COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts	**D.T.E. 01-31**

DIRECT TESTIMONY OF

DR. AUGUST H. ANKUM

On behalf of

Network Plus, Inc.

August 24, 2001

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Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Dr. August H. Ankum. I am a Senior Vice President at QSI Consulting, Inc., a consulting firm specializing in economics and telecommunications issues. My business address is 1261 North Paulina, Suite #8, Chicago, IL 60622.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. I received a Ph.D. in Economics from the University of Texas at Austin in 1992, an M.A. in Economics from the University of Texas at Austin in 1987, and a B.A. in Economics from Quincy College, Illinois, in 1982.

My professional background covers work experiences in private industry and at state regulatory agencies. As a consultant, I have worked with large companies, such as AT&T, AT&T Wireless and MCI WorldCom ("MCIW"), as well as with smaller carriers, including a variety of competitive local exchange carriers ("CLECs") and wireless carriers. I have worked on many of the arbitration proceedings between new entrants and incumbent local exchange carriers ("ILECs"). Specifically, I have been involved in arbitrations between new entrants and NYNEX, Bell Atlantic, US West, BellSouth, Ameritech, SBC, GTE and Puerto Rico Telephone. Prior to practicing as a telecommunications consultant, I worked for MCI Telecommunications Corporation ("MCI") as a senior economist. At MCI, I provided expert witness testimony and conducted economic analyses for internal purposes. Before I joined MCI in early 1995, I worked for Teleport Communications Group, Inc. ("TCG"), as a Manager in the Regulatory and External Affairs Division. In this capacity, I testified on behalf of TCG in proceedings concerning local exchange competition issues, such as Ameritech's Customer First proceeding in Illinois. From 1986 until early 1994, I was employed as an economist by the Public Utility Commission of Texas ("PUCT") where I worked on a variety of electric power and telecommunications issues. During my last year at the PUCT I held the position of chief economist. Prior to joining the PUCT, I taught undergraduate courses in economics as an Assistant Instructor at the University of Texas from 1984 to 1986.

A list of proceedings in which I have filed testimony is attached hereto as AHA Exhibit -1.

INTRODUCTION AND PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. In the Interlocutory Order on Scope of July 9, 2001, the Department found the following:

> That this proceeding be bifurcated into consecutive phases, and the initial phase of this proceeding will comprise an investigation into whether the services for which Verizon seeks pricing flexibility are sufficiently competitive and whether the remaining

services warrant a departure from traditional cost-of-service or indexed price cap regulation;

My testimony will address Verizon's request for pricing flexibility. I will discuss the twin dangers associated with prematurely granting pricing flexibility to a dominant firm such as Verizon: unless appropriate rules are in place, Verizon could:

(1) *increase* its retail rates and earn supra normal profits at the expense of ratepayers; and/or,

(2) *lower* its retail rates in select circumstances in an exercise of anticompetitive pricing to defeat competitors.

An appropriate price floor would prevent anticompetitive pricing. However, the Department has relegated that discussion to the second phase of this proceeding. In this phase, the Department drects parties to specifically discuss "*whether the services for which Verizon seeks pricing flexibility are sufficiently competitive*." (Emphasis added.) I will show that the current level of competition is *not sufficient* to curtail Verizon's ability to engage in anticompetitive pricing possible under the flexibility sought for the category of services called *All Other Retail Services*.[1]

Further, in order to place Verizon's request for pricing flexibility in the larger context of the state of the competitive telecommunications industry and its ability to curtail Verizon's market power, I present the results of a financial analysis of publicly traded CLECs, including the larger IXCs.

Specifically, I have calculated the change in market value of the CLEC industry over the period of December 31, 1999 through April 23, 2001, based on the value of the common shares held by investors. For the IXC and CLEC industries the total decline in market capitalization over this period is a staggering *$405 billion, or 64%.*[2] The data for just CLECs, excluding IXCs, is $122 billion, or 69%. By contrast, the RBOCs experienced declines in market capitalization over the same period of only 16%, a percentage roughly comparable to the decline in the S&P 500 Index. While this analysis is not specific to Massachusetts, the Department should consider that many of the carriers operating in Massachusetts are affected by these national trends. According to VZ-MA, since the passage of the Telecommunications Act of 1996, in Massachusetts alone there have been approximately *140 instances* of CLECs discontinuing their collocation arrangements and there are no less than *440 requests for CLECs to discontinue their collocation arrangements*.[3] Those data and responses to data requests[4] show that Massachusetts is not isolated from the nationwide decline in the CLEC industry.[5] Furthermore, even to the extent that CLECs

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[1] Verizon Massachusetts Alternative Regulation Plan, paragraph J, as filed on April 12, 2001.

[2] Tables 2.2 through 2.4 below list the CLECs, IXCs, and RBOCs for which the change in market capitalization has been calculated.

[3] See D.T.E. 01-02, VZ-MA's responses to CC 8 – 1 and CC 8 – 10, attached hereto as AHA Exhibit - 2.

[4] See VZ-MA's responses to AG-VZ 3-19.

[5] Collocation arrangements are painfully expensive and represent sunk costs as none of the investments in collocation, other than the equipment itself, can be recovered. When

remain collocated in many offices, collocation by itself is not sufficient to enable facilities based competition. Indeed, Verizon does not make its facilities sufficiently available to CLECs, which are needed to serve end-user customers and foster competition, because Verizon continuously rejects many CLEC orders due to no facilities and does not explain whether the facilities need to be deployed or attached to certain electronics to make them available.[6] Moreover, given Verizon's poor provisioning and maintenance performance, granting Verizon's broad request for nearly unrestricted pricing flexibility will most certainly imperil the further development of competition in the local exchange marketplace.

In short, while Verizon is showing the Department that competitors are serving customers in Massachusetts, the financial state of the CLEC industry Verizon fails to demonstrate that competition is sufficiently robust to curtail Verizon's market power.

SUMMARY OF FINDINGS AND RECOMMENDATIONS

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND STATE YOUR RECOMMENDATIONS.

A. While there is competition in Massachusetts, competitors are clearly in the early stages of development and many rely critically on Verizon's facilities. As

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CLECs abandon them, it is a true sign of trouble in the marketplace and demonstrates that the market cannot be considered irreversibly open to competition.

[6] See, e.g., Verizon's CLEC Industry Letter dated July 24, 2001, available at http://www22.verizon.com/wholesale/frames/generic_frame_east/0,2656,industry_letters,00.html.

such, these competitors' ability to curtail Verizon's market power is limited. This is particularly true for resellers and competitors that rely predominantly on unbundled network elements.

Most importantly, an analysis of market data shows that Verizon is still the dominant firm. Specifically, the market data show that competition is not nearly widespread enough to curtail Verizon's ability to engage in anticompetitive pricing policies against competitors. Again, given that many of competitors are critically dependent on the use of Verizon's facilities, they are particularly vulnerable to such anticompetitive pricing policies. In view of this, it seems unwise to grant Verizon its broad request for nearly unrestricted pricing flexibility for many services. I recommend that if the Commission grants Verizon any pricing flexibility, then it should impose serious and significant restrictions on Verizon's ability to change prices. The nature of those restrictions is the topic of phase two to this proceeding.

EVALUATION OF MARKET CONDITIONS

Q. IN DETERMINING WHETHER MARKETS ARE SUFFICIENTLY COMPETITIVE TO GRANT VERIZON PRICING FLEXIBILITY SHOULD THE DEPARTMENT USE THE SAME STANDARD AS IT DID IN VERIZON'S 271 FILLING?

A. No. The issues before the Department in the current proceeding are different than those in Verizon's 271 filling.

In Verizon's 271 filling, the focus of the Department was on the question of whether Verizon had met the requirements of the Telecommunications Act of 1996 and irreversibly opened its local exchange markets in Massachusetts to competition. The Department and the FCC found this was indeed the case. By contrast, in the current proceeding, the focus is, among others, on the question of whether the level of competition is sufficient to curtail Verizon's market power as a dominant provider of telecommunications services in Massachusetts. As will be discussed shortly, there should a significantly higher threshold to answer this question affirmatively.

Q. IN GENERAL, GIVEN VERIZON'S POSITION AS THE DOMINANT PROVIDER, WHICH ARE THE FORMS OF PRICING STRATEGIES THE DEPARTMENT SHOULD BE CONCERNED ABOUT?

A. The Department directed parties to determine "whether the services for which Verizon seeks pricing flexibility are sufficiently competitive." In this determination, there are two forms of pricing strategies possible under pricing flexibility that should concern the Department. Unless appropriate rules are in place, Verizon could:

(1) *increase* its retail rates and earn supra normal profits at the expense of ratepayers; and/or,

(2) *lower* its retail rates below a relevant price floor in select

circumstances to defeat competitors, potentially driving them out of the market, and deterring others from entry.

It is important to note that these two pricing strategies are not mutually exclusive. To the contrary, the two strategies are most effective for Verizon if they are executed simultaneously.

For example, Verizon would be able to fend off competitors by selectively lowering rates for certain services in certain regions while remaining optimally profitable by raising rates for customers not subject to competition. This strategy would involve *cross-subsidization* from customers not subject to competition to customers that are subject to competition.

Another variation of mixing these two pricing policies may involve the bundling of services that are subject to competition with monopoly services in an effort to circumvent pricing restrictions. This issue, however, is perhaps more appropriately discussed in the second phase of this proceeding.

Q. HAVE YOU READ VERIZON'S PROPOSALS FOR PRICING FLEXIBILITY?

A. Yes. I have read the testimonies and reviewed the Verizon's Massachusetts Alternative Regulation Plan. Verizon is asking the Department for a broad grant of pricing flexibility. The plan provides for important price caps and other restrictions on some residential services. For business services, however, Verizon requests nearly unregulated pricing flexibility; or as the Verizon puts it: "Pricing for these services will be at the discretion of the Company."[7]

Q. IN GENERAL, IS THE CURRENT LEVEL OF COMPETITION SUFFICIENT TO CURTAIL VERIZON'S MARKET POWER?

A. No. While there clearly is competition in Massachusetts, it is important to note that Verizon itself recognizes that, in general, the level and scope of competition is still insufficient to curtail Verizon's market power. Most notably, Verizon itself proposes price caps and other restrictions on its ability to change the rates for certain residential services; presumably, because market forces are not strong enough to keep the company from raising such rates to increase profits.[8]

Q. SPECIFICALLY, IS THE CURRENT LEVEL OF COMPETITION SUFFICIENT TO CURTAIL VERIZON'S ABILITY TO ENGAGE IN ANTICOMPETITIVE PRICING STRATEGIES?

A. Definitely not. Again, the Department directed parties to determine "whether the services for which Verizon seeks pricing flexibility are sufficiently competitive." As discussed, for the services for which Verizon seeks pricing flexibility,[9] Verizon would be able to engage in anticompetitive pricing

[7] Verizon's Massachusetts Alternative Regulation Plan, paragraph J.
[8] See Direct testimony of Paula L. Brown, page 9, lines 7-9.
[9] See Appendix A of Verizon's Alternative Regulation Plan, services subject to paragraph J of the plan, as filed on April 12, 2001.

strategies. Specifically, absent regulatory restrictions, Verizon would be able to selectively lower certain rates for retail services, such as business services, in order to defeat competitors. Under the Massachusetts Alternative Regulation Plan, Verizon would be able to engage in this type of pricing for business services on *a per customer and per location basis*. While, according to the Department's Interlocutory Order on Scope of July 9, 2001, this is not the place to argue for competitive safeguards (such as pricing rules), it is important to discuss here, per the Department's directives, that the current level of competition is *insufficient* to curtail Verizon's market power in this regard if it is given full market-based pricing flexibility as Verizon requests.

Q. IS ANTICOMPETITIVE PRICING MOST HARMFUL TO COMPETITORS THAT ARE DEPENDENT ON VERIZON'S UNBUNDLED NETWORK ELEMENTS?

A. Yes. While all competitors could potentially be harmed if Verizon's engaged in anticompetitive pricing strategies, most vulnerable are carriers that use Verizon's unbundled network elements.

Carriers that use Verizon's unbundled network elements have only a limited ability to lower their prices in response to Verizon. Specifically, if Verizon lowers its prices to select customers below the imputed costs of serving those customers with unbundled network elements, then the dependent competitor can no longer compete *profitably:* given its own costs for retailing and overhead, the competitor would pay more for the unbundled network elements than it could recoup from the customer. This situation is called a price squeeze.[10]

Q. DOES THE PRESENCE OF RESELLERS SIGNIFICANTLY INCREASE THE DEGREE OF COMPETITION IN THE MARKETPLACE?

A. Yes but only minimally. Resellers are dependent competitors whose ability to lower price in competition with Verizon is restricted by the resale discount. That is, resellers can only lower prices proportional to the resale discount set by Verizon. However, given that resellers face a variety of costs associated with retailing the service, the margin available to set a competitive price below Verizon's is extremely limited.

Q. WILL THE COMPETITIVE ROLE OF RESELLERS BE DIMINISHED IF VERIZON IS GIVEN THE PRICING FLEXIBILITY THAT IT HAS REQUESTED?

Yes. As previously discussed, the role of resellers in making the marketplace competitive is limited in the first place. However, the nearly unrestricted pricing flexibility requested by Verizon will further reduce the role of resellers. For example, under the proposal Verizon will have an even greater ability to bundle services subject to the resale discount with services that are not subject to resale discounts, or even further, not available to a reseller. In doing so, Verizon will be able to offer customers a package of

[10] A price squeeze may be defined as a situation in which the margin between the retail prices for services provided by a dominant firm and the wholesale prices for services offered by this firm to dependent competitors is so small that the dependent competitors,

services at a price that resellers cannot match. But these topics and the competitive safeguards needed to protect CLECs are more appropriately addressed in the second phase of this proceeding.

Q. PLEASE EXPLAIN IN MORE DETAIL WHY THE CURRENT LEVEL OF COMPETITION MAY TO SOME EXTENT CURTIAL VERIZON'S ABILITY TO RAISE RATES BUT NOT VERIZON'S ABILITY TO ENGAGE IN ANTICOMPETITIVE PRICING?

A. As discussed, when the Department directs parties to determine "whether the services for which Verizon seeks pricing flexibility are sufficiently competitive," the determination should concern itself with two potential pricing strategies: (1) Verizon's ability to increase rates, at the expense of ratepayers; and (2) Verizon's ability to lower rates, at the expense of competitors.

With respect to the first pricing strategy, the department should note that -- to the extent that there is competition -- competition may be effective in curtailing Verizon's ability to raise prices in certain locations.[11] For example, if Verizon raises rates for certain customers, then competitors that are suitably located may offer those customers service – by means of unbundled network elements or over their own facilities -- at lower prices.

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even if they are efficient, can longer viably compete. An extreme case of a price squeeze exists if retail prices fall below wholesale prices.

[11] As discussed presently, resellers do not pose serious competition since their ability to under-price Verizon is restricted to Verizon's resale discount.

With respect to the second potential pricing strategy, the Department should note that the market dynamics that may prevent Verizon from increasing certain rates are *ineffectual* in curtailing Verizon's ability to engage in anticompetitive pricing practices.

Q. PLEASE DESCRIBE IN MORE DETAIL WHY COMPETITION IS INEFFECTUAL IN PROTECTING ITSELF AGAINST ANTICOMPETITIVE PRICING STRATEGIES THAT ARE POSSIBLE UNDER THE PRICING FLEXIBILITY VERIZON SEEKS FOR CERTAIN SERVICES.

A. Competition in Massachusetts is simply not sufficiently robust to withstand anticompetitive pricing strategies possible under the flexibility sought by Verizon.

To defeat a company's efforts at anticompetitive pricing, there needs to be a serious possibility that such strategies will be futile. This is only true if competition is sufficiently robust to meet and withstand Verizon's efforts at altering prices from a level that is consistent with its costs. That is, if competition can withstand a temporary reduction in prices, then Verizon has little to gain. Competitors would lower prices in tandem and preserve their market share rather than exit the market. Again, if competition is robust, then Verizon would have little to gain from lowering prices inconsistent with its costs.[12]

[12] Likewise, if sufficient competition exists, a Verizon strategy of raising prices would be futile, since customers could capture Verizon's market share by maintaining their price

From Verizon's testimony and answers to data request we know, however, that -- giving Verizon's calculations the benefit of the doubt despite the concerns I raise later in my testimony about the information Verizon used to derive that conclusion -- at most only approximately 13% of Verizon's serving area is served by fully facilities based competitors. All other competitors are either in whole or in part dependent on Verizon's facilities.

This level of competition cannot curtail Verizon's ability to engage in anticompetitive pricing. For example, if Verizon lowers its retail rates below a certain price floor (such as the imputed cost of unbundled network elements and other retail related expenses), then dependent competitors are unable to withstand such price decreases and will have no choice but to relinquish market share. That is, Verizon's actions will not be futile.

In sum, anticompetitive pricing will most certainly be successful for the company and competition is insufficient to curtail it.

levels. However, the level of competition sufficient to defeat a price increase is significantly lower than that needed to defeat an anticompetitive strategy.

Q. WHAT LEVEL OF COMPETITION IS REQUIRED BEFORE VERIZON WILL NO LONGER BE ABLE TO ENGAGE IN ANTICOMPETITIVE PRICING?

A. As long as Verizon is a dominant firm, it will always be in a position, absent regulatory constraints, to increase rates for some customers and lower rates for other customers in order to defeat competitors without endangering its own profitability. As Verizon's answers to data requests indicate, competition is present only for select customers in select regions of the state.[13] Indeed, not even Verizon is arguing at this point that the company is no longer dominant in local exchange markets in Massachusetts.[14] In view of this, it is simply premature to grant the company the broad pricing flexibility it seeks for virtually all of its services other than some residential services.

Q. HAVE YOU REVIEWED VERIZON'S DATA ON THE PRESENCE OF COMPETITION?

A. Yes. I have reviewed the testimonies of Mr. Robert Mudge and Dr. William E. Taylor as well as Verizon's answers to data requests. I am not in the position, however, to validate the numbers presented by Verizon.

[13] See for example, AG-VZ-11. This data request answer indicates a wide disparity in competitive presence across the state.
[14] See Direct testimony of Paula L. Brown, page 9, lines 7-9.

Moreover, I do not believe that other parties to this proceeding, other than the Department itself, are able to validate the numbers either.

Q. PLEASE EXPLAIN WHY NEITHER YOU NOR PARTIES, OTHER THAN THE DEPARTMENT, ARE ABLE TO VALIDATE VERIZON'S DATA?

A. Verizon's data are critically dependent on information from the E911 database. Specifically, all conclusions regarding the presence of facilities-based competition are derived from this database. However, the CLEC specific information contained in the E911 database is proprietary and Verizon will make it available only "to the Department and to those parties to whom the CLECs authorize disclosure."[15] This presents nearly insurmountable problems. First, Network Plus does not know which CLECs have information contained in the E911 database. Second, even if Network Plus did know which CLECs are in the E911 database, it is not clear that those CLECs would allow Network Plus, a competitor, access to this data. Third, given the time constrained imposed by the procedural schedule, it is not feasible to obtain timely authorization from all CLECs within in the E911 database. In short, as a practical matter, I do not and will not have access to the E911 database information necessary to validate Verizon's claims.

[15] See Verizon's response to ATT-VZ-1-2.

Q. DO YOU HAVE SERIOUS CONCERNS ABOUT VERIZON'S USE OF THE E911 DATABASE?

A. Yes. At this point I am not sure what carriers are included in the E911 database figures presented by Verizon. The figures are supposed to represent facilities-based competition. However, I am not sure whether the data include 911 numbers assigned to, for example, wireless carriers or Verizon affiliates, say for data services. Again, I simply cannot validate Verizon's market analysis.

Q. IN VIEW OF THE FACT THAT NO PARTY OTHER THAN VERIZON AND THE DEPARTMENT HAVE ACCESS TO THE INFORMATION IN THE E911 DATABASE, IS IT CRITICALLY IMPORTANT THAT THE DEPARTMENT CAREFULLY VALIDATES VERIZON'S CLAIMS?

A. Yes. The Department should very carefully scrutinize the E-911 database information to ascertain whether or not Verizon's claims regarding facilities-based competition are valid.

COMPETITIVE MARKET FORCES ARE DETERIORATING AND MAY NOT BE SUFFICIENT TO CURTAIL VERIZON'S MARKET POWER

Q. WOULD VZ-MA HAVE THE DEPARTMENT BELIEVE THAT LOCAL COMPETITION IS FLOURISHING IN MASSACHUSETTS?

A. Yes. I believe, however, that this representation is unwarranted and, in fact, dangerous. As my analysis will demonstrate, the CLEC industry is in not nearly as a good a shape as VZ-MA is suggesting.

Q. HAVE YOU PERFORMED A FINANCIAL ANALYSIS THAT MAY ILLUSTRATE THAT THE COMPETITIVE INDUSTRY IS NOT NEARLY AS VIBRANT AS VZ-MA WOULD HAVE THE DEPARTMENT BELIEVE?

A. Yes. I have performed an analysis that calculates the dramatic change in market value of the CLEC industry over the period of December 31, 1999 through April 23, 2001, based on the value of the common shares held by investors. For the IXC and CLEC industries, the total decline in market capitalization over this period is a staggering *$405 billion, or 64%.*[16] The data for just CLECs, excluding IXCs, is *$122 billion, or 69%.* By contrast, the RBOCs experienced declines in market capitalization over the same period of *only 16%,* a percentage roughly comparable to the decline in the S&P 500 Index.

Since the period covered in this analysis, the industry has further declined. Indeed, over the last six months, *no less than 31 CLECs have filed for bankruptcy*.[17]

[16] Tables 2.2 through 2.4 list the CLECs, IXCs, and RBOCs for which the change in market. capitalization has been calculated.
[17] See "PointOne is latest telecoms sector casualty," *Financial Times*, August 18, 2001. Page 8.

Q. PLEASE DESCRIBE IN MORE DETAIL HOW YOU CALCULATED THE CHANGE IN MARKET CAPITALIZATION.

A. As noted, this change in value was determined from December 31, 1999 to April 23, 2001. Market capitalization as of December 31, 1999 was used as the baseline value for two primary reasons: (1) this point in time was still within the bull market period before the first significant market correction took place in the first quarter of 2000; and (2) the components necessary to calculate market capitalization, common shares outstanding and market price, were both readily available from publicly available sources such as websites that provide current and historical price quotes and Securities Exchange Commission ("SEC") filings.

The companies included in the analysis were classified into three categories:

(1) CLECs & Wholesale Suppliers
This category includes CLECs and wholesale suppliers. Not included are the CLEC divisions of the major IXCs – they are included in the third category described below. (The companies included in this category are identified in AHA Exhibit - 3.)

(2) RBOCs
This category includes the four RBOCs: Qwest, SBC, BellSouth, and Verizon.

(3) Major IXCs
This category includes the major IXCs: Williams Communications, Level 3 Communications, Global Crossing, Sprint, WorldCom, and AT&T.

These categories mirror the groups of companies that are compared and contrasted within the Kellogg-Huber Report of April 5, 2001, *Competition* *for Special Access Service, High Capacity Loops, and Interoffice Transport*, attached to the petition filed by Verizon, SBC and BellSouth before the FCC to be relieved of their obligations to provide unbundled access to high-capacity facilities.[18] Major IXCs such as AT&T, WorldCom, Level 3, and Sprint that also operate as CLECs were separated from the CLECs & Wholesale Suppliers category because the nature and scope of their operations are quite different from the other CLECs.

The Debt to Equity ratio was also determined for each company over the same time period to measure changes in relative financial strength based on the amount of debt used to fund operations versus stockholder's equity. Large ratios or ratios that increase over time indicate declining financial strength as debt becomes a larger component of the firm's capital structure. This can be attributed to a greater use of debt as equity markets dry up, declining stockholder's equity as a result of accumulated operating deficits, or a combination of both.

Q. PLEASE DISCUSS THE RESULTS OF YOUR ANALYSIS.

A. The analysis demonstrates that the competitive carriers have suffered serious financial setbacks over the last year. The decline in market capitalization for

[18] Joint Petition of BellSouth, SBC, and Verizon for Elimination of Mandatory Unbundling of High-Capacity Loops and Dedicated Transport, CC Docket No. 96- 98, DA 01-911, April, 2001.

the three categories, CLECs & Wholesale providers, RBOCs and Major IXCs, is summarized as follows:

TABLE 2.1

CATEGORY	DECLINE IN MARKET CAPITALIZATION	% DECLINE IN MARKET CAPITALIZATION
Category 1: **CLECs & Wholesale Providers**	($122,332,734,915)	- 69%
Category 2: **RBOCs**	($78,812,529,670)	- 16%
Category 3: **Major IXCs**	($283,267,806,743)	- 62%

A more detailed breakdown of the decline in market capitalization for these three categories of carriers is found in tables 1, 2, and 3 below. The summary results are illustrated in the graphs below.

DIAGRAM 1

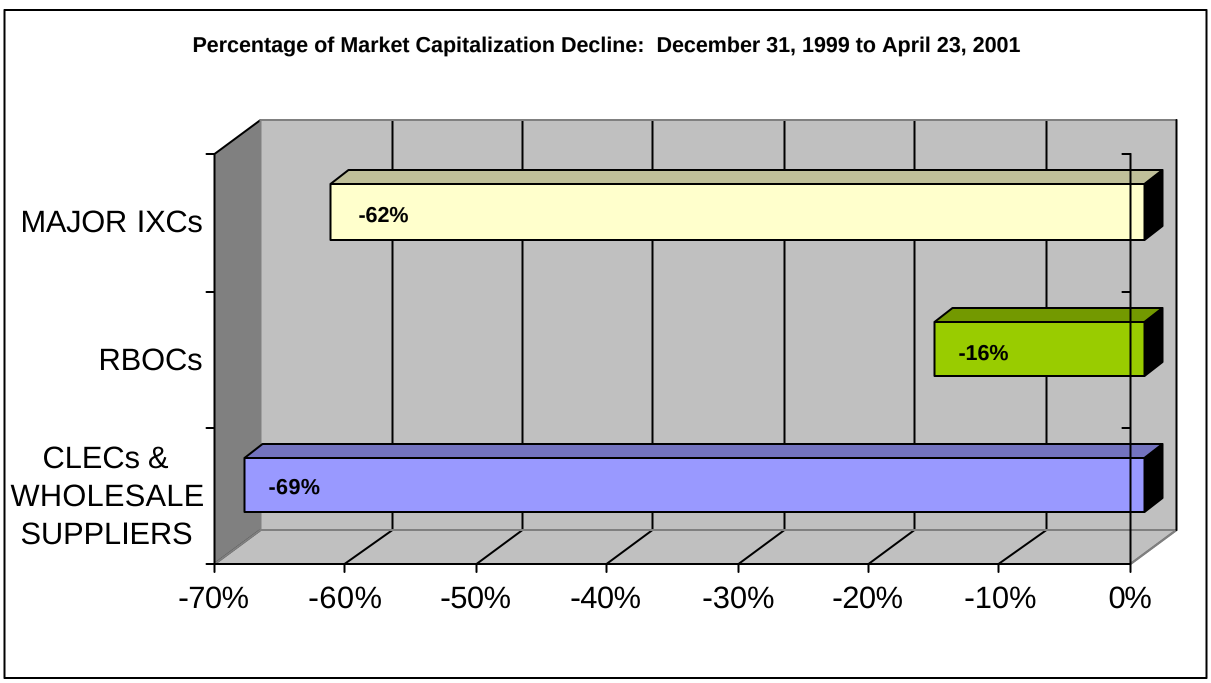
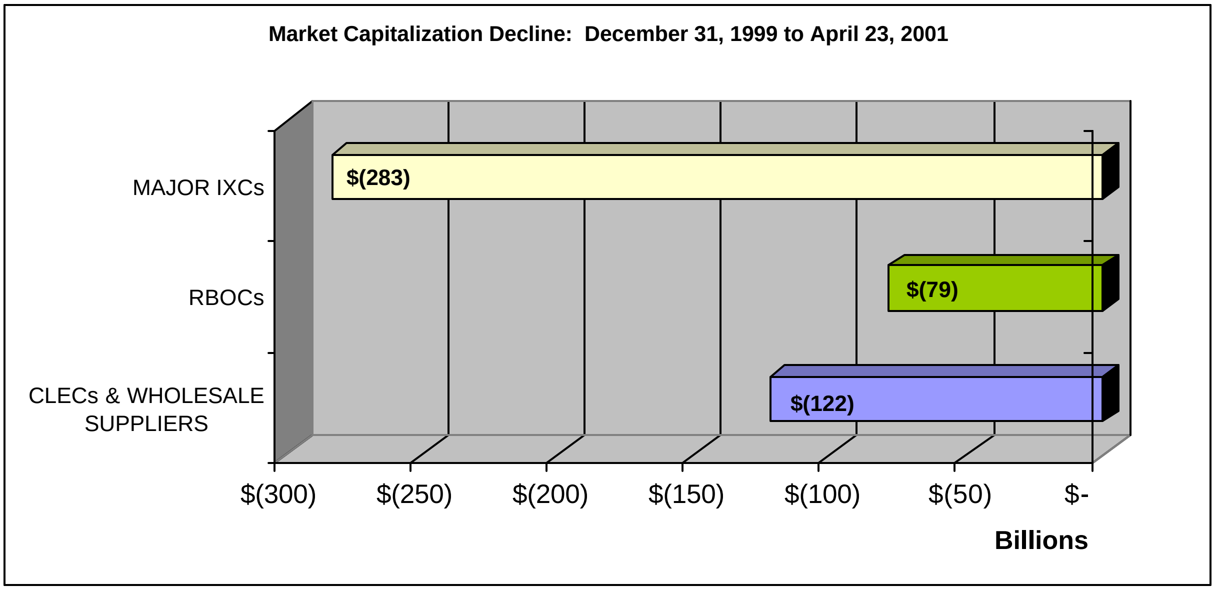


DIAGRAM 2



Over 30 CLECs have filed for bankruptcy protection or liquidation in the last six months.[19]

Since the market capitalization decline of the CLECs and IXCs is significantly greater than for the RBOCs, the relative value of each group to the total of the three groups combined has also changed dramatically. The following pie charts illustrate the increasing relative financial strength of the RBOCs over the last 15 months:

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[19] For example, Advanced Radio Telecom Corp., Convergent Communications, e.spire Communications, Inc., ICG Communications, Inc., NorthPoint Communications Group, Inc., Winstar Communications, Inc. and Teligent. As noted, over the last six months no less than 31 CLECs have filled for bankruptcy. See "PointOne is latest telecoms sector casualty," *Financial Times*, August 18, 2001. Page 8

DIAGRAM 3

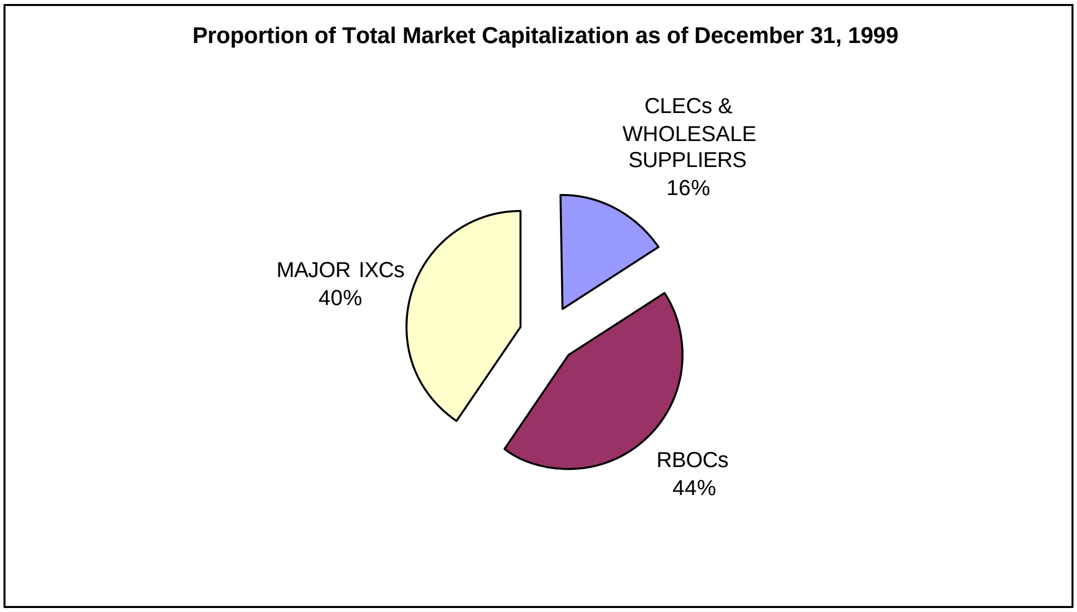
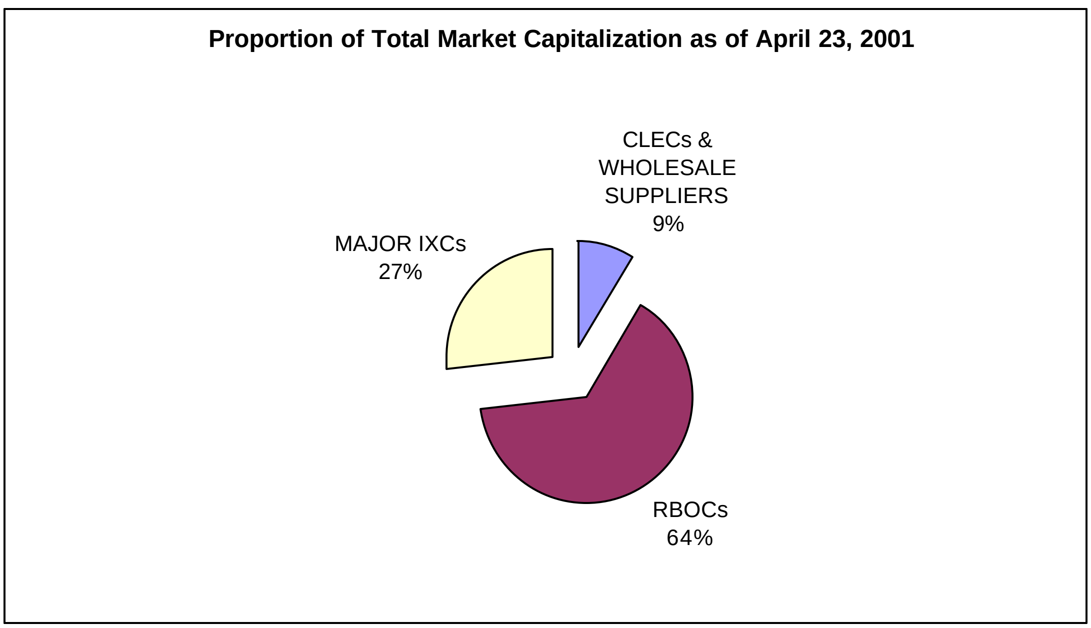


DIAGRAM 4



It is clear from the above pie chart that the financial strength of the remaining four RBOCs is increasingly dominating the telecommunications industry. It is also clear that the state of the CLEC industry is not as rosy as VZ-MA would the Department believe.

Q. HAS THE FINANCIAL DECLINE IN MARKET CAPITALIZATION OF THE CLEC INDUSTRY BEEN NOTED BY THE FINANCIAL COMMUNITY AND THE PRESS?

A. Yes. The collapse in market value of the competitive telecommunications industry, including long distance, which is apparent from the financial data, has been duly noted by the financial community and the press. Not a day goes by without some pundit or another commenting on the dismal state of telecommunications competition. As one analyst concludes:

> In telecommunications, we are rolling back the competitive progress made over the last ten years – disabling the enabling industry of economic growth when we need it most.[20]

Other articles go so far as to declare the entire competitive effort to be a failure and note that the RBOCs have slowly but steadily out-maneuvered their would be competitors. A recent article in The New York Times declared that the battle is over:

> Of the Baby Bell local phone carriers, once seven in number, three [sic] remain — Qwest Communications, SBC Communications and Verizon Communications — and they are by far the most powerful and important communications companies in the nation. The corporations once known as long-distance carriers, like AT&T, are shells of their former selves. … The Bells — the race's tortoises — have won.[21]

[20] Brian Adamik, Yankee Group, *The Death of Competitive Telecom?* CBS MarketWatch, May 3, 2001.

[21] Seth Schiesel, *Sitting Pretty: How Baby Bells May Conquer Their World*. The New York Times, Money&Business, Section 3, page 1. Sunday, April 22, 2001.

The potential danger to the nation's economy cannot be overstated. As is well recognized, the telecommunications industry is a critical component in the "high-tech engine" that has propelled our economy forward over a period longer than any other in modern times. That "engine" is now at risk of being usurped – as a natural result of the corporate quest for profit maximization -- by a small group of very powerful companies: the RBOCs. As Wired magazine notes in yet another article on the demise of the competitive telecommunications industry:

> The Bells own 88 percent of the local lines in the US and upgrade on their own terms – conveniently, after most of their competitors have died off.[22]

Whatever may be the merit of these somber prognoses, the fact remains that the competitive telecommunications industry is struggling to survive. In the war of attrition, waged by the RBOCs against their competitors, in the market place, in the U.S. Congress, the courts, and before regulators, it has not gone well for the CLEC industry: and the financial community knows it.

CONCLUSION

Q. WHAT ARE YOUR RECOMMENDATIONS?

A. Verizon is still the dominant firm in local exchange markets in Massachusetts and the marketplace is not "sufficiently competitive" for the services for which Verizon proposes full market-based pricing flexibility. Further, as demonstrated, the CLEC industry remains extremely vulnerable to anticompetitive pricing strategies on the part of Verizon. In view of this, I recommend that the Commission reject Verizon's request for broad pricing flexibility for all existing and new services subject to the provisions of the category *All Other Retail Services*, identified in paragraph J of Verizon's Massachusetts Alternative Regulation Plan.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does. A summary of my testimony was provided in the introduction to this testimony.

[22] Frank Rose, Telechasm: *Can we get to the future from here? First we have to get telecom out of the Stone Age.* Wired, May 2001, page 131.