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SOUTHWESTERN BELL TELEPHONE, L.P. D/B/A
SBC MISSOURI

CASE NO. TO-2004-0207

REBUTTAL TESTIMONY

OF

TIMOTHY J. TARDIFF

Cambridge, Massachusetts

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of a Commission Inquiry into) Case No. TO-2004-0207
the Possibility of Impairment without)
Unbundled Local Circuit Switching When)
Serving the Mass Market)

AFFIDAVIT OF TIMOTHY J. TARDIFF

STATE OF CALIFORNIA)

COUNTY OF SAN FRANCISCO

I, Timothy J. Tardiff, of lawful age, being duly sworn, depose and state:

1. My name is Timothy J. Tardiff. I am presently a Vice President – National Economic Research Associates.
2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony.
3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.


Timothy J. Tardiff

Subscribed and sworn to before me this 12th day of January, 2004.


Notary Public

My Commission Expires: Feb. 26, 2004

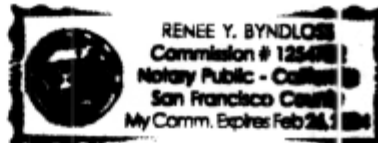


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I. INTRODUCTION

Q. PLEASE STATE YOUR FULL NAME, EMPLOYER AND BUSINESS ADDRESS.

A. My name is Timothy J. Tardiff. I am a Vice President at National Economic Research Associates, 1 Main Street, Cambridge, MA 02142.

Q. ARE YOU THE SAME TIMOTHY J. TARDIFF THAT FILED DIRECT TESTIMONY IN THIS CASE ON DECEMBER 18, 2003?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REPLY TESTIMONY?

A. I respond to the assertions of various witnesses—primarily Dr. August Ankum for MCI,¹ Mr. Joseph Gillan for the CLEC Coalition,² Mr. Michael Starkey for Sage,³ and Mr. Mark Harper for Sprint.⁴ In addition, I respond to testimony filed by Mr. Walter Cecil and Mr. Christopher Thomas of the Missouri PSC Staff. My testimony discusses their recommendations regarding the correct geographic market for the mass-market switching

¹ Direct Testimony of August H. Ankum, on behalf of MCI, before the Missouri Public Service Commission, Case No. TO-2004-0207, December 18, 2003 (“Ankum Direct”).

² Direct Testimony of Joseph Gillan, on behalf of the CLEC Coalition, before the Missouri Public Service Commission, Case No. TO-2004-0207, December 18, 2003 (“Gillan Direct”).

³ Direct Testimony of Michael Starkey, on behalf of Sage, before the Missouri Public Service Commission, Case No. TO-2004-0207, December 18, 2003 (“Starkey Direct”).

⁴ Direct Testimony of Mark D. Harper, on behalf of Sprint, before the Missouri Public Service Commission, Case No. TO-2004-0207, December 18, 2003 (“Harper Direct”).

1 analysis, as well as their general assertions concerning the state of and proper policies for
2 local competition.

3
4 **II. MARKET DEFINITION ISSUES**

5
6 **Q. WHAT HAVE THE VARIOUS WITNESSES RECOMMENDED WITH REGARD**
7 **TO THE GEOGRAPHIC SCOPE OF THE MARKET?**

8 A. The proposals range from Mr. Gillan's suggestion that the geographic extent of the
9 market should be large, e.g., a LATA, to Sprint's and CenturyTel's agreement⁵ with SBC
10 Missouri that the proper market is the MSA, to the Staff's proposal of an exchange
11 forming the market,⁶ to the misguided claims of Dr. Ankum and Mr. Starkey that each
12 ILEC wire center is a separate geographic market.⁷ Significantly, unlike the SBC

⁵ Direct Testimony of Arthur P. Martinez on behalf of CenturyTel, before the Missouri Public Service Commission, Case No. TO-2004-0207, December 18, 2003 ("Martinez Direct"). Mr. Harper and Mr. Martinez qualitatively consider many of the same factors I did when I observed that economic theory and previous decisions by regulators support the conclusion that application of the TRO's market definition rule results in MSAs as reasonable representations of geographic markets.

⁶ Rebuttal Testimony of Christopher C. Thomas on behalf of the Missouri Public Service Commission Utility Operation Division, before the Missouri Public Service Commission, Case No. TO-2004-0207, January 9, 2004 ("Thomas Rebuttal") and Rebuttal Testimony of Walter Cecil on behalf of the Missouri Public Service Commission Utility Operation Division, before the Missouri Public Service Commission, Case No. TO-2004-0207, January 9, 2004 ("Cecil Rebuttal").

⁷ The testimonies of Dr. Ankum and Mr. Starkey not only recommend the same geographic market definition, but also advance very similar rationales to support their recommendation. In contrast, Mr. McCausland (who, like Mr. Starkey, also filed testimony on behalf of Sage), provides a market definition which would produce geographic markets much wider than single wire centers. In particular, he suggests that geographic boundaries should be established with reference to CLEC network deployment. Such a process would produce results similar to what Mr. Fleming and I found when, pursuant to the TRO's rule, we identified the locations of customers actually being served by CLEC switches. Those locations (which are the result of CLEC network deployment) cover major portions of the three MSAs in which SBC Missouri is proposing to apply a trigger analysis. Direct Testimony of Robert W. McCausland, on behalf of Sage, before the Missouri Public Service Commission, Case No. TO-2004-0207, December 18, 2003 ("McCausland Direct") at p. 9.

1 Missouri witnesses (Mr. Fleming and myself), Dr. Ankum, Mr. Starkey, Mr. Gillan, Mr.
2 Cecil and Mr. Thomas have not explicitly applied the FCC's market definition rule,⁸ nor
3 definitively considered the factors the FCC identified in the paragraphs of the TRO that
4 explain the rule.⁹

5
6 **Q. WHY HAVE THE PROPONENTS OF WIRE CENTERS¹⁰ ARRIVED AT AN**
7 **INCORRECT DEFINITION OF GEOGRAPHIC MARKETS?**

8 A. In the context of the requirements of the TRO, they (1) have not performed the analyses
9 required by the TRO's market definition rule, including the explanatory paragraphs and
10 (2) have instead applied their own erroneous re-interpretation of the rule. In addition,
11 they have made other erroneous economic assertions to which I will respond below.

⁸ *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers* (CC Docket No. 01-338), *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996* (CC Docket No. 96-98), *In the Matter of Deployment of Wireline Services Offering Advanced Telecommunications Capability* (CC Docket No. 98-147); Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, FCC 03-36 (released August 21, 2003) ("Triennial Review Order" or "TRO") at 47 U.S.C. § 51.319(d)(2)(i).

⁹ TRO at ¶ 495-496.

¹⁰ As I indicated earlier, Dr. Ankum and Mr. Starkey for the most part present very similar arguments in support of their recommendation that wire centers should be used as geographic markets. Accordingly, I will generally discuss their recommendations according to issue, rather than by the separate witnesses.

**Q. HOW HAVE DR. ANKUM AND MR. STARKEY FAILED TO PERFORM THE
REQUIRED MARKET DEFINITION ANALYSES?**

A. As I described in my direct testimony at page 15, the FCC's market definition rule expressly requires consideration of specific items: the locations of mass market customers being served by CLEC switches, variations in factors affecting competitors' abilities to serve customers, and competitors' ability to target and serve specific markets, in order "to distinguish among markets where different findings of impairment are likely." Further, while state commissions are directed to perform the analysis at a granular level, the FCC made clear that the geographic scope of the market should not be too small, i.e., it should not preclude a CLEC from taking advantage of economies of scope and scale.¹¹

Rather than performing any analysis tied to the objective of identifying areas for which different findings of impairment are likely to emerge, Dr. Ankum and Mr. Starkey have focused on a few aspects of the market definition rule in isolation. In particular, their reasoning amounts to the following: because (1) CLECs make decisions whether or not to serve customers in particular wire centers, and (2) certain factors such as the amount of revenue generated by particular customers can vary from wire center to wire center, and (3) wire centers are "granular," in the sense that data may be available at a wire center

¹¹ TRO at ¶ 495. And a finding of impairment would logically depend on the definition of impairment, i.e., whether efficient CLECs can operate economically absent particular unbundled elements at TELRIC prices (TRO at ¶ 84). Accordingly, the relevance of factors that may vary spatially is not the variation itself, but the extent to which it determines whether or not it is economic for CLECs to operate economically.

1 level and/or CLECs generally can serve ubiquitously throughout a wire center once they
2 have established a presence, then (4) each wire center necessarily constitutes a
3 geographic market. Aside from ignoring the specifics of the FCC's market-definition
4 rule, this mode of analysis conflicts with established economic analysis and market-
5 definition principles.

6
7 **Q. PLEASE PROVIDE EXAMPLES WHERE TERMINOLOGY THAT IS**
8 **COUNTERPRODUCTIVE TO THE TRO'S OBJECTIVES IN DEFINING**
9 **GEOGRAPHIC MARKETS HAS BEEN INTRODUCED.**

10 A. One example is Dr. Ankum's use of the term "unit of analysis" in a way that is almost
11 interchangeable with geographic markets. That view seems to suggest that because data
12 are obtainable at the wire center level, each wire should be viewed as a separate "unit of
13 analysis" and thus as a separate geographic market. That leap of logic is not well
14 founded. For example, Dr. Ankum cites a ruling by the Connecticut commission that
15 appeared to base its market definition on the fact that data may be available on a wire
16 center basis.¹² Significantly, however, the Connecticut commission has explained that it
17 merely wanted data to be presented on a wire center level so that its market analysis
18 could begin there – not because it viewed each wire center as a separate market.
19 Moreover, just because data may be conveniently available for individual wire centers
20 does not automatically mean that (1) CLECs are able to take advantage of scale and

¹² Ankum Direct at p. 31. As Mr. Fleming explains, the Connecticut Commission subsequently clarified its ruling so that geographic markets may be larger than single wire centers.

1 scope economies within individual wire centers and/or (2) findings of impairment would
2 be different for groups of contiguous wire centers within a wider area, such as an MSA.
3 In fact, as Mr. Fleming and I demonstrated in our direct testimonies, (1) CLECs' actual
4 entry decisions demonstrate that they are able to enjoy economies of scale in deploying
5 switches that serve multiple wire centers and (2) that once they have entered within a
6 particular MSA, CLECs generally serve throughout the MSA, demonstrating that
7 findings of impairment do not differ across the wire centers within an MSA.¹³
8

9 Second, Dr. Ankum's distinction between the location of customers and the location of
10 the switch that serves them¹⁴ and his reference to "exhausting economies"¹⁵ are elements
11 of an argument that MCI and/or its witness have made elsewhere that proceeds along the
12 following lines:¹⁶ because CLEC scale economies may not be completely *exhausted*
13 within an area such as an MSA (e.g., a CLEC may serve an area larger than an MSA with
14 a single switch), the TRO's rules can be satisfied by *assuming* that the CLEC has taken
15 advantage of most such economies within each wire center. But assuming something that
16 is clearly contrary to the facts, i.e., that a CLEC could enjoy most of the relevant

¹³ Tardiff Direct at pp. 17-19.

¹⁴ Ankum Direct at p. 19.

¹⁵ Ankum Direct at p. 37

¹⁶ In fact, MCI's witness, Ms. Terry Murray presented such an argument in her rebuttal testimony in a recent Ohio proceeding and her client, MCI, included such arguments in its brief.

1 economies *within* a single wire center, cannot satisfy the TRO's requirement that the
2 geographic market be large enough to accommodate such economies.

3 **Q. IS THERE ANY DOUBT THAT PROPER CONSIDERATION OF CLECS'**
4 **ECONOMIES OF SCALE WILL PRODUCE GEOGRAPHIC MARKETS WIDER**
5 **THAN WIRE CENTERS?**

6 A. Clearly not when the TRO's rule is applied in Missouri, as Mr. Fleming and my direct
7 testimonies demonstrated. Further, CLECs themselves (including MCI, Dr. Ankum's
8 client) have described these economies. For example, a little over one year ago, MCI
9 (then WorldCom) observed that CLECs serve customers in multiple ILEC wire centers
10 with a single switch.¹⁷ And in the ongoing mass market switching proceeding in
11 California, AT&T's (one of Mr. Gillan's clients) economic witness noted the following:¹⁸

12 [I]t is unlikely that the 'efficient CLEC' would enter a state intending to
13 serve only a single wire center. Rather, the model CLEC would likely
14 map out a footprint that is large enough to permit it to realize necessary
15 economies of scale and to market to a broad range of potential customers.
16 In most cases, this will approximate an MSA, LATA or other similarly
17 broad area, while in some very dense areas it may be only a portion of
18 such an area, depending on the local demographics.
19

20 **Q. DR. ANKUM AND MR. STARKEY'S DISCUSSIONS OF HOW GEOGRAPHIC**
21 **MARKETS ARE ECONOMICALLY DEFINED IN OTHER CONTEXTS (E.G.,**

¹⁷ Letter from Donna Sorgi, Vice President, Federal Advocacy, WorldCom to William F. Maher, Chief of the Wireline Competition Bureau, Federal Communications Commission, CC Docket No. 01-338, January 8, 2002.

¹⁸ Direct Testimony of Nicholas S. Economides, on behalf of AT&T, before the Public Utilities Commission of the State of California, Order Instituting Rulemaking on the Commission's Own Motion into Competition for Local Exchange Service. R.95-04-043 and Order Instituting Investigation on the Commission's Own Motion into Competition for Local Exchange Service, I.95-04-044, December 12, 2003 at p. 40.

1 **THE DOJ/FTC MERGER GUIDELINES) SUGGEST THAT THEY BELIEVE**
2 **THEIR RECOMMENDATION OF WIRE CENTERS AS GEOGRAPHIC**
3 **MARKETS IS SUPPORTED BY SUCH ANALOGIES. ARE THEY CORRECT?**

4 A. No. For example, Mr. Starkey appears to believe that because the Merger Guidelines
5 (and similar market definition explanations) *start* with a limited product and geographic
6 scope, correctly defined geographic markets that emerge at the *end* of the process will
7 likely be narrow as well.¹⁹ However, there is no requirement that geographic markets be
8 narrow in scope. Further, in a couple of cases, interpretations of the requirements of
9 geographic market definition that have no basis in economics have been offered. For
10 example, both Dr. Ankum and Mr. Starkey opine that a market must be defined so that
11 every customer has three alternative providers.²⁰ Similarly, Dr. Ankum incorrectly
12 claims that correct geographic market definition requires “near uniformity” of economic
13 and operating conditions.²¹ To the contrary, market definition in economics is not based
14 on any particular number of competitors and does not require uniformity in factors such
15 as cost throughout the entire market. Rather, the fundamental question is whether the
16 firms and products considered to be in the market constrain the ability of any firm to

¹⁹ Starkey Direct at p. 45.

²⁰ Starkey Direct at p. 17. Ankum Direct at p. 17: “It would be wrong as a matter of economic principle, and contrary to the purpose of the trigger analysis, to lump together multiple geographic areas, each of which has fewer than three competitive suppliers, and treat those as a single geographic market in which the trigger is met.”

²¹ Ankum Direct at p. 39

1 increase prices above a competitive level.²² I note further that to the extent that Dr.
2 Ankum and Mr. Starkey intend these statements to be critical of SBC Missouri's
3 recommended geographic market determination, they have set up a straw man. The
4 specific facts that Mr. Fleming and I considered show that in the "trigger" MSAs, there
5 are many individual wire centers where CLECs are serving mass market customers with
6 their own switches. Similarly, we did not ignore variation in factors that may vary across
7 wire centers. Rather, our analysis showed that such variation was not sufficient to
8 produce different findings of impairment, which is the very kind of analysis the FCC
9 intended.

10
11 **Q. BOTH DR. ANKUM AND MR. STARKEY CLAIM THAT THE MOST**
12 **ACCURATE GEOGRAPHIC MARKET DEFINITION WOULD TREAT EACH**
13 **CUSTOMER LOCATION AS A SEPARATE MARKET.²³ ARE THEY**
14 **CORRECT?**

²² See, for example, Department of Justice and Federal Trade Commission *Horizontal Merger Guidelines*, April 2, 1992, Sections 1.1.1:

Absent price discrimination, the Agency will delineate the product market to be a product or group of products such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ("monopolist") likely would impose at least a "small but significant and nontransitory" increase in price. That is, assuming that buyers likely would respond to an increase in price for a tentatively identified product group only by shifting to other products, what would happen? If the alternatives were, in the aggregate, sufficiently attractive at their existing terms of sale, an attempt to raise prices would result in a reduction of sales large enough that the price increase would not prove profitable, and the tentatively identified product group would prove to be too narrow.

²³ Ankum Direct at p. 24 and Starkey Direct at p. 45.

1 A. No. Such a definition is inconsistent with both the FCC's market definition rule for mass
2 market switching and the economic literature they cite. The TRO's requirement that the
3 market not be defined so narrowly as to preclude CLECs from taking advantage of scale
4 and scope economies is the basis for a geographic market much larger than individual
5 customer locations.²⁴ And as a matter of economic theory, customers at different
6 locations would be in the same market, because the prices competing firms would offer to
7 customers in a particular area would be influenced by what was being offered in nearby
8 areas.²⁵ Finally, the FCC chose to define the market in terms of single customer locations
9 in the case of loops, but explicitly and conspicuously did not do so when it came to mass
10 market switching.

11
12 **Q. SHOULD THIS COMMISSION BE CONCERNED ABOUT THE FACT THAT**
13 **THE OFFICE OF MANAGEMENT AND BUDGET DOES NOT CONSIDER**
14 **SPECIFIC TELECOMMUNICATIONS CRITERIA WHEN IT DELIMITS**
15 **MSAS?**²⁶

²⁴ In particular, the TRO paragraph (309) that Dr. Ankum cites to define "considerations of practicality" instead speaks to the accommodation of the scale and scope economies that the TRO mass market switching geographic market definition rule requires: "...in the mass market where revenues are small, customers are typically served in large groups, using uniform technologies and mass marketing and provisioning techniques to minimize the cost of serving each customer."

²⁵ Dr. Ankum's basis for positing such a narrow market is that customers are tied to their locations, e.g., they would not generally be willing to move in order to consume telecommunications services. But such lack of mobility is not unique to telecommunications. For example, residential consumers would be equally reluctant to move to take advantage of home remodeling services. Yet, it is clear that the geographic markets for such services are considerably larger than individual houses.

²⁶ Ankum Direct at p. 40.

1 A. No. The way in which MSAs have been defined is totally irrelevant to whether or not
2 they satisfy the requirements of the TRO's geographic market definition rule. Indeed, the
3 FCC invited Commissions to consider geographic market definitions that they have used
4 for other purposes,²⁷ none of which could have been designed with the requirements of
5 the TRO in mind.

6
7 **Q. DR. ANKUM AND MR. STARKEY SUGGEST THAT THIS COMMISSION CAN**
8 **ALSO SPECIFY THE PRODUCT DIMENSION FOR MASS MARKET**
9 **SWITCHING.²⁸ ARE THEY CORRECT?**

10 A. No. They recommend that the product market be defined to distinguish between business
11 and residential customers. As I described in my direct testimony, however, the FCC has
12 already defined the product market. The only task for this Commission is to distinguish
13 between *mass-market* and *enterprise* customer locations. Their suggestion that the
14 Commission also define a product market here, even when the FCC has already done so,
15 is misguided for two reasons. First, while the FCC suggested that it could treat small
16 business locations differently than residential locations, it said it would do so "where it is
17 appropriate in our analysis."²⁹ But the FCC did not make such a distinction in the case of
18 mass-market switching which clearly indicates that it is not appropriate for a state
19 commission to define such a "product market." Second, the FCC indicated that when it

²⁷ TRO at ¶ 496.

²⁸ Ankum Direct at pp 31-35 and Starkey Direct at pp. 39-42.

²⁹ TRO, fn. 432.

1 found such a distinction to be appropriate, it would include small business locations in
2 the *enterprise* market. Consequently, had it done so, under the unchallenged presumption
3 of non-impairment for enterprise switching, ILECs would no longer have to provide
4 switching at TELRIC-based prices to small business customer locations at all.

5 Further, Dr. Ankum and Mr. Starkey have misconstrued the DOJ/FTC Merger Guidelines
6 in their attempt to justify separate residential and business product markets. The type of
7 price discrimination that may call for separate product markets is that which a
8 hypothetical *profit-maximizing* monopolist would engage in.³⁰ This theoretical construct
9 is a far cry from the historical regulatorily-imposed lower residential basic service prices
10 that typify the telecommunications industry. In fact, the very first reason the D.C. Circuit
11 gave as a deficiency of the previous FCC unbundling requirements was precisely this
12 historical fact.

13 One reason for such market-specific variations in competitive impairment is
14 the cross-subsidization often ordered by state regulatory commissions,
15 typically in the name of universal service. This usually brings about
16 undercharges for some subscribers (usually rural and/or residential) and
17 overcharges for the others (usually urban and/or business)...Competitors
18 will presumably not be drawn to markets where customers are already
19 charged below cost, unless either (1) the availability of UNEs priced well
20 below the ILECs' historic cost makes such a strategy promising, or (2)
21 provision of service may, by virtue of economies of scale and scope, enable
22 a CLEC to sell complementary services (such as long distance or enhanced
23 services) at prices high enough to cover incomplete recovery of costs in

³⁰ See footnote 17 above in which the *Merger Guidelines* utilizes a profit maximizing hypothetical monopolist. In the specific discussion of price discrimination (1.1.2), the Guidelines note:

The analysis of product market definition to this point has assumed that price discrimination--charging different buyers different prices for the same product, for example--would not be profitable for a hypothetical monopolist. A different analysis applies where price discrimination would be *profitable* for a hypothetical monopolist. (emphasis added)

1 basic service. The Commission never explicitly addresses by what criteria
2 want of unbundling can be said to impair competition in such markets,
3 where, given the ILECs' regulatory hobbling, any competition will be
4 wholly artificial.³¹
5

6 In other words, by overlooking the fact that the price differences between residential and
7 business services are the result of public policy and not private profit-maximization, their
8 misapplication of the Merger Guidelines would compound the ILECs' historical
9 "regulatory hobbling" (the requirement that they cross-subsidize certain services) with
10 the continuation of the regulatory hobbling that the UNE platform has increasingly
11 imposed on them.
12

13 **Q. MR. GILLAN DISCUSSES GEOGRAPHIC MARKET DEFINITION ISSUES.³²**
14 **PLEASE PROVIDE YOUR OBSERVATIONS CONCERNING HIS DISCUSSION.**

15 A. First, while Mr. Gillan provides a general qualitative discussion of the TRO's geographic
16 market definition rule, he has not actually performed the fact-intensive analysis that the
17 TRO requires. Further, as I discuss in detail below, Mr. Gillan's attempts to link market
18 definition (or any other aspect of an impairment analysis) to how competitors currently
19 use UNE-P³³ is both irrelevant and misleading. In particular, Mr. Gillan has erroneously
20 interpreted the requirement that the locations of customers served by CLECs (which the

³¹ *United States Telecom Association v. FCC*, 290 F.3d 415 (D.C. Circuit 2002).

³² Gillan Direct at pp. 13-20.

³³ Gillan Direct at pp. 13-17 .

1 TRO's rule requires to be considered) to refer to UNE-P customers, rather than the
2 customers of CLECs that use their own switches.

3
4 **Q. PLEASE SUMMARIZE YOUR CONCLUSIONS ON THE OTHER PARTIES'**
5 **DISCUSSIONS OF GEOGRAPHIC MARKETS FOR MASS MARKET**
6 **SWITCHING.**

7 A. Consistent with the analyses Mr. Fleming and I performed in our direct testimonies, both
8 the TRO's rule for defining mass market switching and economic reasoning support the
9 use of MSAs as the proper geographic scope of the markets for a mass market switching
10 impairment analysis. Indeed, both Mr. Harper and Mr. Martinez arrived at the same
11 conclusion. Dr. Ankum's and Mr. Starkey's contrary recommendation that individual
12 wire centers constitute geographic markets is inconsistent with both the TRO's rule and
13 sound economics.

14
15 **Q. THEN HOW DO YOU RESPOND TO DR. ANKUM'S ALLUSION TO THE**
16 **POSSIBILITY THAT THIS COMMISSION CAN LIMIT THE GEOGRAPHIC**
17 **SCOPE OF THE MARKETS TO THOSE AREAS WHERE COMPETITORS ARE**
18 **SERVING CUSTOMERS WITH THEIR OWN SWITCHES?**³⁴

19 A. This particular suggestion in the TRO by no means supports the use of individual wire
20 centers as geographic markets. Indeed, the data Mr. Fleming and I presented and

³⁴ Ankum Direct at p. 17, which cites footnote 1537 of the TRO.

1 analyzed in our direct testimonies demonstrated that competitors are, in fact, serving
2 customers in multiple wire centers throughout the three “trigger” MSAs and these wire
3 centers cover substantial portions of the MSAs.³⁵

4
5 **Q. DO YOU AGREE WITH THE RECOMMENDATION OF THE STAFF**
6 **WITNESSES THAT EXCHANGES BE USED AS GEOGRAPHIC MARKETS?**

7 A. No. The staff witnesses offer this proposal as a supposed compromise among the
8 competing proposals of the parties³⁶ and further claim that it is consistent with previous
9 Missouri legislation.³⁷ However, the definitive standard for whether a market definition
10 is appropriate for the purpose at hand is whether it comports with the TRO’s rule. And
11 while staff witnesses reproduce the rule,³⁸ they do not carry out the explicit investigations
12 required by that rule: an examination of the locations of customers being served and other
13 factors for the purpose of determining areas where different findings of impairment are
14 likely.³⁹ And while staff correctly observes that the TRO’s requirement that CLEC scale
15 and scope economies be considered implies markets broader than single wire centers,⁴⁰

³⁵ And the locations of customers being served by CLEC switches is only one of the several criteria that the TRO’s rule requires be considered, implying that such an area would be the *minimum* possible area.

³⁶ Cecil Rebuttal at p. 10.

³⁷ Thomas Rebuttal at pp. 11-12.

³⁸ Thomas Rebuttal at p. 13.

³⁹ While Mr. Cecil correctly observes that information relevant to market definition for an impairment analysis is available at the exchange level, staff has not analyzed such information to support their recommendation. Cecil Rebuttal at pp. 11-12.

⁴⁰ Thomas Rebuttal at p. 14.

1 their proposal would nevertheless produce “geographic markets” the majority of which
2 would be single wire centers. While Mr. Thomas correctly notes that state commissions
3 can use geographic areas that have been used for other purposes, it is apparent that such
4 practical considerations come into play only if those areas comport with the specific
5 requirements of the TRO’s geographic market definition rule.

6
7 **Q. PLEASE COMMENT ON MR. CECIL’S CLAIM THAT THE MERGER**
8 **GUIDELINES ARE INAPPROPRIATE FOR DEFINING GEOGRAPHIC**
9 **MARKETS IN THIS CASE.⁴¹**

10 **A.** At the outset, I note that Mr. Fleming’s and my recommendation to use MSAs as
11 geographic markets is not only consistent with economic analysis such as described in the
12 Merger Guidelines, but also perhaps more importantly, is the result of applying the
13 TRO’s market definition rule. Further, the distinction Mr. Cecil attempts to draw
14 between telecommunications and other goods, i.e., that consumers do not typically travel
15 to purchase telecommunications services, by no means rules out the relevance of the
16 standard economic market definition analysis.⁴² Indeed, when defining local exchange

⁴¹ Cecil Rebuttal at pp. 7-8.

⁴² My direct testimony (at pp. 8-9) describes how geographic market determination in the case of mass market switching is similar to the processes used for the typical products Mr. Cecil mentions.

1 markets for purposes of analyzing the effects of a merger, the FCC itself relied on
2 economic analyses consistent with the Merger Guidelines.⁴³

3
4 **III. OTHER ECONOMIC ISSUES**
5

6 **Q. SEVERAL OF THE CLEC WITNESSES, IN GENERAL,⁴⁴ AND MR. GILLAN,⁴⁵**
7 **IN PARTICULAR, URGE THE COMMISSION TO BASE FINDINGS OF**
8 **IMPAIRMENT ON COMPARISONS OF THE VOLUMES THAT CLECS HAVE**
9 **ENJOYED AS A RESULT OF UNE-P. IS SUCH A RECOMMENDATION**
10 **SOUND?**

11 **A.** No. As I observed earlier, the FCC established a focused process for state commissions
12 to perform the trigger analysis. Suggestions that the Commission consider other
13 information are both irrelevant and counterproductive. Furthermore, such comparisons
14 are not only essentially irrelevant (because they have nothing to do with the trigger test in

⁴³ For example, I described in my direct testimony (at pp. 13-14) how the FCC determined that metropolitan areas were the appropriate market for this purpose. The basis for this conclusion was the application of the procedures embodied in the Merger Guidelines: "In evaluating the competitive impact of a proposed merger and thus whether a proposed merger will enhance competition, we use a framework for competitive analysis that we use for assessing market power in other contexts and that is also embodied in the antitrust laws, including the Department of Justice and Federal Trade Commission 1992 Horizontal Merger Guidelines and the April 8, 1997 revisions." *In re Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee, for Consent to Transfer Control of NYNEX Corporation and its Subsidiaries*, File No. NSD-L-96-10, Memorandum Opinion and Order, Released August 14, 1997 at ¶ 37.

⁴⁴ In particular, Mr. Starkey and Mr. McCausland couch their discussion in terms of the operation of a particular UNE-P CLEC.

⁴⁵ Gillan Direct at pp. 5-6.

1 the TRO), it would violate the clear instructions of the D.C. Circuit Court, which the
2 TRO was required to heed. The TRO's impairment standard is clear:

3 We find a requesting carrier to be impaired when lack of access to an
4 incumbent LEC network element poses a barrier or barriers to entry,
5 including operational and economic barriers, that are likely to make entry
6 into a market uneconomic. That is, we ask whether all potential revenues
7 from entering a market exceed the costs of entry, taking into consideration
8 any countervailing advantages that a new entrant may have.⁴⁶
9

10 The impairment standard speaks to whether or not CLECs can economically enter and
11 compete absent the UNE being examined (in this case local switching) and is totally
12 silent on how much volume such entrants can expect to achieve. That outcome will be
13 the result of the competitive *process* that the Telecommunications Act was intended to
14 facilitate⁴⁷ and not some predetermined target demanded by CLECs as part of the
15 regulatory process. Indeed, a hallmark of competitive industries with characteristics
16 similar to telecommunications⁴⁸ is that competitive outcomes (e.g., what types of firms
17

⁴⁶ TRO at ¶ 84, emphasis added.

⁴⁷ "To promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and to encourage the rapid deployment of new telecommunications technologies." Preamble, 1996 Telecommunications Act of 1996. Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 47 U.S.C.)

⁴⁸ In particular, a cost structure that has a high proportion of long-lived capital assets, some of which are subject to rapid technological change.

1 will enter (or leave) markets, what products they will offer, and what shares of the market
2 they will realize) are impossible to predict. A corollary is that regulatory attempts to
3 predetermine such outcomes are at best futile and at worst positively harmful.⁴⁹
4

5 **Q. IN WHAT WAY DOES A UNE-P BENCHMARK VIOLATE THE DIRECTIVES**
6 **FROM THE D.C. CIRCUIT?**

7 A. More than once, the Court admonished against basing impairment on the amount of
8 “competition” that liberal unbundling could produce. For example,

9 If competition performed with ubiquitously provided ILEC facilities counts,
10 the more unbundling there is, the more competition. The Commission, here
11 in unison with the ILEC petitioners, evidently assumes that the
12 Commission-imposed prices are highly attractive to CLECs; on that
13 assumption, universal rules encompassing as many elements as possible
14 would indeed generate a rapid spread of "competition."⁵⁰ But the
15 Commission never makes the argument in quite so stark a form, unwilling
16 to embrace the idea that such completely synthetic competition would fulfill
17 Congress's purposes.⁵¹

⁴⁹ In particular, rather than promote particular outcomes, such as the continued operations of particular CLECs and/or types of business strategies (as suggested by Messrs. Starkey, McCausland, and Gillan), a focus on the competitive process would determine whether or not impairment is present and then leave it to the market to determine how firms will take advantage of the opportunities that proper interpretation of the Telecommunications Act provides.

⁵⁰ For example, if in the extreme UNE switching were available for free, there would likely be a large increase in CLEC volumes and even perhaps reductions in retail prices as well. However, such short-term effects would not last, because the industry could not sustain itself under these conditions.

⁵¹ *USTA v. FCC, op. cit.*. The proposition that TELRIC prices are highly attractive to CLECs is reiterated in the TRO's explanation of its wholesale switching trigger (at ¶ 505): “A competitive carrier that is considering deploying switching facilities for the purpose of providing a wholesale offering is likely to be encouraged to deploy if its deployment will eliminate switching priced at TELRIC rates.” This same reasoning applies to self-deployment as well.

1 **Q. BUT SHOULD NOT THIS COMMISSION BE CONCERNED ABOUT THE**
2 **ALLEGED “DIMINUTION” OF COMPETITION, ESPECIALLY FOR**
3 **RESIDENTIAL CUSTOMERS?**

4 A. A core purpose of the 1996 Act is to promote competition in all markets, and the
5 Commission, in fulfilling its part, will of course be concerned with competition. In this
6 instance, however, the FCC has already determined that the procompetitive goals of the
7 1996 Act are facilitated by not requiring unbundled switching for the mass market where
8 the triggers are met (or potential deployment is likely). Moreover, the alleged
9 “diminution” in competition would be the result of replacing the FCC’s prior unbundling
10 rules, which the D.C. Circuit determined provided overly generous access to unbundled
11 elements and thus were inconsistent with the Telecommunications Act’s impairment
12 standard. That Court soundly rejected the view that more unbundling is synonymous with
13 more competition and the TRO does not permit such an analysis. Further, the attempt by
14 the CLEC witnesses to draw meaningful conclusions about the current levels and trends
15 in service volumes provided by CLECs that self-deploy switches is highly misleading,
16 because of the strong influence that UNE-P at its very attractive price has. That is, any
17 assessment (or prediction) about how self-deploying CLECs would fare absent UNE-P
18 cannot at the same time assume that the debilitating drag of UNE-P on other forms of

1 entry and competition would persist.⁵² In particular, rather than there being no
2 alternatives available to CLECs currently using UNE-P and their volumes consequently
3 drying up in its absence, there would in fact remain the alternatives of self-deployment
4 (and UNE-L), resale, and the use of UNE-L with switching obtained through means other
5 than mandatory unbundling. Indeed, the presence of UNE-P at attractive prices makes
6 predictions of an existing CLEC's viability in a world without UNE-P essentially useless.
7 Just as UNE-switching at attractive TELRIC rates would inhibit a wholesale switch
8 provider, so to would a self-deploying CLEC lack the incentive to expand its switching
9 facilities when UNE-switching is a cheaper alternative.⁵³

10
11 **Q. ARE THERE OTHER REASONS WHY USING UNE-P VOLUMES AS A**
12 **BENCHMARK IS COUNTERPRODUCTIVE?**

13 A. Yes. Very early in the TRO, the FCC clearly stated the superiority of facilities-based
14 competition over other means of entry.⁵⁴

15 Although we recognize that Congress intended to create a competitive
16 landscape through resale, interconnection and facilities-based provision, and
17 a combination of these modes of entry, in practice, we have come to
18 recognize more clearly the difficulties and limitations inherent in

⁵² Ironically, to the extent that CLECs have convinced regulators that the ILECs' current networks are inefficient and as a result succeeded in obtaining low UNE rates, that success is now the basis for their attempts to demonstrate impairment on the basis of a putative loss in current UNE-P volumes.

⁵³ Claims that CLECs are unable to serve mass-market customers without UNE-P would further seem to be undermined by the counter-example provided by the success of GCI in Alaska, a CLEC that serves substantial shares of mass-market customers, especially in Anchorage, with UNE-L and its own facilities. General Communications, Inc., 2002 Annual Report on Form 10-K, pp. 31-34 and "GCI Reports Detailed Third Quarter 2003 Financial Results," November 5, 2003.

⁵⁴ TRO at ¶ 3.

1 competition based on the shared use of infrastructure through network
2 unbundling. While unbundling can serve to bring competition to markets
3 faster than it might otherwise develop, we are very aware that excessive
4 network unbundling requirements tend to undermine the incentives of both
5 incumbent LECs and new entrants to invest in new facilities and deploy
6 new technology.
7

8 Unfortunately, recent data suggests that when such UNEs, and the UNE-P, continue to be
9 available at current rates, facilities-based competition is harmed in the process. In
10 particular, the recent surge in UNE-P volumes that the CLEC witnesses tout has been
11 accompanied by a virtual cessation in the growth of other forms of CLEC deployment.
12 Indeed, the FCC's most recent local competition report shows that while UNE-P volume
13 increased by about 30 percent nationwide between December 2002 and June 2003, UNE-
14 L (as well as resale) volumes actually declined.⁵⁵ In other words, CLEC are starting to
15 reduce their use of self-deployed switching. Similarly, while the volume of UNE-P has
16 more than quadrupled since the end of 2000, the number of CLEC-owned loops
17 (excluding those owned by "intermodal" cable television providers) *declined* by over 20
18 percent.⁵⁶ That is, the increased use of UNE-P has apparently coincided with
19 *disinvestments* in CLEC-owned switch and loop facilities.
20

21 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

22 A. Yes.

⁵⁵ Federal Communications Commission, Industry Analysis and Technology Division, Wireline Competition Bureau, "Local Telephone Competition: Status as of June 30, 2003," December 2003, Table 4.

⁵⁶ Ibid, Tables 3 and 5.