- BEFORE THE PUBLIC UTILITIES COMMISSION OF OREGON -

IN THE MATTER OF THE PETITION OF QWEST CORPORATION TO EXEMPT FROM REGULATION QWEST'S SWITCHED BUSINESS SERVICES	))))))	**DOCKET NO. UX 29**

TESTIMONY OF

DOUGLAS DENNEY

ON BEHALF OF

ESCHELON TELECOM, INC. AND ADVANCED TELECOM, INC.

[REDACTED]

SEPTEMBER 9, 2005

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Douglas Denney. I work at 730 2nd Avenue South, Suite 900 in Minneapolis, Minnesota.

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

A. I am employed by Eschelon Telecom, Inc. as Senior Manager of Pricing and Policy. My responsibilities include negotiating interconnection agreements, monitoring, reviewing and analyzing costs, and representing Eschelon in regulatory proceedings.

Q. PLEASE DESCRIBE YOUR EDUCATION AND PROFESSIONAL BACKGROUND.

A. I received a B.S. degree in Business Management in 1988. I spent three years doing graduate work at the University of Arizona in Economics, and then I transferred to Oregon State University where I have completed all the requirements for a Ph.D. except my dissertation. My field of study was Industrial Organization, and I focused on cost models and the measurement of market power. I taught a variety of economics courses at the University of Arizona and Oregon State University. I was hired by AT&T in December of 1996 and spent most of my time with AT&T analyzing cost models. In December of 2004, I was hired by Eschelon Telecom, Inc., where I am presently employed.

I have participated in over 30 proceedings in the 14-state Qwest region. Much of my prior testimony involved cost models -- including the HAI Model, BCPM, GTE's ICM, U S WEST's UNE cost models, and the FCC's Synthesis Model. I have also testified about issues relating to the wholesale cost of local service -- including universal service funding, unbundled network element pricing, geographic deaveraging, and competitive local exchange carrier access rates.

Q. HAVE YOU PREVIOUSLY TESTIFIED IN OREGON?

A. Yes, I have participated in numerous dockets in Oregon. I have testified in multiple phases of docket UM-731 regarding universal service, UT-148 regarding Qwest's unbundled loop rate, and UT-138/139 regarding the mapping of building blocks to unbundled network elements. In addition I participated in numerous workshops in UM-125 regarding Qwest unbundled network elements.

Q. HOW IS THIS TESTIMONY ORGANIZED?

A. This testimony is broken into five parts. The first part introduces this testimony and summarizes the findings of Eschelon in this case. Part II summarizes the competition facing Qwest in Oregon today. This section explains the importance of considering only competition that has the ability to "regulate" Qwest's behavior in the market place. Part III discusses Qwest's request for deregulation and what Qwest's enhanced market power would impact Oregon businesses and Qwest's competitors. Part IV discusses the problems with the evidence Qwest has relied upon in this case and demonstrates that the competitive pressures upon Qwest's business are significantly less than represented by Qwest. This section demonstrates that a close examination of Qwest's support raises serious doubts about Qwest's petition. Part IV concludes the testimony and recommends that this Commission deny Qwest's petition.

I. PURPOSE AND SUMMARY OF TESTIMONY

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. The purpose of this testimony is to evaluate Qwest's petition to exempt from regulation all retail switched business services in Oregon. It is important to keep in mind that the burden of proof in this case is on Qwest to show that it meets Oregon state criteria for the deregulation of telecommunications services. This testimony reviews Qwest's support for its petition and the data available in this case to determine whether Qwest meets its burden of proof.

A review of the facts in this case shows that Qwest does not meet this burden. This testimony details the shortcomings of Qwest's support for its petition and explains why switched business services should not be deregulated in Oregon at this time.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. Qwest currently faces only minimal competition across Oregon, rendering deregulation of business services unjustified by the facts in this case. In addition, the local market is undergoing substantial changes that bring into doubt the stability of competition as it exists today. One real, measurable change currently taking place is the restriction on competitive local exchange carrier ("CLEC") access to unbundled network elements ("UNEs") imposed by Qwest as a result of the FCC's decisions in its Triennial Review Order ("TRO") and Triennial Review Remand Order ("TRRO").

Eschelon recommends that this Commission deny Qwest's petition for deregulation of business services because it is not supported by the data in this case. When the full impact of the FCC TRRO decisions have become clear, Qwest can easily re-file this application, if warranted by the data and the increase in competition it claims will take place in the near future.

Mr. Brigham, on behalf of Qwest, states that "the Commission should focus on whether there is sufficient competition to constrain Qwest's ability to raise prices for its services in the market."[1] On this we are in agreement. To put it another way, competition, when sufficient, is the "regulator" of Qwest's behavior in the market. The disagreement in this case lies in whether competition in the Oregon retail switched business services market is currently sufficient to replace regulation.

A firm is "regulated" by the market when a firm's behavior is constrained by competitive alternatives. In other words, if a firm in a competitive market increases price above economic cost (cost plus a reasonable profit), consumers will migrate to other alternatives, forcing the firm that increased prices to reduce them. In addition, a firm in a competitive market cannot offer an inferior product

[1] Direct Testimony of Robert H. Brigham for Qwest Communications, August 5, 2005, page 38, lines 17 –

unless consumers are compensated for this lower quality in the form of lower prices.

Competition will exist when there are no barriers to entry and exit in a market. Qwest claims that there are no barriers to entry in the local market.[2] Qwest makes this claim whether or not competition manifests itself in CLEC market share. However, if markets are truly open, then a lack of competition should indicate to this Commission that serious barriers to entry do exist and that it is premature to deregulate Qwest's switched business services.

In order for competition to replace regulation in the market, this competition must have the ability to constrain the behavior of the incumbent. Competition from services offered or controlled by Qwest cannot be counted in an analysis to determine whether regulation should be relaxed. Market shares of CLECs that have the ability to place competitive pressures upon Qwest are minimal across Oregon and fall short of levels necessary to supplant regulation. As a result, Qwest's petition for deregulation should be denied.

Nine years after the 1996 Telecommunications Act, the estimated market share for switched business services of CLECs that effectively compete with Qwest is only [*** Begin Proprietary ***] [*** End Proprietary ***].

Market shares of the level mentioned above are indicative that the local market for switched business services across Oregon is not a competitive market.

19.
[2] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 47, lines 5 – 6.

Qwest's request for deregulation of switched business services is premature at this time. The FCC's *TRO* and *TRRO* decisions are likely to significantly constrict CLEC access to facilities in the near future. Continued vigilance on the Commission's part is still required in order to protect the competitive market that has begun to develop in Oregon.

II. QWEST FACES VERY LITTLE COMPETITION IN OREGON

Q. DOES QWEST CURRENTLY FACE SIGNIFICANT COMPETITION IN OREGON?

A. No. Competition in the local telecommunications market has been slow to develop nationwide, and competition in Oregon is no exception. Nine years after the Telecommunications Act, CLECs in the state of Oregon have captured only 16 percent of the **total** market compared to 18 percent nationwide[3]. The business market in Oregon has a better, but still poor, showing with a CLEC effective market share of [*** Begin Proprietary ***] [*** End Proprietary ***] percent[4]. Further, CLECs rely upon Qwest for access to end users. Of all CLEC lines, [*** Begin Proprietary ***] [*** End Proprietary ***] percent,

[3] *Local Telephone Competition: Status as of June 30, 2004*, Table 6 End User Access Lines Served by Reporting Local Exchange Carriers (as of June 30, 2004), http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/lcom0705.pdf

[4] I use effective market share throughout this testimony to refer to CLEC market share that has the potential ability to constrain Qwest's behavior in the competitive market. As is discussed in detail in section IV of this testimony, data involving CLEC resale lines and CLEC UNE-P/QPP lines are excluded from the CLEC market share calculation.

including UNE-P, QPP and resale, rely upon Qwest's last mile facilities[5]. This means that Qwest controls last mile facilities to at least [*** Begin Proprietary ***] [*** End Proprietary ***] percent of all switched business customers in Oregon. In other words, even where competitors exist, they are reliant upon Qwest to reach retail business customers. As will be discussed more fully below, the Herfindahl-Hirshman Index ("HHI"), a common measure of market concentration, shows that the business market in Oregon is highly concentrated, implying that the dominant carrier, Qwest, has significant market power.

All indications are that Qwest faces minimal competition in Oregon and that this is unlikely to change in the near future.

Q. WHY SHOULD WE HAVE EXPECTED THAT THE CLEC MARKET SHARE IN OREGON WOULD BE GREATER THAN 16 PERCENT NINE YEARS AFTER THE TELECOMMUNICATIONS ACT?

A. Qwest claims that the 1996 Telecommunications Act removed all barriers to entry and thus opened local markets to competition.[6] If these markets were truly open, we would have expected to see competitors make much greater gains in the market than we currently see. One useful exercise is to compare the levels of competition in the local market with those witnessed in the long distance market after the break up of AT&T. Chart 1 below compares the market share of competitive long distance carriers after the break up of AT&T in 1984 with the market share of CLECs after the Telecommunications Act of 1996.

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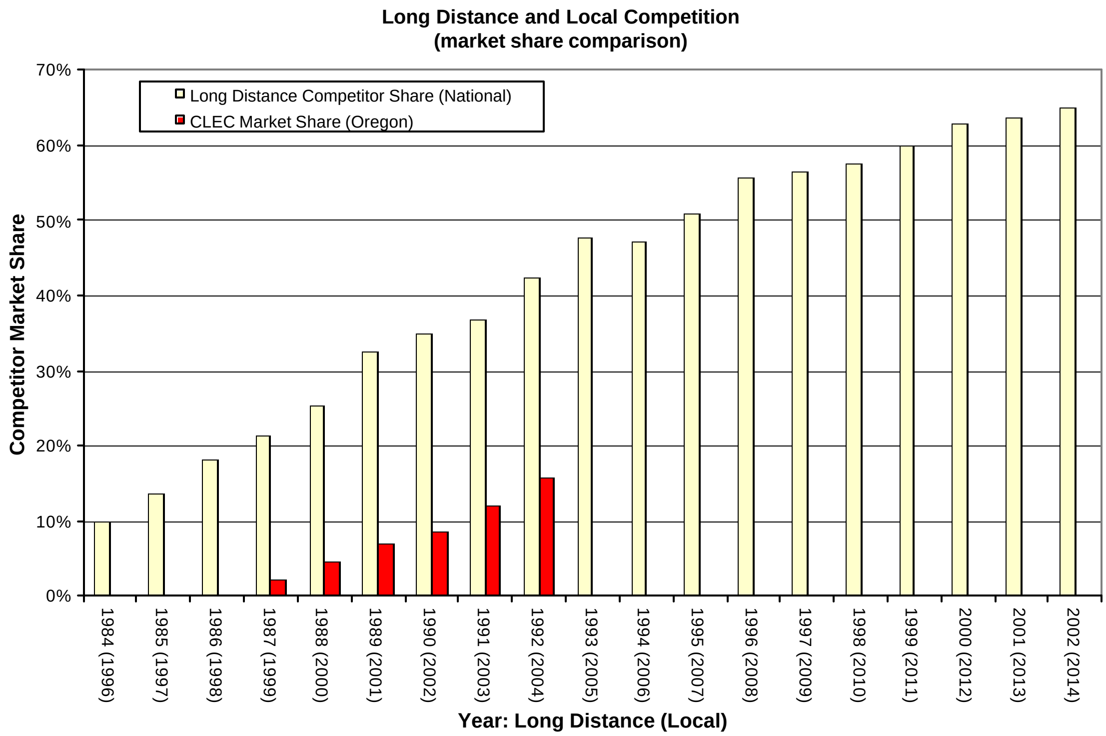
[5] This data is derived from tables D and E of Mr. Brigham's direct testimony, pages 36 and 37.

Chart 1: Local and Long Distance Market Share Comparison[7]



As can be seen in Chart 1 above, the long distance competitor market share was above 40 percent nine years after the break up of AT&T, while CLEC market share is only 16 percent nine years after the 1996 Telecommunications Act. This is a clear indication that local markets are not fully open to competition. With a large and diverse customer base, there is no other reason that CLEC market shares

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[6] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 42, lines 5 – 7 and 16.

[7] CLEC data for this chart is taken from the FCC *Local Telephone Competition* Reports which can be found at http://www.fcc.gov/wcb/iatd/comp.html. Data for 1996 – 1998 is not available. Data for 1998 and 1999 is estimated from 2000 data and national growth rates from 1998 through 2000. All data represents June of the year indicated, except for 2002, which uses December data because June data was not available. Long Distance competitor data was taken from Table 9.7 in *Trends in Telephone Service, May 2004* available at http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend504.pdf.

are as low as they are nine years after the Telecommunications Act.

Q. ARE THERE ANY ECONOMIC MEASURES THAT SUGGEST THAT QWEST HAS SIGNIFICANT MARKET POWER IN OREGON?

A. Measures of concentration can be used as an indication of the degree of market power enjoyed by a dominant firm in an industry. If markets are open and barriers to entry low, we would expect to see many competitors with similar market shares in a market. When one or a few firms dominate the market it is an indication that markets are not open. The dominant firm or firms, in this situation, has or have the incentive and ability to extract monopoly profits and protect its market power. Qwest's current effective market share for the switched business market is [*** Begin Proprietary ***] [*** End Proprietary ***] percent in Oregon.[8] A single firm rarely has market shares of this level. A market share of this level is not seen in open, competitive markets.

[8] See Chart 1.

Another common, simple, measure used to gauge the degree of concentration in a market, and thus the likelihood of monopoly behavior by dominant firms in the market, is the four firm concentration ratio. This is calculated simply by adding the market share of the four largest firms. The effective four-firm concentration ratio based on the staff survey of competition is over [*** Begin Proprietary ***] [*** End Proprietary ***] percent.

Another, more popular measure of market concentration is the HHI index. This measure is the sum of the squares of each firm's market share. The result ranges from 10,000 in a monopoly to nearly 0 in a perfectly competitive market. A calculation of the HHI demonstrates that the switched business service market in Oregon is highly concentrated. The Department of Justice views an industry as concentrated if the HHI is greater than 1800.[9] With the data available the upper and lower bound of the HHI can be determined.[10] The upper bound HHI for effective competitors in the switched business market is 6,008, while the lower bound is 5,755.

The numbers indicate that the switched business service market is highly concentrated. For comparison purposes, I estimated an upper bound estimate of the HHI for the long distance market to be 2504[11]. This upper bound estimate still

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[9] See http://www.usdoj.gov/atr/public/testimony/hhi.htm.

[10] In order to accurately calculate the HHI, market shares of individual CLECs are required. However, by knowing the number of competitors and the market share of the dominant firm, an upper and lower bound for the HHI can be determined.

[11] This is from table 9.7 of the FCC Report *Trends in Telephone Service*, released May 4, 2004. The data market share data is from 2002. http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend504.pdf For purposes of this calculation the column labeled "All other Toll Carriers, Wireless and CLECs" was treated as one large company which biases the HHI upward. This was done to create an upper bound estimate.

shows concentration, but is substantially below the lower bound calculation for Qwest switched business service in Oregon.

III. THE NEGATIVE IMPACT OF DEREGULATION ON OREGON BUSINESSES AND QWEST'S COMPETITORS.

Q. WHAT PRECISELY IS QWEST ASKING FOR IN ITS PETITION FOR DEREGULATION?

A. Qwest is asking for exemption from regulation for "all rates, terms and conditions associated with its retail switched business services in Oregon."[12] Qwest is asking for this exemption for its whole territory in Oregon, not specific areas within the state,[13] and for all switched business services, rather than specific switched business products.[14] This means that Qwest's switched business services would not be subject to regulatory review or a regulatory approval process, and that Qwest would no longer be required to file tariffs and price lists, including special contracts.[15]

Q. WHAT CONCERNS SHOULD THIS COMMISSION HAVE WITH QWEST'S REQUEST FOR TOTAL DEREGULATION?

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[12] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 10, lines 16 –17.
[13] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 15, lines 12 – 13 and page 81, lines 27 – 33.
[14] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 82, lines 25 – 27 and page 83, lines 1 – 7.
[15] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 13, line 9, page 10, line 20 and page 13, lines 12 - 13.

A. The Commission's primary concern should be the impact of Qwest's deregulation on retail customers in the state of Oregon. Retail customers are best served by vibrant competitive markets. Deregulation that adds to the level of competition in the telecommunications industry will provide benefits to Oregon's consumers. Deregulation that increases one firms dominance in the market will certainly benefit Qwest's shareholders, but at the expense of Oregon's consumers and competitive carriers.

Deregulation of Qwest's switched business service across the state of Oregon is premature at this time and offers Qwest the opportunity to exploit its dominant position in the market place at the expense of its competitors.

Without regulatory oversight, including the filing of tariffs and/or price lists, Qwest is in a much better position to target its pricing toward driving its competitors from the market. Qwest pays lip service to this concern by noting that it is subject to "all existing legal constraints concerning fair competition."[16]

If Qwest is no longer required to file tarrifs and/or price lists, including special contracts, it is nearly impossible for a competitor to determine when Qwest is behaving in an anti-competitive manner. Where able, as a result of the FCC's Triennial Review Orders, Qwest has already raised most CLECs' cost of doing business, and the full impact of the FCC Orders is yet to come. There is no reason to think Qwest will not engage in similar practices regarding CLEC revenues if given the opportunity.

[16] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 11, line 12.

Q. WHAT EVIDENCE DOES QWEST RELY UPON IN ORDER TO SUPPORT ITS PETITION FOR DEREGULATION?

A. Qwest relies upon data estimating CLECs' market share in order to argue that sufficient competition exists to constrain Qwest's behavior in the market place. A close examination of this data shows that the degree of effective competition is vastly overstated. Qwest also attempts to point to anecdotal evidence of competition from wireless and VoIP providers. Qwest's conclusions based on this evidence are suspect.

Qwest also argues that, even if there is little competition, all barriers of entry into the local telecommunications market have been eliminated and the Commission may thus rest assured that the mere threat of competition is enough to "regulate" Qwest's behavior.

IV. PROBLEMS WITH QWEST'S EVIDENCE IN SUPPORT OF ITS PETITION FOR DEREGULATION

Q. WHAT ARE THE PROBLEMS WITH THE MARKET SHARE DATA QWEST RELIED UPON FOR SUPPORT OF ITS DEREGULATION PETITION?

A. First, as mentioned previously, it is important to keep in mind that for the purposes of deregulating Qwest's switched business services, the question is whether competition is sufficient to discipline Qwest's competitive behavior in the absence of regulation. On this point it appears both Qwest and Eschelon agree.

However, when Qwest presents data regarding CLEC lines and market share, it ignores this important caveat and counts lines being utilized by CLECs whether or not they have the ability to place competitive pressures upon Qwest. The fact is that CLEC customers served via resale, UNE-P, or QPP have little or no ability to serve as the competitive discipline necessary to replace regulation. Resale, UNE-P and QPP lines lack this competitive pressure because Qwest has total control over both their availability and their price to CLECs. As a result, when investigating competition in Oregon, only those lines that have the ability to "regulate" Qwest's behavior should be considered in an analysis of competition. Therefore, only lines purchased via unbundled loops or lines fully provisioned by the CLEC should be considered in this type of analysis of competition.

Even the use of unbundled loops and "full facilities-based" lines should be treated with caution. Qwest appears to treat all unbundled loops as though they are used for switched business services, but this is not necessarily the case. Unbundled loops can be used to serve both business and residential customers, and Qwest recognizes this.[17] However, for the purpose of Qwest's analysis, Qwest assumes all unbundled loops are used to serve switched business customers. Further, even if no CLEC uses loops to serve residential customers, it is not necessarily the case that all loops are used for switched business services -- unbundled loops may also

[17] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 23, lines 20 – 23.

be used to provision data services, such as DSL. Qwest made no attempt to adjust the loop counts to ensure that it includes only switched business services.

"Full facilities based" line counts must also be carefully examined because of potential differences in methodologies used to count switched access lines. The data for unbundled loops and Qwest's retail business lines were compiled by Qwest and Qwest presumably attempted to count these on a consistent basis. However, the "full facilities-based" CLEC lines were taken from the staff's CLEC Survey data, which may not mirror Qwest's methodology. Different line count methodologies may significantly impact market analyses.

One example of different methodologies used to count business lines can be seen in Qwest's financial reports. Qwest quarterly reports line count data for different Qwest services so that investors can analyze changes in Qwest's market. In one portion of Attachment D[18] Qwest reports "Total Business Access Lines", for all of Qwest's territory, as 4,297,000. Later, on the same spreadsheet, Qwest reports 66,852,000 business "voice grade equivalent access lines." Both sets of line counts are legitimate, but serve different purposes and count lines in different ways. As a result, care must be taken that similar methodologies are used to count switched lines or else their combination for a competitive analysis is suspect.

The FCC *Local Competition Report* includes a table that reports the "CLEC-Reported End-User Switched Access Lines by State". This table includes data for

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[18] http://media.corporate-ir.net/media_files/IROL/11/119535/2Q2005FINAL.xls

both residential and business lines across the state of Oregon, not just Qwest's territory. As of December 31, 2004 there were 41,403 CLEC lines reported. This number is slightly less than the number from the staff competitive survey that included business-only lines in Qwest's territory as of May 31, 2005. This should raise concerns as to whether the methodology used by "full facilities based" CLECs to count lines for the purpose of the staff survey is consistent with the line counts utilized by Qwest in its testimony.

Q. PLEASE EXPLAIN FURTHER WHY UNE-P AND QPP LINES SHOULD NOT BE CONSIDERED IN THIS ANALYSIS.

A. UNE-P was an effective method available to CLECs to acquire customers at economic cost, giving CLECs the ability, in most areas, to compete with Qwest for retail customers. However, this changed when the FCC eliminated ILECs obligation to provide UNE-P in its Triennial Review Remand Order. Effective March 11, 2006, Qwest will no longer provide UNE-P.[19] As a result of this, Qwest has very few UNE-P lines remaining in Oregon, as most CLECs have migrated to Qwest's UNE-P replacement product called QPP.[20]

While the rates for UNE-P were based on forward-looking economic cost as determined in cost proceedings held before the state commissions, the rates and terms for QPP reflect Qwest's monopoly power in the provision of wholesale services. The QPP contracts significantly increase the cost for unbundled

[19] Direct Testimony of Robert H. Brigham, August 5, 2005, page 27, lines 5 – 6.
[20] Direct Testimony of Robert H. Brigham, page 28, lines 8-9 – "97% of the combined UNE-P/QPP lines in Oregon" are QPP.

switching over the life of the contract; exempt Qwest from most wholesale service quality measures related to UNE-P that were part of the Oregon Performance Assurance Plan ("OPAP"); and terminate, for all CLECs in 2007.

CLECs signed up for the QPP, despite switch port rate increases of over 350% over the life of the contract, because CLECs essentially had no other options. CLECs signed up for QPP as soon as they did, because Qwest sent notices to CLECs threatening to remove the QPP offer from the table, potentially leaving CLECs that did not act without a UNE-P replacement.[21]

Since Qwest is able to dictate the terms and conditions of QPP, this service can hardly be said to place competitive pressures upon Qwest, especially to the degree of supplanting regulation.

[*** Begin Proprietary ***]

[*** End Proprietary ***]

Q. PLEASE EXPLAIN FURTHER WHY RESALE LINES SHOULD NOT BE CONSIDERED IN THIS ANALYSIS.

A. The methodology for setting the resale discount is based on the cost avoided by Qwest from not providing the retail service. Section 252(d)(3) of the

[21] Qwest sent a notice to CLECs on January 4, 2005 stating the following: "In the spirit of continued cooperation with our CLEC partners, Qwest is pleased to announce that QPP™ MSAs are available for signature until January 31, 2005 at the same terms, conditions and rates provided to date. Qwest must receive executed agreements on or before January 31, 2005. After this date, Qwest may withdraw or modify the QPP™ offering, so any CLEC wishing to take advantage of QPP™ as it is presently offered should act immediately."

Telecommunications Act outlines the methodology used to set the resale discount rates.

> WHOLESALE PRICES FOR TELECOMMUNICATIONS SERVICES. — For the purposes of section 251(c)(4), a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.

Therefore, Qwest should be financially indifferent between serving the customer itself or having the customer served by a CLEC using the resale discount. In other words, the profit earned by Qwest is the same whether Qwest serves the customer or the customer is served by a CLEC using the resale discount.

Further, when Qwest changes retail prices, the wholesale prices (including a guaranteed margin) it charges to CLECs using the resale discount change accordingly. For these reasons, CLECs using the resale discount to compete do not impose market discipline with respect to prices. The result is that CLECs using the resale discount cannot replace the Commission for price regulation of Qwest.

Q. ARE QPP AND RESALE IMPORTANT WHOLESALE OPTIONS EVEN IF THEY DO NOT COMPETITIVELY CONSTRAIN QWEST?

A. Yes, although QPP and the resale discount cannot be used to discipline Qwest with respect to prices in the market, these wholesale products continue to play an important role in the development of competition. In order for facilities-based competition to be viable, a CLEC needs, among other things, a sufficient number of customers to justify the building of facilities. QPP and the resale discount can be used to acquire a customer base by which the decision of when and if to build can be made. QPP and the resale discount are thus crucial, especially with the elimination of UNE-P, to the long term survival of competition in the telecommunications market.

Q. CAN YOU RECALCULATE QWEST'S TABLES SHOWING CLEC MARKET SHARE TO ADJUST FOR YOUR CONCERNS LISTED ABOVE?

A. Yes, the tables can be adjusted for some of the concerns listed. I was able to recalculate Qwest's market share tables to more accurately reflect competitor lines that could potentially impose market forces upon Qwest. As previously discussed, I removed UNE-P, QPP and resale lines from CLEC line counts. I was unable to adjust unbundled loops utilized for non-switched business services, such as DSL, or adjust CLEC "full facility" based line counts to ensure these counts are consistent with the Qwest data. The results are below.

Recalculation of Brigham Table B

[* BEGIN CONFIDENTIAL ***]**

[redacted]

[* END CONFIDENTIAL ***]**

Recalculation of Brigham Table C

[* BEGIN CONFIDENTIAL ***]**

[redacted]

[* END CONFIDENTIAL ***]**

Recalculation of Brigham Table E

[* BEGIN CONFIDENTIAL ***]**

[redacted]

[* END CONFIDENTIAL ***]**

Q. WHAT CONCLUSIONS CAN BE REACHED FROM AN ANALYSIS OF THE COMPETITIVE DATA IN THIS CASE?

A. Based on the data above, Qwest faces much less competitive pressure from CLECs than it claimed in its direct testimony.

Q. QWEST ALSO CLAIMS TO FACE INTENSE COMPETITION IN THE SWITCHED BUSINESS MARKET FROM WIRELESS AND VOIP PROVIDERS. ARE QWEST'S CLAIMS CREDIBLE?

A. No, Qwest's claims of competition from wireless and VoIP providers are clearly overstated and not credible.

Wireless

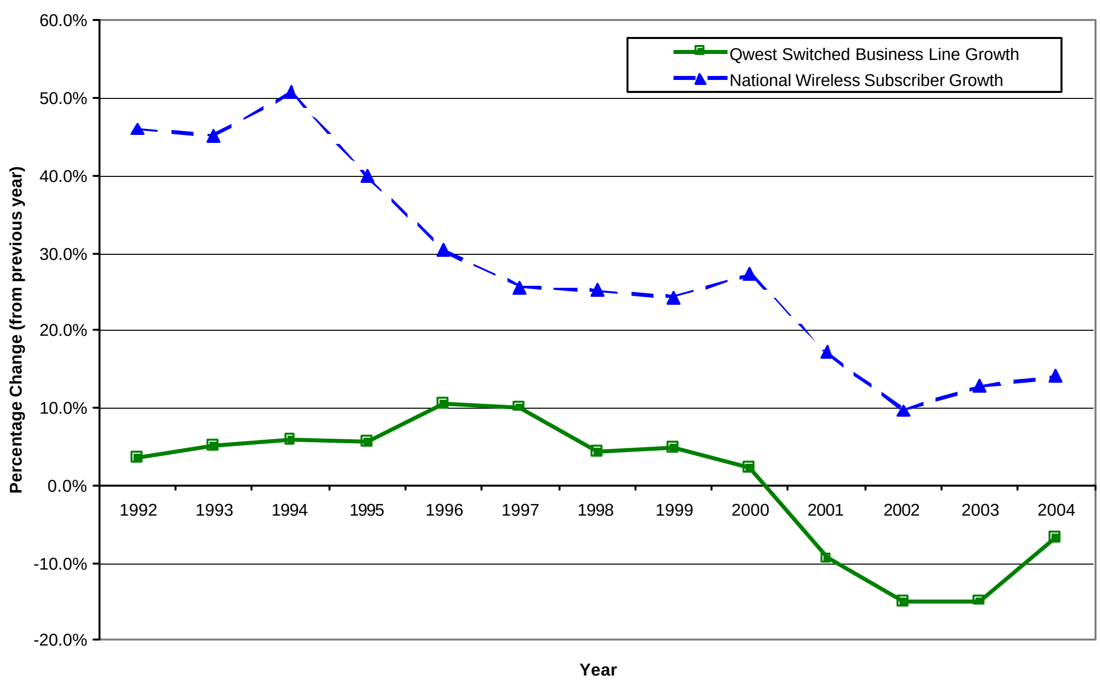
Qwest claims that, because wireless subscribers increased over the same period that business lines decreased, "it is clear that wireless service is gaining market share at the expense of wireline services."[22] Such a statement is incorrect. Simply because two events occur simultaneously does not mean that one event causes the other. The chart below shows nationwide wireless subscriber growth compared with Qwest business access line growth in Oregon.[23] As can be seen in

[22] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 60, lines 21 – 22.

[23] Oregon specific wireless subscriber growth was not used, because state level data does not exist over this time period. Trends in Telephone Service 2005 April 2005. http://www.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend605.pdf

the graph below, growth rates for both wireless and wireline track together, with wireless growth being consistently higher than wireline growth.

Wireless and Business Line Growth Comparison



If Qwest had looked at the period 1992 to 1996, Qwest would have concluded that the growth in wireless subscribers was causing the growth in Qwest's business lines, which would also be incorrect.

This chart suggests that a third cause, such as business cycles, is most likely impacting the growth rates for both wireless subscribers and switched business lines.

Qwest also relies upon a survey in Colorado that concludes customers would **consider** switching from their business service to wireless service if Qwest raised prices by $25 per month.[24] Qwest concludes that "because an increase in Qwest's prices (or a decline in its service quality) would likely cause some business customers to replace their wireline services with a wireless phone," wireless acts to constrain Qwest's prices. This statement is economically incorrect. Even an absolute monopolist faces some degree of pricing constraint, as raising prices at some point decreases a company's profitability – otherwise monopolies would charge infinitely high prices to consumers. The correct calculus is not whether some customers would leave if Qwest were to raise its price, but whether Qwest has the ability to increase its profits by raising its price. In a truly competitive market, no firm has the ability to individually raise prices because all of its customers have alternatives. What the Colorado survey tells us is that wireless does not have the ability to "regulate" Qwest's pricing behavior. According to the Colorado survey Qwest has the ability to almost double its prices to business customers, but would lose only 25 percent of its customers. This means that Qwest can increase revenues by increasing prices, because a relatively small number of Qwest's customers will leave the Qwest network for the wireless network. In other words, demand for switched business services is fairly inelastic with respect to price. This indicates that wireless is a poor substitute for switched business services.

Qwest has offered no evidence that wireless subscribers can or do act as a market constraint upon Qwest's behavior.

[24] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 63, lines 10 – 15.

VOIP

Qwest's claims regarding VoIP competition in the business market blatantly ignore the important fact that VoIP services require last mile access to business customers. Therefore, if VoIP competition for switched business services exists to any significant degree in Oregon, then much of it would already be captured in the unbundled loop data contrary to Qwest's claim.[25]

If, as in the residential market, VoIP providers are relying upon high-speed data connections provisioned by someone other than the VoIP provider, then VoIP services are contributing to Qwest's growing DSL market.

Qwest points to VoIP providers such as AT&T and Vonage as examples of the intense competition it is facing from VoIP providers.[26] Qwest points to an AT&T, December, 2003, press release describing VoIP as AT&T's "major new initiative." Despite AT&T's optimistic outlook, in its 2004 financial results AT&T reported that it had only 53,000 VoIP customers on its new platform nationwide.[27]

The use of nationwide claims by VoIP providers may not be reliable in a state analysis of VoIP. During a workshop before the Arizona Commission in February, 2004, Vonage admitted that, despite having over 500,000 customers nationwide, it had only approximately 2,000 customers in Arizona.

[25] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 39, lines 2 – 3.
[26] Direct Testimony of Mr. Robert H. Brigham, August 5, 2005, page 48, lines 7 – 9; page 70, lines 28 - 29.
[27] http://www.att.com/ar/docs/annualreport_2004.pdf

Qwest has offered no evidence that VoIP subscribers can or do act as a market constraint upon Qwest's behavior.

Q. DOES QWEST OFFER WIRELESS AND VOIP PRODUCTS TO BUSINESS CUSTOMERS?

A. Yes, Qwest offers a number of products that may be cannibalizing their retail switched business offerings. Qwest's most recent financial report boasts growth in wireless and VoIP subscribers. Qwest's wireless subscribers now number 744,000 and Qwest's VoIP business service is available in 250 cities across the country.[28]

The table below shows data from Qwest's ARMIS reports and financial reports. This shows changes in Qwest's switched business lines both in Oregon and in the Qwest region as a whole. This data can be compared with Qwest's reports of Business Voice Grade Equivalents which have been growing every year. Voice grade equivalent counts include total voice grade capacity delivered to business instead of simply switched capacity. While Qwest's switched line counts have decreased in recent years, Qwest's voice grade equivalent counts have clearly grown. One possible explanation for the decline in switched business lines is the increase in the demand for non-switched business services. Similarly, Qwest's DSL lines have been steadily increasing. Consumers may disconnect switched lines used primarily for dial up internet access and instead purchase DSL services

[28] From 2Q 2005 Financial Report
http://media.corporate-ir.net/media_files/irol/11/119535/q_2Q05er.pdf

from Qwest. The result is a customer substituting one Qwest service for another, but is certainly not an indication of increased competition in the switched business line market.

Year	Switched Business Lines (Oregon)	Switched Business Lines (Regional)	Business Voice Grade Equivalents	DSL Subscribers	Wireless Subscribers
2000	482	5,810	34,956	255	805
2001	436	5,222	46,111	432	908
2002	371	4,880	52,058	510	1,114
2003	316	4,362	56,520	638	893
2004	294	4,170	64,932	1,037	767
2Q2005			66,852	1,190	744

Q. QWEST CLAIMS THAT BARRIERS TO ENTRY HAVE BEEN ELIMINATED IN THE LOCAL TELECOMMUNICATIONS MARKET. IS THIS THE CASE?

A. No. In a market as large and diverse as the switched business market in Oregon, there can be only one reason that we do not see a greater degree of competition -- substantial barriers to entry must exist in the market.

A barrier to entry is a circumstance particular to a given industry that creates disadvantages for new competitors attempting to enter the market. The FCC, in its TRO, recognized the following barriers to entry in the local telecommunications market: scale economies, sunk costs, firm-mover advantages, absolute cost advantages, and barriers within the control of the incumbent LEC such as operational or technical barriers. All of these are real barriers faced by CLECs that can impede or slow the development of competition.

Mr. Brigham states that there are no barriers to entry in the local telecommunications market, because these barriers were eliminated by the 1996 Telecommunications Act.[29] While the Telecommunications Act diminished the barriers to entry faced by CLECs it certainly did not eliminate them.

One piece of evidence that demonstrates barriers to entry exist in the local telecommunications market can be seen from the rates Qwest charges CLECs to access the Qwest network. Unit cost, (total cost /demand) in the telecommunications network is largely driven by demand. In other words, the telecommunications network is typically built with sufficient excess capacity such that the additional network cost of adding additional customers is close to zero. The reverse is also true – a reduction in customers served over the existing network does not result in a reduction in network costs. The result is that, if Qwest faced meaningful competition from facility-based providers, Qwest would price wholesale services (UNEs and Resale) in such a way as to encourage the use of its network as opposed to a competitor's network. In fact, if meaningful wholesale competition exists, prices in the wholesale market would reflect the forward-looking economic cost of those wholesale elements. This is the idea behind Total Element Long Run Incremental Cost ("TELRIC") pricing for Unbundled Network Elements. In the TRRO, the FCC recently found that CLECs are not impaired without access to unbundled switching. If Qwest faced meaningful competition from facility-based CLECs, then Qwest's commercial offering for unbundled switching should be close to the forward-looking

[29] Direct Testimony of Robert H. Brigham, August 5, 2005, page 42, line 16.

economic cost of switching--in other words, the TELRIC rates for switching. Competition in such a market would be significant enough to constrain Qwest's pricing behavior. Instead, as discussed previously, Qwest has offered CLECs a temporary replacement for unbundled-switching referred to as QPP. The fact that Qwest proposes to charge almost five times the TELRIC rate for the local switch port demonstrates that Qwest believes significant barriers to entry exist. Qwest clearly does not believe there is a true competitive threat from CLECs building their own switches.

Q. YOU MENTION THAT QWEST'S DOMINANCE OF THE BUSINESS MARKET IN OREGON IS UNLIKELY TO DECLINE IN THE NEAR FUTURE. WHAT LEADS YOU TO THIS CONCLUSION?

A. A number of factors point to the fact that Qwest is getting stronger and its market dominance is growing rather than shrinking. Despite Qwest's stated vision of a telecom marketplace where competition has arrived, actual changes taking place today are strengthening Qwest's monopoly power in Oregon. Some of the reasons behind Qwest's strengthening position are described below.

1) <u>FCC Triennial Review</u> – The FCC recently issued its Remand order in its Triennial Review proceeding. Pursuant to that order, final rules are now in place that allow an ILEC to significantly constrain a CLEC's ability to compete. Among the changes being imposed by Qwest as a result of the FCC's findings are:

a) elimination of unbundled switching and thus UNE-P;

b) elimination of UNE DS1 and DS3 loops in certain wire centers;

c) elimination of UNE DS1 and DS3 transport routes between certain wire centers;

d) elimination of dark fiber loops and some dark fiber transport;

e) restrictions placed upon the number of DS1 and DS3 UNE loops that can be purchased to reach a single location;

f) restrictions placed upon the number of DS1 and DS3 UNE transport facilities that can be purchased between two wire centers.

As a result of the FCC's orders, Qwest has issued a list of wire centers where it will no longer provide DS1 and DS3 loops at forward-looking economic cost. In addition, Qwest has provided CLECs a list of transport routes where CLECs will no longer be able to purchase DS1, DS3 and Dark Fiber transport at TELRIC rates.

The elimination of TELRIC rates will certainly raise CLECs costs and impact their business plans. [*** Begin Proprietary ***]

[*** End Proprietary ***]

2) <u>Qwest Financial Reports</u> – In its recent press release on 2nd quarter financial results for 2005, Qwest has already begun reporting to its investors that its competitive losses have slowed and that its gains in the

market are rebounding.[30]

Some highlights from Qwest's press release includes:

> This represents the fifth consecutive quarter of stable revenues, as well as **year-over-year growth in mass markets and business revenues**. Wireline revenues benefited from an **improvement in business local**, data and Internet revenues, mass markets growth products such as long-distance and high-speed Internet, as well as wholesale settlements.
>
> Increased package and bundle penetration, **win-back initiatives** and Qwest's "Feet on the Street" customer acquisition program, **and reduction in UNE competition** have delivered benefits to the company.
>
> **Small-business access lines grew** both sequentially and year-over-year. **Access lines resold by Qwest competitors were down** 40,000 sequentially as regulatory changes have leveled the competitive environment.

In fact, a review of Qwest's financial reports shows that the number of resold lines (lines used by competitors such as unbundled loops, resale, UNE-P and QPP) peaked in the 3rd quarter of 2004 and has decreased each quarter since.[31] This is hardly a sign of robust competition as claimed in Qwest's testimony.[32]

Nowhere in its reports does Qwest mention impending doom from alternative forms of competition such as VoIP, wireless, cable providers or CLECs.

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[30] From 2Q 2005 Financial Report
http://media.corporate-ir.net/media_files/irol/11/119535/q_2Q05er.pdf
[31] Qwest's financial reports can be found at:

V. CONCLUSIONS

Q. DOES THE DATA IN THIS CASE SHOW THAT QWEST FACES SUFFICIENT COMPETITION SUCH THAT QWEST'S SWITCH BUSINESS SERVICES CAN BE DEREGULATED IN OREGON?

A. No. A review of the data shows that Qwest faces very minimal effective competition in Oregon. The determination on whether to deregulate Qwest switched business services should be based on the existence of competitive forces that will provide sufficient market discipline on Qwest's behavior. The theory behind relaxing regulation on a firm is that regulation is not needed when the market is able to function in such a way that regulations are not necessary. For example, in a competitive market, price regulation would not be necessary, since no firm in the market would be able to impact prices. Qwest has not demonstrated that such a market has been achieved in Oregon.

Q. WHAT RECOMMENDATIONS DO YOU HAVE FOR THE COMMISSION?

A. Qwest has requested this commission deregulate all switched business services in the entire state of Oregon. The burden of proof in this case is on Qwest to demonstrate that it meets the criteria set forth by the Oregon statute and rules. Qwest did not meet this burden and thus Qwest's petition should be denied. Qwest confuses competitors with competition. A review of the evidence

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http://phx.corporate-ir.net/phoenix.zhtml?c=119535&p=irol-reportsOther

[32] Direct Testimony of Robert H. Brigham, August 5, 2005, page 20, line 18.

demonstrates that Qwest dominates the switched business market in Oregon and that complete deregulation would only increase Qwest's market power.

As a result, this Commission should reject Qwest's petition to deregulate Qwest's switched business services.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.