

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of)	
)	
AT&T Corp.)	RM No. 10593
)	
Petition for Rulemaking to Reform)	
Regulation of Incumbent Local Exchange)	
Carrier Rates for Interstate Special)	
Access Services)	

REPLY COMMENTS OF QWEST COMMUNICATIONS INTERNATIONAL INC.

Pursuant to the Federal Communications Commission’s (“Commission”) *Public Notice*,¹ Qwest Communications International Inc. (“Qwest”) respectfully submits its Reply Comments in the above-captioned proceeding. For the reasons set forth below, and in Qwest’s opening comments, the petition for rulemaking (“petition”) submitted by AT&T Corp. (“AT&T”)² should be denied, and this proceeding terminated forthwith.

ARGUMENT

The pricing flexibility rules challenged by AT&T represent incremental reforms that are consistent with the Commission’s approach to telecommunications services increasingly subject to competition. They are likewise consistent with, if not compelled by, the Telecommunications Act of 1996, the purposes of which are to “promote competition and reduce regulation.”³ Indeed, contrary to the claims supporting the petition, adoption of the relief sought by AT&T, not retention of the pricing flexibility rules for special access services, would effect a “radical” departure from settled law.

¹ *Public Notice*, DA 02-3393, rel. Dec. 9, 2002.

² AT&T’s petition was filed Oct. 15, 2002.

³ Pub. L. No. 104-104, 110 Stat. 56, 56 (Feb. 8, 1996).

I. THE COMMENTS SUPPORTING THE PETITION ADD NO DATA OR ARGUMENTS THAT HAVE NOT BEEN REFUTED BY OPPOSING COMMENTS

Without exception, the parties supporting the petition have chosen to rely entirely on the same “data” and arguments submitted by AT&T. These arguments have been thoroughly refuted by the opening comments of Qwest, SBC Communications Inc. (“SBC”) and other incumbent local exchange carriers (“LEC”).

A. Comments Supporting the Petition Fail to Demonstrate “Changed Circumstances”

Most fundamentally, commenters supporting the petition have offered no evidence, much less substantial evidence, of “changed circumstances” that would support the abolition or revision of the rules adopted in the *Pricing Flexibility Order*.⁴ That is hardly surprising, for the petition was filed less than three years after adoption of the *Order*, only two years after the first grant of pricing flexibility in any Bell Operating Company (“BOC”) territory, and less than six months after Qwest received its first grant of pricing flexibility.⁵ Qwest is not aware of any retrenchment of regulatory reforms similar in scope to that proposed by AT&T in so short a period of time.

The only “changed circumstances” even alleged in comments supporting the petition are based on allegations about accounting rates of return and price increases for special access

⁴ *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers; Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA, Fifth Report and Order and Further Notice of Proposed Rulemaking*, 14 FCC Rcd. 14221 (1999) (“*Pricing Flexibility Order*”), *aff’d*, *WorldCom v. FCC*, 238 F.3d 449 (D.C. Cir. 2001). As AT&T (*e.g.*, petition at 36) concedes, its petition cannot be granted unless it meets its burden of showing “changed circumstances” since the Commission’s adoption of the pricing flexibility rules.

⁵ See SBC at 18-19. *And see In the Matter of Qwest Petition for Pricing Flexibility for Special Access and Dedicated Transport Services, Memorandum Opinion and Order*, 17 FCC Rcd. 7363 (2002).

services, and bankruptcies in the competitive LEC industry. These were the same claims made by AT&T in its petition, which have been refuted by the oppositions of Qwest, SBC and others. The comments supporting the petition fail to provide any new or different data, or other support.

1. “Rate of return” analysis

Specifically, contrary to the claims of CompTel (at 2), WorldCom (at 2-3), US LEC (at 4), Time Warner (at 3) and others, the rate of return analysis submitted by AT&T does not demonstrate that circumstances have changed since the BOCs first began to implement pricing flexibility, and does not support claims that the incumbent LECs’ rates for special access services were set at supra-competitive levels for *any* period. First, AT&T’s rate of return analysis does not show changed circumstances because the data upon which it is based relate to the period 1996-2001, which was before the BOCs began to exercise their rights under the pricing flexibility rules. Thus, as SBC (at 19) explains, these data “do not show that pricing flexibility had a significant impact on BOC special access earnings and revenues, nor, consequently, do the[se] data show that pricing flexibility has enabled BOCs to exercise market power to establish excess rates.”⁶ That should be dispositive of the matter for purposes of the instant petition.

Second, even if the data relied upon by AT&T did not suffer from the timing flaw described above, they would not support a finding that the BOCs possess market power and have been charging supra-competitive rates. As Qwest explained in detail in its opening comments (at 7-17), the federal cost allocation process is incapable of generating a meaningful estimate of a price cap LEC’s rate of return for special access services.⁷ Indeed, it is for that reason that the

⁶ See also Qwest Comments at 5.

⁷ By “federal cost allocation process,” Qwest is referring to the costing rules in Parts 32, 36, 64 and 69 of the Commission’s rules.

Commission has recognized in the context of price cap LECs that reducing “regulatory reliance” on rate of return accounting data is “essential.”⁸ With regard to special access in particular, a number of factors in the Commission’s rules understate the costs that are assigned to those services, resulting in an overstatement of rates of return.⁹ Further, the unreliability of the federal cost allocation process for the purpose of measuring profitability of particular services has been magnified over time.¹⁰

2. Maintenance of, or increases in, prices

Likewise meritless are claims by some commenters that maintenance of, or increases in, rates for some special access services provided in areas where BOCs have been granted pricing flexibility are evidence of changed circumstances, or otherwise disprove the Commission’s predictive judgement that it could rely on market forces to ensure that rates are not unreasonably high.¹¹

First, these price increases are not evidence of circumstances that were not considered by the Commission. To the contrary, the Commission acknowledged in the *Pricing Flexibility Order* that the removal of price caps “may enable incumbent LECs to increase access rates for

⁸ *In the Matter of Price Cap Performance Review for Local Exchange Carriers, Fourth Report and Order*, 12 FCC Rcd. 16642, 16701 ¶ 150 (1997).

⁹ Qwest Comments at 11-12.

¹⁰ *Id.* at 10-11.

¹¹ *See, e.g.*, Sprint at 6-7; WorldCom at 6-8; US LEC at 4. Notably, none of these commenters (nor any other party for that matter) has proven unlawful any special access rate in a Metropolitan Service Area (“MSA”) for which pricing flexibility has been granted and exercised. Indeed, to the best of Qwest’s knowledge, no party has even challenged any such rates pursuant to the Commission’s formal complaint process. The availability of the enforcement process was cited in the Commission’s decision to adopt (*Pricing Flexibility Order*, 14 FCC Rcd. at 14267 ¶ 83, 14289-94 ¶¶ 125, 127, 129, 131), and the Court of Appeals’ decision to affirm (*WorldCom v. FCC*, 238 F.3d at 455), the pricing flexibility rules. Obviously, having never attempted to use the enforcement process, neither AT&T nor its supporters can demonstrate that the combination of market forces and the enforcement process are insufficient safeguards.

some customers.”¹² The Commission concluded nevertheless to permit pricing flexibility for incumbent LEC special access services in the circumstances described in the *Order*, because of its belief that at least some price increases may be warranted, and that in all events “the public interest is better served by permitting market forces to govern special access rates.”¹³

Second, as Drs. Kahn and Taylor explain, under the conditions present in the market for special access services, price increases do not necessarily evidence the possession or exercise of market power.¹⁴ Indeed, Kahn and Taylor demonstrate that the BOCs’ special access revenues per line have *decreased* by more than one percent and three percent annually in nominal terms and constant dollars, respectively.¹⁵ Thus, the arguments based on the incumbent LECs’ special access prices would wholly fail to justify revisiting the Commission’s rules, even if they had been based on data accumulated over a meaningful period of time -- which they have not been.

3. Financial stability of competitive LECs

Finally, arguments based on the financial health of the competitive LEC industry in general and certain carriers in particular do not constitute a showing of changed circumstances even close to what would be sufficient to warrant revisions to the Commission’s pricing flexibility rules. As demonstrated in the *UNE Fact Report*, and summarized below, competition for special access services continues to grow.¹⁶ Carriers continue to enter the market and expand their reach. And the fact that some competitive LECs have filed for bankruptcy has little if any relevance to the instant petition. Many if not most of such carriers continue to provide service

¹² *Pricing Flexibility Order*, 14 FCC Rcd. at 14301-02 ¶ 155.

¹³ *Id.*

¹⁴ Kahn and Taylor Declaration (attached to Qwest’s opening comments) at 14.

¹⁵ *Id.* at 15.

¹⁶ *UNE Fact Report*, at III (submitted as Attachment B to Qwest’s Comments, dated Apr. 5, 2002, in the Commission’s Triennial Review proceeding, CC Docket No. 01-338).

while in bankruptcy. Should carriers fail to emerge from bankruptcy, their sunk investment will be available to other firms for the provision of competing services.¹⁷

B. The Remaining Arguments Supporting the Petition Were Previously Considered and Rejected by the Commission in the *Pricing Flexibility Order* and Elsewhere

In the end, having failed to demonstrate “changed circumstances,” commenters supporting AT&T fall back on arguments that -- as some of them readily admit -- were considered and rejected by the Commission and the Court of Appeals.¹⁸ In particular, these commenters repeat, without adding any new data or argument, AT&T’s claims about (1) the use of collocation triggers in lieu of a broader analysis of market power as a basis for the grant of pricing flexibility,¹⁹ (2) the amount and types of competition for special access services,²⁰ and (3) the possibility that pricing flexibility will result in predation and other forms of anticompetitive behavior.²¹ These claims are no more persuasive today than they were in 1999. Indeed, developments in the market provide further support for the *Pricing Flexibility Order*.

1. The use of collocation-based triggers

For example, the Commission recognized in the *Pricing Flexibility Order* that its collocation-based triggers for pricing flexibility “underestimate” competition in relevant markets as “[they] fail[] to account for the presence of competitors that . . . have wholly bypassed

¹⁷ Recognizing these facts, some commenters argue that the real concern is that large customers question the reliability of competitive LECs in light of the perceived financial instability of that segment of the industry. *Cable & Wireless* at 13. Similar arguments, however, did not prevent the Commission from granting AT&T increasing amounts of pricing flexibility at the same time its nascent competitors were attempting to counter similar concerns, and there is no reason for a different result here.

¹⁸ *See, e.g.*, *Time Warner* at 5 (conceding that its arguments about anticompetitive conduct had been, asserted “before the Commission adopted its pricing flexibility rules”).

¹⁹ *See, e.g.*, *Sprint* at 2; *WorldCom* at 8-10.

²⁰ *See, e.g.*, *Sprint* at 3-4; *Cable & Wireless* at 7.

²¹ *See, e.g.*, *Time Warner* at 4-12; *Sprint* at 5-6.

incumbent LEC facilities.”²² The conservative nature of the collocation-based triggers in this regard has been magnified over time, as competitive LECs employ direct connections to customer premises, and take advantage of points of traffic concentration, such as “collocation hotels,” that are alternatives to collocation offered by the incumbent LECs. Data traffic at these locations is growing at an annual rate of 100%. There are now alternative collocation providers in virtually all major metropolitan areas throughout the country.²³ None of these data are considered, however, in determining whether an incumbent LEC qualifies for pricing flexibility.

2. Competition for special access services

Other data confirm that competition for special access has increased since the adoption of the *Pricing Flexibility Order*. The number of competitors providing alternatives to the incumbent LECs’ special access services grew to at least 532 as of 2001. Competitors now earn between 28 and 39 percent of all special access revenues.²⁴ Estimates of fiber route miles deployed by competitive LECs range from 184,000 to 339,501.²⁵ All but nine of the top 100 MSAs are served by at least three competitive LEC fiber networks.²⁶ Competitive LECs’ attempts to prove a dearth of competitive alternatives based on claims that competitive LECs’ networks are connected to “only” 30,000 buildings,²⁷ are highly misleading, for they ignore the fact that “special access customers are highly concentrated in a limited number of wire centers

²² *WorldCom v. FCC*, 238 F.3d at 462, quoting *Pricing Flexibility Order*, 14 FCC Rcd. at 14274 ¶ 95.

²³ *UNE Fact Report* at III-4, 5.

²⁴ *Id.* at III-8.

²⁵ SBC at 12 nn.54, 55.

²⁶ *UNE Fact Report* at III-7.

²⁷ Sprint at 3-4.

and a small number of buildings in those wire centers.”²⁸ That is a key factor in understanding why competitive LECs have been able to garner such a substantial share of special access revenues.

3. The possibility of unlawful, exclusionary behavior

Finally, the comments of Time Warner and others about “predation” and other forms of exclusionary behavior are the same ones that the Commission rejected in the *Pricing Flexibility Order*.²⁹ As a preliminary matter, these commenters rely entirely on speculation; none of them describe an instance of unlawful exclusionary conduct. These commenters fail, moreover, to demonstrate that the Commission’s formal complaint process does not provide an adequate safeguard against predation.³⁰

The commenters’ claims about the possibility of exclusionary behavior fail even as a theoretical matter. In particular, the commenters (*e.g.*, Time Warner at 2) object to incumbent LECs use of pricing flexibility “to selectively drop prices for individual customers . . . to meet the limited facilities-based competitive entry that exists today.” These claims are extraordinary. At bottom, they amount to the incongruous argument that competition for special access services is somehow a reason to repudiate procompetitive doctrines such as “meeting competition” and “competitive necessity” that were first applied in the telecommunications industry when the Bell System and later AT&T had a *monopoly*.

²⁸ SBC at 11. In Qwest’s territory, more than 60 percent of special access revenues are generated from 11 percent of Qwest’s total wire centers. *UNE Fact Report* at III-8 n.40.

²⁹ *Pricing Flexibility Order*, 14 FCC Rcd. at 14264-67 ¶¶ 80, 83.

³⁰ As the Court of Appeals recognized in affirming the *Pricing Flexibility Order*, “there is a consensus among commentators that predatory pricing schemes are rarely tried and even more rarely successful.” *WorldCom v. FCC*, 238 F.3d at 463. That fact renders even more defensible the Commission’s prior determination to rely on the enforcement process as opposed to prophylactic regulation to address the purported concerns about predatory behavior.

The simple fact is that the act of providing targeted discounts that respond to offers by competitors “is quintessentially procompetitive and pro-consumer.”³¹ As AT&T explained over a decade ago, “the antitrust laws and every pertinent decision since the enactment of the Communications Act . . . establish that, far from being anticompetitive, the practice of meeting a competitor’s prices on a customer-by-customer basis is “the essence of competition’ and could not violate Section 202’s ban on ‘unreasonable’ rate discrimination.”³² That is so, “regardless of the degree of competitiveness in the industry or the market power of the seller.”³³ Based on these precedents, the Commission’s consistent practice has been to grant “dominant” or incumbent carriers pricing flexibility for services that, like special access, are increasingly subject to competition, notwithstanding the very same arguments asserted here.³⁴ These arguments thus provide no basis to revisit the pricing flexibility rules for special access services.

³¹ Rebuttal of AT&T, Tariff FCC No. 15, Competitive Pricing Plan No. 2, CC Docket No. 90-11, June 5, 1992 (“AT&T Rebuttal”) at i.

³² Direct Case of AT&T, Tariff FCC No. 15, Competitive Pricing Plan No. 2, CC Docket No. 90-11, May 7, 1992, at 14. As AT&T further explained, “the courts and the Commission have held that rate differences are part and parcel of the competitive process that drives prices closer and closer to cost, and they will benefit all of the carrier’s customers so long as the discounted rates are necessary to retain or obtain a customer’s business and are a contribution to the carrier’s fixed costs.” AT&T Rebuttal at 4.

³³ AT&T Rebuttal at 7.

³⁴ See, e.g., *In the Matter of Competition in the Interstate Interexchange Marketplace, Report and Order*, 6 FCC Rcd. 5880, 5899-5901 ¶¶ 108-16 (1991); *In the Matter of Guidelines for Dominant Carriers’ MTS Rates and Rate Structure Plans, Memorandum Opinion and Order*, 59 R.R.2d 70, 76-77 ¶ 21 (1985) (“[w]e recognize that as competitors increase their range of offerings, and increasingly impinge on the dominant carriers’ markets, a competitive response by dominant carriers will be in the interest of consumers, as well as the dominant carriers themselves. Indeed, we believe this is the essence of the competitive process.”).

II. CONCLUSION

The Commission should forthwith deny AT&T's petition and terminate this proceeding.

Respectfully submitted,

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January 23, 2003

CERTIFICATE OF SERVICE

I, Richard Grozier, do hereby certify that I have caused the foregoing **REPLY**
COMMENTS OF QWEST COMMUNICATIONS INTERNATIONAL INC. to be 1) filed
with the FCC via its Electronic Comment Filing System, 2) served via hand delivery or e-mail on
the person/entity on the attached service list marked with an asterisk (*), and 3) served via First
Class United States Mail, postage prepaid, on all other persons listed on the attached service list.

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