Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Qwest Corporation	)	Transmittal No. 178
Tariff FCC No. 1	)	

REPLY OF QWEST CORPORATION TO PETITION TO SUSPEND AND INVESTIGATE

Qwest Corporation ("Qwest"), pursuant to Section 1.773(b)(iii) of the Rules of this Commission, hereby files this Reply in opposition to a Petition to Suspend and Investigate Transmittal No. 178, a revision to the DSL rate sections of Qwest Tariff FCC No. 1, Section 8, filed November 28, 2003. The Petition was filed on December 5, 2003 by EarthLink, Inc. ("EarthLink").

SUMMARY

The Qwest tariff filing is designed to further the FCC's stated goal of facilitating broadband deployment, and is consistent with the FCC's rules and regulations. EarthLink objects to the fact that the price of two DSL services is different, despite the fact that they share a common infrastructure cost. Qwest decided to assign a lower margin (and consequently lower price) to the DSL Choice product compared to the higher speed DSL Choice Deluxe product. This decision was based on marketing analysis. The broadband market, which includes DSL service, is dependent on attracting current dial-up customers, especially when it comes to the initial decision to move from dial-up access to Internet-based services to broadband services. This target group is very price sensitive. Consequently, price becomes the compelling reason to move initially to broadband from dial-up. Qwest has determined that customers are more willing to try out a lower speed DSL product for a lesser price than they are to move immediately to a higher speed DSL service. Once the customer has discovered the efficiencies afforded by DSL service at a lower speed, the customer is considerably more likely to purchase one of the higher-speed DSL products such as the DSL Choice Deluxe service. Accordingly, in order to accelerate the marketing of all speeds of DSL service, Qwest has chosen to price the DSL Choice service at an entry-level rate, while recovering a significantly higher margin from DSL Choice Deluxe service.

This decision is completely consistent with the Commission's rules and policies, in addition to acting to promote the overall goal of increasing the availability of broadband service to all consumers. There is no FCC rule that prohibits a carrier from pricing services offering different transmission speeds differently, or from assigning overheads and common costs among different high capacity services in a non-uniform manner.

BACKGROUND

Qwest's tariff filing makes several pro-competitive and pro-consumer modifications to its DSL service offering by reducing the price of two different Qwest DSL products:[1]

	Old Rate (per month)	New Rate (per month)
DMT Qwest Choice DSL	$21.95	$15.00
DMT Qwest Choice DSL Deluxe	$31.95	$28.00

[1] Description and Justification, p. 2.

EarthLink's objection is that the price of Choice DSL Deluxe service has not been reduced as much as the price of Choice DSL service. Reduced to basics, Earthlink contends that the FCC's rules should be read so as to prohibit a carrier from pricing different speeds of broadband service differently in order to respond to competitive market needs. This position is simply wrong.

Qwest's Choice DSL service is offered at a speed of 256 KBPS, while the Choice DSL Deluxe service is offered at a speed of 256 KBPS up to 640 KBPS.[2] The best marketing of the Qwest DSL family of products in general is based on attracting customers to the slower speed broadband service based on price considerations, and then demonstrating the added benefits of higher speed service based on service quality and feature compatibility.   Thus, DSL Choice service is priced in a manner that encourages this purchasing pattern. EarthLink itself purchases DSL services from Qwest at an 11% discount (based on volume).[3] This discount is available to Earthlink whether it purchases Qwest DSL Choice or Qwest DSL Choice Deluxe service. EarthLink is accordingly able to purchase either service at less than Qwest sells the service to its own retail customers.

In the Description and Justification filed with Transmittal No. 178, Qwest described the methodology that it used to establish a single TSLRIC cost for its DSL products,[4] and established this TSLRIC cost as $141.57 per year, or $11.80 per month. This TSLRIC cost was not broken down along product lines. Instead, the cost is a

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[2] As a practical matter, DSL Choice Deluxe service provides 640 KBPS.
[3] Qwest Tariff FCC No. 1, Section 8.4.5.C. All DSL services are available at volume discounts.
[4] Description and Justification, pp. 4-5 and Workpaper 1.

blended cost that was set as an infrastructure cost applicable to all related DSL products. Starting from this baseline cost, and considering "a combination of internal analysis and external competitive factors,"[5] Qwest established the prices for the different DSL products as described above. The prices for the total family of products are set to recover the TSLRIC cost of the services and a reasonable total margin (which includes common costs, overhead and profit). As is obvious from the filed materials, based on the chosen cost methodology, the prices chosen reflect different margins for the different DSL services based on the blended TSLRIC costs assigned to the products generally. These margins are set to recover overhead, common costs and a reasonable profit.

Qwest's decision to assign a lower margin (and consequently lower price) to the DSL Choice product was based on marketing analysis. The broadband market, which includes DSL service, is dependent on attracting current dial-up customers. This target group is very price sensitive. Consequently, price becomes the compelling reason to move to broadband. Qwest has determined that customers are more willing to try out a lower speed DSL product for a lesser price than they are to move immediately to a higher speed DSL service. Once the customer has discovered the efficiencies afforded by DSL service at a lower speed, the customer is considerably more likely to purchase one of the higher-speed DSL products such as the DSL Choice Deluxe service. Qwest's strategy is designed to further the FCC's stated goal of facilitating broadband adoption and deployment. Accordingly, in order to accelerate the marketing of all speeds of DSL service, Qwest has chosen to price the DSL Choice service at an entry-level rate, while recovering a significantly higher margin from DSL Choice Deluxe service.

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[5] Description and Justification, p. 2.

THE TARIFF FILING IS LAWFUL

EarthLink objects to the non-uniform recovery of margins among these services. Notably, EarthLink does not object to the reasonableness of the total overhead and common costs that Qwest seeks to recover in the margins assigned to the different DSL products. Instead, EarthLink's objection is that the recovered margin (i.e., assigned overhead and common costs) on the DSL Choice Deluxe service is disproportionately high compared to the margin on the DSL Choice product.[6] EarthLink is unable to claim any cognizable harm from Qwest's pricing decision because Qwest is lowering the price of both DSL products covered by this tariff filing, and both products are available to Earthlink at the volume discounts under which it purchases.[7]

Qwest's marketing choice is consistent with the Commission's tariffing policies and is not unreasonable. As a general principle, a carrier is not required to apply uniform overhead and similar loadings to its related services, even if the services are "like" each other for purposes of 47 USC Section 202(a).[8] So-called "strategic pricing" for high capacity services has been recognized as a valid response to the telecommunications marketplace consistent with the Act for many years. For example, in establishing the so-called "crossover ratios" governing the price relationship between DS1 and DS3 services in 1988, the Commission observed that:

[6] Earthlink does contend that the margin assigned to the DSL Choice Deluxe service is unreasonably high per se. Petition, p. 3. However, this objection is really a function of the recovery of overhead and common costs among the services, not an objection to the actual amount of overhead and common costs to be recovered.

[7] If EarthLink really believes that the Qwest DSL Choice service is priced in such a manner that it will be more attractive to Qwest's own retail customers, EarthLink may purchase that service at the specified 11% volume discount and resell that service to its customers.

[8] In the Matter of Transport Rate Structure and Pricing, 10 FCC Rcd 3030, paragraph 60 (1995).

> We have considered the lawfulness of pricing HiCap and DDS services to reflect strategic considerations in addition to relative cost. We conclude that the LECs should have the flexibility to price these services based on objectives other than cost recovery such as deterring uneconomic bypass and managing the migration of demand for substitutable special access services.[9]

The marketing objectives sought by Qwest in the instant tariff filing are both bona fide (from a marketing perspective) and consistent with the Commission's own broadband goals.

The case cited by EarthLink for a contrary proposition[10] was based strictly on the unique facts of that case. In that proceeding, ILECs were assigning a greater percentage of overhead costs to interconnection services used by competitors (for which there was no viable alternative) than to their own retail services that competed directly with the users of those very interconnection services. As the Commission noted in that case (in contrast to the instant tariff filing):

> We note that our concern regarding the LEC's' ability to establish overhead loadings for virtual collocation based on market conditions is due strictly to the unique circumstances of expanded interconnection: that the LECs control the bottleneck facilities that interconnectors need to enter the interstate access service market.[11]

In this case, of course, Earthlink can purchase <u>both</u> DSL services covered by the instant tariff filing at a discount, and is not disadvantaged at all by Qwest's marketing decision. Moreover, DSL service itself is subject to intense competition and, unlike the situation described in the case relied on by EarthLink, Earthlink itself has numerous competitive

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[9] In the Matter of Investigation of Special Access Tariffs, CC Docket 85-166, Phase II, Part 1, 4 FCC Rcd 4797, paragraph 2 (1988).
[10] In the Matter of Local Exchange Carriers' Rates, Terms and Conditions for Expanded Interconnection Through Virtual Collocation, 10 FCC Rcd 6375 (1995).
[11] Id. at note 132.

alternatives to the Qwest service it currently purchases. As the Commission observed in its *Triennial Review Order*:[12]

> The Commission staff's *High Speed Services December 2002 Report* shows that, nationally, cable modem service is the most widely used means by which the mass market obtains broadband service. Indeed, two reports show that the gap between cable modem and ADSL subscribership continues to widen.
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> * * * *
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> [T]he fact that broadband service is actually available through another network platform and may potentially be available through additional platforms helps alleviate any concern that competition in the broadband market may be heavily dependent upon unbundled access to the HFPL.

The competitive environment faced by the Commission in reviewing allocation of overhead costs to virtual collocation facilities bears no relationship to the environment in which Qwest's DSL services are offered.

In fact, Qwest submits that its repricing of its DSL services in the manner established in Transmittal 178 is closely analogous to the express permission the Commission has given non-uniform overhead loadings when a new service is introduced by a carrier. In the case of application of the "new services test," the Commission has stated that non-uniform overhead loadings are not only permissible but can affirmatively advance the public interest. In the words of the Commission:

> We believe that the simplest, most effective way to make this clear is to state that we will consider non-uniform overhead loadings presumptively reasonable whenever a LEC uses them to justify the introduction of a new service at a level below the imputed "old" price of the service from which the new service is attracting customers. We reach this decision

[12] Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, FCC 03-36, released August 21, 2003, paragraphs 262-3.

> only after noting that such a rule will ensure that LEC customers will be better off in at least one way, if not two. First, customers will benefit because of the price of the new service will be below that to the old one. Second, customers will benefit from any improvements in the quality of the service.[13]

In the case of the instant tariff filing, all customers, including EarthLink, receive the benefit of Qwest's rate reduction for DSL service. The logic that permits non-uniform overhead loadings in the case of services introduced under the "new services test" is equally applicable to the instant tariff filing.

CONCLUSION

Simply stated, Qwest has a legitimate, indeed fundamental, marketing reason for applying different margins to the different speeds of DSL service affected by Transmittal No. 178. In Qwest's judgment, the chosen pricing structure will ultimately attract more customers to all speeds of Qwest DSL service, including the DSL Choice Deluxe service. The tariff filing is consistent with Commission precedent permitting the pricing of high capacity services to meet market needs and the non-uniform allocation of overhead expenses for new services, as well as with the Commission's policy of promoting broadband deployment. EarthLink is not harmed by the tariff because both tariffed services are available to it, the price of both services has been reduced, and EarthLink can

[13] In the Matter of Amendments of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture, 7 FCC Rcd 5235, 5237 (1992) (Memorandum Report and Order on Second Further Reconsideration), 10 FCC Rcd 1570, paragraph 5 (1994) (Memorandum Opinion and Order on Third Further Reconsideration).

purchase both services at an 11% discount in order to compete with Qwest's retail services. Transmittal No. 178 should be permitted to take effect without further action.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Patricia O'Brien, do hereby certify that I have caused the foregoing **REPLY OF QWEST CORPORATION TO PETITION TO SUSPEND AND INVESTIGATE** to be filed with the FCC via its Electronic Tariff Filing System, and served on the parties on the attached service list as indicated below, via email or facsimile and First Class United States mail, postage prepaid.

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