

1 **Q. Is there currently a process in Arizona by which services can be classified as**  
2 **competitive?**

3 A. Yes. Current rules allow a carrier to petition the Commission to classify as competitive any  
4 service or group of services. [R-14-2-1108, A.A.C.]. The carrier has the burden of proving  
5 that the service or group of services is competitive. Under current rules, pricing of competitive  
6 telecommunications services must be at or below the maximum tariffed rate, and at or above  
7 TSLRIC. [R-14-2-1109, A.A.C.]. Price changes that fall within this range become effective  
8 with concurrent notice to the Commission. [Id.]. Competitive Telecommunications Services are  
9 defined as: “any telecommunications service where customers of the service within the relevant  
10 market have or are likely to have reasonably available alternatives”. [R-14-2-1102, A.A.C.].  
11 Relevant Market is defined as:

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13 Where buyers and sellers of a specific service or product, or of a group of  
14 services or products, come together to engage in transactions. For  
15 telecommunications services, the relevant market may be identified on a  
16 service-by-service basis, a group basis, and/or by geographic location. [Id.].  
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18 Although the definition of “relevant market” appears to contemplate differentiating competitive  
19 conditions by geographic area, the remainder of the rules seem to indicate otherwise. Nowhere  
20 in the rules is there a specific provision which expressly allows a service to be classified as  
21 competitive in one geographic area while remaining regulated in the remainder of the state.  
22 Thus, even if competition for a particular service were to become quite intense in downtown  
23 Phoenix, there is no clear process available for obtaining competitive status for a service in that  
24 one particular area. Whatever the original intent, until competition advances throughout the  
25 entire state, pricing flexibility would be difficult, if not impossible, to obtain under the existing  
26 rules.  
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**Q. The Company claims that dozens of carriers are now competing with US West in Arizona. How substantial is the competition?**

A. If one judges by the number of announced *competitors*, it may seem substantial. However, if one judges by the extent to which these firms have actually entered the market and are actually persuading customers to try new carriers, the situation looks far different.

The sheer number of announced competitors by itself reveals very little at this early juncture. A lone whale doesn't get much competition from a school of minnows. Depending upon how many actual *customers* these firms have obtained, the level of revenues they are generating, and the extent to which these customers are profitable to serve (and thus the competitors are likely to remain viable) one can reach vastly different conclusions about the actual status of a market.

Consider, for example, how the situation would differ if new entrants are forced to sell their services below cost in order to overcome customer inertia, or to overcome customers' perception that US West's offerings are the "safest" and most reliable choice. Under these circumstances, the economic barriers to entry may remain quite high, despite the nominal presence of a large number of entrants. The telling detail would be the extent to which the new firms have gained market share, and are likely to soon grow large enough to truly challenge US West's dominant position in the market.

In judging the extent to which barriers to entry have declined, the market share of the combined competitors--and the distribution of that market share in various geographic submarkets-- can reveal much about the true state of the market.

**Q. What is US West's current market share in Arizona?**

A. Nowhere in its prefiled case does the Company supply any evidence concerning this vital indicator of competitive conditions. However, internal documents and data supplied by the

1 Company in response to discovery confirm the obvious—the Company continues to enjoy quasi-  
2 monopoly status in most markets. For example, US West periodically prepares a Competitive  
3 Report for internal use, which was provided in response to discovery. The most recent report I  
4 have seen indicates that, as of May 2000, the Company’s statewide residential market share  
5 was \*\*\*Proprietary Proprietary\*\*\* [Response to RUCO 30-001] This provides  
6 an indication of the overall extent of competition in the state. However, this percentage was  
7 developed using a rather generous definition of “competition” which includes wireless carriers  
8 and resellers. Many customers consider wireless service to be complementary to traditional  
9 wireline service, rather than considering it to be a substitute or competitive alternative. And,  
10 while resellers compete with US West, they continue to provide substantial wholesale revenues  
11 to US West, and they are limited in the extent to which they can place the Company under  
12 competitive pressure.

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14 **Q. US West wants to initially classify as competitive 47 wire centers for business**  
15 **customers and 23 wire centers for residence customers. Has the Company provided its**  
16 **market share in these particular locations?**

17 A. No. US West apparently does not separately track market share for each wire center, nor has  
18 the Company provided any estimates of its overall market share in the wire centers it wants to  
19 immediately classify as “competitive.” While the Company has provided some limited  
20 information about competitive activity in these locations, the information provided isn’t sufficient  
21 to conclude that competitive pressures are significantly greater in these wire centers than in  
22 other parts of the state, much less that competitive pressures have increased to the point where  
23 increased pricing flexibility is justified.

24 For instance, discovery responses provided by US West in this proceeding indicate that  
25 the Company has \*\*\*Proprietary Proprietary\*\*\* residence access lines in the 23  
26 wire centers that the Company proposes to immediately classify as competitive. [See Response

1 to RUCO 30-002]. This represents approximately **\*\*\*Proprietary Proprietary\*\*\*** of  
2 US West's total residential access lines. In contrast, competitive resellers are using  
3 **\*\*\*Proprietary Proprietary\*\*\*** of the Company's residential 1FR lines in these 23  
4 wire centers, as of June 2, 2000. [Response to RUCO 30-004]. This represents approximately  
5 **\*\*\*Proprietary Proprietary\*\*\*** of the **\*\*\*Proprietary Proprietary\*\*\*** such  
6 lines being resold statewide. While the level of resale competition is slightly higher in these wire  
7 centers, it certainly couldn't be considered significantly more intense than the level of resale  
8 competition in other parts of the state.

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10 **Q. Have you attempted to develop a rough estimate of US West's current residential**  
11 **market share in the wire centers it wishes to immediately declare to be "competition**  
12 **zones"?**

13 A. Yes. I have used information provided by US West through the discovery process, to estimate  
14 the Company's market share in the wire centers it wants to immediately convert to competitive  
15 zones. The most detailed information available is for the number of resold services by wire  
16 center. As of June 2, 2000, **\*\*\*Proprietary Proprietary\*\*\*** US West residential lines  
17 were being resold by competitors in the 23 wire centers. [Response to RUCO 30-004]. As of  
18 June 1, 2000, **\*\*\*Proprietary Proprietary\*\*\*** telephone numbers in these 23 wire  
19 centers were ported to facilities-based competitors, including both business and residential  
20 customers. [Response to RUCO 30-006]. Similarly, **\*\*\*Proprietary Proprietary\*\*\***  
21 Local Interconnection Service ("LIS") trunks were purchased by competitors from US West,  
22 for use in providing service to both residence and business customers. [Response to RUCO  
23 30-007]. Another indication of the magnitude of competitive activity is the fact that just  
24 **\*\*\*Proprietary Proprietary\*\*\*** unbundled loops were being used by competitors to  
25 serve business and residence customers in these 23 wire centers. [Response to RUCO 30-  
26 005].

1           After considering these statistics and others, I estimate that competitors were probably  
2           providing service to roughly **\*\*\*Proprietary           Proprietary\*\*\*** or fewer residential  
3           lines in these 23 wire centers, as of May 2000. The data suggests that more than four years  
4           after passage of the 1996 Telecom Act, the trend towards increased competition is still in its  
5           infancy. US West continues to overwhelmingly dominate the picture, with an overall residential  
6           market share which remains close to **\*\*\*Proprietary           Proprietary\*\*\***, even in the wire  
7           centers where it claims competitive pressures are the most intense.

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9           **Q.    What is your overall impression of the status of competition in Arizona local exchange**  
10           **markets?**

11           A.    Perhaps the 49 wire centers identified by the Company have seen more competitive activity  
12           than some other parts of the state, but even in these areas, the trend towards increased  
13           competition is at a very early stage. I expect competitors will continue to refine their business  
14           plans, and will increasingly gain credibility with customers. Over time, they can be expected to  
15           provide an increasingly more significant competitive challenge to US West. However, even the  
16           most generous interpretation of the market data suggests that competitive entry is not an easy  
17           process, and it will be quite a while before US West no longer dominates the market in most  
18           parts of the state.

19           If the existing system of regulation were truly hamstringing US West's ability to respond  
20           to competitive pressures, if barriers to entry had truly declined by as much as the Company  
21           implies, and if asymmetrical regulation were truly placing the company at a severe disadvantage  
22           (e.g., because the Company can't cut prices in response to competitors), the competitors'  
23           market share would be much larger, and the Company's share of the market would be  
24           declining much more rapidly than it actually has.

25           While the data supplied by the Company has limitations and ambiguities which make it  
26           difficult to fully evaluate market conditions, it is more than sufficient to confirm the obvious: it is

1 not yet time to being thinking about deregulating the Company, or providing it with the type of  
2 extreme pricing flexibility that it seeks in this proceeding. US West continues to enjoy a  
3 dominant share of most Arizona telecommunications market, and its competitors are far too  
4 small to provide an adequate substitute for continued regulatory oversight by the Commission.

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6 **Q. Would you please elaborate upon why the current market share data argues against**  
7 **giving US West the pricing flexibility it seeks?**

8 A. Yes. An effectively competitive market cannot emerge until barriers to entry have been lowered  
9 and customers perceive the competitive offerings as adequate substitutes for the services  
10 provided by the dominant carrier. The extent to which barriers to entry persist, and the extent  
11 to which customers accept the competitive offerings as viable substitutes for those of US West  
12 is shown by, *inter alia*, by the way they behave in the marketplace. Until customers actually  
13 change carriers, and are satisfied with the service provided by the new entrants, there is no  
14 empirical basis for assuming that the market has successfully completed the transition from  
15 monopoly conditions to effective competition.

16 Legal barriers to entry were largely eliminated with passage of the 1996 Federal Act,  
17 and many economic and technical barriers to entry are being reduced over time. However, this  
18 does not mean that the remaining barriers to entry are insignificant. To the contrary: the 1996  
19 Federal Act is now more than four years old, yet the transition to effective competition is still at  
20 a relatively early stage. This is confirmed by many indicators, including the fact that very few  
21 customers have ever seriously contemplated changing their local carrier, and the fact that the  
22 total number of competitive local exchange carriers operating in Arizona is much lower than the  
23 analogous number of competitive long distance providers.

24 Even more tellingly, local competitors have not yet enjoyed much success in actually  
25 penetrating the local exchange market, developing a market presence, gaining customers, or

1 building revenues. Despite all the rhetoric and impressive sounding announcements, the actual  
2 level of market penetration is very modest, as indicated by the Company's market share.

3 The mere fact that a certain number of "warm bodies" have shown up and announced  
4 their intention to offer local telephone service is not indicative of the extent to which meaningful  
5 "entry" is actually occurring or the extent to which customers are willing to accept these firms'  
6 offerings as viable substitutes for those of their existing carrier. It is one thing to claim that a  
7 market is potentially "contestable"; it is another (and far more significant) thing to show that  
8 barriers to entry have largely or entirely been eliminated, or to show that the market is in fact  
9 being successfully contested.

10 Government price regulation has historically been imposed on firms like US West as a  
11 substitute for effective competition. In fact, one of the key economic principles underlying  
12 traditional rate of return regulation was the premise that regulation should attempt to simulate  
13 the results of effective competition. The mere presence of new entrants is not sufficient to justify  
14 eliminating the protections afforded by regulation. Regulation should be relaxed, or withdrawn,  
15 as competitive conditions intensify to the point where customers no longer need the protections  
16 it affords. Stated differently, as market conditions evolve, providing customers with more and  
17 more of the benefits of effective competition, (including protection from price gouging), the role  
18 of regulation should evolve and diminish. But, regulatory protections should not be removed  
19 prematurely.

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21 **Q. What is your opinion concerning the sort of retail market share that US West would be**  
22 **expected to retain if barriers to entry didn't exist, and conditions were ripe for a rapid**  
23 **transition to a fully competitive market?**

24 A. Because the local telecommunications markets are evolving and no clear precedents exist, no  
25 one can say for sure. However, there are some indicators. For example, a survey by People's  
26 Choice provides an indication of the potential distribution of market shares that could be

1 expected once an effectively competitive telecom market is established: if given a free choice of  
2 carrier, only 63.5% of residence customers would stay with their incumbent carrier. The rest  
3 would migrate to an IXC, competing utility, or cable company. [*Public Utilities Fortnightly*,  
4 January 1, 1998, p. 15.] This finding is consistent with the actual state of the long-distance  
5 market, in which the incumbent (AT&T) has steadily lost market share over the past 13 years  
6 and now commands barely half. [FCC Long Distance Market Share Report, 4th Quarter  
7 1998, released 3/99.]

8 Admittedly, local and long-distance markets have different characteristics, but these  
9 survey figures are consistent with what one would expect. There are few, if any markets, in  
10 which customers all freely choose the same supplier. Where viable alternatives exist, customers  
11 tend to pick different suppliers based upon their individual tastes and preferences. Conversely,  
12 in markets where a single supplier enjoys an overwhelmingly dominant market share, barriers to  
13 entry typically exist, or the dominant carrier enjoys the benefits of patent protections, market  
14 inertia, or other factors which diminish the effectiveness of the competitive process.

15 In my opinion, technical, legal and economic barriers to entry largely explain the reason  
16 by so few customers have tried another local carrier. Otherwise, it would be reasonable to  
17 expect US West to have already lost somewhere between one-third and one-half of its retail  
18 business. Stated differently, if Phoenix customers truly believed that they can freely choose  
19 amongst a variety of different local telecommunications vendors, one would not see  
20 **\*\*\*Proprietary Proprietary\*\*\*** of the customers remaining with a single supplier.

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22 **Q. It could be argued that market share data are backward-looking and fail to reflect the**  
23 **extent of current and prospective competition. Do you agree?**

24 A. No. In my opinion, market share and market concentration data can provide extremely useful  
25 information in the current context, provided that consideration is also given to trends in that  
26 data. The evidence available in this proceeding indicates that US West continues to enjoy an

1           overwhelmingly large share of most markets. The potential exists for US West to abuse its  
2           market power, or to obstruct the trend towards increased competition, if the regulatory  
3           constraints were removed prematurely. Of course, the door should remain open for US West  
4           to provide the Commission with updated, more complete information concerning competitive  
5           conditions. At some point in the future, there may be evidence that US West's market share has  
6           severely declined in a particular area, and that it is continuing to decline rapidly. Evidence of  
7           that sort would offer greater assurance that US West's market power has been sufficiently  
8           diluted to justify reduced regulation within that particular market.

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