, batteries lose their ability to stay charged over time. This is not a problem with
5 landline service.[50]

6 Security also has long been an issue with wireless service. Not only are people
7 able to listen in on conversations, but cell phone "cloning" can occur as well. Cloning
8 occurs when an individual monitors radio wave transmissions and steals your electronic
9 serial number and telephone number. The ESN/MIN is then used in another phone at
10 your expense. Generally speaking, this type of insecure calling is unacceptable to
11 businesses.[51]

12 **Pricing.** A business that decides to rely on wireless service, initiates service
13 with a provider and purchases new wireless phones for its employees expends a
14 considerable sum of money. Those phones cannot be used with another carrier, and that
15 is a sunk cost that must be considered when switching providers. This is true even if the
16 new provider offers a "free" phone, after rebates. Such sunk costs will serve as a
17 disincentive for businesses to move their service to another provider.[52]

18 Moreover, wireless pricing is confusing and anything but conventional. The
19 variety of pricing plans was illustrated in Mr. Teitzel's testimony. He notes that "direct
20 pricing comparisons between wireline service and wireless services are typically not
21 straightforward…"[53]

[50] Exhibit 501T at p. 29.
[51] Exhibit 501T at p. 31.
[52] Exhibit 501T at p. 32.
[53] See Exhibit 51 at page 18; Exhibit 501T at p. 32.

1 Wireline phone users have predictability in phone costs per month; that generally
2 is not the case with wireless. Unlimited local calling is rare, so one must pick a usage
3 plan. It may take months before a business determines the best (most cost effective) plan
4 for calling patterns. Further, if the business oversubscribes – that is, it purchases too
5 many minutes that aren't used – the minutes are lost at the end of each month.[54] To make
6 things more difficult, with wireless phones the user must pay for "incoming" calls. So
7 absent refusing all incoming calls, it is very difficult to control usage. Further, when a
8 business exceeds its particular usage limit, high penalty rates apply.[55]

9 Many wireless calling plans include different rates by time of day and day or
10 week. So a business must take care in making calls during those transition periods or risk
11 being billed for calls that it believed would be free. For instance, if one starts a one hour
12 call at 8:59 pm when your free (unlimited) "night" calling period begins at 9:00 pm, the
13 entire 60 minutes will be deducted from the "anytime" minutes because the call started
14 prior to the "night" period.[56]

15 While some plans allow for free long-distance, a wireless user still must pay
16 roaming charges when outside his/her local calling area. The roaming charges – initial or
17 per day, plus per call charges – can be very expensive.

18 There is also the matter of initiating and terminating wireless service. If the
19 existing wireless contract is not concluded the business will need to pay a termination
20 liability to get out of the contract. The new provider will likely require the business to
21 buy a new phone – since phones are not transferable among providers – sign a new

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[54] Cingular Wireless is now offering a plan that allows a user to rollover the "peak" minutes of use for up to one year.

[55] Penalty rates commonly range from 25 cents to 35 cents per minute; Exhibit 501T at pp. 32-33.

[56] Exhibit 501T at p. 33.

1 contract, and require the business to pay an "activation" fee.[57] Businesses do not have to
2 pay termination liabilities when it changes local wireline service providers and does not
3 need unique phones for each local service provider. These types of penalties and up-front
4 charges would be terribly difficult to manage for a company.

5 The table in Mr. Gates' direct testimony provides the Commission with a list of
6 differences between wireless and landline phone service.[58] This list further summarizes
7 the argument that wireless service is not the functional equivalent of landline service.
8 The evidence Qwest should have presented in order to support its argument would be
9 something along the lines of demonstrating that a minor increase in landline prices would
10 cause a massive shift away from local landline service to wireless service.[59] No evidence
11 exists in the record that Washington businesses would scrap their existing phone systems,
12 sacrificing each of the conveniences and necessities illustrated in Mr. Gates' table and
13 "convert solely to wireless" for even significant price increases in landline service.[60]

14 Typically consumers use one or the other of substitute products. Clearly, nearly
15 every consumer that has a cell phone also has landline service, in other words, consumers
16 don't use *either* wireless or landline service, they use *both*. The reality of the matter is
17 that wireless service is used to augment the communications needs of businesses that
18 have landline service. These goods are not close substitutes – if they were, declining
19 wireless prices would result in businesses bypassing the landline network and relying

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[57] Some providers will offer a "free" phone with activation of service for a specified period of time – usually one or two years. The free phone, however, is usually an older, outdated model and not the phone that most people would desire.
[58] Exhibit 501T at pp. 34-36.
[59] See Idaho Qwest Order at p. 9.
[60] Exhibit 501T at p. 34.

1 entirely on cellular phones (consistent with the economic definition of substitute).
2 Wireless service is merely a complement to wireline service, not a substitute.[61]

3 **Voice over the Internet Protocol.** Voice Over Internet Protocol ("VoIP") is
4 also not a close substitute for Qwest's business services. It may be that someday VoIP
5 services will be refined sufficiently to provide a substitute service, but today they are not.
6 Service quality and equipment requirements make VoIP services limited in their
7 application. As Mr. Teitzel recognizes, it is difficult to compare the limited VoIP
8 offerings to Qwest's basic business offerings.[62]

9 Similarly, Mr. Wilson's discussion of VoIP, Wi Fi, digital cable and other
10 technologies is interesting, but he has not shown that those alternative technologies are
11 substitutes for Qwest's basic business services today. For instance, nowhere in Staff's
12 testimony does it address the cost of these offerings, or the upfront investment required
13 for SIP[63] phones or fixed wireless antennae.[64] There are many reasons why VoIP is not a
14 good substitute for Qwest basic business services, but those issues were ignored. Even an
15 article on the Qwest website recognizes the problems with VoIP telephony today:

16 Voice Over Internet Protocol (VOIP)
17
18 What is it? VOIP is a new breed of phone service that operates over the
19 Internet. The technology allows you to use your computer as a telephone
20 or use the Internet to transmit your call over ordinary phone lines.
21
22 What's the big deal? VOIP bypasses AT&T, Sprint, and MCI for long-
23 distance calling. That means you can place domestic calls that are either
24 free or cost mere pennies a minute, and international rates are almost as
25 low. VOIP is also a step toward the geek dream of "convergence," a
26 technological nirvana in which Web, E-mail, phone, fax, radio, and TV
27 come together in one device. That's big enough for Microsoft to promise
28 phone features in its next operating system.

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[61] Exhibit 501T at pp. 31-32.
[62] See Exhibit 51 at page 22; Exhibit 501T at pp. 37-38.
[63] SIP stands for Session Initialization Protocol. Cisco SIP phones cost at least $200 and most cost much more.
[64] Exhibit 504T at p. 24.

1
2 What can I use it for? You can cut your phone bill substantially, especially
3 if you have branch offices, multiple call centers, or overseas customers.
4 Flexibility is another plus. Instead of calling the phone company to order
5 special features, you can reconfigure your phone service as often as you
6 like over the Web -- for example, screening out a persistent bill collector
7 or forwarding only your best customer's call to your cell phone.
8
9 What'll it cost me? Pricing is volatile, variable, and not regulated by the
10 Federal Communications Commission. You can download Net2Phone's
11 software at no charge, with free calls and rates of less than 5¢ a minute for
12 many international calls. If you plan to use VOIP to replace your office
13 phones, for instance, Voicenet Communications, in Philadelphia, starts
14 with a $160 hardware fee plus a $19.95-per-line activation fee and a $9.95
15 basic monthly fee for each line.
16
17 Is it soup yet? Not if you expect to dial 911 on your telephone and actually
18 get someone. Most VOIPs have yet to link up with emergency call centers.
19 Sound quality ranges from very good to barely audible. Billions of dollars
20 are being spent on better infrastructure. Plan to keep a regular phone line
21 as a backup in case your provider folds or the electricity goes out.
22
23 Should I care? If not now, soon. VOIP cuts costs, and flexible features can
24 make small companies sound bigger than they are. VOIP also promises to
25 reduce the expense and bother of administering a traditional phone system
26 -- unless you like waiting for the phone company to install new lines every
27 time you reorganize your staff.
28 --Jane Salodof MacNeil [65]
29

30 There are other obvious problems with VoIP that prevent its use as a substitute for
31 Qwest's basic local exchange service in most situations. For instance, if the power goes
32 out the customer loses phone service, unlike regular phones that are powered from the
33 central office. As noted above, 911 services will not work with VoIP and the quality is
34 poor.[66]

35 A quick visit to the websites cited in Mr. Wilson's testimony shows why these
36 new offerings are not good substitutes for Qwest's basic local exchange service. For
37 example, Accima provides fixed wireless and other DSL services. For High Speed

[65] See Link to Qwest.net -- Business Content -- VoIP; Exhibit 504T at pp. 24-25.
[66] Exhibit 504T at p. 25.

1 Symmetric DSL, Accima charges an $800 installation fee plus $35 per month in addition
2 to the telco charges. The wireless DSL requires a $50 setup fee, $15 per month for rental
3 of the equipment and $40 per month for Internet. The installation fee is waived if you
4 purchase the equipment ($200 for antenna, 30 feet of LMR 400 coaxial cable, and a high
5 speed wireless data radio) and install the antenna, cable and radio yourself.[67]

6 Mr. Gates testified that he called PocketiNet and discussed their service offerings.
7 They do not provide any telephony services. High Speed.com is another Internet service
8 provider identified by Mr. Wilson. In fact, Mr. Wilson states, "At least one of the
9 providers listed above, High Speed.Com, is also registered as a telecommunications
10 company, with lines reported and accounted for in the market share analyses I have
11 referenced." When Mr. Gates called High Speed, he was told that they provided no
12 telephone services, and had no plans to do so. Given this information, it is curious that
13 Staff has included High Speed lines in its market share analysis.[68]

14 In summary, the Commission should reject any consideration of VoIP as a
15 substitute for Qwest business services in this Petition since no evidence exists in the
16 record of the actual availability of VoIP or its comparison to the terms and conditions of
17 Qwest's services. At page 26 of Mr. Teitzel's testimony he admits, "…Qwest has no
18 means of assessing the number of business customers served by alternative VoIP
19 providers." Given this lack of empirical evidence, the Commission should not give any
20 weight to the potential existence of some VoIP offerings in its deliberations. If Qwest
21 cannot provide empirical evidence of effective competition by VoIP, it has not met its
22 burden here. The Commission should not rely on the mere existence of VoIP technology

[67] Exhibit 504T at p. 26.
[68] Exhibit 504T at p. 27.

to conclude that it has been deployed in this state and is a viable and effective competitive substitute for Qwest's business services.

D. OTHER INDICATORS OF MARKET POWER

No evidence exists in the record to show that CLECs would expand and extend their service offerings if Qwest raised its retail rates. More importantly, no evidence is in the record that Qwest has attempted to respond to competitive entry by reducing rates. In fact, Qwest offers no objective demonstration that it lacks market power or that it needs additional pricing flexibility to respond to competition.

In its Petition and direct testimony, Qwest simply identified the number of certificated carriers and the number of lines "lost" to competition. It did not show any instance in which Qwest's competitor took its business, even after Qwest utilized its available pricing flexibility. Indeed, Qwest has provided no evidence of how it has responded to this supposed competition. As noted in the Commission's 2000 Order, "Qwest can use banded rate tariffs, offer business services through a competitive affiliate, offer promotions, offer win back incentives, and lower prices in response to competition."[69] It appears that Qwest has not taken advantage of its existing pricing flexibility to respond to the limited competition it faces today. Until Qwest proves that its current flexibility is insufficient to respond to competition, and until effective, price constraining competition exists as required under RCW 80.36.330, Qwest's request for competitive classification should be denied.[70]

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[69] See Commission's 2000 Order at page 8, paragraph 23 and at page 20, paragraph 70.
[70] Exhibit 501T at pp. 38-40.

1 A company has market power if it is profitably able to charge supra-competitive
2 prices. In short, market power allows the company to set prices profitably above
3 competitive levels.[71]

4 **Market Share.** As discussed above, the evidence Qwest has provided in this case
5 is based on the quantities of wholesale services purchased by CLECs – unbundled loops,
6 UNE-P and resold business services. This "resale" competition – which leaves
7 alternative providers dependent upon Qwest and its services -- is not sufficient to
8 reclassify Qwest's business services. Further, even after 7 years of attempts to lure away
9 Qwest business customers, the 161 registered CLECs evidently only have about 16
10 percent of the market, by Qwest's own calculations.[72]

11 Qwest witness, Mr. Shooshan, refers to certain economic texts for descriptions of
12 markets, but those references are to effective and/or workable competition, not
13 competition that occurs in an environment in which the dominant retail firm is the
14 monopoly supplier of inputs to its own competitors. In such an environment (as currently
15 exists in the telecommunications market in Washington) the dominant firm has the ability
16 to control the strength and viability of its competitors, and market restraint is nonexistent.
17 Without facilities-based competition, no effective or workable competition exists in
18 Washington, and therefore, Mr. Shooshan's arguments should be disregarded.[73]

19 Qwest's market share estimate of 84 percent misrepresents the CLEC presence in
20 the market. This is due to the fact that Qwest controls 100 percent of the wholesale
21 market, and therefore, controls any portion of the market that is served by CLECs that
22 rely on Qwest's facilities. Further, Qwest is profiting from each of the 104,019 lines it
23 has identified as lines Qwest has lost to CLECs. For instance, if a customer in Seattle

[71] Exhibit 501T at p. 40.
[72] Exhibit 501T at p. 40.
[73] Exhibit 501T at p. 42.

1 chooses to change his business service from Qwest to Integra, then Qwest simply
2 replaces its retail revenue stream with a wholesale revenue stream. It is true that the
3 revenue stream is reduced, but, consistent with this Commission's TELRIC pricing
4 standard, all of Qwest's costs are covered and profits are generated. Consequently
5 Qwest's claims of lost lines and market share, when put in the proper light, are really
6 complaints about reduced profits.[74]

7 There is no criterion in the statute referring to reduced profits. A reduction in
8 market share implies lost revenues and profits, but not from resale. Qwest is still
9 providing the underlying service, controlling the service quality and the cost of service
10 for its dependent competitors. Qwest maintains market power because it is the
11 underlying carrier with control over facilities, quality of service, speed to market, and all
12 other important aspects of service provisioning. Resale is not the type of competition that
13 would ultimately reduce Qwest's market power.[75]

14 The distinction between the *existence of competition* and *effective competition* is
15 based on the ability to control Qwest's activities in the market place. Since Qwest
16 benefits whether it sells the service or a reseller sells the service, resellers are not
17 effective competition. While Qwest would prefer to have all services and all customers,
18 losing a customer to a reseller has less of an impact on its bottom line than losing a
19 customer to a facilities-based provider. When CLECs resell Qwest services, Qwest still
20 has a revenue stream, albeit reduced by the amount of its avoided costs.[76]

21 In his rebuttal testimony, Mr. Stacy performed an analysis, which incorporates
22 and relies upon the data used by Staff in the development of Staff Exhibits 205C
23 (including the additional CLEC lines discovered by Staff), and 209C. This analysis is

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[74] Exhibit 501T at p. 43.
[75] Exhibit 501T at p. 44.
[76] Exhibit 504T at p. 10.

1 illustrated in Exhibit No. 604C. After eliminating Qwest's monopoly wholesale lines
2 from the analysis, Staff's data shows that all CLECs in Washington combined, occupy
3 only 16% of the share of the market on a statewide-average basis. Further, the analysis
4 shows that CLECs have less than a 5% market share in 52 of the 66 exchanges in
5 Washington. In other words, Qwest enjoys a market share exceeding 95% in more than
6 three-quarters of the exchanges in Washington. Qwest's market share is greater than
7 originally reported by Qwest and Staff. Moreover, as illustrated in this analysis, effective
8 competition cannot be considered to be present in Washington.[77]

9 Because individual CLEC market shares in Washington are insignificant in
10 comparison to Qwest's dominant market position. Over the past nine years, the majority
11 of CLECs present in the local exchange market have been able to achieve only
12 inconsequential market penetration. Based on wire center data provided by Staff in Staff
13 Exhibit 209C, the average CLEC market share in any given wire center in Washington is
14 1.5%. Even more illuminating is the fact that the median CLEC market share in the State
15 is 0.3%.[78] These numbers demonstrate the relative insignificance of CLECs in the local
16 market. The following table illustrates the comparison between Qwest market share and
17 that of CLECs in Washington.

18

19

MARKET SHARE COMPARISON		
MEAN CLEC MARKET SHARE	MEDIAN CLEC MARKET SHARE	QWEST MARKET SHARE
1.5%	**0.3%**	**75.5%**

[77] Exhibit 603T at pp. 5-6.
[78] The median market share represents the market share for which one-half of the values are lower and one-half of the values are higher.

1 The data clearly show that individual CLECs have a tiny fraction of the customer base
2 enjoyed by Qwest. As the carrier with significant dominance in the market, if its services
3 were deregulated, Qwest would pose a serious threat to these vulnerable alternative
4 carriers.[79]

5 The Commission should find that the Qwest calculated market shares – based on
6 resold Qwest services – is not sufficient to show that effective competition exists for
7 Qwest's business services at issue in this case. It is clear that Qwest is still the
8 underlying carrier for all the "lost" lines to CLECs and, as such, the customers, while
9 being ostensibly served by a CLEC, are captive customers of Qwest.

10 **Market Concentration**. The United States Department of Justice Horizontal
11 Merger Guidelines use the Herfindahl-Hirshman Index (HHI) to evaluate market
12 concentration.[80] As noted in the Guidelines:

13 Although the Guidelines should improve the predictability of the Agency's
14 merger enforcement policy, it is not possible to remove the exercise of
15 judgment from the evaluation of mergers under the antitrust laws. Because
16 the specific standards set forth in the Guidelines must be applied to a
17 broad range of possible factual circumstances, mechanical application of
18 those standards may provide misleading answers to the economic
19 questions raised under the antitrust laws. Moreover, information is often
20 incomplete and the picture of competitive conditions that develops from
21 historical evidence may provide an incomplete answer to the forward-
22 looking inquiry of the Guidelines. Therefore, the Agency will apply the
23 standards of the Guidelines reasonably and flexibly to the particular facts
24 and circumstances of each proposed merger.
25
26 The results of the market concentration analyses are tempered by the "competitive
27 significance" of the provider. In other words, the Department of Justice must determine,
28 through judgment and analysis, whether the current market share of a particular firm
29 "…either understates or overstates the firm's future competitive significance."[81]

[79] Exhibit 603T at pp. 9-10.
[80] See Link to DOJ/FTC 1992 HORIZONTAL MERGER GUIDELINES
[81] See Horizontal Merger Guidelines at Section 1.52.

1 As noted in the Merger Guidelines, other things being equal, market concentration
2 affects the likelihood that a firm could successfully exercise market power.[82] Qwest's
3 market share of 84 percent is evidence of its ability to exercise market power. Indeed, the
4 Merger Guidelines provide significant guidance on how to view the data in this case.

5 The Merger Guidelines suggest that under certain circumstances, a market share
6 of 35 percent is evidence that consumers would be adversely affected. For instance, at
7 Section 2.211 of the Merger Guidelines it states:

> 8 Where market concentration data fall outside the safe harbor regions of
> 9 Section 1.5, the merging firms have a combined market share of at least
> 10 thirty-five percent, and where data on product attributes and relative
> 11 product appeal show that a significant share of purchasers of one merging
> 12 firm's product regard the other as their second choice, then market share
> 13 data may be relied upon to demonstrate that there is a significant share of
> 14 sales in the market accounted for by consumers who would be adversely
> 15 affected by the merger.

16
17 Section 1.51 addresses the use of the HHI calculations of market concentration.[83] The
18 safe harbor regions are the HHI concentrations listed below:

19 a) Post-Merger HHI Below 1000. The Agency regards markets in this
20 region to be unconcentrated. Mergers resulting in unconcentrated
21 markets are unlikely to have adverse competitive effects and ordinarily
22 require no further analysis.
23 b) Post-Merger HHI Between 1000 and 1800. The Agency regards
24 markets in this region to be moderately concentrated. Mergers
25 producing an increase in the HHI of less than 100 points in moderately
26 concentrated markets post-merger are unlikely to have adverse
27 competitive consequences and ordinarily require no further analysis.
28 Mergers producing an increase in the HHI of more than 100 points in
29 moderately concentrated markets post-merger potentially raise

[82] Section 2.0 of the Merger Guidelines states "The smaller the percentage of total supply that a firm controls, the more severely it must restrict its own output in order to produce a given price increase, and the less likely it is that an output restriction will be profitable." It is clear in this case that Qwest controls the majority of supply (at least 84 percent – Qwest lines, resold lines and UNE-P lines) and that this market presence provides both the incentive and ability to exercise market power in the absence of regulation. The phrase "exercise market power" refers to the ability of the provider to price or control the market in a manner that would harm the public interest.

[83] The HHI index is the most popular summary measure of concentration in markets. See, for example, F.M. Sherer and David Ross, "Industrial Market Structure and Economic Performance" (Houghton Mifflin Company, Boston: 1990) at 72.

significant competitive concerns depending on the factors set forth in Sections 2-5 of the Guidelines.

c) Post-Merger HHI Above 1800. The Agency regards markets in this region to be highly concentrated. Mergers producing an increase in the HHI of less than 50 points, even in highly concentrated markets post-merger, are unlikely to have adverse competitive consequences and ordinarily require no further analysis. Mergers producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns, depending on the factors set forth in Sections 2-5 of the Guidelines. Where the post-merger HHI exceeds 1800, it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise. The presumption may be overcome by a showing that factors set forth in Sections 2-5 of the Guidelines make it unlikely that the merger will create or enhance market power or facilitate its exercise, in light of market concentration and market shares.

An HHI analysis provides an "easy way to gauge the market concentration from available evidence of the relative output of firms in a given market." HHI may range from zero in a perfectly competitive market to 10,000 in a perfect monopoly market.[84]

Qwest did not support its Petition with any evidence of CLEC-owned lines. Qwest states that it "…does not have direct knowledge of the total number of access lines served by CLECs via CLEC-owned facilities."[85] The Commission, however, pursuant to RCW 80.36.330(5) solicited line information from CLECs.[86] The Staff of the Commission reviewed and organized the data received from the CLECs and then distributed the information to the parties.

Based on this Staff-collected data, Staff calculated the HHI indices for the Washington local business market and found that the market is "highly concentrated."

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[84] See Commission's 2000 Order at p. 7.
[85] Id. a page 3.
[86] See ORDER REQUIRING DISCLOSURE OF INFORMATION; ORDER NO. 06; Docket No. UT-030614; dated June 30, 2003.

1 Staff calculations include resale and UNE-P lines in the market share calculations. Even
2 with that data included, however, the Qwest HHI results all **exceed 5,000**.[87]

3 The results of Staff's analysis should be of great concern to the Commission.
4 Nevertheless, both Staff and Qwest argue, "…the results of the HHI analysis do not
5 provide the best representation of the market."[88] In order to preserve their positions in
6 the case, Staff and Qwest must try to discount these results. The market share data
7 provided by Staff does not support its recommendation to the Commission that Qwest's
8 Petition be approved. In fact, based on an analysis which combines the data initially
9 provided by Qwest in this docket with the additional data gathered by Staff, and
10 eliminating CLEC lines provided via UNE-P and resale from the analysis, this data
11 provides support for MCI's recommendation to deny Qwest's Petition.

12 Mr. Stacy, in his analysis, eliminated lines used to provide services via these
13 media because it is appropriate to do so in a market share/market concentration analysis.
14 The Merger Guidelines would consider both resale and UNE-P providers to be
15 "uncommitted entrants."[89] Only CLECs utilizing CLEC-owned or UNE-Loop lines
16 should be considered "market participants."[90]

17 Moreover, it is important to remember that there are two markets that directly
18 impact retail competition in Washington, that is, the retail market and the wholesale
19 market. Qwest is the sole supplier of wholesale inputs for CLECs providing retail service
20 via UNE-P and/or resale, and, therefore, as the monopoly provider to captive CLEC
21 customers of Qwest, Qwest is in the position to dictate what services end-use customers
22 may choose from and at what price. Qwest is the underlying carrier of these lines to

[87] See Exhibit 201T at Exhibit 208C. See also Exhibit 101 at pages 8-9; Exhibit 504T at p. 18.
[88] See Exhibit 201T at page 19.
[89] See Horizontal Merger Guidelines at Section 1.32.
[90] Exhibit 504T at p. 21.

1 CLECs and, as such, the retail customers, while ostensibly served by a CLEC, remain
2 captive customers of Qwest. Because of Qwest's complete monopoly in the wholesale
3 market, it is not appropriate to include services offered by CLECs though resale or UNE-
4 P in any market share analysis. To do so would skew the results of the analysis and
5 understate Qwest's presence in the marketplace.[91]

6 If Staff had considered only the CLEC-owned and UNE-Loop lines, the
7 concentration ratios would have been much higher. Mr. Stacy provides an analysis of the
8 results with more reasonable inputs. The data show that of the 66 exchanges in
9 Washington, 28 would have an HHI value of 10,000. The United States Department of
10 Justice regards an HHI of 10,000 as representing a "pure monopoly".[92] In the remaining
11 exchanges, the HHI ranges from 5,327 to 9,993, indicating an extremely concentrated
12 market. This evidence demonstrates that the local market for the Petitioned Services is
13 not subject to effective competition at this time. To the contrary, the figures indicate that
14 Qwest continues to maintain a dominant position in the marketplace.[93]

15 MCI agrees with Staff that a market concentration analysis is static. This is a
16 primary reason that it was not a major part of MCI's initial analysis. However, Staff fails
17 to mention that *any* market share analysis (including the analysis offered by Staff in
18 support of Qwest's Petition) suffers from the potential of rapidly becoming stale. This is
19 because should Qwest receive the relief sought in this proceeding, market dynamics will
20 undoubtedly change dramatically, and likely in favor of Qwest. After all, Qwest seeks
21 deregulation here presumably to improve its opportunity to win back market share that it
22 has lost over the past nine years. Therefore, while it is true that market share data today
23 will likely not be valid 12 or 18 months from now, it is very unlikely that the results of a

[91] Exhibit 603T at p. 3.
[92] U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines.
[93] Exhibit 603T at pp. 6-7.

1 market share/market concentration analysis performed in the future would show results
2 that are more in line with Staff and Qwest's recommendations today. Future analysis
3 would, more likely, show an increase in Qwest's market share. In other words, even if
4 the Commission were to conclude that the market share analyses performed in this docket
5 would support granting Qwest's Petition, that information in and of itself would be
6 insufficient to grant Qwest's Petition because of the negative impact on the public
7 interest on a going forward basis.[94]

8 As quoted above, if as the result of proposed market modifications, the HHI
9 would rise by 100 or more points, it is a matter of significant concern. Staff's
10 observations about current competitor market share project from the present retail price
11 regulated service into a non-price regulated future without accounting for the radical
12 change in the competitive environment that would result from retail deregulation of
13 Qwest. There is no basis in evidence for Staff's conclusion that competitor market share
14 would be maintained into the future, much less grow in the new environment, and much
15 reason for concern that Qwest's new and virtually unfettered pricing opportunity would
16 produce quite the opposite result, resulting in a more concentrated market.[95]

17 Some academics suggest that dominance in the market is more of a problem than
18 oligopoly. For instance, William Shepherd states,

> 19 Another interesting HHI property is that dominance has very high values.
> 20 Thus a share of 60 percent has an HHI of 3,600, which is much higher
> 21 than the tight-oligopoly threshold value of 1,800. This suggests, correctly
> 22 on the whole, that dominance is a much more serious problem than even
> 23 tight oligopoly.[96]

24

[94] Exhibit 603T at pp. 7-8.
[95] Exhibit 603T at p. 8.
[96] See, William G. Sheperd, "The Economics of Industrial Organization", (Prentice Hall, Englewood Cliffs, New Jersey; 1990), at 67.

Staff and Qwest argue that the HHI results are overstated. If anything, the HHIs are understated. First, including resale and UNE-P lines (which are not competitively significant) overstates CLEC market share, which is results in a lower HHI. Second, Staff calculates an HHI based on an erroneous assumption – that the cumulative market share of all CLECs is the appropriate measure of competition faced by Qwest. This assumption – taking all CLECs together as opposed to individually – dramatically understates the HHI. By taking the total market share of all CLECs, Staff's analysis assumes that the CLECs are working together -- using their combined resources in a coordinated manner -- in one statewide, orchestrated attack against Qwest. This is clearly not the case. The CLECs are competing against Qwest, but they are also competing against one another. To group all CLECs together suggests a much more effective competitive threat to Qwest than is actually occurring in the State. As discussed by Mr. Stacy, Qwest enjoys a market share exceeding 95 percent in more than three-quarters of the exchanges at issue in this proceeding.[97]

The guidelines state that there would be "…significant competitive concerns" if concentration increases over time. Indeed, where the post-merger – or in this case, post competitive classification – HHI exceeds 1,800, "…it will be presumed that mergers producing an increase in the HHI of more than 100 points are likely to create or enhance market power or facilitate its exercise."[98] That section also notes that mergers producing an increase in the HHI of more than 50 points in a highly concentrated market raise significant competitive concerns.

If Qwest receives the regulatory flexibility it seeks in this case, it will likely use that ability to win back customers. Even if we assume the worst-case scenario, where

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[97] Exhibit 504T at p. 19.
[98] See Horizontal Merger Guidelines at Section 1.51.

1 Qwest has only 75 percent of the market, a one percent increase in market share will
2 result in a 147-point increase.[99] This result, which is very conservative given Qwest's
3 market presence and resources, is three times higher than the Merger Guideline for
4 raising "significant competitive concerns."[100]

5 Qwest's market share would likely not go down if the Commission granted
6 Qwest's Petition. But even if it did go down, that would not necessarily mean that
7 Qwest was harmed. One of the benefits of competition is the stimulation that occurs as a
8 result of rivalrous behavior. Not only do consumers see new and innovative services,
9 better customer service and lower prices, but the market itself grow. In other words, one
10 of the results of competition is growth in the "pie." This growth in the market may
11 actually mask Qwest's growth in revenues even in the face of a market share decrease.[101]

12 **Growth in market share.** RCW 80.36.330(1) identifies growth in market share
13 as a consideration in determining whether effective competition exists. Not surprisingly,
14 Qwest has focused on this measure. If an analysis starts with a small number and doubles
15 it, the analysis still has a small number, despite the 100 percent increase. Qwest has
16 calculated growth in CLEC market share of about 32 percent from December 31, 2001
17 through December 31, 2002.[102] Even a growth rate of 32 percent for CLEC owned loops
18 would likely result in a very small total percent of the market. [103]

19 **Ease of entry.** Qwest's testimony also attempts to address the issue of ease of
20 entry. Indeed, Mr. Reynolds testifies, "By using Qwest's facilities, CLECs can enter the

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[99] HHI for 75 percent market share would be 5658. HHI for 76 percent market share would be 5805. The difference would be 147.
[100] Exhibit 504T at pp. 19-20.
[101] Exhibit 504T at pp. 20-21.
[102] See Exhibit 1T at page 13.
[103] Exhibit 504T at p. 44.

1 market with ease."[104] Again, Qwest is relying on a "resale" standard for competition
2 instead of a "facilities-based" standard. If AT&T had been allowed to rely upon a
3 "resale" standard for deregulation, it would have been declared non-dominant in the mid
4 1980s instead of the mid 1990s. Assuming Qwest's numbers, CLECs have only gained
5 about 16 percent of the market with resale in 7 years. The CLEC-owned line market
6 share is obviously much less. Entry into the local market is anything but easy.[105]
7 Qwest has attempted to show that a vibrant CLEC industry is taking its market
8 share and growing dramatically such that Qwest needs the Commission to step in and
9 allow Qwest to compete on the same terms.
10 The telecommunications industry grew almost uncontrollably as an initial
11 response to the passage of the 1996 Act. After a few years of very limited success in
12 trying to break into the local market, however, intense scrutiny of companies and
13 business plans took the glow off the CLEC industry. The CLEC industry imploded in
14 2000, and the entire telecommunications sector suffered with it. The CLEC industry has
15 still not recovered.[106]
16 Mr. Gates presented an analysis that calculates the dramatic change in market
17 value of the CLEC industry over the period of December 31, 1999 through January 17,
18 2003 based on the value of the common shares held by investors.[107] For the major IXCs,
19 the total decline in market capitalization over this period is a devastating 92 percent. The
20 total decline in market capitalization for the CLECs and wholesale suppliers during that

[104] See the Exhibit 1T at page 14.
[105] Exhibit 501T at p. 46.
[106] Exhibit 501T at pp. 46-47.
[107] Exhibit 503

1 same period was a staggering 86 percent.[108] The RBOCs had a decline in market
2 capitalization over the same period of 49 percent.[109]

3 Of the 40 companies comprising the CLEC and IXC categories (Categories 1 and
4 3), of Mr. Gates' analysis, 18 have filed for bankruptcy protection since December 31,
5 1999 with seven of these filings occurring in the six months preceding the filing of his
6 testimony in this case.[110] A few of the carriers that initially filed for protection have
7 since closed down their operations and sold off their assets to competitors. The number
8 of CLECs and IXCs that have reported negative stockholders' equity due to accumulated
9 operating deficits increased to 28 as of January 17, 2003 compared to eight as of
10 December 31, 1999.[111]

11 The analysis demonstrates that the competitive carriers have suffered serious
12 financial setbacks over the last two and one-half years. The capital markets have dried up
13 for these providers and expanding operations is becoming more difficult. A more
14 detailed breakdown of the decline in market capitalization for these three categories of
15 carriers is found in Attachment 1 to Mr. Gates' study.[112]

16 Thus, contrary to Qwest's claims, all is not well in the CLEC industry. Moreover,
17 as discussed further below, the FCC has changed the rules for the ILECs' unbundling
18 obligations, which may further hinder the development of competition and creates
19 additional uncertainty for CLEC business plans. This means that the Commission cannot
20 rely on the CLEC industry to protect the ratepayers from Qwest's efforts to raise prices.
21 Further, the Commission should recognize that carriers operating in Washington are not

[108] Exhibit 503, Attachment II lists the companies for which the change in market capitalization has been calculated.
[109] Exhibit 501T at p. 47.
[110] See detailed listing of bankruptcy filing dates on Exhibit 503, Attachment II.
[111] The 28 carriers with Stockholder's Deficits as of August 28, 2002 include carriers that have filed for bankruptcy since December 31, 1999; Exhibit 501T at p. 49.
[112] Exhibit 501T at p. 49.

insulated from the financial difficulties of the CLEC industry and that for the foreseeable future most CLECs will remain dependent on Qwest for UNEs, access, and interconnection services. As discussed at length by Mr. Stacy, this dependency makes the CLECs extremely vulnerable to anti-competitive pricing strategies that Qwest could employ under its deregulation proposal. To be sure, if the Commission approves Qwest's proposal, then the long-term viability of CLECs that use Qwest's UNEs is seriously impaired.[113]

Theoretically, if the services are fully competitive, then the Commission could forebear from enforcing quality of service rules. In other words, if the services in question are fully competitive, then the market forces are sufficient to ensure quality service to consumers at reasonable rates. If the Commission is not willing to deregulate Qwest with respect to quality of service, it should also not deregulate Qwest's prices, terms and conditions for those services. MCI is not recommending in this docket that the Commission relieve Qwest of quality of service obligations. The point is that when effective competition is present, market forces will ensure quality services at competitive rates. As the evidence in this case has demonstrated, however, effective competition does not exist today for Qwest's services. As such, the Commission must continue to regulate quality of service and other aspect of service delivery; not only to consumers, but to dependent competitors.[114]

V. OTHER ISSUES

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

Triennial Review Issues Will Dramatically Impact the Industry. There is no question that the FCC's recently released Triennial Review Order will dramatically

[113] Exhibit 501T at pp. 49-50.
[114] Exhibit 501T at pp. 50-51.

1 impact the industry, the status of competition and the ability of CLECs to compete with
2 the ILECs in the provision of local services in the future. The FCC has identified two
3 markets – the enterprise market and the mass market – and is treating unbundled
4 switching differently in each.[115] The difference between UNE-P and UNE-Loop is, of
5 course, the switching UNE. For the enterprise market customers, the FCC has concluded
6 that CLECs are not impaired without access to unbundled switching, however, the state
7 commissions may petition the FCC within 90 days for a waiver of this finding.[116] For
8 mass-market customers, the FCC adopted a national finding that CLECs are impaired
9 without access to unbundled switching, subject to state commission findings.[117] The FCC
10 adopted a complicated multipart test that states must apply in determining whether to
11 remove UNE switching for the mass market. The states are given some discretion to
12 define the precise line between the enterprise and mass markets and to define the
13 geographic market for application of the FCC's impairment tests. The FCC has now
14 eliminated UNE-P for "enterprise" customers and no carrier has filed a petition here in
15 Washington to challenge that finding. Therefore, Qwest is no longer required to provide
16 UNE-P for "enterprise" customers here.

17 There is no question that if UNE-P is no longer available in its current form that
18 the ability of CLECs to compete in the local market – even on a resale basis -- will be
19 significantly impaired. UNE-P is the only resale pricing that permits switchless carriers
20 or carriers who do not have facilities in a given area to accumulate customers on the basis
21 of TELRIC costs of the platform elements. It is a primary market entry strategy for
22 competitors who wish ultimately to become effective competitors to monopoly services.

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[115] Enterprise market customers are those that could be economically served by a DS1 loop, even if they presently are being served by DS0 loops. Mass-market customers are those that could not be economically served by a DS1 loop.
[116] See TRO at paragraph 451.
[117] See TRO at paragraph 459.

1 As referenced above, Section 1.521 of the Federal Horizontal Merger Guidelines
2 discusses changing market conditions and the impact of those changes on the firm's
3 competitive significance. For instance, as a result of the Triennial Review Order, UNE-P
4 is eliminated for a sector of the market. Thus, the availability or cost of services
5 currently available to CLECs is significantly changed. That fact changes the relative
6 strength of Qwest's position in the market. The Guidelines state, "However, recent or
7 ongoing changes in the market may indicate that the current market share of a particular
8 firm either understates or overstates the firm's future competitive significance."
9 This is yet one more reason why the Commission should not grant Qwest's
10 request for competitive classification of its business services at this time.
11 **B. Cost floor**
12 Other than the requirement that rates must preserve affordable universal service, the
13 Commission is only required by the statute to determine the "proper cost standards." This
14 determination is critical in that the extent to which Qwest could execute a price squeeze on
15 its competitors is dependent upon the retail rates Qwest is allowed to charge.
16 In general, given Qwest's market position, there are two forms of pricing strategies
17 that should concern the Commission in granting Qwest pricing flexibility. Absent existing
18 restrictions, Qwest could do either one or both of the following:
19 (1) *Increase* its retail rates and earn supra normal profits at the expense of
20 ratepayers; and/or,
21 (2) *Lower* its retail rates below a relevant price floor in select circumstances to
22 defeat competitors.[118]
23
24 These two pricing strategies are not mutually exclusive. To the contrary, the two
25 strategies are most effective for Qwest if they are executed simultaneously. In that manner,

[118] Once Qwest has defeated its competitors through anticompetitive pricing, it will be able to raise its retail rates to the detriment of ratepayers; Exhibit 601T at p. 18.

1 Qwest would be able to fend off competitors by selectively lowering rates for certain
2 services in the pockets where it faces some competition and/or it knows that CLECs have
3 facilities, while remaining optimally profitable by raising rates for customers not subject to
4 competition. This is of particular concern in Washington given the fact that competitive
5 activity is not pervasive throughout the state. A carrier with a significant market dominant
6 position (such as Qwest) may view short-term losses, as a cost of doing business that would
7 be more than recovered in the long term, when competition is eliminated.[119]

8 If Qwest's application for reclassification were to be approved by the Commission,
9 Qwest would have the ability to price local exchange service in such a way that it would be
10 impossible for competitive carriers to respond profitably. Under these conditions,
11 competitors would have a disincentive to enter or remain in the market. Qwest can
12 accomplish this objective by engaging in classic price squeeze tactics.[120]

13 A price squeeze is created when a vertically integrated firm (such as Qwest) has
14 unrestrained retail pricing freedom to compete against companies (such as CLECs) in retail
15 markets while controlling critical inputs that its competitors are dependent upon. In this
16 situation, the vertically integrated firm can use the price squeeze as an anticompetitive
17 device by lowering the price for the retail service to or below the price which it charges for
18 the wholesale elements necessary for competitors to compete, thus squeezing the dependent
19 competitors' margins between retail rates and wholesale rates, and reducing or eliminating
20 their ability to recover their costs. A price squeeze can more formally be defined as follows:

> 21 Considering a situation in which a monopoly supplier is integrated
> 22 downstream, a price squeeze [is] the situation in which "the monopoly
> 23 input supplier charges a price for the input to its downstream competitors

[119] Exhibit 601T at pp. 18-19.
[120] Exhibit 601T at p. 19.

1 that is so high they *cannot profitably* sell the downstream product in
2 competition with the integrated firm[121]" (Emphasis added.)
3
4 The FCC discusses the price-squeeze strategy and notes that it occurs when a
5 dominant firm with downstream competitors that rely on facilities and services from the
6 dominant firm is "charging prices for inputs that preclude[] competition from firms relying
7 on those inputs.[122]" The upshot of a price squeeze is that competitors would have to pay
8 more to their wholesale provider than they can charge to their end-users, thereby losing
9 money on every customer. In this docket, the dominant firm (Qwest) is obviously not
10 seeking to increase the price of its competitor's inputs (UNEs), as the Commission has
11 previously set those. Nevertheless, what Qwest *does* seek in this docket (unrestricted retail
12 pricing capabilities) would provide Qwest with the very same opportunities to execute a
13 price squeeze.[123]

14 The table below provides a simple example of how Qwest could execute a price
15 squeeze in Washington using the retail pricing freedom it seeks in this case. By setting
16 its retail prices at levels that are lower than the levels at which its UNE elements which
17 make up the service are priced, Qwest would put its competitors in an extremely difficult
18 position in which the CLEC would be faced with one of two options: (1) price its retail
19 service to end-users at levels higher than Qwest (significantly reducing the opportunity
20 for attracting new customers and likely losing existing customers to Qwest), or (2) set
21 prices at a level which would be competitive with Qwest, but would not recover the costs
22 of providing the service (taking a loss on each existing and/or new customer). Obviously,
23 neither option would be attractive to any CLEC and would have a chilling effect on

[121] Jean Tirole, "The Theory of Industrial Organization," The MIT Press, Cambridge, Massachusetts, 1988, page 186. Tirole quotes from Joskow, P. 1985. Mixing Regulatory and Antitrust Policies in the Electric Power Industry: The Price Squeeze and Retail Market Competition. In "Antitrust and Regulation: Essays in Memory of John J. McGowan," ed. F. Fisher. City: Publisher.
[122] *Sprint v. FCC,* 274 F.3d 549, 551 (2001); Exhibit 601T at pp. 19-20.
[123] Exhibit 601T at p. 20.

1 competition in Washington.

2 **PRICE SQUEEZE EXAMPLE**

QWEST'S WHOLESALE INPUT PRICE	QWEST'S RETAIL PRICE	CLEC LOSS
$15	**$12**	**-$3**

3

4 In this manner, Qwest could squeeze competitors out of the marketplace and eliminate any
5 and all competition by simply setting prices at levels that do not recover the costs of offering
6 the service.[124]

7 In simple terms, most CLECs live or die by the margins between the wholesale rates
8 for UNEs and their retail rates. That margin must cover the CLECs' own costs and provide
9 a return on investment, if the CLECs are ever to become effective competitors. The larger
10 the margin between the wholesale rates CLECs pay to Qwest and the retail rates they can
11 charge in the market place, the larger will be their profits – if any – or the smaller will be
12 their losses. If that margin shrinks, so will the CLECs' ability to operate in Washington.
13 Thus, if Qwest is granted the nearly unrestricted downward retail flexibility it is asking for,
14 Qwest will be able -- at will -- to increase or decrease the margin available to its dependent
15 competitors. As such, Qwest is largely in control of the strength and viability of its
16 competitors, which -- coming full circle -- are the very companies that Qwest claims will
17 protect customers from a deregulated Qwest. The construct underlying Qwest's proposed
18 reclassification is deeply flawed: *to be sure, if granted as proposed, it will "place the fox in*
19 *charge of the hen house."*[125]

20 Qwest attempts to defend its case by arguing that Qwest's retail rates are currently
21 higher than UNE rates. However, this testimony only serves to provide an explanation as to

[124] Exhibit 601T at pp. 20-21.
[125] Exhibit 601T at pp. 21-22.

why competitive activity *currently* exists, because the relationship Mr. Reynolds describes must exist in order for CLECs to offer retail services profitably. CLECs relying on Qwest to provide UNEs in order to offer retail service could not be in the market if Qwest's UNEs were priced higher than Qwest's retail rates. That relationship exists because both Qwest's UNE prices and its retail prices are subject to regulation by this Commission. Mr. Reynolds' testimony regarding this issue should give the Commission no confidence whatsoever regarding whether CLECs will have the ability to continue to offer retail service in competition with Qwest. This is due to the fact that Qwest would have the power to reverse the current UNE/retail rate relationship, and would therefore have the ability to control when and if CLECs could compete in the retail market in the future.[126]

Qwest's ability to price at anti-competitive levels could be potentially damaging to facilities-based CLECs as well. Facilities-based competitors are often not facilities-based for 100 percent of the facilities that they use to serve their customers. They often purchase collocation, UNE loops, transport, dark fiber, and other elements that they use in conjunction with their own facilities to provide a finished retail service to their customers. As such, they would be very vulnerable if Qwest were to move its own retail prices down closer to the prices that they pay Qwest for the elements they must have to compete. In addition, facilities-based competitors have generally made very substantial investments in switches, collocated equipment, and other plant to provide service to their customers. Should Qwest be given the freedoms it seeks and exercises its ability to squeeze its competitors from the market, these carriers would have no way of recovering this massive investment.[127]

In short, both facilities- and non-facilities-based CLECs would suffer as a result of

[126] Exhibit 601T at pp. 22-23.
[127] Exhibit 601T at pp. 23-24.

1 reclassification. Needless to say, Washington consumers would suffer as well if Qwest were
2 permitted to undo the emerging consumer benefits of competition that have been a goal of
3 this Commission for many years.[128]

4 After competing firms have been driven from the marketplace through Qwest's
5 below cost pricing, Qwest would no longer be constrained by competitive pressure from
6 raising prices to levels well in excess of cost. In other words, once the price squeeze has
7 successfully eliminated competitors, Qwest could freely increase prices to monopoly profit
8 maximizing levels without any threat of a competitive response. In the long run, consumers
9 would therefore not experience prices that are competitively driven. Rather if the Petitioned
10 Services are classified effectively competitive, customers could expect to experience prices
11 well in excess of cost, and (since alternative providers have exited the market) have no
12 alternative but to pay those prices. Even in the short term, Qwest's pricing tactics would not
13 likely provide widespread benefits to customers in Washington. This is because the
14 temporary price reductions would likely be limited to the CLEC's largest customers whom
15 Qwest is most interested in winning back. In short, although a pricing strategy that includes
16 reductions in retail rates appears on its face to be appealing from a consumer perspective, in
17 actuality, such a scheme will result in higher, rather than lower rates and in much narrower
18 choices of providers and services for consumers.[129]

19 Staff argues that because Qwest is able to achieve sufficient revenue in every wire
20 center to pass an imputation test, "competitors can, too".[130] Unfortunately, this
21 observation is meaningless in terms of assisting the Commission in its decision regarding
22 whether sustainable, effective competition is present in Washington. This is because
23 once again, this conclusion is based on static analysis that does not take account of the

[128] Exhibit 601T at p. 24.
[129] Exhibit 601T at pp. 25-26.
[130] Exhibit 201T at page 22.

1 dramatic changes to the competitive market that would result from granting Qwest's
2 Petition. One of the major threats to the competitive market, should Qwest's Petition be
3 approved, is Qwest's ability to engage in price squeeze tactics, including setting prices
4 that do not pass a break-even test. Therefore, the concern is not so much whether Qwest
5 is passing such a test at this point in time, but rather, whether if Qwest will have the
6 essentially unrestrained opportunity to engage in pricing tactics in the future that would
7 result in Qwest's failing the test. Passing a break-even analysis test now – prior to
8 deregulation – should be of little comfort to the Commission on a going forward basis.
9 Qwest, to date, has given the Commission no assurance that it will set prices which
10 would pass a break even test in the future, or that it will set prices that cover costs, as
11 required by RCW 80.36.330(3).[131]

12 Should the Commission determine that it is appropriate to award Qwest some
13 level of additional regulatory freedom, MCI recommends that such freedom be strongly
14 conditioned to prevent the potential for Qwest to engage in anti-competitive pricing
15 strategies that could quickly eradicate the gains the competitive market has made in
16 Washington in recent years. Specifically, at a minimum, the Commission should impose
17 a price floor consistent with RCW 80.36.330(3), below which Qwest would not be
18 allowed to set retail rates. Generally speaking, the Commission should set the floor
19 using, at a minimum, the following two cost components:

20 *(1)* *Imputed costs of all the UNEs used to provide the service.*
21 This should be calculated by multiplying the quantity of the UNEs used to
22 provide the service *times* the UNE TELRIC prices. Also included should be
23 some recognition of the non-recurring charges to order UNEs.
24
25 *(2)* *A measure of minimum retail related costs.*
26 An appropriate proxy for these retail costs could be established by using the
27 Commission approved percentage for resale discounts. The Commission

[131] Exhibit 603T at pp. 12-13.

1 should recall that the resale discount is calculated based on Qwest's retail
2 related expenses.[132]
3

4 **C. Access charges**

5 Another issue that should be on the Commission's mind when it considers
6 Qwest's Petition in this docket is access charges. The fact remains that Qwest is the
7 incumbent provider of the last mile and that alternative toll providers must still pay
8 Qwest for access. Those access rates are not priced at TELRIC[133] levels and include
9 significant contribution with which Qwest can subsidize its local and long distance
10 competitive offerings.[134]

11 Commission rule WAC 480-120-540 identifies the structure for access charges.
12 That structure includes costs that are not TELRIC compliant – the Interim Terminating
13 Access Charge or ITAC. The ITAC is really a universal service surcharge and should not
14 be included in the access charge structure.[135]

15 Qwest's access charges are designed to subsidize local rates. In the recent Order
16 in the AT&T Access Complaint proceeding, this Commission notes:

17 Historically, access charges have provided a substantial portion of local
18 exchange company revenues and have assisted, along with averaging of
19 rates across high-cost and low-cost locations, in keeping rates for local
20 exchange service lower than might be otherwise necessary.[136]
21

[132] Exhibit 601T at p. 8.
[133] TELRIC stands for Total Element Long Run Incremental Cost. The FCC defines TELRIC as, the forward-looking cost over the long run of the total quantity of the facilities and functions that are directly attributable to, or reasonably identifiable as incremental to, such element, calculated taking as a given the incumbent LEC's provision of other elements. (47 C.F.R. Section 51.505(b))
[134] Exhibit 501T at p. 51.
[135] Exhibit 501T at p. 51.
[136] See ELEVENTH SUPPLEMENTAL ORDER; ORDER SUSTAINING COMPLAINT, DIRECTING FILING OF REVISED ACCESS CHARGE RATES; Docket No. UT-020406; Released August 12, 2003 at pages 11-12. Hereinafter "Verizon Access Charge Order".

This is not unusual, since other states have also allocated the cost of the loop to other services. It is time, however, to rationalize the rate structure and make all subsidies explicit and portable.

The FCC also recognized that access charges subsidize local offerings. In the FCC's First Report and Order in CC Docket 96-45 the FCC stated:

> States have maintained low residential basic service rates through, among other things, a combination of geographic rate averaging, high rates for business customers, high intrastate access rates, high rates for intrastate toll service and high rates for vertical features and services such as call waiting and call forwarding.[137]

The intrastate access charges cause market distortions by virtue of the excessive contribution they provide to Qwest. Access charge reform must be completed before Qwest is deregulated.

This Commission recognized the need to restructure access charges in its recent Verizon Access Charge Order. At page 12 of that Order it states:

> It is clear that competitive circumstances have changed radically since the Commission's orders in U-85-23. The level and the structure of access charges that were permissible and competitively neutral when first adopted are now impermissible. And the record is also clear that an activity countenanced in one rule may—inadvertently or not—act to stifle competition, and therefore violate another rule or law.

Access is a monopoly offering that provides significant contribution for Qwest. From a shareholder perspective, Qwest would be remiss to voluntarily reduce such rates. Nevertheless, the public interest requires Qwest to rationalize its rate structure and make the implicit subsidies within access charges explicit.[138]

The industry is moving toward more and more bundled offerings. MCI's "The Neighborhood" offering combines local, long distance and other features into one flat-

[137] Before the Federal Communications Commission; In the Matter of Federal State Joint Board on Universal Service; CC Docket No. 96-45; **REPORT AND ORDER**; dated May 8, 1997; at ¶ 14.
[138] Exhibit 501T at p. 53.

1 rate package. Qwest is offering similar "bundled" services. Assuming the best possible
2 outcome – that Qwest does reduce service prices instead of raising them – then the
3 services will be priced closer to cost. The margins for those services will be reduced
4 thereby providing benefits to consumers. Qwest, however, will be able to use the
5 subsidies inherent in access charges to subsidize its competitive offerings to the detriment
6 of its competitors. In effect, Qwest can subsidize its competitive offerings with profits
7 from its competitors. Mr. Stacy discusses this phenomenon in his testimony.[139]

8 RCW 80.36.186 requires that carriers offering noncompetitive services provide
9 rates and access that are not unduly discriminatory and are not preferential or causing
10 competitive disadvantage.[140] The Commission found in the Verizon Access Charge
11 Order that "By maintaining high access charge rates, Verizon provides a preference to
12 itself and a disadvantage to its competitors in interexchange service within Verizon's
13 territory."[141]

14 The industry has recognized that implicit subsidies must be removed for the
15 market to work efficiently. The FCC noted:

16 It is widely recognized that, because a competitive market drives prices to
17 cost, a system of charges, which includes non-cost based components, is
18 inherently unstable and unsustainable. It also well recognized that access
19 charge reform is intensely interrelated with the local competition rules of
20 section 251 and the reform of universal service.[142]
21
22 In its access charge reform proceeding, the FCC reiterated the benefits of moving
23 access charges to cost:

[139] Exhibit 501T at p. 53.
[140] See Verizon Access Charge Order at page 13.
[141] Id. at 14.
[142] See *Local Competition Order,* at ¶ 8.

1 Restructuring rates to reflect more accurately cost-causation will promote
2 competition, reduce per-minute charges, stimulate long-distance usage,
3 and improve overall efficiency of the rate structure.[143]
4
5 The FCC also encouraged the states to identify intrastate implicit subsidies:

6 Congress intended that states, acting pursuant to sections 254(f) of the
7 Communications Act, must in the first instance be responsible for
8 identifying intrastate implicit universal service support. Indeed, by our
9 decisions in this Order and in our companion *Universal Service Order*, we
10 strongly encourage states to take such steps.[144] (Emphasis in original)
11
12 The FCC has made considerable progress in moving interstate access charges
13 towards cost. The CALLS[145] and MAG[146] Orders issued in 2000 and 2001 respectively
14 have reduced interstate access rates significantly and rationalized the rate structures. The
15 introduction to the CALLS Order states:

16 By simultaneously removing implicit subsidies from the interstate access
17 charge system and replacing them with a new interstate access universal
18 service support mechanism that supplies portable support to competitors,
19 this Order allows us to provide more equal footing for competitors in both
20 the local and long-distance markets, while still keeping rates in higher cost
21 areas affordable and reasonably comparable with those in lower cost
22 areas.[147]
23
24 As discussed above, the FCC has recognized that the implicit subsidies in access
25 charges must be removed. It is imperative that those subsidies be removed **before** Qwest
26 receives additional pricing flexibility. With those subsidies from access charges, Qwest
27 will be able to cross-subsidize its competitive offerings on the backs of its competitors.

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[143] Before the Federal Communications Commission; In the Matter of Access Charge Reform; Price Cap Performance /Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges; CC Docket Nos. 96-262, 94-1, 91-213, 95-72; **FIRST REPORT AND ORDER**; Released May 16, 1997; at ¶ 131.
[144] Id. at ¶ 11.
[145] CALLS stands for the Coalition for Affordable Local and Long Distance Service.
[146] The Multi-Association Group (MAG) Plan was put into place for rate of return carriers at the federal level. The Order (FCC 01-304) was released on November 8, 2001.
[147] Before the Federal Communications Commission; In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers, Low-Volume Long Distance Users; Federal-State Joint Board on Universal Service; CC Docket Nos. 96-262, 94-1, 99-249, 96-45; **SIXTH REPORT AND ORDER IN CC DOCKET NOS. 96-262 AND 94-1; REPORT AND ORDER IN CC DOCKET NO. 99-249; ELEVENTH REPORT AND ORDER IN CC DOCKET NO. 96-45;** Released May 31, 2000; hereinafter referred to as the "CALLS Order", at ¶ 3.

1 There is no Washington universal service fund or an intrastate subscriber line charge in
2 Washington. As such, many of the implicit subsidies still remain in Washington's
3 intrastate access charges.

4 Last summer in Colorado the parties signed a stipulation that would have
5 restructured intrastate access charges in much the same manner as MCI proposes in this
6 proceeding. (See Attachment hereto). Intrastate access charges would have been reduced
7 to interstate levels and an intrastate subscriber line charge (SLC) would have been put
8 into place. The access restructuring was revenue neutral to Qwest and the proposed
9 intrastate SLC was less than $2 per month per line. The Colorado Commission
10 ultimately rejected the proposal, but it is important to note that Qwest, AT&T, MCI,
11 Sprint and the Colorado Telecommunications Association supported the proposal.[148]

12 Until access charges are reduced to cost-based levels, Qwest will enjoy an
13 artificial cost advantage in the market place – in both the local and long-distance markets
14 -- that it can leverage into other markets. Allowing Qwest to charge its dependent
15 competitors above cost rates puts those competitors at a distinct competitive
16 disadvantage. Qwest will have every incentive to use those excessive profits against the
17 competitors in the market.[149]

18 MCI recommends that the Commission specifically recognize that the current
19 level of Qwest's intrastate access charges is far above economic cost, is not conducive to
20 an efficient market and that the implicit subsidies in those access charges cause
21 distortions in the market and hamper the development of competition. Further the
22 Commission should initiate a proceeding or rulemaking in which the rules surrounding

[148] Exhibit 501T at p. 56.
[149] Exhibit 501T at pp. 56-57.

the pricing of access and mechanisms for eliminating the implicit subsidies could be considered.

Specifically, MCI recommends that the Commission initiate a proceeding whereby three important issues could be considered:

- The complete elimination of the Interim Terminating Access Charge;
- The refinement of Qwest's access rates so that access charges reflect the economic cost and the rate structure reflects cost causation;
- Development of an intrastate Universal Service Fund to ensure reasonable and affordable rates for all consumers in Washington.[150]

Qwest has failed to show a need for additional pricing flexibility in this proceeding. If Qwest were deregulated under these conditions – the lack of effective competition and access charges far above cost – the public interest would be harmed. The Commission should observe how Qwest behaves now that it has received 271 authority, encourage Qwest to use the pricing flexibility it currently has, fix the remaining rate distortions, and then – if necessary – consider granting Qwest additional pricing flexibility.[151]

VI. CONCLUSION

For all the reasons set forth herein, MCI respectfully requests that the Commission deny Qwest's Petition.

[150] Exhibit 501T at p. 57.
[151] Exhibit 501T at p. 58.

1 Dated this 28th day of October 2003.

2 Respectfully submitted,

3 **MCI**

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5 __________________________________

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