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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF
QWEST CORPORATION D/B/A CENTURLINK-
QC ("CENTURLINK") TO CLASSIFY AND
REGULATE RETAIL LOCAL EXCHANGE
TELECOMMUNICATIONS SERVICES AS
COMPETITIVE, AND TO CLASSIFY AND
DEREGULATE CERTAIN SERVICES AS NON-
ESSENTIAL.

Docket No. T-01051B-11-0378

**NOTICE OF FILING
TESTIMONY**

GALLAGHER & KENNEDY, P.A.
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Pursuant to the requirements of the January 17, 2012 and March 9, 2012 Procedural
Orders, the Arizona Investment Council files the Rebuttal Testimony of its President, Gary
Yaquinto, on its behalf in the above-entitled docket.

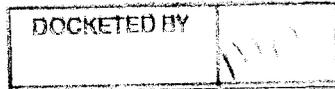
RESPECTFULLY SUBMITTED this 23rd day of April, 2012.

GALLAGHER & KENNEDY, P.A.

Arizona Corporation Commission

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APR 23 2012



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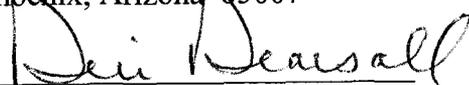
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18762-10/3026343

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Docket No. T-01051B-11-0378

Rebuttal Testimony of

Gary M. Yaquinto

on Behalf of

Arizona Investment Council

April 23, 2012

1 **Q. Mr. Yaquinto, did you file direct testimony in this matter?**

2 A. Yes, I did.

3
4 **Q. Have you reviewed the direct testimony presented in this case by Messrs. Abinah**
5 **and Fimbres on Staff's behalf?**

6 A. Yes.

7
8 **Q. What is your understanding of Staff's recommendation concerning the competitive**
9 **classification of CenturyLink's services?**

10 A. Staff is recommending a competitive classification only for the Large or Enterprise
11 Business Services customers. For residential, small and medium business services
12 customers, Staff does not recommend competitive classification under Rule 1108.¹ The
13 latter conclusion and recommendation appear to be based primarily on its use of the
14 Herfindahl-Hirschman Index ("HHI"). In using the HHI, Staff concludes that the market
15 for residential and small/medium business services is not competitive (Fimbres Direct,
16 pp. 12-13).

17
18 **Q. Based on your review of that testimony, have you made any changes to your**
19 **recommendations?**

20 A. No. I continue to believe the Arizona market for residential and small/medium business
21 services is indeed competitive and should be declared so by the Commission. That
22 declaration would allow CenturyLink to seek pricing flexibility for these services under
23

24 ¹ R14-2-1108.

1 Rules 1109 and 1110. Staff's reliance on the HHI as the primary basis for determining
2 competitive classification of CenturyLink's local exchange services is misplaced.
3 Furthermore, Staff's conclusions in applying the HHI place CenturyLink at an unfair
4 disadvantage in the market, vis-à-vis its competitors.
5

6 **Q. Why do you believe Staff's use of the HHI for determining competitive classification**
7 **is misplaced?**

8 A. The HHI is intended to measure the degree of market concentration among competing
9 firms. It is a metric utilized primarily by the U.S. Department of Justice ("DOJ") and
10 states' Attorneys General in anti-trust cases. Its function is to gauge whether, for
11 example, a proposed merger or acquisition of a rival company or companies within a
12 market will result in an unacceptable concentration of market power. The DOJ, for
13 example, looks at how the HHI changes under conditions of combining market shares of
14 merging companies to assess whether a merger results in too much market concentration
15 and, therefore, may violate anti-trust laws.
16

17 In this case, however, the issue is market competition, not concentration. A market can
18 be moderately or even highly concentrated and still exhibit a high degree of
19 competitiveness among the firms and technologies competing for customers. So, the HHI
20 is not a very good indicator of whether a market can or should be characterized as
21 competitive or whether it is viably contested among providers.
22
23
24

1 Staff's testimony agrees with the proposition that the Arizona market for local exchange
2 services is characterized as one in which consumers have many choices of both
3 technologies and providers. As Mr. Fimbres states, "End-users, particularly consumers,
4 have several alternative technology options for communications – wireline voice, VOIP,
5 Wireless voice, Wireless texting and broadband e-mailing" (Fimbres Direct, p. 12,
6 ll. 8-10). In that regard, as Mr. Brigham notes, wireless subscribers have grown to about
7 5.3 million – almost double the number of both ILEC and non-ILEC wirelines (Brigham
8 Direct, p. 43, ll. 5-7). Mr. Fimbres also agrees with CenturyLink that the company's
9 access lines have declined by 54 percent between 2001 and 2010, while Arizona's
10 population increased by more than 24 percent during that same time period (Fimbres
11 Direct, p. 11).

12
13 So, what happened? Did more Arizonans decide to communicate less or did they shift
14 away from CenturyLink to alternative providers and technologies? Clearly, our levels of
15 communication among family, friends, business associates and others did not decrease
16 over the past decade. Instead, the answer is the one Mr. Fimbres gave in his testimony –
17 consumers have many competitively offered options. And, those options are poorly
18 reflected in a simplistic metric like the HHI.

19
20 **Q. Please explain further.**

21 A. A simple hypothetical mathematical example demonstrates why the use of HHI is not
22 appropriate for determining the level of competition – which is the central issue involved
23 here. Let's assume that the market is comprised of four firms with each having an equal
24

1 market share (i.e., 25 percent). The HHI index would be calculated as $4 \times (.25^2) = .25$ or
2 2500 which, as Mr. Fimbres notes, is “outside the range used by DOJ to indicate a
3 Moderately Concentrated Market (1,000 to 1,800).” Fimbres Direct, p. 13, ll. 12-13.
4 However, this measure of market concentration says nothing about the fact that each of
5 the four firms, nevertheless, has a very strong incentive to increase its market share, both
6 by competing for the other firms’ customers and in drawing new customers to its service.
7 In fact, the competition among the four competitors would likely be very robust. In this
8 example, the market would be competitive (the issue under Rule 1108), but would fail
9 Staff’s use of the HHI test for determining competitiveness.

10
11 The degree of concentration as measured by the HHI gets worse (i.e., market
12 concentration increases) if we assume a situation where there are two large firms and
13 several smaller firms in the market, not unlike that existing in Arizona with CenturyLink,
14 Cox, other cable providers, wireless and other alternative communications technologies
15 providers. Based on one series of calculations, Mr. Fimbres estimates the HHI for the
16 Arizona market at 2520, which is concentrated, but not helpful as a measure of
17 competition among providers and technologies. One need only examine the advertising
18 battle that blazes between CenturyLink and Cox Communications (as well as Vonage,
19 Skype, multiple wireless carriers, et al.) to get a strong sense that competition for market
20 share in Arizona is very real and very intense.

21
22 Yet, under the Commission’s current regulatory environment, cable providers are
23 afforded a competitive designation with pricing flexibility and streamlined ratemaking,
24

1 while the prices of CenturyLink services continue to be traditionally and strictly
2 regulated.

3
4 If the HHI is used as a main determinant for competitive designation, it is unlikely
5 CenturyLink can ever “earn” a competitive designation and be treated like its competitors
6 without sacrificing even greater market share to its competitors. Even more striking is
7 that if CenturyLink gives up most of any of its market share to its next largest competitor,
8 the HHI will continue to show the market as highly concentrated and, therefore, based on
9 Staff’s approach, not competitive.

10
11 In this sense, use of the HHI for determining the competitive designation under
12 Rule 1108 is much like the water dunking tests used in the Salem trials to determine
13 whether a person is a witch – drown and you’re not a witch or live and you’re hanged.

14
15 **Q. Mr. Yaquinto, do you understand Rule 1108 to require the use of HHI in**
16 **determining competitive classification?**

17 **A.** No. My understanding is that Rule 1108 requires a provider seeking a competitive
18 designation to provide information regarding the market for which it seeks competitive
19 classification. However, that rule does not address how the information is to be evaluated
20 by the Commission, nor does it specify the use of any metric, including the HHI. Further,
21 Rule 1108 also does not specify how any metric or metric threshold is to be used for
22 determining the competitive classification.

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Although Mr. Fimbres indicates that his use of the HHI in this case is “. . . only one factor Staff considered in its analysis” (Fimbres Direct, p. 13), it is clear that it is the only factor which supports the conclusion that the market is not competitive.

In fact, his testimony acknowledges that CenturyLink faces “. . . a formidable land-line competitor in the market . . . [which] has pricing flexibility for its services” (Fimbres Direct, p. 16; emphasis supplied). Add to that the array of price unregulated wireless and VOIP providers which are also vying for customers and it is abundantly clear that this market and these services are competitive.

Q. Do you have a recommendation for the Commission?

A. Yes. As I stated in my direct testimony, CenturyLink’s application and testimony offer clear evidence that the company’s services are subject to competitive pressures and should be determined so by the Commission.

Q. Does that conclude your testimony?

A. Yes.