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March 30, 2001

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Mr. Kyle Dixon
Federal Communications Commission
445 12th Street, SW, 8B-204
Washington, DC 20554

RE: Petition of U S WEST Communications, Inc. for Forbearance from Regulation as a Dominant Carrier for High Capacity Services in Phoenix, Arizona MSA, CC Docket No. 98-157

Petition of U S WEST Communications, Inc. for Forbearance from Regulation as a Dominant Carrier for High Capacity Services in Seattle, Washington MSA, CC Docket No. 99-1

Dear Mr. Dixon:

On March 20, 2001, Sharon Devine, John Kure and I met with you to discuss the status of Qwest's Section 10 forbearance petitions now that the D.C. Court of Appeals has issued its remand in Qwest's appeal of the Commission's *Order* denying the petitions. We look forward to working with the Commission in demonstrating that the markets for high capacity services in Phoenix and Seattle are highly competitive and that Qwest lacks market power in the provision of these services.

As you know from our discussion, Qwest's primary interest is in having its forbearance petitions evaluated under the Commission's existing standard for non-dominance (*e.g.*, as articulated in the *AT&T Nondominance Order*) at the earliest possible date. As we stated in our meeting, we anticipate making a decision in the very near future as to how we might refresh the record in this proceeding, if at all. Qwest will forgo revising its forbearance petitions if we conclude revision will delay or unreasonably extend the length of time necessary for the Commission to complete its deliberative process. We will be contacting you in the near future to get your thoughts on this issue.

I have enclosed a short summary of Qwest's position on the petitions and Section 10 forbearance as I agreed to do in our meeting. Please contact me if you have any further questions after reviewing the attached summary.

Respectfully,

James T. Hannon /dc

James T. Hannon

Attachment

cc: Dorothy Attwood, Glenn Reynolds, Tamara Preiss

Qwest's Forbearance Petitions for the Phoenix and Seattle MSAs

Qwest Corporation, formerly U S WEST Communications, filed petitions requesting that the FCC exercise its authority under Section 10 of the Telecommunications Act to forbear from regulating Qwest as a dominant carrier in the provision of high capacity services (*i.e.*, special access and dedicated transport for switched access at DS1 and higher transmission levels) in the Phoenix and Seattle MSAs. Under Section 10, the Commission must forbear from regulating Qwest as a dominant carrier of high capacity services if it finds that: (1) enforcement is not necessary to ensure that rates and practices are just, reasonable and not unreasonably discriminatory; (2) enforcement is not necessary to protect consumers; and (3) forbearance is consistent with the public interest.

The Petitions

In its petitions, Qwest demonstrated that the markets for high capacity services in Phoenix and Seattle are robustly competitive and that Qwest does not have market power. Qwest's analysis was based on well-accepted antitrust principles and factors that the Commission has traditionally applied in determining whether a carrier is dominant in relevant product and geographic markets.[1] These factors include: (1) market share; (2) the demand elasticity of customers; (3) the supply elasticity of the market; and (4) the carrier's cost, structure, size and resources.

Following the approach the Commission used to assess market power in the AT&T non-dominant proceeding and other proceedings, Professors Alfred E. Kahn and Timothy J. Tardiff concluded that Qwest lacks market power in the provision of high capacity services in Phoenix and Seattle because:

- Qwest has a steadily declining market share:
  --29% share of the retail market in Phoenix and 79% share of the wholesale market as of 4th Qtr. 1997;
  --21% share of the retail market in Seattle and 72% share of the wholesale market as of 4th Qtr. 1997;
  --Competitors growing significantly faster than Qwest.
- Customers have high demand elasticities:
  --Large, well-financed, sophisticated customers;
  --Ability of customers to "self-provision" (*e.g.*, AT&T and WorldCom);
  --Customers are highly price-sensitive;
  --Retail customers are often unaware of underlying (wholesale) service provider.
- These high capacity markets have high supply elasticities:
  --Competitors have built over 800 route miles of backbone fiber in Phoenix and 700 miles in Seattle;
  --65% of Qwest's high capacity demand is located within 100 feet of competitive fiber networks in Phoenix and 61% in Seattle;

[1] *AT&T*, 11 FCC Rcd. 3271, 3285 ¶ 19 (1995); *Comsat*, 13 FCC Rcd. 14083, 14118 ¶ 66 (1998).

--Cost to build-out competitive networks to all of Qwest's customer locations which are within 1000 feet is minimal; $45 million in Phoenix and $46 million in Seattle;
--Significant amount of unused capacity available in competitive networks;
--Time to build-out competitive networks is relatively short, 18-24 months.

- Qwest does not enjoy an advantage over its competitors in terms of its costs, structure, size and resources.

In light of Qwest's lack of market power, Kahn and Tardiff concluded that competition, without dominant carrier regulation, is sufficient to constrain Qwest's ability to impose anti-competitive prices and other terms and conditions of service. In fact, Kahn and Tardiff concluded that continued regulation of Qwest's high capacity services in these highly competitive markets would be "anti-competitive and injurious to consumers."[2] They also observed that even if Qwest successfully engaged in anti-competitive pricing practices against such unlikely candidates as AT&T, installed fiber networks would remain in place.

Given Qwest's demonstrated lack of market power in the market for high capacity services in Phoenix and Seattle, Qwest's petitions satisfy the Section 10 criteria for forbearance since: (1) dominant carrier regulation is not necessary to ensure that rates and practices are just, reasonable, and not unreasonably discriminatory; (2) dominant carrier regulation is not necessary to protect consumers because Qwest cannot control prices or act in a discriminatory manner; and (3) continuing to subject Qwest's high capacity services in Phoenix and Seattle to dominant carrier regulation deprives customers of the benefits of true competition.

Procedural Background and Court Remand

Qwest filed its forbearance petitions for Phoenix and Seattle on August 24, 1998 and December 30, 1998, respectively. On November 22, 1999, the Commission issued a joint order denying the forbearance petitions of Qwest, SBC, Bell Atlantic, and Ameritech. In this *Order*, the Commission emphasized "that the *Pricing Flexibility Order* establish[ed] a mechanism by which the petitioners may receive much of the relief that they seek without having to demonstrate loss of market power."[3] The Commission observed that dominance/non-dominance inquiries were difficult and time consuming and basically directed petitioners to seek relief through the framework established in the *Pricing Flexibility Order*.[4] In addressing the merits of the petitions, the Commission found the market share data provided by Quality Strategies to be deficient but it did not analyze any other indicia of market power (*e.g.*, elasticity of demand, elasticity of supply, intensity of competition, cost structure of competitors).

On January 23, 2001, the D.C. Court of Appeals issued its opinion on Qwest's appeal of the Commission's *Forbearance Order*. The Court found that the Commission had "departed from its traditional non-dominance analysis without explanation" and "completely failed to address the evidence other than the market share data" submitted by Qwest to show its lack of

[2] Economic Evaluation of High-Capacity Competition in Seattle, Alfred E. Kahn and Timothy J. Tardiff, dated Dec. 22, 1998 at 3; Economic Evaluation of High-Capacity Competition in Phoenix, dated Aug. 14, 1998 at 3.
[3] *Forbearance Order*, 14 FCC Rcd. 19947, 19968 ¶ 36.
[4] *Id.* at 19954 ¶¶ 12-13.

market power.[5] The Court also found that the Commission's conclusion "that market share data is essential for a *prima facie* showing of competition simply is not consistent with the agency's earlier decisions."[6] In remanding the case back to the Commission, the Court clarified that Congress established Section 10 as a "viable and independent means of seeking forbearance" and "the availability of the Pricing Flexibility Order as an alternative route for seeking pricing flexibility does not diminish the Commission's responsibility to fully consider petitions under § 10."[7] The Court issued it mandate on March 14, 2001.

Appropriate Standard For Non-Dominance

In its recent decisions addressing requests by dominant carriers that they be classified as non-dominant in the provision of certain services, the Commission has applied a consistent framework of competitive analysis to determine whether a carrier continued to possess market power.[8] The four factors considered in the Commission's analysis were: (1) market share; (2) the demand elasticity of the carrier's customers; (3) supply elasticity of the market; and (4) the carrier's cost structure, size and resources.

For some unexplained reason, the Commission chose not to consider any factors other than market share in evaluating Qwest's forbearance petitions. This departure from the Commission's traditional non-dominant analysis was the primary reason for the Court's remand. While it might be possible for the Commission on remand to justify using market share as its sole basis for determining dominance (*i.e.*, market power), it would be unwise to do so. Adopting a non-dominance test solely based on market share would be at odds with a long line of antitrust precedent and much of the Commission's own past analysis.[9]

The Commission itself has recognized the shortcomings of market share stating that "[m]arket share alone is not necessarily a reliable measure of competition, particularly in markets with high supply and demand elasticities."[10] In fact, the Commission has found AT&T to be non-dominant in markets in which it had a 100% market share.[11] Non-dominance is about market power, not market share. A company with a high market share in the provision of a specific service may or may not have market power -- that is why it is critical that other factors such as elasticities of supply and demand be examined. Moreover, a company may have market power in markets for some services but not in other markets.[12] Clearly, the multi-factor test that the Commission used in the AT&T and Comsat decisions is the appropriate standard for determining whether a carrier has market power and should be used in any analysis of whether a carrier is a "dominant" provider of certain services.

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[5] *AT&T v. FCC*, Case No. 99-1535, Opinion rel. Jan. 23, 2001 (D.C. Cir.) at 14 and 9 respectively, *remanded for further recon.*

[6] *Id.* at 13.

[7] *Id.* at 16.

[8] *AT&T*, 11 FCC Rcd. at 3303-09 ¶¶ 57-73; *AT&T International*, 11 FCC Rcd. 17963, 17977-93 ¶¶ 37-79 (1996); *Comsat*, 13 FCC Rcd. at 14118-150 ¶¶ 66-134.

[9] *AT&T*, 11 FCC Rcd. at 3307-08 ¶ 68; *AT&T International*, 11 FCC Rcd. at 17976 ¶ 34.

[10] *AT&T*, 11 FCC Rcd. at 3307-08 ¶ 68 (citing the *First Interexchange Competition Order*, 6 FCC Rcd. at 5890).

[11] *AT&T International*, 11 FCC Rcd. at 17998-99 ¶¶ 96-97.

[12] *BOC Out-of-Region InterLATA Order*, 12 FCC Rcd. 15756, 15782 ¶ 41 (1997).