

64. Sprint also argues that the other Regional Bell Operating Companies' (RBOCs) choice to not compete against each other outside of their respective regions, and the financial difficulties of some competitive LECs (in particular Adelphia), suggest that the public interest is not served by granting Verizon section 271 approval in Vermont.²³³ We reject these arguments. Again, factors beyond the control of the applicant, such as a weak economy or individual competing LEC and out-of-region RBOC business plans can explain the lack of entry into a particular market.

A. Price Squeeze Analysis

65. AT&T and WorldCom contend that they cannot profitably enter the Vermont residential telephone market using the UNE-Platform in roughly half the state because Verizon's UNE rates are allegedly inflated.²³⁴ Before analyzing these contentions, we begin with a discussion of a pending remand on the issue of how allegations of a price squeeze should be considered under the public interest standard of section 271(d)(3)(C). In the Commission's *SWBT Kansas/Oklahoma Order*, the subject of the *Sprint v. FCC* ruling, the Commission declined to consider allegations that a section 271 applicant should fail the 14-point checklist because competitors are unable to make a profit in the residential market using the UNE-platform.²³⁵ The Commission concluded that the Act requires a consideration of whether rates are cost-based, not whether market entry is profitable.²³⁶ The Commission also stated that if it were to focus on profitability, it would have to consider a state's retail rates,²³⁷ which are generally outside its jurisdictional authority. Appellants asserted that their inability to make a profit in the residential market showed that granting the BOC's section 271 application was not in the public interest.²³⁸ The court concluded that the Commission's rejection of the appellants' profitability argument was not responsive.²³⁹ The court did not, however, vacate the order. Instead, it remanded the Commission's rejection of the price squeeze issue for reconsideration.²⁴⁰

66. The Commission intends to issue an order addressing the questions posed in the *Sprint v. FCC* ruling about how we should consider allegations of a price squeeze that are raised

²³³ Sprint Comments at 4-6.

²³⁴ AT&T Comments at 2-3, 19-20; AT&T Lieberman Decl. at 13-18, paras. 32-47, AT&T Reply at 6 and 8; WorldCom Comments at 7-8; Declaration of Vijetha Huffman on Behalf of WorldCom, Inc. (WorldCom Huffman Decl.) at 3-5, paras. 7-13.

²³⁵ *SWBT Kansas/Oklahoma Order*, 16 FCC Rcd at 6269, para. 65 and 6280-81, para. 92.

²³⁶ *Id.* at 6280-81, para. 92.

²³⁷ *Id.*

²³⁸ *Sprint v. FCC*, 274 F.3d at 553.

²³⁹ *Id.* at 554.

²⁴⁰ *Id.* at 556.

in section 271 proceedings. Because we have not yet addressed the issues remanded by the court, we consider the specific allegations presented by the parties in this case. Verizon disputes both whether a price squeeze analysis is a relevant consideration under the public interest requirement and, if so, the required scope of such an inquiry.²⁴¹ AT&T and WorldCom argue that the analysis is relevant and that the appropriate test is whether a price squeeze exists for competitive LECs using the UNE-Platform to provide residential service in Vermont.²⁴² We conclude that AT&T and WorldCom have not established the existence of a price squeeze because they have not shown that “the UNE pricing [at issue] doom[s] competitors to failure.”²⁴³

67. AT&T and WorldCom assert that evidence of a minimal statewide average margin between the costs associated with providing service utilizing the UNE-Platform and the revenues available from potential customers is sufficient to demonstrate that a price squeeze exists in the Vermont residential market.²⁴⁴ AT&T contends that *FPC v. Conway*,²⁴⁵ the Supreme Court decision cited by the District of Columbia Circuit Court of Appeals in its comments on price squeeze in *Sprint v. FCC*, requires this result.²⁴⁶ Based on differences between the circumstances before us here and those circumstances that were before the Federal Power Commission in *Conway*, we disagree. First, in *Conway* the competitive product at issue was an undifferentiated commodity, electricity. Here, the competitive product at issue is phone service that can be provided with or without numerous differentiated products, at the choice of the competitor and consumers. Thus, the wholesale price at issue in *Conway* was for exactly the same product that the wholesaler was selling at retail, and the ability of a competitor to distinguish itself based on products or prices offered was minimal. The wholesale prices at issue here are for the piece parts that a competitor can use to sell a product of the competitor’s design, which may or may not be the same product as that sold by the wholesaler at retail, all of which may affect the price a customer will pay the competitor. Second, in *Conway* the wholesale price for electricity did not vary based on location of the retail customer. Here, the prices for the piece parts, or network elements, vary based on cost-related differences arising from the distances between the customers being served and the BOC or competitive LEC switches. These cost differences directly affect the amount of achievable profit in certain locations in the state. The fact that retail prices in some areas are lower than the wholesale prices of the piece parts used to provide competitive service is not the result of a mistake or oversight by the Vermont Board. Rather, it is the result of an intentional state policy to keep retail rates affordable. Third, in the context where phone

²⁴¹ Verizon Application at 88-91; Verizon Reply at 2, 29-30.

²⁴² AT&T Comments at 18-19, 36-38; AT&T Lieberman Decl. at 22-23; AT&T Reply at 7; WorldCom Huffman Decl. at 2-3, paras. 5-6 and Attach. 1.

²⁴³ *Sprint v. FCC*, 274 F.3d at 554 (emphasis in original).

²⁴⁴ AT&T Comments at 18-19; 36-38; AT&T Lieberman Decl. at 22-23; AT&T Reply at 7; WorldCom Huffman Decl. at Attach. 1. The lowest statewide average margin alleged is \$1.35. See AT&T Lieberman Decl. at 18, Exhibit B-1.

²⁴⁵ *FPC v. Conway Corp.*, 426 U.S. 271 (1976).

²⁴⁶ AT&T Comments at 36-37.

service is most like the commodity at issue in *Conway* because wholesalers and retailers are selling exactly the same thing, i.e., resale. The Act protects against a price squeeze by requiring that the BOC sell each service that it offers at retail at a wholesale discount that excludes avoided costs.²⁴⁷ Accordingly, we find *Conway* distinguishable, and consider issues beyond the amount of the statewide average margin utilizing the UNE-Platform here.

68. We find first that AT&T and WorldCom have not established that their higher costs of providing residential service in the more rural areas of Vermont are due to the pricing of UNEs at too high a point in the TELRIC band. The clear cost difference between zone one, where AT&T and WorldCom assert a margin of at least \$8.32 or 31 percent, and zone three, where AT&T and WorldCom assert a margin of at most negative \$5.59 or negative 21 percent, is the difference in the prices they pay Verizon for the loop.²⁴⁸ Notably, neither AT&T nor WorldCom challenge the reasonableness of Verizon's Vermont loop rates. Accordingly, it is likely that here, any difficulty entering the residential market profitably through the UNE-Platform may be the result of subsidized local residential rates in one or more zones and not the fact that UNE rates are not at an appropriate point in the TELRIC range.²⁴⁹ In many states, particularly rural states such as Vermont,²⁵⁰ higher business rates subsidize some residential rates, and, consequently, certain residential services are priced below cost.²⁵¹ We do not believe that it would be in the public interest to deny a section 271 application simply because the local telephone rates are low. If UNE-Platform rates are priced at cost, we believe competitors will have the opportunity to make competitive entry. The existence of local rate subsidies might mean that, initially, the competition would be most prevalent in business markets and for higher-margin residential customers. This competition, however, will eventually erode the subsidies and create pressure to rebalance local rates. Thus, we will look beyond a negative margin for the provision of residential service in high-cost areas using the UNE-Platform when examining allegations of price squeeze.

²⁴⁷ 47 U.S.C. § 252(d)(3).

²⁴⁸ See AT&T Lieberman Declaration at 18, Exhibit B-1. WorldCom admits to margins of \$9.49 in zone one and negative \$4.42 in zone three. WorldCom Huffman Decl. at Attach. 1. On the 82nd of the 90 days permitted for review of Verizon's application, AT&T submitted new price squeeze data taking available universal service support into account. Letter from Robert W. Quinn, Jr., Vice President, Federal Government Affairs, AT&T to William F. Caton, Acting Secretary, Federal Communications Commission, CC Docket No. 02-7 (filed April 9, 2001). This late submission indicates that higher margins are available for qualifying carriers in zone three. This new information does not, however, change our conclusion.

²⁴⁹ The Court of Appeals for the District of Columbia Circuit noted this argument as a potential basis for declining to find a price squeeze. The Court did not address this argument because the Commission did not rely on it in the underlying *SWBT Kansas/Oklahoma Order*. *Sprint v. FCC*, 274 F.3d at 555.

²⁵⁰ Parties to this proceeding recognize that Vermont has a highly rural population. See Verizon Application at 75-77 and Attach. A, Exhibits 4 and 5; Verizon Reply at 7-8 and n.11; Verizon March 18 *Ex Parte* Letter, establishing that Vermont is the most rural state in the country. According to AT&T, Vermont is so rural that weekend and business day traffic are equal. AT&T March 25 *Ex Parte* Letter at 10. See also AT&T Comments at 38-39.

²⁵¹ See *Sprint v. FCC*, 274 F.3d at 555.

69. We find that the Act contemplates the existence of subsidized local rates in high-cost areas and addresses such potential price squeezes through the availability of resale. AT&T and WorldCom contend that it is inappropriate to consider the availability of resale as a competitive option because the margin is insufficient.²⁵² We disagree. The distinction between how UNEs and resale are priced is significant here. UNEs are priced from the "bottom up," that is beginning with a BOC's costs plus a reasonable profit, whereas resale is priced from the "top down," that is, beginning with a BOC's retail rate and deducting avoided costs. Such differing price structures are evidence that Congress envisioned competitors entering the market through different entry mechanisms under different circumstances. Such a distinction ensures that resale provides a profit margin where, as is the case here, the costs of individual elements exceed the retail rate. Accordingly, we conclude that it is appropriate to consider the effect of resale on whether a price squeeze exists. Neither AT&T nor WorldCom, however, has provided an analysis of how using a mix of the UNE-Platform and resale to provide service would affect its price squeeze arguments.

70. We find AT&T and WorldCom's evidence and analyses asserting the existence of a price squeeze lacking in several additional respects. For example, AT&T and WorldCom argue that they must earn at least \$10.00 to cover their internal costs to enter the Vermont residential market, but provide no cost and other data to support that assertion.²⁵³ As we have noted previously, conducting a price squeeze analysis requires a determination of what a "sufficient" profit margin is.²⁵⁴ Resolving the issue of what is a sufficient profit requires far more than determining what is sufficient for a particular carrier to make a profit. Although AT&T and WorldCom allege that they need to make at least \$10.00 per line, the pertinent question here is what is a sufficient profit for an efficient competitor. The evidence demonstrates that competitive LECs in Vermont can achieve margins of 31 percent in zone one and 29 percent in zone two. The record evidence does not establish that these profit margins are inadequate for an efficient competitor. Thus, the evidence submitted by AT&T and WorldCom is an inadequate basis for us to determine that a price squeeze exists in the Vermont residential market.

71. AT&T and WorldCom also fail to present other evidence that would be relevant in a residential-only price squeeze analysis, such as the incremental toll revenues that would be generated by winning the local, intrastate, and interstate toll business of customers that currently use other carriers for these services. There is also no evidence in the record concerning the ability of competitors such as AT&T and WorldCom to leverage their presence in the long-distance or business markets, together with expected net access revenues and savings, into an economically viable residential telephone service business. For these reasons and all the other factors discussed above, we conclude that AT&T and WorldCom have not demonstrated that a price squeeze exists in the Vermont residential market.

²⁵² AT&T Comments at 18-19; 36-38; AT&T Lieberman Decl. at 22-23; AT&T Reply at 7; WorldCom Huffman Decl. at 2-3, paras. 5-6 and Attach. 1.

²⁵³ AT&T Reply at 6; WorldCom Huffman Decl. at 3, para. 8 and Attach. 1.

²⁵⁴ *Verizon Massachusetts Order*, 16 FCC Rcd at 9008-09, para. 41.

72. AT&T contends as a separate claim that the evidence it provides of a price squeeze also establishes that Verizon's Vermont UNE rates are discriminatory in violation of checklist item two.²⁵⁵ As discussed above, we conclude that AT&T has not established the existence of a price squeeze in the residential market. AT&T submits no separate price squeeze analysis in support of this claim. Accordingly, we need not decide whether the existence of a price squeeze in the residential market would constitute a separate violation of checklist item two.

73. For the reasons stated above, we reject the contentions of AT&T and WorldCom regarding an alleged price squeeze, and conclude that there is no evidence in the record that warrants disapproval of this application based on allegations of a price squeeze, whether couched as discrimination in violation of checklist item two, or under the public interest standard.

B. Assurance of Future Compliance

74. As set forth below, we find that the PAP currently in place in Vermont will provide assurance that the local market will remain open after Verizon receives section 271 authorization.²⁵⁶ We have examined certain key aspects of Verizon's PAP and we find that the plan falls within a zone of reasonableness and is likely to provide incentives that are sufficient to foster post-entry checklist compliance. The Vermont Board adopted a self-executing PAP, modeled on the PAPs adopted in New York, Massachusetts and Connecticut.²⁵⁷ The Vermont PAP uses the standards and measures set forth in the New York Carrier-to-Carrier Guidelines.²⁵⁸ The Vermont PAP exposes Verizon to the same level of liability as in the Massachusetts PAP.²⁵⁹

75. While the New York PAP forms the basis for the Vermont PAP, the Vermont PAP differs from that PAP in certain details to reflect the specific concerns of the Vermont Board.²⁶⁰ The Vermont Board expressly conditioned its recommendation on "several changes designed to make possible effective DSL offerings by Verizon's competitors."²⁶¹ including

²⁵⁵ AT&T Comments at 18-20. AT&T Reply at 6.

²⁵⁶ *Ameritech Michigan Order*, 12 FCC Rcd at 20748-50, paras. 393-98. In all of the previous applications that the Commission has granted to date, the applicant was subject to an enforcement plan administered by the relevant state commission to protect against backsliding after BOC entry into the long distance market.

²⁵⁷ Verizon Application at 93.

²⁵⁸ See Letter from Richard T. Ellis, Director - Federal Regulatory, Verizon, to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket No. 02-7 Attach. (filed Jan. 30, 2002) (Verizon Vermont PAP); Verizon Application at 93-94.

²⁵⁹ Verizon Application at 93-94. The Massachusetts and Vermont PAPs place 39% of Verizon's yearly net income for each state at risk. Vermont Board Comments at 16.

²⁶⁰ Vermont Board Comments at 7.

²⁶¹ Vermont Board Comments at 8, n.8.

adding several metrics to the three portions of the PAP.²⁶² The Vermont Board modified the New York PAP method for curing small sample sizes.²⁶³ Finally, unlike other PAPs in Verizon's region, the Vermont PAP requires Verizon to make payments for Mode of Entry measures to the Vermont Universal Service Fund.²⁶⁴

76. As in prior section 271 orders, our conclusions are based on a review of several key elements in the PAP: total liability at risk; the definitions of the performance measurement and standards; the structure of the plan; the self-executing nature of remedies in the plan; the plan's data validation and audit procedures; and the plan's accounting requirements.²⁶⁵ We find generally that the Vermont PAP satisfies our analysis in each of these respects, and we discuss in detail only those elements that commenters have raised in the record before us.

77. We disagree with AT&T that the Vermont PAP does not adequately detect discrimination.²⁶⁶ AT&T raised concerns about the relative tradeoff between a Type I error (a finding that discrimination has occurred when it has not) and a Type II error (a finding that discrimination has not occurred when it has), particularly given the small sample sizes observed in Vermont.²⁶⁷ We find that the statistical methodology chosen by the Vermont Board is like that used in other states in which Verizon has received section 271 approval. We also note that the Vermont Board has promised to reconsider this issue, if necessary, in the future.

78. We also disagree with AT&T that the Vermont PAP cannot effectively promote market entry and deter anticompetitive conduct because the Mode of Entry Measure payments are made to the Vermont Universal Fund rather than to the competitive LECs.²⁶⁸ While the competitive LECs will not receive payment for failure on these metrics, any failure of Verizon to meet these metrics will result in penalty payments by Verizon. The Vermont Board reasoned that

²⁶² The Vermont Board added a number of performance metrics including: performance metrics to cover DSL services in the Critical Measures; performance metrics to examine Open Orders on Hold Status for POTS and Specials in the Mode of Entry Measures; and billing metrics in the Special Provisions Measures. Letter to V. Louis McCarren, President and CEO Verizon Vermont, Jan. 16, 2002, at 5. Verizon Application, Appendix L, Tab 21; Vermont Board Comments at 10. The Department of Justice takes note of the Vermont PAP's incorporation of the billing metrics in response to concerns raised by the Vermont Department of Public Service. Department of Justice Evaluation at 6, n.21.

²⁶³ Vermont Board Comments at 15, 19-20.

²⁶⁴ Verizon Vermont PAP at 10, 18.

²⁶⁵ See, e.g., *Verizon Massachusetts Order*, 16 FCC Rcd at 9121-25, paras. 240-49; *SWBT Kansas/Oklahoma Order*, 16 FCC Rcd at 6377-81, paras. 273-80.

²⁶⁶ AT&T Comments at 22; AT&T Comments Tab C, Declaration of Michael Kalb on Behalf of AT&T Corp. at paras. 25-30 (AT&T Kalb Decl.).

²⁶⁷ AT&T argues that the fixed critical value of -1.645 which results from the 95% confidence interval is unsound because the Type I error rate (5%) chosen by the Vermont Board is too small. AT&T argues that the critical value should vary with the sample size in the same way as the modified z score. AT&T Kalb Decl. at paras. 25-30, Exh. 1.

²⁶⁸ AT&T Comments at 22-23; AT&T Kalb Decl. at paras. 16, 18-24; AT&T Reply at 8-9.

making all PAP payments to competitive LECs would not compensate the general harm to society from Verizon's failure to meet the Mode of Entry Measures, and that the Vermont Universal Service Fund is an appropriate repository for payments that accrue when competition is generally harmed.²⁶⁹ We find the Vermont Board's decision to direct funds to the Vermont Universal Service Fund to be reasonable and does not detract from the overall effectiveness of the plan.²⁷⁰

C. Other Issues

79. We find that DIRECTV's requests that the Commission negotiate commitments from Verizon to provide tariffed interLATA ATM transport services to ISPs on reasonable terms and conditions, or obtain information from Verizon regarding any plans to degrade its tariffed DSL offering, are beyond the scope of this section 271 proceeding.²⁷¹

VII. SECTION 271(d)(6) ENFORCEMENT AUTHORITY

80. Section 271(d)(6) of the Act requires Verizon to continue to satisfy the "conditions required for . . . approval" of its section 271 application after the Commission approves its application.²⁷² Thus, the Commission has a responsibility not only to ensure that Verizon is in compliance with section 271 today, but also that it remains in compliance in the future. As the Commission has already described the post-approval enforcement framework and its section 271(d)(6) enforcement powers in detail in prior orders, it is unnecessary to do so again here.²⁷³

81. Working in concert with the Vermont Board, we intend to monitor closely Verizon's post-approval compliance for Vermont to ensure that Verizon does not "cease[] to meet any of the conditions required for [section 271] approval."²⁷⁴ We stand ready to exercise our various statutory enforcement powers quickly and decisively in appropriate circumstances to ensure that the local market remains open in Vermont. We are prepared to use our authority under section 271(d)(6) if evidence shows market opening conditions have not been maintained.

²⁶⁹ Vermont Board Comments at 18-19.

²⁷⁰ We note that in three prior SWBT applications (Texas, Kansas and Oklahoma), certain penalties were paid into the respective State treasury rather than to competitive LECs. As we find with regard to Verizon, the Commission found that SWBT would face other consequences if it fails to sustain a high level of service to competing carriers, including: federal enforcement action pursuant to section 271(d)(6); liquidated damages under interconnection agreements; and remedies associated with antitrust and other legal actions. See *SWBT Kansas/Oklahoma Order*, 16 FCC Rcd at 6379, para. 274; *SWBT Texas Order*, 15 FCC Rcd at 18562, para. 424.

²⁷¹ DIRECTV Comments at 1-2, 4-7.

²⁷² 47 U.S.C. § 271(d)(6).

²⁷³ See, e.g., *SWBT Kansas/Oklahoma Order*, 16 FCC Rcd at 6382-84, paras. 283-85; *SWBT Texas Order*, 15 FCC Rcd at 18567-68, paras. 434-36; *Bell Atlantic New York Order*, 15 FCC Rcd at 4174, paras. 446-53.

²⁷⁴ 47 U.S.C. § 271(d)(6)(A).

82. We require Verizon to report to the Commission all Vermont carrier-to-carrier performance metrics results and Performance Assurance Plan monthly reports beginning with the first full month after the effective date of this Order, and for each month thereafter for one year unless extended by the Commission. These results and reports will allow us to review, on an ongoing basis, Verizon's performance to ensure continued compliance with the statutory requirements. We are confident that cooperative state and federal oversight and enforcement can address any backsliding that may arise with respect to Verizon's entry into the Vermont long distance market.²⁷⁵

VIII. CONCLUSION

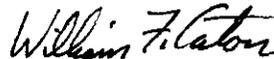
83. For the reasons discussed above, we grant Verizon's application for authorization under section 271 of the Act to provide in-region, interLATA services in the State of Vermont.

IX. ORDERING CLAUSES

84. Accordingly, IT IS ORDERED that, pursuant to sections 4(i), 4(j), and 271 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 154(i), 154(j), and 271, Verizon's application to provide in-region, interLATA service in the State of Vermont, filed on January 17, 2002, IS GRANTED.

85. IT IS FURTHER ORDERED that this Order SHALL BECOME EFFECTIVE April 29, 2002.

FEDERAL COMMUNICATIONS COMMISSION


William F. Caton
Acting Secretary

²⁷⁵ See, e.g., *Bell Atlantic-New York, Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in the State of New York*, Order, 15 FCC Rcd 5413-23 (2000) (adopting consent decree between the Commission and Bell Atlantic that included provisions for Bell Atlantic to make a voluntary payment of \$3,000,000 to the United States Treasury, with additional payments if Bell Atlantic failed to meet specific performance standards and weekly reporting requirements to gauge Bell Atlantic's performance in correcting the problems associated with its electronic ordering systems).