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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of)
)
Petition of U S West Communications, Inc.)
For Forbearance from Regulation) CC Docket No. 99-1
As a Dominant Carrier for High Capacity)
Services in the Seattle, Washington MSA)

OPPOSITION OF SPRINT CORPORATION

Pursuant to the Commission's Public Notice, DA 99-104 (released January 4, 1999), Sprint Corporation ("Sprint") respectfully submits its opposition to the above-captioned Petition ("Petition") filed by U S West Communications, Inc. (U S West).

I. INTRODUCTION AND SUMMARY

U S West seeks forbearance under Section 10 of the Communications Act of 1934, as amended, 47 USC §10, from dominant carrier regulation in the provision of high capacity special access and dedicated transport for access services ("high capacity services") in the Seattle Metropolitan Statistical Area ("MSA"). Petition at 1. U S West claims that forbearance is in the public interest in this case because its incumbent local exchange carrier ("ILEC") in the Seattle MSA no longer has market power in the provision of high capacity facilities (defined as DS1 and above); that the market for such facilities has become "robustly competitive"; and, that it faces competition in providing such facilities from " . . . both resellers and three established facilities-based competitors with substantial resources and extensive fiber networks." Petition at 3.

U S West's request for forbearance should be denied. As explained in more detail below, U S West retains market power even in the self-selected, high capacity facilities market within the Seattle area. Thus, by its own admission, U S West still provides nearly three-quarters of the high capacity facilities in the Seattle MSA. In fact, the Quality Strategies Study that U S West relies on for evidence of its loss of market share appears so fundamentally flawed as to render it meaningless. Moreover, these facilities are essential inputs used in important downstream service markets (namely, local service and exchange access) where U S West retains a near monopoly. The need to integrate high capacity facilities with U S West's local network (so that competitors can use these facilities to reach the vast majority of customers taking local service in the Seattle MSA) results in a bottleneck which U S West can use against competing providers of high capacity facilities by degrading the service of these rivals, by raising their costs, or by otherwise engaging in discrimination both blatant and subtle.

There is, in any case, no need for the relief urged by U S West. The Commission's "zone density rules" already grant U S West substantial flexibility in pricing high capacity facilities not only in Seattle, but throughout U S West's service territory. If U S West feels threatened by competition in Seattle in the sale of high capacity facilities, it can lower its prices for these facilities to contest its competitors so long as it undertakes the same reduction in other areas of equivalent density and, presumably, equivalent costs. U S West may also make its high capacity facilities available pursuant to term and volume discounts. To grant U S West's request will allow its Seattle ILEC to segment its markets and lower prices only where U S West has come under competitive pressure. It would then be able to continue to receive monopoly rents from users that have similar cost characteristics but that lack competitive choices, and use the supranormal profits obtained from its remaining monopoly customers to charge below-cost rates in areas where competition is only beginning to present a challenge to U S West.

The problem of such cross-subsidization is hardly a remote threat. U S West provides high capacity facilities, local service and exchange access on a vertically and horizontally-integrated basis. Accounting constraints are hardly adequate to prevent U S West from raising prices to monopoly users and then using these increases to lower its prices for high capacity facilities below its applicable costs. Price caps may be helpful in preventing such behavior but they are hardly a panacea. This Commission and State regulatory agencies continue to carefully monitor the prices of local carriers and yet "costless predation" is still a viable business strategy.

Finally, the Commission is already actively reviewing proposals from regional Bell Operating Companies (RBOCs) for additional pricing flexibility for their access services in the Access Charge Reform proceedings. Public Notice FCC 98-256 (released October 5, 1998). Petitions such as this one are simply attempts by the RBOCs to have as many "bites at the apple" as possible. Sprint respectfully requests that the Commission preserve its limited resources for completing more significant proceedings already before it, especially those in which the instant issues have already been raised. Until then, the Commission should refrain from engaging in any serious consideration of the redundant and multiple RBOC petitions such as this one.

II. THE COMMISSION SHOULD CAREFULLY CONSIDER WHETHER IT IS IN THE PUBLIC INTEREST FOR IT TO RULE ON REQUESTS FOR FORBEARANCE FROM DOMINANT CARRIER REGULATION ON A CITY-BY-CITY, PRODUCT-BY-PRODUCT, AND SERVICE-BY-SERVICE BASIS

As noted, U S West already has substantial pricing flexibility. There can be no serious argument that it is so burdened by existing regulation that it will be unable to compete fairly against emerging competition for high capacity facilities. U S West does not claim that there is anything unique about the Seattle MSA that would allow competition for high capacity facilities to develop there but not in other major cities or comparable centers of population density. On the contrary, its filing repeatedly suggests that Seattle is quite typical and that the competitors that it faces there operate nationwide or at least in other major cities.

While U S West goes to great lengths to pattern its request for non-dominant treatment after that of AT&T's, the fact remains that AT&T's Motion covered a substantially larger scale and scope of services. See Motion for Reclassification of American Telephone and Telegraph Company as a Non-Dominant Carrier, CC Docket No. 79-252, filed September 22, 1994; see also Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, *Order*, 11 FCC Rcd 3271 (1995) ("AT&T Domestic Non-dominance Order").

In the AT&T Domestic Non-Dominance Order, the Commission agreed with AT&T that the relevant market should be defined as all interstate, domestic interexchange services. Id. at ¶ 21 (emphasis supplied). Such a market essentially encompassed all of AT&T's interexchange services, with the exception of international services. After a careful analysis of all of the relevant services offered in the defined market, the Commission determined that while AT&T possessed market power with respect to a few discrete services, it lacked market power in the overall nationwide interstate, domestic interexchange market. Id. at ¶ 39. In contrast, U S West seeks non-dominant regulatory treatment for its narrowly defined offering in one small geographical area, the Seattle MSA.

This is U S West's second attempt to obtain piecemeal regulatory reclassification of its high capacity facilities offered in a niche geographic market. See Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA, CC Docket No. 98-157 ("Phoenix Petition"). In its opposition to U S West's Phoenix Petition, Sprint warned that Commission entertainment of forbearance petitions of such minute scale and scope would needlessly suck up enormous resources of the Commission and all other interested parties. See Sprint Comments, CC Docket 98-157 at 4. Unfortunately, the RBOCs have proven Sprint's prediction to be correct. In a period of less than two months, RBOCs have filed four additional, and substantially identical, petitions.[1] This flurry of copycat petitions augurs for more of the same from the RBOCs. After all, the petitions filed thus far cover only a small fraction the MSAs in the United States and only two of the many products and services offered by the RBOCs that are subject to dominant carrier regulation. To deter the RBOCs from attempting to overwhelm the Commission's limited resources, the Commission should clearly indicate that it will not seriously entertain such narrow and redundant forbearance petitions.

Granting petitions such as U S West's on a piecemeal basis would also inevitably lead to inconsistencies. Each petition would require an in-depth, fact-intensive competitive analysis for each service offered in small geographical areas. Small differences in the factual circumstances surrounding the provision of services in each narrow geographical area would, in all likelihood, give rise to inconsistent rulings. The Commission would be engaged in making increasingly narrow distinctions and determinations concerning small market segments in smaller and smaller geographical areas. Ultimately, the Commission's analytical exercises would resemble that of the proverbial medieval monks who would debate how many angels can fit on the head of a pin. The probability of inconsistent rulings would increase as the product and geographical markets

[1] In chronological order, the five RBOC forbearance petitions are: 1) U S West Phoenix Petition, CC Docket No. 98-157 (filed Aug. 24, 1998); 2) Petition of SBC Communications, Inc. for forbearance in 14 MSAs, CC Docket No. 98-227 (filed Dec. 7, 1998); 3) U S West Seattle Petition, CC Docket 99-1 (filed Dec. 30, 1998); 4) Petition of Bell Atlantic Telephone Companies for Forbearance in 12 jurisdictions, CC Docket 99-24 (filed January 20, 1999); and 5) Petition of Ameritech for Forbearance in the Chicago LATA, CC Docket No. 99-65 (filed February 5, 1999).

became smaller. To avoid this result, the Commission should make clear that it will not rule on petitions for non-dominance such as those filed by U S West, SBC, Ameritech and Bell Atlantic, unless they cover a wider range of products and services, such as all residential or business local access services in a state or entire RBOC region.

III. U S WEST RETAINS MARKET POWER IN THE HIGH CAPACITY FACILITIES MARKET

A. U S West controls bottleneck local exchange and exchange access services

High capacity circuits are used by some carriers and end users in order to provide local exchange and exchange access services. As such, these dedicated circuits constitute an essential input for a defined set of customers. U S West contends that this upstream market exhibits indicia of competition and therefore the Commission should not regulate it as dominant for this market. However, U S West continues to maintain a virtual monopoly in the non-competitive downstream markets of local exchange and exchange access services. As a result, U S West can, absent dominant carrier regulation, exercise its downstream market power to the detriment of consumers and providers of dedicated circuits.

U S West has both the ability and the incentive to exercise its bottleneck control over its local exchange and exchange access services in order to harm competition in the dedicated circuit market. Any choice that carriers or end users may have over the supplier of dedicated circuits would be undermined by U S West's ability to act anticompetitively. For example, U S West could charge higher interconnection fees or degrade the quality of interconnection to those customers who subscribe to competitive dedicated circuit providers. Because dedicated circuit subscribers have no choice but to subscribe to U S West's local exchange and exchange access services, they will not be able to respond to this type of anticompetitive conduct. Rather, they would have only the choice of keeping their dedicated circuit provider and accepting higher priced or lower quality local services, or switch to U S West for their dedicated circuit needs. Until U S West opens its local markets to competition, the Commission must maintain dominant carrier regulation over U S West's provision of high capacity facilities.

In addition to maintaining monopoly power over local exchange and exchange access services, U S West also has bottleneck control over adjacent inputs that are essential for the provision of local services. For example, U S West has bottleneck control over interconnection and local switching services in the Seattle area. U S West could raise its charges for these services and use the additional revenues to cross-subsidize its dedicated circuit offerings. In doing so, U S West would at least be able to harm competitive providers of high capacity facilities and, conceivably, would be able to drive them out of the market entirely. Neither accounting regulation nor price caps on their own provide effective safeguards against such anticompetitive behavior. In order to help prevent U S West from engaging in cross-subsidization, the Commission must continue to require U S West to file tariffs and cost support for its provision of dedicated circuits.

B. U S West maintains very high market share in each of the relevant markets.

Perhaps the most obvious indication of U S West's dominance is its market shares for the markets it purports to have identified. In the putative overall high capacity circuits market (which includes high capacity provider and transport circuits), U S West admits that it maintains a 72 percent market share. Such a high market share indicates that this market segment is highly concentrated and that U S West, with overwhelming market share, maintains market power.[2]

[2] Petition at Attachment A, p. 6. Assuming that the remainder of the market is equally divided among the three facilities-based competitive providers in Seattle, the overall high capacity market would have a minimum Herfindahl-Hirschman Index (HHI) value of 5546.6, with U S West's share equaling 5299.8. Under the Department of Justice's *Merger Guidelines*, these very high numbers would indicate that this market is highly concentrated and that U S West has probable market power.

Similarly, U S West admits that it maintains a 65.2 percent market share of the provider circuits market, which is another strong indicator of market power over this essential input.[3] Finally, U S West admits that it maintains a 74 percent market share of the transport market, indicating that this too is a highly concentrated market, with U S West as the clear dominant carrier.[4] But because there appear to be fundamental flaws in the methodology employed by Quality Strategies to calculate these figures, and because U S West provides none of the underlying raw data, the "Market Study" fails to demonstrate any erosion of U S West's market power.

A more fundamental problem with the Quality Strategies Study is its exclusive reliance on DS-1 equivalent circuits for measuring market shares. Petition at 18 and Attachment A, Quality Strategies Report at 25. Unfortunately for U S West, the Commission has consistently considered revenues at least as important, if not more so, in gauging the amount of competition in a particular market. See, AT&T Domestic Non-Dominance Order, 11 FCC Rcd 3271 (1995). Thus, no meaningful analysis of U S West's market power can begin until a comparison can be made between the high capacity revenues earned by U S West and its facilities-based competitors. Such revenue figures would allow for a comparison of paying customers to U S West and its competitors and would provide a more complete portrait of the high capacity market in Seattle.

In addition, because U S West does not include the raw data on which the market share calculations were based, there is no way for the Commission (or any other interested parties) to judge the validity of the analysis. As Quality Strategies clearly states, the "study" is a "high level overview of the Seattle MSA...High Capacity Market." Petition at Attachment A, page 1. As

[3] Id. The minimum HHI value for this market (4654.7) again demonstrates that this market is highly concentrated, with U S West maintaining a highly dominant position (it has an HHI value of 4251).

[4] Id. This market exhibits a minimum HHI value of 5697.9, with U S West's share amounting to 5476.

such, it provides no more evidence as to U S West's market power in the putative high capacity market than would a U S West press release.

But even if U S West were correct in its assertion that capacity alone is the most appropriate barometer of the level of competition (and Sprint believes that U S West is incorrect), the manner in which Quality Strategies appears to have counted circuits skews market share measurements. The Quality Strategies study notes that market shares were based upon DS-1 equivalents and that one DS-3 (45 Mbps) circuit is counted as 28 DS-1 circuits. While this relationship makes sense from an engineering standpoint, Sprint notes that a DS-3 circuit is not 28 times as expensive as a DS-1 circuit. Thus, customers will order DS-3 service even if they do not need all of the capacity available in the DS-3.

If a carrier has a customer mix that is more heavily weighted towards DS-1 rather than DS-3 customers, that carrier will derive greater revenue per DS-1 equivalent than a carrier whose customer mix leans more towards DS-3 customers. This is so even though the nominal amount of DS-1 equivalent circuits provided by both carriers is identical. In its Petition, U S West concedes that indeed its Seattle customer mix leans disproportionately towards those purchasing DS-1s. As noted above, U S West maintains a 65.2 percent market share of the provider circuit market. Quality Strategies' breakdown of U S West's market share reveals that 69 percent of U S West's customers purchased DS-1 provider circuits while only 59.2 percent purchased DS-3 provider circuits.[5] By contrast, its competitors' 34.8 percent provider circuit market share breaks down in the opposite manner, with only 31 percent of their customers purchasing DS-1s and 40.8 percent purchasing DS-3 provider circuits. U S West would be expected to have a higher proportion of DS-1 customers generally than its competitors because of the greater ubiquity of its

[5] Id. at Attachment A, page 7. Quality Strategies did not provide a similar breakdown for the transport market.

facilities. Were revenue figures disclosed, they would most likely demonstrate that U S West also has a disproportionately greater share of high capacity revenues and thus a much greater market share of the Seattle provider circuit market.

In the putative retail market,[6] U S West states that it has only a 20.7 percent market share. Id. at Attachment A, page 11. However, U S West, by its own admission, provisions almost three-quarters of all high capacity circuits, even though it has a billing relationship with end users for only 20.7 percent of these circuits. It is not clear what comfort U S West derives from the fact that there is a "secondary" or "resale" market for high capacity facilities. U S West does not participate in this secondary market. Rather, it sells the high capacity facilities which it, not the reselling carriers, provides. It is in the high capacity facilities market where U S West seeks to be declared non-dominant based on its claims that it no longer possesses market power. U S West's share of this market is, of course, critical to its assertion of non-dominance.

The existence of a secondary market for such facilities is irrelevant. For example, if U S West had 100 percent of the market for high capacity facilities, it would have complete control of this facilities market. And, this would be true regardless of whether a lively secondary market for such facilities existed or not. As explained by the court in *Rothery Storage & Van Co.* v. *Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986), *cert. den.* 479 U.S. 1033 (1987) at 221:

> The degree of intrabrand competition is wholly independent of the level of interbrand competition confronting the manufacturer. Thus, there may be fierce intrabrand competition among the distributors of a product produced by a monopolist and no intrabrand competition among the distributors of a product produced by a firm in a highly competitive industry. But when interbrand competition exists, ... it provides a significant check on the exploitation of intrabrand market power because of the ability of consumers to substitute a different brand of the same product.

[6] The retail market consists of carriers who sell switched access and high capacity services to end users directly.

Because U S West actually provides more than 70 percent of the circuits, even though it may not bill them, the possibilities of facilities-based competition (and the competitive check such competition provides) are limited. For this reason, the Commission should be slow to attach significance to U S West's 20.7 percent figure.

Moreover, U S West's claims that it is rapidly losing market share ring hollow in view of the substantial changes that are likely forthcoming in access charges. Demand for high capacity circuits is greatly affected by the pricing of switched versus special access service under the current access charge regime. The Commission has already identified the usage sensitive carrier common line (CCL) rate structure as "an economically inefficient cost recovery mechanism and implicit subsidy."[7] As the Commission is well aware, this usage sensitive rate structure results in larger users overpaying for access, driving many of them to avoid switched access fees by substituting high capacity service linking them directly with interexchange carriers ("bypass").

As the Commission reforms its interstate access charge regime, it is clear that the subsidies inherent in the current CCL rate element will diminish, rendering the bypass of switched access through high capacity services much less attractive. As a result, the market for high capacity services is likely to shrink and some providers may exit the market. For U S West to assume that its past loss of market share will continue unabated in the future is overly simplistic and ignores the likely effect of forthcoming regulatory actions.

U S West also mistakenly claims that, because existing competitors have significant amounts of fiber in the ground in the Seattle area, they have "more than sufficient readily available excess capacity to constrain U S West's pricing behavior." Id. at 26. The fact that U S West's competitors may have fiber in the ground does not equate to the ability to absorb U S

[7] Access Charge Reform, First Report and Order, 12 FCC Rcd 15982 (1997), *recon. pending, aff'd in part sub nom. Southwestern Bell v. FCC,* Case No. 97-2618, Eighth Circuit, August 19, 1998.

West's high capacity demand quickly enough to discipline U S West's pricing behavior. Sprint has considerable experience with use of alternate providers of high capacity. It speaks from experience in stating that it is complicated and expensive to shift from an ILEC's high capacity circuits onto those of an alternate provider. In order to minimize potential interruptions to customers and maintain quality, such cutovers do not occur with the push of a button.

For example, individual Sprint customer circuits are manually "rolled" one by one from the ILEC to the alternate provider, usually at night when traffic is minimal. Sprint must pay both its and the ILEC's personnel overtime wages to perform this task. Moreover, the testing necessary to ensure end-to-end quality and continuity of the circuit usually requires the involvement of the alternate provider in addition to the ILEC and Sprint, complicating this task significantly.

IV. THERE IS NO NEED FOR FORBEARANCE: U S WEST ALREADY HAS SUFFICIENT PRICING FLEXIBILITY TO ALLOW IT TO COMPETE EFFECTIVELY IN THE HIGH CAPACITY SERVICES RETAIL MARKET

Under Section 69.123 of the Commission's rules, 47 C.F.R. §69.123, independent local carriers may establish density pricing zones for special access and switched transport services. Within these zones, carriers are allowed to charge different rates for special access services. See 47 C.F.R. §69.123(c). Thus, U S West may price its special access services provided in high density areas such as Seattle at lower rates than it provides such services in rural areas. This rule enables U S West to respond to incipient competition in urban areas by lowering its prices in these pricing zones.

U S West complains that it cannot compete effectively because Section 69.123 requires that it must maintain uniform pricing for each density pricing zone within a study area. Essentially, U S West is complaining that in order to lower the price of its high capacity services in Seattle, it would also have to lower the price of those services in the same density zone areas other than Seattle in the Washington study area. Of course, because U S West does not face the same degree of competition outside of Seattle, it would like to maintain the above-cost rates it is able to charge in the non-competitive areas. If U S West needs to compete more effectively in Seattle, it can, under section 69.123, solve its "dilemma" by reducing its prices for high capacity services throughout all of the areas in the density pricing zone in which Seattle resides in the Washington study area. It would certainly not be in the public interest for the Commission to enable U S West to segment the market by continuing to charge above-cost rates for its high capacity services in areas outside of Seattle by forbearing from regulating U S West as a dominant carrier within Seattle.

The Commission's Density Zone Pricing rules provide a far better accommodation between the need for the Commission to allow some pricing flexibility in markets where nascent competition is pressuring existing carriers to lower rates and the need to prevent incumbents from harming competition by selectively lowering prices. Because U S West provides high capacity facilities on an integrated basis with its monopoly local exchange and exchange access services, there is a palpable threat of cross-subsidization. The threat of such discriminatory actions are at least eased if any price reduction must be made available to all customers with equivalent zone densities and, presumably, with equivalent costs. The benefits of competition are thereby spread to all similarly-situated customers, rather than being limited only to those customers that are directly targeted by competition.

In addition, U S West can offer term and volume discounts on its high capacity services. Nothing in the Commission's rules forbids U S West (or any other ILEC) from offering such discounts,[8] which should enable U S West to compete fiercely in Seattle's high capacity circuit market. U S West's status as an incumbent with by far the majority of installed facilities in Seattle should allow it to offer term and volume discounts that would be difficult for its new competitors to match.[9]

V. U S WEST SHOULD OPEN ITS LOCAL MARKETS TO COMPETITION

Finally, U S West complains throughout its Petition that it cannot compete as effectively as its competitors because U S West alone is prohibited from bundling in-region, interLATA services with its high capacity services offerings. U S West cites the Communications Act's interLATA restrictions as support for its request for non-dominance. But as should be obvious, U S West does not need non-dominant carrier regulation in order to compete more effectively against its rivals. Rather, U S West need only comply with the requirements spelled out in section 271 of the Communications Act, 47 USC §271. If U S West needs to offer bundled services in order to compete against its rivals, then it should open its local markets to competition. Granting U S West's petition would only dampen U S West's incentives to open these markets in Seattle and throughout the U S West Region.

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8 Of course, any discounts offered must be cost-based and not reliant on cross-subsidies from other services.

9 There are obviously substantial scale economies associated with the provision of high capacity facilities. Because fiber must be buried, the construction of a single fiber route is relatively expensive. On the other hand, increasing the capacity of that fiber route becomes progressively less costly. Thus, on a circuit basis it is far cheaper to add a fiber line that carries thirty DS3s worth of traffic than to build a system that carries one DS3 or, conceivably, one DS1. U S West's near monopoly provision of both local service and exchange access provides it with traffic flows that its competitors cannot yet begin to match.

VI. CONCLUSION

For the reasons stated above, the Commission should deny U S West's Petition.

Respectfully submitted,

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February 18, 1999

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing **Opposition of Sprint Corporation** was sent by hand or by United States first-class mail, postage prepaid, on this the 18th day of February, 1999 to the parties on the attached list.

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