

Docket No. 2004-809  
Rebuttal Testimony of Robert Loubé

BEFORE THE MAINE PUBLIC UTILITIES COMMISSION

INVESTIGATION INTO LINE SHARING PURSUANT TO STATE LAW

DOCKET NO. 2004-809

REBUTTAL TESTIMONY

OF ROBERT LOUBE, Ph.D.

ON BEHALF OF

OFFICE OF PUBLIC ADVOCATE

March 18, 2005

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ROBERT LOUBE**

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**I. INTRODUCTION**

**Q: Please state your name and business address.**

**A:** My name is Robert Loube. My business address is 10601 Cavalier Drive, Silver Spring, Maryland 20901.

**Q: By whom are you employed and in what capacity?**

**A:** I am the Director, Economic Research, Rhoads and Sinon, LLC.

**Q: On whose behalf are you testifying?**

**A:** I am testifying on behalf of Office of Public Advocate (OPA).

**Q: Are you the same Robert Loube who provided direct testimony in this proceeding?**

**A:** Yes.

**II. PURPOSE OF TESTIMONY**

**Q: What is the purpose of your testimony?**

**A:** The purpose of my testimony is to rebut the contentions of Mr. Dinan, Vasington, and Meehan regarding the usefulness of a state authorized line sharing UNE. Their declarations contend that the line sharing UNE is not necessary because:

- broadband deployment is expanding without the UNE,
- the UNE discourages investment in broadband facilities,
- the UNE interferes with negotiations that lead to the establishment of private commercial agreements,
- Private commercial agreements are acceptable substitutes for the UNE.

1 I will show that these contentions are incorrect, and that requiring Verizon to offer a  
2 line-sharing UNE is a positive step towards obtaining affordable access to those  
3 information services that require a computer and rely on the use of the  
4 telecommunications network.

5 With regard to the independent telephone carriers, my review of their filing shows  
6 that, in general, DSL service is available to their customers. However, in some  
7 cases, the service does not appear to be affordable. Therefore, my testimony  
8 supports a recommendation that the Commission forbear from requiring the  
9 independent carriers from offering the line sharing UNE in those instances where  
10 the carrier commits to ensuring that affordable service is available. If a carrier does  
11 not make the commitment, then the Commission should require that carrier to offer  
12 the line sharing UNE so that competition has a chance to reduce the rate to an  
13 affordable level.

14 **III. THE DECLARATION OF MR. EDWARD DINAN**

15 **Q: Please summarize Mr. Dinan's declaration.**

16 **A:** Mr. Dinan describes the growth of broadband services in Maine. He further  
17 contends that this growth does not depend on a line sharing mandate. He also  
18 believes that there is no reason for the state to establish a line sharing mandate  
19 because line sharing arrangements are available to competitors through commercial  
20 agreements. Finally he discusses the legislative history of Section 7101(4).

21 **Q: Has there been a growth in the number of consumers of broadband services in**  
22 **Maine?**

1   **A:**   Yes. However, the dramatic increases are function of the starting point of the  
2           analysis. Large percentage increases occur when the base is small. For example, if  
3           the base is 100 lines, then an addition of 30 lines is a 30 percent increase, but if the  
4           base in 1000 lines, then an addition of 30 lines is only a 3 percent increase. To  
5           understand whether the performance of Maine's carriers and broadband market is  
6           acceptable, Maine's record should be compared to the record of another state(s).

7   **Q:   What state is comparable to Maine?**

8   **A:**   Vermont is comparable to Maine. There are three reasons why Maine and Vermont  
9           are comparable. First, in both states, Verizon receives high cost model support  
10          from the federal universal service fund.<sup>1</sup> Second, Verizon's rates for DSL service  
11          are the same in both states and changes in these rates occur at approximately the  
12          same time.<sup>2</sup> Third, Verizon serves approximately 83 percent the customers in Maine  
13          and 85 percent of the telephone customers in Vermont.<sup>3</sup>

14   **Q:   How does Maine compare with Vermont with regard to the provision of DSL**  
15       **service?**

16   **A:**   The Vermont record is superior to Maine's in terms of the percentage of customers  
17          purchasing DSL service. In Vermont, the ratio of DSL service to the number of  
18          telephone lines is 5.3 percent, while in Maine this ratio is 3.6 percent. Vermont  
19          ranks 20<sup>th</sup> among the 48 states and the District of Columbia for which this DSL  
20          ratio is available, while Maine ranks 47<sup>th</sup>.<sup>4</sup> These values compare the entire states  
21          and are not Verizon specific. However, because Verizon serves approximately the

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<sup>1</sup> <http://www.universalservice.org/overview/filings/2005/Q1/default.asp>

<sup>2</sup> Verizon's response to OPA's Data Request No. 2-9.

<sup>3</sup> Exhibit RL\_1.

1 same percentage of the lines in each state, these percentages are a good indicator of  
2 Verizon's performance. Obviously, if the pattern of DSL service among  
3 independent carriers differs among the states, then the usefulness of these statistics  
4 decline.

5 **Q: Does line sharing play a significant role in the broadband market in Maine?**

6 **A:** Yes. GWI states that it serves approximately seven thousand DSL customers using  
7 line sharing arrangements.<sup>5</sup> The FCC reports that there are 31, 577 DSLs in Maine  
8 for the year 2004. Thus, GWI represents approximately 18 percent of Maine's DSL  
9 service.<sup>6</sup>

10 **Q: Do commercial agreements provide a reasonable alternative to the line sharing**  
11 **UNE?**

12 **A:** No. The commercial agreements restrict other carriers' ability to provide DSL  
13 service. For example, other carriers cannot provide service to customers that  
14 Verizon serves using DLCs, and other carriers are not allowed to add customers in  
15 the fourth year of the agreement. Moreover, the continuation of the commercial  
16 agreements depends on the existence of the line-sharing UNE. These restrictions  
17 and several other restrictions are discussed in detail as part of my discussion of the  
18 declarations of Mr. Vasington and Mr. Meehan.

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<sup>4</sup> Exhibit RL\_2.

<sup>5</sup> Testimony of Fletcher Kittredge, page 1, lines 7-10.

<sup>6</sup> It is my understanding that GWI lines are not included in the FCC report. The Commission, if it agrees to maintain the confidentiality of the data, can obtain all of the Maine data that is used by the FCC to construct the tables in the report. "High-Speed Services for Internet Access: Status as of June 30, 2004," Industry Analysis and Technology Division, released December 2004, [www.fcc.gov/wcb/stats/](http://www.fcc.gov/wcb/stats/), Table 7.

1                   IV.     THE DECLARATION OF MR. PAUL B. VASINGTON

2  
3     **Q: Please summarize Mr. Vasington's position with regard to requiring**  
4       **incumbent carriers to provide a line sharing UNE.**

5  
6     A: Mr. Vasington believes that the Maine Commission should not require carriers to  
7       offer the line sharing UNE. He believes that such a requirement "would undermine  
8       commercial negotiations and distort the now improved competitive and investment  
9       climate." He stresses that market incentives drive firms to innovate and that  
10      regulators should take a hands-off approach to the innovation and investment  
11      decision making of carriers. He believes that the improvement in the investment  
12      and competitive climate is due to the relaxing of the unbundling requirements, the  
13      revising of pricing standards and relaxation of procedural rules associated with  
14      commercial agreements. He concludes that the best way to achieve Maine's  
15      broadband goals is to allow the market to act free of regulatory intervention rather  
16      than to mandate line sharing.

17    **Q. Do you agree with Mr. Vasington?**

18    A: No. Mr. Vasington failed to analyze the needs of the particular market in Maine.  
19      He did not follow the instructions of the USTA I court to develop a granular  
20      analysis of the broadband market in Maine. He missed the fact that the CLECs in  
21      Maine are small businesses. While small businesses are important to the American  
22      economy in general, they play an unusually large role in the broadband market in  
23      Maine. Instead, Mr. Vasington first focused on the large oligopolistic market  
24      players, and how these players compete through innovation. Even here, he did not

1 provide a complete analysis of how those large entities operate. Second, he  
2 compared central planning to a market economy. While I agree with him that  
3 market economies have proven to be more successful in innovating and responding  
4 to consumer demand than centrally-planned economies, I do not agree with his  
5 jump in logic that equates central planning with the activities of state regulatory  
6 commissions. State commissions attempt to correct for market failures. They are  
7 not central planning agencies. Third, Mr. Vasington asserts that the 1996 Act  
8 contains a preference for the use of competitive markets rather than state mandates  
9 to meet the goal of providing advanced services to all consumers. While this  
10 preference exists, it does not preclude state commissions from developing  
11 infrastructure plans. Moreover, the issue in this proceeding is not an infrastructure  
12 plan. Instead, it centers on whether line sharing will promote the goal of providing  
13 affordable broadband service. Line sharing promotes competition by allowing  
14 small businesses to operate without having to build loop facilities. These small  
15 businesses are still facilities-based CLECs because they invest in central office  
16 equipment. Finally, Mr. Vasington expresses three of his own complaints about the  
17 way the FCC has implemented its regulations under the Telecommunications Act.  
18 These complaints focus on the amount of unbundling, the UNE pricing standard,  
19 and the procedural rules associated with commercial agreements. I will show that  
20 his complaints are misplaced and do not address the needs of the companies  
21 operating in Maine.

22 **Q: When is a market an oligoplistic market?**



1    **A:**    An oligopolistic market is a market that is dominated by a few large firms. The  
2            firms are aware of each other. They know that their profits and their existence  
3            depend not only on their own actions but also on the actions of the other large  
4            players that operate in the same market. They develop strategic decisions that must  
5            take into account their expectation of the reaction of the other members of the  
6            oligopoly to that action.

7    **Q:    When does Mr. Vasington focus on oligopolistic companies?**

8    **A:**    Mr. Vasington focuses on the activities of companies in an oligopolistic market  
9            when he references Professor William Baumol's "The Free Market Innovation  
10           Machine." In that monograph, Professor Baumol makes a strong case for the theory  
11           that large firms compete in terms of innovation strategy rather than with regard to  
12           price.

13   **Q:    Why do you claim that Mr. Vasington does not provide a complete analysis of**  
14           **how these companies operate?**

15   **A:**    Mr. Vasington uses Professor Baumol's argument to support his belief that  
16           innovation is best left to the activity of private firms acting through the market  
17           mechanism. Mr. Vasington does not present the fact that Professor Baumol admits  
18           that his theory cannot explain why an industry will operate with a particular level of  
19           innovation. Rather Professor Baumol demonstrates that his theory will explain why  
20           firms try to keep up with the innovation strategies of their rivals and that there will  
21           be a tendency to increase the level of innovation activity over time.<sup>7</sup> Hence, the

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<sup>7</sup> William J. Baumol, *The Free-Market Innovation Machine*, Princeton University Press, 2002, pages 47-51.

1 Baumol theory does not explain why the telecommunications industry is subject to  
2 rapid technological advances.

3 **Q: Have the rapid technological advances experienced by the telecommunications**  
4 **industry been solely the result of the actions of competitive firms acting**  
5 **through the market place?**

6 **A:** No. The remarkable advances in communications technology have been the result  
7 of the interactions of private concerns and government agencies. This complex  
8 interaction is a long and complicated story. For example, Voice Over Internet  
9 protocol (VOIP) telephone service was introduced by small innovative firms, but  
10 this new means of communication is the child of a government-planned innovation  
11 process that developed the Internet and the Internet Protocol. Government agencies  
12 were significant contributors to the development of computers. Bell Labs,  
13 supported by the profits of a regulated monopoly, developed many of the  
14 innovations that have led to advances in the telecommunications industry. Thus,  
15 the technological advances in the telecommunication industry are a result of a  
16 combination of the cumulative efforts of private concerns, both large and small,  
17 regulated and deregulated, and of government agencies. Policy advocates such as  
18 Mr. Vasington who seek to ignore one of those elements - government agencies -  
19 ignore history and, in doing so, will lead us to inferior results.

20 **Q: On what basis does Mr. Vasington claim that state utility commissions are**  
21 **engaged in central planning?**

1    **A:**   Mr. Vasington believes that state commissions engage in central planning when the  
2           commissions develop integrated resource plans for their electric utilities and require  
3           telephone carriers to invest in particular investment strategies.<sup>8</sup>

4    **Q:**   **Do you agree with Mr. Vasington's claim that least-cost planning and state**  
5           **telephone infrastructure investment requirements are examples of central**  
6           **planning?**

7    **A:**   No. Central planning has nothing to do with least-cost planning and state  
8           infrastructure development plans. Central planning starts with a government  
9           determination of the level and types of goods and services that will be produced. It  
10          proceeds by setting output goals for each firm or production unit in the economy.  
11          The plan must coordinate the outputs of the firms and provide incentives to the  
12          firms' management such that the output goals are met. Because of the size of the  
13          coordination task these plans often fail. The results are shortages in some goods  
14          and huge inventories of other goods. In addition, because of the limited  
15          responsibility given to each firm, the firms are not able to develop new products or  
16          introduce cost-saving processes based on technological advances.

17   **Q:**   **How would you describe the state utility commission activities?**

18   **A:**   State utility commission activities are generally designed to enhance the  
19          performance of individual industries. State commission do not seek to co-ordinate  
20          the actions of multiple industries. With regard to electric utilities, state least-cost  
21          plans are designed to overcome the bias of electric utility planning towards

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<sup>8</sup> See Verizon's responses to OPA Data Request No. 2-13.

1 considering only supply-side options, while telephone infrastructure requirements  
2 are designed to fulfill universal service goals.

3 **Q: How does least-cost planning overcome the bias of electric utility planning?**

4 **A:** Least-cost planning requires utilities to determine the minimum cost method of  
5 meeting consumers' demand for energy services. That cost method has to compare  
6 the ability of demand-side alternatives to meet the demand as well as supply side  
7 options. Thus, least-cost plans require utilities to compare the conservation of  
8 electricity through efficient commercial lighting to the construction of additional  
9 power plants. On the other hand, traditional utility planning begins with the same  
10 demand for energy services but only looks to supply options to serve that demand.  
11 Therefore, traditional planning could lead to higher cost inefficient solutions for  
12 meeting the consumers' demand for energy services. In some instances, the plans  
13 also require utilities to consider the environmental impact of the demand and supply  
14 options. Markets fail because they do not consider the impact of the externality on  
15 both consumers and non-consumers of energy services. Incorporating the  
16 externality directly into the planning decision improves upon the market outcome  
17 because it explicitly considers externalities (pollution in this case) associated with  
18 production of energy services.

19 **Q: How would you describe the infrastructure development plans required by**  
20 **state commissions?**

21 **A:** State commissions adopt these plans to fulfill universal service goals. As  
22 incorporated into the Telecommunications Act of 1996, these goals include access  
23 to advanced telecommunications and information services to consumers in all

1 regions of the country and to low-income consumers and consumers residing in  
2 rural and high cost areas.<sup>9</sup> For the most part, the infrastructure plans require the  
3 carriers to make DSL services, or their equivalents, available to their consumers  
4 within a certain time frame.<sup>10</sup>

5 **Q: Does the Telecommunications Act of 1996 preclude states from requiring**  
6 **carriers to invest in particular infrastructure projects?**

7 **A:** No. The Act allows states to adopt additional definitions and standards to preserve  
8 and advance universal services within that state. The states can determine how  
9 these standards will be supported as long as that support is collected on an equitable  
10 and nondiscriminatory basis and does not burden the Federal universal service  
11 support mechanism.<sup>11</sup> Thus, if the state wants to direct the carriers to provide  
12 additional services, it would not be prohibited under the Act.

13 **Q: Is infrastructure planning relevant to this proceeding?**

14 **A:** No. This proceeding is not about directing carriers to increase their infrastructure  
15 investments. Rather, it is about opening up a market to competition by requiring  
16 carriers to offer a line-sharing UNE. Therefore, Mr. Vasington's comments about  
17 the Act's preference for competitive markets over mandated investments are out of  
18 place in this proceeding.<sup>12</sup>

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<sup>9</sup> 47 U.S.C § 254 (b)(2)&(3).

<sup>10</sup> See Perez-Chavolla, Lilia, "State Retail Rate Regulation of Local Exchange Providers as of September 2004," National Regulatory Research Institute, issued November 2004, Table 4, cited in the Verizon response to OPA Data Request No. 2-13.

<sup>11</sup> 47 U.S.C. § 254(f).

<sup>12</sup> Declaration of Paul B. Vasington, ¶¶ 16-20.

1 **Excessive Unbundling**

2 **Q: What is excessive unbundling?**

3 **A:** Excessive unbundling occurs when incumbent carriers are required to unbundle too  
4 many network elements. According to Mr. Vasington, the excessive unbundling  
5 existed in the past due to the FCC's broad interpretation of the "necessary" and  
6 "impair" standards. Following several Court remands, the FCC altered its  
7 definition of the "impair" standard. The new FCC interpretation of the "impair"  
8 standard reduced the number of network elements that must be unbundled. While it  
9 is not clear that Mr. Vasington believes that the reduction removed all of the  
10 excessive unbundling, it is clear that he believes that reduction was in the right  
11 direction.<sup>13</sup>

12 **Q: What is the impact of the FCC's revised "impair" standard on the**  
13 **requirement to offer a line-sharing?**

14 **A:** In the TRO, the FCC removed the federal obligation for incumbent carriers to  
15 provide a line-sharing UNE as part of a carrier's Section 251 obligations. The FCC  
16 held that the "impairment" standard should be based on all potential revenues that  
17 could be derived for using the entire loop rather than evaluating the revenues that  
18 could be derived from offering one service. FCC found that, once it took into  
19 account that a number of services could be provided using the entire loop, the  
20 economic costs of the loop are offset by the total revenue that could be derived  
21 from leasing the entire loop. In addition, the FCC believed that retaining the line-

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<sup>13</sup> Declaration of Paul Vasington, ¶¶ 21-23.

1 sharing UNE would discourage line splitting and other product innovation by  
2 CLECs.<sup>14</sup>

3 **Q: Should the FCC's reasoning be adopted in this proceeding?**

4 **A:** No. The FCC's reasoning should not be adopted in this proceeding because the  
5 TRO did not provide an examination of the facts in Maine. A reading of that order  
6 does not reveal any analysis of the Maine market place. Thus, the TRO did not  
7 meet the mandate of the USTA I court to use a granular examination of the  
8 individual markets.

9 **Q: How would a granular examination of the Maine market support the**  
10 **requirement to offer the line-sharing UNE?**

11 **A:** First, the CLECs operating in Maine and using the line-sharing UNE appear to be  
12 small businesses. These carriers do not have the resources needed to provide the  
13 full range of services that would support the purchase of the stand-alone loop, even  
14 though at least one carrier is struggling to provide service using stand-alone loops.<sup>15</sup>  
15 Second, the ability to provide DSL services by line-splitting with another CLEC  
16 appears to be very limited in Maine.<sup>16</sup> Currently there are no line-splitting  
17 arrangements in the Verizon service territory.<sup>17</sup> CLECs, offering testimony in this  
18 proceeding, do not believe that there will be significant line-splitting opportunities

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<sup>14</sup> In the Matter of the Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-038, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, FCC 03-36, released August 21, 2003, (TRO), ¶¶ 258-261.

<sup>15</sup> Testimony of Vernon Burke on behalf of Skowhegan Online Incorporated, at 6; Testimony of Flecher Kittredge on behalf of Biddeford Internet Corporation D/B/A Great Works Internet, page 7, line 16 to page 8, line 3.

<sup>16</sup> Line splitting requires two CLECs. One CLEC would provide the DSL type service using the high frequency portion of the loop, and the second CLEC would provide voice service using the voice grade portion of the loop.

<sup>17</sup> See Verizon response to OPA Data Request No. 2-22.

1 because so many of the current CLEC lines are being served through UNE-P  
2 arrangements.<sup>18</sup> In addition, AT&T is withdrawing from residential and small  
3 business markets.<sup>19</sup> As a result, a very large potential operator that could provide  
4 the voice segment of a line-splitting arrangement is no longer part of the market.  
5 Thus, the conditions supporting the FCC's decision to eliminate the line-sharing  
6 UNE do not exist in Maine.

7 Third, line sharing would accelerate the provision of broadband services in Maine  
8 and may lead to the provision of innovative products in conjunction with the line-  
9 sharing offerings. Line sharing would accelerate the provision of broadband  
10 services because it would provide a vehicle for small businesses to offer broadband  
11 service to other small businesses and residential customers. GWI has shown that it  
12 can provide these types of services. In addition, Verizon will have a greater  
13 incentive to intensify its efforts to provide broadband service and to develop the  
14 broadband market because Verizon will have active competitors that are using its  
15 own facilities. Innovative products may be offered as a competitive tool by which  
16 companies like GWI attempt to compete with Verizon.

17  
18 **Pricing**

19 **Q: Do you agree with Mr. Vasington's assertion that the FCC undermined the**  
20 **establishment of efficient market structure for competition and investment**  
21 **through its pricing rules?**

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<sup>18</sup> Burke at 5; Kittredge at page 7, lines 5 to 14.

<sup>19</sup> Merger of SBC Communications Inc. and AT&T Corp., Description of the Transaction, Public Interest Showing, and Related Demonstrations, Filed with the FCC, February 21, 2005, pages 48-56.



1 A. No. The pricing rules adopted in the Local Competition Order were based on the  
2 standard models used by incumbent carriers to support their competitive filings.  
3 The only part that was changed in the rules was that TSLRIC (total service long-run  
4 incremental cost) became TELRIC (total element long-run incremental cost). That  
5 is, the carriers used total long-run incremental cost studies to support their service  
6 specific cost studies. These studies were used to justify pricing in allegedly  
7 competitive markets. The FCC, in adopting the TELRIC rules, simply applied the  
8 incumbent carrier methods to the estimate of the cost of network elements.<sup>20</sup>  
9 Because the TSLRIC standard had been used to determine efficient service prices, it  
10 is likely that the TELRIC standard would generate efficient element prices.

11 **Q. Are you concerned about the fact that the TELRIC method appears to rely on**  
12 **a hypothetical network rather than on activities encountered by a carrier**  
13 **acting as a going concern that has a history and must act through time?**

14 A. Yes. I share the concerns that Verizon has expressed about the hypothetical  
15 nature of the TELRIC method. However, I realize that TELRIC is a consistent  
16 method. It does not allow an analyst to pick and choose the assumptions that best  
17 fit the desired outcome. Therefore, any substitute for TELRIC -- for example, a  
18 method that specifically introduces the time path of demand growth and supply  
19 enhancing investments -- must also treat these activities consistently. I know of only  
20 one instance in which a model that contained such a property has been filed in a  
21 regulatory proceeding. The example was sponsored by the Staff of the Public

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<sup>20</sup> In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, released August 8, 1996, FCC 96-325, ¶ 678.

1 Service Commission of the District of Columbia.<sup>21</sup> The case dealt with cost of  
2 basic service. The process involved development by Staff of a cost analysis over a  
3 planning horizon. It calculated the net present value of additional cost and  
4 additional demand over the planning horizon. It determined incremental cost by  
5 dividing the net present value of additional cost by net present value of the  
6 additional demand. In that case, the incumbent local exchange carrier, a company  
7 owned by a predecessor of Verizon, declined to use the time path defined cost  
8 study. Instead, the company chose to support a TSLRIC type model.

9 **Q: Do you share Mr. Vasington's belief that the new cost-of-capital and**  
10 **depreciation guidelines will lead to lower UNE rates, and thus, eliminate**  
11 **alleged disincentives for investment?**

12 **A:** No. It is not possible to predict the direction of UNE rates as the states adopt the  
13 new guidelines in future UNE rate reviews. In order to understand how these  
14 guidelines might work their way through the rate making process, it is necessary to  
15 review how the cost-of-capital and depreciation inputs have been determined.

16 **Q. What FCC rules guide state commission cost-of-capital determinations?**

17 **A.** The FCC's rules require the cost of capital to be forward-looking.<sup>22</sup> In adopting this  
18 rule, Local Competition Order states that the "current authorized rate of return at  
19 the federal level or state level is a reasonable starting point for TELRIC  
20 calculations, and incumbent LECs bear the burden of demonstrating with specificity  
21 that the business risks that they face in providing unbundled network elements and

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<sup>21</sup> Direct Testimony of Fred J. Kelsey Direct Testimony on behalf of the Staff of the Public Service Commission of the District of Columbia, Formal Case No. 850, Before the Public Service Commission of the District of Columbia, filed July 22, 1991.

1 interconnection services would justify a different risk-adjusted cost of capital or  
2 depreciation rate.”<sup>23</sup> The Local Competition Order also states that “states may  
3 adjust the cost of capital if a party demonstrates to a state commission that either a  
4 higher or lower level of cost of capital is warranted, without that commission  
5 conducting a ‘rate of return or other rate based proceeding’.”<sup>24</sup> Therefore, the FCC  
6 authorized the state commissions to determine the cost of capital as long as that cost  
7 of capital is based on forward-looking principles. It recognized that existing  
8 authorized cost-of-capital values were legitimate starting points for determining the  
9 current cost of capital. The cost of capital used in the federal jurisdiction, however,  
10 was adopted in 1990. At that time, interest rates “were in the range of 8.0% on one-  
11 year treasury notes and 8.4% on thirty year treasury bonds.”<sup>25</sup> Given that current  
12 interest rates for one-year notes are 3.25% and long-term rates are 4.85%,<sup>26</sup> a party  
13 arguing for a return above the FCC-approved 11.25% level would have to  
14 demonstrate a significant increase in the level of risk associated with  
15 telecommunications markets.

16 **Q. Has the FCC provided states with any additional guidance with regard to**  
17 **determining the cost of capital?**

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<sup>22</sup> 47 C.F.R. § 51.505(b)(2)

<sup>23</sup> In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98, FCC 96-325, rel. August 8, 1996, (“Local Competition Order”), ¶ 702.

<sup>24</sup> Id.

<sup>25</sup> In the Matter of Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers, Order, CC Docket No. 89-624, rel. December 21, 1990, ¶ 120.

<sup>26</sup> Federal Reserve statistical release, H.15 (daily) Selected Interest Rates, for immediate release on March 11, 2005.

1 A. Yes. The FCC addressed general issues associated with the cost of capital in the  
2 Triennial Review Order<sup>27</sup> and provided a specific example of how to determine the  
3 cost of capital in the Virginia Arbitration Order.<sup>28</sup>

4 **Q. Please summarize the FCC's conclusions in the Triennial Review Order.**

5 A. The FCC explained that states should consider two types of risks that are associated  
6 with providing UNEs. The first type of risk is the risk associated with the  
7 competitive market. The Order stated that "the objective of TELRIC is to establish  
8 a price that replicates the price that would exist in a market in which there is  
9 facilities based competition."<sup>29</sup> The implication of this statement is that the cost of  
10 capital should not reflect the cost currently associated with an individual carrier.

11 Rather, it is important to determine a cost-of-capital level that reflects the results of  
12 a competitive market.

13 Second, the FCC allowed carriers to "attempt to demonstrate that the cost of capital  
14 associated with new services that might be provided over mixed copper/fiber loops  
15 is higher than the cost of capital used for voice services provided over other  
16 UNEs."<sup>30</sup> Because the FCC no longer requires ILECs to unbundle their broadband  
17 networks, it is not necessary to determine the impact of this second type.

18 **Q: Please summarize the FCC's cost-of-capital conclusions in the Virginia**  
19 **Arbitration Order?**

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<sup>27</sup> In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, *Report and Order and Order on Remand and Further Notice of Proposed Rulemaking*, CC Docket No. 01-338, FCC No. 03-36, rel. August 21, 2003, ("Triennial Review Order").

<sup>28</sup> In the Matter of Petition of WorldCom, Inc, Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc. and for Expedited Arbitration, Memorandum Opinion and Order, DA 03-2738, rel. August 29, 2003, ("Virginia Arbitration Order").

1 A. In the Virginia Arbitration Order, the Wireline Competition Bureau put into  
2 practice the FCC's guidelines developed in previous orders. The Bureau made  
3 findings with regard to:

- 4 1. The use of telecommunications industry debt cost.
- 5 2. A preference for the CAPM method over the DCF.
- 6 3. The adoption of a Beta that equals one.
- 7 4. The use of a forward-looking capital structure.

8 By using the Beta equal to one, the Virginia arbitration order fulfilled the TRO  
9 mandate to reflect the results of a competitive market rather any one individual  
10 carrier's risk. Given the current long-run and short-run interest rates, the use of the  
11 Virginia arbitration may lower the cost of capital. A lower cost of capital would  
12 imply a lower UNE rate, implying that current UNE rates are unreasonably high.

13 **Q: Please summarize the FCC's TRO conclusions regarding depreciation.**

14 **A:** The FCC did not adopt a particular asset life method. That is, it declined to adopt  
15 the financial asset lives that many of incumbent carriers were proposing, nor did it  
16 adopt the regulatory lives that the interexchange carriers were proposing. Rather, it  
17 clarified that, whatever depreciation lives that a state commission adopts, those  
18 lives must reflect "the actual useful life of an asset that would be anticipated in a  
19 competitive market."<sup>31</sup> In addition, the FCC recognized that a "carrier may  
20 accelerate recovery of the initial capital outlay for an asset over its life to reflect any

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<sup>29</sup> Triennial Review Order, ¶ 680.

<sup>30</sup> *Id.* ¶ 683.

<sup>31</sup> *Id.* ¶ 689.

1 anticipated decline in its value.” The FCC directed the states to incorporate its  
2 clarifications in any future UNE rate case.<sup>32</sup>

3 **Q: Will the FCC’s clarifications automatically lead to higher UNE rates?**

4 **A:** No. The FCC’s new instructions must be utilized along with the general concept of  
5 cost causation. Assume for the sake of the argument that the life of copper wire  
6 should be reduced substantially. This reduction would not imply that the rate for  
7 the use of the copper wire for the provision of narrow band service should be  
8 increased because such an increase would be inconsistent with cost causation  
9 principles. The inconsistency is due to the fact that the reason for decrease in the  
10 copper life is due to the desire to provide broadband services. Therefore, any cost  
11 increase associated with the depreciation change should be assigned to services  
12 using the broadband platform. However, in the TRO, the FCC eliminated the  
13 requirement to provide UNEs associated with next generation facilities. Thus,  
14 increasing the UNE rate for elements used to provide plain old telephone services  
15 (POTS) would require the purchaser of those elements to finance other elements  
16 that they are prohibited from buying. Such a rate increase is not consistent with  
17 competitive markets. Rather, it is a predatory tactic designed to raise rivals’ cost of  
18 doing business.

19  
20 **Commercial agreements**

21 **Q: Please summarize Mr. Vasington’s position regarding commercial**  
22 **agreements?**

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<sup>32</sup> Id, ¶690-691.

1    **A:** Mr. Vasington believes that private negotiated interconnection agreements are  
2       preferred to arbitration by state commissions. Second, he believes that private  
3       negotiations are undermined by the FCC rules related to unbundling and UNE  
4       pricing. Finally, he believes that the elimination of the “pick and choose” standard  
5       will promote meaningful private negotiations.<sup>33</sup>

6    **Q: Do you believe that the VISTA agreements are the product of meaningful**  
7       **private negotiations?**

8    **A:** No. The VISTA agreements that allow CLECs to continue to purchase a service  
9       that is similar to line sharing contain a number of restrictions and do not appear to  
10      be meaningful private negotiations. Rather, they appear to be shotgun marriages, --  
11      i.e., “sign or die” agreements.

12   **Q: Please explain what you mean by a “number of restrictions.”**

13   **A:** In this section I will explain the restriction related to digital line carriers (DLCs). In  
14      the section of my testimony dealing with Mr. Meehan’s testimony, I will discuss  
15      other restrictions.

16   **Q: Please explain the restriction related to DLCs.**

17   **A:** The contract explicitly prohibits the use of the service to serve consumers on DLC  
18      systems. The contract states: “The Service does not include the capability to  
19      provide xDSL services to Customers served by digital loop carrier systems.”<sup>34</sup> This  
20      restriction appears to be overly broad. A more reasonable restriction would be that  
21      the service would be available only if it were technically feasible to provide it and if

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<sup>33</sup> Vasington, ¶28-32.

<sup>34</sup> Verizon response to OPA Data Request No.1-11, attachment 1 to the VISTA agreement between Verizon and GWI, ¶ 1.

1 the company were not required to upgrade facility to provide the service. However,  
2 the restriction in the contract will prohibit a CLEC from providing the DSL service  
3 to customers served by DLCs even when Verizon has upgraded the DLC to provide  
4 DSLAM functionality. One CLEC asserted interest in serving such a customer.

5 However, the VISTA agreement will not allow the CLEC to provide DSL service to  
6 these customers.<sup>35</sup>

7 Moreover, in the TRO, the FCC expressed its belief that ILECs would offer the use  
8 of their fiber systems to CLECs for the purpose of connecting to customers behind  
9 DLCs. The FCC stated: "Specifically, we expect that incumbent LECS will

10 develop wholesale offerings for access to their fiber feeder to ensure that  
11 competitive LECs access to copper subloops."<sup>36</sup> This expectation was based, in  
12 part, on a Verizon comment which stated that:

13 The widespread deployment of broadband services and facilities will  
14 require enormous investments and result in huge fixed costs. Obviously,  
15 the more traffic on the network, the easier it is to recover those costs. For  
16 example, we have suggested that we would be willing to deliver a service  
17 to other providers at our central offices so that they can reach their  
18 customers over our network, provided that we can do so on commercially  
19 reasonable, negotiated terms. But it is critical in a competitive market such  
20 as broadband that any such arrangement be at rates, terms and conditions  
21 that are determined by the marketplace rather than regulatory fiat.<sup>37</sup>  
22

23 The VISTA contract is a negotiated contract that was not subject to regulatory fiat.

24 However, instead of allowing other providers to reach their potential consumers, the

25 VISTA contract prohibits other providers from reaching an entire class of

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<sup>35</sup> Kittredge, page 11, line 19 to page 12, line 11.

<sup>36</sup> TRO, ¶ 253.

<sup>37</sup> Comments and Contingent Petition for Forbearance of the Verizon Telephone Companies, In the Matter of the Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338, filed April 5, 2002, page 82.



1 customers, a class of customers that the FCC expected the ILECs would allow other  
2 providers to serve.

3  
4 **V. THE DECLARATION OF MR. ROBERT D. MEEHAN**

5  
6 **Q: Please summarize Mr. Meehan's declaration.**

7 **A:** Mr. Meehan described the technology used to provide DSL service, discussed the  
8 FCC's line-sharing rules, and provided information regarding Verizon's new  
9 commercial agreements. According to Mr. Meehan, the commercial agreements  
10 allow other carriers to continue to offer DSL services through line-sharing  
11 arrangements, even though the FCC no longer requires incumbent carriers to offer  
12 line sharing as a UNE under Section 251 of the Telecommunications Act. He states  
13 that "the availability of commercially negotiated line sharing agreements, in  
14 addition to line sharing alternatives (also described below), should alleviate all  
15 concerns about the FCC's elimination of line sharing and its potential impact on  
16 broadband competition in the State of Maine."<sup>38</sup>

17 **Q: Do the commercially negotiated line-sharing agreements alleviate all concerns**  
18 **about the FCC's elimination of the line sharing UNE?**

19 **A:** No. There are a number of restrictions in the contract that add to my concerns  
20 regarding the ability of other carriers to provide line sharing. These include the  
21 inability to serve customers who are being served through the use of DLCs, the  
22 limitation on orders during the fourth year of the service, the inability to convert

1 customers from the VISTA service to a line-sharing UNE arrangement, and ability  
2 of Verizon to cancel the service in the future if the state does not require Verizon to  
3 provide a line sharing UNE.

4 **Q: Please explain Verizon's ability to cancel the service in future.**

5 **A:** According to the terms and conditions of the agreement, in any state that does not  
6 require Verizon to provide line-sharing arrangements "following the Term of this  
7 agreement, Verizon will have the option in its discretion to discontinue VISTA  
8 service arrangements in that state upon thirty (30) days notice."<sup>39</sup> The term of the  
9 agreement is four years. This provision will allow Verizon to cancel the service  
10 after the four-year period with only 30 days notice. At the end of the four years,  
11 Verizon may be willing to negotiate a new agreement with the CLECs. However,  
12 the existence of this provision reduces the bargaining power of the CLECs. If the  
13 CLEC does not agree to Verizon's new terms, it may find itself without the service.  
14 Therefore, in order to ensure that future negotiated commercial agreements  
15 associated with line-sharing are fair and reasonable, I recommend that the  
16 Commission adopt a line sharing UNE now and maintain that requirement into  
17 future.

18 **Q: Please discuss the restriction that prohibits the CLEC from using the line**  
19 **sharing UNE?**

20 **A:** There appear to be at least two restrictions on CLECs' use of any line-sharing UNE.  
21 First, in the description of the service, the agreement states, "Upon the effective

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<sup>38</sup> Declaration of Robert D. Meehan, ¶10.

<sup>39</sup> Verizon response to OPA Data Request No.1-11, VISTA agreement between Verizon and GWI, ¶ 5.

1 date, all line sharing arrangements that Purchaser obtains from Verizon shall be  
2 converted to the Service and shall be billed at the rates set forth in Attachment 2.”<sup>40</sup>

3 Second, in the terms and conditions, the agreement states “ at no time may  
4 Purchaser convert existing Service arrangements to Line sharing arrangements.”<sup>41</sup>

5 Thus, the CLEC must convert all current line sharing arrangements to the VISTA  
6 service and it is not allowed to convert future VISTA customers to line sharing.

7 This requirement means that any carrier that signed the VISTA agreement in order  
8 to stay in business will not be able to use the line sharing UNE if the Commission

9 authorizes the UNE in this proceeding. Besides limiting the applicability of the

10 Commission’s authorized UNE, this requirement restricts the CLEC’s ability to

11 negotiate because the CLEC has to make a decision about the VISTA agreement

12 prior to knowing what its alternative may be. That is, CLEC has to either accept the

13 VISTA agreement and forgo the ability to use a UNE that may be approved; or not

14 sign the agreement and forgo the ability to increase the number of DSL customers it

15 serves until such time as the Commission decides whether it will require the line-

16 sharing UNE. Such a restriction may be valid when the market contains multiple

17 providers of line sharing arrangements. However, given that Verizon is the only

18 carrier providing a line- sharing arrangement, it is my opinion that the restriction is

19 anti-competitive.

20 **Q: Please discuss the restriction that prohibits CLECs from obtaining additional**  
21 **customers during the fourth year of the agreement.**

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<sup>40</sup> Id, ¶ 2.

<sup>41</sup> Id, ¶ 5.

1    **A:** In the terms and conditions, the agreement states that “During the fourth year of the  
2       Term, Purchaser may not order any new Service arrangements pursuant to this  
3       Agreement and existing Service arrangements will be discontinued on the earlier of  
4       the end of the Term or the date that Purchaser ceases to provide xDSL to a  
5       Customer at the same location over the same Loop.”<sup>42</sup> On the other hand the  
6       agreement also provides “that during the fourth year of the Term, Purchaser may  
7       purchase new VISTA Service arrangements and existing VISTA arrangements will  
8       continue in effect in a state to the extent Verizon is required by Applicable Law to  
9       provide line sharing in that state.”<sup>43</sup> The implication of these two statements is that  
10      there is value to the Commission approving the line-sharing UNE even if no  
11      customer purchases from that tariff. If the Commission authorizes the line sharing  
12      UNE, then the CLECs will be able to compete in the fourth year of the agreement.  
13      This activity will increase the level of competition and provide the service to more  
14      Maine consumers.

15      In addition, the restriction regarding the cessation of service at a location appears to  
16      be a very confining. For example, in the fourth year, if one customer leaves the  
17      location and another customer moves in, and the service is not immediately  
18      continued by the new customer, it appears that the CLEC would lose the ability to  
19      serve the new customer. It would be more reasonable to allow the CLEC a longer  
20      time period to attract the new customer. Also, the decision regarding whether to  
21      serve the customer with the same or a different loop is Verizon’s decision.. If

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<sup>42</sup> Id.

<sup>43</sup> Id.

1 Verizon chooses to change the loop serving the location, then the CLEC  
2 automatically loses the new customer, even if the new customer has requested the  
3 CLEC's services.  
4

5 **VI. THE COMMENTS OF TELEPHONE ASSOCIATION OF MAINE**  
6

7 **Q: Please summarize the comment of the Telephone Association of Maine (TAM).**

8 **A:** TAM believes that it is not Commission's responsibility to determine broadband  
9 policy in the state. It believes that Section 7101 does not require the provision of  
10 broadband services, and that the Section 7101 mandate has been fulfilled through  
11 previous Commission action. TAM also asserts that requiring their carriers to  
12 provide UNEs would force their carriers to upgrade their facilities and to upgrade  
13 the software capabilities of their computer systems. TAM believes that paying for  
14 these upgrades would reduce the amount of funds available to deploy broadband  
15 services. In addition, there is a chance that the carriers would not be able to recover  
16 the expenses associated with the upgrades because the competitors that would use  
17 the facilities may never appear. Finally, TAM provides a confidential attachment  
18 that describes each carrier's deployment of facilities that are capable of providing  
19 DSL.

20 **Q: Please summarize the confidential attachment regarding the deployment of**  
21 **DSL capable facilities?**

22 **A:** In general, it appears that the TAM carriers have the ability to provide DSL service  
23 to their customers. Many carriers can provide DSL services to between 85 to 100

1 percent of their customers. That is, either the central office or the DLC that these  
2 customers are served from has a DSLAM or DSLAM functionality. I was not able  
3 to obtain information regarding whether the customers are greater than 18,000 feet  
4 from the wire center or DLC, or whether there are loading coils attached to the  
5 lines. There is one carrier that cannot provide DSL service, and several carriers for  
6 whom the percentage of customers served from DSL capable equipment is less than  
7 50 percent. In several instances where there was some ambiguity in the filing, I  
8 asked for and received additional information that clarified the filing.

9 **Q: Does the TAM filing address the question of whether the DSL service is**  
10 **affordable?**

11 **A:** No.

12 **Q: Have you been able to obtain any information regarding the rates charged by**  
13 **TAM carriers for DSL service?**

14 **A:** Yes. I obtained rates for DSL service that are available to customers in the TAM  
15 carriers' service territory. The actual provider of the service could be the affiliate  
16 of the carrier. The rates vary among the carriers and also vary according to the  
17 speed of the DSL service. Some carriers charge as little as \$29.95, while for other  
18 carriers the lowest rate starts at \$47.95.

19 **Q: Is it possible to establish an affordable rate for DSL service?**

20 **A:** Yes. An affordable rate is \$34.95. That is Verizon's rate when the DSL service not  
21 purchased as part of its Freedom Package. Customers served by Maine's various  
22 Fairpoint carriers can also purchase DSL service at that rate. The service speed  
23 associated with the Verizon service is greater than the speed associated with the

1 Fairpoint service. The Fairpoint service guarantees speeds up to 256k  
2 download/128k upload.

3 **Q: What would be a reasonable minimum speed for DSL service?**

4 **A:** A reasonable minimum speed would be a speed that at least meets the FCC standard  
5 for high-speed services. In its second Section 706 Advanced Services Report the  
6 FCC determined that high-speed services are those services capable of delivering  
7 transmission speeds in excess of 200 kbps in at least one direction.<sup>44</sup>

8 **Q: What action should the Commission take with regard to the provision of DSL**  
9 **service by TAM carriers?**

10 **A:** I recommend that the Commission forebear from requiring a TAM carrier to  
11 provide a line-sharing UNE if the carrier commits to making available to customers  
12 in its service territory a DSL service for \$34.95 that has a download speed of at  
13 least 200 kbps. By taking this action, affordable DSL service at a reasonable  
14 service speed will be available, and the carrier will avoid the cost of providing the  
15 UNE. That rate and level of service are in the range of possible rates and speeds  
16 that TAM carriers are now providing. Some carriers that are charging high rates  
17 will be required to reduce those rates. If a carrier is not willing to make that  
18 commitment, then the Commission should require that carrier to offer the line-  
19 sharing UNE. Once the UNE is available, it will be possible for competition to  
20 drive the DSL rate down to an affordable level.

21  

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<sup>44</sup> In the Matter of Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment

VII. CONCLUSIONS AND RECOMMENDATIONS

**Q: Please summarize your conclusions and recommendations.**

**A:** I have reached the following conclusions with respect to the declarations and comments filed in this proceeding:

- The existence of the federally mandated line-sharing UNE was an important factor in the development of the broadband market in Maine.
- The VISTA service contract does not alleviate my concerns regarding the FCC's elimination of the federally mandated line-sharing UNE.
- State utility commission action in the form of least-cost plans or telephone infrastructure investment directives are positive improvements to market activities.
- I recommend that the Commission should require Verizon to offer a line-sharing UNE in Maine because:
  - By providing small businesses an alternative to the VISTA service, it will have a positive impact on the commercial agreements;
  - Without the line-sharing UNE, the VISTA agreement prohibits alternative provider sales in the fourth year of the agreement;
  - Without the line-sharing UNE, the VISTA agreement allows Verizon to terminate service with 30 days notice following the TERM of the agreement;



- 1           • The VISTA agreement prohibits CLEC from serving customers that Verizon  
2           serves using DLC systems;
- 3           • Using the line-sharing UNE, CLECs will be able to compete with Verizon  
4           and customers will benefit from that competition.
- 5           • I recommend that the Commission forebear from requiring that the independent  
6           carriers offer a line-sharing UNE as long as those carriers commit to providing  
7           an affordable DSL service at a reasonable service level.

8   **Q: Does this conclude your testimony?**

9   **A:** Yes.