STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

Re:	Verizon Rhode Island Alternative Regulation Plan	: :	Docket No. 3445

POST-HEARING BRIEF OF COX RHODE ISLAND TELCOM, L.L.C.

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I. INTRODUCTION

Cox Rhode Island Telcom, L.L.C. ("Cox"), through its undersigned counsel, respectfully submits this post-hearing brief in the above-referenced docket. The State of Rhode Island Public Utilities Commission's (the "Commission's") decision regarding Verizon New England Inc. d/b/a Verizon Rhode Island's ("Verizon's") proposed alternative regulation plan could fundamentally alter not only how the Commission regulates Verizon, but also the development and sustainability of local telephone competition in Rhode Island.

Verizon's original alternative regulation plan was strongly opposed by Cox and all other competitors participating in this proceeding.[1] The original plan was subsequently modified by Verizon, after the filing of testimony and the completion of evidentiary hearings, via a two party settlement between the Rhode Island Division of Public Utilities and Carriers (the "Division") and Verizon (hereinafter, as modified, the "Verizon Proposal").[2] The Verizon

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1 See, e.g., Docket No. 3445 - In Re: Verizon Rhode Island Alternative Regulation Plan, Direct Testimony of Cindy Z. Schonhaut on Behalf of Cox Rhode Island Telcom, L.L.C. (Sept. 20, 2002) (hereinafter "Schonhaut Direct Testimony"); Docket No. 3445, Direct Testimony of Dr. August H. Ankum on Behalf of Conversent Communications of Rhode Island, LLC (Sept. 20, 2002) (hereinafter "Ankum Direct Testimony").

2 Verizon filed its settlement proposal on December 6, 2002. A hearing regarding the settlement proposal was held before the Commission on December 11, 2002.

Proposal failed to cure the many significant defects in the original alternative regulation plan, including the fact that the current level of competition in the Rhode Island local exchange market is insufficient to prevent anti-competitive abuses on Verizon's part. Like the initial alternative regulation plan, the Verizon Proposal does "absolutely nothing to establish and sustain competition."[3] The Verizon Proposal is a request for dramatic action by the Commission. As Cox's expert witness, Ms. Cindy Schonhaut, stated: "[s]imply put, Verizon ultimately seeks the ability to raise and lower prices at will."[4] Ms. Schonhaut further explained that providing Verizon "unfettered flexibility to both raise and lower rates likely will establish seriously anti-competitive conditions in the local market."[5]

In seeking the adoption of its proposal, Verizon is asking the Commission to ignore the fact that unbundled network element ("UNE") prices have not yet been set, making it impossible to gauge the level of UNE-based competition. Verizon is also asking the Commission to ignore the fact that the telecommunications marketplace as a whole is in well-documented financial difficulty and in general has been in an escalating state of turmoil. The Verizon Proposal is premature and the Commission should reject it.

Verizon's basic premise regarding the sufficiency of competition in the marketplace is directly contradicted by the unrebutted testimony of Cox's expert witness, Ms. Schonhaut, and by Conversent's witness, Dr. Gus Ankum. For example, Ms. Schonhaut, testified at length that the competitive marketplace is not sufficiently established to protect

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[3] Schonhaut Direct Testimony at 8.

[4] Id.

[5] Id. at 7; see also Docket No. 3445, Surrebuttal Testimony of Cindy Z. Schonhaut on Behalf of Cox Rhode Island Telcom, L.L.C., at 2 (Nov. 8, 2002) (hereinafter "Schonhaut Surrebuttal Testimony").

against predatory pricing and other anti-competitive behaviors by Verizon.[6] The Commission must not lose sight of the negative impact of the Verizon Proposal on the Commission's long standing policies favoring the development of competition. If adopted as proposed, the Verizon Proposal would harm not only existing competitors, such as Cox and Conversent, but also potential competitors. Competition brings many benefits to Rhode Island consumers: lower prices; increased technological innovation; higher quality of service; and the availability of new service offerings.[7] The Commission should not reverse, in one swoop, the strides it has made toward establishing sustainable competition in the State.

Cox sees only one possible benefit in the Verizon Proposal - bridge financing for school and library Internet access. During the hearings in this docket, numerous entities testified as to the value of the school and library programs. Neither Cox nor any other carrier opposed the need to secure a stable, long-term, competitively neutral source of funding for these valuable programs. Cox continues to believe, however, that the library and school program requires a long-term, competitively neutral funding source, one best established by the legislature. Thus, Cox continues to support the establishment of a separate proceeding to address this important issue and Cox remains willing to work with other providers to coordinate legislative resolution of the issue.

The Commission, however, must not view itself as hostage in this proceeding to the schools and library Internet funding issue. The short term immediate need for Internet bridge financing, no matter how worthy the programs being served, should not override consideration of

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[6] Schonhaut Direct Testimony at 5, 9-11, 20-27.

[7] Id. at 5-6.

how the Commission will regulate the dominant local telephone provider in Rhode Island for the near future.

Finally, there is no pressing need for the Commission to act. In most instances, Verizon already possesses the ability to price flexibly and to bundle services attractively for large business customers. In fact, Verizon's witness, Ms. Theresa O'Brien, testified that Verizon believes that it has quite attractive bundled products in the marketplace.[8] The Commission also has numerous options. The Commission can reject the Verizon Proposal outright, propose improvements to it and ask Verizon to accept the new terms and conditions, adopt a price cap plan, or impose traditional rate-of-return regulation on Verizon. In any case, Verizon's rates would remain the same until such time as Verizon filed a new tariff seeking different rates.

If the Commission rejects the Verizon Proposal outright, the Commission could ask Verizon voluntarily to continue the funding subject to refund when a permanent funding mechanism is established. As part of the Verizon Proposal, Verizon agreed to provide limited Internet bridge financing. Should the Commission ultimately adopt the Verizon Proposal as modified to include, among other protections, the revised Total Element Long Run Incremental Cost ("TELRIC") price floor requested by Cox, it is reasonable for the Commission to expect Verizon to continue its commitment regarding Internet bridge financing. Verizon's temporary $3-4 million commitment[9] must be weighed against the multi-millions that it would stand to gain, potentially at the expense of competitors and competition itself, should it be granted virtually unfettered pricing flexibility. The Commission is not obligated to adopt a proposal that

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[8] Tr. at 167, lines 6-10 (Nov. 19, 2002).

[9] Verizon made it abundantly clear that its voluntary obligation would immediately cease on the earlier of a permanent funding source being secured.

neither protects the public interest nor promotes important Commission goals and should not do so in this docket.

Once the single short term benefit of school and library temporary bridge financing is removed, the Verizon Proposal provides little or no public benefit. Verizon has failed to meet its burden of demonstrating that the settlement is fair, reasonable and in the public interest. Accordingly, the Commission should reject the settlement or, at a minimum, add significant protections for local competition such as an appropriate TELRIC price floor.

II. ARGUMENT

A. Verizon's Alternative Regulation Plan Is Premature and Should Not Be Adopted At This Time

The Commission should reject the Verizon Proposal because it is overly broad and premature.[10] Verizon is asking the Commission to ignore the fact that the telecommunications marketplace as a whole has been in an escalating state of turmoil. Current conditions in the telecommunications market are "to say the least, uncertain and, to say the most, dangerously unstable."[11] There have been an incredible number of bankruptcy filings and serious allegations of fraud and criminal corruption at several major telecommunications companies. The ongoing investigations by the U.S. Department of Justice and the SEC, as well as by Congress, are a few examples of the unprecedented upheaval now taking place in the industry.[12] Conversent's witness, Dr. Ankum, testified as to the near "catastrophic decline in market capitalization for the competitive part of the industry"[13] that has placed the competitive

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[10] Schonhaut Direct Testimony at 6.

[11] Id. at 9.

[12] Id.

[13] Docket No. 3445, Surrebuttal Testimony of Dr. August H. Ankum on Behalf of Conversent Communications of Rhode Island, LLC, at 5 (Nov. 8, 2002) (hereinafter "Ankum Surrebuttal Testimony").

telecommunications industry in a severely weakened state. He noted that for every dollar invested in telecommunications competitors, $0.88 invested has been lost.[14]

Additional uncertainty in the marketplace is sure to follow from Verizon's recently granted authorization to provide interLATA services.[15] Given that less than a year has passed since the Federal Communications Commission granted Verizon such authority, the Commission has yet to see whether Verizon will be able to meet the numerous commitments that it made in its Section 271 application.

Great regulatory uncertainty also exists in Rhode Island regarding UNE-based competition. Dr. Ankum, addressing UNE competitors in general, was correct when he testified that "most [competitive local exchange carriers ("CLECs")] live or die by the margins between the wholesale rates for unbundled network elements ("UNEs") and retail rates."[16] The UNE pricing proceeding remains pending. The availability and pricing of UNEs (both recurring and non-recurring charges) will determine the viability of future UNE-based facilities competition both in the residential and business market.[17]

Dr. Ankum further testified that "if Verizon is granted the nearly unrestricted downward retail flexibility it is asking for, Verizon will be able - at will - to increase or decrease the margin available to its dependent competitors."[18] Dr. Ankum continued by noting that the

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[14] Id.

[15] Schonhaut Direct Testimony at 10.

[16] Ankum Direct Testimony at 5.

[17] Schonhaut Surrebuttal Testimony at 5.

[18] Ankum Direct Testimony at 5.

"construction underlying the proposed Alternative Regulation Plan is deeply flawed: to be sure, if granted as proposed, it will 'place the fox in charge of the hen house.'"[19]

Conversent's witness explained that if adopted unmodified, the Verizon Proposal "would allow Verizon to selectively approach customers in wire centers and geographic areas served by CLECS - and regain its lost customers by offering them excessively attractive packages that CLECs cannot match."[20] Dr. Ankum correctly concluded that such a policy would "be rational for Verizon but harmful to the public interest."[21]

This volatile and unpredictable time in the telecommunications market cries out for stability in regulatory policies.[22] It is "exactly the wrong time to implement any public policies that could have any negative impact on competition."[23] Given the highly unstable and uncertain state of the market, and the significant level of flexibility requested by Verizon, the Verizon Proposal will provide little or no benefits to consumers or the local telecommunications market in Rhode Island.[24]

Moreover, there is no pressing need for the Commission to act. As noted above, in most instances, Verizon already possesses the ability to price flexibly and to bundle services attractively for large business customers. In fact, Verizon's witness, Ms. Theresa O'Brien, testified that Verizon believes that it has quite attractive bundled products in the marketplace.[25] Commissioner Gaynor correctly noted that the Commission's first duty should be "do no harm to

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19 Id.

20 Id. at 6.

21 Id.

22 Schonhaut Direct Testimony at 22.

23 Id. at 23.

24 Schonhaut Surrebuttal Testimony at 3.

25 Tr. at 167, lines 6-10 (Nov. 19, 2002).

competition where it exists."[26] For this reason, and the many reasons articulated by Cox in this proceeding, the Commission should not "grant the extreme type of pricing flexibility Verizon seeks" in these highly volatile and unpredictable times.[27] The Verizon Proposal is premature, harmful to competition and not in the public interest. The Commission should therefore reject the Verizon Proposal.

B. Competition In Rhode Island Is Not As Robust As Verizon Would Have the Commission Believe and Is Insufficient to Constrain Anti-Competitive Behavior By Verizon

Verizon's request for virtually unfettered pricing flexibility is premised upon its claim that sufficient competition exists today in the Rhode Island local exchange telecommunications market to prevent Verizon from engaging in predatory pricing, price squeezes and other anti-competitive behavior. The record simply does not support Verizon's contention. Verizon's testimony is replete with numerous attempts to paint an overly optimistic picture of the current status of competition in Rhode Island. This position is out of synch with the present day realities of the marketplace and fails to take into account the fact that Verizon remains the dominant provider with the vast majority of retail lines in the state.[28]

While Verizon's witnesses "set forth grand economic theories about how the ideal market should work, they miss the reality that the telecommunications marketplace is at a crossroads."[29] Verizon seems bent on ignoring the fact that numerous carriers are struggling to survive and face serious financial constraints.[30]

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[26] Tr. at 60, lines 23-24 (Nov. 21, 2002).

[27] Schonhaut Direct Testimony at 11.

[28] Tr. at 269, line 24 (Nov. 19, 2002); Id. at 270, lines 1-2.

[29] Schonhaut Surrebuttal Testimony at 2.

[30] Id. at 3.

The Verizon Proposal is heavily dependent upon the validity and weight to be given to the competitive profile filed by Verizon.[31] The weight to be accorded Verizon's economic witness, Dr. William E. Taylor, is also dependent to some extent upon the validity of the competitive profile. Dr. Taylor, Verizon's primary economic witness, admitted that he relied on the grossly out of date competitive profile in forming his conclusions and opinions regarding the status of competition in Rhode Island.[32] Thus, to the extent the competitive profile does not reflect the current state of competition in Rhode Island, even Dr. Taylor's economic conclusions, which are based heavily thereon, cannot be accepted.

The competitive profile, the data for which was apparently gathered in March 2002,[33] is at best seriously outdated and at worst seriously misleading. It greatly overstates the competition faced by Verizon in Rhode Island today. In fact, the primary Verizon witness sponsoring the competitive profile, Mr. Arthur Silvia, testified that Verizon actively elected not to update the competitive profile on a CLEC specific basis to see who is currently providing services. Verizon's surprising decision to not update the database, particularly in light of its knowledge of the significant downward trend in the competitive marketplace that has occurred since the original profile was prepared, denied the Commission what Cox believes to be particularly relevant information.

In preparing the competitive profile Verizon made no attempt to anticipate which carriers would survive for the multi-year duration of the plan.[34] Verizon's witnesses also did not know the impact of the various Chapter 11 filings by companies listed in the competitive profile

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31 See Tr. at 67, lines 12-16 (Nov. 19, 2002).

32 Id. at 141, lines 10-13.

33 Id. at 175, lines 2-6.

34 Tr. at 163, lines 19-24 (Nov. 20, 2002); Id. at 164, lines 1-5.

and Verizon undertook no investigation to ascertain such information.[35] Had Verizon done so, it would have found that at least eight carriers included in the competitive profile had filed bankruptcy. Verizon also made no attempt to identify carriers who were licensed but not active. Verizon's witness, Mr. Silvia, agreed that being authorized as a carrier does not mean that a carrier actually will engage in the provision of service.[36] Even more troubling, Mr. Silvia testified that Verizon elected to include companies in the competitive profile that Verizon knew had their licenses rescinded.[37] This action alone casts a long shadow on the validity and credibility of the competitive profile filed by Verizon.[38]

The Verizon Proposal therefore lacks essential information relating to the status of competition. Notwithstanding this fact, Verizon requests that the Commission approve an unprecedented multi-year pricing flexibility plan that relies almost exclusively on purportedly robust competition to constrain anti-competitive behavior by the dominant provider. The Commission must look carefully not only at what the competitive profile reflected at the moment in time that it was created, but also at the reality of competition going forward. Mr. Silvia conceded that even assuming the competitive profile was correct at the time it was made it does not reflect future market participation.[39]

Chairman Germani astutely recognized the merits of determining the current and likely ongoing status of competition. He specifically inquired if there was a "way we can get this

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35 Tr. at 186, lines 1-5 (Nov. 19, 2002).

36 Tr. at 169, lines 22-24 (Nov. 20, 2002); Id. at 170, line 1.

37 Tr. at 181, lines 12-17 (Nov. 19, 2002).

38 Cox requests that the Commission carefully review this information, including any updated materials filed as a response to an "on the record" request from the evidentiary hearings.

39 Tr. at 164, lines 2-5 (Nov. 20, 2002).

information on the record."[40] Although the burden was on Verizon to do so, a burden that it failed to meet, at least a partial answer (one that does not look nearly as rosy as Verizon would have the Commission believe) is contained in a proprietary Division Exhibit setting forth the revenue of the remaining competitors and in a Cox Exhibit, which updated the Verizon competitive profile to illustrate just how many carriers have either gone out of business or are no longer major players. The level of competition claimed by Verizon simply does not exist.

The dramatic changes in the status of so many competitors listed in the competitive profile since Verizon filed its alternative regulation plan serves only to further illustrate deterioration in the competitive marketplace. Many smaller competitors, both existing and potential, have been eliminated from the market by bankruptcy or shrinking business plans. For example, in Rhode Island, at least two companies that once provided competitive services have exited the market: CTC and Network Plus.[41] In reality, as the Division's witness testified, of the thirty-six competitors identified in the Verizon Competitive Profile, only about six CLECs have more than 10,000 access lines or significant market penetration.[42]

It follows that the vast majority of the competitors cited in Verizon's competitive profile have relatively modest operations, as shown by their intrastate revenues and the fact that they are either private companies or have stock prices under one dollar. While the revenue information is considered proprietary and was not made available to Cox, the Division did make it available to the Commission.[43] Cox urges the Commission to review the data provided by the Division. Moreover, as Dr. Ankum correctly pointed out, Verizon's assertions regarding

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[40] Tr. at 225, lines 4-5 (Nov. 19, 2002).

[41] Schonhaut Surrebuttal Testimony at 5.

[42] Tr. at 106, lines 4-7 (Nov. 20, 2002).

[43] Tr. at 213, lines 11-15 (Nov. 19, 2002).

competition are not consistent with the general understanding in the industry about the status of CLECs. Verizon's claims of booming competition are "at odds with reports in media and financial papers that describe a very different picture."[44] Dr. Ankum believes that Verizon's "representations are unwarranted, and, in fact dangerous."[45] He noted that "contrary to [Verizon's] claims, all is not well with the CLEC industry."[46]

Cox is not arguing that facilities-based competition in Rhode Island has not made some progress. It has, primarily in residential areas, based on the Cox's operations and efforts. Even there, Verizon's witnesses attempt to exaggerate the extent of Cox's presence in the local exchange market.[47] For example, Verizon seeks to make much of a few discreet competitive wins by Cox in the municipal market. It is difficult to comprehend why these few examples are significant when, as Verizon admits, there are over thirty-nine municipal entities in the state.

Verizon's witness also testified in an uncharacteristically imprecise manner that Cox has a near ubiquitous presence in the state. Yet when questioned, Dr. Taylor quickly qualified his response by stating that he was not privy to exactly where the Cox network was located. In fact, he acknowledged that Cox could not reach somewhere between 25% and 10% of residential customers. Dr. Taylor also sought to clarify his earlier broad statements about Cox's ubiquity to completely reach Rhode Island businesses.[48] By his own admission, Dr. Taylor's claims about Cox's ubiquitous network are overstated. As Dr. Taylor ultimately

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44 Ankum Direct Testimony at 32.

45 Id.

46 Id. at 36.

47 Schonhaut Surrebuttal Testimony at 6-7.

48 Tr. at 197, lines 18-23 (Nov. 20, 2002).

conceded, in particular for business areas, Cox's network is not ubiquitous.[49] Cox does not have a ubiquitous network especially when compared to the size and scope of Verizon's network.[50] Moreover, even if Cox's transport network passes by a building, a build-out may still be necessary to reach potential customers. Thus, large sums of capital and construction time are necessary for Cox to continue to expand its network. As Dr. Taylor acknowledged, every company has a limited supply of capital for constructing facilities and specifically stated, "capital is in short supply."[51]

Dr. Taylor vainly attempted to bolster Verizon's overly rosy view of competition by resorting to economic theory. Dr. Taylor readily conceded that to some extent, if the Rhode Island-specific information he received from Verizon was incorrect then his opinions based on the data would be wrong as well.[52] Dr. Taylor conducted no formal due diligence of the Verizon competitive profile information.[53] Economic theory cannot change reality. Dr. Taylor tried to "window dress" the surprising number of failing competitors by claiming that in pure economic theory a competitor exiting the market leaves behind those facilities it has put in place which theoretically can and will be used by another competitor. Whether this, in fact, will be the case remains to be seen in Rhode Island.

Cox's witness, Ms. Schonhaut, testified why in reality this might not happen.[54] First, the bankruptcy process itself may tie up the assets for a considerable period of time.

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49 Tr. at 268, lines 2-9 (Nov. 21, 2002).

50 Schonhaut Surrebuttal Testimony at 6.

51 Tr. at 184, lines 19-24 (Nov. 20, 2002).

52 Tr. at 139, lines 22-24 (Nov. 19, 2002); Id. at 140, lines 1-4.

53 Id. at 140, lines 17-22.

54 Schonhaut Surrebuttal Testimony at 5.

Verizon's panel acknowledged that they were not experts on bankruptcy laws or process.[55] On cross-examination, Dr. Taylor agreed that it was possible that a delay in the bankruptcy proceedings could cause a facility held by the bankrupt estate to go dark for a considerable period of time.[56] Thus, any "speculation" on the part of Verizon's witnesses regarding either the timing or how the assets of a bankrupt entity will be operated or sold is just that, mere speculation. In fact, Ms. O'Brien conceded that no Verizon witness could predict the outcome of any entity involved in a Chapter 11 bankruptcy proceeding.[57] In addition, Dr. Taylor also agreed that it was possible that facilities installed in the past to meet the needs and specifications of one carrier may not be in a location or along a route that any successor or potential buyer of those facilities would currently need.[58] While in theory abandoned assets may work to provide competition in the long-term, during the short-term, such assets may not be available as a result of the bankruptcy process, may represent out-of-date technology, may duplicate existing capacity, and/or may not be available. Under these conditions, such assets will provide little or no constraint on Verizon's behavior.

Competition in Rhode Island may be characterized as "broad" but not "deep."[59] Despite Verizon's efforts to convince the Commission otherwise, the current level of competition is not sufficient to curtail Verizon's market power.[60] It is also not sufficient to

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55 Tr. at 280, lines 5-13 (Nov. 19, 2002).

56 Tr. at 182, lines 7-17 (Nov. 20, 2002).

57 Tr. at 281, lines 1-5 (Nov. 19, 2002).

58 Tr. at 181, lines 23-24 (Nov. 20, 2002); Id. at 182, lines 1-6.

59 Schonhaut Direct Testimony at 20.

60 Ankum Direct Testimony at 11.

curtail Verizon's ability to engage in anti-competitive pricing strategies.[61] Accordingly, the Commission should reject the Verizon Proposal.

C. The Commission Should Not Believe Verizon's Claims That Resale Is a Cure All

When Verizon's witnesses were pressed about the fragile state of competition, they repeated their apparent mantra that competition exists because resale is available.[62] Verizon's belief is misplaced and quite curious given Verizon's concession that facilities-based competition is widely considered the most potent form of competition in the local telephone industry.[63] Verizon also agreed that resale was an inferior competitive option since it does not involve competition for the whole service but only the packaging of the retail component.[64] The reseller is not able to "compete for the whole nine yards."[65]

Verizon would have the Commission adopt the Verizon Proposal even though in many circumstances resale would be the only remaining competitive option. Such an option is not one likely to be utilized. Dr. Taylor claimed that an efficient competitor could engage in resale. When pressed to identify such a competitor in the real world, he conceded that for local services, MCI, ATT or any other major telecommunications provider has been unable to fit within that category.[66] Once again, theory conflicts with reality. In the actual Rhode Island market, the resale method of entry in the local exchange market has proven impossible because of thin margins. Moreover, to the extent that the Commission is looking for competition to

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61 Id. at 14.

62 See, e.g., Tr. at 233, lines 9-24 (Nov. 20, 2002); Id. at 234, lines 1-10.

63 Tr. at 147, lines 13-24 (Nov. 19, 2002).

64 Id.

65 Id. at 150, lines 10-11.

66 Tr. at 198, lines 13-24 (Nov. 20, 2002).

constrain Verizon's competitive behavior, resale cannot do so. A reseller, whose wholesale rates are pegged to Verizon's retail prices, by definition puts no pressure on Verizon's pricing. Dr. Ankum's testimony illustrates that resale is not effective in constraining Verizon's pricing.[67]

Resale is also not a viable alternative for carriers whose business models were based on other entry strategies. Dr. Ankum made it very clear why, despite Verizon's theoretical claims, facilities-based or UNE-based competitors cannot slide back to resale. Resale is therefore not the cure or answer. Facilities-based providers (including UNE-based providers) have expended considerable expense in engineering their current facilities based on certain network design. Competitors have expended considerable labor to make facilities operational and invested in specific operations support systems. To engage in large scale resale would require significant modifications and redesign of their networks as well as their business models. In reality, it simply is not practical. Although refusing to quantify the amount, Verizon's witness conceded that the creation of an appropriate resale operation and support system would cost money.[68] The reason the companies took on the additional risk inherent in facilities-based competition was their belief that pursuing resale as a business strategy would be unprofitable. In short, to force a facilities-based provider back to resale would require the facilities-based provider to leave so much investment behind that it would likely be pushed right out of the market.[69] Despite Verizon's theoretical and wishful thinking, the availability of resale can not cure the many defects evident in the Verizon Proposal.

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[67] Tr. at 146, lines 2-24 (Nov. 21, 2002).

[68] Tr. at 158, lines 1-8 (Nov. 20, 2002).

[69] Tr. at 203-204 (Nov. 21, 2002).

D. The Commission Has Ample Authority to Reject the Settlement, Impose Modifications or Regulate Verizon In a Different Manner

Given that the Verizon Proposal does not take into account the concerns of all the parties in this proceeding, including Cox, and does not serve the important public interest of fostering competition, the Commission should not be forced to accept such settlement by virtue of Verizon's claim that the current price regulation plan and Verizon's commitment for funding Internet access for schools and libraries expired on December 31, 2002. The Commission possesses general authority to accept Verizon's Proposal, to modify Verizon's Proposal as the Commission deems necessary or to adopt a different regulatory plan, such as a rate-of-return or rate cap regulation plan, in order to protect the public interest and to promote the Commission's goals of a competitive local exchange telecommunications market in Rhode Island.

Even assuming the correctness of Verizon's assertions that the current Price Regulation Successor Plan expired on December 31, 2002, the Commission retains adequate jurisdiction over Verizon absent an existing regulation plan. Prior to the Price Regulation Successor Plan, the Price Regulation Plan and the Price Regulation Trial, Verizon operated under traditional rate-of-return regulation.[70] In 1989, the Commission altered the regulatory regime by approving a stipulation which permitted Verizon (then New England Telephone Company) to share in profits generated through efficiency and cost reductions.[71] The Commission could reinstate rate-of-return regulation, which generally refers to the "percentage of net profit which a telephone company is authorized (by a regulatory commission) to earn on rate base,"[72] for

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[70] Docket No. 1997 - In Re: New England Telephone Company, Order No. 14129, Report and Order, 141 PUR4th 115 (Feb. 2, 1993).

[71] Id.

[72] Newton's Telecom Dictionary, 16th Edition (2000).

Verizon as a default regulation plan. Rate-of-return regulation would provide the Commission satisfactory jurisdiction over Verizon to protect the public interest.[73]

However, regardless of whether rate-or-return regulation would be the default mechanism absent the Price Regulation Successor Plan, the Commission possesses ample authority to institute the type of price regulation plan that it believes, based on the record in this proceeding, will adequately protect the public interest and the Commission's goals related to competition in the telecommunications market in Rhode Island.

Based on the arguments presented herein and throughout the proceeding by Cox and Conversent, it is clear that Verizon's Proposal does not promote the Commission's goals and protect the public interest. Thus, Cox requests that the Commission reject Verizon's Proposal.

E. Additional Safeguards Must Be Included If the Commission Adopts Incentive Regulation for Verizon

If the Commission should determine that an incentive regulation plan similar to Verizon's Proposal is appropriate at this time, additional safeguards must be included. The most critical protection is the establishment of an appropriate price floor that would prevent Verizon from utilizing its dominant position to target specific competitors.

The Division's witness, Mr. Thomas Weiss, testified as to the need for a price floor which would prevent a price squeeze that would ultimately force a CLEC out of business.[74] Unfortunately, Mr. Weiss fails to set the Division's proposed price floor high enough to be effective. The Long Run Incremental Cost ("LRIC") (also described as TSLRIC) price floor proposed by the Division is slightly better than no floor, but in reality provides little or no new

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[73] The Rhode Island Supreme Court has defined "rate of return" as "the percentage by which the rate base is multiplied to provide a figure that allows a utility to collect revenues sufficient to pay operating expenses and attract investment." See Providence Gas Co. v. Burman, 119 R.I. 78, 376 A.2d 687 (1977).

[74] Tr. at 66, lines 4-8 (Nov. 20, 2002); Id. at 15, lines 19-24; Id. at 16, lines 1-12.

protection from that which exists under prevailing anti-trust standards. The LRIC floor supported by the Division is simply inadequate. The LRIC floor proposed in the Verizon Proposal would do nothing to prevent the price squeeze that would stifle future competitors' business development plans.[75] The Division's witness conceded that the standard will not protect facilities-based providers that utilize UNEs. The inadequacy of the Division's standard was apparent in the following question by Conversent's counsel:

> "But if they price below the cost of the UNEs [and above the TSLRIC price floor proposed by the Division] that Conversent used to provide retail service, how would Conversent compete with Verizon?
>
> Answer: It may have some difficulty in that regard . . . .[76]

Despite Mr. Weiss' use of understatement, the fact is that Conversent and other UNE-based carriers would not just have difficulty, they would find it impossible to compete. In fact, when Commissioner Gaynor requested that Mr. Weiss elaborate, Mr. Weiss conceded that while he thought it unlikely, it is possible that Verizon could drive out UNE competitors and still price above the Division's floor.[77] Those carriers facing a risk of extinction can take little comfort in the fact that Mr. Weiss does not view it as a highly likely event.

Mr. Weiss also acknowledged that the TSLRIC price floor proposed by the Division is more administratively difficult to enforce than a TELRIC standard.[78] Unlike the TELRIC rates that will be fully litigated and readily available, TSLRIC rates would require the completion of new studies and agreement on the appropriate methodology. Based on the difficulty of establishing agreement on the methodology in the current TELRIC docket, a task

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[75] Ankum Surrebuttal Testimony at 15.

[76] Tr. at 75, lines 22-24 (Nov. 20, 2002); Id. at 76, lines 1-6.

[77] Id. at 81, lines 20-24.

[78] Id. at 88, lines 3-10.

which has taken almost a year, the Commission must surely recognize that this would be a huge challenge. Dr. Ankum testified that "as to what LRIC means you have a much larger number of different ideas and costs studies floating out there and if you were to ask me is there a uniform standard for what LRIC means, I would say probably not."[79] Moreover, as Commissioner Gaynor properly noted and the Division witness agreed, to arrive at TSLRIC prices new cost studies may need to be created, all of which would take "lots of time."[80] She correctly noted that using TELRIC would not require the Commission to "reinvent the wheel."[81] The TSLRIC price floor proposed by the Division should be upgraded to the TELRIC-based UNE floor proposed by Conversent's witness, Dr. Ankum.

Dr. Ankum's unrebutted testimony demonstrates how Verizon could engage in predatory pricing under the Division's price floor that would drive UNE-based competitors from the market. To prevent such a price squeeze, Dr. Ankum elaborated in great detail on the appropriate and correct price floor in his testimony.[82] The price floor for all services should include the following two cost components: 1) the imputed costs of all the UNEs used to provide the service; and 2) a measure of minimum retail related costs. The imputed UNE costs would be calculated by multiplying the quantity of the UNEs used to provide the service times the UNE TELRIC prices. Also included should be some recognition of the non-recurring charges to order UNEs. An appropriate proxy for the minimum retail related costs could be established by using the Commission-approved percentage for resale discounts.[83] Such a price

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79 Tr. at 154, lines 5-9 (Nov. 21, 2002).

80 Tr. at 89, lines 1-18 (Nov. 20, 2002).

81 Id. at 89, lines 19-24.

82 Ankum Direct Testimony at 7.

83 Id.

floor would be easily verifiable and, more importantly, easily enforceable. The Commission should adopt Dr. Ankum's price floor.

The higher price floor should not be problematic if, as Verizon's witnesses seem to believe, Verizon will never lower its retails prices so that dependent CLECs will be in a price squeeze. If this is true, Verizon should have no objection to a price floor based on UNE prices.[84] Dr. Taylor testified that "price floors aren't as important as everyone will tell you, that they don't really come in all that frequently."[85] It is his view that Verizon has no economic incentive to engage in a price squeeze since such an action is likely to be unsuccessful. However, Dr. Taylor also agreed that he is not consulted by Verizon each time Verizon sets prices.[86] The fact that Verizon might not ultimately make money from its pricing tactics provides cold comfort for competitors faced with anti-competitive Verizon pricing activity. Floors are critical protections, even if they are never in fact triggered. Their mere existence serves to constrain anti-competitive behavior.

Price squeezing behavior is not unheard of in the industry. In fact, Dr. Taylor admitted that he knew of allegations of Verizon engaging in a price squeeze. Verizon's witness also acknowledged the possibility that Verizon could elect to engage in an unsuccessful price squeeze.[87] While such an activity might not ultimately be profitable (and therefore not fit the technical definition of a successful price squeeze), it could have a devastating impact on specific competitors. In response to questions from Commissioner Gaynor, Dr. Taylor acknowledged that if Verizon were to engage in a price squeeze, a competitor may be unable to recover its

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84 Ankum Surrebuttal Testimony at 14.

85 Tr. at 65, lines 6-8 (Nov. 21, 2002).

86 Id. at 109, lines 13-20.

87 Tr. at 193, lines 19-24 (Nov. 20, 2002).

investment and sunk costs and that in the short-term the individual competitor could be harmed.[88]

The Commission appeared troubled by the fact that Cox might, in some instances be able to price below a Verizon TELRIC price floor. The Commission should not be concerned. As a new entrant, Cox faces many other costs not borne by Verizon. Cox might only benefit in those areas where it has ubiquitous facilities, which is certainly not in the business market. In fact, Cox may need to or elect to utilize UNEs in those areas in which it lacks facilities, thus making Cox subject to the UNE TELRIC-based price floor. In such a circumstance, Cox would have no advantage over Verizon or other UNE facilities-based providers. In addition, should the Commission wish to encourage not only those current players in the residential market but future players, it must have a TELRIC floor. Because there are no current or potential competitors in the residential market with widespread wireline networks, any additional residential competition in Rhode Island is likely to occur, at least initially, only on a UNE basis. If Verizon is allowed to price at a TSLRIC floor that is below the sum of the UNE rates, no new residential competitors are likely and no new sources of competition will develop.

The risk that Cox could somehow take advantage of a TELRIC floor is also minimized by the fact that for large customers Verizon already has flexibility via individual case basis pricing.[89] Moreover, Dr. Ankum testified that Verizon retains the most experience, the largest network, the greatest buying power and leverage on its switch vendors, and all the advantages of incumbency.[90] It is not very plausible that other carriers will have a lower cost.

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88 Tr. at 106-108 (Nov. 21, 2002).

89 Id. at 218, lines 10-17.

90 Id. at 219, lines 1-10.

It is true that where Cox has facilities, it might be able to put pressure on the incumbent.[91] It is unlikely that the pressure will challenge the dominant status of Verizon. At a minimum, it takes time for a competitor to gain market share. The amount of time will vary based on many factors.[92] Even if Cox is widely successful beyond all reasonable expectations, for the two or three year life of the plan, Cox will not become the dominant carrier. It has taken over six years for all competitors to obtain approximately twenty percent of the market.

A TELRIC floor also provides the proper incentives to Verizon. If TELRIC is used, Verizon knows that the TELRIC rate is going to be used to determine its own price floor. So if Verizon attempts to increase the TELRIC rate artificially, it knows that its own price floor will be higher.[93] This becomes an effective self-policing mechanism.[94] Dr. Ankum correctly pointed out that the threat of Cox as a competitor provides even greater incentive to Verizon to perform its TELRIC studies with greater accuracy and attention to detail and that "if these costs come out too high, that it may bump up against a competitive situation against Cox and that it may lose out."[95] If using a TELRIC measure Verizon cannot meet the price that Cox is setting, then "Verizon needs to face the situation and say [for] that particular customer or for those particular groups of customers, I'm just not the efficient provider and I think that TELRIC is indicative of that."[96] If TELRIC is adequately set, it should provide for efficient competition on the basis of the most efficient costs.[97] The Commission should implement an appropriate price

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91 Tr. at 96, lines 4-13 (Nov. 20, 2002).

92 Id. at 190, lines 9-19.

93 Tr. at 156, lines 20-24 (Nov. 21, 2002); Id. at 157, lines 1-5.

94 Id. at 163, lines 10-13.

95 Id. at 195, lines 1-10.

96 Id. at 198, lines 12-16.

97 Id. at 199, lines 1-9.

floor to prevent Verizon from engaging in a price squeeze. The record is clear that the TSLRIC floor is inadequate and the TELRIC-based floor proposed by Dr. Ankum should be adopted.

Should the Commission elect to adopt a modified alternative regulation plan for Verizon, the Commission should make it clear that the burden of proof remains with Verizon. Should any competitor submit what appears to be a valid challenge to a rate proposed by Verizon, automatic suspension of the rate should occur while that rate is investigated. Verizon appears to have taken the position that should an incentive regulatory plan be put in place that the burden to support certain tariff filings is removed from Verizon. It is unclear from a line of questioning by Commissioner Gaynor whether agreement on the burden of proof was reached. Verizon appeared at times to argue that the burden is on the competitor seeking to challenge the filing to demonstrate that the filing was not in compliance.[98] If a version of the Verizon Proposal is adopted, the Commission should clarify that in the event a competitor challenges a tariff filing by Verizon the burden of proof remains on Verizon to demonstrate that the rate is in full compliance with the adopted plan and applicable law. There should be no confusion on this point.

Finally, any modified Verizon Proposal should continue to include the bridge funding for school and library Internet access. Given the liberal pricing flexibility that would be conferred upon Verizon even under this modified proposal, it is reasonable for the Commission to expect Verizon to continue this commitment. Verizon's temporary $3-4 million commitment must be weighed against the millions it stands to gain under the modified proposal even with the TELRIC floor. The only way Verizon's Proposal can meet all of the Commission's goals and protect the public interest is if all of the above-referenced items are included in the final plan.

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[98] Tr. at 263, lines 23-24 (Nov. 19, 2002); Id. at 264, lines 1-6.

F. Internet Funding for Schools and Libraries Must Not Drive Policy In Determining an Appropriate Alternative Regulation Plan for the Dominant Telephone Provider

The only real benefit provided by the Division's settlement with Verizon and the only true value in the Verizon Proposal was the agreement that Verizon would provide temporary funding or bridge financing for school and library Internet access for a few months. As noted above, numerous entities testified as to the value of the school and library programs. Neither Cox nor any other carrier opposed the need to secure a stable long term competitively neutral source of funding for these valuable programs. It is not in the public interest, however, to allow the need for bridge financing for these program to control how the Commission will regulate the dominant local telephone provider for the near future. Cox continues to believe that the library and school Internet access programs are important enough to require a separate proceeding or forum that will result in the creation of a long-term, competitively neutral funding source, one best established by the legislature.[99] Cox has consistently supported school and library Internet access programs. Cox remains willing to work with the Division, the Commission, and all other providers to coordinate legislative resolution of this issue.

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[99] Schonhaut Direct Testimony at 33.

III. CONCLUSION

For the reasons set forth above, the Verizon Proposal is neither fair, reasonable nor in the public interest and it should be denied by the Commission. In the alternative, should the Commission wish to accept the Verizon Proposal significant additional protections for competition, as discussed above, must be included to protect competition in the local telecommunications market in Rhode Island.

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Respectfully submitted,

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