

1 STATE OF RHODE ISLAND
2 PUBLIC UTILITIES COMMISSION

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6
7 In Re: Verizon – Rhode Island)
8 Alternative Regulation Plan) Docket No. 3445
9

10 Direct Testimony of
11 Thomas H. Weiss
12 on behalf of the
13 Division of Public Utilities and Carriers
14
15

16 **Q. MR. WEISS, PLEASE STATE YOUR BUSINESS ADDRESS AND**
17 **OCCUPATION.**

18 A. I am an engineer employed as president of Weiss Consulting, Inc. My business
19 address is 405 Crossway Lane, Holly Springs, NC, 27540.
20

21 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
22 **PROFESSIONAL EXPERIENCE?**

23 A. Appendix A to this testimony is my resume that outlines principal elements of my
24 educational background and professional experience.
25

26 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY AT THIS TIME?**

27 A. On behalf of the Rhode Island Division of Public Utilities and Carriers (the
28 Division), my purpose is to explain the results of the Division’s review of the
29 Verizon-Rhode Island (“Verizon” or “the Company”) filing (dated July 1, 2002)
30 that presents the Company’s proposed “ALTERNATIVE REGULATION PLAN

1 APPLICABLE TO VERIZON RHODE ISLAND INTRASTATE
2 OPERATIONS,” otherwise referred to herein as “the Plan.”

3

4 **Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE PLAN.**

5 A. The Plan constitutes the Company’s proposal for an alternative form of regulation
6 to govern Verizon’s intrastate rates and charges in Rhode Island after December
7 31, 2002.

8

9 The Plan includes specific provisions for pricing certain products and services;
10 prices for all other retail products and services would be exempt from regulation.

11 Specific pricing rules apply to residence basic exchange service, intrastate
12 switched access service and the network interconnection, and to unbundled
13 network elements (“UNE”) that are the subject of this Commission’s current
14 investigations in connection with Docket No. 2681. In effect, except for primary
15 residence basic exchange service, local usage and intrastate access service, the
16 Plan would exempt all intrastate retail services from price regulation. For those
17 services that are not immediately exempt from price regulation under the Plan,
18 price regulation would cease two (2) years after the initial effective date of the
19 Plan. Significant specific provisions of the Plan are discussed below.

20

21 Under the provisions of the Plan, prices for “primary” residence basic exchange
22 service¹ would be subject to a maximum total \$2.00 per month increase during the

¹ “Primary” basic exchange service is the first local exchange access line at a residence. The prices for second and subsequent residential lines at the same premises would not be regulated.

1 first two years after the Plan first becomes effective. Similarly, prices for
2 residence measured local exchange usage would remain unchanged from current
3 levels for two years. After the end of the second year, prices for both primary
4 residence basic exchange service and residence local exchange usage would no
5 longer be subject to regulation by the Commission. For the life of the Plan,
6 changes in the credits for Lifeline services would track the changes in price for
7 primary residence basic exchange access service as described above.

8
9 The Plan would allow prices for individual elements of intrastate access services
10 to increase, provided that the total revenue derived from the increases is equal to
11 or less than revenue derived from price reductions applicable to other intrastate
12 access elements. That is, changes in the prices for individual elements of
13 intrastate access service would be constrained by a requirement for revenue
14 neutrality in the intrastate access category of services.

15
16 Under the Plan, all “other” retail services (i.e., those not specifically discussed
17 above) would be exempt from price regulation beginning on the date when the
18 Plan first becomes effective. This provision would apply to the prices for all
19 “other” existing services and the prices for any new retail services that may be
20 introduced by Verizon in Rhode Island for the period over which the Plan is
21 effective.

22

1 Prices for local exchange interconnection and UNEs offered to Competitive Local
2 Exchange Carriers (“CLECs”) would be set outside the pricing provisions of the
3 Plan, and in accord with the requirements of the Telecommunications Act of 1996
4 (“TA96”) – that is, for example, in accord with this Commission’s findings and
5 conclusions in Docket No. 2681, Phase II.

6
7 According to Verizon, like the PRSP, the Plan contains provisions that would
8 allow Verizon’s prices to reflect the financial impact on Verizon of events that are
9 currently unforeseen and beyond the Company’s control,² such as: changes in tax
10 laws; changes in Generally Accepted Accounting Principles (“GAAP”); changes
11 in FCC jurisdictional separations rules; and other federal and/or state regulatory,
12 judicial or legislative changes that affect the telecommunications industry
13 generally in Rhode Island. The Plan would allow for a maximum financial impact
14 of \$2.5 million annually to be recovered in price changes. To the extent that the
15 financial impact of exogenous changes exceeds \$2.5 million in a given year, the
16 excess would be carried-over to the following year and aggregated with that
17 following year’s exogenous changes but still subject to the \$2.5 million annual
18 cap in that following year.³

19
20 The Plan would require Verizon to extend the period of its funding for Internet
21 access to Rhode Island schools and libraries only through June 30, 2003. The

² Referred-to generally in price regulation plans as “exogenous” events.

³ Subject to Commission approval, the \$2.5 million annual cap can be exceeded if the excess can be attributed to changes in state or local taxes.

1 total amount of such funding would not exceed \$1.0 million from January 1, 2003
2 through June 30, 2003. Verizon has limited its funding for Internet access by
3 schools and libraries because it believes that such funding should be borne by all
4 carriers that operate in Rhode Island. According to Verizon, its proposal to
5 continue funding the program through June 30, 2003 is voluntary and designed to
6 give the Division and the Commission time to determine an equitable mechanism
7 for funding the program.

8

9 **Q. DO THE TERMS OF VERIZON'S PROPOSED PLAN DIFFER**
10 **MARKEDLY FROM THE TERMS OF THE PRSP THAT IS**
11 **CURRENTLY IN EFFECT?**

12 A. Yes. While both plans have the broad common objective to regulate the prices for
13 some of the services that Verizon offers at retail in Rhode Island, they approach
14 that objective in markedly different ways. Most significantly, the PRSP employs
15 an index approach to capping prices for a wide range of services. The Plan
16 proposes to set hard caps on the prices charged for certain services, and it
17 eliminates pricing ties to broad indices altogether.

18

19 **Q. IS IT APPROPRIATE AT THIS TIME FOR THE COMMISSION TO**
20 **ADOPT A PRICE REGULATION APPROACH FOR VERIZON THAT**
21 **REJECTS BROAD ECONOMIC INDICES AS MEANS TO GOVERN**
22 **PRICE CHANGES FOR RETAIL SERVICES?**

1 A. As a general proposition, adherence to index pricing plans should be relaxed. A
2 key element of that relaxation is the elimination of the relatively complex
3 component of the PRSP that sets prices for a broad range of Verizon's retail
4 intrastate products and services on the basis of changes in the Gross Domestic
5 Product Price Index ("GDP-PI"). Such index-based pricing mechanisms
6 somewhat complicate a pricing process. Furthermore, in spite of the level of the
7 price caps that derive from index pricing arrangements, telephone companies
8 (including Verizon) that are subject to index pricing arrangements rarely, if ever,
9 raise their prices to the fullest extent of the caps. In effect, the plans tend to
10 produce prices that fall generally below any price limits that may result from
11 application of the index mechanism. Accordingly, at this juncture, for Verizon, I
12 recommend that the Commission transition away from alternative price regulation
13 plans that are tied to broad economic indices.⁴

14

15 **Q. DOES THE DIVISION HAVE ANY COMMENTS AND/OR**
16 **RECOMMENDATIONS CONCERNING VERIZON'S PROPOSAL?**

17 A. Yes. The evidence presented here by Verizon demonstrates that competition for
18 local exchange access in Rhode Island has progressed generally,⁵ but especially in
19 the traditional business services market.⁶ In fact, according to statistics
20 maintained by the FCC, on a state-by-state basis as of year-end 2001, the CLECs'

⁴ Other New England states, including Massachusetts, Maine, Vermont, and Connecticut, have relaxed their use of index-related pricing for telephone services.

⁵ See PROPRIETARY Section A of Attachment 1 to the testimony of Verizon witness Silvia.

⁶ Id.

1 share of end user switched access lines in Rhode Island was second nationally in
2 overall percentage only to the state of New York.^{7, 8} Furthermore, in its report to
3 the FCC in connection with the FCC's CC Docket No. 01-234, the Commission
4 correctly found that the Rhode Island local exchange market is open to
5 competition and that both commercial and residential customers were benefiting
6 from it.⁹ Thus, it appears that local exchange competition is taking hold here in
7 Rhode Island and, with continued regulatory oversight, continued local exchange
8 market penetration by CLECs is possible. Those facts argue generally in favor of
9 some relaxation of the state's telecommunications price regulation model for
10 Verizon.

11
12 Those facts notwithstanding, however, it should be noted and emphasized here
13 that this Commission's observations in its report to the FCC concerning the state
14 of competition in Rhode Island should be viewed by Verizon and others as a
15 finding only that Verizon has demonstrated a willingness to provide competitors
16 with the tools to compete, not a finding that regulation of intrastate service in
17 Rhode Island should be abandoned. In fact, significant work, involving continued
18 regulation albeit in less traditional forms, remains to be done to ensure the

⁷ See: http://ftp.fcc.gov/Bureaus/Common_Carrier/Reports/FCC-State_Link/IAD/trend502.pdf.
By December 31, 2001, in Rhode Island, sixteen percent of total end-user access lines were served by
CLECs; in New York, twenty-five percent of total end-user access lines were served by CLECs.

⁸ The technically more accurate (and economically traditional) measure of market share is the
proportion of total market sales (revenue) accounted-for by one firm or appropriate grouping of individual
firms. However, according to Verizon's 4/30/02 response to the Division's informal information request in
the instant docket, competitors' sales figures are not available to Verizon.

1 continued development of competition for telecommunications services in Rhode
2 Island with the ultimate goal of fair prices for high quality, reliable and innovative
3 telecommunications service in the state. As Commissioner Sam J. Irvin IV of
4 North Carolina observed recently concerning the future role of regulation in the
5 transition to competition:

6
7 “The regulatory process was created to prevent harm to the public.
8 Although regulation is a less than perfect instrument for the achievement
9 of societal goals and although unnecessary regulation can be just as
10 harmful as or even more harmful than insufficient regulation, recent
11 events have demonstrated the potential harms that may result from
12 unrestrained corporate conduct.”¹⁰
13

14 Verizon’s Plan is grounded in that proposition that competition for local exchange
15 access has developed sufficiently in Rhode Island so as to allow the Commission
16 to conclude that a more relaxed form of price regulation can be applied to
17 Verizon’s operations in the state. Mr. Silvia’s testimony and Dr. Taylor’s
18 testimony are dedicated almost exclusively to proving the proposition and
19 explaining the economic theory to support it. I have reviewed both of these
20 witnesses’ testimonies and I do not disagree with the evidence or the theory
21 presented in support of Verizon’s general proposal. Accordingly, I believe that
22 the general form of the Company’s proposal is appropriate for regulating
23 Verizon’s prices at this time. There are, however, some specific provisions of the
24 Plan with which I disagree.

⁹ *Report of the Rhode Island Public Utility Commission on Verizon Rhode Island’s Compliance With Section 271 of the Telecommunications Act of 1996*, December 14, 2001, FCC CC Docket No. 01-234.

¹⁰ Concurring Opinion of Commissioner Sam J. Irvin IV in *Re Bell South Telecommunications, Inc.*, Docket No. P-55, Sub 1022, July 9, 2002 (NCUC) – TA96, Section 271 recommendation by the NCUC to

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Q. WHAT DO YOU MEAN WHEN YOU SAY THAT THE “GENERAL FORM” OF THE COMPANY’S PROPOSAL IS APPROPRIATE FOR REGULATING VERIZON’S PRICES AT THIS TIME?

A. As described above, the general form of Verizon’s proposal seeks to limit the application of price regulation rules to services for which prices should remain regulated to some degree in order to further encourage the universal availability of basic access to the network, and to encourage further development of competition in both the toll calling and local exchange markets. Consistent with that objective, Verizon has proposed that the prices for the initial access line to a residential premises and the local usage associated with such lines be subject to price regulation (i.e., a \$2.00 cap on the maximum amount by which the price of initial residence access lines can be increased over the term of the plan, and a freeze at current prices for the usage associated with such lines).

I agree with the Company that intrastate switched access services should remain subject to price regulation. I also agree with the Company that prices charged to CLECs for local exchange interconnection and UNEs should be governed by this Commission’s deliberations, findings and conclusions in separate investigations regarding such matters.

the FCC to permit Bell South Telecommunications, Inc. to offer long distance services to its local customers.

1 Finally as to the proposed general form of alternative price regulation, I agree
2 with the Company that competition has developed sufficiently in the markets for
3 other retail services so that price regulation of such services should be effectively
4 eliminated.

5
6 **Q. ARE THERE OTHER ASPECTS OF THE PLAN WITH WHICH YOU DO**
7 **AGREE?**

8 A. Yes. Notable in this regard are: the proposal for the Life Line Credit to track
9 changes in the prices for primary residential local exchange service, essentially
10 capping rates charged to Life Line customers at their current levels; the proposed
11 tariff filing arrangements; the proposal to freeze primary residential access usage
12 rates at current levels; the proposal to allow depreciation rate adjustments subject
13 to a depreciation rate floor equal to the rates in effect as of January 1, 1994; and
14 the proposal for filing annual financial reports and other information requested by
15 the Commission. I recommend that the Commission approve and adopt Verizon's
16 proposals with regard to each of these provisions of the Plan.

17
18 **Q. DO YOU AGREE WITH VERIZON THAT THE TERMS OF THE PLAN**
19 **SHOULD BE ALLOWED TO EXPIRE AFTER THEY HAVE BEEN IN**
20 **EFFECT FOR ONLY TWO YEARS?**

21 A. No. A two-year period is insufficient for the Division or the Commission to
22 assess the effects of the Plan on the Company's end-user customers and/or its
23 competitors. Other New England states have recognized this and have adopted 3-

1 year effective periods for the alternative regulatory plans that they have adopted.
2 According, I recommend that the Commission adopt a three-year effective period
3 for the new alternative regulation plan that results from the instant docket. After
4 the three-year term, the Commission should re-assess the competitive state of the
5 local exchange market in Rhode Island; this is especially important given the
6 current upheaval in the domestic telecommunications market generally.

7

8 **Q. IS VERIZON REASONABLE IN PROPOSING TO LIMIT INCREASES IN**
9 **THE RATES FOR PRIMARY RESIDENCE ACCESS LINES \$2.00 PER**
10 **MONTH (\$24.00 ANNUALLY) OVER THE LIFE OF THE PLAN?**

11 A. No. In effect, for primary FR residence access lines alone, such a proposal could
12 represent a percent increase in the range of between 11.6 percent and 16.2 percent
13 for residence end-user primary basic exchange rates. Verizon has presented no
14 evidence to demonstrate that the magnitude of such an increase is necessary or
15 appropriate from a cost perspective. Furthermore, an increase of this magnitude
16 would contravene to the objective of maintaining and continuing the development
17 of universal basic residential access to the network in Rhode Island - an obligation
18 which the Division believes should remain with Verizon since competition for
19 residential end-user access has yet to develop adequately (e.g., to the extent
20 currently exhibited in business markets) in Rhode Island.¹¹

21

22 However, it is possible that Verizon's cost to provide residence access service
23 could increase over the next three years. Therefore, the Division recommends

1 that the alternative regulatory plan adopted ultimately by this Commission for
2 primary residence access service should reflect the following terms: (1) should
3 differentiate between residence primary Flat Rate (“FR”) service and Measured
4 Rate (“MR”) service; (2) FR rate access should be allowed to increase by \$0.50
5 per month in each year of the Division’s recommended three-year term for the
6 plan; and (3) MR access be allowed to increase by \$0.25 per month in each of the
7 three years.

8

9 **Q. UNDER TERMS OF THE PLAN, VERIZON WOULD BE FREE TO SET**
10 **THE RATES ITS CHARGES FOR RESIDENCE “SECONDARY” ACCESS**
11 **LINES WITHOUT ANY REGULATORY RESTRAINT. IS THIS**
12 **PROPOSAL REASONABLE?**

13 A. Yes. Recent advances in the technology available to carriers to provide end-user
14 access have enabled data and voice services to be carried simultaneously over the
15 same fixed loop. A market effect of these advances has been to reduce the
16 demand for so-called “secondary” residential lines that previously had been used,
17 for example, for dial-up access to the Internet. In short, secondary residential
18 access lines have become discretionary in the residence market. Verizon could
19 preserve and, possibly, revive its market for residence “secondary” access lines
20 (and its revenue stream from them) if it was free to set the prices according to its
21 perception of market forces . Accordingly, the Division recommends that the
22 Commission accept Verizon’s proposal that it be allowed to set the rates for both
23 secondary FR and MR residential access lines.

¹¹ See PROPRIETARY Section A of Attachment 1 to Mr. Silvia’s testimony.

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Q. IS VERIZON REASONABLE IN PROPOSING TO LIMIT CHANGES TO INTRASTATE ACCESS RATES TO EFFECT INTRASTATE ACCESS REVENUE NEUTRALITY?

A. Yes. On the surface, the concept of revenue neutrality is appealing. However, advocacy of a revenue neutral approach to pricing the subsets of services in a particular service category (such as intrastate access charges) can mask anticompetitive pricing behavior for individual services within the category. For example, Verizon could reduce the rates it charges to an Inter-eXchange Carrier (“IXC”) when that IXC’s end-user customer dials “1” to reach it’s switch to place a toll call (originating access); under the concept of revenue neutrality, a corresponding increase would be required for the rate that Verizon charges to terminate a call from an IXC to one of Verizon’s own end-user customers (terminating access). Under a revenue-neutral approach, the change in Verizon’s prices for such originating and terminating traffic will depend upon the relative demand volumes of such traffic presented to and handled by Verizon. That is, Verizon could change the rates that it charges for such services in a seemingly revenue-neutral way based on the actual volume of originating and terminating access traffic in a given year while expecting the relative volumes of such traffic to shift in a revenue-positive way in the next year. To compound matters, a change in terminating access charges¹² could cause IXCs’ access costs to increase to such an extent as to require them to increase their toll charges to their

¹² Because the incumbent carriers still serve most access lines, far more IXC traffic terminates in incumbent carriers’ local exchange networks than originates to IXCs from the incumbents’ networks.

1 customers. This is an especially important consideration now that Verizon in
2 Rhode Island has secured authority from the FCC to enter the interLATA toll
3 market.

4

5 I believe that Verizon's proposal to set access charges subject to the condition of
6 revenue neutrality should be accepted by the Commission. Should Verizon wish
7 to change to its switched access rates, however, it can seek such changes only
8 upon motion to the Commission with full rights of intervention available to the
9 Division and the IXCs.

10

11 **Q. DO YOU HAVE ANY COMMENTS ON VERIZON'S PROPOSAL THAT**
12 **IT BE ALLOWED TO CHANGE PRICES OF "OTHER" SERVICES**
13 **BASED ON ITS PERCEPTION OF THE MARKET?**

14 A. Yes. While I am convinced that the transition to competition, especially for
15 predominantly business related services, is doing well in Rhode Island, I remain
16 concerned that under terms of the Plan Verizon could adjust prices for the "other"
17 services in a way that may prove to be anticompetitive. In order to insure against
18 anticompetitive pricing of the "other" services, Verizon's prices for them must not
19 be allowed to fall below Verizon's Long Run Incremental Cost ("LRIC") to
20 provide them.

21

22 For this reason, I recommend that Verizon not be permitted to set its prices for the
23 "other" services below a price floor that is equal to Verizon's LRIC to provide

1 individual services and/or bundles of individual services. Obviously, to comply
2 with this requirement, it will be necessary, at least initially, for Verizon either to
3 directly apprise the Commission of its LRIC for the individual “other” services or
4 to certify to the Commission that its proposed price changes do not result in prices
5 that are lower than LRIC for the service(s). Obviously, competitors should have
6 the right of petitioning the Commission to open an investigation of Verizon’s
7 prices for any of the “other” services if the competitors believe that Verizon’s
8 proposals produce an anticompetitive result. In the event of such a challenge,
9 Verizon should have the burden to prove that its proposed prices exceed the
10 appropriate LRIC.

11

12 **Q. SHOULD THERE BE ANY CEILING PLACED ON THE CHANGES**
13 **THAT VERIZON MIGHT PROPOSE TO ITS PRICES FOR THE SO-**
14 **CALLED “OTHER” SERVICES?**

15 A. At this point in the evolution to a more competitive telecommunications market in
16 Rhode Island, the Commission should focus principally on pricing policies that
17 are designed to advance competitors’ participation in the market while, at the
18 same time, protecting the universal availability of telephone service to residential
19 customers in the state. As a general proposition, pricing policies should not now
20 be crafted, as in the past under the traditional regulatory model, with the objective
21 of regulating Verizon’s earnings. Ceiling prices can be a mechanism to constrain
22 earnings.

23

1 “Other” products and services are offered generally in competitive environments
2 or they are “bells and whistles” types of services that would be consumed at the
3 customer’s sole discretion. However, for some services in the “Other” category
4 (e.g., alternative white pages directory listings), Verizon maintains significant
5 market control. Accordingly, Verizon should not be allowed total unrestrained
6 freedom in pricing “other” product and services. The Division believes that the
7 Commission should restrain increases to the prices of “Other” products and
8 services to a maximum of fifteen percent annually over the 3 year term of the
9 alternative regulatory plan.

10

11 **Q. DO YOU HAVE ANY COMMENTS REGARDING VERIZON’S**
12 **PROPOSAL FOR PRICING THE LOCAL INTERCONNECTION AND**
13 **UNES THAT ARE EMPLOYED BY CLECS AS MEANS TO COMPETE**
14 **WITH VERIZON?**

15 A. As noted earlier, Verizon proposes that the prices for local exchange
16 interconnection and UNEs offered to CLECs would be set outside the pricing
17 provisions of the Plan, and in accord with the requirements of the
18 Telecommunications Act of 1996 (“TA96”). The Division believes that
19 Verizon’s proposal in this regard is fundamentally sound and I recommend that
20 the Commission accept it. However, continued progress into competitive
21 telecommunications markets in Rhode Island is largely dependent on the
22 difference between retail prices that Verizon would charge for its intrastate end-
23 user access lines and the prices that Verizon would charge to CLECs for UNE

1 loops (i.e., RI PUC Docket No. 2681, Phase II). Thus, for example, in connection
2 with Docket No. 2681, should the Commission allow Verizon to increase the
3 prices that it charges to CLECs for UNE loops while, at the same time, in
4 connection with the instant docket, permit Verizon to reduce the prices that it
5 charges at retail to its end-users for basic exchange access, a classic price squeeze
6 could ensue with the result that growth of local exchange competition would
7 suffer.

8

9 **Q. AS WITH PREVIOUS ALTERNATIVE REGULATION**
10 **ARRANGEMENTS IN RHODE ISLAND, THE PLAN CONTINUES TO**
11 **INCLUDE PROVISIONS THAT WOULD ALLOW VERIZON TO**
12 **INCREASE ITS INTRASTATE RATES AND CHARGES TO OFFSET**
13 **THE IMPACT OF SO-CALLED “EXOGENOUS” EVENTS. DO YOU**
14 **HAVE ANY RECOMMENDATIONS FOR THE COMMISSION WITH**
15 **REGARD TO THIS PROVISION OF THE PLAN?**

16 A. Yes. Basically, as I understand it, under the Plan Verizon is proposing to
17 continue the same provisions for recognizing the effects of exogenous events as
18 are included in the PRSP that is currently in effect. To my knowledge, in all
19 previous alternative regulatory plans in Rhode Island, Verizon (and/or its
20 predecessor companies) has exercised the provisions to recognize the financial
21 effects of only two “exogenous” events -- a *reduction* in the state gross receipt tax
22 rate due to a legislative change, and a *reduction* in intrastate costs due to a change

1 in the FCC’s jurisdictional cost allocation procedures. In both instances,
2 intrastate rates were reduced.

3
4 The Plan and its predecessor alternative regulatory arrangements have permitted
5 recognition in rates of the financial impact of exogenous events mainly as a
6 backstop on possible earnings erosion resulting from implementing competition
7 and alternative forms of regulation. With the implementation of the Price
8 Regulation Trial (“PRT”) and successive regulatory plans (the Price Regulation
9 Plan (“PRP”) and the PRSP), exogenous event provisions were justified because
10 neither the carriers nor this Commission were clear as to the financial effects of
11 transitioning to a competitive telecommunications market. Now, however, we are
12 better informed about such matters and under either the Plan as recommended by
13 Verizon or under the proposed alternative recommended by the Division, Verizon
14 would have substantially increased flexibility in setting the prices it charges for
15 intrastate services in Rhode Island. These improvements reduce Verizon’s risk of
16 earnings erosion due to competition and alternative regulation. At this juncture,
17 then, I believe that the degree of Verizon’s protection from the financial effects of
18 exogenous events can be relaxed such that Verizon should absorb more of the risk
19 that was mitigated previously by the exogenous events provisions of earlier
20 alternative regulatory plans. Therefore, still subject to the existing \$2.5 million
21 annual cap on revenue increases for exogenous events, I recommend that the
22 Commission modify the provisions for recognizing the financial effects of
23 exogenous events by requiring Verizon to absorb the first \$2.0 million of the

1 intrastate revenue effects for exogenous events before the financial impact of such
2 events can be recognized in the prices that Verizon charges for its intrastate
3 services. It may follow, without saying, that to the extent to which the financial
4 effects of exogenous events are allowed in intrastate rates, those effects must be
5 allocated fairly between those products and services that are covered by the new
6 alternative regulatory plan¹³ and any other products and services that Verizon
7 offers in Rhode Island and that do not fall specifically under the provisions of the
8 new alternative regulatory plan.

9

10 **Q. THE PLAN CONTAINS PROVISIONS THAT WOULD ALLOW**
11 **VERIZON TO INCREASE THE ANNUAL “CAP” ON THE FINANCIAL**
12 **EFFECTS OF EXOGENOUS EVENTS BY AN AMOUNT THAT EQUALS**
13 **INCREASES IN LOCAL AND STATE TAXES. IS THAT PROVISION**
14 **REASONABLE?**

15 A. Verizon has not explained the reason(s) for this proposal; nor has it distinguished
16 increases in local and state taxes from other items listed in the Plan as being
17 exogenous. In fact, Verizon’s list of exogenous events specifically includes
18 “changes in tax laws”¹⁴ which should include changes in state and local tax rates
19 and tax structures. I recommend that the Commission reject Verizon’s proposal
20 to increase the annual cap on the effects of exogenous changes.

21

¹³ Appendix A to Verizon’s proposed *Alternative Regulatory Plan Applicable to Verizon Rhode Island Intrastate Operations*.

¹⁴ Verizon’s proposed *Alternative Regulatory Plan Applicable to Verizon Rhode Island Intrastate Operations*, page 2 of 3.

1 **Q. IN THE PLAN, VERIZON PROPOSES TO LIMIT AND EVENTUALLY**
2 **TERMINATE ITS FUNDING FOR INTERNET ACCESS BY SCHOOLS**
3 **AND LIBRARIES IN THE STATE. IS THIS A REASONABLE**
4 **PROPOSAL?**

5 A. No, not at this time. For Verizon to be permitted to back away from its support of
6 this vital program is likely to be nearly fatal to educational accomplishments that
7 have been made possible by the funding. The Division was supportive of using
8 earnings to jump start the telecommunications explosion that has taken place in
9 the schools and libraries in the state. Verizon has also used the program to its
10 advantage in that the dollars were matched with E-rate dollars that could be used
11 by the schools and libraries to purchase additional Verizon services.

12
13 While substantial progress has been made in the march toward a competitive
14 telecommunications market in Rhode Island, the fact remains that Verizon is still
15 the dominant local exchange carrier in the state, especially for products and
16 services that exhibit relatively inelastic demand relative to price;¹⁵ certainly, at
17 this juncture, Internet access for schools and libraries fits into that category.

18 Accordingly, I recommend that the Commission reject Verizon's proposal
19 regarding funding of Internet access for schools and libraries at this time and
20 require the Company to continue funding the program through December 31,
21 2005 (sunset of the Division's recommend alternative regulatory proposal) as a
22 part of its approval of any alternative regulatory plan in this docket. In the

¹⁵ For example, residential services.

1 meantime, parties can pursue legislation to ensure continuation of support for
2 Internet access to schools and libraries in the state.

3

4 Q. VERIZON'S PROPOSAL IS TO CONTINUE WITH A SERVICE QUALITY
5 COMPONENT IN ITS PROPOSED PLAN, THOUGH VERIZON BELIEVES
6 THAT THERE IS NOT A NEED FOR THE COMMISSION TO CONTINUE
7 TO RETAIN SERVICE QUALITY STANDARDS. DO YOU HAVE A
8 COMMENT REGARDING SERVICE QUALITY?

9 A. The Division believes that service quality standards must be a component of the
10 regulatory plan for Verizon. James Lanni will be addressing this issue on behalf
11 of the Division in a separate submission of testimony in this Docket.

12

13 **Q. DOES THAT CONCLUDE YOUR TESTIMONY AT THIS TIME?**

14 A. Yes, it does.