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January 11, 2002

Magalie Roman Salas
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Washington, D.C. 20554

Re: Application by Verizon et al. for Provision of In-Region InterLATA Service in Rhode Island, CC Docket No. 01-324

Dear Ms. Salas:

I am writing to correct a typographical error in AT&T Corp's ("AT&T") Reply Comments filed in the above-captioned proceeding on January 10, 2002. Specifically, on the cover page the Docket Number was listed as 01-277 rather than 01-324. Attached hereto is the filing with the corrected cover page.

Please let me know if any additional information is required. Thank you.

Very truly yours,

Greg Neff /sra

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Encl.

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of

Application by Verizon New England, Inc, Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), Verizon Global Networks, Inc, and Verizon Select Services, Inc., for Authorization to Provide In-Region, InterLATA Services in Rhode Island	)	CC Docket No. 01-324

AT&T'S REPLY

AT&T Corp. ("AT&T") hereby submits its reply in opposition to Verizon's application for authorization to provide in-region long distance services in the State of Rhode Island.

I. VERIZON'S APPLICATION MUST BE REJECTED BECAUSE ITS UNE RATES ARE NOT CONSISTENT WITH THE RI-PUC'S OWN DEFINITION OF TELRIC

Neither the RI-PUC nor Verizon has disputed AT&T's (at 1-17) and WorldCom's (at 4-12) evidence that Verizon's UNE rates – especially its rate for the critical unbundled local switching element – are not TELRIC compliant. First, the RI-PUC's rote references to "TELRIC"[1] cannot hide the fact that the rates upon which Verizon relies here do not reflect that commission's own *contemporaneous* rulings that specifically define the inputs required to develop TELRIC-compliant rates in Rhode Island.[2] And critically, the RI-

[1] *See* Report of the Rhode Island Public Utilities Commission on Verizon Rhode Island's Compliance with Section 271 of the Telecommunications Act of 1996 at 43-45.

[2] AT&T's and WorldCom's comments (at 5 and 8-9, respectively) also demonstrate that there is no evidence *at all* to support an assertion that the switch port rate in Massachusetts should be more than *double* the rate in New York and Massachusetts.

PUC has not required Verizon to implement rates that reflect those TELRIC-compliant inputs until well *after* this Commission must act on the pending application.[3] Thus, neither the RI-PUC nor Verizon can legitimately claim that the rates Verizon presents here comply with TELRIC in general or with the RI-PUC's own definition of that standard.

Second, the assertion in Verizon's January 2, 2002 *ex parte*[4] that the Rhode Island PUC "has adopted a full suite of TELRIC-complaint rates" for UNEs in "legally binding decisions" finalized prior to November 26, 2001 is inconsistent with Verizon's own application and supporting declarations, and is deliberately misleading. Verizon's application asserted that the RI-PUC's only analysis or explanation of the specific inputs and assumptions that must underlie TELRIC-complaint rates was in the *TELRIC Order*.[5] But as noted above, the RI-PUC did *not* adopt UNE *rates* in accord with that order. Instead, as AT&T has described,[6] it left in place *previously adopted* rates, *i.e.*, the interim rates that had been adopted without any analysis. Moreover, the RI-PUC did not require Verizon to adopt actual UNE rates that comply with the *TELRIC Order*'s substantive rulings until a future compliance filing that will not be made until *well after* this Commission must rule upon Verizon-RI's application.

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[3] *See* AT&T at 4; RI-PUC Report and Order, *Review of Bell Atlantic-Rhode Island TELRIC Study*, Docket No. 2681 (Nov. 18, 2001) ("*TELRIC Order*"), App. F, Tab 34 at 76.

[4] This *ex parte* submission is incorrectly dated January 2, 2001.

[5] *See* Verizon App. at 88, citing the Cupelo/Garzillo/Anglin Decl. ¶¶ 41-50, citing in turn the *TELRIC Order*.

[6] AT&T at 1-3.

Verizon-RI does not, and cannot, dispute these simple facts. Accordingly, Verizon's January 2nd *ex parte* attempts to avoid this crucial problem by suggesting that the *TELRIC Order* -- which had been issued only days earlier -- is irrelevant, and that it is instead relying upon the conclusory statements of "TELRIC-compliance" in the RI-PUC's April 11, 2001 order and at its November 15, 2001 Open Meeting. But those conclusory statements about purported TELRIC compliance are not entitled to any weight, because they were not based on any analysis or fact finding whatsoever. Moreover, AT&T's and WorldCom's comments show in particular that the new switching rates the RI-PUC referred to as "TELRIC-compliant" at its November 15 Open Meeting are patently inconsistent with the state commission's specific findings that were issued only three days later (after nearly four years of litigation), which explicitly identified the specific inputs and assumptions that must be reflected in a TELRIC-compliant cost study for Rhode Island.[7]

Finally, both AT&T (at 14-17) and WorldCom (at 9-10) showed that Verizon's critical UNE switching rates are not within the range of TELRIC-compliant rates in other Verizon states, including Pennsylvania.[8] Therefore, Verizon's purported proof of TELRIC compliance in this proceeding must be rejected.

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[7] WorldCom (at 10-12) also shows that Verizon's loop rates do not comply with the RI-PUC's specific requirements.

[8] The RI-PUC's reliance on Verizon's *proposed* switching rates in the "anchor" state of Massachusetts (RI-PUC at 44) is flatly inconsistent with the Commission's prior precedent, which looks at the actual rates established by a state commission in another state. AT&T and WorldCom have shown that Verizon's proposed switching usage rate in Massachusetts has not been reviewed by that state commission, and that it fails utterly to comply with the RI-PUC's TELRIC requirements. Moreover, there can be no dispute that the switching port rate in Rhode Island is excessive when compared to the Massachusetts port charge. Finally, any notion that Massachusetts can serve as an "anchor" state is itself odd, since Verizon did not rely on the Massachusetts Commission's rates in its own section 271application for that state.

II. THE EVIDENCE THAT VERIZON'S UNE RATES CREATE A PRICE SQUEEZE ESTABLISHES THAT VERIZON HAS FAILED TO SATISFY BOTH THE CHECKLIST AND THE PUBLIC INTEREST REQUIREMENT

In addition to showing that Verizon's UNE rates in Rhode Island are not TELRIC-compliant, AT&T's opening comments separately showed that those rates were so high that they preclude efficient local entry. *See* AT&T at 17 & Declaration of Michael R. Lieberman. Specifically, those rates effect a price squeeze that prevents UNE-based competitors from earning sufficient margins to provide local service economically in competition with Verizon, by imposing wholesale costs on Verizon's competitors that render it impossible for them to offer a retail service that would be price competitive. Verizon's imposition of rates that foreclose broad-based local competition has two independent legal consequences in this proceeding.

First, it establishes that those rates violate the checklist. Checklist item 2 requires Verizon to show that it provides UNEs "in accordance with the requirements of sections 251(c)(3) and 252(d)(1)." 47 U.S.C. § 271(c)(2)(B)(ii). Section 251(c)(3), in turn, requires UNE rates that are "just, reasonable, and *nondiscriminatory*." 47 U.S.C. § 251(c)(3) (emphasis added). The Supreme Court has held that, even if a regulated utility has charged wholesale and retail rates that otherwise fall within the permissible ranges for those rates, its wholesale rates can nonetheless fail to satisfy a nondiscrimination requirement if the utility has foreclosed retail competition by charging retail rates at the lower end of the permissible range and wholesale rates at the higher end of the permissible range. *See FPC* v. *Conway Corp.*, 425 U.S. 271, 276-282 (1975); *see also NY, NH & H R.Co.* v. *ICC*, 200 U.S. 361, 390-91 (1905) (railroad engages in discrimination if it sells coal at retail prices that are lower than the sum of its

transportation rate, the cost of the coal, and the cost of delivering the coal from the railroad line to the retail customer). Even if the Commission were to conclude (incorrectly) that Verizon's rates satisfied TELRIC, those rates would still be discriminatory, and unlawful under Section 251(c)(3), because they foreclose competition in precisely the manner described in *Conway*.

Second, the direct evidence of a price squeeze also establishes that granting the application could not be consistent with the "public interest." 47 U.S.C. § 271(d)(3)(C). The Supreme Court has explained that the statutory term "public interest" "takes [its] meaning from the purpose of the regulatory legislation." *NAACP* v. *FPC*, 425 U.S. 662, 669 (1976). The central purpose of Section 271 is to ensure that local telephone markets in a State are open to competition – and that competing carriers therefore have the legal and economic ability to provide competing local services – before a BOC in that State is permitted to provide long-distance services. As the Commission has held, Congress adopted Section 271 in order to assure that BOCs could not provide long distance service at a time when their local monopolies would give them an "unfair advantage" over long distance competitors in, *inter alia*, providing "combined packages" of local and long distance service to customers who desire "one-stop shopping." *AT&T* v. *Ameritech*, 13 FCC Rcd. 21438, ¶¶ 5, 39 (1998), *aff'd sub nom. U S WEST* v. *FCC*, 177 F.3d 1057 (D.C. Cir. 1999). If, by contrast, long-distance entry were allowed before other carriers could provide competing combined packages, it would "threaten competition" in both the local and the long-distance markets by granting the BOC a monopoly in the provision of such combined services. *Id.* ¶ 5. The Commission has thus held that the "public interest" prong of Section 271 requires it to "ensure that no other relevant factors exist that would

frustrate the congressional intent that markets be open." *SBC 271 Kansas/Oklahoma Order*, 16 FCC Rcd. 6237, 6375 (2001); *Verizon 271 Massachusetts Order*, 16 FCC Rcd. 8988, 9118 (2001). A price squeeze that would foreclose efficient local entry into the residential market obviously constitutes such a "relevant factor." And proof that such a factor in fact exists demonstrates conclusively that the market is not – and cannot be -- open.

The Commission nonetheless had previously held that it need not consider evidence of a price squeeze in evaluating a Section 271 application. That holding was based on the Commission's view that such evidence was "irrelevant," and that considering it would improperly involve the Commission in the process of setting local retail rates that are outside its jurisdiction. *Id.* at 6280-6281, 6381. But the Court of Appeals for the D.C. Circuit, relying on the Supreme Court's decision in *Conway*, has now squarely rejected that view. *Sprint* v. *FCC*, 2001 U.S. App. LEXIS 27292 (D.C. Cir. 2001). Indeed, because the central purpose of the 1996 Act is "stimulating competition," the D.C. Circuit held that the "public interest" analysis under Section 271 may weigh even "*more heavily* towards addressing potential 'price squeeze'" than was required under the Federal Power Act in *Conway*. *Id.*, at *14 (emphasis added).

Moreover, the *Sprint* Court also confirmed that the Commission's lack of jurisdiction over retail rates was no bar to such an analysis, because the Commission can respond to a price squeeze without disturbing retail rates. Instead, because the Commission has said that TELRIC rates exist within a "band," one entirely permissible solution is to "'fix[] the wholesale rates, which [a]re under its jurisdiction, at a lower level within'" that band. *Id.* at *12 (citing *Conway*, 426 U.S. at 279). Here, because, as

AT&T has shown, Verizon's rates are not TELRIC-compliant to begin with, there is certainly plenty of room for downward movement.

Under *Sprint* v. *FCC*, therefore, when evidence is presented in a Section 271 proceeding that UNE-based residential competition is economically infeasible, the Commission cannot grant that application without evaluating and addressing that evidence. Unless the Commission rejects this application on other grounds, therefore, it must develop and apply a framework in this proceeding for analyzing such price squeeze claims.[9] That framework must reflect the objectives of Section 271, and is therefore straightforward: if a BOC's UNE prices, analyzed in conjunction with its retail rates and associated local service-related revenues, foreclose efficient entry into the local residential market in a State, that market plainly is not "open" and the public interest would not be served by authorizing long-distance entry for the local monopolist. Further, in making that determination, the Commission should compare all the costs of providing competitive local service (UNE prices together with all other costs of offering service) with the expected local revenues (including vertical feature revenues, access revenues (or savings) and explicit subsidy payments such as the Subscriber Line Charge) to assess whether there would be a sufficient profit margin to make competitive entry a rational business decision. The analysis provided in AT&T's opening comments follows this

[9] In recognition of the need to develop and apply such a framework in Section 271 proceedings where such claims are made, the Commission recently asked the Court of Appeals for the D.C. Circuit to suspend briefing in the appeal of its order granting Verizon interLATA authority in Massachusetts. The Commission asked for that suspension so that it could address the price squeeze claims that had been made in that proceeding but that the Commission's order had not properly addressed. *See* FCC's Emergency Motion for Temporary Suspension of Briefing, *WorldCom* v. *FCC*, No. 09-1198 (D.C. Cir.) (filed Jan. 7, 2002).

path, and establishes that efficient UNE-based entry in Rhode Island has been effectively foreclosed and that this application must therefore be denied.

In remanding the Kansas-Oklahoma decision to the Commission for further consideration, the *Sprint* Court also noted "without evaluation" two "points" raised by the Commission in its defense of that appeal. *Id.* at *15. Neither of those issues would warrant a grant of the Rhode Island application in the face of the price squeeze evidence. First, there is no reason to believe that the statute's "90-day limit" (*id.*) would make it impossible or even difficult to assess that evidence. The price squeeze issue is considerably less complex and fact-intensive than many other issues the Commission considers in its review of a Section 271 application, such as compliance with the requirement to provide non-discriminatory access to OSS. Moreover, in the event a BOC wishes to enter the long-distance market in a State, it can substantially facilitate – and potentially moot – any analysis of a price squeeze by itself choosing voluntarily to charge UNE rates at the lower end of the TELRIC range, and demonstrating the absence of a price squeeze in its application.

Second, the Court noted the suggestion that retail residential service in a State might not cover the costs of providing it, but might instead depend on subsidies from other services. Under that hypothesis, it was suggested that even wholesale rates set at the lower end of the TELRIC range might not render residential competition feasible. *Id.* at *13-14, 15-16. But there is no evidence to suggest that is the case here, and every reason to believe that it is not. The issue is not whether the basic local exchange service rate alone covers the costs of providing local residential service, but whether all the revenues derived from providing such service – including vertical features, exchange

access and SLC payments -- cover those costs. There has been no suggestion, much less evidence, that the combination of those revenues does not cover Verizon's cost of providing residential service in Rhode Island. AT&T's analysis, by contrast, shows that that this entire combination of revenues still leaves a CLEC with *negative* gross margin, *i.e.*, a *less than zero* return without even taking into account the CLEC's significant internal costs to provide a UNE-based service.

Nor is it any answer to suggest that an entrant could simply use profits it obtains in other markets – such as local services to large businesses, or long-distance services – to subsidize unprofitable entry in the local residential market. Indeed, Section 271 itself recognizes the importance of assuring competitive opportunities to provide service to both "residential and business subscribers." 47 U.S.C. § 271(c)(1)(A).[10] The inescapable reality is that the possibility of profits in a different market is irrelevant to the decision whether to enter the residential market, and it will *never* be rational for a firm to enter such an unprofitable market or market segment. Even if the firm is earning excess profits in one such market, it has no incentive to dissipate those earnings by investing them in unrelated unprofitable ventures. If the residential market cannot support efficient entry on a standalone basis, entry will simply not occur for those customers.

Finally, even if the provision of local residential service were found to be unprofitable even when all revenues are taken into account, and even when UNEs are priced at the lower end of the range, then that would simply establish that the Section 271 application must be denied. In that case, the evidence shows that the local market is not

[10] *See also*, Memorandum Opinion and Order, *Applications of Ameritech Corp. and SBC Communications Inc., for Consent to Transfer Control*, 14 FCC Rcd. 14712, 14746 (1999) (separately analyzing discrete markets).

open to competition, and BOC entry in those circumstances would patently *dis*serve the public interest by enabling the BOC to remonopolize the long-distance market in that State. A denial of such an application would then afford the State regulatory authority the opportunity to consider whether any interest it has in encouraging competitive entry into the local market and further entry into the long-distance market would warrant taking steps with respect to retail rates, or explicit subsidies for the provision of retail service, to make such entry possible. This is especially appropriate for Rhode Island, where the RI-PUC has in fact developed guidelines for the development of TELRIC-compliant rates but has not had the opportunity to ascertain how those guidelines will operate in practice, and whether, once those rates are in place, any additional actions may be required. This further underscores the fact that Verizon's application is premature and should be denied.

CONCLUSION

For the reasons stated above and in AT&T's initial comments, Verizon's application should be denied.

Respectfully submitted,

AT&T CORP.

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January 10, 2002

CERTIFICATE OF SERVICE

I, Theresa Donatiello Neidich, do hereby certify that on this 10th day of January, 2002, a copy of the foregoing Reply Comments of AT&T Corp. was served by US first class mail, postage prepaid, on the parties named on the attached service list.

/s/ Theresa Donatiello Neidich
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