

1 **III. *The Competitive Climate***

2
3 **Q. Please turn to the third part of your testimony, concerning the competitive climate in**
4 **southern Nevada. What does the Company claim has happened to this climate as a**
5 **result of recent changes in federal and state laws and regulations?**

6 A. Centel's view is that the competitive climate has been fundamentally altered by such events as
7 passage of the 1996 Telecommunications Act and the Commission's comprehensive Omnibus
8 Rules. Both allow CLECs, ILECs, and IXCs all to offer one-stop shopping; both require
9 ILECs to unbundle their network elements and allow resale of their tariffed services; both
10 sanction facilities-based competition. "In sum, customers have a choice of providers, and a
11 choice of service options with all the attendant benefits." [97-8006 Petition, p. 9.] According to
12 the Company, this means that Centel no longer is the monopoly local exchange provider, and
13 thus the major reason for the marketing restriction no longer applies.

14 Centel argues that the restriction reflects the NPSC's historic concerns about joint
15 marketing by a monopoly LEC and a competitive provider of long distance services. The
16 Company cites the Commission's rejection of a sales representative agreement between
17 Central Telephone and Centel Net, which the Commission found to be "an impermissible
18 mixing of regulated and nonregulated activities. The monopoly, Central Telephone, could
19 influence customers about a competitive activity." [Order in Docket 88-1156, p. 35, cited by
20 Pfeiffer, p. 8.] The Commission at that time expressed doubt that "one-stop shopping"
21 provided by a dominant carrier was compatible with competition. Similarly, the Company
22 notes in Mr. Pfeiffer's testimony that the Commission in Docket Nos. 91-5054 and 91-7026
23 declined to allow Centel to market the services of any long distance carrier without a tariff,
24 citing the Company's monopoly status. [Pfeiffer, pp. 8-9.] Finally, the joint marketing restriction

1 was included in a stipulation of the parties in the Centel-Sprint merger proceeding, as a
2 continuation of the previous policies.

3 The Company now claims that the introduction of competition into the local markets
4 and the availability of “one-stop shopping” from competitive providers justifies removal of the
5 restriction. According to the Company, the considerations that prompted the Nevada PSC to
6 impose marketing restrictions on Centel and its Sprint affiliates no longer apply, and
7 “Commission action in favor of this petition will eliminate what now is an unfair and unnecessary
8 restriction on Central Telephone not similarly imposed on its competitors.” [97-8006 Petition.,
9 p. 10.]

10
11 **Q. Do you agree with the Company’s assessment of the changed situation?**

12 A. No, I do not. I agree that the industry is moving towards a more competitive market structure,
13 and the cause of competition has been furthered by the passage of various legislation and rules
14 at the state and federal levels, this does not mean that effective competition has arrived, nor
15 does it suggest the time has arrived when Centel can be treated as just another carrier in
16 southern Nevada telecommunications markets. By the reasoning advanced by Centel, one
17 could argue that the time has come for complete deregulation of Centel, replacing the historic
18 policy of pervasive economic regulation with a hands-off policy of “buyer beware,” since it no
19 longer enjoys a legally protected pure monopoly, and since price regulation imposes “unfair and
20 unnecessary” restrictions on Centel that are not similarly imposed on any of its competitors

21 It is sometimes assumed that a market is competitive if it contains, or arguably could
22 contain, more than one operating firm. This generous interpretation of competition, and the
23 closely related theory of “contestable markets,” is typically used by dominant firms that want
24 to be treated like everyone else. However, *effective* competition is only present when a
25 market is free of substantial barriers to entry and exit and when no firm or consortium of firms

1 has enough market power to set or strongly influence market prices. Both buyers and sellers
2 must view price as a given. All participants in the market must behave as if market prices are
3 unaffected by their own decisions regarding how much they should purchase or produce.

4 If either buyers or sellers recognize that they can control prices, competitive conditions
5 do not prevail. The greater the degree of control which can be exercised, the less competitive
6 forces will prevail. Usually, four conditions are considered sufficient to assure that sellers will
7 behave as "price takers," or be effectively competitive with each other. If any one of these
8 conditions is absent, the prospects for effective competition are diminished or eliminated. These
9 conditions are:

- 10 (1) Homogeneity of product: The products of the supplying firms must be generally uniform
11 (from the perspective of the buyers in the market). If consumers view the product or
12 service as unique, the firm will not need to behave as a "price taker." For example, if
13 the local Yellow Page directory is perceived as "official" or otherwise endorsed by the
14 firm that controls most of the telephone numbers listed in the various directories, then
15 any other classified directory, by definition, is sufficiently different to be considered an
16 inferior substitute. Yellow Page directories closely associated with the local telephone
17 company are a unique product which cannot be duplicated by other firms without the
18 cooperation and assistance of the local exchange company, and thus the "official"
19 directory typically generates enormous monopoly profits which competitive forces are
20 incapable of eliminating.
- 21 (2) Unlimited supply: The number of supplying firms must be large enough so that the total
22 amount supplied to the market cannot be restricted. It always is in the interest of
23 suppliers to limit the total amount supplied to the market, because by limiting supply,
24 they can charge a higher rate and earn greater returns (economic profits) than under the
25 conditions of competition.

- 1 (3) Lack of barriers to entry and exit: Firms must be free to enter and exit the industry. If
2 any firm decides to produce the service, no substantial legal, financial, or other barrier
3 must stand in its way. Patents or trademarks (such as brand names) and other legal
4 barriers can preclude effective entry.
- 5 (4) Lack of a dominant supplier: Most importantly, no one firm can have a dominant share
6 of the market. If a firm engages in price leadership, dominant firm pricing, or price
7 discrimination, its behavior is inconsistent with competitive behavior. Needless to say,
8 this condition is violated in the provision of any service where a carrier's market share is
9 greater than that of all its competitors combined.

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11 In reviewing this list, it is readily apparent that the various state and federal legislation
12 and rules are designed to break down barriers to entry and exit, to erode historic patterns of
13 market dominance, and to move towards conditions of effective competition. However, those
14 conditions have not yet been achieved in Southern Nevada local telecommunications markets.
15 Furthermore, regulatory policies designed to treat dominant carriers differently than other
16 competitors can potentially serve a useful purpose in attempting to speed the transition to
17 effective competition.

18

19 **Q. Centel claims, correctly, that it is “no longer the only provider of local exchange**
20 **services.”[Petition, p. 10.] Does it therefore follow, as the Company also claims, that**
21 **the joint marketing restriction should be lifted?**

22 **A.** No. One swallow does not a summer make. The mere existence of isolated indicators of
23 competition, or even the presence of actual competitors, is insufficient to demonstrate that
24 competition is effective or that existing regulatory safeguards can safely be eliminated. As local
25 telecommunications markets in southern Nevada do not yet comport with the concept of

1 *effective competition*: this is not a market in which all substantial barriers to entry and exit
2 have been eliminated, nor is it a market where no single firm (e.g. Centel) or consortium of firms
3 (e.g. Sprint and Centel) can exercise market power--i.e., can set or strongly influence price
4 levels. Effective competition implies the presence in the market of multiple firms selling
5 essentially identical products *at prices set by market forces*. No consensus exists concerning
6 the criteria which should be used in measuring the degree to which a market has evolved
7 towards effective competition, but it is surely obvious that conditions have not reached that
8 status at this early stage. It has traditionally been assumed that a high market share enjoyed by a
9 single carrier or consortium implies market power and thus the absence of effective
10 competition, and this certainly fits current conditions in Centel's Nevada service territory.

11 In a fully competitive market, prices are established by the market itself, and competing
12 producer firms are price-takers, not price-setters. However, in a less than fully competitive
13 market, a carrier with market power has the ability to influence or control prices and may do so
14 in ways that are contrary to the public interest, unless constrained by regulators.

15
16 **Q. In its Modified Final Order of November 14, 1997, the Commission concluded that**
17 **Centel has "significant market power." [p. 5.] Do you agree?**

18 A. Yes. Although I do not have direct knowledge of the precise subscription levels of Centel's
19 competitors, it is clear that Centel's share of the local market remains very close to pure
20 monopoly levels. As of November 1997, the Company had *** access lines in service. Of
21 that number, *** were business lines resold to competitors, and another *** were residential
22 lines resold to competitors. In addition, Centel provided *** unbundled loops to CLECs in
23 November 1997. [Centel Responses to UCA Data Requests 2-7, 2-8, 2-9, 2-10.]

24 It is my understanding that NextLink currently has about *** lines, most of them its
25 own loops. MGC (formerly NevTel) has approximately *** lines in Centel's territory, of

1 which nearly *** are unbundled loops leased from Centel. It is my understanding that the other
2 five certificated CLECs in the area are generally smaller than MGC and NextLink, but precise
3 data are not available to me. Let's generously assume they jointly own and/or resell another
4 ***; in this case, all seven CLECs together would service only *** lines in southern Nevada,
5 including their own and those leased from Centel. That would give the combined competition
6 approximately *** of the local market, leaving Centel with ***

7 Furthermore, while growth of the CLECS has been rapid, it hasn't even been sufficient
8 to eliminate Centel's own growth. In other words, while Centel's share of the market is
9 eroding it is still growing. Centel added *** access lines to its network in the year ending in
10 November 1997,¹ while the movement of existing lines from the retail to wholesale categories
11 represented just a fraction of that total. In fact, I estimate that Centel's own subscribership is
12 growing at a faster rate than the combined total of all of its competitors (in absolute terms).
13 Furthermore, to date, much of the competition is limited to the retail market, with the
14 competitors providing unbundled element lease payments or other compensation to Centel out
15 of their limited revenue stream. Since much of the competition is still dependent on its use of
16 Centel's facilities, the *** market share figure actually understates the degree to which the
17 Company continues to dominate the market.

18 It is thus nonsensical to claim that monopoly conditions no longer exist, and that Centel
19 should now be freed from regulatory restrictions because it faces competition in its local
20 market. The policies designed to enhance local competition have just recently been

¹During the 12 months ending November 1997, the Company put in service the following new
access lines:***

[Centel Responses to UCA Data Requests 2-12, 2-13, 2-14.]

1 implemented, and Centel continues to enjoy special standing in the Southern Nevada area;
2 while not a pure monopolist, its market power continues to be very substantial.
3

4 **Q. Even if Centel does retain a large share of the market and is thus theoretically capable**
5 **of exercising market power, are there not numerous safeguards in place or proposed**
6 **to prevent the exercise of that power?**

7 A. That is the Company's claim. According to Centel, safeguards (both structural and
8 nonstructural) are in place or available to prevent anticompetitive practices and cross-subsidies.
9 First, the Company pledges to require customer representatives to adhere to business office
10 procedures "which comply with federal equal access guidelines and Commission orders."
11 [Petition Exhibit B, p. 1.] Scripts and scenarios followed by the customer representatives would
12 ensure fairness. Second, the Company cites procedural safeguards that prevent unauthorized
13 use of customer proprietary network information (CPNI) [Petition Exhibit C.] Third, the
14 Company says that FCC accounting safeguards are adequate to prevent cross-subsidies.
15 Fourth and finally, Central and Sprint LD will continue to operate independently as separate
16 corporate entities with separate employees, offices, books, records, and they will transact all
17 business on an arm's length basis. However, two very important structural safeguards are in the
18 process of being, or are proposed to be, eliminated: First, both regulated and unregulated
19 operations would be conducted under a single name (Sprint), thereby blurring or eliminating any
20 distinction in the minds of most customers between the regulated, quasi-monopoly portion of
21 Sprint's corporate family and the unregulated portion of that family, including the long distance
22 and CLEC operations. Second, the prohibition against joint marketing would be eliminated
23 further compounding the effect of the name change. Taken collectively, elimination of these
24 structural protections could prove to be very significant, making many of the other safeguards
25 less useful and less effective.

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Q. Would you enlarge on the last state ment?

A. Yes. The problem is not with unified brand names or with joint marketing per se. The problem is with Centel's status as the dominant carrier in the southern Nevada area. If Centel had a nondominant market position in the Las Vegas area similar to its position in the Reno area (and in Chicago, Denver, Miami, and hundreds of other metropolitan areas), its proposals for joint marketing and unified branding with Sprint would not be especially troubling. To the contrary, joint marketing of Sprint's local and long distance services might actually be pro-competitive, since it could help Sprint gain market share from Nevada Bell, Ameritech, U.S. West, BellSouth, and other dominant carriers around the country. Sprint's situation in Nevada is fundamentally different from its situation in most metropolitan market areas. Sprint is already the possessor of the lion's share of the local market. To the extent uniform branding and joint marketing help Sprint retain or capture customers in the Las Vegas area, it will be using those tools to retain a dominant share of the local market, and possibly to leverage its market power from the local market into dominant position in other markets.

As I have just shown, Centel still appears to possess more than ***% of the local exchange market in southern Nevada. If it were successful in jointly marketing toll and local services to all of its local customers in this area, it would potentially move to a *** share of the Las Vegas long distance market as well. Admittedly, its joint marketing efforts are unlikely to be this successful, and thus I would not anticipate it being able to convert its dominant position in the local market into an equally dominant position in other markets. However, the point is that uniform branding and joint marketing are tools that are uniquely powerful when they are used by a firm that already enjoys quasi-monopoly status in one or more markets. Consider the example of Microsoft: partly through the judicious use of uniform branding, joint marketing and bundling of various products, it has progressively moved from a dominant share of the market

1 for personal computer operating systems (DOS and Windows) to a near-dominant share of the
2 market for word processing, spreadsheets, and many other software products.

3 Due to historic circumstances, Centel has a dominant share of many
4 telecommunications markets in the Las Vegas area. In fact, due to many years of pervasive
5 regulation and discouragement of competition, it has a quasi-governmental status in the minds of
6 many Las Vegas subscribers. Due to its historic position, and its control of the largest local
7 network, it will continue to get most of the calls for new service. Furthermore, most customers
8 are not in the habit of "shopping around" for local telephone services, and thus it will continue to
9 enjoy the benefits of customer inertia for many years to come. Hence, Sprint is in a unique
10 position, with a unique ability to gain benefits from joint marketing, bundling, and uniform
11 branding of local, toll and other services--particularly where these activities are carried out
12 using the same infrastructure and the same employees. Simply stated, joint marketing would be
13 uniquely valuable and powerful for Centel and Sprint in the southern Nevada area, potentially
14 providing the parent firm with an opportunity to leverage its market power, retain its dominant
15 share of the local market, and expand the scope of its dominant position.

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17 **Q. Is the Company also in a unique position with respect to access to customer**
18 **proprietary network information?**

19 A. Yes. While every conscientious effort might be made by Centel customer representatives to
20 maintain competitive neutrality while processing customer calls, the fact remains that only they
21 (and thus Sprint) have unique direct access to Centel's CPNI. Even though customer
22 representatives may have to get the customer's assent before accessing this information on
23 Sprint's behalf, it is unlikely that many customers will refuse a casual request, since the
24 distinction between Sprint Long Distance and Centel will be blurred or non-existent in the
25 minds of the customer. Thus, Sprint agents will be in a unique position to gain the benefit of this

1 information when attempting to migrate customers from regulated to unregulated services, or to
2 sell different bundles or combinations of services. In short, the safeguards touted by the
3 Company cannot remove the core problem--the fact that a regulated entity with monopoly
4 power and a nonregulated entity are acting in tandem with a common purpose on behalf of a
5 common parent. When they use the same brand name and engage in joint marketing efforts, the
6 line between the unregulated and regulated operations is largely erased, making other
7 safeguards less effective, and compounding the difficulties in policing the activities of the two
8 entities. As the Commission said almost a decade ago, "This is an impermissible mixing of
9 regulated and nonregulated activities. The monopoly, Central Telephone, could influence
10 customers about a competitive activity." [Opinion in Docket No. 88-1156, p. 35., cited by
11 Pfeifer, p. 8.] The issue remains the same, even though Centel is no longer a pure monopoly.