

**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
PUBLIC UTILITIES COMMISSION**

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Verizon-Rhode Island Alternative Form )  
of Regulation )  
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**Docket No. 3445**

**BRIEF OF CONVERSENT COMMUNICATIONS OF RHODE ISLAND, LLC**

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**STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
PUBLIC UTILITIES COMMISSION**

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**Verizon-Rhode Island Alternative Form  
of Regulation**  
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**Docket No. 3445**

**INITIAL BRIEF OF  
CONVERSENT COMMUNICATIONS OF RHODE ISLAND, LLC**

**INTRODUCTION**

At the same time that Verizon is seeking unprecedented pricing flexibility for its retail local exchange services in Rhode Island, it is also seeking to defeat competition in the local exchange by attempting to retrench from its unbundling obligations and increase the costs of its competitors. For example, while Verizon relies, in part, upon competition in the local exchange from market entrants that use the unbundled network element platform ("UNE-P") to support its request for retail pricing flexibility, it is advocating to the FCC that UNE-P be eliminated as an entry strategy. *See*, Proprietary Table 1 in, VZ-Exh. 6, p. 5; Nov. 20, 2002 Tr., p. 269. At the same time that Verizon is relying, in part, on competition in the local exchange from CLECs that use unbundled network elements ("UNEs") to support its request for retail pricing flexibility, it is urging the FCC to remove high capacity loops and interoffice transport, including dark fiber, as UNEs. *See*, Proprietary Table 1, VZ Exh. 6, p. 5; Dec. 11, 2002, Tr., p. 249. At the same time that Verizon is relying, in part, on competition from carriers that use special access circuits to support its request for retail pricing flexibility, it is seeking additional pricing flexibility for special access services. *See*, Proprietary Table 1, VZ Exh. 6, p. 5; Verizon Exh. 1, p. 1 ¶ C, Pleading Cycle Established for Verizon Petition for Pricing Flexibility for Special Access and

Dedicated Transport Services, Public Notice, DA 02-3499 (FCC rel. Dec. 19, 2002). At the same time that Verizon touts the existence of a strong contingent of facilities-based competitors in the Rhode Island local exchange market, it is seeking to substantially increase the hot-cut NRC and the monthly recurring charges of unbundled network elements in Docket 2681. VZ Exh. 4, p. 5; . Dec. 11, 2002, Tr., p. 70. At the same time that Verizon is relying, in part, on the competition it faces from CLECs that use UNEs to support its request for pricing flexibility, it is urging the FCC to remove from its unbundling obligations loops that are used to provide data services. Dec. 11, 2002 Tr., p. 249; *See*, Verizon Reply Comments, FCC CC Docket Nos. 01-338, 96-98, 98-147 at 65, 66 (July 17, 2002).

Despite all of the above described attempts to defeat competition, and the great regulatory uncertainty that such efforts create, Verizon and the Division of Public Utilities and Carriers ("Division") have entered into a Settlement Agreement ("VZ/Division Settlement Agreement") that fails to include any safeguards to ensure that the developing facilities-based competition that exists today, which in large measure comes from CLECs that are dependent on Verizon<sup>1</sup>, will continue to exist and grow if Verizon is permitted to obtain the retail pricing flexibility that it seeks. *See*, Conversent Exh. 3, pp. 28-32; Dec. 11, 2002 Tr., pp. 59, 63, 82, 132. The Alternative Regulation Plan set forth in the VZ/Division Settlement Agreement will only generate positive results if during the course of the Plan there is competition in Rhode Island that is strong enough to discipline all market participants, including and most importantly Verizon. Conversent Exh. 3, p. 28. Therefore, a plan that leaves competitors that use UNEs to provide

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<sup>1</sup> For example, Cox witness Schonhaut testified that Cox serves primarily residential customers and that, except for a few exceptions, "Cox does not have a presence in the business market yet." Thus, Verizon's competition in the business market comes largely from carriers that use UNEs and from resellers, both of which are dependent on Verizon. *See*, also, Proprietary Table 1, Columns 3 and 4 (pertaining to UNE Platform lines and E-911 listings to business customers).

local exchange service (in part or in whole), exposed to possible anti-competitive pricing by Verizon must not be permitted to go in effect.

Other state commissions have incorporated safeguards into the Alternative Regulation Plans that they have approved for Verizon in order to protect the competitive process. Most recently, the Massachusetts Telecommunications Department and Energy ("Massachusetts D.T.E.") adopted a UNE based price floor for Verizon retail local business services that are contestable by UNEs. Massachusetts D.T.E. 01-31, Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to Succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' Intrastate Retail Telecommunications Services in the Commonwealth of Massachusetts, p. VII (hereinafter the "Massachusetts D.T.E. Order"). If a business service cannot be provided on a wholesale basis by way of UNEs, Verizon is not given retail pricing flexibility for that service. Id.

It is true that the New York Public Service Commission ("NY-PSC") did not adopt a TELRIC price floor, but it did substantially reduce the TELRIC rates for UNEs to levels well below the cost of UNEs in Rhode Island, thereby making it more difficult for Verizon to price its retail services below the costs of the inputs that New York CLECs use.<sup>2</sup> The NY-PSC also recognized the importance of a reasonable hot-cut rate to the continued development of facilities-based competition in New York and established a ceiling of \$35 per hot-cut in the VZ-NY Alternative Form of Regulation. Id. at 7; Conversent Exh. 3, p. 27. However, the safeguards in New York do not stop there. The NY-PSC also required Verizon to continue providing the UNE

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<sup>2</sup> State of New York Public Service Commission, Case 00-C-1945 - Proceeding on Motion of the Commission to Consider Cost Recovery by Verizon and to Investigate the Future Regulatory Framework, Case 98-C-1357 - Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements, "Order Instituting Verizon Incentive Plan", stating that rates for UNEs are those set in the UNE

platform throughout the course of the plan, even if there is a change in federal law. Id.; Dec. 11, 2002 Tr., p. 82. The plain fact is, neither the Massachusetts D.T.E. nor the New York-PSC viewed Verizon's Alternative Form of Regulation solely from "the perspective of the ILEC", as the Division concedes it did, but also from the perspective of safeguarding the competitive process. Nov. 20, 2002 Tr., p. 80. Conversent urges the Commission to either reject the proposed VZ/Division Settlement Agreement or to take steps to modify it to include some or all of these competitive safeguards.

### **PROCEDURAL BACKGROUND**

On July 1, 2002, Verizon filed an Alternative Regulation Plan accompanied by the Direct Testimony of Theresa L. O'Brien, Arthur D. Silvia and Dr. William E. Taylor. The Alternative Regulation Plan was offered to succeed price cap regulation for Verizon's intrastate retail telecommunications services. Among other things, the Alternative Regulation Plan would grant Verizon relief from pricing regulation of its local exchange services to business customers.

On September 20, 2002, Conversent filed the Direct Testimony of Dr. August Ankum and Cox Rhode Island Telecom, LLC ("Cox") filed the Testimony of Cindy Z. Schonhaut. On September 25, 2002, The Division filed the Direct Testimony of Thomas Weiss.

On October 22, 2002, Verizon filed the Rebuttal Testimony of Theresa L. O'Brien, Arthur D. Silvia and Dr. William E. Taylor. On November 8, 2002, Conversent filed the Surrebuttal Testimony of Dr. August H. Ankum and Cox filed the Surrebuttal Testimony of Cindy Z. Schonaut. On or about the same date, Thomas Weiss and James Lanni filed the Surrebuttal Testimony for the Division. The Commission conducted evidentiary hearings on November 19<sup>th</sup>, 20<sup>th</sup>, 21<sup>st</sup> and 22<sup>nd</sup>.

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Order as specifically set forth in Appendix A to the Joint Proposal which are \$7.70, \$11.31 and \$15.51 for two-wire analog unbundled loops depending upon the density zone and \$2.57 for a port.

On or about December 6, 2002, Verizon and the Division entered into the VZ/Division Settlement Agreement that was filed on or about the same date. On December 11, 2002, the Commission held a hearing on the VZ/Division Settlement Agreement.

### ARGUMENT

**I. The VZ/Division Settlement Agreement is Not in the Public Interest, Does Not Assure that Rates Will Remain Just and Reasonable, Does Not Guard Against Unjust Discrimination, and Does Not Guard Against Unfair or Destructive Competitive Practices. Therefore, it Must Be Rejected or Modified.**

The Commission is statutorily obligated to ensure that Verizon's proposed Alternative Regulation Plan is in the "public interest" and that it will result in "just and reasonable rates and charges for [its] services... without unjust discrimination, undue preferences or advantages, or unfair or destructive competitive practices" throughout the term of the Plan. Rhode Island General Laws, §39-1-1 (a)(1)(b).<sup>3</sup> Verizon's position, essentially, is that competitive conditions constrain its ability to unduly increase rates. Verizon points to the fact that it faces competition from all three modes of entry: resale, unbundled network elements and full facilities-based entry. *See*, Verizon Exh. 2, pp. 4-6; Verizon Exh. 3, p. 10; Verizon Exh. 4, pp. 16, 17.

One of the most notable aspects of Verizon's initial proposal, as well as the VZ/Division Settlement Agreement, is that they would grant Verizon relief from pricing regulation of its local business services. Verizon Exh. 1. In support of its application, Verizon emphasizes the existence of "facilities-based competition" as a constraint on Verizon's ability to unduly increase prices. *See*, Verizon Exh. 4, pp. 8, 9, 17, 18.

During the course of the evidentiary hearings, it became clear that the facilities-based competition that Verizon relies on to support its request for flexible pricing does not just include

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<sup>3</sup> It is important to note that the Rhode Island General Laws do not specify any particular manner of regulating public utilities. Nor do federal statutes or the Constitution require any particular method of regulation. *See*, Verizon v. FCC, 122 S.Ct. 1646, 1650 (2002) (discussion of history of rate making methodology and noting that "responsibility for "just and reasonable" rates leaves methodology largely subject to discretion").

competition from so-called "full facilities-based" carriers such as Cox, but also facilities-based carriers like Conversent and ChoiceOne that have installed their own switches and transmission equipment and have collocated with Verizon in order to purchase unbundled network elements ("UNEs"), including unbundled loops and interoffice transport. Nov. 20, 2002, Tr., p. 203. Carriers that use this entry strategy typically combine leased UNEs from Verizon with their own equipment and facilities to serve end-users. Conversent Exh. 1. Thus, much of the competition that Verizon relies on to support its application for upward pricing flexibility comes from carriers that are dependent on Verizon for the inputs that they use to provide retail service. *See*, Conversent Exh. 2, Verizon Response to PUC 1-3, Referring to Table 8 of the FCC's July 2002 Report, entitled "Local Telephone Competition: Status as of December 31, 2002" which demonstrates that CLECs that use UNEs were providing service to 25,581 local access lines in Rhode Island. At the same time, it is these very carriers that use UNEs (some like Conversent and ChoiceOne that combine UNEs with their own facilities and others that rely entirely on UNE-P) that are the most susceptible to the ability of Verizon to impose a price squeeze that would, in turn, weaken competition. Conversent Exh. 3, pp. 5, 6, 14, 15.

A price squeeze concerns a situation in which a vertically integrated firm (such as Verizon) competes against companies (such as CLECs) in retail markets while controlling prices in wholesale markets for critical inputs that its competitors are dependent upon. In this situation the vertically integrated firm can use the price squeeze as an anti-competitive device by lowering retail rates, thus squeezing the dependent competitors' margins between retail rates and the wholesale rates, reducing their ability to recover their costs.<sup>4</sup> Conversent Exh. 3, pp. 16, 17; Nov. 21, 2002 Tr., pp. 143, 144. It is important to note that "classic price squeeze cases have never turned on a finding that competition by the input - purchasing firms was absolutely



precluded." WorldCom v. FCC, 308 F.3d 1, 10 (D.C. Cir. 2002). Rather the inquiry is whether there are anti-competitive effects. Id., Anaheim v. FERC, 941 F.2d 1234, 1238 (D.C. Cir. 1991).

In Phase I of a docket that is investigating the appropriate regulatory plan to succeed price cap regulation for Verizon in Massachusetts, the Massachusetts D.T.E. "granted Verizon's request for pricing flexibility for those retail business services that are available on a wholesale basis as unbundled network elements," but was very concerned about the ability and incentive of Verizon to engage in a price squeeze with respect to UNE based CLECs and established a UNE based price floor as follows:

[D]ownward pricing flexibility for Verizon's retail business services would enable Verizon to engage in a "price squeeze", with respect to UNE based CLECs. Consequently, the Department [will implement] an enhanced price floor for Verizon's retail business services, equal to the density zone specific UNE rates for the elements that make up the service plus a mark-up for Verizon's retailing costs as reflected in the wholesale discount.

Massachusetts D.T.E. Order, p. VII. It is important to note that it was only after adopting such a safeguard, that the D.T.E. was able to conclude that "prices to business customers [under the Alternative Regulation Plan] are consistent with G.L.c 159's mandate of just and reasonable rates." Id., pp. 101 - 104.

Conversent urges this Commission to ensure that it do no less to protect facilities-based competition in Rhode Island than the D.T.E. provided in the Commonwealth of Massachusetts. Without such action, competition will weaken and the Commission cannot be assured that Verizon's rates will remain "just and reasonable" over the course of the Plan.

**A. The Settlement Agreement Does Not Protect CLECs That Use UNEs From a Price Squeeze and Contains No Safeguards Against Discriminatory Pricing**

The initial proposal of the Division and the subsequent Verizon/Division Settlement Agreement both establish a price floor for Verizon's retail pricing flexibility that is based on

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<sup>4</sup> CLECs that use UNEs must also recover their own costs. Nov. 21, Tr., p. 137.

Verizon's long run incremental cost ("LRIC"). At the November evidentiary hearings, Division witness Weiss testified that "LRIC is likely to be below TELRIC" and, conceded that if Verizon is permitted to price below the cost of UNEs that CLECs use to provide the retail service that they "would have difficulty competing." Nov. 20, 2002 Tr., p. 66.

When pressed from the bench, Mr. Weiss appeared to hedge his support for a LRIC price floor somewhat by suggesting that the Division's position was not the "be-all and end-all" and stated that the Division had looked at the price floor from "the perspective of the ILEC." Nov. 20, 2002 Tr., pp. 79, 80. He acknowledged that if a "competitor relies on UNE-P [and] the retail price that Verizon charges for the service is below the TELRIC of the UNE-P, then there is a bit of a problem." *Id.*, p. 80. For carriers that have their own switch, such as Conversent, Mr. Weiss candidly stated that "to the extent that Verizon can price its service below the UNE [loop] price, oh, most definitely...that would definitely run people right out of the market. *Id.*, pp. 77, 78.<sup>5</sup> Questioned from the Bench, Mr. Weiss further conceded that "at the very worst, Verizon should accept the sum of TELRIC of the various elements" that make up the retail service! *Id.*, p. 90.

Despite Mr. Weiss' candid testimony in the November evidentiary hearings concerning the shortcomings of a LRIC price floor and that "Verizon should accept the sum of TELRIC of the various elements that make up the retail service", at the hearing on the VZ/Division Settlement Agreement, Mr. Weiss inexplicably reverted to his position that the proper floor should be LRIC and stated that the LRIC floor in the Settlement Agreement uses the same standard as initially set forth in his prefiled testimony. Dec. 11, 2002 Tr., p. 63. Mr. Weiss acknowledged that the Division has the obligation to ensure that Verizon can not engage in a price squeeze to defeat competition by CLECs who use UNEs, but then admitted that there is

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<sup>5</sup> Mr. Weiss failed to address the fact that carriers that have their own switch must recover the costs of such a switch, plus their retail related costs.

nothing in the VZ/Division Settlement Agreement that would protect CLECs that rely on UNEs from Verizon pricing below the TELRIC cost of the UNEs that make-up the retail service. Id., pp. 59, 63.

The LRIC-based price floor contained in the Settlement Agreement is not in the "public interest" and does not guard against "unfair or destructive competition practices" if it permits Verizon to implement a price squeeze on CLECs that use UNEs, thereby making it difficult for them to compete. Second, the whole purpose of a price floor is to "protect the competitive process." Nov. 21, 2002 Tr., p. 155. Yet the Division admitted that it did not even consider the impact of a LRIC price floor on competitors, but rather viewed the issue solely from "the perspective of the ILEC." Nov. 20, 2002 Tr., p. 80. Third, the Division seemed unclear about who it was representing in this proceeding. Was it all ratepayers? Just residential? Was it small businesses? Was it medium sized businesses? The Division appeared to have difficulty answering these questions. Dec. 11, 2002 Tr., p. 56. Fourth, the Division had difficulty with questions about the degree of pricing flexibility that Verizon would have and whether it would be improper price discrimination for Verizon to offer similarly situated customers different rates for the same service. Nov. 20, 2002 Tr., pp. 57, 58. Dec. 11, 2002 Tr., pp. 216 - 222. It is hard to imagine how the Division could support a Settlement Agreement it entered into as being in the public interest when it viewed the issue of a proper price floor from the perspective of the ILEC, when it admitted that there was nothing in the Settlement Agreement to protect CLECs that use UNEs from Verizon lowering prices below the TELRIC rates for the UNEs that make-up the retail service, when it admitted that CLECs that use UNEs "would have difficulty competing" if Verizon is permitted to price below the cost of UNEs that make up the retail service, and when it was unclear whether it would be discriminatory for Verizon to treat similarly situated customers differently.

**B. The VZ/Division Settlement Agreement Should be Rejected or Modified to Adopt a UNE Based Price Floor for the Pricing of Verizon's Retail Business Services**

The Commission should adopt Dr. Ankum's recommendation that pricing flexibility for Verizon's retail local and intrastate tariffed services should be subject to a UNE based price floor that is equal to the UNE rates for the elements that make up the retail service, plus a mark-up for Verizon's retailing costs as reflected in the wholesale discount. Nov. 21, 2002 Tr., p. 152. At the very least, this price floor should be applied to pricing of Verizon's retail business services, as in Massachusetts. The UNE based price floors, like Verizon's TELRIC rates in Docket 2681, would be density zone specific. *Id.*, pp. 191, 192.

The UNE based price floor proposed by Dr. Ankum cures many of the defects associated with the LRIC based price floor set forth in the VZ/Division Settlement Agreement. First, the objective of a price floor is to "protect the competitive process." Nov. 21, 2002 Tr., p. 155. As Dr. Ankum testified, permitting Verizon to price its retail local exchange services below an appropriate floor "is equivalent to [requesting] pricing flexibility for UNE rates because it's in the margin between resale and wholesale rates that determines the profitability and its that profitability in the market that determines how viable competition is." *Id.*, at 143. If the competitive process is protected, the Commission can have some comfort that there will continue to be competitive pressure on Verizon, thus acting as constraint on its ability to unduly increase prices. Second, competitors that use UNEs face a TELRIC based price when they purchase such UNEs, they don't face a LRIC price. *Id.* 155. Accordingly, adopting a LRIC based price floor is using the "wrong tool for the task." *Id.*

Third, the TELRIC methodology has been well defined by both the FCC and a large number of state commissions. There is large agreement on what TELRIC is. *Id.* at 153. In contrast, there are a much larger number of ideas and cost studies about what LRIC means. *Id.* at

154. Accordingly, both Dr. Ankum and Mr. Weiss agree that it would be easier for the Commission to administer and monitor a TELRIC based price floor than a LRIC based price floor. Id. at 154; Nov. 20, 2002 Tr., pp. 88, 89.

Fourth, a LRIC price floor would likely result in increased litigation, whereas if the Commission were to adopt a TELRIC based price floor the existing approved TELRIC rates have already been litigated. Nov. 20, 2002 Tr., p. 68.

Fifth, because TELRIC rates are density zone specific, adopting a TELRIC based floor addresses many of the problems associated with discriminatory pricing that would exist if the Commission adopted a LRIC test. Id., pp. 169, 192. That is, Verizon could geographically de-average its retail prices for business services, but only subject to a price floor equal to the density zone specific UNE rates underlying the service, plus a mark-up equal to the resale discount percentage. As a result, the Commission would not have to wrestle with whether it would be discriminatory for Verizon to offer, for example, a business customer that is located in Providence a lower rate than a similarly situated business customer that is located in Warwick or Foster. On the other hand, Verizon would not be permitted to go into a narrow geographic region, such as an urban density zone, and charge different rates for the same service. Id. This appears to be the approach taken by the Massachusetts D.T.E. when it adopted a TELRIC based floor for Verizon's retail business local exchange services in Massachusetts. The Massachusetts D.T.E. ruled that its grant of pricing flexibility for retail business services that are contestable on a UNE basis was "subject to a price floor equal to the density zone specific UNE rates underlying the service plus a mark-up equal to the resale percentage." Massachusetts D.T.E. Order, p. 104. The Department continued that for business services, Verizon "may geographically de-average its prices for business services" and "charge different rates for the same service in different areas of the state, to respond to local market conditions and to reflect

differences in the cost of serving different areas of the state." Id., p. 105. This, of course, is exactly what Dr. Ankum recommended. Nov. 20, 2002 Tr., pp. 169, 170.

Finally, divorcing the cost methodology that applies to UNE rates from the methodology that is used for a price floor results in a perverse incentive structure for Verizon. Nov. 21, 2002 Tr., pp. 156, 157. Such a structure would provide Verizon with an incentive to seek to *inflate* the TELRIC prices that it charges CLECs for the inputs they need to compete and, at the same time, to deflate the LRIC price floor to which it could engage in downward pricing flexibility. Id., Dec. 11, 2002 Tr., p. 153. In contrast, if the Commission adopts a TELRIC standard for both purposes it creates an additional incentive for Verizon to file accurate, properly deaveraged TELRIC cost studies because it will know that such TELRIC rates are going to be used to determine its own price floor. Nov. 21, 2002 Tr., pp. 156, 157.

Verizon witness Taylor testified that Verizon has neither the incentive nor the ability to impose a price squeeze on dependent competitors. Verizon Exh. 7, p. 2. He also argued that if Verizon did price its local service below the cost of the UNEs, the CLEC could always compete by way of resale. At the outset, it must be stated that if Dr. Taylor believes that Verizon would never lower its retail prices so that dependent CLECs would be in a price squeeze, Verizon should have no objection against a price floor based on UNE prices. Conversent Exh. 4, p. 14. Second, while Dr. Taylor made an economic argument for why Verizon may or may not engage in a price squeeze, there is no guaranty that Verizon will behave consistent with Dr. Taylor's testimony. Id., p. 15. Third, the Massachusetts D.T.E rejected Dr. Taylor's argument and established a UNE-based price floor for all Verizon's business services that are contestable on a UNE basis as follows:

"By contrast, granting Verizon unlimited downward pricing flexibility would enable Verizon to engage in a "price squeeze" with respect to UNE based CLECs. Verizon would be free to decrease its retail rates to the point where the margin

between the market price of a service and the cost of the underlying UNE was "squeezed" until UNE based CLECs could not profitably compete with Verizon. Allowing such freedom to an incumbent would defeat UNEs' purpose as both a means of providing service and a tool for moving to a facilities-based network. Verizon asserts that UNE based providers can switch to resale, and the existing resale discount price floor would serve a "safety net" preventing anti-competitive pricing. Accepting Verizon's argument on this point would, however, impede the development of facilities-based competition envisioned by the FCC, and, as mentioned above in Section V. B. 4, it is not certain that facilities-based CLECs would be willing and able (given sunk costs) to shift quickly to resale...Consequently, the Department will require a UNE based price floor for Verizon's business services that are contestable on a UNE basis. The price floor should be equal to the UNE rates for the elements that make up the retail service, plus a mark-up for Verizon's retailing costs as reflected in the wholesale discount.<sup>6</sup> The price floors will be density zone specific."

Massachusetts D.T.E. Order, pp. 101, 102. While Dr. Taylor tried to suggest that such a UNE-based price floor only applied to "a very, very, narrow set of services," (Nov. 20, 2002 Tr., p. 235), Verizon's own compliance filing in Massachusetts in D.T.E. 01-31 flatly contradicts Dr. Taylor's testimony in Rhode Island as follows:

"With the exception of administrative charges (e.g., dishonored check charges, late payment charges, etc., which are charges that a CLEC can apply to their own customers), *all of Verizon MA's Retail Business Services can be replicated by competitors via UNEs*. A complete list of all business services and the relevant UNEs that other carriers can use to provide competing services is contained in Tab C. (emphasis added)."

Conversent Exhibit 7, p. 8. Moreover, a review of all the business services contained in Tab C reveals a list of approximately a hundred services that Verizon has stated are business retail services contestable with UNEs. Id., Tab C, pp. 1-4. At the December 11, 2002 evidentiary hearing, Dr. Taylor agreed that according to the Verizon Massachusetts Compliance filing, virtually all of Verizon's business retail services are contestable with UNEs. Dec. 11, 2002 Tr.,

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<sup>6</sup> The Department made clear that for the mark-up for Verizon's retailing costs, "Verizon shall use the existing resale discount until a new discount level is approved by the Department."

91. Accordingly, virtually all of Verizon's business retail services are subject to a UNE-based price floor.

Verizon also suggested in the evidentiary hearings that it would be unfair to subject Verizon to a TELRIC based price floor if the same floor does not apply to Cox. As a threshold matter, if the Commission adopted the same price floor in Rhode Island that the Massachusetts D.T.E. approved, it would only apply to business services. Massachusetts D.T.E. Order, pp. VII, 101. Cox witness Schonhaut was clear that, for the most part, "Cox's network in Rhode Island is primarily in the residential areas of the state and does not reach most business areas." Dec. 11, 2002 Tr., p. 268. The fact is, except for some notable exceptions, "Cox does not have a presence in the business market yet." Id., p. 269. Therefore, adopting a UNE-based floor for business services would not disadvantage Verizon vis-a-vis Cox.

Even if Cox had a network that reached business customers, and even if Cox was aggressively marketing full facilities-based services to businesses, the concerns raised by Dr. Taylor would have no merit. First, Dr. Ankum stated it is not necessary to subject a carrier to a TELRIC based floor if it is not supplying dependent competitors with UNEs. Nov. 21, 2002 Tr., p. 210. Second, Dr. Ankum testified that he has never heard a suggestion that cable companies can offer telephony more cheaply than the incumbent local exchange carrier. Id., p. 221. Third, he testified that the FCC has found that new entrants typically have higher costs as a result of low levels of utilization as follows:

"The FCC has found through extensive analysis that new entrants typically have higher costs than lower costs and the reasons are obvious. When you go in with new switches and facilities typically you start with very low rates of utilization. A large central office switch can handle 80,000 to 90,000 customers. I can guarantee you that none of these competitor's switches sitting there have that rate of utilization while Verizon switches typically are nearly fully utilized. That is enormous economies of scale. All the fiber facilities, everything else that Verizon puts into the ground is utilized not only by its own customers but it has these other CLECs that are drawing on its resources as well. The key in telecommunications



is to get the economies of scale that you need to be cost efficient. If you go in with a large network but you don't have customers, it is very difficult to have low costs. You seemingly can not reach the rate of utilization. Even though Cox is a cable company and passes by many houses and residential customers, I don't think that there has been any demonstration here as a telephone company it has a economies of scale that's anywhere near what Verizon has...it runs contrary to all of the analysis that the FCC has put forth and it runs contrary to common sense."

Id. at pp. 219, 220. Fourth, Dr. Ankum re-emphasized that the existence of a TELRIC based price floor combined with a competitor like Cox actually creates a proper incentive structure for Verizon in connection with its cost studies. That is, Verizon knows that "if it doesn't perform the TELRIC studies with enough accuracy in it, with enough attention to detail and if these costs come out too high, that it may bump up against a competitive situation against Cox and it may lose out. So it knows that it must try find exactly what its true costs are." Id. at 194. Finally, Dr. Ankum pointed out that if Cox were able to price below the TELRIC based price floor, there would be an incentive on Verizon to come back to the Commission and demonstrate that its TELRIC costs are too high and that they should be reduced. As a result, by tying the TELRIC methodology in Docket 2681 to the methodology used for Verizon's price floor it becomes a self-policing mechanism. Id. at 162.

**C. The Commission Should Modify the VZ/Division Settlement Agreement to Incorporate the Same Safeguards That Other States Have Adopted.**

Verizon's Alternative Regulation Proposals have been modified in other jurisdictions to protect competition. Before reaching a settlement with the Staff and other parties in New York, Verizon's proposal in that jurisdiction was very much the same as the proposal that the company is presenting in Rhode Island. The Alternative Regulation Plan ultimately approved in New York, however, was modified significantly. Conversent Exh. 3, pp. 22, 23. Most notably, the Alternative Regulation Plan in New York included a cap on the hot-cut NRC of \$35. In the words of the New York Public Service Commission Staff:

The Commission had, in its UNE decision, increased this charge from about \$24 to more than \$185. This increase would have created a serious barrier to those CLECs trying to migrate their customer basis away from Verizon's switches. By reducing the charge in the Plan from \$185 level to \$35, we successfully removed this barrier.

Id., pp. 27, 28.<sup>7</sup> The record evidence in this proceeding is that Verizon is proposing to increase the hot-cut non-recurring charge from about \$42 to \$156. Dec. 11, 2002 Tr., p. 70. Dr. Ankum testified that an increase in hot-cuts from \$42 to \$156 would "impair the development of facilities-based competition and begin to greatly favor the less effective resellers." Nov. 21, 2002 Tr., p. 148.<sup>8</sup> Although Verizon insists that the issue of the hot-cut NRC be disposed of in Docket 2681, the D.C. Circuit Court of Appeals in Sprint v. FCC, rejected an argument made by the FCC that "any price squeeze claim is effectively rebutted by the Commission's finding that UNE rates were cost based." Sprint v. FCC, 274 F.3d 549, 555 (D.C. Cir. 2001). Accordingly, Verizon's repeated claims that the Commission will eventually establish a TELRIC rate for hot-cuts in Docket 2681 does not effectively rebut the concern about a possible price squeeze, because the existence of a TELRIC rate by itself is not sufficient to rebut a price squeeze claim. In other words, if the Commission approves the VZ/Division Settlement Agreement as is, and later this year it approves Verizon's proposed hot-cut rate of \$156, the fact that the \$156 hot-cut rate would be a TELRIC rate is not sufficient to rebut a claim that such a charge would be so excessive that it is likely to result in a price squeeze on CLECs that rely on Verizon to perform hot-cuts.

The New York Public Service Commission also conditioned Verizon's Alternative Price Regulation Plan on an agreement that Verizon continue to offer UNE-P for the life of the Plan even if there was a change in federal law. Dec. 11, 2002 Tr., p. 82. In the instant docket,

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<sup>7</sup> Mr. Ankum's testimony refers to New York Staff Panel Testimony, p. 53 in New York PSC Case 00-C-1945.

Conversent witness Ankum recommended that Verizon's Alternative Regulation Plan in Rhode Island be conditioned on a willingness to continue to provide the same set of UNEs that exist today for the life of the Plan. Conversent Exh. 3, p. 30. If the Commission does not fully adopt Dr. Ankum's recommendation, it should at least modify the VZ/Division Settlement Agreement to include the same safeguard that was adopted in New York, that is an agreement by Verizon to continue to provide UNE-P for the life of the Plan.

### **CONCLUSION**

For the above reasons, Conversent respectfully urges the Commission to either reject the VZ/Division Settlement Agreement in its entirety and keep Verizon subject to a price cap form of regulation, or in the alternative, modify the VZ/Division Settlement Agreement and thereby grant Verizon the pricing flexibility it seeks, subject to the following conditions:

1. Verizon will be granted pricing flexibility for retail intrastate business telecommunications services, subject to a price floor that is equal to the density zone specific UNE rates for the elements that make up the service, plus a mark-up for Verizon's retailing costs as reflected in the wholesale discount;
2. Verizon will cap the hot-cut NRC at \$35 for the life of the Plan;
3. Verizon will offer the same set of UNEs that it is currently offering for the life of the Plan, or in the alternative, will at least continue to provide the UNEs that make up the UNE Platform, on an individual basis and as a combination, for the life of the Plan.

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<sup>8</sup> By this, Dr. Ankum explained that resellers would be "less effective in terms of containing Verizon's market power." Id.

Respectfully submitted,

/s/ Scott Sawyer

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