

Exhibit No:
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Sponsoring Party: AT&T Communications of the
Southwest, Inc.
Case No: TO-2001-467

IN THE MATTER OF THE TARIFF OF
INVESTIGATION OF THE
STATE OF COMPETITION IN THE
EXCHANGES OF SOUTHWESTERN BELL TELEPHONE COMPANY

REBUTTAL
TESTIMONY

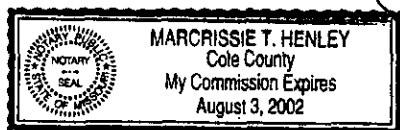
OF

R. MATTHEW KOHLY

FILED²
AUG 16 2001

Missouri Public
Service Commission

Jefferson City, Missouri
August 16, 2001



**BEFORE THE STATE OF MISSOURI
PUBLIC SERVICE COMMISSION
DOCKET TO-2001-467**

1 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

2 **A.** My name is R. Matthew Kohly. My business address is 101 West
3 McCarty Street, Jefferson City, Missouri 65101.

4 **Q. HOW ARE YOU EMPLOYED?**

5 **A.** I am employed by AT&T in its Law and Government Affairs organization
6 as District Manager – Government Affairs. In this position I am responsible for the
7 development and implementation of AT&T's regulatory activities in Missouri.

8 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

9 **A.** I have completed a Master of Science in Agricultural Economics from the
10 University of Missouri as well as a Bachelor of Science in Business Administration also
11 from the University of Missouri.

12 **Q. WHAT IS YOUR PRIOR WORK EXPERIENCE?**

13 **A.** Prior to joining AT&T, I was employed by Sprint Communications Company L.P.
14 as a Manager, State Regulatory Affairs. My responsibilities included the development of
15 Sprint's regulatory policy focusing on issues surrounding competitive market entry such
16 as TELRIC costing of unbundled network elements, universal service, access charges,
17 and Section 271 proceedings.

18 Before that, I was employed at the Missouri Public Service Commission as a
19 Regulatory Economist in the Telecommunications Department and, later, on the
20 Commission's Advisory Staff. While in the Telecommunications Department, I assisted in
21 developing Staff's position on issues related to costing, local interconnection and resale,
22 universal service and tariff issues. While serving on the Advisory Staff, I advised the
23 Commission on economic and competitive issues in the telecommunications industry and
24 assisted in the preparation of orders and opinions. Also, while employed at the

Commission, I participated on the Commission's Arbitration Advisory Staff assigned to mediation and arbitration proceedings filed pursuant to the 1996 Federal Telecommunications Act.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY?

A. I have filed written testimony and/or testified before the Missouri Public Service Commission, Montana Public Service Commission, Oklahoma Corporation Commission and the Telecommunications Regulatory Board of Puerto Rico.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY

A. The purpose of my testimony is to address SWBT's request to have each service it offers designated as a competitive service throughout its entire service territory. My testimony will focus on AT&T's specific concerns with SWBT's request. However, I need to emphasize that the fact that AT&T may not specifically oppose certain aspects of SWBT's request should not be construed as agreement with those aspects of SWBT's request.

Q. WHAT IS SWBT SEEKING IN THIS DOCKET?

A. SWBT is asking the Commission to find that every service it offers faces effective competition throughout all of SWBT's Missouri exchanges and should therefore be classified as competitive and no longer subject to price cap regulation.

Q. WHAT ARE AT&T'S CONCERNS WITH CLASSIFYING SWBT'S SERVICES AS COMPETITIVE?

A. AT&T has two primary concerns. First, as a customer of SWBT's access services, both special and switched, AT&T is concerned that classifying SWBT's access services as competitive will permit SWBT to exercise its monopoly power in the market and increase rates for these bottleneck services. Second, as a competitor of SWBT in both the local and the toll markets, AT&T is concerned that classifying SWBT's retail services as competitive will enable SWBT to engage in predatory pricing to drive competitors such as AT&T from the market. AT&T's focus in this case will be on those two issues.

1
2 **Q. BEING CONCERNED ABOUT ACCESS RATE INCREASES AND PREDATORY**
3 **PRICING AT THE SAME TIME SEEMS LIKE A BIT OF CONTRADICTION. IS IT?**
4

5 **A.** Not at all. AT&T is concerned that SWBT will increase rates for services that realistically
6 do not face competition (i.e. switched access) to recover revenue losses from reducing
7 rates to predatory levels for services that may face competition, such as retail business
8 services. In essence, SWBT would be allowed to engage in what is commonly referred
9 to as Ramsey pricing in which SWBT reduces rates to predatory levels for services facing
10 competition and increases rates for services that are insulated from competitive
11 pressures. AT&T is concerned that SWBT will be in a position to reduce retail rates for
12 business customers to predatory levels and recover those lost revenues through
13 increases in rates for services such as switched or special access that do not face
14 competitive pressures that would discipline SWBT's pricing. In addition, AT&T is
15 concerned that if granted competitive classification, SWBT will attempt to restructure its
16 switched access rates by reducing rate elements such as transport and recovering the
17 reduction through residually priced interconnection charges.

18 **Q. AS AN INTITAL MATTER, MR. HUGHES ASSERTS THAT THERE IS A**
19 **PRESUMPTION THAT SWBT SHOULD RECEIVE COMPETITIVE CLASSIFICATION**
20 **AND THAT THE OTHER PARTIES BEAR THE BURDEN TO DEMONSTRATE THAT**
21 **EFFECTIVE COMPETITION DOES NOT EXIST. DO YOU HAVE A RESPONSE?**
22

23 **A.** I disagree. Pursuant to Section 392.245, the Commission must review the status of
24 competition in exchanges in which at least one CLEC has been certificated and has
25 provided basic local service in that exchange for at least five years. If the commission
26 determines there is not effective competition, SWBT's services cannot be classified as
27 competitive. If the legislature intended for SWBT to automatically have its services
28 declared competitive, the statute would have provided for that. As the statute clearly
29 reads, there is no provision for an automatic conversion to competitive classification.
30 While few parties to this case would agree to the reason why, I believe all parties would
31 agree that the development of local competition has taken far longer and been far more
32 difficult than anyone envisioned at the time the Telecommunications Act of 1996 and
33 Senate Bill 507 became law.

At the time SB 507 became law, the MO legislature may have thought five years was a sufficient time to review whether effective competition existed. However, the fact that the legislature required Commission action as a check before granting competitive status clearly indicates the legislature was not convinced that five years would be sufficient. Just as Mr Hughes suggests that there should be no market share threshold that triggers the determination of whether there is effective competition, there is also no specific time limit that triggers a presumption of effective competition¹. I do agree with SWBT in one sense that market share is not dispositive of whether there is effective competition - - SWBT's competitors could enjoy significantly greater market share than they do today and that would not be conclusive evidence that SWBT faces effective competition. However, as I discuss below, market share data is a sound indicator of various factors related to effective competition.

The effect of the statute is that the Commission must find that there is effective competition before SWBT's services can be classified as competitive services. Whether you start from the presumption that there is effective competition in Missouri as SWBT suggests or the presumption that there is not effective competition when deciding the outcome of this case, the statute still requires there to be effective competition before SWBT's services can be declared competitive.

Q. HAS THE CRITERIA THAT AT LEAST ONE CLEC BE CERTIFICATED AND PROVIDING BASIC LOCAL SERVICE IN AN EXCHANGE FOR AT LEAST FIVE YEARS BEEN MET FOR ALL OF SWBT'S SERVICE TERRITORY

A. Not necessarily. Communications Cable-Laying Company d/b/a Dial US (Dial US) became certificated to offer basic local exchanges service in all of SWBT's exchanges in December 1996. Mr. Hughes notes this on page 17 of direct testimony. However Mr. Hughes does not address whether Dial US's tariffs actually permitted Dial US to offer service throughout all of SWBT's exchanges at that time or whether Dial US was actually providing services throughout all of SWBT's territory at that time. **Q. FOR PURPOSES OF THIS CASE, EFFECTIVE COMPETITION IS DEFINED BY SECTION 386.020(14) RSMo. 2000. CAN YOU IDENTIFY AND DESCRIBE THE VARIOUS COMPONENTS OF THAT STATUTORY DEFINITION?**

A. The statutory definition of effective competition requires the Commission to base its decision on the following factors:

¹ Direct Testimony of Thomas Hughes, page 26.

1. Section 386.020(14)(a) - the extent to which services are available from alternative providers in the relevant market;
2. Section 386.020(14)(b) - the extent to which the services of alternative providers are functionally equivalent or substitutable at comparable rates, terms, and conditions.
3. Section 386.020(14)(c) - the extent to which the purposes and policies of chapter 392, RSMo, including the reasonableness of rates, as set out in section 392.185, RSMo. as set out in section 392.185 RSMo. are being advanced
4. Section 386.020(14)(d) - existing economic or regulatory barriers to entry;
5. Section 386.020(14)(e) - any other factors deemed relevant by the Commission and necessary to implement the purposes and policies of Chapter 392 RSMo. 2000.

Q. CAN YOU DESCRIBE WHAT SECTION 386.020(14)(a) REQUIRES?

A. This section requires the Commission to consider the extent of competition in Missouri. In doing so, Commission must consider both the depth and breadth of local competition in determining whether there is effective competition in Missouri. The best way to determine this is by performing an analysis of market share data and the manner in which competitive services are provisioned by CLECS. While Section 386.020(14)(a) does not explicitly impose a market share threshold, the Commission should consider whether the level and scope of competition in Missouri could effectively discipline SWBT's pricing strategies and restrain SWBT's ability to engage in anti-competitive behavior. In considering whether competition is sufficient to discipline SWBT's pricing strategies and restrain SWBT's ability to engage in anti-competitive behavior, the Commission should also consider the various means, such as resale, unbundled elements, or their own facilities, competitors are relying upon to provision services. Resale is not sufficient to restrain SWBT's pricing activities and CLEC's reliance upon UNEs still leaves them more vulnerable to anti-competitive behavior than a CLEC that self-provisions facilities. That is not to say that CLEC relying on its own facilities are immune from anti-competitive behavior.

If there is not sufficient competition to restrain these activities, the Commission must ensure there are adequate safeguards in place to protect against such behavior. Such consideration is necessary because of the future implications of this case. If SWBT is prematurely deregulated, SWBT will have the market power to increase rates to retail and wholesale customers. SWBT will also have the market power to engage in anti-

1 competitive behavior such as predatory pricing and cross-subsidization designed to
2 restrict CLECs' and IXC's ability to compete.

3 While AT&T believes that market share data by provisioning method is extremely
4 relevant to this case, AT&T does not have that type of data nor did SWBT present such
5 data in its direct case. SWBT is in the best position to determine and reveal to the
6 Commission its market share relative to its competitors - - an individual competitor's
7 market share, even some data on multiple competitors, would still not provide a complete
8 picture. At this time, AT&T cannot put forth a market share analysis. The fact that SWBT
9 has not proffered such data suggests to me that SWBT does not believe it would be
10 favorable to their application. If another party presents such data in rebuttal testimony,
11 AT&T will provide comments in surrebuttal testimony. If this type of data is presented in
12 SWBT's surrebuttal testimony, AT&T may request another round of testimony in order to
13 be able to respond.

14
15 **Q. HAS SWBT PREVIOUSLY PRESENTED ANY TESTIMONY ADDRESSING**
16 **EFFECTIVE COMPETITION AND MARKET CONCENTRATION THAT SHOULD BE**
17 **CONSIDERED IN A MARKET SHARE ANALYSIS?**

18
19 **A.** Yes. In SBC's petitions for 271 approval at both the state and federal level SWBT
20 contended the interLATA long distance market was not effectively competitive. To
21 support this position, SBC retained Richard L. Schmalensee and Paul S. Brandon to
22 analyze the competitiveness of the interLATA long distance market. In their analysis, Dr.
23 Schmalensee and Dr. Brandon made the following conclusion;

24 If a large fraction of the goods or services in a market are supplied by
25 few firms, that market is called highly concentrated. The residential
26 interexchange market certainly qualifies as highly concentrated. In 1998,
27 the latest year for which we have data, AT&T alone had 57 percent of
28 residential interexchange carrier revenues in the U.S., and the Big Three
29 carriers together controlled 80 percent².

30

2 Affidavit of Richard L. Schmalensee and Paul S. Brandon, *In the matter of Application of SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc., d/b/a Southwestern Bell Long Distance, for Provision of In-Region, InterLATA Services in Missouri*, CC Docket No. #, June 2001.

1 The authors also went on to analyze the interLATA toll market and determined
2 that their "findings are inconsistent with effective competition." based, in part, upon the
3 above finding.³ Whether you agree with Dr. Brandon's and Dr. Schmalensee's findings
4 or not, it is quite obvious that the interLATA toll market is significantly more competitive
5 than the local exchange market in Missouri. In Case No TO-99-227, the Commission
6 found that CLECs served about 12% of the access lines in SWBT territory. SWBT's
7 claims that the interLATA market, in which three carriers share 80%, is not effectively
8 competitive completely contradicts SWBT's assertions in this case that the local market,
9 in which a single carrier possesses well over 80% of the market, is effectively
10 competitive.

11
12 **Q. CAN YOU DESCRIBE WHAT SECTION 386.020(14)(b) REQUIRES?**

13
14 **A.** This provision requires the Commission to determine the extent to which services offered
15 by alternate service providers are functionally equivalent to the services offered by
16 SWBT.

17 **Q. WHAT IS REQUIRED TO MEET THIS STANDARD?**

18 **A.** To meet this standard, the services must be relatively substitutable at the retail level. In
19 addition, the services must be functionally equivalent in the manner in which they are
20 provisioned. In other words, the only substitute for SWBT's facilities-based service is
21 another facilities-based service. Resale is not a market substitute for SWBT's services.
22 By itself, resale cannot impose price discipline upon the ILEC. In the local resale market,
23 CLECs receive a percentage discount from SWBT retail rate. If SWBT increases its
24 retail rates, the reseller's costs also increase and the reseller will be forced to also
25 increase its rates to account for the increased costs. This is true whether the reseller
26 provides only regulated local and intraLATA toll service to customers or combines resale
27 with other services such as Cable TV, broadband services, paging or other services.

28
29 **Q. ARE THE SERVICES OFFERED BY AT&T FUNCTIONALLY EQUIVALENT TO THE**
30 **SERVICES OFFERED BY SWBT?**

Ibid. page 3.

1
2 **A.** At the retail level, many of the services offered by AT&T may potentially be
3 functionally equivalent and substitutable to the services offered by SWBT, but the
4 products vary in their availability and subscribership in the differing SWBT exchanges.

5 In addition, there are some product differences that are important and that cause
6 services to not be functionally equivalent or substitutable. For example, AT&T's service
7 offering of AT&T Digital Link Service found in P.S.C. Mo. No. 3, Section 9 is not
8 functionally equivalent to basic local service. This service has a different calling scope
9 and does not include any of the following services; operator assisted services, Special
10 Access Codes, Special Services Codes, or Special Service Codes including 911 and
11 other N11 services. AT&T Digital Link Customer also cannot receive Person-to-Person
12 calls, Collect calls, or Third Number Bill calls. As a condition of purchasing AT&T Digital
13 Link Service, customers are required to purchase basic local service, either from AT&T or
14 another LEC to access the services list above. For this reason, AT&T's Digital Link
15 Service cannot be considered a substitute for standard basic local business services.
16 Consequently, this means all business services are not readily substitutable.

17 In addition, AT&T does not offer any optional intraLATA calling plans that are
18 substitutable to SWBT's Local Plus, Designated Number or other flat-rated intraLATA toll
19 calling plans. Because of the switched access rates and SWBT's failure to make Local
20 Plus and the other services available for resale to facilities-based CLECs and IXC's,
21 AT&T is unable to economically offer a substitutable product.

22 Beyond the retail level, AT&T's toll service is not functionally equivalent to
23 SWBT's intraLATA toll service because AT&T provides intraLATA toll service under very
24 different circumstances than SWBT. As an interexchange carrier originating and
25 terminating intraLATA toll traffic and as a CLEC terminating traffic to SWBT, AT&T is
26 required to pay out-of-pocket switched access charges to SWBT in the provision of toll.
27 These access charges are not cost-based and greatly exceed the incremental cost of
28 SWBT providing the switched access services. As a LEC, SWBT does not have to pay
29 switched access charges when its customers originate an interexchange call or terminate

1 that call to another SWBT end-user. Instead SWBT only considers the incremental cost
2 of switching services when making its pricing decision. While an end-user may view the
3 two services as similar, they are provisioned under vastly different economic
4 circumstances. Therefore, at the wholesale level, AT&T's interexchange services and
5 SWBT's interexchange services cannot be considered functionally equivalent.

6 Similarly, to the extent AT&T relies upon unbundled network elements from
7 Southwestern Bell Telephone Company, the services offered by AT&T cannot be
8 considered functionally equivalent or substitutable as long as SWBT is not provisioning
9 those UNEs at parity with the service SWBT provisions to its own customers. Failure to
10 provide parity service at the wholesale or provisioning level affects the customer's
11 perception of comparability at the retail level by limiting AT&T's ability to provision
12 services in a manner equal to the manner in which SWBT provides the service.

13
14 **Q. BESIDES AT&T, ARE SERVICES OFFERED BY ALTERNATIVE PROVIDERS**
15 **FUNCTIONALLY EQUIVELANT TO THOSE OFFERED BY SWBT?**

16
17 **A.** With respect to services offered by other CLECs, I have not analyzed their
18 offerings and cannot comment on whether they are functionally equivalent to the services
19 offered by SWBT.

20 With respect to some of the "non-traditional" services that SWBT asserts are
21 substitutes; I do not agree that those are functionally equivalent to the services offered by
22 SWBT for the purposes of competing with SWBT's services. For example, SWBT urges
23 the Commission to consider services such as e-mail and instant messaging as
24 functionally equivalent to the services offered by SWBT⁴. I do not think that this is
25 appropriate. While it is possible to type a message and send it to another party, that is
26 not the equivalent of basic local telephone service. Has anyone ever e-mailed an E-911
27 PSAP in an emergency? At some level, all forms of communications are substitutable - -
28 the bottom line is people want to convey a message or information. In that sense, a

4 SWBT fails to consider the fact that a person relying upon e-mail or instant message generally must have basic local phone service and place a phone call to access the Internet and use e-mail. In this instance, e-mail is a complement to basic local service rather than a substitute.

1 mailed letter could be a substitute for local phone service. Obviously the immediacy, and
2 personal and informative nature of hearing someone's voice, distinguishes local phone
3 service from other forms of communication, and certainly distinguishes local phone
4 service from e-mail or instant messaging.

5
6 **Q. SWBT ALSO URGES THE COMMISSION TO CONSIDER WIRELESS PHONES AS A**
7 **SUBSTITUTE FOR SWBT'S BASIC LOCAL SERVICE. DO YOU HAVE A**
8 **RESPONSE?**
9

10 **A.** According to the national data presented by SWBT, 3% of wireless customers
11 elected not to purchase a wireline phone. SWBT contends that this indicates that
12 wireless phones are substitutes for local landline service. I disagree with this
13 interpretation as this data actually shows that wireless service is not a substitute for
14 wireline service. After all, 97% of the people purchasing wireless phones still maintain
15 wireline phones indicating that all but a very few consumers view these services as
16 complements rather than substitutes.

17 **Q. IS THERE A BARRIER TO ENTRY THAT IS UNIQUE TO WIRELESS PROVIDERS**
18 **THAT WISH TO OPERATE IN MISSOURI?**
19

20 **A.** Yes, there is. As it stands today, wireless providers are not recognized
21 as MCA participants in the optional tiers of the MCA zones. Because wireless providers
22 are not recognized as MCA participants, their customers are not treated as optional MCA
23 subscribers by SWBT and other LECs. Thus, this creates the exact same situation that
24 facilities-based CLECs were facing less than a year ago – a customer would switch to a
25 CLEC and suddenly the customer would not be able to receive the same inbound calling
26 scope that customer had when being served by SWBT. Today, customers subscribing to
27 wireless providers, either for fixed-wireless service or traditional cellular will not be able to
28 receive calls from SWBT customers according to the MCA calling scope. As long as the
29 MCA plan discriminates based upon technology, it constitutes a barrier to entry and
30 violates LECs obligations to provide dialing parity to competitors. This barrier needs to
31 be removed before effective competition can exist in the MCA calling areas. Certainly,

1 the presence of this barrier to entry undermines SWBT's claims that wireless phone are
2 substitutes for local landline service and also warrants consideration under the fourth
3 criteria contained in Section 386.020(14)(d) RSMo. 2000 that is described later in my
4 testimony.

5 **Q. CAN YOU DESCRIBE WHAT SECTION 386.020(14)(c) REQUIRES?**

6
7 **A.** Section 386.020(14)(c) - the extent to which the purposes and policies of Chapter 392
8 RSMo 2000, including the reasonableness of rates, are set out in Section 392.185,
9 RSMo. 2000 as set out in section 392.185 RSMo. 2000 are being advanced. While each
10 purpose set forth in this section is relevant and must be considered in the determination
11 of whether or not there is effective competition, I will only focus on three that are directly
12 related to AT&T's concerns. Those three are:

13 Section 392.185(3) – promote diversity in the supply of telecommunications
14 services and products throughout Missouri.

15 Section 392.185(4) – ensure that customers pay only reasonable charges for
16 telecommunications services.

17 Section 392.185(6) – allow full and fair competition to function as a substitute for
18 regulation when consistent with the protection of ratepayers and otherwise
19 consistent with the public interest.

20
21 The first purpose requires the Commission to determine whether granting SWBT
22 competitive classification will promote competitive entry by promoting diversity among
23 telecommunications suppliers. The second requires the Commission to determine
24 whether there is sufficient competition to ensure that customers pay only reasonable
25 charges. Under this requirement, the Commission should consider whether SWBT has
26 the market power to sustain rates that greatly exceed their costs. The fact that SWBT
27 may be able to increase rates does not, in and of itself, mean there is not sufficient
28 competition. However, the ability to sustain rates that greatly exceed the underlying cost
29 of providing the service is an indication that effective competition does not exist. Finally,
30 the purposes set forth in Section 392.185(6) requires the Commission to only classify
31 SWBT's services as competitive if there is sufficient competitive activity to ensure the
32 ratepayers will be protected and that such price deregulation is in the public interest.

1 As with Section 386.020(14)(a), AT&T believes Section 386.020(14)(c) requires
2 the Commission to consider the depth and breadth of local competition in determining
3 whether there is effective competition in Missouri. The best way to do that is by
4 performing an analysis of market share data. While neither section contains an explicit
5 market share loss requirement, AT&T believes the Commission should consider whether
6 the level and scope of competition in Missouri can effectively discipline SWBT's retail
7 pricing and restrain SWBT's ability to engage in anti-competitive behavior. As stated
8 above, AT&T does not have this data and is unable to conduct such an analysis.

9 In addition to looking at level of competition today, this section as well as Section
10 386.020(14)(c) also requires the Commission to consider whether the respective markets
11 are "irreversibly competitive". This case involves the issue of whether or not an ILEC is
12 deregulated going forward. The three criteria mentioned above require the Commission
13 to consider the future ramifications of classifying SWBT's services as competitive.

14 For this reason, the Commission must be certain that effective competition is
15 sustainable going forward as well. If competition is not irreversible or sustainable, the
16 competitive market cannot effectively replace price regulation and price deregulation will
17 be premature.

18 **Q. CAN YOU EXPLAIN THE FOURTH CRITERIA SET FORTH IN THE MISSOURI**
19 **STATUTES?**

20 **A.** The fourth criteria that must be considered is the presence of any existing
21 regulatory or economic barriers to entry. SWBT's witness, Dr. Aron, notes, "The
22 existence of barriers to entry is fundamentally important to ascertaining the
23 competitiveness of a market, especially when few firms (or only one) currently provide
24 service in that market."⁵ If there is a general lack of competition, it is crucial that the
25 Commission consider whether entry barriers are reason for the general lack of
26 competition.
27

28 **Q. IS THERE A GENERAL LACK OF COMPETITION IN MISSOURI?**
29
30

5 Direct Testimony of Dr. Debra Aron, page 19.

1 **A.** The only way to gauge the relative level of competition in Missouri is to compare
2 Missouri to other jurisdictions to evaluate the relative degree of competition in Missouri.
3 A relative lack of competition does indicate the presence of barriers to entry absent
4 another explanation. Dr. Aron cites the Local Telephone Competition: Status as of
5 December 31, 2000 published by the FCC and released in May 2001 in her testimony. In
6 that same report cited by SWBT, Table 6. End-User Lines Served by Reporting Local
7 Exchange Carriers (As of December 31, 2000) provides a comparison of CLEC market
8 share by state. While the data in this report is based upon statewide data and not
9 specific to an individual LEC, it is the best comparative data that is available.

10 According to that report, Missouri CLECs have a 5.5% market share statewide.
11 Using CLEC penetration as a percentage of ILEC lines, Missouri is ranked 25th tying with
12 Indiana. The national average CLEC penetration is 8%. In the Southwestern Bell Five-
13 State serving territory, Missouri significantly lags behind both Texas (12.3%) and Kansas
14 (12.7%) and barely behind Oklahoma (5.8%). Given the relative size of the TX market, it
15 may not be surprising that Missouri lags behind Texas. However, it does seem surprising
16 that Missouri lags behind Kansas and Oklahoma given that Missouri has almost twice as
17 many access lines and two major metropolitan areas as well as significant regional
18 population centers such as Springfield. In its review of SBC's 271 Application, the
19 United States Department of Justice ("DOJ") noted a lack of competition by firms
20 "seeking to use UNEs, including the UNE- platform"⁶ and also noted "there are some
21 indications that a failure by SBC to satisfy all of its obligations may have constrained this
22 type of competition."⁷ The relative lack of competition in Missouri and with the DOJ's
23 findings regarding the use of UNES, indicates a presence of fundamental entry barriers in
24 Missouri that will not permit truly sustainable competition.

25
26 **Q. WHAT IS SWBT'S POSITION REGARDING THE PRESENCE OF REGULATORY OR**
27 **ECONOMIC BARRIERS TO ENTRY?**
28

6 Evaluation of the U.S. Department of Justice SBC-Missouri, May 9, 2001, pg. 6-7.

7 Ibid., pg. 6-7.

1 **A.** SWBT's witness Dr. Aron addresses this issue and concludes that barriers to
2 entry are low in Missouri. In reaching this conclusion, Dr. Aron relies upon two factors to
3 support that conclusion. The first is that the Commission recommended that the FCC
4 approve SWBT's 271 application at the FCC.⁸ The second factor is that carriers have
5 been certified to provide service in an exchange and are providing service⁹.

6
7 **Q. WHAT IS YOUR RESPONSE?**

8
9 **A.** The Commission's 271 recommendation is not synonymous with effective
10 competition. At best, that means the PSC has determined that SBC meets the minimum
11 standards required to open the local market to competition. It does not mean that there is
12 actual effective competition. Indeed, the entire purpose of the M2A was to set out what
13 SWBT would do going forward once the Commission recommended approval of SWBT's
14 271 application. Approval of the M2A did not necessarily mean that SWBT had been or
15 was currently meeting the checklist items.

16 Secondly, the fact that the PSC may have endorsed SWBT's application should
17 not be considered an indicator that SWBT has met the checklist items to demonstrate its
18 local market is open to competition. As has been well publicized, SBC withdrew its
19 application because "concerns surfaced related to cost-based pricing in the region and
20 operations support systems (OSS)."¹⁰ As the DOJ noted, "[p]rices which are not properly
21 cost-based act as a barrier to entry; such prices may prevent entry entirely, or limit entry
22 in type or scale".¹¹ As a result of these barriers to entry, the DOJ noted a general lack
23 of competition by firms "seeking to use UNEs, including the UNE- platform, and there are
24 some indications that a failure by SBC to satisfy all of its obligations may have
25 constrained this type of competition."¹²

26 SWBT has yet to file its second Missouri 271 Application with the FCC. On the
27 same day that rebuttal testimony is due to be filed in this case, SWBT will be making a

8 Direct Testimony of Dr. Aron, page 25.

9 Ibid. page 26.

10 Statement of FCC Chairman Powell, FCC news media release, June 7, 2001

11 Evaluation of the U.S. Department of Justice SBC – Kansas/Oklahoma, Dec. 4, 2000, pg. 10.

1 presentation about what additions, deletions, or modifications SWBT will be making to its
2 original 271 application filed with the FCC. Until the FCC grants approval of SBC's 271
3 application, it is certainly premature to conclude barriers to entry related to checklist items
4 are low.

5 With respect to Dr. Aron's assertions that CLECs are certified to provide service
6 in an exchange and are providing service, the fact that CLEC is certificated does not
7 satisfy the requirements of effective competition. A certificate is only one step in the
8 process of providing service and does not mean the company is actually competing and
9 really is not a good indicator that the company will actually compete in the near future, as
10 many CLECs who were certificated in the wake of the FTA's passage are no longer in
11 business.

12 Regarding the assertion that CLECs are providing service in Missouri, Dr. Aron
13 does not put forth any independent evidence to support her conclusion that CLECs are
14 indeed providing service. Likewise, Dr. Aron does not put forth any independent
15 testimony regarding the number of CLECs actually serving each respective market or the
16 depth of actual competition. In reviewing her testimony, the only thing mentioned that
17 could be interpreted as supporting the claim that CLECs are providing service in Missouri
18 is a response to the question asking Dr. Aron to describe the nature of competition in
19 Missouri in SWBT's territory. In response, Dr. Aron states, "According to data provided to
20 me by SWBT, CLECs with tariffs in Missouri include ..."13. The fact that a CLEC may
21 have approved tariffs does not provide any evidence regarding the actual competition
22 those CLECs provide in SWBT's exchanges in Missouri.

23 **Q. EVEN IF IT WERE PRESUMED THAT SWBT FULLY COMPLIED WITH THE**
24 **REQUIREMENTS OF 271 AND HAD MET EACH OF THE CHECKLIST ITEM AND THE**
25 **PUBLIC INTEREST, WOULD THE CRITERIA FOR EFFECTIVE COMPETITION BE**
26 **SATISFIED?**
27

28 No. As stated above, effective competition goes beyond the requirements of the
29 Section 271 of the TA96 and even SWBT for that matter. Section 271 only requires that

12 Evaluation of the U.S. Department of Justice SBC-Missouri, May 9, 2001, pg. 6-7.
13 Dr. Debra Aron, Direct Testimony, page 8.

SWBT open its markets to competition. Effective competition in this case means going beyond opening markets and requires having meaningful and sustainable competition. If CLECs face barriers to entry that are not related to SWBT's actions, it is still a barrier to entry and effective competition cannot exist. Those barriers may be inability to attract capital, customer perception that choosing service from a CLEC is risky or that new technologies such as fixed-wireless or cable telephony are not as reliable as SWBT's service.

GENERAL COMMENTS

Q. BEFORE YOU ADDRESS SPECIFIC SERVICES OR CONCERNS, DO YOU HAVE ANY GENERAL COMMENTS ON SWBT'S TESTIMONY IN THIS CASE?

A. Yes. I think much of SWBT's testimony is not really relevant as to whether there is effective local competition in Missouri. For example, much of SWBT's testimony attempts to demonstrate there is effective competition in Missouri based upon selected publications, CLEC press releases, trends in cable television and general suppositions about what CLEC's may be doing across the country and what CLECs may do in the future. For example, in support of SWBT's case, several SWBT witnesses refer to investments cable companies have made across the country and cable television market share. SWBT also states that AT&T is the largest cable company in the United States as proof there is effective competition in Missouri. While various facts within those statements may be correct, they do not necessarily or logically support the conclusion that there is effective competition in the local and intraLATA telecommunications markets throughout SWBT's Missouri territory. While AT&T maybe the largest cable company in the United States, AT&T only provides telephony service using cable assets in two exchanges served by SWBT. Further, AT&T has no plans to expand its cable telephony operations into additional SWBT exchanges, and is in fact divesting itself of those telephone operations in those exchanges. Providing telephony service in two exchanges does not mean there is effective competition in those two exchanges much less across SWBT's entire service territory.

1 Mr. Hughes and Mr. Anvin also urge the Commission to speculate on future
2 CLEC activity in determining whether effective competition exists today¹⁴. To some
3 extent, I agree that future CLEC activity in Missouri is relevant since the Commission's
4 decision must consider if the competition is meaningful as well as irreversible. If the
5 Commission is going to rely upon SWBT's collection of press materials, suppositions and
6 national statistics, the Commission should consider some more recent publications that
7 show the current status of the CLEC industry. Two industry publications, PHONE+ and
8 EXCHANGE, each recently published articles discussing the future of CLEC industry.
9 The article in PHONE+ stated that, "[T]wenty percent of the largest CLECs likely will file
10 for bankruptcy protection or go out of business by the end of the year, according to Peter
11 Jarich, director of broadband research at The Strategis. At least 10 percent of the top
12 competitors have already skidded down that road he notes."¹⁵ EXCHANGE magazine
13 notes that 'the increasing number of troubled CLECs has affected overall industry growth.
14 In the past six months, numerous CLECs including Teligent, Inc. (www.teligent.com),
15 Winstar Communications, Inc. (www.winstar.com), ICG Communications
16 (www.icgcomm.com) and e.spire (www.e.spire.com) have filed for bankruptcy
17 protection."¹⁶ In addition to these companies, Covad Communications Group, Inc.,
18 Northpoint Communications Inc. and Rhythms Communications, Inc. also sought
19 bankruptcy protect or completely ceased operations.

20 In addition to bankruptcies, numerous other surviving CLECs have been forced
21 to scale back expansion plans. According to EXCHANGE, "Industry signs indicate that
22 demand for CLEC services remain strong, but factors such as scaled back expansion

14 Sharply contrasting with SWBT's willingness to speculate on future CLEC entry and competitive activities to support is direct case is SWBT's position that its future activities in the event that SWBT receives competitive classification are "irrelevant to any issue in this case." AT&T submitted data requests seeking "copies of all business plans and analysis related to SWBT's pricing strategies in the event that SWBT receives competitive classification in Missouri." Among the numerous objections was SWBT's position that AT&T's request was "irrelevant to any issue in this case." If SWBT's own analysis about its future activities is irrelevant, certainly speculation and suppositions about other companies' activities is also irrelevant.

15 Agents Eye CLECs with Caution, Phone+, John Long, August 2001, page 40.

16 Surviving the CLEC-Tive Market, EXCHANGE, Judy Reed Smith and Marilyn Shen, August 2001, p. 28.

1 plans, tight capital markets and more bankruptcies will affect the industry's market share
2 gained from RBOCs. Examples of those that curtailed expansions include XO
3 Communications, Inc. (www.xo.com), McLeodUSA Inc. (www.mcleodusa.com), and
4 Adelphia Business Solutions, Inc. (www.adelphia.com). XO cut \$2 billion of its budget
5 and McLeodUSA shaved off \$300 million. Adelphia reduced its year-end target of 175
6 markets to 80 markets."¹⁷

7 Also impacting the future of CLEC activity in Missouri are attempts at the FCC to
8 modify the list of UNEs available to CLECs. On April 5, 2001, the Joint Petition of
9 BellSouth, SBC, and Verizon for Elimination of Mandatory Unbundling of High-Capacity
10 Loops and Dedicated Transport ("Joint Petition") was filed with the FCC. If granted, SBC
11 and other ILECs would no longer be required to unbundled High-Capacity Loops and
12 Dedicated Transport. Instead, CLECs would have to self-provision or purchase these
13 facilities at non-cost based rates set by SBC at a time when "[c]apital markets are
14 'basically closed' to CLECs"¹⁸. Obviously, approval of this Petition would have a
15 profound negative impact on Missouri CLECs' ability to continue to serve business
16 customers much less expand their operations. It is a startling contradiction that SWBT's
17 witness Sylvia Acosta Fernandez cites the availability of these UNEs to support claims of
18 effective competition for High Capacity Services in Missouri while SBC is simultaneously
19 trying to eliminate its obligation to make these UNEs available to CLECs. Even if this
20 petition is not ultimately granted, it still harms CLEC's ability to continue to compete by
21 creating uncertainty in the marketplace. Granting SWBT's requests for competitive
22 classification is premature until the Commission is assured that there is effective
23 competition in the local and intraLATA toll markets and that competition is sustainable.
24 Uncertainty about whether or not UNEs will continue to be available eliminates any
25 assurance that competitive entry in Missouri is sustainable.

17 Ibid.

18 *Wall Street Has More Bad News For CLECs*, Communications Daily (Feb. 22, 2001) (2001 WL 5052608) (reporting that Morgan Stanley Dean Witter analyst Todd Scott stated that "[c]apital markets are 'basically closed' to CLECs" and "predicted that telecom IPOs would be 'limited or nonexistent in 2001.'").

1 All of this has affected competitive activity Missouri. Many of the CLECs
2 identified above either did or currently operate in Missouri. Another stark reminder of the
3 uncertainty in the local market in Missouri is that many of the CLECs that are co-
4 sponsoring consultants in other proceedings before the Commission are now asking their
5 co-sponsoring CLECs to pay half of their share up front because of fears CLECs will
6 cease operations and be unable to pay the fees at the end of the case.

7 **Q. SWBT ALSO ATTEMPTS TO APPEASE FEARS OF PREMATURE PRICE**
8 **DEREGULATION BY SUGGESTING THE STATUTE PROVIDES A MECHANISM FOR**
9 **THE COMMISSION TO WITHDRAW SWBT'S COMPETITIVE CLASSIFICATION IF IT**
10 **SO CHOOSES. IS THIS A SUFFICIENT SAFEGUARD?**
11

12 **A.** Absolutely not. In order to withdraw SWBT's competitive classification pursuant
13 to Section 392.245(5), the Commission would have to conduct a hearing and render a
14 decision to determine that effective competition no longer existed. During this time,
15 SWBT would still be functioning as a competitive company. For example, if SWBT were
16 to engage in predatory pricing in an attempt to drive CLECs from the market, some event
17 would have to trigger a Commission inquiry into whether effective competition continued
18 to exist. Once the Commission began that inquiry, it would take several months at a
19 minimum for the Commission to determine that effective competition no longer exists.
20 During that time, SWBT would continue to engage in the predatory pricing or anti-
21 competitive behavior.

22 **Q. FINALLY, SWBT ALSO SUGGESTS THAT THE COMMISSION'S ABILITY TO SET**
23 **UNE RATES AND RESALE DISCOUNTS CAN CONSTRAIN SWBT FROM PRICING**
24 **SERVICES ABOVE MARKET LEVELS. DO YOU HAVE A RESPONSE?**
25

26 **A.** The Commission's ability to set UNE rates and resale discounts is not a substitute for
27 price cap regulation. The TA96 and the FCC's rules requires the Commission to set cost
28 based rates for unbundled network elements without reference to rate-of-return or other
29 rate-based proceeding. In setting those rates, the Commission cannot consider SWBT's
30 retail pricing activities. A Commission decision that set low UNE rates because SWBT
31 was charging excessive retail rates would certainly be challenged in the courts by SWBT.
32 Unless those UNE rates could be cost justified, they would most likely be overturned.
33

1
2 **Q. AN ADDITIONAL COMMON THEME THROUGHOUT MUCH OF THE TESTIMONY**
3 **FILED BY SWBT IS THAT REGULATORY PARITY IS NEEDED TO PROMOTE**
4 **COMPETITION. DO YOU HAVE A RESPONSE?**

5
6 **A.** In and of itself, regulatory parity is not a reason to deregulate. Regulated firms
7 must be regulated based upon their market power. The fact that a CLEC may be
8 regulated differently from an ILEC is not an injustice as SWBT asserts. Instead, it is
9 simply the recognition that firms have different market power and, therefore, need to be
10 regulated differently. Disparate regulatory treatment is nothing new. As Mr. Hughes
11 points out, on Sept. 15, 1989, the Commission ruled that AT&T must be regulated as a
12 transitionally competitive company while all other interexchange carriers were classified
13 as competitive carriers¹⁹. At that time regulators felt that AT&T should be treated
14 differently than other interexchange carriers. Eventually, competition in the interLATA
15 toll market evolved and AT&T is now treated as a competitive company as are the other
16 interexchange carriers.

17 **Q. DOES SWBT POSSESS MARKET POWER IN MISSOURI?**

18 **A.** Yes, SWBT possesses market power in Missouri. In Case No. T0-99-227, the
19 Commission found that CLECs serve approximately 12 percent of access lines in SWBT
20 territory. Therefore, SWBT has an 88 percent market share. An incumbent local
21 exchange carrier with that degree of market share does indeed have market power.

22 **Q. CAN SWBT USE THAT MARKET POWER TO THE DETRIMENT OF CLECS?**

23 **A.** Not only can SWBT use that market power to harm CLECs, SWBT has used that market
24 power to harm competitors. It was less than a year ago that SWBT was still excluding
25 facilities-based CLECs from the MCA plan. In doing this, SWBT prevented its local
26 customers from placing locally dialed calls to CLEC customers in the optional tiers
27 according to the MCA calling scope. The fact that SWBT was able to restrict its own
28 customer's outbound calling scope to exclude CLEC customers and still maintain their
29 monopoly position indicates customers did not have a choice of providers. If customers
30 had a true choice among local providers, they would simply have switched to a CLEC

1 that was not restricting their outbound calling scope. Of course, if the customer did that,
2 their inbound calling scope would have been reduced and friends, family members,
3 customers, etc. served by SWBT would not have been able to call them. Instead of
4 market forces dictating customer choice, it was prolonged litigation and a Commission
5 Order that restored CLECs as MCA participants.

6 In addition to this, SWBT has also shown a willingness to price services below
7 cost in an effort to drive competitors from the local and toll market. Local Plus is the
8 perfect example. The service was originally and continues to be priced below the
9 imputed cost of switched access. The Commission recognized this and tried to remedy
10 the detrimental effect of predatory pricing by requiring SWBT to make the service for
11 resale to CLECs and IXC's. In addition the Commission required that the dialing pattern
12 functionality should be made available for purchase to IXC's and CLECs on both a resale
13 and unbundled network element basis. Recently, "the Commission found that SWBT has
14 not fulfilled its obligation to make Local Plus available for resale by all of its competitors.
15 As a result, those companies seeking to compete against SWBT in the Basic Local
16 Service market through the use of their own facilities, or through the use of unbundled
17 network elements, have been placed at a competitive disadvantage. That disadvantage
18 has continued for nearly three years." In that case, SWBT used its market power to
19 engage in predatory pricing to the disadvantage of CLECs and IXC's for nearly three
20 years. The lesson from this is that even with regulatory oversight, a company with
21 market power can leverage that power to the detriment of competitors and consumers.

22
23
24 **SERVICES PREVIOUSLY DESIGNATED AS TRANSITIONALLY COMPETITIVE**
25

26 **Q. DO YOU AGREE WITH MR. HUGHES THAT SERVICES PREVIOUSLY CLASSIFIED**
27 **AS "TRANSITIONALLY COMPETITIVE" AUTOMATICALLY BECAME CLASSIFIED**
28 **AS COMPETITIVE ON JANUARY 10, 1999?**
29

30 **A. No, I do not. Section 392.245 RSMo. 2000 sets forth a comprehensive regulatory**
31 scheme that governs SWBT's provision of intrastate regulated services, including

SWBT's ability to change prices and the process for designating services offered by SWBT as competitive. When SWBT converted to price regulation, the "Transitionally Competitive" designation for regulated services was no longer applicable. There is nothing in Section 392.245 RSMo. 2000 that allows services to automatically become classified as competitive services. Instead, under Section 392.245.5, a service offered by SWBT can only be classified as competitive in an exchange in which at least one alternative local exchange carrier has provided basic local exchange service for at least five years and the Commission has found that effective competition does exist. When SWBT converted from rate base/rate of return regulation to price cap regulation, this became the standard that SWBT must meet in order for a service to be designated as a competitive service. Indeed, that is the purpose of this proceeding.

Q. DO SWBT'S RECENT RATE INCREASES SUPPORT THE NEW CLAIM THAT ITS TRANSITIONALLY COMPETITIVE SERVICES AUTOMATICALLY BECAME COMPETITIVE ON JANUARY 10, 1999?

A. No. Mr. Hughes provides list of services previously classified as transitionally competitive on page 10 of his Direct Testimony. Included on that list is MTS (i.e. Toll) and Operator Services. On March 30, 2001, SWBT filed a proposed tariff to increase rates for various MTS calling plans and basic schedule rates. In the cover letter filed with that proposed tariff, SWBT stated, "These rates are being increased 8% as allowed under price cap regulation." SWBT made a similar filing to increase rates for operator services on June 5, 2001. As with the previous increase, SWBT stated the rates "are being increased within the 8% cap allowed under price cap regulation". These increase were made more than one year after the January 10, 1999 date that SWBT now claims the services became competitive. The fact that SWBT justified these rate increases as being allowed under price cap regulation more than a year after the date that SWBT now claims the service automatically became competitive undermines their current claims.

ACCESS SERVICES

Q. WHAT IS YOUR RESPONSE TO SWBT'S REQUEST TO HAVE ACCESS SERVICES DELCARED COMPETITIVE SERVICES?

1 A. AT&T is opposed to this request on the grounds that regardless of the number of local
2 providers, switched access is a locational monopoly and not a truly competitive service at
3 this time. When Interexchange Carriers ("IXC") purchase switched access services to
4 originate and terminate interexchange calls, the IXCs have no choice among access
5 providers. For this reason, switched access providers, especially terminating access
6 providers, possess locational monopolies and have market power at the particular
7 location they serve.

8 **Q. CAN YOU EXPLAIN WHAT YOU MEAN BY LOCATIONAL MONOPOLY?**

9 A. Yes. As an IXC and as a CLEC, AT&T purchases switched access services
10 when it provides toll service. When toll customers purchase toll service from AT&T,
11 AT&T, in turn, must purchase wholesale switched access services from that customer's
12 local provider in order to originate and terminate toll calls. AT&T cannot choose among
13 switched access providers but, instead, must purchase access services from the toll
14 customer's local provider. That is because the local provider is the one company that a
15 physical network connection to that customer. If a SWBT local customer selects AT&T
16 as her/his toll provider, AT&T must purchase originating access from SWBT. By
17 selecting AT&T as the toll provider, it is the toll customer that makes the purchase
18 decision for AT&T. For this reason, IXCs are typically considered "captive customers".
19 On the originating side, AT&T has two choices; either provide toll service to the
20 customers or choose not to provide toll service. That is not much of a choice, especially
21 when you consider AT&T is competing against SWBT in the intraLATA toll market. On
22 the terminating side, AT&T does not even have choice of whether to terminate the call or
23 not. When an AT&T toll customer places a toll call, AT&T must terminate that call
24 wherever the toll customer selects. To complete that call, AT&T must purchase access
25 services from the local provider. For that reason, the local provider possesses a
26 locational monopoly and the IXC has no choice.

1 **Q. HAS THE COMMISSION PREVIOUSLY RECOGNIZED THAT SWITCHED ACCESS**
2 **SERVICES WERE NOT SUBJECT TO COMPETITIVE PRESSURE?**

3 **A.** Yes. The Commission recognized that switch access services were not truly
4 competitive, even when offered by CLECs in Case TO-99-596, *In the Matter of the*
5 *Access Rates to be Charged by Competitive Local Exchange Telecommunications*
6 *Companies in the State of Missouri*. The Report and Order from that case states:

7 Consequently, the LECs' exchange access rates are not subject
8 to competitive pressure because IXCs have no choice but to pay
9 them in order to complete their subscribers' calls. An IXC cannot
10 select a lower cost alternative because there is no lower cost
11 alternative. Additionally, because access charges are not billed
12 directly to individual LEC subscribers, the access charges are
13 further insulated from competitive pressure.

14 The LECs thus enjoy a locational or situational monopoly with
15 respect to exchange access services. The IXCs are captive
16 customers, with no choice other than the choice not to serve the
17 customers of a LEC whose access rates are considered to be
18 too high.

19
20 The fact that access services were not subject to competitive pressure was the
21 reason the Commission imposed a cap on the access rates that a CLEC may charge.
22 Just as this logic applies to CLECs, it applies even more so to SWBT because of its
23 dominant position in the exchange access market. In recognition of this, the
24 Commission's statement referenced above cites LECs in general and is not specific to
25 CLECs. The fact that the Commission felt that it was necessary to impose a cap on the
26 rates CLECs may charge for switched access makes it seem incomprehensible that any
27 real consideration would be given to the notion that SWBT's switched access service is
28 effectively competitive and should not be regulated under price cap regulation.

29 **Q. HAS THE FCC MADE A SIMILAR OBSERVATION?**

30 **A.** Yes. The FCC acknowledged, "that the market for access services does not appear to
31 be structured in a manner that allows competition to discipline rates"²⁰.

32

20 Seventh Report and Order and Further Notice of Proposed Rulemaking, CC Docket Number 96-262, adopted April 26, 2001, ¶ 32.

1 **Q. WHAT WAS SWBT'S POSITION IN THE CASE REGARDING THE CAP ON**
2 **SWITCHED ACCESS RATES CHARGED BY A CLEC?**

3
4 **A.** SWBT was one of the parties that insisted a cap on access rates charged by
5 CLEC was necessary. In Case No. TO-99-596, SWBT's Witness Debra Hollingsworth
6 testified that,

7 Originating and terminating access services are not competitive
8 services because access customers (i.e. IXC's), do not have an
9 opportunity to select the CLEC providing either originating or
10 terminating access for toll calls carried by the IXC. For example,
11 if a CLEC end user places a toll call, the IXC selected by the end
12 user to carry this call must pay the CLEC its originating access
13 rates for this call. The IXC is a "captive" customer of this CLEC.
14 Likewise, if this toll call is destined for an end user served by a
15 CLEC in a different exchange, the IXC must pay the CLEC
16 terminating this toll call terminating access. Again, the IXC has
17 not opportunity to choose a difference CLEC with lower
18 terminating access rates to terminate this call.

19
20 In its initial brief, SWBT went on to say that the cap was necessary "to prevent CLECs
21 from imposing runaway and excessive exchange access rates on their captive access
22 customers."²¹ In addition to asserting a cap on switched access was necessary in TO-
23 99-596, in Case No. TO-99-227, SWBT's General Counsel, Paul Lane cited the need to
24 ensure that CLECs capped their switched access rates as one of the reasons that SWBT
25 intervened in virtually every single case involving a CLEC's request for service authority
26 to provide local service. Even though SWBT may have stopped intervening in CLEC
27 applications after being chastised by the Commission, SWBT is still trying to impose the
28 access cap on CLECs. In the recent AT&T/SWBT arbitration, SWBT proposed to place a
29 cap on AT&T's switched access rates.²² Given SWBT's previous testimony and its
30 persistence in ensuring CLECs capped their switched access rates, SWBT's attempts to
31 have its access services declared competitive is sheer hypocrisy. Granting SWBT's
32 request for competitive classification for access services will allow SWBT to impose
33 "runaway and excessive exchange access rates on their captive access customers".

21 Case No. TO-99-428, *In the Matter of the Access Rates to be Charged by Competitive Local Exchange Telecommunications Companies in the State of Missouri*, Initial Brief of Southwestern Bell Telephone Company, page 10.

22 Case No. TO-2001-455, *Application of AT&T Communications of the Southwest, Inc. TCG St. Louis and TCG Kansas City, Inc. for Compulsory Arbitration of Unresolved Issues with Southwestern Bell Telephone Company*

1 These same access customers are also SWBT's toll competitors. It obvious to the most
2 casual of observers that SWBT would certainly have incentive to increase the IXC
3 competitor's wholesale costs in an effort to drive them from the market. For this reason,
4 SWBT's access services must not be declared competitive.

5 **Q. SWBT CONTENTS THAT CLECS HAVE GREATER PRICING FLEXIBILITY THAN**
6 **SWBT AND THEREFORE SWBT IS AT A DISADVANTAGE. DO YOU AGREE?**

7
8 **A.**No. Under price cap regulation, SWBT has the ability to reduce switched access
9 rates to meet any competitive pressures that might be created as a result of by-passing
10 switched access. Other than the mandatory switched access rate adjustment contained
11 in Section 392.245 RSMo, SWBT has not made any move to reduce switched access.

12 SWBT's testimony cites to the fact that wireless long distance and e-mail is being
13 used a substitute for wireline long distance as a reason switched access services must
14 be declared competitive. AT&T agrees that wireless long distance is substituting for
15 wireline long distance. Declaring switched access rates a competitive service is not
16 required to allow SWBT to provide a competitive response. SWBT's high switched
17 access rates and the resulting higher toll rates are the reason why many consumers are
18 using wireless phones to make long distance calls. SWBT can remedy this situation by
19 lowering its switched access rates so that all toll providers can offer intrastate toll
20 services at rates comparable to wireless toll rates. Today, under price cap regulation,
21 SWBT has this ability and can do so at any time.

22 **Q. WHAT DO YOU THINK THE LIKELY OUTCOME WOULD BE IF SWBT'S ACCESS**
23 **SERVICES WERE GRANTED COMPETITIVE CLASSIFICATION?**

24 **A.**Rather than decrease rates if granted competitive classification for switched
25 access, SWBT would likely increase switched access rates to make up for reduced
26 revenues caused by declining access minutes. As this Commission, the FCC, and even
27 SWBT have acknowledged, switched access services are not subject to competitive
28 pressures and absent price controls, SWBT would be able to increase its switched
29 access rates.

1 This belief is further supported by the fact that SWBT's testimony cites Case TR-
2 95-342, *In the Matter of Southwestern Bell Telephone Company's tariff sheets designed*
3 *to restructure local transport rates*, in which SWBT attempted to engage in Ramsey
4 Pricing by reducing rates for transport services and recover that reduction through a non-
5 cost based Interconnection Charge that was less likely to be by-passed by Competitive
6 Access Providers, which is something SWBT is unable to do under price cap regulation²³.
7 In that case, SWBT's proposed Interconnection Charge was rejected because it was not
8 cost-based. If SWBT were granted competitive classification, SWBT could likely impose
9 this same rate structure that was previously rejected. It should also be noted that CLECs
10 are also prohibited from using non-cost based interconnection charges as well so this is
11 not a regulatory parity issue²⁴.

12 Also supporting this belief is the fact that SWBT was granted limited pricing
13 flexibility in the Kansas City MSA of Missouri at the interstate level for some of its special
14 access services such as Mega-Link Custom Service. This new pricing flexibility was
15 justified because of competition. The result of this new flexibility was higher rates for
16 many of the Mega-Link Services since they did not receive the same rate reductions as
17 those subject to price cap regulations.

18
19 **Q. FINALLY, ARE SWBT'S SWITCHED ACCESS SERVICES CONSIDERED A**
20 **"COMPETITIVE SERVICE" AT THE INTERSTATE LEVEL OR IN OTHER STATES?**

21
22 **A. No. The FCC sets SWBT's interstate switched access rates and SWBT does not have**
23 the ability to unilaterally increase those rates or restructure the rate elements. Under the
24 CALLS plan adopted by the FCC, SWBT's interstate switched access rates are set until
25 July, 2005. In addition, SWBT does not have this pricing flexibility in any other state in
26 which it operates.

27
28
29 **INTRALATA TOLL SERVICE**
30

23 Direct Testimony of Sandra Douglas, page 8.

24 Ibid. page 19. -- See Commission's Website -- Application for Certificate of Service Authority for CLEC service

1 **Q. WHAT IS AT&T'S RESPONSE TO SWBT'S REQUEST TO HAVE ITS TOLL**
2 **SERVICES DECLARED COMPETITIVE?**

3
4 **A.** AT&T opposes this request on the grounds that SWBT monopoly in switched access
5 services (a necessary input in the provision of toll) combined with the access rates that
6 are priced above cost, give SWBT the ability to engage in anti-competitive behavior by
7 pricing its retail toll services at or below the price of switched access services in an effort
8 to drive competitors from the market. For this reason, toll services offered by SWBT
9 should not be treated as competitive services and should continue to be subject to a price
10 floor that includes the price of switched access plus an incremental costs.

11 **Q. CAN YOU PLEASE EXPLAIN HOW THE SUBSIDIES PROVIDE SWBT WITH AN**
12 **ARTIFICIAL COST ADVANTAGE?**
13

14 **A.** SWBT's access cost advantage works as follows: If the IXC's and SWBT face the same
15 costs for providing the toll network and marketing and billing portion of intraLATA toll
16 calling, then the only cost difference they will face will be the price each pays for switched
17 access to originate and terminate toll calls. The cost (i.e. switched access rate) to the
18 IXC's for originating and terminating a call in SWBT's Missouri territory averages
19 approximately 6.1¢ per minute while the cost to SWBT to provide the access service is
20 approximately a 1¢ per minute. This allows SWBT to enjoy a 5.1¢ per minute cost
21 advantage when competing with the IXC's for intraLATA toll traffic. In a competitive
22 market where success depends upon fractions of cents, SWBT's 5.1¢ per minute cost
23 advantage in switched access is fatal to its IXC competitors. The following table sets
24 forth a numerical example, which summarizes SWBT's artificial cost advantage.

25
26 **SBC's Access Cost Advantage**

	IXC Provides Toll	SWBT Provides Toll
Revenue to IXC/SWBT	\$0.095	\$0.095
Costs to IXC Access	\$0.061	\$0.010
Exp./Cost Toll Network Costs	\$0.020	\$0.020

Marketing and Billing	\$0.014	\$0.014
Net to IXC	\$0.000	
Net to SWBT		\$0.051

1
2 If the cost of providing the toll portion of the call is approximately 2¢ per minute for both
3 companies then IXCs face a cost of 9.5¢ per minute to provide toll service (6.1¢ for
4 switched access plus 2.0¢ for their toll network plus 1.4¢ for marketing and billing). While
5 SWBT faces an actual cost of only 4.4¢ per minute to provide toll service (1.0¢ for
6 switched access plus 2.0¢ for their toll network plus 1.4¢ for marketing and billing). This
7 provides SWBT with a 5.1¢ advantage.
8

9 **Q. HOW CAN SWBT USE THIS ADVANTAGE TO DRIVE COMPETITORS FROM THE**
10 **MARKET?**
11

12 **A.** If granted competitive classification, SWBT would be able to price its toll services
13 at or near the IXCs' cost of providing toll services. In doing so, SWBT will still enjoy a
14 5.1¢ per minute profit margin because SWBT is receiving access revenues. The IXCs,
15 on the other hand, will be forced to match SWBT's 9.5¢ per minute price to stay
16 competitive. However, at 9.5¢ per minute, the IXCs are earning zero profit while SWBT
17 would be earning a profit of 5.1¢.

18 SWBT would be able to take this one step further and charge lower rates so that
19 the IXC was actually losing money while SWBT would still be earning a profit. Clearly,
20 this creates the ability to engage in anticompetitive pricing to gain market share and drive
21 competitors from the market.
22

23 **Q. HAS THE FCC ADDRESSED THE COMPETITIVE ADVANTAGE PROVIDED TO ILEC**
24 **AFFILIATES BY ACCESS RATES SET CONSIDERABLY ABOVE COST?**
25

26 **A.** Yes. The FCC stated "by driving switched access usage charges closer to their
27 actual costs more quickly than would occur under the existing price cap regime, the
28 CALLS Proposal will minimize the competitive advantages BOC affiliates would have
29 over IXCs in offering long-distance services while switched access rates were
30 significantly above cost."²⁵

31 In sharp contrast, Missouri switched access are not cost-based. For that reason,
32 FCC statements that an ILEC does not have ability to engage in anti-competitive

behavior in the toll markets are irrelevant to Missouri. The FCC is able to take this position at the interstate level because interstate access rates are priced close to incremental cost.

Q. IN MISSOURI, HAS SWBT PROPOSED TOLL OFFERINGS THAT ARE PRICED BELOW THE PRICE OF SWITCHED ACCESS?

A. Yes. At least two of SWBT's intraLATA interexchange offerings, Designated Number and Local Plus are priced based upon incremental costs and are priced below the imputed cost of switched access. SWBT did not make the its pricing decision based upon an imputation analysis.²⁶

Q. HAS THIS COMMISSION CONSIDERED THE COMPETITIVE ADVANTAGE PROVIDED TO SWBT BY ACCESS CHARGES SET CONSIDERABLY ABOVE COST?

A. Yes. The Missouri Commission has recognized this as a problem in the context of intrastate access charges. This competitive advantage is the reason the Commission has required an imputation standard in considering rates for intraLATA toll in the past. This is also the reason the Commission has asked SWBT to make intraLATA toll offers such as Local Plus and 1+Saver that are priced below the price of switched access available for resale to IXC's. When the Commission recently determined that SWBT failed to meet those obligations, the Commission recognized that competitors had been placed at a competitive disadvantage for nearly three years.

Q. IN TESTIMONY, SWBT WITNESSES ASSERT THERE ARE SEVERAL HUNDRED INTRALATA COMPETITORS IN SWBT'S EXCHANGES. DOES THAT MATTER?

A. No. While there may be hundreds of IXC competitors in the intraLATA market, each of them is still relying upon SWBT's switched access service to provision intraLATA toll service. As long as SWBT retains a monopoly in the upstream switched access markets and rates are priced above costs, SWBT still has the ability to engage in predatory pricing whether there is one competitor or six hundred.

Q. WHAT SAFEGUARDS AGAINST PREDATORY PRICING WOULD AT&T LOSE IF SWBT'S TOLL SERVICES WERE CLASSIFIED AS COMPETITIVE?

²⁵ CALLS Order, paragraph 158.

²⁶ Case No. TO-990254, In the Matter of an Investigation Concerning The Primary Toll Carrier Plan and IntraLATA Dialing Parity, Testimony of William C. Bailey, Transcript, page 1682.

1
2 **A.** According to SWBT, competitive classification would permit SWBT to change prices (up
3 or down) on short notice to the Commission without the need of providing cost support for
4 the change. It is the relief from this requirement to provide cost support that AT&T is
5 concerned about. SWBT is seeking to have all of its services declared as competitive. If
6 this request is granted, SWBT would also be considered a competitive company and
7 would be able to lower rates pursuant to Section 392.500(1) after seven days notice to
8 the Commission. The rate reduction would not even require Commission approval to be
9 effective and the Commission would be unable to use any regulatory oversight prior to
10 the tariff going into effect and the service being offered to customers. To regulate
11 SWBT's rates, the Commission would first have to make a finding that SWBT and the
12 service in question was no longer effectively competitive and reclassify the service in
13 question and consequently SWBT. Only after this process was completed would the
14 Commission be able to assert regulatory control over SWBT's rates to prevent
15 anticompetitive behavior. During this time, SWBT could be marketing and offering the
16 service at anticompetitive prices and terms. AT&T believes permitting the opportunity for
17 this type of predatory pricing is completely unacceptable.

18
19 **Q. UNDER WHAT CONDITIONS WOULD AT&T SUPPORT SWBT'S CLASSIFICATION**
20 **OF ITS INTEREXCHANGE SERVICES AS COMPETITIVE?**
21

22 **A.** AT&T would support classifying SWBT's toll services as competitive if SWBT's access
23 rates were reduced to incremental cost. Classifying SWBT's toll services as competitive
24 would be appropriate in this situation because SWBT would no longer have ability
25 to engage in an anti-competitive price squeeze and the services provided by AT&T and
26 SWBT functionally equivalent or substitutable as both companies could make pricing
27 decisions based upon incremental costs.

28 **Q. ARE SWBT'S INTRALATA TOLL SERVICES DEREGULATED IN OTHER STATES?**

29 **A.** In Kansas, SWBT's toll services are price deregulated but are still subject to a price floor
30 of imputed switched access plus incremental costs. In Oklahoma, SWBT's intraLATA
31 toll services are classified as "emerging competitive" in all but three areas. "Emerging
32 Competitive services are subject to a price floor of long run incremental cost plus a 20%
33 markup or an imputation standard where appropriate. In the three areas where SWBT's
34 intraLATA toll services have been classified as competitive, the services are still subject to a
35 price floor of long run incremental cost or an imputation standard.

1
2 **Q. SO FAR, YOUR CONCERNS ABOUT PREDATORY PRICING HAVE FOCUSED ON**
3 **TOLL SERVICES. DO YOUR CONCERNS EXTEND TO THE LOCAL MARKET?**

4
5 **A.** Yes. AT&T is concerned about predatory pricing in the local market.

6 Heretofore, my testimony focused on the intraLATA toll market because there are ready
7 examples of SWBT's attempts to engage in predatory pricing through interexchange
8 services like Local Plus. SWBT also has the same ability to engage in similar conduct in
9 the local market. This is especially true when CLECs rely upon UNEs purchased from
10 SWBT in provisioning services to their customers. In this instance, just as in the toll
11 market, SWBT controls a necessary input and has the ability to discriminate against
12 competitors relying upon SWBT's wholesale UNEs.

13 **Q. HAS SWBT PROPOSED RATES OR PRICING PLANS THAT RAISE CONCERNS**
14 **ABOUT PREDATORY PRICING?**

15
16 **A.** Yes. In the last few months, SWBT has filed several Win-back type tariff filings
17 that raise concerns about predatory pricing as well as the use of term contracts and
18 discriminatory targeting of select customers. Because of opposition to those filings,
19 SWBT has withdrawn several tariffs and one involving term discounts for MCA service
20 was recently suspended by the Commission. If such services are declared competitive,
21 SWBT could easily refile identical or similar tariffs and they could potentially be subject to
22 less regulatory scrutiny. At a minimum, SWBT would be able to file those tariffs with a 7
23 or 10 day effective date making it much more difficult to resolve concerns about predatory
24 pricing, term commitments or the discriminatory targeting of select customers.

25 Regardless of whether SWBT is price deregulated, the Commission should
26 initiate an investigation and rulemaking related to SWBT's "Win-back" operations and
27 pricing. One thing I found troubling in SWBT's testimony was the use of 911 listings to
28 identify the exchanges where CLECs are operating²⁷. AT&T believes this is completely
29 inappropriate. The 911 database is maintained for public safety not for competitive
30 snooping. The fact that SWBT relies upon 911 listings to support its regulatory initiatives
31 raises concerns that SWBT is also using this database for "Win-back" purposes.

1 **Q. DO OTHER STATES IN SWBT'S FIVE STATE REGION HAVE SAFEGUARDS TO**
2 **PREVENT PREDATORY PRICING FOR LOCAL EXCHANGE SERVICES?**

3
4 **A.** Yes. In Texas, where there is significantly more local competition, SWBT is prohibited
5 from pricing a package of services containing basic network services and non-basic
6 services below the lesser of the following:

- 7 • the sum of the long run incremental costs of any basic network services and non-
8 basic services contained in the package; or
- 9 • (2) the sum of the tariffed prices of any basic network services contained in the
10 package and the long run incremental costs of non-basic services contained in the
11 package.

12 In addition, Texas law also prohibits SWBT from pricing basic and non-basic services
13 offered on a stand alone basis below the service's long run incremental cost ("LRIC").²⁸
14 In Kansas, SWBT is prohibited from pricing local exchanges services below LRIC as well.
15 Consequently, even in a state like Texas where more local competition exists than in
16 Missouri, SWBT's pricing flexibility for competitive non-basic services is tempered by a
17 price floor. The wisdom of this approach should be obvious - - unless all of SWBT's
18 services are competitive then SWBT still has a monopoly on some services and can use
19 that monopoly power in those services to subsidize its competitive services. Competitive
20 status may justify allowing flexibility in raising rates because the theory is that competition
21 will discipline rate increases, but competition is no defense against cross-subsidization
22 from monopoly services and so even competitive services must be subject to a price floor
23 as long as SWBT remains a monopoly for some, if not all, of its services.

24
25 **CONCLUSION**

26 **Q. CAN YOU PLEASE SUMMARIZE YOUR TESTIMONY?**

27 **A.** Yes. Pursuant to Section 392.245 RSMo. 2000, the Commission must review
28 the status of competition in exchanges in which at least one CLEC has been certificated
29 and has provided basic local service in that exchange for at least five years. After that

27 Direct Testimony of Thomas Hughes, pgs 26-27.

28 The only exception for non-basic services, such as basic local business service, is when the service's tariffed rate on September 1, 1999 was already below LRIC.

1 review, if the Commission determines that effective competition exists, SWBT's services
2 may be classified as "competitive". SWBT has requested the Commission classify all of
3 SWBT's services as competitive services throughout all of SWBT's exchanges.

4 Based upon the testimony so far, AT&T believes this request is premature.
5 SWBT did not present sufficient data to analyze the extent of competition in Missouri.
6 Examining effective competition requires looking beyond statewide market share or even
7 just the number of CLECs providing service. The fact that pre-paid resellers, or any
8 reseller for that matter, may be serving in each of SWBT's exchanges does not mean
9 there is effective competition for each service offered by SWBT. It is also clear that
10 SWBT still possess the ability to engage in price discrimination. In addition, there are still
11 barriers to entry in Missouri that prevent effective competition.

12 With respect to access services, it is clear that there is not sufficient competition
13 for those services that would warrant price deregulation, as access services do not face
14 competitive pressures. This has been recognized by this Commission, the FCC, and
15 even by SWBT itself. Granting competitive classification to access services would likely
16 lead to excessive and runaway access rates.

17 With respect to other services, AT&T is concerned about predatory pricing. It is
18 clear that SWBT has the ability and incentives to engage in such activities. Indeed,
19 SWBT has done so and is currently doing so. To the extent that competitive
20 classification eliminates or reduces prohibitions against predatory pricing, AT&T believes
21 granting competitive classification is premature.

22 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

23 A. Yes.