

The Honorable Theodora M. Mace

BEFORE THE
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

In the Matter of the:

Application of Qwest Corporation's Request
for Competitive Classification of Basic
Business Exchange Telecommunications
Services.

Docket No. UT-030614

WeBTEC'S REPLY BRIEF
[November 7, 2003]

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I. INTRODUCTION

1. The Washington Electronic Business & Telecommunications Coalition ("WeBTEC") submits the following reply brief in opposition to Qwest's petition requesting competitive classification of its basic business exchange services. Most of the arguments made by Qwest and Staff in their initial briefs have already been addressed in the opening briefs of WeBTEC and the other parties opposing Qwest's petition. Accordingly, this brief will focus on only a few key points raised by Qwest and Staff.

2. As pointed out in WeBTEC's initial brief, Qwest and Staff have failed to properly analyze and define the relevant market, making it virtually impossible to develop meaningful measures of two of the key indicators of market power, market share and market concentration. However, the evidence that is available strongly suggests Qwest still retains significant market power over the business local exchange services it now seeks to have competitively classified. Qwest and Staff argue that the Commission should ignore the overwhelming evidence of Qwest's market power, based on their assertion that entry is easy, notwithstanding the fact that the analysis they offer in support of that assertion is shallow, superficial, and seriously incomplete. Moreover, they ask the Commission to put its head in the sand and ignore the implications of the pending Triennial Review impairment proceeding, Docket No. UT-033044, dealing with mass market switching and dedicated transport. That proceeding could seriously undermine the foundation of Qwest's and Staff's case, namely, the continued availability of UNE-P at TELRIC rates. WeBTEC submits that the Commission should deny Qwest's petition and direct the company to refile its case after the completion of the impairment proceeding. Important evidence that would be key to the proper determination of whether price constraining competition actually exists in Qwest's service territory will be developed in that impairment proceeding and could be made

available in a refiled competitive classification case. After that proceeding the Commission should have a much better record about the presence of CLEC facilities and the extent of economic and operational impairment faced by CLECs if UNE-P were to end.

II. DEFINITION OF RELEVANT MARKET

3. Rather than face up to the serious flaws in its case, Qwest accuses its opponents in this case of using a “shotgun approach” in an effort to create confusion, delay, and fear. Qwest’s Brief at 1-2. The so-called “shotgun approach” is, in fact, a response to the myriad of shortcomings and problems with the evidence and arguments presented Qwest and Staff.

4. Qwest argues that its opponents have sought to create confusion for the Commission regarding the services subject to this proceeding and the data offered in support of Qwest’s petition. Qwest’s Brief at 1. In fact, the confusion is all of Qwest’s creation. Qwest in its petition seeks competitive classification of its analog business local exchange services. That’s fine. However, Qwest then argues that the relevant market is limited to analog business local exchange services and submitted evidence only about its own analog services. At the same time, Qwest confirmed that both analog and digital services can be and often are provided over digital facilities (Reynolds Cross, Tr. 112-114); that some of its digital exchange services have similar functionality to its analog services (Reynolds Cross, Tr. at 112); and that “competitors’ digital switched services are competing with Qwest PBX, Centrex, and business lines” (Reynolds Cross, Tr. at 179). Qwest also asks the Commission to consider other services which it claims are substitutes, including wireless and voice over IP. Reynolds Cross, Tr. at 181-82. Either these other services are close substitutes and should be included in the relevant market and in the measurement of market share and market concentration, or they are not and should be ignored. Staff, of course, conducted no analysis of the relevant market; it merely accepted Qwest’s

definition. Wilson Cross, Tr. at 1507. Thus, any confusion was created by Qwest and Staff and their failure to properly define the relevant market.

5. As pointed out in WeBTEC's initial brief, proper market definition focuses on the likely consumer responses to a "small but significant and nontransitory" price increase. WeBTEC's Brief at 6. Here, Qwest and Staff have failed to properly analyze each of the services listed in Qwest's petition and determine what consumers would realistically consider to be substitutes if Qwest were to increase prices. This failure relates both to the product and to the geographic components of the relevant market. Indeed, both Qwest and Staff continue to argue that the geographic scope of the relevant market is Qwest's entire service territory, statewide. Qwest's Brief at 7; Staff's Brief at 15-16. This makes no sense given that the subject of this proceeding is *local* exchange services; i.e., wired services provided to specific end-user locations. It is highly unlikely that any business consumer would consider a local exchange service line delivered to a different location, even a neighbor's premise, to be a meaningful substitute for service delivered to his own premise. As WeBTEC stated in its initial brief, an exchange access line available from a CLEC in Spokane – whether via CLEC-owned loops, UNE-P, UNE-L, or Total Service Resale (TSR) – is simply not a substitute for an exchange access line needed at a customer location in Seattle. WeBTEC's Brief at 11. Largely for purposes of administrative convenience, the geographic scope of the relevant market should be defined at the wirecenter. It should definitely not go beyond the exchange level.

6. Qwest also argues that its opponents have sought to introduce delay. Qwest's Brief at 1. Again, this is another attempt to divert attention away from serious questions about the reliability of the evidence presented by Qwest and Staff. In particular, serious questions remain about whether the line counts used in the analyses of market share and market concentration really

involve a comparison of Qwest analog lines to CLEC analog lines. Given the confusion by the CLEC parties to the case about what Staff was seeking with its questionnaire and Staff's failure to ask clear questions and provide clear definitions in its attempt to confirm the numbers reported, the Commission cannot be sure that the data about CLEC line counts really reflect what they purport to represent.

7. Qwest's accusation that its opponents have engaged in fear tactics by urging the Commission to focus on hypothetical, future doomsday scenarios is also without merit. This is an important case. Premature granting of pricing flexibility to Qwest could have serious consequences for the public interest. Competition in this state is still at a delicate stage, with many, if not all, CLECs still struggling to achieve minimum viable scale. Premature competitive classification could lead to a serious decline in the level of that competition. WeBTEC strongly believes this is a concern that the Commission should take very seriously. Moreover, it is deeply troubling that Staff has made no attempt whatsoever to evaluate what the true economic and operational barriers may be for the various CLECs operating in the state or what the likely effect on the market will be if pricing flexibility is granted to Qwest at this time.

III. REVIEW OF STATUTORY FACTORS FOR EVALUATING EFFECTIVE COMPETITION

8. As discussed in WeBTEC's initial brief, a key premise of the Washington State statutory scheme for the regulation of telecommunications services is to protect against the exercise of market power by telecommunications companies. Thus, the protections of regulation are to be retained unless and until sustainable, effective competition (*i.e.*, competition sufficient to constrain the exercise of market power) develops. *See Legislative History of Regulatory Flexibility Act* (*See WeBTEC's Brief at 9-10*); *see also* RCW 80.36.135 (directing the

Commission to consider whether an alternative form of regulation to traditional, rate of return, rate base regulation would “[p]reserve or enhance the development of effective competition and protect against the exercise of market power during its development...”).

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

10. The concept of “market power” is well-understood in antitrust analysis. According to the U.S. Dep’t of Justice and Federal Trade Commission, *Horizontal Merger Guidelines* (April 8, 1997) (“*HMG*”), “[s]eller market power is the ability to profitably maintain prices above competitive levels for a significant period of time.” *HMG*, § 0.1 Purpose and Underlying Policy Assumptions. *See* WeBTEC’s Brief at 12.

11. In its brief, Staff argues that “market power” means the ability to profitably raise price above cost without losing market share. Staff’s Brief at 26. This is a change from the definition offered by Mr. Wilson at hearing. *See* WeBTEC’s Brief at 12, n.5. Still, Staff’s definition does not accurately reflect the accepted concept of market power. The essence of the concept is the ability to maintain prices above the competitive level for a significant period of time, or, stated somewhat differently, without losing so many sales so rapidly that the price

increase is unprofitable and must be rescinded. *See* WeBTEC's Brief at 12. Given the inevitable price inelasticity faced by a firm with significant market power, it is entirely possible for such a firm to be able to profitably maintain prices above the competitive level and still lose market share.

12. In its brief, Qwest argues that what matters for market power is the ability to restrict market output profitably. According to Qwest, by virtue of the universal availability of UNEs and resale, competitors have the ability to expand output and extend capacity throughout Qwest's local market. Qwest's Brief at 32. However, Qwest misses the point. Since local exchange service is essentially a combination of loops, switching, and some local transport, the critical question is whether the CLECs operating in Qwest's service territory are able to increase the total supply of all or some of those elements. Only CLECs using their own loops, transport, and switching are able to have a meaningful impact on the market, and the available evidence is that the number of CLEC-owned loops in the market is very small and unevenly distributed. CLECs using UNE-P or TSR add nothing to the supply of the essential elements in the market; they simply use the facilities (supply) provided by Qwest. CLECs using UNE-L add only to the supply of switching; transport and loops are still provided by Qwest. In short, the facts don't help Qwest's argument much at all.

A. Other Indicators of Market Power.

1. Market Share Analysis.

13. The traditional starting point for appraising whether a firm has market power is its market share. A low market share will virtually preclude a finding of market power, whereas a high market share indicates the possibility that market power exists. ABA Section of Antitrust Law, *Antitrust Law Developments* (5th ed. 2002), at 68. *See* WeBTEC's Brief at 19. Staff notes

that Qwest estimates its market share in the relevant market (as it defines it), using only wholesale data, to be 83%. Staff's Brief at 26. Staff, however, estimates Qwest's market share to be 71.88%, which Staff acknowledges is "relatively high". *Id.* at 28. Both are well above the level that the 9th Circuit Court of Appeals says constitutes prima facie evidence of market power. *See MetroNet Servs. Corp. v. U S West Communs.*, 325 F.3d 1086, 2003 U.S. App. LEXIS 6007 (9th Cir. 2003); amended, *MetroNet Servs. Corp. v. U S West Communs.*, 2003 U.S. App. LEXIS 9796 (filed May 21, 2003)(a market share of 65% is considered to be prima facie evidence of market power). *Id.* at *38.

14. Staff asks the Commission to overlook the fact that market share numbers indicate that Qwest retains significant market power in the relevant market. According to Staff, ease of entry and the number of competitive firms indicates Qwest is not able to exercise market power. However, Staff has not really conducted any meaningful analysis of the economic and operational barriers faced by CLECs. *See* WeBTEC's Brief at 22-24. Nor does Staff appear to recognize the significance of the fact that most, if not all, of the CLECs operating in Qwest' territory have very small market shares. That fact is reflected in the high market concentration measures reported by the various parties. And, raises a question about whether any of the CLECs has achieved the minimum viable scale necessary to be profitable. If a CLEC hasn't reached minimum viable scale, it is hard to see how it can constrain Qwest's prices. It is likely to be simply a price-taker and will follow any Qwest price increase with price increases of its own.

2. Market Concentration Analysis.

15. As noted in the *HMG*, market concentration is a function of the number of firms in a market and their respective market shares. Other things being equal, "market concentration

affects the likelihood that one firm, or a small group of firms, could successfully exercise market power.” *HMG* at §§ 1.5, 2.0.

16. Again, Qwest and Staff want the Commission to overlook the fact that the HHI analyses presented in this case all show that the relevant market is highly concentrated, and, thus, subject to the exercise of significant market power by Qwest. Staff even suggests that while a high HHI might not be acceptable for purposes of a merger analysis, a high HHI would be for purposes of evaluating a competitive classification petition. Staff’s Brief at 29. Qwest makes a similar argument. Qwest’s Brief at 31-32. Contrary to Staff’s suggestion, market concentration is measured and used in merger analysis for precisely the same reason it should be measured and used in evaluating a competitive classification petition; i.e., as a means of gauging market power. The critical question is whether there are other factors that would prevent the dominant firm from exercising market power, notwithstanding the highly concentrated nature of the market. As noted elsewhere, there has not been a meaningful examination of whether there is a sustainable and sufficient ease of entry to meet that burden. What we do have is the fact that the results of Staff’s analysis show that the market concentration in all exchanges throughout the state ranged from 5,627 to 10,000, which is clearly indicative of a highly concentrated market. *Staff’s Market Analysis*, Ex. 209C.

3. Ease of Entry.

17. Qwest and Staff attempt to overcome the presumption that Qwest has significant market power that flows from the high market share and market concentration data presented by arguing that entry is easy and CLECs face no barriers to entry or expansion in the relevant market as they define it. However, neither has seriously analyzed the issue. Neither has done a meaningful examination of whether there are significant economic or operational barriers to

CLEC entry or expansion in the relevant market. They certainly haven't done such an analysis for the different service platforms used by the various CLECs, or what the situation would be if UNE-P is eliminated in all or parts of the Qwest territory as the result of the Triennial Review impairment proceeding. *See* WeBTEC's Brief at 22-24. As pointed out in that brief, Staff has not done any analysis of the various barriers to local entry identified by the FCC in the TRO. It has not looked at what CLEC customer churn or life is, what the expected level of revenues would be after competitive classification, CLEC customer acquisition costs, costs of capital, sunk costs, batch hot-cut costs, collocation costs, non-recurring costs. Neither has Qwest. In short, the opinions expressed about ease of entry by Qwest and Staff are without foundation.

4. Other.

18. In the final analysis, the best evidence about Qwest's market power is the fact that Qwest's business local exchange service prices are well above cost. As pointed out in WeBTEC's initial brief, it is well established that pricing well above competitive (cost) levels is direct evidence of market power. *See Data General Corp. v. Grumman Systems Support Corp.*, 36 F.3d 1147, 1182 n.60 (1st Cir. 1994) ("supracompetitive" prices are evidence of monopoly power"); *see* WeBTEC's Brief at 24-25. Such direct evidence of market power is largely independent of market definition and largely superior to it.

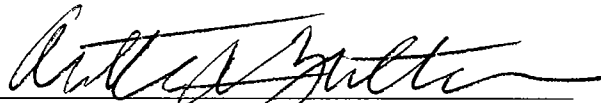
IV. CONCLUSION

19. For the reasons discussed above and in WeBTEC's initial brief, WeBTEC submits that Qwest's petition be denied and the company be directed to refile its petition after the conclusion of the pending TRO impairment proceeding, when the evidence from that proceeding will be available to import into the new competitive classification case record, and Qwest, the other parties, and the Commission can "do it right."

20. Notwithstanding the flaws in the record, if the Commission determines to grant Qwest's petition, in whole or in part, WeBTEC requests that, for the reasons discussed in WeBTEC's initial brief at pages 29-30, the Commission condition the grant on continuation of the revised DID number portability policy as expressed in Exhibit 85 and direct Qwest to revise its SGAT to reflect the revised policy explanation.

RESPECTFULLY SUBMITTED this 7th day of November, 2003.

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

DATED this 7th day of November, 2003, at Seattle, Washington.

