

STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS  
PUBLIC UTILITIES COMMISSION

IN RE: VERIZON-RHODE ISLAND'S SUCCESSOR :  
ALTERNATIVE REGULATION PLAN : DOCKET NO. 3692

REPORT AND ORDER

I. INTRODUCTION

New England Telephone ("NET") operated under traditional rate of return regulation until 1989. In 1989, the Rhode Island Public Utilities Commission ("Commission") altered NET's regulatory structure by approving a stipulation that permitted NET to have earnings sharing for a three-year period. After a comprehensive review of telecommunications in Rhode Island, the commission approved a four year Price Regulation Trial ("PRT") in which NET was permitted certain pricing flexibility. In 1996, the Commission approved a Price Regulation Plan ("PRP") to regulate NYNEX, NET's successor. The PRP eliminated earnings sharing but implemented a service quality adjustment factor ("SQAF"). In 2000, the Commission approved a Price Regulation Successor Plan ("PRSP") for Bell Atlantic-Rhode Island ("BA-RI"), NYNEX's successor. The PRSP continued the regulatory framework of the PRP but included additional commitments by the company such as an increase in data network access funding of school and libraries, a Lifeline credit for low-income customers, a \$5 million refund to residential customers, and the expansion of calling areas. In 2003, the Commission approved the Alternative Regulation Plan ("ARP") for BA-RI's successor, Verizon-Rhode Island ("VZ-RI"). The ARP gave VZ-RI pricing flexibility on business rates. However, VZ-RI was subject to price caps on residential services, a price floor, and service quality penalties. In addition, VZ-RI was required to maintain funding for

internet access for schools and libraries for two years and to increase the Lifeline credit for low-income customers.

## II. VZ-RI'S DIRECT TESTIMONY

On August 19, 2005, VZ-RI submitted pre-filed direct testimony in support of its successor ARP by the following individuals: Theresa L. O'Brien, VZ-RI's Vice-President of Regulatory Affairs; Robert Kenney, Executive Director of VZ's Public Affairs, Policy and Communications Department; and Paul B. Vasington, Director-State Public Policy for VZ. In her testimony, Ms. O'Brien explained that VZ-RI's market share of both business and residential customers has declined since 2002 and indicated that VZ-RI has no market power in retail telephone services given the current conditions of market share as well as supply and demand elasticity. Next, Ms. O'Brien summarized the successor ARP. She stated that the pricing flexibility will be extended from business retail services to residential retail services. However, she indicated that late payments and returned check charges are excluded from the successor ARP.<sup>1</sup>

Also, Ms. O'Brien explained that in addition to waiving the federal subscribers' line charge ("SLC"), VZ-RI funds a Lifeline credit of up to \$9.00 per month. VZ-RI funds \$5.50 of this credit and the federal government funds \$3.50. Accordingly, VZ-RI's Lifeline customers who have unlimited basic exchange service pay between \$5.30 to \$10.26 per month depending upon the exchange from which the customer is served. Meanwhile, VZ-RI's Lifeline customers using measured service only pay \$1.00 per month. Ms. O'Brien explained that as long as the state or VZ-RI's Lifeline support is at least \$3.50 per month, the federal government will provide \$3.50 per month in Lifeline support. Under VZ-RI's successor ARP, VZ-RI would reduce its monthly Lifeline

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<sup>1</sup> VZ-RI Ex. 1 (O'Brien's direct testimony), pp. 4-7.

support for basic unlimited service by \$1.00 in 2006, and by another \$1.00 in 2007, and VZ-RI would reduce its monthly Lifeline support for measured service customers by 17¢ in 2007. As a result, by 2007 VZ-RI's funding of the Lifeline credit will be reduced from \$5.50 to \$3.50 and the overall credit would be \$7.00. Ms. O'Brien stated that as of December 31, 2004, there were 39,348 Lifeline customers in Rhode Island, which would cost VZ-RI \$2.5 million in 2005. Under VZ-RI's proposal, the cost would be reduced to \$2.1 million in 2006 and \$1.6 million in 2007. She emphasized that VZ-RI's Lifeline customers have not experienced an increase in basic telephone service in 11 years. Also, she noted that this reduction in VZ-RI's subsidy would bring it to the level of support provided by Cox, the only other Eligible Telecommunications Carrier ("ETC") in Rhode Island.<sup>2</sup>

Ms. O'Brien stated that VZ-RI is proposing to eliminate monthly service quality reports and associated penalties. She pointed out that other carriers are not subject to service quality standards and that the competitive market can discipline VZ-RI's service quality. VZ-RI also proposed not to file its semi-annual competitive profile reports or its annual earnings report. She argued that no other carrier is required to provide such information. Furthermore, she also argued that the competitive profile only depicts the wireline market share and does not capture the impact of wireless or Voice Over Internet Protocol ("VOIP"). Ms. O'Brien did indicate that wholesale prices for VZ-RI's unbundled network elements ("UNEs") and resale will be set in accordance with the Telecommunications Act of 1996 ("Telco Act"), and that VZ-RI was not proposing any

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<sup>2</sup> Id., pp. 7-9.

change to the treatment of intrastate switched access services or the long-run incremental cost (“LRIC”) price floor approved in the previous ARP.<sup>3</sup>

In his direct testimony, Mr. Kenney described the status of competition in Rhode Island. He noted a dramatic increase in the CLEC share of residential telephone land lines since 2002, and noted that this does not include the impact of VOIP or wireless. He indicated that according to the FCC, Rhode Island has the highest CLEC market share for land lines in the nation. He discussed VOIP alternatives in Rhode Island which offer unlimited calling plans to anywhere in the United State and Canada at \$19.95 per month. Mr. Kenney also discussed the increase in wireless subscribers in Rhode Island from 314,000 in 2000 to 607,000 in December 2004, and noted the corresponding decline in VZ-RI’s land lines and total minutes of use. Mr. Kenney indicated that the clearly predominant form of CLEC competition in Rhode Island is facilities-based, but noted that CLECs can compete through resale or through a UNE-P like product offered by VZ-RI at commercially available rates. He also stated that the intraLATA toll market has been competitive in Rhode Island for many years. In conclusion, Mr. Kenney states that VZ-RI’s share of land-based residential access lines is below 70 percent and therefore, VZ-RI should have the same pricing flexibility in this area as it currently has for business services.<sup>4</sup>

In his direct testimony, Mr. Vasington explained that VZ-RI’s successor ARP is consistent with public policy and that the telephone market is sufficiently competitive to lift regulatory controls. Mr. Vasington noted that an unregulated competitive market maximizes consumer welfare and that regulation exists to replicate, to the extent possible,

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<sup>3</sup> *Id.*, pp. 9-12.

<sup>4</sup> VZ-RI Ex. 2 (Kenney’s direct testimony), pp. 3-14.

the effects of a competitive market. As a result, less regulation is needed where competitive forces are sufficient to discipline firms to produce products and services customers want at reasonable prices. Mr. Vasington concurred that the telecommunications market in Rhode Island is not perfectly competitive, but noted that perfect competition is a theoretical model. He indicated the real issue is whether there is sufficient competition to prevent VZ-RI from exercising market power.<sup>5</sup>

Mr. Vasington stated that because of technological changes, wireless and VOIP should be considered reasonable substitutes to land-based telephone. He also stated that the market should be assessed on a statewide basis because the basic structure of the telecommunications market in Rhode Island does not vary by exchange or density zone. Mr. Vasington explained that supply elasticity is determined by whether existing or potential competitors are willing and able to serve the market by entering the market or expanding their current market share. He indicated that when supply elasticity is high, market share is less important but when supply elasticity is low, then market share is more important. Mr. Vasington stated that supply elasticity in Rhode Island is relatively high and that there is significant facilities-based competition. In regard to demand elasticity, Mr. Vasington stated that it refers to the willingness and ability of a consumer to change the quantity of a good consumed in response to a change in the price of that product. Mr. Vasington stated that in the context of this investigation, it is appropriate to look at demand elasticity as the willingness of customers to change suppliers and therefore, he concluded that there is demand elasticity for VZ-RI customers. As for market share, Mr. Vasington stated that it provides a static view of any market and that regulators should view the market as dynamic in order to assess the likely response of

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<sup>5</sup> VZ-RI Ex. 3 (Vasington's direct testimony), pp. 3-6.

competitors and consumers to the attempted exercise of market power. Regardless, Mr. Vasington emphasized that VZ-RI's market share for residential lines is below 70 percent.<sup>6</sup>

Mr. Vasington noted that telephone rates were historically not set at efficient levels. Thus, regulators should allow companies to make adjustments in response to competition where overpriced rates would decline and underpriced rates would increase. He also noted that because of wireless, which has 607,000 subscribers in Rhode Island as of December 2004, and VOIP, which as of December 2004 was available to 165,000 subscribers of high-speed Internet service, there is not a duopoly in the residential market. Therefore, if a VZ-RI residential customer is not satisfied with VZ-RI, it could switch to Cox, another CLEC, wireless or VOIP.<sup>7</sup>

### III. COX'S DIRECT TESTIMONY

On October 26, 2005, Cox Rhode Island Telecom ("Cox") filed the direct testimony of F. Wayne Lafferty, an outside consultant. First, Mr. Lafferty stated that VZ-RI's proposal does not address customer promotions. He stated that VZ-RI can offer promotions without time limits or any price floor, thus opening the door to predatory pricing. He recommended that VZ-RI's promotions should be subject to the LRIC price floor. Second, Mr. Lafferty indicated that VZ-RI offers bundles of regulated services and non-regulated services. He indicated that VZ-RI's bundles should be subject to the LRIC price floor for both the stand-alone regulated retail service and bundles that include regulated retail services. Third, Mr. Lafferty noted that VZ-RI's proposal would not prohibit rate de-averaging among similarly situated customers. He noted that competition

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<sup>6</sup> Id., pp. 6-21.

<sup>7</sup> Id., pp. 21-27.

is not developing on a uniform basis and thus he stated that VZ-RI could target more competitive areas at the expense of consumers with fewer alternatives. He recommended that rate de-averaging among similarly situated customers be prohibited in VZ-RI's proposal. Fourth, Mr. Lafferty stated that VZ-RI's proposal would keep its plan in effect for an indefinite period of time. Due to recent FCC decisions and industry consolidation, he recommended that the plan be set for a three-year term. Fifth, Mr. Lafferty stated that VZ-RI's current self-certification requirement that its rates comply with the LRIC price floor is inadequate. Instead, Mr. Lafferty recommended that any CLEC be allowed to request a cost study of VZ-RI to determine if VZ-RI's proposed rate complies with the LRIC price floor. Lastly, Mr. Lafferty indicated that Cox did not oppose reporting requirements on VZ-RI, but opposed any new reporting requirements on Cox.<sup>8</sup>

#### IV. DIVISION'S DIRECT TESTIMONY

On October 26, 2005, the Division of Public Utilities and Carriers ("Division") submitted the pre-filed direct testimony of Thomas Weiss, an outside consultant. Mr. Weiss acknowledged the increase of CLEC market share in the residential market and the impact of wireless and VOIP on customers. However, Mr. Weiss stated that for a segment of VZ-RI residential customers who cannot avail themselves of new technologies or justify a switch to another wire line provider, VZ-RI would be able to increase their basic residential phone rates. As a result, the Division recommended that monthly rates for primary residential basic exchange should only be allowed to increase by the maximum of \$1.00 in any 12 month period and if VZ-RI does not increase the rate by \$1.00 in any given 12 month period, it should be allowed to bank the \$1.00 increase

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<sup>8</sup> Cox Ex.1 (Lafferty's direct testimony), pp. 6-21.

for application in a subsequent 12 month period. However, the Division stated that VZ-RI should not have price ceilings on residential discretionary services.<sup>9</sup>

In addition, Mr. Weiss stated that the term of the VZ-RI plan should be four years to allow for further regulatory review of the competitive landscape. Mr. Weiss indicated that the Division did not object to systematically reducing the level of VZ-RI's contributions for Lifeline customers. However, the Division recommended that VZ-RI's proposal on Lifeline be delayed for twelve months to allow the Rhode Island General Assembly to consider legislation that would impose uniform application of Lifeline support contributions to other carriers. The Division stated that there should be no exogenous event provision in VZ-RI's form of regulation, and also stated that there should be no restriction on VZ-RI's depreciation practices. The Division did agree to eliminate service quality penalties on VZ-RI and monthly service quality reports. However, the Division did support requiring VZ-RI to provide annual intrastate earnings, semi-annual competitive profiles, and quarterly service quality reports.<sup>10</sup>

#### V. VZ-RI'S REBUTTAL TESTIMONY

On November 14, 2005, VZ-RI submitted rebuttal testimony by Ms. O'Brien, Mr. Kenney, and Mr. Vasington. In her rebuttal testimony, Ms. O'Brien stated that VZ-RI's residential customers have many telephone choices and, therefore, there is no justification for price ceilings. Ms. O'Brien also rejected a four-year term for the plan by explaining that the Division could always petition to the Commission to alter VZ-RI's regulatory plan based on changes in market conditions, and that the Commission has statutory authority to review VZ-RI's form of regulation at any time. She also indicated that VZ-

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<sup>9</sup> Div. Ex. 1 (Weiss' direct testimony), pp. 3-11.

<sup>10</sup> Id., pp. 12-16.

RI's contribution to Lifeline should be allowed to decrease to Cox's level without any delay in anticipation of legislative action because Lifeline customers have not had an increase in over 11 years and VZ-RI should not have a higher burden to subsidize Lifeline than Cox. She concurred that VZ-RI should not have an exogenous events provision if VZ-RI receives the pricing flexibility it proposed. In regards to reporting requirements on VZ-RI, Ms. O'Brien stated that the Commission or the Division can request information anytime from VZ-RI. Also, she indicated that any reporting requirements should be applied to all telecommunications competitors and that financial data should be afforded proprietary treatment. In addition, she stated that if a customer is dissatisfied with VZ-RI's service quality, the customer can go to another carrier. As for promotions, Ms. O'Brien noted that due to Order No. 12605, VZ-RI's promotions are limited to six months and she noted that since 1988, there has never been a price floor on VZ-RI's promotions and that Cox does not presently have a price floor on its promotions. Lastly, Ms. O'Brien stated that VZ-RI should not be required to file a tariff and comply with a price floor for bundles of services that include non-regulated services. She pointed out that Cox does not file tariffs for bundles of services that include non-regulated services.<sup>11</sup>

In his rebuttal testimony, Mr. Kenney stated that if a carrier believes that VZ-RI's price for a service were to fall below the price floor, it could request the Commission to investigate the filing. Otherwise, VZ-RI would request equal treatment to allow VZ-RI to request cost studies from CLECs when they make new filings. Also, Mr. Kenney

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<sup>11</sup> VZ-RI Ex. 4 (O'Brien's rebuttal testimony), pp. 2-10.

noted that Cox's de-averaging concerns can be addressed when VZ-RI makes tariff filings to determine if the filing complies with Title 39's anti-discrimination statutes.<sup>12</sup>

In his rebuttal testimony, Mr. Vasington discussed the recommendations of the Division and Cox. He stated that Cox's concerns about predatory pricing are misplaced because predatory pricing is demonstrable in theory, but almost never observed in practice. Also, Mr. Vasington stated it is not possible for VZ-RI to engage in predatory pricing because VZ-RI could not drive its competitors out of the market with the assurance that competitors would be unable to eventually re-enter the market. He stated that a price floor for promotions is not appropriate because the purpose of promotions is for a company to forego short-term revenues in order for the consumer to take service for the longer-term. Mr. Vasington noted that promotions cannot be used to engage in predatory pricing because of the six-month time limitation on VZ-RI's promotions. As for bundles, Mr. Vasington noted that Cox engages in bundling of services and indicated that bundling reflects the convergence of services in the communications market. Also, he stated that placing a price floor on bundles which offer an unregulated service would have a chilling effect on VZ-RI's ability to offer bundles. On de-averaging of rates, Mr. Vasington stated that there is a very strong likelihood that Verizon would not seek any further de-averaging. He noted that geographic boundaries are becoming less important for marketing and service offerings with the breakdown of Local Access and Transport Area ("LATA") boundaries and the growth of wireless service. He also noted that competition is robust throughout the state. Furthermore, he indicated that Rhode

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<sup>12</sup> VZ-RI Ex. 5 (Kenney's rebuttal testimony), pp. 2-5.

Island has extensive facilities based competition and there is no need for a specific term of years for the plan.<sup>13</sup>

As for the Division, Mr. Vasington stated that robust competition in the residential market will ensure that VZ-RI's residential prices remain just and reasonable, just as it has for VZ-RI's business services. Also, he indicated that it would not be economically advantageous for VZ-RI to purposefully try to have its residential customers migrate to wireless services because VZ-RI has and continues to invest in its wireline network in order to provide advanced broadband services over fiber optic cable.<sup>14</sup>

#### VI. COX'S SURREBUTTAL TESTIMONY

On December 1, 2005, Cox submitted the surrebuttal testimony of F. Wayne Lafferty. Mr. Lafferty explained that Cox is not recommending that VZ-RI file tariffs for bundles that include unregulated services, but Mr. Lafferty stated that any discounted price for the regulated portion of a bundle should be subject to the price floor. Mr. Lafferty reiterated that VZ-RI's promotion should be subject to a price floor even if there is a six-month limitation on VZ-RI's promotions. He also stated that all aspects of Order No. 12605, which address VZ-RI's promotions, should be incorporated into Verizon's regulation plan. Mr. Lafferty noted that Cox and VZ-RI were in agreement that a CLEC can request an investigation of VZ-RI's self-certification when VZ-RI's reduced or initial rates are less than the price floor, but that this right should be specifically incorporated into VZ-RI's regulation plan. Lastly, Mr. Lafferty stated that

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<sup>13</sup> VZ-RI Ex. 6 (Vasington's rebuttal testimony), pp. 2-19.

<sup>14</sup> Id., pp. 19-22.

this proceeding is an inappropriate forum to discuss reporting by other regulatory requirements for CLECs.<sup>15</sup>

#### VII. DIVISION'S SURREBUTTAL TESTIMONY

On December 1, 2005, the Division submitted the surrebuttal testimony of Thomas Weiss. Mr. Weiss stated that because VZ-RI is the carrier of last resort and many residential users do not have viable options, economically or technically, there is a need for price ceilings on residential basic exchange services. Mr. Weiss stated that the Division's proposal to require VZ-RI to continue its current level of subsidization for Lifeline is appropriate and similar to the approach followed in Docket No. 3445 for schools and libraries internet funding. Lastly, Mr. Weiss stated that if reporting requirements were eliminated, then the data necessary for regulators to evaluate the market or service quality may cease to be collected.<sup>16</sup>

#### VIII. PROCEDURAL MOTIONS

During September 2005, Cox, Conversent Communications and the Attorney General filed motions to intervene. These motions were granted.<sup>17</sup> On December 1, 2005, the George Wiley Center filed a motion to intervene. It also filed a motion to continue the hearing in this docket scheduled on December 6, 2005. The George Wiley Center stated that it did not receive notice of the proceeding until the prior week when it was contacted by counsel for the Attorney General. Also, the George Wiley Center stated that the VZ-RI proposal to reduce the current Lifeline subsidy would adversely affect the health and safety of Lifeline customers.

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<sup>15</sup> Cox Ex. 2 (Lafferty's surrebuttal testimony), pp. 5-22.

<sup>16</sup> Div. Ex. 2 (Weiss' surrebuttal testimony), pp. 2-6.

<sup>17</sup> No objection was made to these motions and approved was thus granted pursuant to Commission Procedural Rule 1.13(a).

On December 2, 2005, VZ-RI filed an objection to the George Wiley Center's motion to continue the hearing, but did not object to its motion for late intervention. VZ-RI stated that it provided notice of its filing as required by statute and the Commission's Procedural Rules. VZ-RI noted that on September 9, 2005, there was a pre-hearing conference in this docket. VZ-RI stated that a delay in the hearing would essentially freeze VZ-RI's retail rates at a time when competition is stronger than ever. Counsel for VZ-RI noted that Commission Procedural Rule 2.4 requires a utility to provide published notice of a "filing for general rate schedule changes" but that Commission Procedural Rule 2.2 explicitly states that Part II of the Commission Procedural Rules "shall be applicable only to proceedings involving the investigation of changes in rates constituting a general rate increase in which the respondent utility's overall revenue requirements are at issue." Counsel for VZ-RI explained that Part II of the Commission Procedural Rules are for a traditional rate case since Procedural Rules 2.6 and 2.8 discuss rate year, rate base and test year. VZ-RI's counsel noted that Part II of the Commission Procedural Rules is not applicable to VZ-RI's filing because this proposal applies to VZ-RI's form of regulation. Also, it was noted that since 1989 with the establishment of price-cap regulation for VZ-RI's predecessor, in four different proceedings, no party has ever indicated that Procedural Rule 2.4 was applicable to VZ-RI in its form of regulation proceeding. Lastly, counsel for VZ-RI stated that the interests of low-income customers are protected by both the Division and the Attorney General. Specifically, the Division's expert testimony has recommended that VZ-RI not reduce its Lifeline subsidy for a certain time period.

On December 5, 2005, the Attorney General filed its position on the Gorge Wiley Center's motion for a continuance. The Attorney General stated that the George Wiley Center did not have the opportunity to participate in the hearing after reasonable notice as required by R.I.G.L. Section 42-35-9. Also, the Attorney General stated that Procedural Rule 2.4 should apply since VZ-RI's filing is the equivalent of a general rate filing.

#### IX. HEARING

After duly published notice, the Commission conducted public hearings on December 6, 2005 and December 7, 2005, at its office at 89 Jefferson Boulevard in Warwick, Rhode Island. The following appearances were entered:

FOR VZ-RI	:	Alexander Moore, Esq.
FOR DIVISION	:	Leo Wold, Esq. Special Assistant Attorney General
FOR ATTORNEY GENERAL	:	William Lueker, Esq. Special Assistant Attorney General
FOR COX	:	Craig Eaton, Esq.
FOR GEORGE WILEY CENTER	:	B. Jean Rosiello, Esq.
FOR COMMISSION	:	Steven Frias, Esq. Executive Counsel

At the December 6th hearing, Mr. Henry Shelton gave public comment on behalf of the George Wiley Center. He opposed any reduction in VZ-RI's current Lifeline subsidy. Following his comments, attorneys for the George Wiley Center, the Attorney General and VZ-RI argued the merits of the George Wiley Center's motion to continue the hearings in this proceeding to a later date. VZ-RI argued that the George Wiley Center is not a party entitled to notice under the statute and that if the Attorney General felt additional notice was required, the Attorney General should have made its concern

known at the inception of the case. After oral arguments, the Commission denied the George Wiley Center's motion for a continuance.<sup>18</sup>

VZ-RI presented Ms. O'Brien, Mr. Kenney and Mr. Vasington as a panel of witnesses. Under cross-examination by the Division, Mr. Kenney stated that its cost to provide wireline residential basic exchange service is greater than the revenue derived from that service. Ms. O'Brien admitted that any change in VZ-RI's tariff would have to be approved by the Commission. Also, Ms. O'Brien stated that VZ-RI's proposed regulation plan cannot supersede the Division's nor the Commission's statutory rights.<sup>19</sup> Under cross-examination by Cox, Ms. O'Brien stated that at an open meeting the Commission approved VZ-RI's request to implement promotions after ten days notice to the Commission. Also, Ms. O'Brien explained that the tariffed service within a bundle is subject to the price floor certification. Mr. Kenney agreed that a CLEC could file a complaint with the Commission if it believed that VZ-RI was violating the price floor. Under cross-examination by the Attorney General, Ms. O'Brien stated that the Commission or the Division could request service quality information from VZ-RI at any time.<sup>20</sup>

Under cross-examination by Commission counsel, Mr. Vasington admitted that a duopoly may not necessarily result in a competitive market, but that a competitive market can exist with a duopoly. Mr. Kenney was unaware of the number of VOIP customers in Rhode Island, but stated that 165,000 customers have internet service. Also, Mr. Kenney acknowledged that VOIP still has technical problems such as E-911 access. Mr. Vasington admitted that VOIP may not be a substitute for every customer, but is a

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<sup>18</sup> Tr. 12/6/05, pp. 9-25.

<sup>19</sup> *Id.*, pp. 57, 79, 94-95.

<sup>20</sup> *Id.*, pp. 104, 113, 117, 137.

substitute for enough customers to discipline prices in the marketplace.<sup>21</sup> Mr. Kenney cited an FCC report where 5.5 percent of households have only a wireless telephone. Also, Mr. Kenney stated UNE-P would be available but only under a commercial agreement and not at TELRIC rates. Mr. Vasington agreed, for the most part, that resale does not exert price discipline, and that its impact is marginal. Ms. O'Brien acknowledged that as of October 2003, UNE-L CLECs only provided service to a handful of residential customers.<sup>22</sup>

Utilizing various figures, Mr. Kenney agreed that approximately 70 percent of residential wireline or electric customers have Cox cable service. He also agreed that these Cox customers would have the ability to purchase telephone service from Cox for \$11.95 per month, which is less expensive than what VZ-RI provides for unlimited residential basic exchange services at prices ranging from \$14.30 to \$19.26 per month. Furthermore, Mr. Kenney concurred that the remaining 30 percent of residential customers, who do not have Cox cable service, would be able to purchase Cox phone service at \$19.95 per month. Mr. Vasington stated that because VZ-RI would not be able to identify and target the 30 percent who do not have Cox cable service, VZ-RI must offer prices that are competitive for both groups. As a result, Mr. Vasington indicated that the customers who do not use the option of Cox cable service will get protection from customers who do use the option when it comes to how VZ-RI prices its phone service.<sup>23</sup>

Ms. O'Brien stated that the TELRIC rate, which is the wholesale rate set by the Commission for CLECs to purchase UNEs, in many cases exceeds VZ-RI's unlimited

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<sup>21</sup> *Id.*, pp. 145-146, 149-150.

<sup>22</sup> *Id.*, pp. 153, 158-160.

<sup>23</sup> *Id.*, pp. 163-164, 167-168.

basic residential service rate. Ms. O'Brien indicated that VZ-RI's approximately 66 percent share of the overall residential market is comparable to VZ-RI's share of residential customers who only purchase basic residential telephone service. Mr. Vasington stated that price is only one factor in the marketplace as to why customers choose a carrier. He also stated that a sign of negative duopoly is coordination between the two carriers. Ms. O'Brien stated that a majority of its Lifeline customers have packages or features, but only approximately 2,000 VZ-RI Lifeline customers use only measured service. Also, she stated that it was possible for VZ-RI to earn a return on equity between 14 to 19 percent in a competitive market. In addition, she stated that VZ-RI's service quality has been maintained or improved since 1996. She also acknowledged that some of VZ-RI's carrier-to-carrier metrics are based on parity to VZ-RI's retail services. Mr. Vasington stated that promotions do not violate any economic concepts underlying antitrust law and that promotions occur in unregulated industries.<sup>24</sup>

Under cross-examination by the Commission, Mr. Vasington explained that demand inelasticity means customers wanting access to a telephone network and thus, being largely insensitive to change in price. Mr. Vasington stated that the purpose of economic regulation is to replace the missing discipline provided by the marketplace. He also concurred that pricing in a competitive market is inherently just and reasonable. Under redirect examination, Mr. Vasington further explained that where there is a competitive market with the absence of market power, then the result of this competitiveness are rates that are just and reasonable.<sup>25</sup>

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<sup>24</sup> *Id.*, 170, 174-175, 183, 190, 193-196, 201-203.

<sup>25</sup> *Id.*, pp. 214-219, 232-233.

The next day, Cox presented Mr. Lafferty as its witness. Under cross-examination by VZ-RI, Mr. Lafferty indicated that Cox is an ETC required to offer basic service to any residential customer in Rhode Island. Under cross-examination by Commission counsel, Mr. Lafferty stated that Cox's unlimited basic residential service of \$19.95 per month includes call forwarding and one-hour of intrastate toll calls. He also stated that Cox does not offer measured service in Rhode Island.<sup>26</sup>

The Division presented Mr. Weiss as its witness. Under cross-examination by VZ-RI, Mr. Weiss acknowledged that the Division approved of Cox's Lifeline subsidy of \$7 per month for a residential basic exchange rate of approximately \$20 per month. Counsel for the Division indicated that the Division would not object to providing to the Commission, on an annual basis, the information it receives from CLECs as to the number of lines and revenues. Mr. Weiss concurred that VZ-RI's inability to distinguish between customers with Cox cable service or those without Cox cable service exerts price discipline upon VZ-RI. Mr. Weiss concurred that Lifeline is part of the concept of universal service whereby everyone should have access to a telephone, but that additional features such as call waiting were not originally included as part of Lifeline.<sup>27</sup>

#### X. BRIEFS

On December 20, 2005, the parties filed post-hearing briefs. In its brief, VZ-RI stated that based on market share, demand elasticity and supply elasticity, VZ-RI lacks market power in the residential telephone market. Also, VZ-RI indicated that rates resulting from a competitive market are just and reasonable. VZ-RI noted that Cox, as an ETC, must offer basic residential telephone service to all Rhode Islanders and that Cox's

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<sup>26</sup> Tr. 12/7/05, pp. 19, 23-24.

<sup>27</sup> Id., pp. 55, 61-65, 70-71.

presence in the market disciplines VZ-RI's pricing and behavior. Also, VZ-RI indicated that it has less than 70 percent of the residential market. In addition, VZ-RI noted that discontinuance of UNE-P at TELRIC rates would not harm the Rhode Island market because VZ-RI's strongest competitors in the residential market do not rely on UNE-P. VZ-RI argued that VZ-RI should not be treated differently than Cox in providing a Lifeline subsidy and that VZ-RI's Lifeline customers have not seen an increase in 11 years. Given the competitiveness of the market, VZ-RI argued it should not be required to file financial earnings, service quality or competitive market profile reports. Also, VZ-RI noted that its competitors do not have these reporting requirements. Furthermore, VZ-RI reiterated its opposition to Cox's proposals to require its promotions to have a price floor and indicated there was no need to place certain specific provisions into VZ-RI's regulation plan since they are already encompassed in state law.<sup>28</sup>

In its brief, Cox stated that Verizon's regulation plan should be clearer relative to tariffed retail services in a bundle being subject to the price floor and that different rates for similarly situated customers is prohibited. Also, Cox argued that promotions should be subject to the price floor. In addition, Cox stated that VZ-RI's regulation should expressly allow a CLEC to ask the Division or the Commission to request VZ to file any supporting documentation to confirm that a rate meets the price floor. Lastly, Cox indicated there should be a set term of years to VZ-RI's regulation plan to allow the parties an opportunity to assess the effectiveness of the plan.<sup>29</sup>

In its brief, the Division stated that price caps should be imposed on VZ-RI's residential basic exchange rates because demand for telephone service is inelastic and

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<sup>28</sup> VZ-RI's brief.

<sup>29</sup> Cox's brief.

VZ-RI may target increases to vulnerable customers. Also, the Division argued that tariffed services should remain regulated and that any alteration to these services must be approved by a tariff change as provided in Paragraph H of the prior ARP. In addition, the Division emphasized that the proposed Paragraph E is inappropriate because it limits the ability of the Division to petition the Commission to alter VZ-RI's form of regulation. Furthermore, the Division argued that VZ-RI should still have reporting requirements for service quality, earnings and market share in order to assist regulators in their oversight function.<sup>30</sup>

The George Wiley Center filed a memorandum in opposition to VZ-RI's filing as it affects Lifeline customers. The George Wiley Center stated that the Commission lacked vital information and that the George Wiley Center's interests were not protected in the proceeding. As a result, the George Wiley Center recommended deferral of VZ-RI's request as to Lifeline customers or at least a delay in the implementation of the request for at least a year to permit Rhode Island General Assembly action.

#### XI. DISCOVERY DISPUTE AND OPEN MEETING

On December 20, 2005, the George Wiley Center also filed a motion to compel answers from VZ-RI relating to customers who were terminated due to non-payment. The George Wiley Center stated that this information was relevant, timely and non-competitively sensitive.<sup>31</sup> On December 20, 2005, VZ-RI filed a letter in opposition to the George Wiley Center's motion to compel. VZ-RI stated that the information requested was irrelevant and that the data did not differentiate between Lifeline and non-Lifeline customers. Also, VZ-RI noted that the George Wiley Center refused to treat

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<sup>30</sup> Division's brief.

<sup>31</sup> George Wiley Center memorandum.

information as confidential and proprietary. Chairman Germani, as presiding Commissioner, denied the motion due to lack of relevance to the proceeding.

At an open meeting on December 21, 2005, the Commission reviewed the evidence and the pleadings. The Commission adopted VZ-RI's proposed regulation plan with various modifications. These modifications included making it clear that VZ-RI is still subject to the Commission's statutory authority, must follow the tariff process, and that the Division can request the Commission to order a more restructured form of regulation for VZ-RI if there is a material change of circumstances. In addition, the Commission required VZ-RI to file quarterly service quality reports, semi-annual competitive profiles, and annual earnings reports. Also, the Commission allowed VZ-RI to immediately reduce its Lifeline subsidy for all its Lifeline customers with features and packages, begin to reduce the Lifeline subsidy for those with only basic unlimited service after June 30, 2006, and allowed no reduction in the subsidy for Lifeline customers with only measured service. Furthermore, VZ-RI's regulation plan will be for three years but will stay in effect until further Commission action. Lastly, the Commission will initiate an investigation to determine if Cox should be required to provide measured service to Lifeline customers at the same rate as VZ-RI.

#### COMMISSION FINDINGS

For most of the 20<sup>th</sup> century, telephone was viewed as a natural monopoly, which was subject to cradle-to-grave regulation over prices and services. Government regulation served as the visible surrogate for the invisible hand of the market. However, regulation preferred to mimic government rather than emulate markets by focusing on the transfer of wealth instead of promoting efficiency. As a result, in the name of universal

service, long-distance rates were used to subsidize local rates, business rates subsidized residential rates, urban rates subsidized rural rates, and rates for toll calls as well as features subsidized basic telephone rates.<sup>32</sup>

The epoch ended with the emergence of new technology, first in long-distance telephone and then in local telephone service. Illustrating the theory of economist Joseph Schumpeter, these technological changes in the telephone industry demonstrated that “the process of Creative Destruction is the essential fact about capitalism.”<sup>33</sup> New technologies destroyed the technical justification for a natural monopoly in telephone and created the opportunity for competition. The technological barrier was first broken in long-distance telephone by microwave communications in the 1960s and 1970s.<sup>34</sup> As a result, competition was ordered by Judge Greene in 1982 and the FCC eliminated all price regulation over the once dominant long-distance telephone carrier, AT&T, in 1995.<sup>35</sup> In local telephone, technology advanced at a slower pace but by 1996, with the enactment of the Telco Act, Congress intended to “promote competition and reduce regulation” in local telecommunications.<sup>36</sup> Today, nearly ten years later, this Commission must decide whether to end price regulation for VZ-RI, the dominant carrier.

The justification for government regulation, as stated by economist Milton Friedman, is “to do something that the market cannot do for itself.”<sup>37</sup> Preeminent regulator, Alfred E. Kahn once indicated that, “competition” or “an unregulated market

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<sup>32</sup> Huber, Kellogg and Thorne, Federal Telecommunications Law, 2<sup>nd</sup> Ed. (1999), p. 2, 21-22, 33, 83-84.

<sup>33</sup> Joseph Schumpeter, Capitalism, Socialism & Democracy, (1942), p.82.

<sup>34</sup> Thomas K. McGraw, Prophets of Regulation, (1984), p. 307.

<sup>35</sup> Steve Coll, The Deal of the Century, (1986), pp. 361-363, and Huber, Kellogg, and Thorne, Federal Telecommunications Law, (1999) pp. 2-3, 159.

<sup>36</sup> Preamble of Telecommunications Act of 1996.

<sup>37</sup> Milton Friedman, Capitalism & Freedom, (1962), p. 27.

economy will produce optimum economic results” and therefore, “the single most widely accepted rule” to regulate industries is to do so in a manner which will “produce the same results as would be produced by effective competition, if it were feasible.”<sup>38</sup> Accordingly, as stated by Justice Stephen Breyer, the objective of regulation is either to transform the monopolistic industry into a competitive market or to establish a ratemaking approach that attempts to replicate a competitive market.<sup>39</sup>

Sometimes the purpose of regulation is forgotten and regulation continues for its own sake. For instance, during the 19<sup>th</sup> Century, railroads were considered natural monopolies, but by the 20<sup>th</sup> Century, with the technological emergence of road and air transport competition, the need to end regulation should have been apparent.<sup>40</sup> Instead, government regulation at the Interstate Commerce Commission (“ICC”) persisted in maintaining the regulatory status quo.<sup>41</sup> In many ways, the ICC epitomized the remark by economist, John Maynard Keynes, that “the difficulty lies, not in the new ideas, but in escaping from the old ones.”<sup>42</sup>

In 1843, the Rhode Island Public Utilities Commission was the first public utility commission established in the nation to regulate railroads.<sup>43</sup> The question now is whether this Commission will be the first state utility commission to end price regulation for local residential telephone service due to all of the technological advances ending VZ-RI’s natural monopoly or will this Commission follow the ICC down the road of ignoring competition, and imposing patchwork regulation.

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<sup>38</sup> Alfred E. Kahn, The Economics of Regulation, Vol. 1, (1970) p. 17.

<sup>39</sup> Stephen Breyer, Regulation and Its Reform (1982), p. 37.

<sup>40</sup> Milton Friedman, Capitalism & Freedom, (1962), p.39.

<sup>41</sup> Ari & Olive Hoogenboom, A History of the ICC: From Panacea to Palliative, (1976), p. 188.

<sup>42</sup> John Maynard Keynes, The General Theory of Employment, Interest, and Money, (1936), p. viii.

<sup>43</sup> Thomas K. McGraw, Prophets of Regulation, (1984), p. 17.

The Commission has asserted that the goal of the Telco Act is to “lift the heavy hand of government regulation from the telecommunications market.”<sup>44</sup> In 2002, the Commission granted VZ-RI pricing flexibility for its local business telephone rates. Now in 2005, the Commission must examine if VZ-RI should be granted pricing flexibility for VZ-RI’s local residential telephone rates.

Having the local telephone market open to competition was the standard for a successful Section 271 application by VZ-RI to enter the long-distance telephone market. However, to grant VZ-RI pricing flexibility for retail rates, there must be “a showing that there is sufficient competition to restrain VZ-RI from exercising market power.”<sup>45</sup> The Commission has defined market power as “the ability to profitably raise prices above the competitive level for a sustained period of time.”<sup>46</sup> The analysis of a company’s ability to exercise market power requires an examination of market share, supply elasticity and demand elasticity for the product.<sup>47</sup>

First, however, the product and geographic markets must be defined. In assessing the product market, one needs to determine all reasonable substitutes available to ratepayers for telephone service. In order to be considered a reasonable substitute, the alternative product must be comparable for “purposes of price, use and qualities.”<sup>48</sup> VZ-RI has argued that VOIP and wireless are reasonable substitutes. In regards to VOIP, it is clear that only a portion of the Rhode Island population has internet access since there are only 165,000 high speed internet connections in Rhode Island. Furthermore, VOIP still

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<sup>44</sup> Order No. 16032, p. 9.

<sup>45</sup> Order No. 17417, p. 45.

<sup>46</sup> *Id.*, (citing Ernest Gellhorn & William E. Kovacic, Antitrust Law & Economics in a Nutshell, 4th Ed., (1999), p. 94).

<sup>47</sup> *Id.* (citing Ernest Gellhorn & William E. Kovacic, Antitrust Law & Economics in a Nutshell, 4th Ed. (1999), pp. 95-97).

<sup>48</sup> *Id.*

has not fully resolved issues related to E-911. Thus, VOIP cannot be considered a reasonable substitute at this time. As for wireless, the FCC has indicated that only 5.5 percent of telephone customers use wireless exclusively.<sup>49</sup> Furthermore, there are areas in Rhode Island where wireless coverage may not be available. Thus, although a small technologically advanced portion of our society has decided to cut its umbilical cord to Ma Bell's landline network, there is no evidence that all or even most ratepayers are ready to leave Ma Bell's landline network and substitute wireless for landline. For nearly all customers, wireless is not a substitute for wireline but a complement. Thus, the market for local telecommunication is still largely limited to wireline telephone service.

The next step of analysis is determining the geographic market for local telecommunications services.<sup>50</sup> In the past, the Commission has construed the State of Rhode Island, as a whole, as one geographic market, in particular because of the general uniformity of VZ-RI's retail rates among different regions of the state.<sup>51</sup> It is more apparent now that competition for residential customers is quite robust across the state in urban, suburban, and rural wire centers even though basic exchange rates differ. With the exception of one wire center, Block Island, the CLEC share of residential lines is between 21.1 percent and 50 percent in the remaining twenty-nine wire centers. Only in six of these twenty-nine wire centers is the CLEC market share between 21.1 percent and 29.9 percent.<sup>52</sup> Therefore, the Commission will consider the State of Rhode Island as one geographic market for VZ-RI's residential ratepayers.

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<sup>49</sup> Tr. 12/6/05, p. 153.

<sup>50</sup> Order No. 17417, p. 46.

<sup>51</sup> *Id.*

<sup>52</sup> VZ-RI's Competitive Profile (6/30/05). This information and other proprietary information disclosed in this Report and Order is deemed public in order to satisfy the need to inform ratepayers of the basis for granting VZ-RI pricing flexibility.

The next level of the analysis is an examination of demand elasticity, supply elasticity and VZ-RI's market share. It is acknowledged even by VZ-RI, to some extent, that the demand for basic telephone service is inelastic.<sup>53</sup> This inelasticity for basic telephone service is one reason why telephone service is considered a utility service under Title 39.<sup>54</sup> Therefore, the Commission must turn to other factors.

As for supply elasticity, there are resellers, UNE-P providers and facilities-based competitors who provide residential telephone service. However, even VZ-RI acknowledges that resellers can only "marginally" exert price discipline in VZ-RI's rates.<sup>55</sup> Furthermore, the provisioning of UNE-P at TELRIC rates is a thing of the past due to recent FCC decisions.<sup>56</sup> Now, VZ-RI has the ability to determine at what price it will sell switching to its competitors. Under these circumstances, VZ-RI could require higher prices for UNE-P, which would make telephone service provided by this form of competition less attractive than VZ-RI's retail residential rates. Theoretically, VZ-RI could raise the price it will sell switching to its competitors in a manner which would mirror increases in VZ-RI's residential retail rates. In other words, the new UNE-P would just become another form of resale incapable of exerting much price discipline on VZ-RI. As for facilities-based competition, VZ-RI acknowledged that, as of October 2003, UNE-L providers only serviced a handful of residential customers.<sup>57</sup> Therefore, in the residential market, VZ-RI is primarily competing with one full facilities-based CLEC, Cox. Thus, although there is some level of supply elasticity in the residential market, under these circumstances a better indicator of any market power is market share.

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<sup>53</sup> Tr. 12/6/05, pp. 214-217.

<sup>54</sup> Order No. 17417, p. 47.

<sup>55</sup> Tr. 12/6/05, p. 160.

<sup>56</sup> Tr. 12/6/05, p. 158.

<sup>57</sup> Tr. 12/6/05, p. 159.

As this Commission has stated previously, “market share is the chief tool for assessing the competitive nature of a market.”<sup>58</sup> For example, “in antitrust cases, a market share for one company exceeding 70 to 80 percent supports an inference of market power.”<sup>59</sup> Furthermore, the FCC ended its price regulation of AT&T in the long-distance telephone market once AT&T’s share of presubscribed lines went below 70 percent.<sup>60</sup> In residential markets, VZ-RI now has less than 70 percent (62.2 percent) of all local access residential lines.<sup>61</sup> Thus, there is certainly no need to place price ceilings on residential features or packages. However, the fact that VZ-RI’s residential market share has gone below 70 percent does not end the analysis. In the past, the Commission has expressed a concern that “customers who only have POTS”, which is basic primary residential telephone service without features, “may never be seen by CLECs as a particularly attractive and lucrative business prospect.”<sup>62</sup> However, when one compares the number of VZ-RI residential customers who purchase residential phone service without any additional phone features and the number of Cox residential customers who purchase residential phone service without any additional phone features, VZ-RI has approximately a two-third’s share of these customers.<sup>63</sup> Thus, it does not appear VZ-RI can exercise market power in this small subset of the residential phone market for

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<sup>58</sup> Order No. 17417, p. 48.

<sup>59</sup> *Id.*, (citing Ernest Gellhorn & William E. Kovacic, Antitrust Law and Economics in a Nutshell, 4th Ed. (1994) p. 113, 117-118).

<sup>60</sup> In the Matter of the Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd. 3271, Oct. 12, 1995, Appendix B, Figure 1.

<sup>61</sup> VZ-RI’s Competitive Profile (6/30/05). Even when MCI is included in VZ-RI’s residential market share as a result of the pending merger, VZ-RI’s market share is still clearly below 70 percent. VZ-RI’s PUC Data Resp. 2-3 (12/5/05).

<sup>62</sup> Order No. 17417, p. 51.

<sup>63</sup> Tr. 12/6/05, pp. 172-174. See VZ-RI’s PUC Data Resp. 1-8(b) (11/23/05) and Cox Data Resp. 2 (11/23/05).

POTS.<sup>64</sup> Furthermore, all POTS customers can choose Cox as an alternative to VZ-RI since Cox, as an ETC, is required to provide basic residential phone service to all Rhode Islanders, even those in communities not serviced by Cox cable.

Unfortunately, the residential market is still primarily serviced by two full facilities-based carriers, VZ-RI and Cox. In essence, there is a duopoly. However, there does not appear to be any evidence of negative duopolistic behavior. Although VZ-RI has raised its residential primary basic exchange rates since January 1, 2003, Cox has not raised its stand alone basic residential telephone service rate above \$19.95 per month and Cox has not raised its basic residential telephone service rate of \$11.95 per month, if the customer purchases another Cox product such as cable.<sup>65</sup> Furthermore, nearly 72 percent of residential customers can choose Cox basic telephone service over VZ-RI and pay a lower amount for their telephone service since they subscribe to Cox cable.<sup>66</sup> Cox's basic residential telephone rate of \$11.95, if the customer also purchases Cox cable service, is below VZ-RI's basic unlimited residential telephone rates, which range from \$14.30 per month to \$19.26 per month.<sup>67</sup> For the remaining group of residential customers, who for one reason or another, do not have Cox cable service, there is a concern that these customers will be targeted with rate increases. However, it would be nearly impossible for VZ-RI to identify and target these customers. These non-Cox cable telephone customers would enjoy the price discipline exerted on VZ-RI's retail residential

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<sup>64</sup> In fact, there are only 65,996 VZ-RI residential customers who do not have features or a package. VZ-RI PUC Data Resp. 1-8(b) (11/23/05).

<sup>65</sup> Cox's PUC Data Resp. 4 (11/23/05).

<sup>66</sup> There are approximately 303,067 residential customers who purchase Cox cable service in Rhode Island. (Cox PUC Data Resp. 2-2) (12/2/05). There are approximately 422,477 residential electric customers in Rhode Island (Narr. Elec. 2004 Annual Report, p. 304 and Pascoag Utility District Data Resp. in Docket No. 3709). The overall number of electric residential customers is nearly identical to the overall number of wireline residential customers in Rhode Island 426,210 (VZ-RI's Competitive Profile 6/30/05).

<sup>67</sup> VZ-RI PUC Data Resp. 1-8(a) (11/23/05).

telephone rates by customers who also purchase Cox cable. If VZ-RI ever attempted to target customers without Cox cable, this would be an exercise of market power by VZ-RI and would likely be denied by the Commission when it reviewed the tariff revision.<sup>68</sup>

There may be instances where market power may be exercised through geographic deaveraging. However, “geographic deaveraging is not inherently against the public interest” since VZ-RI’s current basic residential exchange rates are “geographically deaveraged by local calling area based upon the number of access lines reached by the customers in that calling area.”<sup>69</sup> As previously stated by the Commission, the “Commission will vigorously enforce the anti-discrimination provisions of Title 39.”<sup>70</sup> Therefore, “if VZ-RI files tariffs to geographically deaverage retail rates that were uniform statewide or within a particular calling area” then “VZ-RI must rebut the presumption that the proposed rates do not constitute improper discrimination among similarly situated ratepayers.”<sup>71</sup> Since VZ-RI’s successor ARP is subject to Title 39’s anti-discrimination sections and any rate changes must be done through a tariff revision, there is no need to place a clause relating to geographic deaveraging in VZ-RI’s successor ARP.

Some concern was raised that approval of VZ-RI’s proposal would eliminate VZ-RI’s statutory requirement to file tariffs with the Commission. To address this concern and avoid any confusion in this area, the Commission requires VZ-RI to amend its regulatory plan to include the language from Paragraph 8 of the settlement for the 2002

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<sup>68</sup> For instance, if the Block Island exchange was targeted for a rate increase in basic residential service and other exchanges in the same Rate Group were not included, then this would be deemed an exercise of market power by VZ-RI since Block Island has no access to Cox cable service. See VZ-RI’s PUC Data Resp. 1-8(a) (11/23/05).

<sup>69</sup> Order No. 17417, pp. 55-56.

<sup>70</sup> Id., p. 56.

<sup>71</sup> Id.

ARP indicating that the Commission has a continuing statutory obligation to protect the public against improper and unreasonable rates that cannot be precluded by the plan and that it has the authority to review and modify rates to protect the public from rates found to be improper and unreasonable. Also, VZ-RI will amend its regulatory plan to specifically incorporate Section H of the 2002 ARP which requires VZ-RI to follow the tariff revision process. Lastly, Section E of VZ-RI's proposal is to be modified to eliminate the restriction on the ability of the Division to petition the Commission to request VZ-RI to have a more structured form of regulation if there is a material change in circumstances. These changes in VZ-RI's new regulatory plan will make it abundantly clear that VZ-RI is still subject to the statutory requirements imposed on public utilities engaged in local telecommunications. These modifications will also make it clear that the Commission, on its own initiative, or by a petition, can modify VZ-RI's form of regulation "in order to promote the public interest or maintain just and reasonable rates."<sup>72</sup>

Under R.I.G.L. §39-3-11, the Commission must periodically review rates of public utilities. Thus, a term of years for a regulatory plan is an appropriate method to which the Commission can fulfill its statutory duty to periodically review a utility's rates. Since VZ-RI's prior regulatory plan was three years in duration, and this time period proved adequate to demonstrate the growth in the market, VZ-RI's new regulatory plan should also be set for three years or until December 31, 2008. However, there may be no need to change VZ-RI's regulatory plan at the end of these three years. Therefore, this plan will stay in effect until such time, after December 31, 2008, the Commission takes any action. For instance, at some point in the second half of 2008, the Commission will

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<sup>72</sup> Order No. 18198, p.15.

ask VZ-RI if there is any need to alter its regulatory plan. If VZ-RI indicates that the current plan should remain in effect, the other parties to this docket can still petition the Commission to open a proceeding to review VZ-RI's form of regulation. At that point, the Commission will decide whether to open proceedings to change VZ-RI's regulatory plan or simply keep VZ-RI's current plan in place for another period of time.

To assist the Commission in monitoring whether VZ-RI's form of regulation is in the public interest, VZ-RI must comply with certain reporting requirements. First, VZ-RI must continue to file its annual earnings report. The report will keep the Commission informed as to whether VZ-RI is achieving excessive earnings in comparison to other competitive industries and assist the Commission to determine if there is a need to re-examine VZ-RI's form of regulation. At present, CLECs are required to file with the Division annual information indicating the number of lines they have in Rhode Island and their revenues derived from Rhode Island. In lieu of engaging in a rulemaking and duplicating the Division's effort, the Division shall make an annual filing with the Commission on or before June 30th of every year listing the number of lines and the revenues for each CLEC in Rhode Island.<sup>73</sup>

In regards to service quality, "in a competitive market, there is less need for government intervention to establish service quality standards in an industry because competition requires an enterprise to provide reasonable service quality or face the possibility that customers will shift to another competitor."<sup>74</sup> Since the passage of the Telco Act of 1996, VZ-RI's service quality as of 2005 has improved in four categories

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<sup>73</sup> The Division did not object to making such a filing. Tr. 12/7/05, pp. 61-62.

<sup>74</sup> Order No. 17605, p. 29.

and is nearly identical to the levels achieved in 1997 in the other three categories.<sup>75</sup> Therefore, the Commission deemed it unnecessary to impose a service quality plan with penalties on VZ-RI. However, since Rhode Island is still transitioning to a fully competitive market in local telecommunications, it is a prudent measure to monitor VZ-RI's service quality by continuing current reports on a quarterly basis. Although VZ-RI may deem it unfair that it is the only telephone carrier which must file quarterly service reports, the reality is that VZ-RI is still the largest telephone provider in the State and, therefore, to some extent sets the pace for service quality of Rhode Island's local telecommunications. Also, the service quality of many CLECs is dependent on VZ-RI's service quality since they purchase UNEs from VZ-RI, which is a reason for Carrier to Carrier Guidelines and the Performance Assurance Plan.

As for the competitive market, it is important for the Commission to obtain data to properly monitor the market. As a result, the Commission requires VZ-RI to continue to provide on a semi-annual basis its competitive profile reports which contain data regarding CLEC market share by mode of entry, residential and business lines, and total access lines. As previously stated by the Commission, this information will "give the Commission an early warning signal of any dysfunction in the local market."<sup>76</sup>

What is not necessary for the health of the competitive market is more pricing restrictions. Currently, VZ-RI is subject to a LRIC price floor for its tariffed retail services. If it appears VZ-RI has violated this LRIC price floor, the Commission or the Division can request VZ-RI to provide a cost study to ensure that the price floor is not violated. It is always understood that a CLEC can request the Division or the

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<sup>75</sup> Div. PUC Rec. Req. (12/8/05).

<sup>76</sup> Order No. 17417, p. 59.

Commission to seek a LRIC cost study from VZ-RI. A CLEC can ask the Commission or the Division to initiate investigations or for the Commission to suspend a tariff. There is no need to further complicate VZ-RI's regulatory plan to state an option which is always available to CLECs.

Furthermore, there is no need to place a LRIC price floor on promotions. There has been a no price floor on promotions by either Cox or VZ-RI since 1988. No evidence has been presented that a price floor for promotions is necessary to protect the competitive market from predatory pricing. Also, promotions are common in unregulated competitive industries. As the market becomes more competitive, fewer restrictions, not more restrictions are in order. Promotions are a means to attract new customers or to incent current customers to use new services. Thus, promotions usually equate to lower prices for customers. The Commission will not stand in the way of lower prices for consumers, which is the primary benefit of competition. The current restriction on VZ-RI regarding promotions, which are limited to six months duration after ten days notice, is sufficient.<sup>77</sup>

The final issue is the level of protection Lifeline customers need in the residential competitive market. For eleven years, VZ-RI's Lifeline customers have not experienced an increase in their residential basic telephone service. Instead, VZ-RI has increased its contribution to the Lifeline subsidy from \$3.50 per line, per month to \$5.50 per line, per month, which combined with the federal match of \$3.50 totals \$9.00 per line, per month. In contrast, Cox, as Rhode Island's other ETC, is only required to contribute \$3.50 along with the federal matching funds of \$3.50 which totals \$7.00 per line, per month.

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<sup>77</sup> Order No. 12605 and RIPUC Open Meeting Minutes 4/6/00.

The George Wiley Center objected on procedural grounds that VZ-RI failed to provide public notice of its change in rates as required by Commission Procedural Rule 2.4 which requires a utility to provide notice of general rate schedule changes in a newspaper. However, this rule is not applicable to VZ-RI in these circumstances. First, this docket involves VZ-RI's form of regulation and thus this rule has not been applied to VZ-RI, or its predecessors, in their form of regulation plans since 1989. Simply, VZ-RI did not propose any changes in its rates in this case. Secondly, Commission Procedural Rule 2.2 makes it clear that the second part of the Commission's Procedural Rules, including Rule 2.4, "shall be applicable only to proceedings involving the investigation for charges in rates constituting a general rate increase in which the respondent utility's overall revenue requirements are at issue." Since VZ-RI's form of regulation is not a general rate increase in which the overall revenue requirement of the utility is at issue, the notice requirement of Commission Procedural Rule 2.4 is not required. In fact, the second part of the Commission's Procedural Rules is applicable to utilities who file rate cases, not utilities like telecommunications carriers who are in a competitive market. For instance, Commission Procedural Rules 2.6 and 2.8 discuss rate year, rate base and test year. Lastly, the George Wiley Center and the interests of low-income consumers have been adequately protected by other parties in the proceeding such as the Division and the Attorney General. For example, the Division has argued through expert testimony that VZ-RI should be required to maintain its Lifeline subsidy for at least one year. This is similar to one of the George Wiley Center's positions in this proceeding.

Since the George Wiley Center has not intervened in prior VZ-RI's form of regulation plans and its interests overlapped to a large extent with the interests of the

Division and the Attorney General, VZ-RI should not have been required to give the George Wiley Center notice of its filing. The George Wiley Center was not a party as a matter of right. Furthermore, the Commission's interpretation of its own regulations is entitled to deference and the Commission has discretion in how it applies its procedural rules.<sup>78</sup>

At present, VZ-RI has approximately 36,325 Lifeline customers. However, only 13,220 of these Lifeline customers purchase only basic residential telephone service, either unlimited or measured. The remaining 23,105 Lifeline customers have basic residential telephone service as part of a package or with features such as call waiting or caller ID.<sup>79</sup> The Lifeline subsidy is for the purpose of ensuring that all households, regardless of economic hardship, have access to basic telephone service. It is not to ensure that all households have access to special telephone services. If Lifeline customers cannot afford additional increases in basic telephone service, they can reduce the cost of telephone service by eliminating features such as call waiting. Accordingly, VZ-RI can immediately begin to reduce its total Lifeline subsidy from \$9 per line, per month to \$8 per line, per month in 2006, and then to \$7 per line, per month in 2007, as it proposed in its original filing, for Lifeline customers who are purchasing a package or a feature.

Of the 13,220 VZ-RI Lifeline customers who purchase only basic residential telephone service, 11,295 purchase only basic unlimited residential telephone service without packages or features.<sup>80</sup> As stated previously, the Lifeline subsidy is to ensure all

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<sup>78</sup> Order No. 18198, p. 11 (citing Udall v. Tallman, 380 U.S. 1, 16 (1965), and American Farm Lines v. Black Ball Freight Service 387 U.S. 532, 538 (1970)).

<sup>79</sup> VZ-RI's PUC Data Resp. 2-2 (12/2/05).

<sup>80</sup> Id.

households have access to basic telephone service. However, the Telco Act has determined that local telephone service must become a competitive market. Accordingly, basic unlimited residential rates should become more cost based. In many instances, this will mean a rate increase because basic residential telephone rates have been subsidized by other telephone services.<sup>81</sup> If Lifeline customers with basic unlimited residential phone service do not want to pay these higher rates and experience the turmoil of the competitive market, they can choose basic measured residential service. In order to give these customers some time to prepare for the potential transition to measured service, and to allow the Rhode Island General Assembly time to address this issue if they so choose, VZ-RI must continue its current \$9 per line, per month Lifeline subsidy until June 30, 2006 for basic unlimited residential service without features or which is not part of a package. After June 30, 2006, VZ-RI is allowed to reduce its Lifeline subsidy from \$9 per line, per month to \$8 per line, per month in 2006, and then to \$7 per line, per month in 2007, as set forth in its original proposal, for Lifeline customers who are only purchasing basic unlimited residential service.

Lastly, there are 1,925 remaining VZ-RI Lifeline customers with only basic measured residential service.<sup>82</sup> This small handful of customers pays \$1 per month for the most limited access to telephone service. Undoubtedly, many of these customers have such limited service due to economic hardship. In a competitive market, government at times creates a basic and limited safety net for customers to satisfy their basic needs. Measured telephone service with no other features is a limited safety net

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<sup>81</sup> In fact, the residential basic unlimited exchange rate in all but three of VZ-RI's twenty-five exchanges is below the wholesale rate the Commission has approved for VZ-RI to charge its competitors for UNE-P at TELRIC rates. VZ-RI's PUC Data Resp. 1-8(c) (11/23/05).

<sup>82</sup> VZ-RI's PUC Data Resp. 2-2 (12/2/05).

that ensures universal service regardless of economic hardship. Accordingly, VZ-RI is required to subsidize Lifeline customers with measured service only so that they only pay \$1 per month. This safeguard will ensure that no Rhode Islander will go without access to a telephone due to economic poverty. Of course, VZ-RI correctly notes that in a competitive market, one competitor should not be placed at a competitive disadvantage because it carries more societal burdens than other carriers. There are two ETCs in Rhode Island, VZ-RI and Cox. By being ETCs, they receive matching Universal Service funds from the federal government and in return offer basic residential telephone service to all Rhode Islanders. In order to promote fairness, the Commission will initiate an investigation to determine if Cox should also be required to provide Lifeline measured service at a rate similar to that offered by VZ-RI.

Competition in the residential telephone market has developed in Rhode Island. It is not perfect but it is real, substantial, and fully functioning. Where there is a competitive market with the absence of market power, the rates created by this competitive market are just and reasonable under accepted economic principles and under Title 39.<sup>83</sup> In the past, the Commission declared that, “the more competitive the market, the less need for regulatory oversight.”<sup>84</sup> Rhode Island’s local telephone services has grown and developed to the stage where there is a fully developed competitive residential local telephone market and thus, there should be near total pricing flexibility for all carriers. Therefore, the Commission as regulator must step aside like a parent and allow its child, the local telephone market, to stand on its own because it has graduated to the

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<sup>83</sup> There is “no particular formula” which “binds the Commission in formulating its rate decision; the sole requirement is that the ultimate rate be fair and reasonable.” In re Island Hi-Speed Ferry, LLC 746 A.2d 1240, 1245-46. (R.I. 2000).

<sup>84</sup> Order No. 16032, p. 10.

competitive level. But, like any concerned parent, the Commission will continue to watch and monitor the market, but it will only step in and assist if it falters. For now, and hopefully for the future, the local residential telephone market will continue to be strong and will benefit all ratepayers of Rhode Island.

Accordingly, it is

( 18550 ) ORDERED

1. Verizon-Rhode Island's proposed Alternative Regulation Plan filed on August 19, 2005 is approved with the following modifications:

a. The plan shall include Section H from the Alternative Regulation Plan approved by Order No. 17417; language recognizing the Commissions' statutory authority to protect the public against improper and unreasonable rates; and elimination of any restriction in Section E of the proposed plan which would limit the Division's ability to petition the Commission, and instead expressly indicate that the Division can petition the Commission to require Verizon-Rhode Island have a more structured form of regulation if there is a material change in circumstances.

b. The plan as modified shall end on December 31, 2008, but will stay in effect until such time as the Commission takes an action to alter the plan.

c. Verizon-Rhode Island is permitted to reduce its Lifeline subsidy to \$8 per line, per month in 2006 and then \$7 per line, per month in 2007 for those who purchase basic residential telephone service, either unlimited or measured, as part of a package or with features. After June 30, 2006,

Verizon-Rhode Island can reduce its Lifeline subsidy to \$8 per line, per month in 2006 and then \$7 per month in 2007 for those who purchase basic unlimited residential telephone service without any features or not as part of a package. Verizon-Rhode Island must continue its Lifeline subsidy to the extent necessary to allow basic measured residential telephone service without features or not as part of a package to be purchased at \$1 per month by Lifeline customers.

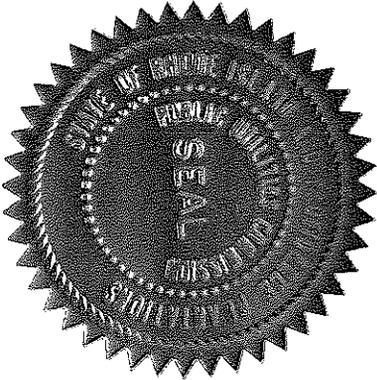
d. Verizon-Rhode Island is required to file with the Commission annual earnings reports, the first page of its semi-annual competitive profile report and quarterly service quality reports.

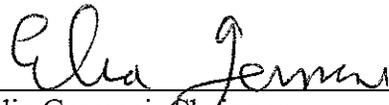
e. Verizon-Rhode Island will file a revised Alternative Regulation Plan within thirty days.

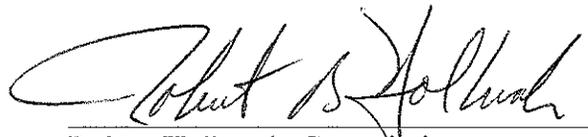
2. The Division of Public Utilities and Carriers shall provide an annual report to the Commission by June 30th of every year containing the information it receives from competitive local exchange carriers as to the revenues and number of lines these entities have in Rhode Island.
3. The Commission shall initiate an investigation to determine if all eligible telecommunications carriers in Rhode Island must provide basic measured service for Lifeline customers.
4. Verizon-Rhode Island shall comply with all other terms and conditions imposed by the Report and Order.

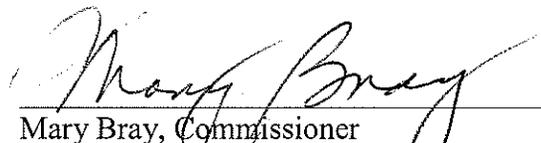
EFFECTIVE AT WARWICK, RHODE ISLAND ON JANUARY 1, 2006  
PURSUANT TO AN OPEN MEETING ON DECEMBER 21, 2005. WRITTEN  
ORDER ISSUED MARCH 17, 2006.

PUBLIC UTILITIES COMMISSION



  
Elia Germani, Chairman

  
Robert Holbrook, Commissioner

  
Mary Bray, Commissioner

**NOTICE OF RIGHT OF APPEAL** PURSUANT TO R.I.G.L. SECTION 39-5-1,  
ANY PERSON AGGRIEVED BY A DECISION OR ORDER OF THE COMMISSION  
MAY, WITHIN SEVEN (7) DAYS FROM THE DATE OF THE ORDER, PETITION  
THE SUPREME COURT FOR A WRITE OF CERTIORARI TO REVIEW THE  
LEGALITY AND REASONABLENESS OF THE DECISION OR ORDER.