

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of,

QWEST CORPORATION

For Competitive Classification of Basic
Business Exchange Telecommunications
Services

DOCKET NO. UT-030614

COMMISSION STAFF'S REPLY BRIEF

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I. INTRODUCTION

1 Qwest has stated that the reason it seeks competitive classification is because it wants the ability to deaverage its retail prices for the services in the petition. Staff submits that allowing Qwest to lower its retail prices in the lower cost zones is consistent with the public interest because it will result in consumers in lower cost zones paying less for Qwest service, and because it will force CLECs, in turn, to be more efficient.

2 Public Counsel argues that “this petition asks the Commission to authorize retail rate deaveraging for thousands of businesses throughout the state and to delegate the implementation of that decision, for all practical purposes, entirely to Qwest.” Public Counsel Br. at 1. Public Counsel is wrong when it suggests that the manner in which Qwest implements rate deaveraging will be entirely at Qwest’s discretion. Following competitive classification, the Commission will retain powerful regulatory tools over Qwest’s retail pricing in the form of the price floor restrictions of RCW 80.36.330 and the prohibitions on unreasonable preference and discrimination of RCW 80.36.170 and 180.

3 Some parties raise the specter that Qwest may price its services so low as to destroy competition or discourage further competitive entry (despite the price floor protections of the statute). Their arguments come close to advocating a market structure in which the incumbent’s prices are propped up above competitive levels for the benefit of the competitors. The Commission should reject those arguments and grant Qwest’s petition.

II. APPLICABLE LAW

4 WeBTECH argues that the four enumerated factors in RCW 80.36.320(1) together constitute an antitrust-type market power analysis. WeBTEC brief at 4, 5. Staff agrees that the legislature envisioned a type of market power analysis. This is clear from the language of the RCW 80.36.330(1)(d) (“other indicators of market power”). However, Staff would caution the Commission to look primarily to the language of statute and to its own precedent in interpreting and applying the statute to the Washington telecommunications industry. The statute states: “Effective competition means 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).

5 Integra apparently misquotes RCW 80.36.330 for the proposition that the statute requires the Commission to “find that alternative providers can freely and readily make functionally equivalent services available to the market ‘under competitive conditions equivalent’ to Qwest.” Integra Br. at 4. The language in quotation marks in Integra’s brief appears nowhere in the statute. In a similar vein, Integra argues that Qwest’s “monopoly” over the local loop is an “other indicator of market power.” Id. at 4. If Integra’s argument is that the statute precludes competitive classification of Qwest’s local phone services until competitors have duplicated Qwest’s last mile facilities, that would be a strict interpretation of the statute indeed. It is certainly not an interpretation that the Commission has employed in the past. As we stated in our opening brief, the wholesale market for unbundled network elements is intensively regulated to prevent the exercise of monopoly power and will remain that way for the foreseeable future. Staff Br. at 1, 2.

III. DEFINITION OF RELEVANT MARKET

A. DEFINITION OF PRODUCT MARKET

6 The issues surrounding the definition of the product market are (1) whether it was proper for Qwest to include only analog voice services in its petition, (2) whether the proponents have provided adequate evidence of competitive alternatives for the separate services in the petition, and (3) whether the proponents have presented evidence that small businesses have competitive alternatives to Qwest basic exchange services.

1. Qwest may put as few services as it chooses in a petition and ATG and Public Counsel's argument that it should have included more is baseless.

7 ATG and Public Counsel argue that the relevant market includes not only analog local exchange services, but also "digital" services (i.e., ISDN BRI and Digital PBX trunks) because consumers can substitute those services for the services in the petition.

8 This a very puzzling argument to be coming from *opponents* of the petition. Staff witness Robert Williamson, in support of the petition, observed that digital services provided by CLECs can be used as substitutes for business basic exchange service, and as such, "Qwest likely is missing or understating its competitors' market share in basic business exchange services by excluding [from its wholesale line counts] unbundled loops typically associated with digital services." Williamson, Ex. 301T at 7:3-5. Mr. Williamson explained that ISDN BRI service can provide two voice lines (in combination with one data line), and that a T1 can transport 24 business exchange lines across an unbundled digital loop by utilizing CLEC equipment at the end of the T1. *Id.* at 6:13 to 7:1.

The result of a broader relevant market definition that includes more competitive substitutes for the petition services can only be a *smaller market share calculation* for Qwest. In antitrust jurisprudence, much depends on the definition of the market, as many parties have pointed out in their briefs. The proponents of a merger, for example, will try to argue that there are many possible substitutes for the products or services of the merging firms, while the opponents will argue that there are few or none. *See U.S. v. Du Pont (the Cellophane case)*, 351 U.S. 377 (1956) (monopolization case in which the government asserted that the relevant market was cellophane—in which Du Pont held a 75 percent market share—while Du Pont argued that cellophane was but one product in a broader “flexible packaging materials” market). The more products or services that are included in the relevant market, the less significant the merging companies’ market share in that market will appear.¹

Of course, ATG and Public Counsel do not argue that the relevant market should be expanded to include digital services like ISDN BRI because they want Qwest’s market share to appear smaller. Rather, they make the argument because they apparently believe that the consequence of the Commission’s acceptance of this broader market definition would be denial of the petition and an instruction to Qwest to come back with a petition that includes both Qwest’s analog and digital voice services. *But this simply does not follow.* There is nothing in the statute,² or Commission’s rules, or in

¹ To be sure, this is why the opponents of Qwest’s petition in this case have attacked the argument that wireless and VoIP services should be considered as potential substitutes.

² RCW 80.36.330 says “The commission may classify a *telecommunications service* as a competitive telecommunications service if *the service* is subject to effective competition [emphasis added].” The statute refers to “the service” in the singular. Additionally, it would be improper to consider Qwest’s own services as substitutes because, as Qwest points out, the statute directs the Commission to consider the affiliation of providers so that the Commission does not count affiliates of the incumbent as competitors. Qwest Br. at 38.

common sense that says the petitioning company must include in a single petition all of *its own* services that consumer may view as substitutes for one another. As counsel for WeBTEC correctly observes, “There is nothing wrong with Qwest seeking competitive classification of just its analog business exchange services and framing its requests in the sort of broad terms that it has. However, the analysis required to grant that petition must be conducted in a responsible way.” WeBTEC Br. at 10.

10 Without sponsoring a witness of its own, ATG has attempted through cross-examination to manufacture an issue that that should not be in this case: namely, should Qwest be required to include *more* services in its petition? On brief, ATG states that “inexplicably, when describing and measuring the market, Staff totally failed to take Qwest’s own digital services (or for that matter the CLEC’s digital services) into account in this case.” ATG Br. at 12. ATG also faults Staff for accepting “at face value Qwest’s representations that the services for which it petitioned constituted a market.” *Id.* at 15. These statements are nonsensical. The services that are included in a petition do not have to “constitute a market” as among themselves. If the company wishes to file a petition for a single service, it may do so. The analyst’s job is not to look at whether the petitioning company offers services that represent substitutes for the services included in the petition. His job is to look at what services are available from the petitioner’s competitors that represent substitutes to the services for which the petitioner seeks pricing flexibility.

11 This is how this digital/analog market bugaboo appears to have arisen:

12 First, Qwest argued that the three main services—basic business lines, PBX trunks, and Centrex—constitute a single product market because customers can

substitute one for the other. The point here is not that customers can substitute, for example *Qwest* PBX trunks for *Qwest* Centrex service. Rather, it is that customers can substitute *CLEC* PBX trunks for *Qwest* Centrex lines if *Qwest* raises the price of Centrex. This is not a controversial argument nor one that the Commission has not previously addressed. See *WUTC v. US WEST Communications, Inc.*, Docket Nos. UT-911488, UT-911490, UT-920252, Fourth Supplemental Order Denying Complaint; Accepting Tariffs Conditionally; Requiring Tariff/Price List Filing (Nov. 1993).

13 Second, *Qwest* quite reasonably chose not include its ISDN BRI service or the trunks that it supplies for digital PBXs in its petition.³ The reason is that, while these services are similar to those in the petition, they are provided over digital lines. The picture that *Qwest* is able to present, from the wholesale data, of what its competitors are doing becomes less clear when wholesale information about digital lines is introduced. Reynolds, Tr. at 118. By focusing only on wholesale information about analog lines, it is much clearer that what *CLECs* are providing over those analog lines is business class voice services like *Qwest*'s basic business lines, PBX trunks (for analog PBXs), and Centrex.

14 Third, in surveying the *CLECs*, the Commission instructed Staff to gather data on *CLEC*'s market share in basic business lines, PBX trunks, and Centrex services. As a result of motions concerning the content of the *CLEC* data request, the Commission instructed Staff to gather data only about *CLEC*'s analog services in each category. As ATG points out, this results in very (perhaps overly) conservative *CLEC* market share numbers because it excludes digital services that *CLECs* may provide, and that

³ As such, these services will remain rate-regulated until *Qwest* is able to convince this Commission that consumers have reasonably available alternatives to purchasing those services from *Qwest*.

customers may view as, substitutes for basic business lines, analog PBX trunks, and Centrex.

2. The Staff-compiled CLEC data provides the service-by-service analysis that many opponents argue is lacking.

15 WeBTECH argues that Qwest and Staff have failed to analyze each of the services listed in Qwest’s petition and determine what consumers would realistically consider to be substitutes. WeBTEC Br. at 6.

16 It is true that there was very little analysis in the record of “cross-elasticities of demand” among different kinds of services—except as between the petition services and wireless and VoIP service. The reason, however, is that the market share analysis provided by Staff was performed along the three main product lines—basic business lines, analog PBX trunks, and Centrex lines—and only included service offerings, on CLEC side of the equation, that are for all relevant purposes *the same* as those offered by Qwest. Wilson, Ex. 232C (basic business lines); Ex. 204C at 3 (PBX); Ex. 204C at 4 (Centrex).

3. The evidence in this case which shows that competitors provide business basic exchange lines is evidence that small businesses have competitive alternatives.

17 Mr. Wilson pointed out that basic business lines are generally purchased by small businesses while PBX and Centrex are the services purchased by medium and large businesses. Wilson, Tr. at 1507:13 to 1508:4. Staff presented separate data for all three of these services based on information received from the CLECs. Wilson, Exs. 232C, 204C.⁴

⁴ In UT-000883, by comparison, the CLEC line count information was not broken out by the particular type of service being provided by CLECs.

18 Both DoD and Public counsel refer to FCC's definition, in its Triennial Review Order, of three customer class distinctions within the market for local telecommunications service: mass market, small and medium enterprise, and large enterprise. DoD Br. at 11; Public Counsel Br. at 9. The FCC states that "These classes can differ significantly based on the services purchased, the costs of providing service, and the revenues generated." Triennial Review Order (TRO) at ¶ 124.

19 The FCC also notes, however, that while it includes very small business customers in the mass market, it does not do so for all purposes, sometimes including them with other enterprise customers. TRO at fn. 432. One reason it does so is that, unlike residential customers, "very small businesses usually pay higher retail rates, and may be more likely to purchase additional services such as multiple lines, vertical features, data services, and yellow page listings." *Id.* Moreover, the FCC states that some competitive LECs have pursued the medium and large business enterprise markets while others have pursued mass market strategies. *Id.* at ¶ 43. Indeed, the FCC's 2002 Local Telephone Competition Report, Ex. 429 at 16, shows that 46 percent of the lines served by CLECs in Washington are for mass market customers who demand three lines or fewer. While this same data shows that ILECs serve a proportionally greater percentage of mass market customers (76 percent of ILEC lines), this is not a basis to conclude that small businesses lack alternatives.

20 Other than Public Counsel's obviously flawed analysis that purports to show that the average Qwest customer demands fewer lines than the average CLEC customer (*see* Sec. IV.E. below), no party has produced any evidence to support dividing the market for basic business lines further into markets for customers who demand three or

fewer lines and those who demand four or more lines. Public Counsel admits that neither Qwest nor its competitors price discriminate along the lines suggested, Tr. 768:9 to 770:7, and there is evidence that CLECs are actively vying for small business customers. Baldwin, Exs. 431, 432 p. 1 (AT&T website defining small and medium business as 1-15 voice lines); Slater, Tr. at 874:23-24.

B. DEFINITION OF GEOGRAPHIC MARKET

21 The opponents generally characterize Qwest and Staff's testimony and evidence on the geographic dimensions of the relevant market as lumping together all of Qwest's service territory and obscuring variations in competition in different geographic areas.

22 In fairness, Public Counsel does acknowledge that both Staff and Qwest provide exhibits that subdivide the data into regions or zones. Public Counsel Br. at 7. Indeed both Qwest and Staff do provide state total market share percentages, but both parties also provide a great deal of granular data that should allow the Commission to conclude that there is virtually no place in the state that customers do not have competitive alternatives to Qwest service. Wilson, Ex. 232C, 204C, 205C; Teitzel, Exs. 53, 54, 55. While this is not to say that there are no differences in market share levels and in the preferred entry strategy employed by CLECs in different parts of the state, it is to say that virtually everywhere in Qwest territory business consumers have genuine alternatives to Qwest service.

23 The argument of WeBTEC, Br. at 11, ATG, Br. at 22, and DoD, Br. at 17, that every wire center or exchange should be addressed as a separate market would make sense if competitors were limited to competing with Qwest without access to unbundled switching. In such a case, there would be issues of where the CLEC

switches are actually deployed, in which wire centers CLECs have actually collocated, and the like. In other words, the Commission might be looking at a case much like the mass market switching and transport cases under the Triennial Review Order.

However, because the CLECs have the ability to serve customers using UNE-P (which includes unbundled loops and switching), none of these questions is determinative of competitors ability to constrain Qwest's retail pricing. Moreover, none of the likely checks one can make of the CLEC data reveals that there is any geographic distinction that has precluded CLECs from entering the market and from winning customers in significant amounts. Neither the East/West, rural/urban, small town/big town, or high-cost zone/low-cost zone criteria for sorting the data have pointed up any significant captive customer base for Qwest. Neither are any captive customers revealed by Ms. Baldwin's suggestion that the Commission should be particularly wary of a lack of alternatives in exchanges where there are fewer large businesses. Baldwin, Tr. at 745:5 to 748:16.

IV. REVIEW OF STATUTORY FACTORS FOR EVALUATING EFFECTIVE COMPETITION

A. NUMBER AND SIZE OF ALTERNATIVE PROVIDERS

24 In its brief, AT&T argues that the record is unclear about how many CLECs are providing local service to Washington business customers and where they are providing such service. Br. 8-9. Similarly, Integra argues that Qwest did not prove that alternative providers of basic business service exist. Br. 6. The Commission has before it a number of different measurements of the number and size of alternative providers. The best measurements are those provided by Qwest in connection with its wholesale

data and by Staff in connection with CLEC responses to the Commission's Order No. 06.

25 Qwest provides specific information regarding 37 CLECs. Reynolds, Ex. 3; Teitzel, Ex. 55C. Staff provides information aggregated from responses from 27 CLECs providing responses to Order No. 06. Staff further estimated that there could be as many as 40 CLECs providing local service to business customers. Staff, Br. 16-19.

26 ATG argues that the "economic tailspin" experienced by the telecommunications industry resulted in weak CLECs. Br. 23. The telecommunications industry is showing remarkable improvements, including emergence from bankruptcy and growth in market capitalization for publicly traded CLECs. Wilson, Ex. 210TC at 10:20-22; Ex. 211; Shooshan, Ex. 103T at 8:1-3.

27 ATG also states that some of the CLECs are "inactive." Br. 23. ATG seems to base its arguments on the number of registered CLECs or the number of CLECs with interconnection agreements with Qwest. This argument ignores the data collected from CLECs actively providing service and presented by Staff. See Wilson, Ex. 204C; Ex. 205C; Ex. 232.

28 Public Counsel and MCI argue that mere presence is not sufficient to create effective competition and that the CLECs in the market today have negligible market shares. Public Counsel, Br. 10-11; MCI, Br. 4-6. Staff agrees that the mere presence of CLECs is not particularly probative; however, the fact that CLECs are actively providing service in both the urban and rural parts of Qwest's service territory is extremely probative. In addition, the market share of the CLECs providing service in rural areas is significant. For example, the eight to 11 CLECs serving small wire centers

such as Graham, Sequim, Longview, Moses Lake and Shelton, as a group, hold market shares ranging from nine to 20 percent. Wilson, Ex. 232; Wilson, Ex. 208C.⁵

29 DoD argues that the record does not contain data sufficient for the Commission to determine whether the number and size of CLECs results in effective competition. Br. 18-21. While there may not be one exhibit the Commission may turn to regarding the number and size of competitors, the Commission may draw from a number of different exhibits: Qwest Exhibits 3 and 55C regarding CLECs purchasing wholesale inputs, Staff Exhibits 204C and 205C consisting of data compiled from CLEC responses, and Staff Exhibits 208C and 209C containing HHI analyses. The Commission has before it enough evidence to determine that the number and size of CLECs is sufficient for a finding of effective competition.

B. EXTENT TO WHICH SERVICES ARE AVAILABLE FROM ALTERNATIVE PROVIDERS IN THE RELEVANT MARKET

30 Several parties argue that theoretical availability of services from alternative providers is not sufficient, but rather actual CLEC activity should be considered. Public Counsel, Br. 11; AT&T, Br. 9-11; DoD, Br. 22-23. Staff agrees that actual CLEC activity should be at the forefront of the analysis in this case. *See* Staff, Br. 20-21. Evidence that CLECs are actively serving an area is direct evidence that CLECs would be willing to serve other customers in that same area.

31 AT&T and DoD argued that the evidence fails to show that CLECs provide service in all wire centers or exchanges at sufficient levels. AT&T, Br. 9; DoD, Br. 23. DoD further argues that the high level of aggregation makes it impossible to assess the

⁵ The HHI analysis shown in Exhibit 208C is based on the wholesale numbers provided by Qwest and does not include CLEC-owned lines. As such, the market shares reflected in this exhibit are understated. Even so, they indicate that robust, effective competition exists.

extent to which services are available. Br. 23. Staff agrees that the aggregated nature of the data provides an obstacle; however, Staff aggregated the data in such a way to provide the most transparency possible. Wilson, Tr. at 12-14. Moreover, the data in this case indicate that customers throughout Qwest's service territory have the ability to choose service from Qwest or a CLEC. Staff, Br. 20-21.

32

C. ABILITY OF ALTERNATIVE PROVIDERS TO MAKE FUNCTIONALLY EQUIVALENT OR SUBSTITUTE SERVICES AVAILABLE

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

a. UNE-P based competition is effective competition within the meaning of RCW 80.36.330 and should not be discounted.

33

It is true that competition in many Qwest exchanges in Washington relies in large measure on the use of UNE-P (i.e., the combination of unbundled loops and switching) that competitors obtain from Qwest. The record demonstrates that competition utilizing UNE-P is a strategy in which CLECs are willing to invest in virtually every part of Qwest's service territory. This is demonstrated by actual CLEC market entry. One statistic is particularly compelling: CLECs offer services in competition with Qwest utilizing the unbundled network element platform in exchanges that account for 99.7 percent of Qwest's access lines (61 of 68 exchanges). Qwest Br. at 19.

34

The petition opponents insist that this UNE-P based competition should not be considered or should be given very little weight under RCW 80.36.330. The reasons they give for discounting this form of competition are that (1) competitors that use unbundled Qwest switching lack the ability to distinguish their services from Qwest's,

(2) Qwest has the ability to control the viability of this form of competition by creating a price squeeze or engaging in discriminatory provisioning, (3) unbundled switching for the mass market may become unavailable as a consequence of the Triennial Review Order impairment proceedings, and (4) competitors who use UNE-P have not had to incur any substantial investment.

35 The reasons the Commission should not be persuaded by these arguments are as follows:

i. Inability to distinguish

36 The inability to distinguish is not a negative for purposes of market power analysis—it means the service represents a perfect substitute in the same way that generic products represent a substitute for brand name products. This argument undervalues the importance of competition based on price, as opposed to distinctive features.

37 To the extent this argument is intended to suggest that CLECs who use UNE-P lack the ability to win customers, it ignores the “proof of the pudding.” UNE-P is enormously successful by various measures, such as its rate of adoption by CLECs and the geographic ubiquity of its use. UNE-P based competition is where many competitors are putting their investment and are experiencing success in winning customers. *Wilson*, Ex. 232C, col. J.

ii. Qwest’s ability to control viability

38 This argument calls upon the Commission to disregard existing regulatory mechanisms in the wholesale market (such as Qwest’s performance assurance plan) and

in the competitive classification statute itself (the price floor). There is no reason to conclude that these mechanisms will fail.

iii. The TRO makes the future of UNE-P uncertain

39 In the so-called “mass market switching” case, UT-033044, this Commission will consider whether Qwest must continue to make the unbundled switching available to competitors that serve customers over individual (DS0) lines. The Commission must conduct this analysis on a granular level and may not consider the whole state as a single market. The Commission must first determine what the relevant markets are, based in part on where competitors are actually serving customers with their own switches. TRO at ¶¶ 441-442, 443-446.

40 In those exchanges where UNE-P is the exclusive method of competition, or where competitors have not yet begun using their own switching (as evidenced by the fact that no CLECs are obtaining UNE-L from the incumbent), Staff submits that it is very unlikely that Qwest will be able to make the case that competitors are not impaired without access to unbundled switching. The so-called “triggers” test, TRO at ¶¶ 498-500, is a rigorous one: in a particular area, the Commission would have to find that there are three or more carriers, unaffiliated with the ILEC, that are serving mass market customers using their own switches or that there are two or more competitive wholesale suppliers of unbundled local circuit switching that are unaffiliated with each other or the ILEC. *Id.*

41 It is possible that, in the event the triggers are not met in a particular geographic area, Qwest can try to make the case the market is, nonetheless, suitable for “multiple, competitive supply” of competitive service over competitors’ own switches. *Id.* at ¶¶

506, 507. Suffice it to say that this, too, is a rigorous test. Nonetheless, it is true, as WeBTEC points out, that the impairment test is not the same as a market power test. In theory, therefore, it is possible that in the mass market switching case, the Commission could conclude that in a particular wire center, competitors are not impaired without access to unbundled switching even though Qwest would enjoy market power in that wirecenter if UNE-P were eliminated. But this is highly speculative and highly theoretical. It also depends in part on the theory that Qwest would be free to take advantage of such a situation by discriminating in its pricing to a very fine degree (i.e., by raising rates only in those geographic area where unbundled switching, and therefore UNE-P, has been removed, but where the company nonetheless enjoys market power). This theory overlooks the fact that Qwest has not sought a waiver of the statutory prohibition against unreasonable discrimination. Reynolds, Tr. at 274, 275.

iv. UNE-P does not require “investment”

Public Counsel denigrates UNE-P because competitors who use it have not made what Public Counsel would term an “investment.” Public Counsel is correct that competition using UNE-P does not require investment in the sense of deploying one’s own facilities. But this is precisely why it is such an effective means of competition—entry barriers are extremely low.

42 The only barrier to entry in rural areas is that of actually doing what’s necessary to have a sales presence there—namely *offering* service. Baldwin, Tr. at 739:1 to 740:6. The evidence shows that CLECs offer the exact services that Qwest offers virtually everywhere in the state.

b. The Commission should not discount competition that is based on total service resale or the use of Qwest special access service in this case.

43 Many parties cite the Commission's decision in UT-000883 for the proposition that competition based on total service resale should be discounted or disregarded in this case because competitors who use total service resale lack the ability to restrain the incumbent's retail pricing. Public Counsel Br. at 12; ATG Br. at 25; Integra Br. at 7; DoD Br. at 24. The theory behind this conclusion in UT-000883 was that, if the incumbent were to raise its retail prices for a given service, the wholesale price would automatically rise with the retail price (since the wholesale price is based on a fixed 14.74 percent discount off the incumbent's retail price). Thus, the incumbent doesn't have to worry that a competitor utilizing total service resale will be able to significantly undercut its retail price if raises it.

44 Since the time the Commission decided UT-000883 however, CLECs have gained the ability to obtain the unbundled network element platform from the incumbent. As some have said, UNE-P is, for practical purposes, the same as total service resale, except that it is available to CLECs at a lower price. And, significantly for this proceeding, it is available to CLECs at TELRIC-based prices that do not change if Qwest raises its retail price. Staff Br. at 24. As a consequence of the better price of UNE-P, CLECs have largely moved from total service resale to UNE-P. Reynolds, Tr. at 307:8 to 308:5. As for those CLEC lines that remain in the total service resale category, it can reasonably be assumed that this ongoing migration from resale to UNE-P would be expedited if Qwest were to raise its retail prices. Because of CLEC's ability to switch from total

service resale to UNE-P in the event of a Qwest retail price increase, the Commission should not disregard total service resale in this case.

45 WeBTEC argues that the Commission should also disregard competition using Qwest special access service as an alternative to UNE-loops and/or UNE-transport. WeBTEC cites to no record testimony or Commission precedent for this argument.⁶ Staff agrees that purchasing special access circuits to reach customers' premises is more expensive than purchasing the equivalent unbundled network elements (such as extended enhanced loops). However, there is no evidence in this case that the UNE provisioning problems, or other factors that may have driven CLECs to purchase special access service in the past instead of obtaining equivalent functionality by purchasing unbundled loops and transport are present any longer. In fact, the evidence is that those conditions are not present because of Qwest's satisfaction of nondiscriminatory access requirements of § 271 approval and its quality assurance plan. As with total service resale, competitors who used special access in the past now have a better alternative in the form of unbundled network elements (and specifically the UNE combination called enhanced extended link or "EELs").⁷ The issue that now concerns the FCC is that those CLECs that also provide long distance service not be allowed to "game" the system by purchasing TELRIC-priced EELs and using them for the purpose

⁶ In fact, Commission precedent is to the contrary. WeBTEC pursued this same theory in its appeal of the Commission's decision in UT-000883 because, in that case, Staff witness Dr. Blackmon, on whose testimony the Commission relied in granting a portion of Qwest's petition, opined that, at that time, Qwest special access was the only proven method whereby CLECs could reach customer's premises (i.e., as an alternative to building its own loop facilities). The Court of Appeals, in an unpublished opinion, rejected TRACER's (now WeBTEC's) arguments identical to those made here.

⁷ See *Competitive Telecommunications Assoc. v. FCC*, 309 F.3d 8, 10-11 (D.C. Cir. 2002); Triennial Review Order at ¶¶ 570, 571, 575-578.

for which special access service is intended—the transport of toll traffic. TRO at ¶ 595.

The Commission should reject WeBTEC’s attempt to make special access an issue in this case. No witness in this case regarded it as relevant enough to mention.

2. CLEC-owned loops

46 Staff does not offer argument in addition to those filed in this section of the
Opening Brief on October 28, 2003.

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

47 Staff does not offer argument in addition to those filed in this section of the
Opening Brief on October 28, 2003.

D. OTHER INDICATORS OF MARKET POWER

1. Market share analysis

48 WeBTEC argues that a 65% market share is prima facie evidence of market
power. Br. 19. WeBTEC cites as authority for this argument *MetroNet Services Corp. v.*
US WEST Communications, 329 F.3d 986 (9th Cir. 2003) (MetroNet).⁸ *MetroNet* does not
stand for the proposition that a regulated company with a 65% market share is
presumed to possess market power. Rather, *MetroNet* states:

The district court was correct to focus its attention on Qwest’s ability to exclude
competition and control prices, rather than simply on market share. In general, a
plaintiff may establish a prima facie case of market power by showing the
defendant has a 65 percent or greater market share. *However, in cases involving*
regulated industries, reliance on statistical market share ... is downright folly where, as
here, the predominant market share is the result of regulation.

⁸ WeBTEC cites the case as *MetroNet Servs. Corp. v. US West Communs.*, 325 F.3d 1086, 2003 U.S. App. LEXIS 6007 (9th Cir. 2003); amended, *MetroNet Servs. Corp. v. US West Communs.*, 2003 U.S. App. LEXIS 9796 (Filed May 21, 2003). The opinion filed on May 21, 2003, replaces the opinion found at 325 F.3d 1086. WeBTEC appears not to have had the reporter citation for the amended opinion. That cite is now available, and Staff uses the reporter citation in this brief.

Id. at 1003-1004 (citation omitted)(emphasis added). Market share is simply a starting point in the market power analysis. *Southern Pacific Communications Co. v. AT&T*, 740 F.2d 980 (D.C. Cir. 1984). Thus, when dealing with a regulated company, the analysis should focus on whether that company can control price, not simply on the company's market share.

49 Several parties argue that the inclusion of resale and UNE-P data in the market share analysis is improper. WeBTEC, Br. 20; Integra, Br. 7-8; MCI, Br. 26-29. Integra estimates that, without resale and UNE-P, Qwest's market share is 92%, and CLEC market share is 8%. Integra, Br. 7. RCW 80.36.330 does not require competition to be competitor-owned competition. In other words, the statute does not require CLECs to own their own facilities before a finding of effective competition can be made. The data indicate that CLECs are weaning themselves away from resale, preferring instead the more attractive economics of UNE-P. Staff, Br. 32; Gates, Tr. at 1195:10-13. Further, UNE-P competition is price constraining and should absolutely be considered in the market share analysis. Gates, Tr. at 1201:2-4.

50 Several parties argue that use of statewide market share figures is improper. Public Counsel, Br. 15; AT&T, Br. 14; DoD, Br. 33. The parties argue that a more granular analysis is required, such as an analysis at the wire center or exchange level. *See* AT&T, Br. 14 (wire center or exchange); DoD, Br. 33 (exchange level). The basis for the argument is that statewide market share numbers mask important data. *See* Public Counsel, Br. 15; DoD, Br. 33-34. The data in the record allow the Commission to assure itself that there are not significant captive customers. Therefore, it is not improper for the scope of the petition to be Qwest's service territory.

51 AT&T argues that Qwest should be required to show that CLECs have captured a 25% market share in each wire center before the Commission can find effective competition. A threshold market share number is not appropriate. Rather, market share and other factors, such as ease of entry, should be considered in concert to determine whether Qwest has the ability to control price in the market.

52 Public Counsel and AT&T argue that Qwest's line-loss data is unreliable. Public Counsel, Br. 17; AT&T, Br. 14. Both parties argue that not all of the lines lost are due to competition, and they are absolutely correct. However, Qwest is losing lines to competition, Reynolds, Ex. 11, and the relative market shares of Qwest and the CLECs are changing such that Qwest's market share is decreasing and the market share of the CLECs (as a group) is increasing. From Staff's perspective, it is sufficient that Qwest's market share is decreasing, and more importantly that the CLECs hold a significant amount of the overall market.

53 Public Counsel argues that 271 approval has given Qwest a powerful marketing opportunity and that Qwest is rapidly signing up customers for its new long distance services at a rate of over 7000 a month.⁹ Br. 16. Even though Qwest has utilized its 271 approval to obtain long distance customers, the number of basic exchange business access lines related to the services for which Qwest seeks competitive classification *decreased* during the same time period shown in Exhibit 24. Reynolds, Ex. 24, p. 2.

⁹ Public Counsel cites to Exhibit 24 for this premise. Exhibit 24 is Qwest's response to Public Counsel's Data Request Number 03-022SI, which requested information about the number of business access lines and the number of business customers. It appears that the number Public Counsel uses in its brief to show the number of customers actually represents number of lines, not customers. See Reynolds, Ex. 24, p. 2. It appears that the number of accounts correlates to the number of customers, while the ANIs (Automatic Number Identifiers which represent billed telephone numbers) correlates to the number of lines. *Id.*

54 DoD argues that certain market structure factors are reflected in market share.
Br. 33. The Commission, however, has recognized that a high market share may result
in competitive classification when the market structure is sufficiently pro-competitive,
indicating that separate analysis of market share and market structure is warranted. *See*
In the Matter of the Petition of Qwest Corp. for Competitive Classification of Business Services
in Specified Wire Centers, Docket No. UT-000883, Seventh Supplemental Order Denying
Petition and Accepting Staff's Proposal at ¶73 (December 2000).

55 In sum, the market share data in this case is sufficient to support a finding of
effective competition. As such, the Commission should grant Qwest's petition.

2. Market concentration analysis

56 MCI argues that excluding data of resale and UNE-P services provided by
CLECs is appropriate because resale and UNE-P providers are "noncommitted
entrants." Br. 32. A noncommitted entrant is a firm *not currently producing or selling* the
relevant product in the relevant area. *Wilson*, Ex. 224 (Merger Guidelines) at 11.
Uncommitted entrants are *included* in the relevant market if they are likely to enter the
market within one year and without significant sunk costs in response to a price
increase. *Id.* A uncommitted entrant is not included in the relevant market only if it is
unlikely to enter the market. *Id.*

57 Deciding what firms to include in the market concentration analysis begins by
identifying all firms currently producing or selling the relevant product in the relevant
area. *Id.* Those firms are included in the analysis. CLECs providing service via resale
and UNE-P are firms currently in the market and should be included in the analysis.
They are not uncommitted entrants.

58 MCI also argues that calculating HHI by grouping the CLECs together rather than using the individual market shares dramatically understates the HHI. Br. 35. This is incorrect. Grouping the CLECs as one and using a combined market share to calculate HHI results in a higher HHI, thus *overstating* the measurement. To illustrate this point, assume a three-firm market. One firm holds 50% of the market, one firm holds 25% of the market, and the last firm holds 25% of the market. Calculating HHI using each firm's individual market share results in an HHI of 3750.¹⁰ Calculating HHI by combining the two smaller firms' market shares results in an HHI of 5000.¹¹

59 ATG and DoD argue that the Commission used 5000 as a threshold level of HHI in Docket No. UT-000883, the last competitive classification case involving Qwest. ATG, Br. 36-37; DoD, Br. 35-36. Docket No. UT-000883 is a related case because it involved the same company, the same services, and the same inquiry (whether effective competition exists). However, the Commission did not establish a mandatory HHI threshold that Qwest must meet in order to achieve competitive classification. Rather, the factors in that case weighed in favor of accepting 5000 as a threshold. *In the Matter of the Petition of Qwest Corp. for Competitive Classification of Business Services in Specified Wire Centers*, Docket No. UT-000883, Seventh Supplemental Order Denying Petition and Accepting Staff's Proposal (December 2000). In the current case, the factors weigh in favor of accepting an HHI greater than 5000 because market-opening mechanisms that did not exist when the Commission considered the case in UT-000883 have come into place. Staff, Br. 3-4. Thus, the HHI data supports a finding of effective competition.

¹⁰ The calculation: $(50*50) + (25*25) + (25*25) = 3750$.

¹¹ The larger firm has a market share of 50%, and the two smaller firms have a combined market share of 50%. The calculation: $(50*50) + (50*50) = 5000$.

3. Ease of entry

60 MCI and ATG suggest that resale and UNE-P should not be included in the entry analysis. MCI, Br. 36-37; ATG, Br. 38. Entry is easy if it is likely, timely, and sufficient. Wilson, Ex. 224 at 25-26. Resale and UNE-P entry methods for firms not already in the market are likely to be uncommitted entry methods because they involve insignificant sunk costs.¹² Uncommitted entry is included in the entry analysis if entrants are likely to remain in the market and would meet the tests of timeliness, likelihood, and sufficiency. *Id.* at 26, fn. 25 and at 11, fn. 13. Because Qwest is required to provide resale and UNEs to CLECs, entry via wholesale methods is easy and should be considered.

61 Several parties argue that Qwest and Staff oversimplify the entry analysis. Public Counsel, Br. 20; AT&T, Br. 15; DoD, Br. 37-38. Entry using CLEC-owned facilities has more costs associated with it than entry using wholesale methods. In analyzing the entry issue, Staff looked at the fastest entry methods and the costs associated with those methods, namely resale and UNE-P. Wilson, Ex. 201 at 23:5-9. Based on that analysis and the number of CLECs currently in the market, Staff determined that entry was easy enough to justify a finding of effective competition.

62 WeBTEC argues that Staff failed to investigate whether CLECs in the market today are profitable. Br. 24. Staff estimates that as many as 40 CLECs exist in the market providing alternatives to Qwest's service. Staff, Br. 18. It may take a CLEC as

¹² This is different from the argument involving uncommitted entrants in the market concentration analysis. There, parties advocated removal of lines served via resale and UNE-P based on the uncommitted entrant argument. Under the merger guidelines, resale and UNE-P lines would be included in the market concentration analysis because they are providing service in the relevant market. See Section IV.D.2 above. In the entry analysis, the "value" of the entry is analyzed.

many as three years to become profitable. Wilson, Tr. at 1328:16 to 1329:9. The fact that CLECs are in the market indicates that CLECs believe they will be able to make a profit.

63 WeBTEC argues that Staff failed to consider certain costs of entry, including those listed in the TRO. Br. 23-24. The inquiry involved in the TRO is a different inquiry than is involved in this case; under the TRO, the question is whether CLECs are impaired without access to certain unbundled elements, not whether effective competition exists. In any event, even the FCC does not require an analysis of entry costs when competitors exist in the market. This is because the existence of competitors proves that entry is possible and likely. *Triennial Review Order* at ¶¶ 504-507. Thus, the fact that a sufficient level of CLECs exist in the market today, analysis of all costs of entry is not required. Moreover, Staff did consider the minimum costs associated with entry. Wilson, Ex. 201 at 23:5-9.

4. Affiliation of providers of service

64 Staff does not offer argument in addition to those filed in this section of the Opening Brief on October 28, 2003.

5. Other

65 WeBTEC argues that Qwest's pricing above cost is evidence that Qwest has market power. Br. 24-25. WeBTEC compares Qwest's retail rates with the "forward-looking cost-based rates" for the elements used to provide those services, concluding that the retail rates are higher than the element rates. *Id.* at 25. The rates Qwest currently charges for retail business basic exchange service were set by Commission order and are presumed to be lawful.

66 WeBTEC and Public Counsel argue that market share is evidenced by Qwest failing to reduce its retail prices after obtaining competitive classification in Docket No. UT-000883. WeBTEC, Br. 25; Public Counsel, Br. 21-22. Qwest testified that the competitive classification it received in Docket No. UT-000883 was difficult to work with, which is one reason Qwest filed the current petition. Reynolds, Tr. at 150:1-19. Difficulty using the flexibility granted to Qwest does not equate to market power.

E. SIGNIFICANT CAPTIVE CUSTOMER BASE

67 Public Counsel and DoD argue that the small business customers are captive customers. Public Counsel, Br. 22-23; DoD, Br. 43-44. Public Counsel offers an analysis of average lines per location to demonstrate that Qwest disproportionately serves the small business mass-market customer. Public Counsel, Br. 22-23. Public Counsel's analysis is flawed. An accurate lines-per-location calculation can not be performed in this case using the data received from CLECs.

68 During cross examination, Public Counsel elicited from Mr. Wilson that seven of the CLECs responding to Order No. 06 failed to provide information about number of locations served. Wilson, Tr. at 1381:5-21. Mr. Wilson accepted that the seven CLECs represented approximately one-third of the total CLEC lines Staff aggregated in Exhibits 205 and 232. Public Counsel further established that an average lines-per-location analysis could not be conducted unless the analyst had information available for one discrete company. Wilson, Tr. at 1382:6-20.

69 To calculate lines per location, Public Counsel divided the number of lines by the number of locations shown in Wilson, Ex. 232. Public Counsel, Br. 23-24. For example, in the Green Bluff example, Public Counsel divided the number in Row 15, Column E

by the number in Row 15, Column M. Public Counsel, Br. 23; Wilson, Ex. 232. The resulting number is likely inflated because somewhere between 25% and 40+% of reported lines are not associated with location data. DoD, Br. 33. Thus, Public Counsel's statistical analysis that attempts to show disparity in the average number of lines provided to CLEC customers versus Qwest customers is based on numbers that incorrectly inflate the alleged disparity.¹³

70 DoD argues that PBX and Centrex customers are captive due to a lack of competition for those services. Br. 44. To the contrary, CLECs hold 46.87% of the PBX market, indicating that there is substantial competition with regard to PBX customers. Moreover, PBX service is heavily dominated by competition from CLEC-owned loops. Wilson, Ex. 210 at 9:17. Additionally, although Qwest holds 94.79% of the Centrex market, Centrex and PBX can serve as substitutes for one another. See Reynolds, Ex. 7RT at 13:15-18; See also *WUTC v. US WEST Communications, Inc.*, Docket Nos. UT-911488, UT-911490, and UT-920252, Fourth Supplemental Order Denying Complaint; Accepting Tariffs Conditionally; Requiring Tariff/Price List Refiling (Nov. 1993).

71 Integra argues that the largest captive customer is the CLEC industry. Br. 9-10. Captive customer, in the context of competitive classification and RCW 80.36.330, refers to the end use customer, not the carriers purchasing wholesale inputs from Qwest. *US WEST Communications, Inc. v. Washington Utilities and Transportation Commission*, 86 Wn. App. 719, 728, 937 P.2d 1326 (1997) (US WEST). The Commission recognized this definition in prior competitive classification cases. *In the Matter of the Petition of Qwest Corp. for Competitive Classification of Business Services in Specified Wire Centers*, Docket No.

¹³ This is also true of Public Counsel's Exhibit 426C.

UT-000883, Seventh Supplemental Order Denying Petition & Accepting Staff's Proposal at ¶65 (Dec. 2000).

72 ATG argues that captive customers include all customers whom CLECs have not been able to serve using UNE loop or CLEC-owned loop, i.e., customers served by resale or UNE-P. Br. 39-40. This definition is inconsistent with the meaning of captive customer. A captive customer is one who has no choice of service providers. *US WEST*, 86 Wn. App. at 728. If CLECs provide service via total service resale, UNE-P, UNE loop, or CLEC-owned loops, the customers in that service area have the ability to choose their service providers. Thus, customers being served by CLECs using UNE-P or resale are not captive customers within the meaning of the statute. The data in the record indicate that there are no significant captive customers in Qwest's service territory.

V. OTHER ISSUES

A. IMPACT OF OTHER DOCKETS (TRO, COST DOCKETS, ETC.)

73 WeBTEC argues that the Commission should deny Qwest's petition now and instruct the company to refile after the TRO proceeding is completed. Br. 25-27. MCI argues that the TRO proceeding will potentially eliminate a popular entry strategy. Br. 39-41. ATG argues that if the Commission finds no impairment in the TRO proceeding the UNE-P portion of the market will effectively disappear. Public Counsel, Integra, AT&T also argues that the TRO proceeding will negatively affect this proceeding. Public Counsel, Br. 28; Integra, Br. 10-11; AT&T, Br. 19.

74 Areas where CLECs rely heavily on UNE-P are least likely to support a finding of no impairment due to the triggers set forth in the TRO. Rather, the areas where

CLECs have a strong facilities-based presence are the areas in which a finding of no impairment is most likely. Thus, the TRO proceeding will likely not result in the elimination of UNE-P for those areas where UNE-P is prevalent. The Commission does not have to wait until the TRO proceeding concludes. *See* Section IV.C.1.a above.

B. COST FLOOR

75 ATG argues that “After the fact action under the statute does not cure the problem [of price squeeze], if that were the case, there would be no need for the competitive classification statute in the first place.” p. 7. This argument confuses the statutory scheme. The market power analysis under the statute is directed at determining whether the company will have the incentive to *raise* its prices above competitive levels. The presence of effective competition does not ensure that the incumbent will not try to *lower* its prices below cost and create price squeeze. That is why the protection against below cost pricing continues to apply after competitive classification is granted.

C. ACCESS CHARGES

76 Staff does not offer argument in addition to those filed in this section of the Opening Brief on October 28, 2003.

D. PROPOSED CONDITIONS ON APPROVAL

77 Staff does not offer argument in addition to those filed in this section of the Opening Brief on October 28, 2003. Because Staff recommends the Commission approve Qwest’s petition, Staff does not believe that conditions are necessary.

E. OTHER

78 N/A

VI. CONCLUSION

79 The data in this case indicate that effective competition exists and that no significant captive customers exist in Qwest's service territory regarding local basic business exchange service. Therefore, Staff recommends that the Commission grant Qwest's petition for competitive classification.

DATED this 7th day of November, 2003.

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