

BEFORE THE STATE OF RHODE ISLAND AND
PROVIDENCE PLANTATIONS
PUBLIC UTILITIES COMMISSION

TESTIMONY OF CINDY Z. SCHONHAUT

Prepared on behalf of Cox Rhode Island Telcom, L.L.C.

d/b/a/ Cox Communications

Docket No. 3445

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1 **I. INTRODUCTION**

2

3 Q. Please state your name, business address and position.

4

5 A. My name is Cindy Z. Schonhaut. My business address is 1020 Fifteenth
6 Street, Suite 33C, Denver, Colorado, 80202. I am an independent
7 consultant to competitive telecommunications companies.

8

9 Q. Please describe your professional experience and educational
10 background.

11

12 A. I have twenty-two years experience in the telecommunications industry,
13 half with the Federal Communications Commission ("FCC") and half with
14 providers of competitive local services. Currently, I serve as a consultant
15 to competitive telecommunications companies.

16

17 Previously, I was Executive Vice President of Government and External
18 Affairs at ICG Communications, where I had responsibility for the
19 company's federal, state and local regulatory, legislative and legal
20 positions and initiatives. I was with ICG for five years, during which time I
21 was promoted from Vice President to Executive Vice President, reporting
22 directly to the Chief Executive Officer. I also was responsible for the
23 company's efforts in implementing the Telecommunications Act of 1996

1 and negotiating interconnection agreements with incumbent local
2 exchange carriers pursuant to that Act.

3

4 Prior to my work at ICG, I served as an attorney for MFS Communications
5 Company, Inc., (formerly known as Metropolitan Fiber Systems and
6 acquired by WorldCom after I left to join ICG). At MFS, I was Vice
7 President of Regulatory Affairs, based in Washington, D.C. with
8 responsibility for federal, state, and local regulatory and legislative
9 matters. I also represented MFS in activities before Congress leading to
10 the passage of the Telecommunications Act of 1996.

11

12 I began my career in telecommunications upon graduation from law school
13 in 1980, joining the FCC as an attorney. In various positions at the FCC, I
14 was assigned to a wide range of domestic telephony matters including:
15 implementation of the divestiture of the former Bell System in 1984, the
16 creation and subsequent reform of access charges, jurisdictional
17 separations and related accounting policies, the introduction of long
18 distance competition, and the early stages of the implementation of
19 competition in the interstate access and local service markets. In addition,
20 I served as the Federal government's liaison to all state regulatory
21 agencies and represented the Federal government on telecommunications
22 matters before the National Association of Regulatory Utility
23 Commissioners ("NARUC"). I also served as the Legal Advisor on

1 telephony issues for Commissioner Andrew C. Barrett. In that position,
2 my experience included advising the Commissioner in cases involving
3 wireless services, spectrum policies and network reliability, among many
4 other matters.

5
6 During my work for competitive telecommunications companies I served
7 as a member of the Board of Directors of the Association for Local
8 Telecommunications Services (“ALTS”) for ten years and the Board of
9 Directors of the Competitive Telecommunications Association (“CompTel”)
10 for three years. In addition, I served on the Executive Committee of ALTS
11 for two years and was elected to a term as Vice Chairman of CompTel in
12 February 1998.

13
14 I have a *Juris Doctor* degree, *cum laude*, from the University of Miami
15 School of Law in Coral Gables, Florida, where I served as an editor of the
16 Law Review. Previously, I received a *Bachelor of Arts* degree in social
17 work from Syracuse University in Syracuse, New York.

18
19 Q. Have you testified previously before the Rhode Island Public Utilities
20 Commission (“Commission”)?

21
22 A. No.

23

1 Q. Do you have experience testifying before other telecommunications
2 policymaking bodies?

3

4 A. Yes. At various times, I testified on behalf of MFS and ICG before
5 regulatory agencies in the following states: Alabama, California, Colorado,
6 Connecticut, Florida, Georgia, Illinois, Indiana, Kentucky, Maryland, Missouri,
7 Nebraska, North Carolina, Ohio, Pennsylvania, Tennessee and Texas. In
8 addition, I testified on behalf of competitive providers as well as on behalf of
9 the trade associations ALTS and CompTel, before the United States House of
10 Representatives, Subcommittee on Telecommunications, and the following
11 state legislatures: Colorado, Florida, Texas, and the City Council of the District
12 of Columbia (which acts as a state legislature for telecommunications
13 policies).

14

15 Q. What is Cox's interest in this case?

16

17 A. As a full-service, primarily facilities-based provider of residential and
18 business telecommunications services in Rhode Island, Cox has a strong
19 interest in the outcome of proceedings that will consider what type of price
20 regulation Verizon New England Inc., d/b/a/ Verizon Rhode Island
21 (Verizon) will be subject to in Rhode Island. Cox is a competitor with
22 Verizon for some - but certainly not all - services encompassed in
23 Verizon's Plan. Without question, Cox like all other telephone service

1 providers in the state has a direct financial interest in the outcome of this
2 proceeding. Cox has invested significantly in the future of
3 telecommunications in Rhode Island and cares about the State's
4 telecommunications policies. Cox believes that this proceeding raises
5 fundamental policy issues about the future of the competition in Rhode
6 Island.

7
8 Verizon seeks to make much of Cox's competitive presence in Rhode
9 Island but to serve Verizon's short-term interests and goals, Verizon
10 presents an incomplete picture of Cox's current situation in Rhode Island.
11 Contrary to Verizon's statements, Cox's presence in the residential service
12 market segment may appear broad, but it cannot be considered deep.
13 Even assuming as true Verizon's estimate that Cox has an almost
14 statewide presence in the residential market, Cox's participation in that
15 market is not yet sufficient to create the critical mass necessary to protect
16 against predatory pricing and other anti-competitive behaviors by Verizon.
17 Moreover, Cox's presence in the business market in Rhode Island is
18 nascent, since it initially sought to serve residential customers and only
19 recently has begun to expand its presence to reach metropolitan areas
20 and office parks where business customers are located.

21
22 Although this docket deals directly with Verizon's rates, the Commission
23 must not lose sight of the impact of Verizon's proposal on competition, not

1 just by Cox, but by other existing and potential competitors. Competition
2 brings many benefits to the public: lower prices, increased technological
3 innovation, higher quality of service, improved customer service and the
4 availability of new service offerings. Those very public interest benefits
5 should be among the guiding principles for the Commission when
6 reviewing Verizon’s proposal. Unfortunately, unless modified by the
7 Commission, some parts of Verizon’s Plan threaten the development and
8 sustainability of local competition in Rhode Island.

9

10 **II. PURPOSE OF TESTIMONY AND EXECUTIVE SUMMARY**

11

12 Q. What is the purpose of your testimony?

13

14 A. The purpose of my testimony is to explain why the proposal by Verizon for
15 essentially unlimited pricing flexibility for local rates in Rhode Island
16 (“Alternative Regulation Plan” or “Plan”) is overly broad and premature. I
17 will address these matters in Section III of my testimony. In that Section, I
18 also will address Verizon’s arguments and testimony filed in favor of the
19 Plan. In Section IV, I will explain why the Commission should defer to
20 another proceeding consideration of any changes to the current funding
21 mechanism for Internet access for Rhode Island K through 12 schools and
22 libraries.

23

1 Q. With respect to the pricing flexibility provisions of the Plan, what do you
2 mean by “overly broad”?

3

4 A. Verizon seeks complete and immediate pricing flexibility for all business and
5 new services. Such unfettered flexibility to both raise and lower rates likely
6 will establish seriously anti-competitive conditions in the local market. In
7 addition, Verizon proposes that it have complete pricing discretion for usage
8 insensitive residential services after two years and limited pricing flexibility for
9 such rates within that initial two-year period. For usage sensitive residential
10 rates, Verizon proposes that it cap rates at current levels for two years, after
11 which time it seeks complete pricing flexibility.

12

13 Verizon also proposes that, with Commission approval, it be permitted to
14 make rate changes due to exogenous events. Verizon proposes, however,
15 that rate changes due to exogenous events be limited to no more than \$2.5
16 million annually, with a limited carry-over provision and a special rule for
17 changes in state or local taxes.

18

19 Q. How would adoption of these proposals harm Rhode Island consumers and
20 thwart competition?

21

22 A. While testimony supporting Verizon’s proposal goes into great detail about
23 current market restraints on Verizon’s ability to raise prices, it does not

1 address the potential for predatory pricing, which anticipates both price
2 decreases and increases. Moreover, Verizon's proposal and supporting
3 documents do not address the issue of anti-competitive pricing through
4 bundling and the "creation" of new services through repackaging for which
5 complete pricing flexibility would be implemented immediately. In addition,
6 on its face, Verizon's plan would allow geographic rate deaveraging for local
7 service in Rhode Island. In fact, Verizon's supporting testimony seems to
8 suggest that such deaveraging would be a good idea. Geographic
9 deaveraging based on varying cost characteristics may sound good in a
10 purely academic or theoretical context, but would have disastrous
11 consequences for consumers in Rhode Island. I address these issues in
12 greater detail below.

13

14 Most importantly, Verizon's proposal would do absolutely nothing to establish
15 and sustain competition. Simply put, Verizon ultimately seeks the ability to
16 raise and lower prices at will. The Plan includes a few detours and caveats,
17 but there can be no doubt that Verizon seeks an end to the regulation of the
18 prices it charges for local services in Rhode Island. While Dr. Taylor explains
19 at great length why Verizon needs (and has earned) such deregulation,
20 nowhere does Verizon's filing address the affect such extreme deregulation
21 would have on existing competition and on the ability of existing competitors
22 and new entrants to compete in the future. Moreover, with the Commission's
23 proceeding on UNE pricing still open, the future of UNE-based competition,

1 one of only three ways to compete with Verizon, is uncertain. In this
2 unpredictable environment, and in light of the Commission's preeminent goal
3 of establishing sustainable local competition in Rhode Island, any major
4 policy change must help achieve that goal or, at the very least, must not
5 undermine that goal. Although it tries to prove local competition is thriving in
6 Rhode Island and that competition is sure to grow, Verizon makes no attempt
7 to explain how its proposal would keep competition alive and well in Rhode
8 Island.

9

10 Q. Regarding the Plan's pricing flexibility provisions what do you mean by
11 "premature"?

12

13 A. Current conditions in the telecommunications market are, to say the least,
14 uncertain and, to say the most, dangerously unstable. The recent
15 bankruptcies of major telecommunications companies, including Global
16 Crossing and MCI/WorldCom, the serious troubles facing Qwest, the
17 allegations of fraud and criminal corruption at several other major
18 telecommunications companies, and ongoing investigations by the U.S.
19 Department of Justice and the Securities and Exchange Commission, as well
20 as by Congress, are a few examples of the unprecedented upheaval now
21 taking place in the industry.

22

1 Additional marketplace uncertainty in Rhode Island will result from Verizon's
2 recently granted authorization to provide interLATA services (FCC Order
3 No. 02-63, Docket No. CC 01-324, released February 22, 2002.) This huge
4 change in a long-standing market policy may well create new market
5 conditions for local service that cannot be predicted with any reasonable
6 degree of accuracy. The Commission has yet to see whether Verizon will be
7 able to live up to the many promises inherent in its Section 271 application or
8 will engage in backsliding. In addition, the Commission has not yet had
9 sufficient time and opportunity to monitor Verizon's compliance with the
10 performance and service quality measures adopted in Rhode Island Docket
11 No. 3195

12

13 In the seven months since Verizon's Section 271 approval was granted,
14 conditions in the local service market have continued to deteriorate. Today,
15 financial conditions in the telecommunications market (affecting both
16 incumbents and competitors) as well as general national economic
17 conditions have slowed growth so significantly that seven months is too short
18 a time to assess the impact of Verizon's entry into the Rhode Island long
19 distance market. Most importantly, Verizon's supporting testimony relies to a
20 great extent on Verizon's expectations of growth in local service competition.
21 While at one time such growth may have been reasonably predictable, given
22 the drastic changes in the telecommunications industry over the last two
23 years, and the number of companies that have been forced to exit the market

1 through bankruptcies, restructurings or other means, the Commission would
2 be well served to scrutinize the Plan carefully, based as it is on overly
3 optimistic predictions and unrealistic expectations of competitive growth.

4

5 For these reasons, and others explained more fully below, the Commission
6 should decline to adopt any changes to the current price regulation scheme
7 for Verizon. Instead, the Commission should continue to gather information
8 and data regarding: the state of local competition in Rhode Island, the impact
9 on local competition of Verizon's recent authorization to provide interLATA toll
10 services, the upcoming resolution of the UNE pricing proceeding, the impact
11 of federal policies on local competition in Rhode Island, the affect of the
12 growth in the wireless market segment on the wired market segment, industry
13 financial conditions as they affect incumbents as well as competitors, and
14 troubling national economic conditions. While the Commission should
15 engage in debate and consideration of possible changes to the current
16 scheme of price regulation for Verizon, in these highly volatile and
17 unpredictable times, the Commission should not grant the extreme type of
18 pricing flexibility Verizon seeks in the instant proposal.

19

20 Q. Regarding pricing flexibility for Verizon's rates for local services in Rhode
21 Island, does Cox have any alternative proposals?

22

1 A. Yes. In Section III, I will explain Cox's proposal for more limited pricing
2 flexibility for Verizon's local rates and suggest an alternative time frame for
3 implementation of that pricing flexibility.

4

5 **III. VERIZON'S PLAN SEEKS TOO MUCH TOO SOON**

6

7 **A. Verizon's Proposal is Unclear and Ambiguous on Key Points**

8

9 Q. Is Verizon's proposal clear about all the key points of its Plan?

10 A. No. Verizon's proposal is unclear in at least three significant ways. First,
11 Verizon's proposal states that "...Primary Residence Basic Exchange
12 rates...shall not be increased by more that \$2.00 per line over the two-year
13 period following the effective date of the plan." (Verizon Plan, paragraph A.)
14 This language does not indicate whether the possible \$2.00 increase is *per*
15 *month* per line or no more than a total of \$2.00 per line over a two-year
16 period. Common sense dictates that Verizon's proposal is for an increase in
17 rates up to \$2.00 per line *per month*. But, Verizon itself must make clear
18 what it intends, rather than asking the Commission to make assumptions
19 about the Plan. In addition, nowhere in the testimony filed by Verizon along
20 with its proposal is this ambiguity clarified. For purposes of my testimony, I
21 have assumed that Verizon is seeking the ability to increase usage
22 insensitive residential rates (for primary lines) up to \$2.00 per line *per month*
23 over two years.

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Second, as quoted above, Verizon’s proposal states that “...Primary Residence Basic Exchange rates...shall not be increased by more that \$2.00 per line over the two-year period following the effective date of the plan.” Verizon makes no mention, however, of whether the Plan contemplates rate decreases. Given further detail provided by Verizon in a prior New York State Public Service Commission proceeding regarding a similarly worded proposal, I have assumed that rate decreases, as well as increases are anticipated by the proposed Plan and that Verizon proposes complete downward pricing flexibility for business as well as residential rates. The Plan should be modified to clarify whether Verizon seeks both upward and downward pricing flexibility.

Third, Verizon’s proposal appears to allow it to implement geographically deaveraged local rates for both residential and business service. In fact, testimony filed with Verizon’s proposal seems to suggest that geographic rate deaveraging is a good idea in a competitive market. (Testimony of Dr. William E. Taylor, page 14, line 1 through page 15, line 4.) If Verizon intends to implement geographically deaveraged rates, it should say so explicitly. Of course, any proposal to allow geographic rate deaveraging would encompass a policy change of such significance for Rhode Island consumers that it should be examined carefully and thoroughly in a separate proceeding. For purposes of this testimony, I will assume that Verizon does

1 not intend to obtain the ability to deaverage local rates on a geographic basis
2 and that Verizon will clarify that its Plan does not anticipate such a dramatic
3 change. If, however, Verizon's rebuttal testimony indicates otherwise, Cox
4 reserves the right to address this issue in surrebuttal testimony.

5

6 At the very least, the Commission should require that each and every aspect
7 of Verizon's proposal be stated in precise and unambiguous language.

8

9 **B. Downward Pricing Flexibility for Verizon's Local Rates Likely Would**
10 **Create Anti-Competitive Market Conditions**

11

12 Q. What problems could arise from allowing Verizon unlimited downward pricing
13 flexibility for local rates?

14

15 A. First, the Plan proposed by Verizon would allow it to engage in predatory
16 pricing, to the detriment of Rhode Island consumers and pro-competitive
17 public policies. Second, the Plan does not include any imputation rules for
18 Verizon, nor does it present standards or provisions allowing for enforcement
19 of any such rule. Third, Verizon's proposal for pricing intrastate access
20 services would allow it to engage in dangerously anti-competitive behavior. I
21 address each of these issues separately.

22

23

1 **1. Predatory Pricing Concerns**

2

3 Q. What do you mean by “predatory pricing”?

4

5 A. Predatory pricing occurs when a firm has market power in the provision of
6 certain services such that it can decrease prices below actual costs for a
7 period of time long enough to cause competitors to exit the market and to
8 prevent new competitors from entering the market. After below-cost pricing
9 eliminates, or significantly reduces competition, the incumbent firm recreates
10 conditions that allow it to raise rates so far above costs as to re-establish a
11 monopoly (or near-monopoly) market.

12

13 Q. How would predatory pricing by Verizon affect the existence of and growth in
14 facilities-based competition?

15

16 A. If Verizon were to price local services below actual costs (based on TELRIC
17 standards already in place), it is likely that it would be decreasing its rates to
18 levels below the costs incurred by competitors to provide the same services.
19 Without the ability to price in a predatory manner themselves and, given the
20 current dismal state of affairs for competitors in the capital markets, facilities-
21 based competitors such as Cox would be squeezed out of the market.

22

23

1 Q. How would such predatory pricing by Verizon affect UNE-based competition?

2

3 A. Because Verizon would be lowering its rates below its own cost of providing
4 the retail service, those prices more than likely would also be below the rates
5 paid to Verizon by competitors for the necessary UNEs, at least for an interim
6 period of time before the Commission could effectuate changes in UNE
7 prices. In such a case, those competitors would exit the market because
8 profit could not be foreseen.

9

10 Q. How would predatory pricing by Verizon affect the ability of resellers to
11 compete?

12

13 A. For resellers, the effects of predatory pricing would be less drastic than for
14 other types of competitors. Since wholesale rates are based on an
15 established, fixed discount applied to Verizon's retail rates, if Verizon were to
16 lower retail rates, wholesale rates would decrease commensurately. Cox
17 concedes that, even if Verizon engages in predatory pricing, the resale
18 market may survive. In that case, however, Rhode Island would lack critical
19 network redundancy since resellers by definition rely on Verizon's network.
20 Moreover, two of the three types of competitive entry anticipated by the
21 Telecom Act, and relied upon by both this Commission and the FCC in
22 granting Verizon Section 271 relief in Rhode Island, would be eliminated or
23 severely restricted.

1 **2. Imputation Issue**

2

3 Q. Does Cox proposes that any Plan adopted by the Commission include
4 imputation requirements?

5

6 A. Yes. If Verizon's Plan is adopted, and especially if adopted without any
7 modifications, clear and enforceable imputation rules must be implemented
8 at the same time. The adoption of readily enforceable imputation rules would
9 allow the Commission to ensure that Verizon treats competitors fairly by
10 requiring it to impute its retail rates into the prices for bundled service
11 packages and into the rates for services it provides to itself. For example,
12 when Verizon provides long distance services, it should impute to itself the
13 same rate it charges other carriers for the access service necessary to
14 provide long distance service. Given the extreme pricing flexibility Verizon
15 seeks in this case, imputation is a critical issue in this proceeding.

16

17 Under an imputation requirement, when Verizon provides services that use
18 its own inputs (such as the access charge component of toll rates), it must
19 include in its retail rates the same amount it charges competitors for use of
20 the same inputs. In other words, Verizon would be required to treat itself just
21 like other carriers when using service elements offered to competitors.
22 Verizon should not be allowed to charge more to others for use of bottleneck
23 facilities than it implicitly charges itself. When Verizon competes in a market

1 in which all carriers are dependent on an input Verizon supplies (in the above
2 example, access services), Verizon must make that input available to all
3 competitors, including itself on the same terms and conditions and at the
4 same prices. Regulators have long believed that an imputation requirement
5 is necessary to ensure the development and continuation of competition.

6
7 If the Commission adopts pricing flexibility for Verizon in Rhode Island, it
8 should require that any pricing flexibility allowed be linked to clear and
9 enforceable imputation rules. Ease of enforcement is a key element. In New
10 York, Verizon is subject to an adequate but difficult-to-enforce imputation
11 requirement. Other imputation standards and enforcement mechanisms
12 should be evaluated carefully. Cox proposes that the Commission request
13 that interested parties submit proposals for the appropriate imputation
14 standard and enforcement mechanism to be included in any pricing flexibility
15 Plan that may be adopted.

16

17 **3. Intrastate Access Pricing**

18

19 Q. Does Verizon's proposal with respect to intrastate access pricing present any
20 problems?

21

22 A. Yes. Verizon proposes that it be allowed to make any changes it wishes to
23 the various elements within its intrastate access service offerings, so long as

1 aggregate access rates do not increase. This proposal would allow Verizon
2 to engage in anti-competitive behavior by manipulating pricing of different
3 elements within its intrastate access service offerings. For example, many
4 competitors have business plans under which they purchase the transport
5 element of access from Verizon, but provide their own switching. In other
6 cases, competitors provide their own transport (or lease transport from a
7 carrier other than Verizon), but buy switching from Verizon. Verizon proposes
8 that it be allowed to change the prices of each access element at will (as long
9 as those changes are accompanied by commensurate changes in the prices
10 for other access elements). In this way, Verizon could engage in price
11 squeezing to the detriment of particular competitors, thus impeding
12 achievement of the Commission's pro-competitive policies.

13 Therefore, Cox suggests that the Commission maintain current pricing
14 regulations for intrastate access services.

15
16 **C. TIME FRAMES INCLUDED IN VERIZON'S PROPOSAL ARE FAR TOO**
17 **AGGRESSIVE BECAUSE THEY WOULD ALLOW TOO MUCH PRICING**
18 **FLEXIBILITY TOO SOON, GIVEN THE CURRENT STATE OF "TURMOIL"**
19 **IN THE INDUSTRY**

20
21 Q. Is Verizon's description and analysis of the current state of the
22 telecommunications market accurate and realistic?

1 A. No. Verizon concludes that price regulation of its local services is no longer
2 necessary (and may well be harmful) because the local service market in
3 Rhode Island is fully subject to “effective competition.” (Taylor Testimony,
4 page 7, line 11 through page 9, line 4.) Dr. Taylor states, “The key question
5 is simply whether the services for which Verizon RI seeks relaxed regulatory
6 treatment are subject to effective competition.” (Taylor Testimony, page 10.)
7 The inquiry, however, should not end there.

8
9 First, local competition in Rhode Island only appears to be “widespread.”
10 Competition in Rhode Island may be characterized as “broad,” but not “deep.”
11 While competition exists in some parts of Rhode Island for some services,
12 certain crucial market segments, such as local business services, do not
13 demonstrate sufficiently deep and sustainable competitive conditions. Even
14 assuming, *solely for the sake of argument*, that effective competition exists
15 today in particular market segments, the key question is whether effective
16 competition can continue, especially if Verizon receives its proposed pricing
17 flexibility. Conditions in the market today can be assessed only by a thorough
18 analysis not only of where the industry stands today, but also of what we can
19 reasonably expect may happen in the future. Certainly major changes in
20 economic and financial conditions in the telecommunications market lead Cox
21 to question whether circumstances in the market may change drastically over
22 the life of the Plan.

23

1 Q. Why are Verizon's conclusions about the status and future of local
2 competition in Rhode Island wrong?

3

4 A. Because the Verizon's testimony scrupulously avoids any mention, let alone
5 discussion, of the uncertainties that exist in the industry today and that will
6 affect the status of competition in the future.

7

8 Just recently, Chairman Michael Powell of the FCC said that the
9 telecommunications market is "riding on very stormy seas," and
10 characterized the results of recent industry financial failures as "devastating."
11 (Statement by FCC Chairman Michael Powell on "Financial Turmoil in the
12 Telecommunications Marketplace: Maintaining the Operations of Essential
13 Communications" before the United States Senate, Committee on
14 Commerce, Science, and Transportation, presented July 30, 2002)
15 ("Chairman Powell Statement"). So much uncertainty surrounds the
16 telecommunications industry that Chairman Powell outlined for Congress six
17 dramatic steps the FCC will undertake to hold the industry together and
18 ensure that services to consumers are not interrupted. These steps involve
19 protecting service continuity, rooting out corporate fraud, restoring financial
20 health, acknowledging prudent industry restructuring, providing new revenue
21 through new services, and reforming economic and regulatory foundations.

22

1 Q. What do these serious concerns about the industry mean for local
2 competition in Rhode Island and potential pricing flexibility for Verizon?

3

4 A. Everything. This volatile and unpredictable time in the telecommunications
5 market cries out for stability in regulatory policies. By that I mean that, within
6 the mandates of the Telecom Act, regulators should be reluctant to adopt
7 significant changes to regulatory policies and should, at least, decline to
8 adopt any regulatory scheme that decides now what will happen at a fixed
9 date in the future. Verizon's proposal anticipates adoption of some policies
10 that would take effect immediately and others that would take effect in two
11 years. In fact, Verizon wants the Commission to decide now that, after the
12 two-year initial period, no pricing regulation will apply to Verizon's local
13 services in Rhode Island. In these days of devastation in the industry (to use
14 Chairman Powell's words), it would be unwise for the Commission to
15 establish now both the form of deregulation that will apply over the next two
16 years and the pricing policies that will apply indefinitely after the initial two-
17 year period.

18

19 It is those very concerns – that the opportunity to compete will wane and the
20 current decline in the industry will only get worse – that have prompted Cox
21 to oppose adoption of Verizon's Plan. Granted, Chairman Powell speaks of
22 the need to give incumbents greater pricing flexibility for local rates. He also
23 states, however, that such pricing flexibility must be balanced with the need

1 to maintain and expand competitive opportunities. (Chairman Powell
2 Statement, pages 12 and 15).

3

4 Q. Given these uncertainties, what does Cox suggest the Commission do?

5

6 A. Wait. At such a volatile time in the telecommunications industry, the
7 Commission must consider any changes in current regulatory requirements
8 carefully and thoroughly. This concern is heightened when the proposed
9 changes could affect both the current status of local competition and
10 opportunities for local competition in the future.

11

12 In fact, this is exactly the wrong time to implement any public policies that
13 could have any negative impact on competition. Verizon's proposed plan
14 would be the first major change in the Commission's rate regulation policies
15 since 1997. Because Verizon's proposal ultimately would eliminate price
16 regulation for all local services, it presents a dramatic departure from existing
17 pricing policies. At this unprecedented and critical juncture in the industry,
18 the Commission should defer consideration of such extreme changes.
19 Interestingly, nowhere in its proposal or supporting testimony does Verizon
20 even mention the current financial crisis in the industry. Perhaps Verizon
21 believes its proposal would help to resolve the current turmoil. I think not. If
22 so, Verizon should have addressed this question directly and in detail.

23

1 Q. Do other factors raise even more uncertainty about the future of the
2 telecommunications market?

3

4 A. Yes. Verizon fails to explain how its Plan would benefit consumers in light of
5 other serious uncertainties in the telecommunications market. For example,
6 recent FCC data indicate that in 2001, for the first time in the history of the
7 telephone, the nationwide number of telephone lines decreased. (Report,
8 "Trends in Telephone Service," FCC, Wireline Competition Bureau, Industry
9 Analysis and Technology Division, May 2002, at Table 8.1, hereinafter
10 "Telecom Trends Report.") Although the FCC has indicated that these are
11 preliminary estimates, data from larger incumbent local telephone companies
12 show that, for 2001, growth in the number of wired telephone lines is either
13 negative or significantly lower than historical trends would indicate.

14

15 Some of the decrease in the growth in wired telephone lines is likely due to
16 the increasing instances of substitution of wireless lines for wired lines. (See,
17 for example, Simon Romero, The New York Times, "When the Cellphone is
18 the Home Phone," August 29, 2002.) In addition, some of the decrease in
19 wired lines may well be due decreased demand for second lines for
20 residences. Deployment of Digital Subscriber Lines ("DSL"), expanded
21 offerings of cable modem services, and the availability of satellite delivery
22 systems for broadband services all reduce the need for second lines for
23 residential Internet access.

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Interestingly, while the historic and expected growth in wired lines has failed to materialize in the last couple of years, we have seen “formidable” increases in communications traffic. (Statement of Chairman Powell, at page 7.)¹ With traffic increasing, but wired local lines decreasing, the fundamental assumptions about market conditions that have formed the basis for current policies must be reevaluated in any attempt to establish new policies.

Moreover, the Commission should not ignore the meaning and impact of the following recent events: (1) bankruptcies of MCI/WorldCom, Global Crossing and Adelphia Business Solutions; (2) the precarious status of Qwest, one of the four remaining former Bell Operating Companies; (3) investigations into several important telecommunications companies by the U.S. Department of Justice, the Securities and Exchange Commission; and, (4) indictment of several executives of major telecommunications companies, with more such indictments likely to come in the future.

Q. What does all this sometimes-conflicting information about the status of the telecommunications industry mean?

¹ See also, Telecom Trends Report, at Tables 2.1 through 2.5, advanced telecommunications; Tables 6.1 through 6.4, international telephony; Tables 10.1 through 10.12, long distance industry; Tables 11.1 through 11.3, minutes of use; and Tables 15.1 through 15.6, residential toll usage; Table 19.2, toll-free telephone numbers.)

1 A. I submit that, under current conditions, no one can predict with reasonable
2 certainty what will happen in the industry's future, even the near-term future.
3 Given recent events, captured in the powerful, and even frightening,
4 language used by Chairman Powell to describe the industry, caution must be
5 the Commission's guiding principle when considering changes to current
6 regulatory policies.

7

8 Q. Should Verizon be required to explain why its proposal should be adopted in
9 spite of all these uncertainties?

10

11 A. Yes. One cannot overstate how unpredictable the telecommunications
12 industry is at this time. Even in the dramatically transformational days of
13 divestiture of the former Bell System in 1984, no one questioned whether the
14 industry would have a growing and profitable future. At that time, and ever
15 since, many have argued about how providers should share those profits.
16 No one ever imagined the profits would not be there for many providers.

17

18 Verizon, however, has nothing to say about the existing drastic and negative
19 market conditions. In fact, Verizon does not mention the crisis in current
20 financial, economic, and market conditions. Verizon simply relies on
21 information compiled in the process of producing its Section 271 application
22 about the status of competition in Rhode Island, the openness of its network
23 in Rhode Island to competitors, and the availability of three kinds of

1 competitive entry in Rhode Island. Even if Verizon's statements about these
2 matters were true, the Commission should not consider changing the form of
3 regulation for the incumbent without also considering the current state of
4 affairs in the industry overall, not just whether, in certain segments of the
5 market, competitors provide local services in Rhode Island.

6
7 Especially given the current downward trend in national economic conditions,
8 the Commission should be concerned that market conditions in Rhode Island
9 may no longer be the same as they were when the FCC authorized Verizon's
10 long distance entry. Recent data showing thwarted growth in local lines are
11 especially troublesome since it is that very growth which has helped to create
12 and sustain competition. Verizon, however, presents the view that market
13 conditions are stable and that the usual growth can be expected.²

14 Dr. Taylor states that "[t]he key question is simply whether the services for
15 which Verizon RI seeks relaxed regulatory treatment are subject to effective
16 competition." (Taylor testimony page 10, lines 5 through 6). That question is
17 incomplete, however. The key question is whether those services "are
18 subject to effective competition and *will continue to be so*, even given the
19 tremendous uncertainties in the telecommunications market today."
20 Verizon's description of current market conditions omits the current financial
21 crisis and other uncertainties, thereby rendering the market descriptions and

² Taylor testimony at page 4, line 18 through page 6, line 7; page 7, line 11 through page 9, line 4; page 16, line 7 through page 17, line 3; page 18, lines 9 through 26. O'Brien testimony at page 5, line 1 through 2; page 7, lines 16 through 23; page 13, line 23 through page 14, line 2. Testimony of Mr. Silvia at page 2, lines 2 through 7; page 3, line 5 through page 10, line 13

1 analysis it presents meaningless. Thus, the Commission should not premise
2 any significant changes in price regulation policies on Verizon's filing. That
3 filing simply omits a huge piece of the complex puzzle that is the current
4 telecommunications industry.

5

6 **D. COX SUGGESTS THAT THE COMMISSION AMEND VERIZON'S PLAN**
7 **TO INCLUDE MORE LIMITED PRICING FLEXIBILITY TO BE**
8 **IMPLEMENTED MORE SLOWLY**

9

10 Q. Given these concerns, what does Cox suggest the Commission should do at
11 this time with respect to Verizon's alternative regulation proposal?

12

13 A. Cox recommends that the Commission hold off on any action that would
14 change the current price regulation plan until market conditions either
15 stabilize or at least are better understood and until the critical areas at stake
16 in the UNE pricing proceeding are resolved. The Commission could issue an
17 order that would continue the current Price Regulation Successor Plan until a
18 fixed date or leave the time frame open-ended. During that time, the
19 Commission may want to keep an open record so that it can continue to
20 compile and analyze information to determine not only the form of regulation
21 that will apply to Verizon's local rates but also an appropriate imputation
22 standard. As the industry stabilizes, the Commission could then consider

1 any proposal for pricing flexibility, such as one, which includes price floors
2 and ceilings, as discussed below.

3

4 Q. If the Commission decides not to continue the Price Regulation Successor
5 Plan and instead adopts some form of alternative regulation for Verizon,
6 what would Cox suggest?

7

8 A. Cox recommends that, if the Commission decides to implement changes in
9 pricing policies for Verizon at the end of this year, Verizon's proposal be
10 modified to protect Rhode Island consumers and to create conditions under
11 which competition could be sustained. As explained previously, any pricing
12 flexibility plan adopted by the Commission must include an effective and
13 enforceable imputation standard. In addition, Cox proposes that Verizon's
14 Plan be modified to include the following: (1) a three-year initial period within
15 which Verizon's pricing flexibility for residential rates remains limited; (2)
16 continued, although much more limited, price regulation for residential rates
17 after the initial three-year period; (3) price ranges for business services for
18 an initial two-year period; and, (4) determination, in an ongoing proceeding,
19 policies to be applied after these initial periods.

20

21 Q. What does Cox propose for residential rates?

22

1 A. Cox recommends that the two-year initial period requested by Verizon be
2 modified to a three-year initial period. During that time, Verizon could raise
3 rates for primary residential lines (that are priced on a usage insensitive
4 basis) up to \$2.00 per month per line over the three-year period. In addition,
5 for primary residential lines that are priced on a usage sensitive basis, rates
6 should be capped at current levels for three years, instead of two years, as
7 proposed by Verizon.

8

9 A longer period of time before Verizon can obtain complete pricing flexibility
10 will serve two purposes. First, it will limit or prevent opportunities for Verizon
11 to engage in predatory pricing. While Verizon could lower rates during that
12 three-year period, it would have to wait a long period of time before it could
13 raise rates (beyond the \$2.00 limit) and charge supra-competitive rates.
14 Arguably, if Verizon were pre-disposed to engage in predatory pricing and
15 price its service below cost, three years would be a very long time for
16 Verizon to wait to be able to recoup those losses. Thus, predatory pricing
17 would be far less likely.

18

19 After the initial three-year period, residential rates could be subjected to price
20 ranges, with rate floors and ceilings. As long as Verizon's rates are within
21 the range between the floor and the ceiling, Verizon would be free to change
22 rates on 30 day's notice, as for other tariff filings. With respect to the
23 establishment of price floors, Cox suggests that these floors be set at the

1 same level as the aggregate price for UNEs that a competitor must buy to
2 provide competitive local service using the UNE platform approach. Cox
3 expects that this price floor will be premised on whatever UNE prices result
4 from the Commission. If those UNE prices change over time, price floors
5 should be adjusted to reflect those changes.

6
7 In other words, Verizon should not be able to price retail services below the
8 level of prices which UNE-based competitors must pay to provide service in
9 Rhode Island. To set the floor otherwise would effectively eliminate one of
10 the three manners in which competitors can enter the local market in Rhode
11 Island. If UNE-based competitors pay more to Verizon for the elements
12 needed to provide services to consumers than Verizon's retail rate for those
13 services, those competitors will be unable to offer competitive pricing to
14 consumers. To win customers, those competitors must meet or beat
15 Verizon's prices. They could not do so, however, and expect to recoup their
16 own costs, let alone derive any profit from the sale of those services, unless
17 Verizon is required to adhere to such a pricing floor.

18 Second, an initial three-year period would allow the Commission to watch
19 closely any potential backsliding by Verizon after its entry into the interLATA
20 market in Rhode Island. Other states in Verizon's region have expressed
21 concerns about post-271 backsliding. By backsliding I mean behavior by
22 Verizon through which it initially engages in pro-competitive behavior, but
23 later reneges and engages in increasingly anti-competitive behavior.

1 Moreover, the retreat from pro-competitive behavior by Verizon could result
2 from the precarious state of affairs in the financial markets, which often
3 cause companies to engage in deep cost cutting and downsizing and,
4 accordingly, failure to meet Section 271 requirements. Given the short
5 period of time since approval of Verizon's request for Section 271 relief in
6 Rhode Island, backsliding has not been an issue. But the concern remains
7 valid.

8

9 Q. What does Cox suggest with respect to business service rates?

10

11 A. During a one-year initial period, Verizon should be subject to existing price
12 regulation policies for business rates, including the ability to implement rate
13 changes due to exogenous factors. After the initial one-year period, Verizon
14 would not be subject to complete unfettered pricing flexibility, as it proposes.
15 Instead, similar to residential rates, for business rates, Verizon would be
16 allowed a reasonable level of pricing flexibility. For example, after the initial
17 one-year period, business rates could be subject to price ranges, with rate
18 floors and ceilings. As long as Verizon's rates are within the range between
19 the floor and the ceiling, Verizon would be free to change rates on 30 days'
20 notice, as for other tariff filings. Any rate within the range established for that
21 service would be presumed to be just and reasonable. If Verizon seeks to
22 change rates to a level either below the floor or above the ceiling, Verizon

1 would have the burden of rebutting that presumption by showing that the
2 proposed rates are just and reasonable.

3

4 In addition, during this one-year initial period applicable to business rates,
5 the Commission should conduct a proceeding to determine whether rate
6 ranges ultimately should be replaced by complete pricing flexibility, as
7 sought by Verizon, or a less limited form of pricing flexibility and, if so, when
8 those changes should take place.

9

10 **IV. EDUCATIONAL FUNDING ISSUES**

11

12 Q. Does Cox agree with Verizon's proposal to change the current funding
13 mechanism for Internet access for Rhode Island schools and libraries?

14

15 A. No. Verizon proposes that the Commission require all carriers to contribute
16 to the fund and agrees to continue paying into the fund until June 2003,
17 pending approval of its entire proposed alternative regulation plan. Verizon
18 would limit its contribution to the fund to \$1.0 million for the first six months of
19 2003. (O'Brien Testimony, page 9.) Cox proposes that the issue of funding
20 Internet access for Rhode Island schools and libraries be referred to another
21 proceeding. Not only does the Internet access funding issue raise very
22 different legal and policy issues from Verizon's proposed alternative
23 regulation plan, but also it is unrelated to the subject of the instant

1 proceeding – adoption of a price regulation scheme that will replace the
2 Price Regulation Successor Plan that expires on December 31, 2002.

3

4 Moreover, consideration of a funding mechanism for Internet access for
5 Rhode Island schools and libraries involves both contributions to the fund
6 and payments from the fund. Although Verizon has been the only carrier
7 contributing to the fund to date, it also has been the only carrier withdrawing
8 from the fund. One issue the Commission should consider is whether the
9 provision of Internet access to schools and libraries in Rhode Island is
10 substantially complete and, if so, what funding mechanism is appropriate for
11 the future.

12

13 Therefore, Cox recommends that this schools and libraries funding issue be
14 referred to another proceeding. Cox believes, however, that the Commission
15 should not require that such a proceeding be complete by June 30, 2003.
16 Rather, the Commission should continue the current funding mechanism
17 until such time as it completes the new proceeding.

18

19 Q. Does this conclude your testimony?

20

21 A. Yes.

22