STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

In the Matter of the Board Investigation	)	
Regarding the Reclassification of	)	
Incumbent Local Exchange Carrier (ILEC)	)	Docket No. TX07110873
Services as Competitive	)	

REDACTED REPLY TESTIMONY OF SUSAN M. BALDWIN ON BEHALF OF THE NEW JERSEY DIVISION OF RATE COUNSEL

RONALD K. CHEN
PUBLIC ADVOCATE

STEFANIE A. BRAND
DIRECTOR

Division of Rate Counsel
31 Clinton Street, 11th Floor
P.O. Box 46005
Newark, NJ 07101
(973) 648-2690 - Phone
(973) 624-1047 – Fax
www.rpa.state.nj.us
njratepayer@rpa.state.nj.us

Filed: January 10, 2008

REDACTED VERSION

TABLE OF CONTENTS

I. INTRODUCTION 1

Qualifications 1

Assignment 3

Summary of Testimony 3

II. PROCEDURAL AND REGULATORY BACKGROUND 8

Regulatory and statutory context for proceeding. 8

III. VERIZON NJ AND EMBARQ TESTIMONY 13

Overview and preliminary analysis of Verizon NJ testimony. 13

Overview and preliminary analysis of Embarq testimony. 19

IV. LOCAL EXCHANGE SERVICE MARKETS IN NEW JERSEY 23

The local exchange services market lacks sufficient competition to protect consumers. . 23

Contrary to the ILECs' assertions, intermodal alternatives do not discipline the rates, terms and conditions of residential dial tone services provided by the ILECs. 41

Á la carte and bundled offerings are not in the same product market. 63

The FCC's recent order in which it denied Verizon's petitions for forbearance in six Metropolitan Statistical Areas includes analyses and findings that are germane to this proceeding. 68

Verizon NJ and Embarq have failed to demonstrate that the statutory criteria for competitive classification have been satisfied. 88

V. MARKET DISTORTIONS 90

Until pricing distortions and price squeezes are remedied, local competition cannot evolve. 90

The mis-alignment of wholesale and retail loop rates prevents the development of effective competition. 90

Over-priced intrastate switched access charges represent a barrier to competitive entry and also distort the market. 93

The special access and private line markets are not competitive, which, in turn, impedes the development of competition. 97

VI. VERIZON'S AND EMBARQ'S EARNINGS AND COMPETITION 101

High profits undermine Verizon NJ's assertions regarding competition. 101

Verizon's supracompetitive profits provide evidence of its market power. 103

The proper assignment and allocation of special access investment to the interstate jurisdiction would likely increase Verizon NJ's return on its intrastate operations significantly. 113

Verizon's supracompetitive profits from its interstate special access services result from its market power. 114

Rates and demand for discretionary features purchased by à la carte and bundled customers provide evidence of ILECs' market power. 115

Numerous rate increases and industry attempts to impose new charges on consumers provide compelling evidence of the lack of sufficient competition in New Jersey markets. 123

The three explicit statutory criteria are the "minimum" factors relevant to an assessment of whether services are competitive. 130

Even if the Board limits its criteria to the three explicit statutory criteria, Verizon NJ and Embarq have not met their burden of proof to demonstrate that mass market services should be classified as competitive. 131

VII. DIRECTORY ASSISTANCE 132

Verizon NJ fails to support its request to classify directory assistance for residential customers as competitive. 132

Verizon NJ's survey exaggerates consumers' awareness of DA alternatives. 140

Summary of analyses and recommendations regarding DA. 147

VIII. CONSUMER HARM 149

The premature classification of mass market services as competitive could lead to rate increases of more than 500 million dollars per year. 149

If the Board grants Verizon NJ's request and if PAR-2 continues, the outcome of this proceeding should be treated as an exogenous event, and earnings sharings should occur. 152

VIII. CONCLUSION 156

Recommendations 156

Conclusion 157

List of Tables

Table SMB-1	Status of CLECs in New Jersey
Table SMB-2	The incumbents own or control 97% of the switched access lines in New Jersey (as of December 31, 2006)
Table SMB-C-3a	Decline in Demand for Additional Lines Explains a Substantial Portion of the Decline in Verizon NJ's Residential Retail Lines
Table SMB-3b	Decline in Demand for Additional Lines Explains Approximately 39% of Decline in Verizon NJ's Residential Retail Lines between December 2003 and December 2006
Table SMB-C-4	The Number of Wholesale Lines Verizon NJ Provides to Other Carriers Has Generally Declined
Table SMB-5	Verizon NJ Affiliates "Compete" with Verizon NJ
Table SMB-6	Wholesale-Retail Price Squeeze
Table SMB-7	Operating Profit Margins, 2003-2006
Table SMB-8	Correction to 2005 Intrastate Financials: Reallocating Local Loop Plant Demonstrates that Verizon NJ Is Earning Supracompetitive Profits
Table SMB-9	Verizon NJ Interstate Special Access Lines (2001 – 2006)
Table SMB-10	Verizon NJ's Phenomenal Returns on Its Interstate Special Access Service Demonstrate Its Market Power
Table SMB-11	Above-Cost Pricing of Discretionary Services Provides Evidence of Market Power: Verizon NJ's Rates Exceed Embarq's Rates, Suppressing Consumer Demand
Table SMB-C-12	Reclassification Could Jeopardize Rates for Low Volume Customers If Verizon NJ Raises Stand-Alone Rates to Encourage

	Sales of Bundled Offerings
Table SMB-C-13	Reclassification Could Jeopardize Rates for Low Volume Customers If Embarq Raises Stand-Alone Rates to Encourage Sales of Bundled Offerings
Table SMB-14	Rate Increases During 2006 Provide Evidence that Markets Are Not Competitive (Illustrative List)
Table SMB-15	Interexchange Carriers' Rates for DA

List of Figures

Figure SMB-1	CLECs' Entry Based on Verizon NJ's Unbundled Network Elements Is Declining
Figure SMB-2	Verizon New Jersey Intrastate Operating Revenues Provide Evidence of Market Power

List of Attachments

Attachment A	Statement of Qualifications
Attachment B	Direct testimony of Susan M. Baldwin, NJ BPU Docket No. TX007110873 (without attachments)
Attachment C	*In the Matter of Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. §160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas*, FCC WC Docket No. 06-172, *Memorandum Opinion and Order*, FCC 07-212, released December 5, 2007
Attachment D	AT&T and BellSouth Merger Conditions (December 28, 2006 letter from AT&T to the FCC)
Attachment E	Verizon/MCI Merger Conditions (Appendix G to FCC's Order)

Attachment F-1	Tariff pages filed by Verizon NJ and by various CLECs during 2006 (Attachment B to Baldwin Direct Testimony in Docket No. TX06120841)
Attachment F-2	Tariff pages (previously Attachment A to Baldwin Reply Testimony in Docket No. TX06120841)
Attachment F-3	Verizon February 2007 promotional tariff filing (previously Exhibit SMB-Reb-2 to Baldwin Rebuttal Testimony in Docket No. TX06120841)
Attachment F-4	Verizon New Jersey Tariff pages (February 1, 2007 increase to business local exchange service and August 13, 2007 introduction of unlimited business dial tone line basic package)

List of Exhibits

Exhibit SMB-1	Verizon NJ response to RC-VNJ-2
Exhibit SMB-C-2	Verizon NJ response to RC-VNJ-10
Exhibit SMB-C-3	Verizon NJ’s response to RC-VNJ-19
Exhibit SMB-C-4	Verizon NJ’s response to RC-VNJ-20
Exhibit SMB-C-5	Verizon NJ’s response to RC-VNJ-21
Exhibit SMB-C-6	Verizon NJ’s response to RC-VNJ-3
Exhibit SMB-C-7	Verizon NJ's response to Sprint VNJ-20(f)
Exhibit SMB-C-8	Verizon NJ response to RC-VNJ-144
Exhibit SMB-9	Attachment BKS-1 to Dr. Staihr’s testimony,
Exhibit SMB-C-10	Embarq’s response to RC-EM-12

Exhibit SMB-C-11	Verizon NJ’s response to RC-VNJ-22
Exhibit SMB-C-12	Verizon NJ’s response to RC-VNJ-56
Exhibit SMB-HC-13	Verizon NJ’s highly proprietary attachment to RC-VNJ-136(b)
Exhibit SMB-HC-14	Verizon NJ’s highly proprietary attachment RC-VNJ-61-65
Exhibit SMB-C-15	Verizon NJ’s proprietary attachment Sprint VNJ-20(i)
Exhibit SMB-C-16	Verizon NJ’s proprietary attachment Sprint VNJ-20(j)
Exhibit SMB-HC-17	Verizon NJ’s response to VNJ-Sprint-20E
Exhibit SMB-HC-18	Verizon NJ's response to RC-VNJ-136(a)
Exhibit SMB-C-19	Verizon NJ’s response to RC-VNJ-23
Exhibit SMB-HC-20	Embarq’s response to RC-EM-19
Exhibit SMB-HC-21	Embarq’s response to RC-EM-27
Exhibit SMB-HC-22	Embarq’s response to RC-EM-45
Exhibit SMB-HC-23	Embarq response to RC-EM-20
Exhibit SMB-24	Embarq response to RC-EM-21
Exhibit SMB-25	Embarq response to RC-EM-48
Exhibit SMB-26	Embarq response to RC-EM-50
Exhibit SMB-27	Embarq response to RC-EM-51
Exhibit SMB-C-28	Embarq’s response to RC-EM-31
Exhibit SMB-C-29	Verizon NJ response to RC-VNJ-23
Exhibit SMB-C-30	Verizon NJ response to RC-VNJ-11

Exhibit SMB-C-31	Verizon NJ response to RC-VNJ-9
Exhibit SMB-C-32	Verizon NJ's response to RC-VNJ-41
* Exhibit SMB-C-33	Verizon NJ's response to RC-VNJ-46
* Exhibit SMB-C-34	Verizon NJ's response to RC-VNJ-47
* Exhibit SMB-C-35	Verizon NJ response to RC-VNJ-49
* Exhibit SMB-C-36	Verizon NJ response to RC-VNJ-52
* Exhibit SMB-37	Verizon NJ response to RC-VNJ-70
* Exhibit SMB-38	Verizon NJ response to RC-VNJ-76
* Exhibit SMB-39	Verizon NJ response to RC-VNJ-82
* Exhibit SMB-40	Verizon NJ response to RC-VNJ-89
* Exhibit SMB-41	Verizon NJ response to RC-VNJ-95
* Exhibit SMB-42	Verizon NJ response to RC-VNJ-96
* Exhibit SMB-C-43	Verizon NJ proprietary responses to RC-VNJ-48
* Exhibit SMB-C-44	Verizon NJ proprietary responses to RC-VNJ-50
Exhibit SMB-C-45	Embarq proprietary Responses to RC-EM-31
Exhibit SMB-C-46	Embarq proprietary Responses to RC-EM-34
Exhibit SMB-C-47	Embarq proprietary Responses to RC-EM-35
Exhibit SMB-C-48	Embarq proprietary Responses to RC-EM-36
Exhibit SMB-C-49	Verizon NJ response to RC-VNJ-54
Exhibit SMB-50	Results from Verizon NJ DA Awareness Survey

Exhibit SMB-51 Recalculated Results from Verizon NJ DA Awareness Survey

* Indicates exhibit is found as part of Exhibit SMB-C-6.

I. INTRODUCTION

Qualifications

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

A: My name is Susan M. Baldwin. I am a consultant, and my business address is 17 Arlington Street, Newburyport, MA, 01950. I specialize in telecommunications economics, regulation, and public policy, and consult to public sector agencies.

Q: Please summarize your educational background and professional experience.

A: I have prepared a Statement of Qualifications, which is included as Attachment A.

Q: Have you previously testified before the New Jersey Board of Public Utilities ("Board")?

A: Yes. Earlier this year, I filed testimony in Docket No. TX0612084 on behalf of the New Jersey Division of Rate Counsel ("Rate Counsel") in the Board's investigation of the reclassification of competitive local exchange carrier ("CLEC") services as competitive. Also, on May 12, 2006, I filed testimony in Docket No. TT97120889, on behalf of Rate Counsel, and in that testimony, I analyzed the directory assistance service ("DAS") of Verizon New Jersey ("Verizon NJ"). On November 29, 2005, I filed testimony in Docket No. TM05080739, on behalf of Rate Counsel, in which I analyzed the petition of United Telephone Company of New Jersey and LTD Holding Company for approval of a change in ownership and control from Sprint Nextel Corporation to LTD.

On behalf of Rate Counsel, I filed testimony on July 8, 2005 and August 19, 2005, in Docket No. TM05030189, opposing the proposed merger between Verizon Communications Inc. ("Verizon") and MCI, Inc. ("MCI"), and on May 4, 2005 and June 1, 2005, in Docket No. TM05020168, I filed testimony opposing the proposed merger between SBC Communications, Inc. ("SBC") and AT&T Corporation ("AT&T").

On January 10, 2005 and February 4, 2005, I filed testimony in Docket No. TO01020095, on behalf of Rate Counsel, in which I analyzed Verizon NJ's request to classify business local exchange service offered to customers with two to four lines as competitive. On December 22, 2004 and January 18, 2005, I filed testimony on behalf of Rate Counsel in Docket No. TT04060442, in which I reviewed Verizon NJ's petition for a rate restructure. On February 4, 2004, in Docket No. TO03090705, I submitted testimony rebutting Verizon NJ's assertion of non-impairment for mass market switching, high capacity loops, and transport in certain geographic areas in New Jersey. In Docket No. TO00060356, I submitted testimony on January 23, 2004, analyzing Verizon NJ's proposed use of financial lives in computing depreciation costs in its recurring and nonrecurring total element long run incremental cost ("TELRIC") studies. Also, in 1992, I testified on behalf of the New Jersey Cable Television Association in Docket No. T092030358, regarding the Application of the New Jersey Bell Telephone Company for Approval of its Plan for an Alternative Form of Regulation.

Assignment

Q: On whose behalf is this testimony being submitted?

A: This testimony is being submitted on behalf of Rate Counsel.

Q: What is the purpose of your testimony at this time?

A: Rate Counsel asked me to file testimony in reply to the testimony filed on December 14, 2007 by Paul B. Vasington and William M. Newman on behalf Verizon New Jersey ("Verizon NJ") and by Brian K. Staihr on behalf of United Telephone Company of New Jersey, Inc. d/b/a Embarq ("Embarq").

Summary of Testimony

Q: Please summarize your recommendations and findings.

A: My testimony demonstrates that:

- The status of competition is insufficient to justify reclassifying mass market services as competitive: entry barriers persist; other telecommunications providers do not compete for affordable stand-alone mass market service; and consumers lack like or substitute services in relevant geographic markets.
- The status of competition is insufficient to justify classifying directory assistance ("DA") services as competitive: entry barriers to DA persist; other telecommunications providers do not offer comparable DA service; and consumers lack like or substitute services in relevant geographic markets.
- The premature reclassification of mass market and DA services as competitive would

cause substantial consumer harm, and could result in increased rates to consumers of more than a half billion dollars *per year*.

- Verizon NJ has failed to demonstrate any cost basis for raising rates, and, therefore, not only would consumers be harmed, but, furthermore, the revenues would be an unwarranted revenue windfall for Verizon's shareholders. This large transfer of monies from consumers to shareholders is clearly contrary to the public interest, and has no basis in economic principles or economic efficiency. Furthermore, this potential rate shock would occur at an ill-timed moment, when consumers' budgets are already facing the constraints of rising oil prices, rising gasoline prices, and declining housing values.
- The Board should deny Verizon NJ's and Embarq's requests for competitive classification because they are inadequately supported and would end affordable telephone service for New Jersey consumers, a result which is contrary to the public interest.

Q: Please summarize your major conclusions and analyses.

A: Among other things, my testimony shows that:

- Competition does not yet exist to discipline the rates, terms, and conditions of Verizon NJ's and Embarq's mass market and DA services.
- Verizon NJ failed to provide direct costs for the services for which it seeks competitive classification, and, therefore, fails to comply with the requirements that the Board set forth in its PAR-II order.
- Numerous rate *increases* and new charges that Verizon NJ and various competitive local

exchange carriers ("CLEC") implemented during 2006 and 2007 subsequent to the Board's classification of multiline business services as competitive provide compelling evidence of the price increases that Verizon NJ likely would seek to impose on mass market customers if the Board grants Verizon NJ's petition in this proceeding. It is important for the Board to consider that in the wake of a competitive classification of à la carte multiline business services, Verizon NJ has *raised* rates. This past behavior provides compelling evidence of Verizon NJ's likely future behavior.

- Verizon NJ's *increase* in business DA rates subsequent to the Board's determination that business DA is competitive shows that:
  - Verizon NJ possesses the ability to raise and sustain price increases above competitive levels; and
  - If residential DA were deemed competitive, Verizon NJ likely would raise DA rates.
- The recent order released by the Federal Communications Commission ("FCC" or "Commission") in which it denied Verizon's petition for forbearance in six Metropolitan Statistical Areas ("MSA") includes analyses and findings that confirm analyses set forth in my testimony here and in other Board proceedings. Among other things, the FCC found that Verizon continues to possess exclusionary market power (that is, it can raise the cost of inputs upon which its rivals rely); retail line loss does not demonstrate the existence of effective competition; cable providers have a limited role in serving

enterprise customers; and competitors serve relatively few buildings.

- Declining CLEC demand for unbundled network element platform (“UNE-P”) (now being provided as Wholesale Advantage) and Verizon’s acquisition of MCI (previously a chief rival) have altered the structure of the local mass market. The emergence of intermodal alternatives does not yet constrain the rates, service quality, or terms and conditions for local exchange service.
- Over-priced intrastate switched access charges and mis-aligned wholesale and retail rates for local exchange service create serious market distortions that prevent the development of effective competition.
- Verizon NJ’s high earnings are evidence of its market power.
- Bundled offerings, rather than constraining the rates for à la carte services, create an incentive for incumbent local exchange carriers (“ILEC”) to raise rates for stand-alone services to encourage migration to double-play, triple-play, and quadruple-play packages.
- The presently flawed interstate special access regime hinders’ CLECs’ entry and therefore provides further evidence that there is insufficient competition in the market .
- Market failures and unresolved regulatory issues (such as special access regulation, intercarrier compensation reform, and separations reform) enable Verizon NJ and Embarq to exercise market power, which precludes the development of sufficient competition in local markets.

Q: Please comment on the Board’s proposed time frame for completing this investigation.

A: The time frame for this proceeding is inexplicably compressed. By contrast, in its investigation in Docket No. TO03090705 (the "impairment" proceeding), the Board sought and obtained detailed, granular data from Verizon NJ and from CLECs regarding local markets, which was critical to an analysis of the merits of Verizon NJ's assertion of non-impairment for mass market switching, high capacity loops, and transport in certain geographic areas in New Jersey. Also, in contrast with the compressed schedule of this investigation, the FCC investigated Verizon's recent petitions for forbearance in six MSAs and the related data and analyses over a fifteen-month period.[1]

Based on my participation in the Board's "impairment" proceeding, as well as in the Board's docket in which it investigated Verizon NJ's request to classify business local exchange service offered to customers with two to four lines as competitive, I anticipate that for the Board to conduct a thorough analysis of relevant ILEC-served customer, geographic, and product markets, this proceeding will require substantially more time that than contemplated by the Board's procedural order.[2]

---

[1] / Verizon submitted its petitions on September 6, 2006, and the FCC released its order on December 5, 2007. *In the Matter of Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. §160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas*, FCC WC Docket No. 06-172, *Memorandum Opinion and Order*, FCC 07-212, released December 5, 2007 ("Verizon Six MSA Forbearance Order").

[2] / *In the Matter of the Board Investigation Regarding the Reclassification of Incumbent Local Exchange Carrier (ILEC) Services as Competitive,* Docket No. TX07110873, *Order,* November 28, 2007 ("Order Opening Investigation").

II. PROCEDURAL AND REGULATORY BACKGROUND

Regulatory and statutory context for proceeding.

Q: Please describe your understanding of this proceeding.

A: The Board initiated this proceeding to determine whether to reclassify ILEC services as competitive. The Board stated:

> Based upon the above, and in response to the request from VNJ, the Board deems it appropriate at this time, to conduct a full investigation of and hearing on the question of whether ILEC provided mass market retail services should be declared competitive pursuant to N.J.S.A. 48:2:21-19 (b), after review and consideration of the necessary criteria. Specifically, the Board seeks to determine if ILEC mass market retail telecommunications services satisfy the necessary elements of ease of market entry, presence of other competitors, and availability of like or substitute services in the relevant geographic area.[3]

Q: What statutory requirements guide the Board's reclassification of services as competitive?

A: In *N.J.S.A.* 48:2.21.16 (a)(1)-(5), the Legislature declared that the policy of the state is to:

> (1) Maintain universal telecommunications services at affordable rates.
>
> (2) Ensure that customers pay only reasonable charges for local exchange telecommunications services, which is available on a non-discriminatory basis.
>
> (3) Ensure rates for non-competitive telecommunications services do not subsidize the competitive ventures of providers of telecommunications services.
>
> (4) Provide diversity in the supply of telecommunications services and

[3] / *Order Opening Investigation*, at 2.

products in telecommunications markets throughout the state.

(5) Permit the Board the authority to approve alternative forms of regulation in order to address changes in technology and the structure of the telecommunications industry; to modify the regulation of competitive services; and to promote economic development.

The New Jersey Telecommunications Act of 1992 ("1992 New Jersey Act") authorizes the Board to "determine, after notice and hearing, whether a telecommunications service is a competitive service."[4] The legislation requires the Board to develop standards of competitive service that, "at a minimum," include evidence with respect to:

- Ease of market entry;
- Presence of other competitors; and
- The availability of like or substitute services in the relevant geographic area.[5]

In addition, the Board has the authority and responsibility to establish reporting requirements to monitor the "competitiveness" of a telecommunications service.[6] The Board retains the authority to reclassify a service previously deemed competitive if, after notice and hearing, it determines that competitive conditions have changed and that "sufficient" competition is no longer present.[7]

Q: Must the Board rely on criteria *in addition to* the three that you identify above?

4/ *N.J.S.A*: 48:2-21.19(b).

5/ *Id.*

6/ *N.J.S.A*: 48:2-21.19(c).

7/ *N.J.S.A*: 48:2-21.19(d).

A: It is my understanding that the Board *may* rely on other criteria when appropriate additional standards are necessary to protect the public interest. This understanding is based on my reading of the statute which states, in pertinent part:

> [I]n making such a determination [about the competitiveness of a telecommunications service], the [B]oard shall develop standards of competitive service which, *at a minimum*, shall include evidence of ease of market entry; presence of other competitors; and the availability of like or substitute services in the relevant geographic area.[8]

Q: What are the implications of the Board classifying a service as competitive?

A: Consumers must rely on market forces to yield just and reasonable rates, and adequate service quality. The statute states in pertinent part: "Notwithstanding the provisions of R.S.48:2-18, R.S.48:2-21, section 31 of P.L.1962, c.198 (C.48:2-21.2), R.S.48:3-1, or any other law to the contrary, the [B]oard shall not regulate, fix or prescribe the rates, tolls, charges, rate structures, terms and conditions of service, rate base, rate of return, and cost of service, of competitive services."[9] Based on this language, if the Board reclassifies a service, rate protection and the service quality standards would no longer apply.

The deregulation of mass market services will only lead to rate increases and service quality degradation. Furthermore, deregulation hinders the Board's ability to promote broadband service and, generally, to ensure that telecommunications policy in New Jersey is compatible

---

8/ *N.J.S.A*. 48:2-21.19(b) (emphasis added).

9/ *N.J.S.A*: 48:2-21.19(a).

with the goals of the state. Because Verizon NJ controls bottleneck elements (switched and special access), which are necessary inputs to its rivals, and does not yet price these elements based on their underlying costs, economically efficient competition cannot evolve. Therefore, CLECs cannot yet constrain the rates of Verizon NJ's services.

Q: If the Board reclassifies mass market services in this proceeding and later determines that these services are non-competitive, doesn't the Board have the authority to re-assert its jurisdiction over services that it has already deemed to be competitive?

A: Yes. Although I am not an attorney, a plain English reading of the statute indicates that the Board retains the authority to reclassify a service previously deemed competitive if, after notice and hearing, it determines that competitive conditions have changed and that "sufficient" competition is no longer present.[10] However, as a practical matter, it is more difficult to re-assess the competitiveness of services once they are declared competitive, and virtually impossible to remedy the consumer harm that premature classification of services as competitive would cause. Furthermore, the burden would shift to other parties and to the Board to initiate an investigation into the possible re-classification of competitive services as non-competitive. Therefore, I recommend that the Board consider carefully whether Verizon NJ and Embarq have met their burden of demonstrating that existing market conditions will discipline the rates, terms, and conditions of their services. The risks of premature classification of services as competitive outweigh significantly the risks of retaining the non-

[10]/ *N.J.S.A*: 48:2-21.19(d).

competitive classification of mass market and DA services.

III. VERIZON NJ AND EMBARQ TESTIMONY

Overview and preliminary analysis of Verizon NJ testimony.

Q: Please summarize your understanding of Verizon NJ's filing.

A: Mr. Vasington filed testimony on behalf of Verizon NJ "to show that Verizon mass market services that have not yet been classified as competitive satisfy the statutory reclassification criteria, and should thus be classified as competitive."[11] Mr. Newman submitted testimony also on behalf of Verizon NJ "to present the results of a survey of awareness and use of directory assistance and substitute services by residential customers in New Jersey."[12]

Q: For which services does Verizon NJ seek competitive classification?

A: Verizon NJ seeks competitive classification of mass market services that it references on pages 4 through 5 of Mr. Vasington's testimony and additional mass market services that Verizon NJ identified subsequent to the filing of Mr. Vasington's testimony.[13] I am including the complete list of services for which Verizon NJ seeks competitive classification, which Verizon NJ provides as an attachment to its response to RC-VNJ-2, as Exhibit SMB-1. Examples of these services are additional listings, call forwarding, call waiting, caller ID, basic local exchange service, directory assistance, and non-published listings.

Verizon NJ groups the services for which it seeks competitive classification among four

---

11 / Direct Testimony of Paul B. Vasington, December 14, 2007 ("Vasington (Verizon NJ)"), at 1.

12 / Direct Testimony of William M. Newman, December 14, 2007 ("Newman (Verizon NJ)"), at 2.

categories: (1) switched services (*e.g.,* exchange access line service and local usage messages); (2) switched ancillary services (*e.g.*, call block, call waiting, etc.); (3) non-switched ancillary services (*e.g.*, additional listings, local operators services, etc.); and (4) DA services (*e.g.*, "411", connect request^SM, and list service (which provides telephone numbers in written form)).[14] According to Verizon NJ, residence and small business exchange services are in the same product market.[15]

Verizon NJ asserts that "[a]nalysis of competitors' expansion and Verizon's corresponding declines, therefore, demonstrates that entry and expansion discipline the New Jersey mass market and prove that there are no substantial entry or expansion barriers."[16]

Q: What forms of competition does Verizon NJ discuss in support of its request for competitive classification?

A: Among other things, Mr. Vasington discusses cable companies' networks,[17] wireless service,[18] voice over Internet protocol ("VoIP"),[19] Internet and broadband technologies,[20] and

---

13 / Verizon NJ response to RC-VNJ-2 (Exhibit SMB-1).

14 / Vasington (Verizon NJ), at 4-5.

15 / *Id*, at 5.

16 / *Id.*, at 10.

17 / *Id*., at 13-18; 49-52.

18 / *Id.,*at 18-19; 53-58.

19 / *Id*., at 19-21.

20 / *Id*., at 21-27.

"traditional" CLECs.[21] In Section IV, I demonstrate why intermodal alternatives do not provide like or substitute services for basic mass market services, and why "traditional" CLEC services fail to discipline the rates and services of Verizon NJ's mass market services. Mr. Vasington also addresses DA service,[22] which I address in Section VII of this reply testimony.

Q: Do you concur with Verizon NJ's depiction of a competitive market?

A: No. As I demonstrate in Section IV, Verizon NJ has not demonstrated the existence of affordable alternatives to its mass market services. Among other things, cable companies' pursuit of triple play customers does not constrain the rates, terms, and conditions of Verizon NJ's à la carte offerings. Similarly, Verizon NJ's example that Towerstream offers high speed service to small and large businesses at prices starting at $175 per month,[23] is not persuasive evidence of price-disciplining competition for Verizon NJ's single line residential and business services. Furthermore, predictions of competitive entry and changing DA demand should be afforded little weight. Instead, the Board should consider the market conditions that exist today.

Q: How many households does Verizon NJ serve?

A: Verizon NJ estimates that it serves **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>** households based on the number of consumer primary lines that it

---

[21] / *Id.*, at 27-28.

[22] / *Id.,* at 28-38.

serves.[24]

Q: How many customers subscribe to the various mass market services for which Verizon NJ seeks competitive classification?

A: Exhibit SMB-C-3, which is a reproduction of Verizon NJ's response to RC-VNJ-19, shows consumer demand, separately by residential and business customers, as of December 2005, December 2006, and September 2007, including bundled and stand-alone customers.

Q: Has Verizon NJ changed the rates or terms of any of these services during the past five years?

A: Yes. Verizon increased the rate for 411 local directory assistance from $0.20 to $0.50 per call on February 1, 2004, and on the same date increased the rate for business DA from $0.75 to $1.25.[25]

Q: In which geographic markets does Verizon NJ serve mass market customers?

A: Exhibit SMB-C-4, which reproduces Verizon NJ's response to RC-VNJ-20, provides an alphabetical list of all wire centers in which Verizon NJ serves mass market customers. Exhibit SMB-C-5, which reproduces Verizon NJ's response to RC-VNJ-21, shows which wire centers serve which municipalities. Since wire center boundaries and municipal boundaries do not coincide, in some instances, a single municipality may be served by

---

[23] / *Id.*, at 24.

[24] / Verizon NJ response to RC-VNJ-10, including attachment (Exhibit SMB-C-2). This exhibit provides estimates of Verizon NJ-served households by wire center.

[25] / Verizon NJ response to RC-VNJ-3 (Exhibit SMB-6).

multiple wire centers (for example, Newark is served by **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY** wire centers, and in other instances, a single wire center may serve portions or multiple municipalities (for example, **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY.**[26]

Q: Mr. Vasington asserts that relevant geographic market should be defined at least as the entire state.[27] Do you agree?

A: No. Verizon NJ does not provide empirical evidence that "competitive conditions are generally similar across the State."[28] The presence of cable telephony, priced significantly in excess of basic local service, does not, for example, demonstrate the presence of statewide competition. Verizon NJ also refers to its "internal data" in support of its proposed use of the state as the relevant geographic market.[29] In response to a Rate Counsel interrogatory seeking the "internal data," Verizon NJ referred to its proprietary attachment to its response to Sprint VNJ-20(f), which I have included as Exhibit SMB-C-7.[30] Although I agree that the referenced document shows the presence of alternative supplier(s) in all wire centers, the data do not prove the existence of effective competition.

---

26 Verizon NJ response to RC-VNJ-21 (Exhibit SMB-C-5).

27 / Vasington (Verizon NJ), at 39.

28 / *Id.*, at 40.

29 / *Id.*, at 41.

30 / Verizon NJ response to RC-VNJ-144 (Exhibit SMB-8). See also Verizon NJ response to RC-VNJ-129,

Q: Please explain.

A: First, the data show aggregate lines provided by mode of entry, and not the number of lines provided by each CLEC. Second, as I discuss in more detail in Section IV, CLEC-served lines that rely on Verizon NJ's wholesale facilities cannot be considered to constrain Verizon NJ's market power. Furthermore, in many wire centers, the cable presence is non-existent or negligible. **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>**[31] Contrary to Verizon NJ's assertion, Verizon NJ's "internal data" show widely varying competitive conditions among wire centers.

Q: Ms. Baldwin, have you conducted a comprehensive analysis of Verizon NJ's "internal data" upon which Mr. Vasington relies?

A: Not at this time. The data in Exhibit SMB-C-7 (Verizon NJ's response to Sprint VNJ-20f) were provided in PDF format. If the Board intends to rely on these data in this proceeding, it should direct Verizon NJ to provide the information in Excel format to the parties to this proceeding. However, even a cursory review shows that competitive conditions vary among wire centers, and that Verizon NJ has failed to provide the empirical data necessary to assess the merits of its recommended use of the entire state as the relevant geographic market.

Q: Have you reviewed the TNS Bill Harvesting data to which Mr. Vasington refers in his

---

which seeks the data in a machine readable excel spreadsheet format.

[31] / There are numerous other examples. For the sake of illustration, I reviewed wire centers beginning with the letter "m."

testimony?

A: No. Although Rate Counsel sought the underlying TNS Bill Harvesting data, which provides information about consumer demand, and information about the survey methodology, Verizon NJ did not provide the requested information because it "seeks confidential, third party data of TNS."[32] In my view, the asymmetry of access to information about consumer demand (where Verizon NJ has access to complete information and other parties do not) limits the usefulness of the record in this proceeding. Verizon NJ apparently is able unilaterally to select the information from the TNS that it considers relevant to the proceeding. Other parties and the Board are unable to assess independently the comprehensiveness of the data provided.

Q: Have you reviewed Dr. Newman's testimony?

A: Yes. In Section VII, I discuss the reasons that the DA survey results are misleading and why the Board should reject Verizon NJ's request to classify residential DA as competitive.

Overview and preliminary analysis of Embarq testimony.

Q: Please provide an overview of Embarq's testimony.

A: Dr. Staihr's testimony seeks to demonstrate that the retail market that Embarq serves "is fully and effectively competitive."[33] Embarq requests that all of its services in its Tariff N.J.

---

[32] / Verizon NJ response to RC-VNJ-6.

[33] / Direct Testimony of Dr. Brian K. Staihr on behalf of United Telephone Company of New Jersey, Inc. d/b/a Embarq, December 14, 2007 ("Staihr (Embarq)"), at 3.

B.P.U. No. 3 be reclassified as competitive,[34] which include business and residential services.

Q: Is Embarq seeking competitive classification of services other than those provided to residential and single-line business customers?

A: Apparently, yes, because the referenced tariff includes, among other services, the following: United TransLink^{SM} (a digital private line service) United DigiLink^{SM} (a digital transmission service), and Multiline Bundle.[35] As I understand the list of services for which Embarq seeks competitive classification in this proceeding, it includes multiline and private line services. For this reason, I am referencing and attaching hereto my direct testimony in this proceeding, which addresses issues relevant to the multiline and private line business market,[36] and which the Board struck in an order issued earlier this month.[37]

.Q: The Embarq list also includes 911 enhanced service.[38] Please comment.

A: The inclusion of emergency reporting services in Embarq's request for competitive classification surprises me. It would seem that the provision of information, trunks and facilities to public safety answering points would continue to be considered a non-competitive (and essential) service. Although I am not familiar with the specific regulatory

---

[34] / Exhibit SMB-9 reproduces Attachment BKS-1 to Dr. Staihr's testimony, which lists the services in this tariff.

[35] / Staihr (Embarq), Attachment BKS-1.

[36] / Attachment B (Direct Testimony of Susan M. Baldwin, December 14, 2007 ("Baldwin Direct")).

[37] / *Order on Motion to Strike*, January 4, 2008.

treatment of E911 in New Jersey, it would seem that, given the essential public-safety characteristics of the service, it would be subject to oversight. Certainly it is hard to imagine that there are competitive alternatives to E911.

Q: Does Dr. Staihr's testimony demonstrate that there are like or substitute services for each of the services for which Embarq seeks competitive classification?

A: No. Dr. Staihr's testimony is general and does not separately address each of the services. Embarq relies on the presence of wireless, cable, non-facilities-based VoIP, and "traditional" CLECs as evidence of competition.[39]

Q: Does Embarq provide any consumer surveys in support of its request to classify business multiline sevice as competitive?

A: No. In prior proceedings, the Board has required a survey of business customers.[40]

---

[38] / Staihr (Embarq), Attachment BKS-1.

[39] / Staihr (Embarq).

[40] / In the *PAR-2 Order*, the Board deferred a decision to reclassify services for business customers with two to four lines until Staff completed a business customer survey regarding the "availability of customer choice for all classes of business customers with special emphasis on the level of competition for business customers with fewer than five lines. *In the Matter of the Application of Verizon New Jersey Inc. For Approval (I) of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-Line Rate Regulated Business Services as Competitive Services, and Compliance Filing*, New Jersey Board of Public Utilities Docket No. TO01020095, *Decision and Order*, August 19, 2003 ("PAR-2 Order"), at 154. The Board retained the services of the Eagleton Institute Center for Public Interest Polling at Rutgers University ("Eagleton") to develop and to administer a survey "to assess the level of competition in the local telephone marketplace for New Jersey small to mid-size businesses." Eagleton conducted the survey in March and April of 2003. *In the Matter of the Application of Verizon New Jersey, Inc. For Approval (I) of a New Plan for Alternative Form of Regulation and (II) To Reclassify Multi-Line Rate Regulated Business Services as Competitive Services, and Compliance Filing*, New Jersey Board of Public Utilities Docket No. TO01020095, *Order*, December 22, 2004, at 1-2; Local Business Telephone Service in New Jersey: A Survey of Small Businesses, Conducted for the New Jersey Board of Public Utilities by the Eagleton Institute of Politics, Center for Public Interest Polling, The State University of New Jersey, Rutgers, Data Collection March-April 2003 ("Eagleton Survey").

Q: In which geographic markets does Embarq serve customers?

A: Exhibit SMB-C-10, which reproduces Embarq's response to RC-EM-12, provides the quantities of households and business sites in each of Embarq's wire centers. There are approximately 111,835 households in Embarq's territory, and Embarq serves 116,216 residential access lines.[41]

Q: Does Embarq justify its request for competitive classification of its services?

A: No. As I demonstrate throughout this reply testimony, and in the attachments and exhibits hereto, Embarq fails to demonstrate that the evidence satisfies the statutory criteria.

[41] / Staihr (Embarq), Attachment BKS-2.

IV. LOCAL EXCHANGE SERVICE MARKETS IN NEW JERSEY

The local exchange services market lacks sufficient competition to protect consumers.

Q: Please describe the status of competition in New Jersey.

A: Verizon NJ dominates traditional telecommunications markets in New Jersey (*i.e.*, local exchange service, long distance service, private line and special access services). As I show below, the vast majority of consumers subscribe to Verizon NJ's basic local exchange service in its operating territory. Furthermore, Verizon NJ and cable companies dominate consumers' access to the Internet as an unregulated duopoly.[42] This duopoly-controlled broadband access provides the platform for the purportedly "competitive" voice over Internet protocol ("VoIP") offerings. Because a competitive and affordable broadband platform does not yet exist, those intermodal alternatives that rely on broadband access, of course, cannot be considered to represent sufficiently competitive substitutes for basic local exchange service.

---

42 / As of year-end 2006, nationally, high-speed lines (both residential and business) served by cable modem represented 53.6% of high-speed lines in service, and high-speed lines served by ADSL technology represented 39.1% of the high-speed lines in service nationwide. Thus, the cable and telephone companies control at least 92% of the broadband pipes to homes and businesses in the United States. In New Jersey, of a total reported 3,392,607 high-speed lines in service as of December 31, 2006, 703,950 were ADSL and 1,385,953 were served by cable modem technology. Additionally, 6,180 lines were SDSL and 18,633 were "other" traditional wireline services. There were no broadband over powerline connections and the numbers for fiber, satellite, fixed wireless, and mobile wireless were "withheld to maintain firm confidentiality" indicating that only one carrier provided service in each of the respective categories. Of the 3,392,607 high-speed lines in service in New Jersey, 2,109,126 (or 38%) of those lines served residential consumers as of December 31, 2006. Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission, *High-Speed Services for Internet Access: Status as of December 31, 2006*, October 2007, at Chart 6, Table 9, and Table 13.

Q: Have CLECs shown much interest in offering basic local exchange services in New Jersey?

A: No. CLECs have shown negligible interest in providing basic local exchange service to the mass market.

- AT&T announced its intention several years ago to "harvest" its mass market customers.[43]
- Several years ago, UNE-P served as a vehicle for CLEC entry into the mass market, but UNE-P-based entry (which has been replaced with "Wholesale Advantage") has been declining steadily as a result of Bells' acquisition of MCI and AT&T, and as a result of an FCC decision issued in February 2005.
- Detailed data submitted by CLECs in 2003, in Docket No. TO03090705, showed that, even during the heyday of UNE-P, CLECs served relatively few areas of the state and largely ignored the mass market.[44] With the dwindling of UNE-P-based service, a comparable analysis of today's data would likely show a similar lack of CLEC presence in the mass market.

---

[43] / Citing among other sources, AT&T Declarant John Polumbo and the Q4 2004 AT&T Earnings Conference Call, the FCC states, "[w]e base this conclusion on AT&T's cessation of marketing, its reductions in consumer operations, its retirement of infrastructure used to support mass market marketing and consumer care for mass market services, and its decision to 'harvest' its mass market business by raising prices, resulting in a declining mass market customer base." *In the Matter of SBC Communications Corp. and AT&T Corp, Inc. Applications for Approval of Transfer of Control*, FCC WC Docket No. 05-65, *Memorandum Opinion and Order*, Rel. November 17, 2005 ("SBC/AT&T Merger Order"), at para. 313. The FCC explains further that "'Harvesting' refers to AT&T's increasing prices to encourage customers to discontinue service" and "'Harvesting' refers to AT&T's steps to manage the decline in its mass market business." *Id.*, at fn 313.

[44] / *See* redacted version of testimony of Susan M. Baldwin, February 2, 2004, Docket No. TO03090705.

- During the past three-plus years (since the Board's "impairment' proceeding), intermodal alternatives, such as VoIP, wireless and cable-based telephony, have created a misleading semblance of competitive activity. In reality, however, all these entry modes rely on the "pipes" of the telecommunications and cable industry. A cable-telecommunications duopoly does not protect consumers from market power. Furthermore, these intermodal alternatives do not protect the consumer who simply seeks basic local exchange service.

Q: Have you examined evidence regarding wireline competition in New Jersey?

A: Yes. According to the FCC's Local Competition Report released December 31, 2007, CLECs accounted for about 18% of switched access lines provided in New Jersey, as of December 31, 2006. The table below summarizes data from these reports beginning with year-end 2004 data.

Table SMB-1

Status of CLECs in New Jersey[45]

	ILECs	CLECs				CLEC % of	Number
	Retail	Resold	UNEs	Owned	Total	Total Lines	of CLECs
12/31/2004	4,972,805	155,703	996,955	241,754	1,394,412	22%	21
6/30/2005	4,846,691	245,018	1,014,796	129,187	1,389,001	22%	44
12/31/2005	4,714,621	606,709	498,785	176,858	1,282,352	21%	51
6/30/2006	4,784,134	563,425	312,129	118,075	993,629	17%	52
12/31/2006	4,543,272	520,812	310,872	145,439	977,123	18%	50

Q: Based on the FCC-reported data, please explain the relationship of Verizon NJ's wholesale facilities to the CLECs' market entry.

A: A large portion of the CLECs' market share (*i.e.*, 85% of the CLECs' access lines) depends on the incumbent carriers' facilities. Viewed solely on a retail basis, the incumbents (Verizon NJ and Embarq) have an 82% market share.[46] However, Verizon New Jersey[47] dominates the vast majority of the local market either directly through its own retail services or indirectly by leasing wholesale facilities to its competitors (*i.e.*, the non-facilities-based competition that occurs through resale, UNE-P, UNE loop, and most recently, Verizon NJ's

[45] / Sources: Federal Communications Commission, Wireline Competition Bureau, Industry Analysis and Technology Division, Local Telephone Competition: Status as of December .31, 2004; Local Telephone Competition: Status as of June 30, 2005; Local Telephone Competition: Status as of December 31, 2005; Local Telephone Competition: Status as of June 30, 2006; Local Telephone Competition: Status as of December 31, 2006 ("FCC Local Competition Report"), Table 7, 11, and 13. UNEs category includes UNE-L, UNE-P and Verizon's Wholesale Advantage product. The large jump in CLEC numbers between December 31, 2004 and June 30, 2005 can be attributed, in part, by changes in reporting requirements leading to a larger number of CLECs that were required to report.

[46] / *Id.*, at Table 7.

[47] / I refer to Verizon NJ here because Verizon NJ is the incumbent in the majority of the wire centers in New Jersey. Embarq serves 116,216 residential lines in New Jersey. Staihr (Embarq), Attachment BKS-2.

Wholesale Advantage product). As Table SMB-2 shows, the incumbents own or control 97% of the end-user switched access lines in New Jersey as of December 31, 2006.[48]

Table SMB-2[49]

The incumbents own or control 97% of the switched access lines in New Jersey (as of December 31, 2006)

Total incumbent lines	4,543,272
Total CLEC lines	977,123
Total end-user switched access lines	5,520,395
CLEC share of end-user switched access lines	18%
CLEC resold lines	520,812
CLEC UNE lines	310,872
CLEC-owned lines	145,439
Total CLEC lines	977,123
CLEC-owned lines as a percent of all lines	3%
Percent of all lines owned or controlled by incumbent	97%

Q: What is your understanding of how the FCC's Local Competition Report accounts for lines served by CLECs that were acquired as a result of the mergers that have occurred in recent years?

A: Based on my reading of the FCC's report, the lines within Verizon's region that were served

48/ *Id.*, at Tables 7 and 11.

49 / *Id.*, at Tables 7 and 11. The Local Competition Reports include data from CLECs that serve customers using coaxial cable. See, *e.g.*, Table 5. As of December 31, 2006 approximately 6.8 million end-user access lines were provided by CLECs over coaxial cable connections nationally, representing approximately 61% of the 11.2 million end-user switched access lines that CLECs reported providing over their own local loop facilities. *Id.*, at 2

previously by MCI are now included as part of the total count of Verizon's incumbent switched access lines. Lines outside of Verizon's footprint that were served previously by MCI are considered as CLEC lines. In its Local Competition Report, the FCC states:

> For this report, end-user switched access lines reported for the incumbent LEC operations of certain entities (i.e., AT&T Inc. and Verizon Communications Inc.) have been increased to reflect merger with a CLEC – to the extent the CLEC operated in the incumbent LEC's service territory – and lines reported for the CLEC operations of these entities have been decreased by the same amount. Such adjustments are necessary when the merged entity treats the former CLEC operations as a separate business unit, and files a separate Form 477 for that business unit.[50]

Q: How does the FCC's Local Competition Report account for cable telephony?

A: As noted by Mr. Vasington,[51] the FCC's Local Competition Report only includes a portion of the cable telephony that is being provided in the state. Because the regulatory status of local telephone service provided by VoIP (particularly fixed service) remains undetermined, the FCC did not add questions about local telephone service as provided by entities utilizing VoIP exclusively to its Form 477 in 2004, but entities already filing information on Form 477 may include information about the local telephone service they provide using VoIP and some providers do.[52]

---

[50] / *Id.*, at 1-2, footnote 5.

[51] / Vasington (Verizon NJ), at 68-69.

[52] / See "Frequently Asked Questions About FCC Form 477 (Local Telephone Competition and Broadband Reporting)," Updated as of 1/18/2006, Question #13, available at www.fcc.gov/broadband/broadband_data_faq.html#overview. Part II of the current Form 477 applies to all entities that a state regulatory commission recognizes as competitive local exchange carriers (or as incumbent local exchange carriers). But the current Form 477 instructions are silent about VoIP. Therefore, individual companies are making their own decisions about whether or not to report their interconnected VoIP subscribers.

Q: What weight should the Board afford to the presence of CLECs that rely on Verizon NJ's or Embarq's wholesale facilities in order to offer telecommunications services?

A: The Board should afford minimal weight to the CLECs that rely on the incumbents in order to provide retail service to consumers. Competition based on Wholesale Advantage (previously provided as UNE-P) has declined substantially in the wake of the *Triennial Review Remand Order* issued by the FCC.[53] The decline in competition via UNE-P may lead to a leveling off, or reversal, of the portion of the trend associated with customer migration from Verizon NJ to other carriers for the provision of telephone lines. The dramatic decline in UNE-P lines contrasts sharply with UNE-P's former importance as a mode of entry for competitive suppliers, and the position of CLECs negotiating access to UNE-P facilities is now seriously weakened due to the expiration of regulated UNE-P access in March 2006. Verizon NJ replaced UNE-P with Wholesale Advantage on March 11, 2006.[54] Nationwide, the number of switched access lines provided through UNEs has declined 46% from a peak in June 2004.[55] Most of the decline is due to a decline in UNE-P. Incumbent local exchange providers report a decline of over 59% in the number of lines they

---

[53] / *Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, FCC WC Docket No. 04-313; CC Docket No. 01-338, *Order on Remand*, Rel. February 4, 2005 ("Triennial Review Remand Order" or "TRRO").

[54] / Verizon NJ response to RC-VNJ-59.

[55] / FCC Local Competition Report, at Table 4. ILECs report providing a total of 21.46 million UNE lines in June 2004 and 11.5 million lines as UNEs in December 2006. ILEC-reported statistics regarding UNEs differs slightly from CLEC-reported data. CLECs reported providing 19.62 million access lines by acquiring UNEs in June 2004 compared to 11.67 million access lines in December 2006. *Id.*, at Table 3. The FCC's data shows that approximately 39% of the switched access lines served by CLECs nationwide are CLEC-owned lines. *Id.*, at Chart 3. Of those CLEC-owned lines, 61% of the lines are provided over coaxial cable. *Id.*, at 2. While the percentage of lines provided by CLECs through

provide to other carriers via UNE-P and a decline of 2% for UNE-L.[56]

In New Jersey, the number of UNE-P lines Verizon NJ reported providing to other carriers declined almost 48% from the peak, from a high of 1,032,941 UNE-P as of June 2004 to 541,358 as of December 2006.[57] As shown in Table SMB-1 above, the total number of CLEC-reported lines (provided by resale, UNE, and CLECs' own facilities) has declined by approximately 30% from a high in December 2004. The number of lines provided through UNE-L or UNE-P (now Wholesale Advantage) has declined 69% and the number of CLEC-owned lines has declined almost 40% over the same period.

As long as the CLECs are relying on the incumbents for essential network components, and particularly now that CLECs must negotiate with Verizon NJ regarding the rates, terms, and conditions of Wholesale Advantage, this mode of competitive entry should not be considered to constrain Verizon NJ's market power. As I discuss in more detail below, the FCC recently determined that Verizon possesses exclusionary market power.[58]

Q: How has CLECs' use of Verizon NJ's wholesale platform changed during the past four years?

UNEs has dropped, lines provided through resale have risen. *Id.*, at Table 3.

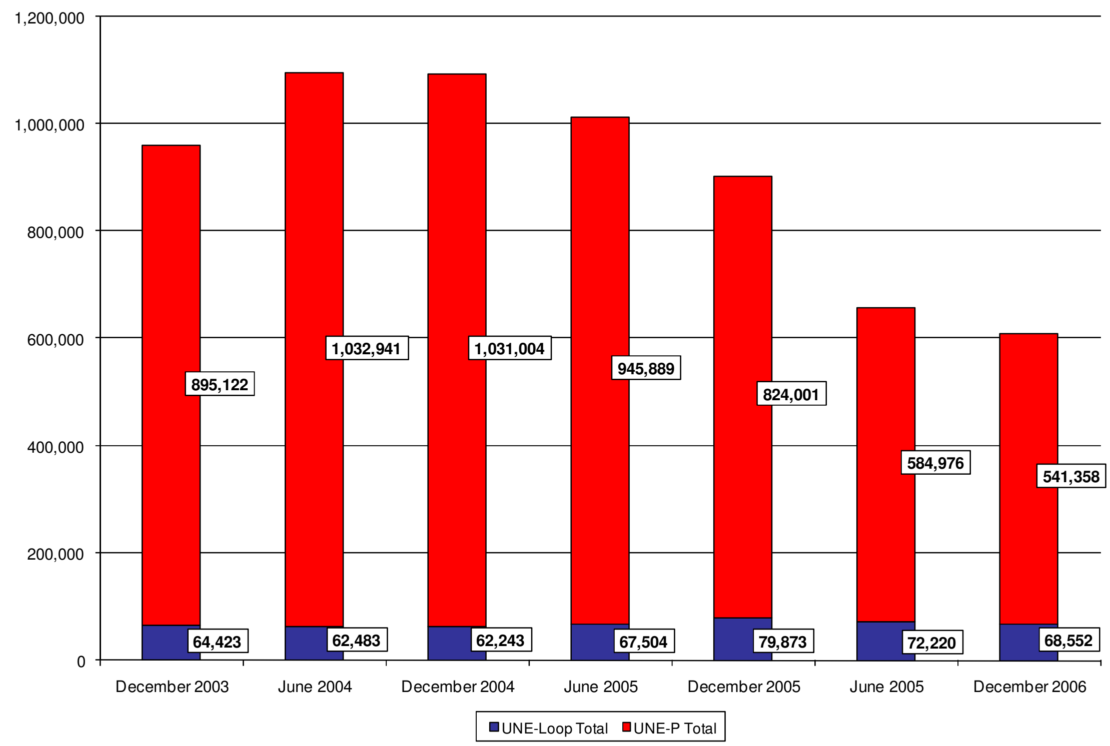
[56] / *Id.*, at Table 4. This decline is for the period June 2004 through December 2006.

[57] / FCC, Selected RBOC Local Telephone Data, December 2003 through June 2006, available from http://www.fcc.gov/wcb/iatd/comp.html.

A: Figure SMB-1 illustrates the declining demand for UNE-P (now Wholesale Advantage) that I discuss above and also shows that CLECs have not substituted demand for UNE-L to replace their use of UNE-P.

Figure SMB-1

CLECs' Entry Based on Verizon NJ's Unbundled Network Elements Is Declining[59]



Q: Mr. Vasington suggests that ILEC line loss evident in the FCC's Local Competition Report demonstrates a rise in wireline competition.[60] Do you agree?

[58] / *Verizon Six MSA Forbearance Order,* para. 45.

[59] / The reference in the figure to UNE-P refers to Wholesale Advantage and UNE-P. Selected RBOC Local Telephone Data, December 2003 through December 2006, available from http://www.fcc.gov/wcb/iatd/comp.html.

A: No. Much of Verizon NJ's retail line loss is attributable to a decline in demand for additional residential lines. Table SMB-C-3a shows that declining demand for additional lines (as customers have increasingly relied on wireless and digital subscriber line ("DSL")) explains approximately **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>** of the line loss experienced by Verizon NJ.

Table SMB-C-3a

<<<BEGIN PROPRIETARY

[redacted]

END PROPRIETARY>>>

Q: Is there a public data source that confirms this analysis?

A: Yes. I have also reviewed public FCC ARMIS data and Table SMB-3b below shows that

---

60 / Vasington (Verizon NJ), at 61.

61 / Verizon response to VNJ-RC-22, proprietary attachment RC-VNJ-22 (Exhibit SMB-C-11).

39% of the line loss experienced by Verizon NJ from December 2003 through December 2006 (the latest data available from ARMIS) was due to a reduction of additional residential lines.

Table SMB-3b[62]

Decline in Demand for Additional Lines Explains Approximately 39% of Decline in Verizon NJ's Residential Retail Lines between December 2003 and December 2006

	Total Residential Lines	Additional Residential Lines
December 2003	4,016,227	882,894
December 2004	3,739,607	708,688
December 2005	3,379,882	584,928
December 2006	2,957,345	474,803
Net Change 2003 to 2006	-1,058,882	-408,091
Additional Residential Line Loss as a Percentage of Total Residential Line Loss		**39%**

The FCC came to a similar conclusion in its recent Order denying Verizon's request for forbearance. The FCC rejected Verizon's calculations of percentage reductions in retail lines as evidence of facilities-based competition, stating: "There are many possible reasons for such decreases unrelated to the existence of last-mile facilities-based competition. For example, as the Commission explained in the *ACS UNE Forbearance Order*, the abandonment of a residential access line does not necessarily indicate capture of that

[62] / ARMIS Report 43-08 Table III. Access Lines in Service by Customer.

customer by a competitor, but may indicate that the consumer converted a second line used for dial-up Internet access to an incumbent LEC broadband line for Internet access."[63]

Q: Did Verizon NJ provide data regarding CLECs' wholesale-based entry disaggregated based on the wire center level?

A: Yes. In response to RC-VNJ-22, Verizon NJ provided information, by wire center, about the number of lines it provides to other carriers categorized by residential UNE-P/Wholesale Advantage; business UNE-P/Wholesale Advantage; UNE-L; residential resale; and business resale for the years 2003 through September 2007. The data response also includes DSL volumes at the state level for residential consumers. I have included this 48-page response as Exhibit SMB-C-11 to my reply testimony.

Q: Have you analyzed the data in this exhibit?

A: Only in a very general sense. Rate Counsel, in its original interrogatory, requested the data in an Excel format but has not yet received the data in any format other than a "PDF" format, which makes data analysis cumbersome under the time period set forth for reply testimony.[64] I provide an analysis of the change in demand for resale, wholesale advantage (including vestige UNE-P), loops & EEL by residential and business for the entire state of New Jersey below.

---

[63] / *Verizon Six MSA Forbearance Order*, at para. 32. *See*, also, *Id.*, at para. 39.

[64] / Verizon NJ response to RC-VNJ-22 (Exhibit SMB-C-11).

Table SMB-C-4[65]

The Number of Wholesale Lines Verizon NJ Provides to Other Carriers Has Generally Declined

<<<BEGIN PROPRIETARY

[redacted]

END PROPRIETARY>>>

Verizon NJ's provision of lines to CLECs has **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>** since the end of 2003. The total number of lines provided through residential resale and residential wholesale advantage (formerly UNE-P) have **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>** respectively, over the time period.

Q: Did Verizon NJ provide data about CLECs' entry by wire center?

A: No. Rate Counsel sought wire-center-based data regarding CLECs' entry, but Verizon NJ

---

[65] / Verizon NJ response to RC-VNJ-22, proprietary attachment, response to RC 1-22(o, p, q, r, s). Volumes include MCI and other VZ affiliates and Wholesale Advantage lines include vestige UNE-P lines. Business resale and Wholesale Advantage include "Pub" lines. Verizon NJ did not provide any information related to the number of lines provided by its affiliates in New Jersey (See objection in Verizon response to RC-VNJ-35 and RC-VNJ-36) and stated that Verizon is not marketing MCI services and Verizon Business (formerly MCI) grandfathered its services offered in New Jersey on May 1, 2006 (See Verizon NJ response to RC-VNJ-37).

did not provide the requested data.[66] Aggregate statewide data about CLECs' presence is insufficient for the purpose of assessing the presence of competitors in the relevant geographic market, which is the wire center. In Virginia, state regulators stated, that they "agree with the NRRI Report introduced by Verizon that 'a whole state is generally too large to be used to define the geographic market.'"[67] The Virginia State Corporation Commission determined that MSAs are "too large and economically diverse to be an appropriate geographic market" and determined that instead the relevant market was the telephone exchange area.[68]

Q: But doesn't Verizon NJ provide the quantities of CLECs that serve each wire center, categorized separately by resale, wholesale advantage, and loops?

A: Yes. Verizon NJ provided this information in response to RC-VNJ-56 (Exhibit SMB-C-12), but the CLEC data is not disaggregated by the volumes of lines that they each serve in each wire center. For example, if a CLEC serves only a single line, it is part of the CLEC tally and is indistinguishable from a CLEC that serves 1000 lines. Furthermore, the 20-page response is a PDF version of a spreadsheet, which makes data analysis unnecessarily difficult. In stark contrast, approximately three years ago, in the Board's investigation of Verizon NJ's request to reclassify multiline business service as competitive, Verizon NJ

---

[66] / Verizon NJ response to RC-VNJ-3.

[67] / Application of Verizon Virginia, Inc. And Verizon South, Inc. For a Determination that Retail Services are Competitive and Deregulating and Detariffing of the Same, Case No. PUC-2007-00008, *Order on Application*, December 14, 2007 ("Virginia Competition Order"), at 26, citing NRRI Report Assessing Wireless and Broadband Substitution in Local Telephone Markets, June 2007 ("NRRI Report"), at 47.

provided comparable data in an Excel format.[69] It is not evident to me why Verizon NJ was able and willing to provide the same data in an electronic format in the previous proceeding in which it sought competitive classification, and, in this proceeding, is providing a PDF version of the same information.

Q: Are there other data that may be relevant to the Board's analysis in this proceeding?

A: Yes. There are numerous responses that Verizon NJ failed to provide in Excel format, which limits my ability to analyze the data. Among the responses are:

- Verizon NJ's highly proprietary attachment to RC-VNJ-136(b), which I incorporate by reference as Exhibit SMB-HC-13.
- Verizon NJ's highly proprietary attachment to RC-VNJ-61-65, which I include as Exhibit SMB-HC-14.
- Verizon NJ's proprietary attachment to Sprint VNJ-20(f) (which I discuss briefly in Section III and include as Exhibit SMB-C-7);
- Verizon NJ's proprietary attachment Sprint to VNJ-20(i), which I include as Exhibit SMB-C-15).
- Verizon NJ's proprietary attachment Sprint VNJ-20(j), which I include as Exhibit SMB-C-16).

---

[68] / *Id.*, at 30.

[69] / *In the Matter of the Application of Verizon New Jersey, Inc. for Approval (I) of a New Plan for an Alternative Form of Regulation and (II) to Reclassify Multi-Line Rate Regulated Business Services as Competitive Services, and Compliance Filing*, New Jersey Board of Public Utilities Docket No. TO01020095, Verizon NJ response to RPA-2.

Q: Have you reviewed the E911 data that Verizon NJ provided in response to VNJ-Sprint-20e?

A: Yes. I have included Verizon NJ's response to VNJ-Sprint-20E as Exhibit SMB-HC-17. These data are consistent with my description of a mass market in which few carriers use their own facilities to serve residential customers. The carrier names are not identified which prevents my further analysis, and, furthermore, the data are not disaggregated by wire center, which prevents any meaningful analysis based on relevant geographic markets.

Q: Have you reviewed the alleged highly proprietary data that Verizon NJ provided in response to RC-VNJ-136(a).

A: Yes. I have included this response as Exhibit SMB-HC-18. The usefulness of the data is limited because (1) the data are not disaggregated by wire center and therefore prevent analysis in the proper geographic market; and (2) the data rely on the E911 database, which has flaws and which the FCC chose not to rely in its recent decision denying Verizon's petitions for forbearance.[70]

Q: But doesn't Verizon NJ's response to RC-VNJ-136(b) include a break-out by wire center and by CLEC?

A: Yes, and as I mention above, I incorporate this response by reference as Exhibit SMB-HC-13. The limitations of this response are twofold: first, the file is in PDF format, which, given the voluminous information, limits the ability to analyze the data; second, the data do

[70] / *Verizon Six MSA Forbearance Order*, at footnote 115.

not include the quantities of lines served in each of the instances. For example, from the response, one learns that "CLEC 23" serves a particular wire center, but one cannot deduce how many lines the carrier serves.

Q: Did you examine other evidence that demonstrates that Verizon NJ continues to dominate the local exchange market?

A: Yes. I examined data related to win overs and win backs. The term "win overs" refers to instances where customers who first were served by CLECs migrate to Verizon NJ. "Win backs" refer to instances where customers who initially were served by Verizon NJ, then switched to CLECs, return to Verizon NJ. As Verizon's response to RC-VNJ-23 (Exhibit SMB-C-19) shows, Verizon NJ was able to win back customers throughout the 2003 to 2007 period. Win backs range from **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>** The decline in the number of annual winbacks is consistent with the timing of the TRRO, where CLECs' diminishing demand for UNE-P was most evident in the wake of the FCC's decision. Exhibit SMB-C-19 (Verizon NJ response to RC-VNJ-23) includes information on both win overs and winbacks for residential and business customers since 2003.

Q: Does Embarq provide evidence of significant presence by "traditional" CLECs?

A: No. Embarq's response to RC-EM-19 (Exhibit SMB-HC-20) shows the minimal wholesale-based CLEC entry in Embarq's territory, on a wire center basis. Embarq's response to RC-EM-27 (Exhibit SMB-HC-21) shows the number of CLECs collocating in Embarq's wire centers. Embarq's response to RC-EM-45 (Exhibit SMB-HC-22) shows, by wire center, the number of CLECs using Embarq's wholesale facilities (separately by mode of entry – resale, UNE-P, and UNE-L). This response does not provide demand data disaggregated both by wire center and by CLEC (i.e., quantities of lines served by each CLEC, separately by wire center). Based on my review of these three data responses, and Embarq's testimony, Embarq has not demonstrated that traditional CLECs offer like or substitute services. Among other things, Dr. Staihr relies on the fact that CLECs have reserved 108,000 numbers in Embarq wire centers as evidence of competition.[71] However, CLECs must obtain an entire block of 1000 numbers for each wire center that they seek to serve, and thus, the reservation of 1000 numbers could translate into serving only a handful of numbers. Therefore, this evidence should be afforded little weight.

Q: Did Embarq provide information regarding win overs and win backs?

A: Embarq provided information about win backs but not about win overs.[72] Embarq's residential win backs total **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>**.[73] Embarq indicates that it does not collect information regarding the reasons for customer disconnections, an indication that the market is far from competitive.[74]

---

71 / Staihr (Embarq), at 29.

72 / Embarq response to RC-EM-20 (Exhibit SMB-C-23).

73 / Embarq response to RC-EM-20 (Exhibit SMB-C-23).

74 / Embarq response to RC-EM-21 (Exhibit SMB-24) and Embarq response to RC-EM-20 (Exhibit SMB-C-23).

Q: Were you able to determine the number of CLECs that purchase UNEs from Embarq and the total number of UNEs Embarq provides?

A: No. Embarq did not provide data regarding the number of CLECs purchasing UNE-P and the quantities of UNE-P purchased by each CLEC[75] nor did it provide comparable data regarding the purchase of UNE-L[76] and resale.[77]

Contrary to the ILECs' assertions, intermodal alternatives do not discipline the rates, terms and conditions of residential dial tone services provided by the ILECs.

Q: Ms. Baldwin, wouldn't you agree that there are many intermodal providers in the New Jersey telecommunications markets?

A: Yes, there certainly are many different types of services available. However, the Board should not equate the variety of offerings with a finding of effective competition. Intermodal alternatives are not economic substitutes for basic local exchange service and therefore do not constrain either the rates or quality of basic service.

Q: What is an economic substitute?

A: As stated above, an economic substitute is generally considered a second product that a consumer is willing and able to buy instead of a first product, in response to a small but significant change in price of the first product,[78] and the most valuable and unbiased

[75] / Embarq response to RC-EM-48 (Exhibit SMB-25).

[76] / Embarq response to RC-EM-50 (Exhibit SMB-26).

[77] / Embarq response to RC-EM-51 (Exhibit SMB-27).

[78] / In the context of service quality, a substitute can also be considered a product that a consumer would buy instead of local wireline phone service from the incumbent if service quality declined. The relevant question is whether a consumer has an alternative product s/he can buy if the price of the first product rises, service quality declines, or for any

evidence about consumers' preferences are consumers' actual purchasing decisions.[79] Verizon NJ has failed to demonstrate that consumers consider wireless, facilities-based VoIP, and "over-the-top" VoIP services as substitutes and has failed to demonstrate that these intermodal alternatives constrain Verizon NJ's prices and service quality for basic voice grade service.

Q: Verizon NJ and Embarq rely upon competition from cable companies as evidence of market entry and the availability of like or substitute services in the telecommunications market in the New Jersey.[80] Do you agree?

A: No. The Board should use caution when considering even facilities-based VoIP services (*i.e.,* cable telephony) as substitutes to wireline services for residential consumers. Currently, the competitive threat faced by the telephone companies is in the provisions of *bundles* of services (often referred to as the "triple play", *i.e.*, phone, video, and Internet access or

---

other reason, the consumer is unsatisfied. This possibility that the business may lose the business of a consumer is theoretically the manner in which the market disciplines the actions of the business (*i.e.*, the business cannot let service quality decline or raise prices too much because the consumer will simply buy services from another business). In its order approving Verizon Communications Inc.'s acquisition of MCI, Inc. ("MCI"), the FCC, stated, that in considering consumer substitution possibilities: "we consider indicia of demand substitution between possible services, including: (1) the attributes and relative prices of possible competing services; (2) evidence that consumers view the possible competing services similarly, and have shifted or have considered shifting purchases between these services in response to relative changes in price or other competitive variables; (3) evidence that service providers consider the prospect of buyer substitution between services in response to relative changes in price or other competitive variables; and (4) the costs a consumer could incur to substitute between traditional services and services provided on an alternative platform." FCC Verizon/MCI Merger Order, footnote 251, citing *DOJ/FTC Guidelines* at § 1.11.

[79] / Consumers, through their purchasing decisions, seek to maximize their utility, and in so doing show their "preferences." See generally, Mas-Colell, Andreu, Michael D. Whinston and Jerry R. Green, *Microeconomic Theory* (New York: Oxford University Press, 1995).

[80] / Vasington (Verizon NJ), at 67; Staihr (Embarq), at 20-26.

"quadruple play," *i.e.*, phone, video, Internet access, and wireless service).[81]

Q: Do cable companies confront barriers to entry in order to compete with Verizon NJ in local markets?

A: Yes. In Virginia, state regulators recently found that the capital and human resources investments necessary for a cable company to offer local telephone service are significant barriers to entry, and further that cable companies are unlikely to make these investments "simply because Verizon raises prices for basic local telephone service."[82]

Q: Dr. Staihr contends that Comcast's and Patriot Media's prices of $33 to $41.95 "compare favorably" with Embarq's most popular bundle, Basic Home Phone, which is priced at approximately $30.[83] How do you respond?

A: These "comparables" are for packages of services. Bundles are a separate product market as I discuss in more detail below. To qualify for a rate that is more comparable to a typical wireline rate, cable telephony customers typically must also subscribe to, and pay for, an entire bundle of services they may not need or desire.[84] For example, the current price for Comcast unlimited digital voice service (either standalone or as a "double play" with either

[81] / The "bundles" to which I refer here include voice services (local, toll, long distance) sold in conjunction with video and Internet access services.

[82] / *Virginia Competition Order*, at 19, cite omitted.

[83] / Staihr (Embarq), at 25.

[84] / The FCC noted at footnote 268 of its *Verizon/MCI Merger Order* that the average monthly household expenditure for billed wireline local telephone service is $37. Of course, rates vary widely among states for a plethora of reasons and many households subscribe to discretionary services. A basic exchange line that provides access to the network, but no bells and whistles will be substantially less. Thus, the cable telephony option will not be price-competitive for the consumer seeking a bare-bones service that provides access to the public switched telephone network.

Comcast Internet or Video services) is $44.95 per month plus a $3.00 monthly modem lease fee if subscribing to voice service only.[85] Furthermore, even those bundled services are not yet competitive, because they are offered by a duopoly consisting of the local telephone company and the incumbent cable company.

Q: In your view, does a cable/telecommunications duopoly represent effective competition?

A: No. First, a cable/telecommunications duopoly, where both industries are competing to offer a bundle of voice, data, and video services to their customers, is irrelevant to the customer of basic local exchange services who does not seek a triple play offering. Second, even for those customers who want triple play offerings, a duopoly does not represent effective competition.

Q: Have others expressed concern about the emerging cable/telco duopoly?

A: Yes. A Congressional Research Report concluded: "With only limited alternatives to the cable and telephone broadband duopoly for the foreseeable future, and with the cable and telephone companies both pursuing largely the same business plan, the broadband providers might have both the incentive and the ability to exploit their control over access to end users to restrict competition (and the innovation it might bring) and harm consumers."[86] FCC

---

[85] / Comcast pricing information available at: http://www.comcast.com/MediaLibrary/1/1/About/PhoneTermsOfService/PDF/DigitalVoice/StatePricingLists/NewJersey/New%20Jersey%20pricing%20list.pdf (accessed 1/8/2008). Pricing is effective December 3, 2007. Comcast also offers a "Local with More" service that included unlimited direct-dialed local only calling for $34.95 per month. *Id.*

[86] / Charles B. Goldfarb, *Access to Broadband Networks*, Congressional Research Service, CRS Report for Congress, Order Code RL33496, June 29, 2006, at 17.

Commissioner Copps cited this conclusion in his dissent in the 2006 Order approving the cable deal essentially splitting Adelphia assets among Time Warner and Comcast as well as transferring current licenses between the two cable giants.[87] More recently, two FCC Commissioners continued to express concern with competitive analyses that rely heavily upon cable competition. In the FCC's recent On December 4, 2007, the FCC denied Verizon's petitions for forbearance in six MSAs for numerous reasons.[88] FCC Commissioner Copps suggests that prior forbearance orders may have erred in their reliance on intermodal competition. Commissioner Copps states:

> I concur in this decision because the Commission continues to rely too heavily on the intermodal efforts of a single alternative provider to decide whether we should forbear from the incumbent's retail and wholesale obligations. The Telecom Act envisioned more than just a cable-telephone duopoly as sufficient competition in the marketplace. In this case, the Order fortunately finds that forbearance is inappropriate because the petitioner does not face enough facilities-based competition from the local cable operator to meet Section 10's forbearance standard. However, I remain concerned that under the Commission's analysis, forbearance might be deemed appropriate were cable found to have a larger market share. Such a finding in the future would put at risk smaller competitive providers as evidenced by the fact that

---

87 / Dissenting Statement of Commissioner Michael J. Copps, Re: *Applications for Consent to the Assignment and/or Transfer of Control of Licenses; Adelphia Communications Corporation (and subsidiaries, debtors-in-possession), Assignors, to Time Warner Cable Inc. (subsidiaries), Assignees; Adelphia Communications Corporation (and subsidiaries, debtors-in-possession), Assignors and Transferors, to Comcast Corporation (subsidiaries), Assignees and Transferees; Comcast Corporation, Transferor, to Time Warner, Inc., Transferee; Time Warner In., Transferor to Comcast Corporation, Transferee, Memorandum Opinion and Order*, FCC MB Docket No. 05-192, July 13, 2006; *See,* also, Statement of Commissioner Michael J. Copps, Re: *Amendment of Part 15 Regarding New Requirements and Measurement Guidelines for Access Broadband over Power Line; Carrier Current Systems Including Broadband over Power Line Systems, Memorandum Opinion and Order*, August 3, 2006.

88 / *Verizon Six MSA Forbearance Order*. Verizon sought forbearance from "the following dominant carrier regulations to the extent that they apply to its mass market interstate switched access services: tariffing requirements, price cap regulation, and dominant carrier requirements concerning the processes for acquiring lines, discontinuing services, assignment or transfers of control, and acquiring affiliations." *Id.*, at para. 21. The mass market is defined as residential consumers and small business customers. *Id.*, at footnote 78.

> some competitors chose not to compete in Omaha after the *Qwest-Omaha* forbearance decision. I would have been more comfortable with an analysis less accepting of duopoly as a competitive marketplace and that did not lead us further down this road.[89]

Commissioner Adelstein also expressed concerns about a duopoly, stating:

> I continue to believe that the Act contemplates a competitive environment based on more than a simple rivalry – or duopoly – of a wireline and cable provider. Section 10 requires the Commission to consider, among other things, competitive conditions, the protection of consumers, and the public interest. The Commission must be ready to respond to a dynamic marketplace but it must also beware of the potential to lock consumers into a choice between two providers, a result that would have been more likely were relief granted here and one that would fall far short of the vital goals of the 1996 Act.[90]

A duopoly is not an effective form of competition for either basic customers or for customers seeking advanced services.

Q: Why not?

A: In the first instance, cable companies do not discipline the prices, quality, and terms of conditions of basic telecommunications services offered to customers who do not seek bundles. Furthermore, even those customers who are willing and able to pay for bundled packages of voice, data, and/or video services confront high transaction costs to migrate from one supplier to another. Transaction costs include the time and financial outlay for service

---

[89] / *In the Matter of Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. §160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas*, FCC WC Docket No. 06-172, *Memorandum Opinion and Order*, FCC 07-212, released December 5, 2007, Statement of Commissioner Michael J. Copps, Concurring.

[90] / *In the Matter of Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. §160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas*, FCC WC Docket No. 06-172, *Memorandum Opinion and Order*, FCC 07-212, released December 5, 2007, Statement of Commissioner Jonathan S. Adelstein, Concurring.

installation, equipment, and an e-mail address change. Moreover, telecommunications service providers use various tactics to lock-in customers. Although some of these tactics may offer short-term consumer benefits, they also impose transaction costs if customers later wish to change service providers.

Q: Please describe these transaction costs.

A: Some of the tactics that deter migration include:

- offering discounts for one-year contracts, instead of month-to-month agreements,
- bundling necessary equipment with a long-term commitment,
- imposing early termination fees, and
- features such as an e-mail address that is non-portable.

In addition to the business goal of seeking to attract customers in the high revenue segment of the market, the desire to lower customer churn is one of the industry's key motivating reasons for marketing bundled offerings to customers. The FCC stated in reviewing the Verizon/MCI merger:

> Verizon's documents reveal that its research and development, marketing, and corporate strategies focus upon service offerings designed to encourage consumers to subscribe to a local and long distance service bundle. Verizon's incentive is to drive consumers to purchase all telephone services from Verizon to reduce its marketing costs and churn, as well as to increase its average revenue per user.[91]

[91]/ *FCC Verizon/MCI Merger Order,* at note 296. The Commission also stated, "[m]oreover, these strategies are revealed in their marketing." *Id.*, citing, Verizon Second Quarter 2005 Earnings Conference Call at 6, wherein it was stated: "In consumer, our approach to the marketplace is to focus on customer retention and loyalty, while increasing the average monthly revenue per customer through these new services and higher penetration of bundles and packages." See, also, *FCC AT&T/BellSouth Merger Order*, at para. 102.

The Board should not rely on this duopoly to protect consumers from Verizon's exercise of its near-monopoly power.

Q: Please elaborate.

A: A duopoly, which is an extreme form of an oligopoly, is only one step away from a monopoly. In an oligopoly, a number of firms compete in a market, and the firms' behavior, cost functions, and strategic interaction, as well as consumers' demand functions, affect the market structure. One textbook describes the behavior of firms in an oligopoly as follows:

> Any realistic theory of oligopoly must take as a point of departure the fact that when market concentration is high, the pricing decisions of sellers are interdependent, and the firms involved can scarcely avoid recognizing their mutual interdependence. If they are at all perceptive, the managers of oligopolistic firms will recognize too that profits will be higher when cooperative policies are pursued than when each firm looks only after its own narrow self-interest. As a result, we should expect oligopolistic industries to exhibit a tendency toward the maximization of collective profits, approximating the pricing behavior associated with pure monopoly.[92]

At an analyst conference, AT&T Chairman and CEO Ed Whiteacre suggested that there would not be a "price war" between cable and telephone companies, stating "We're not going to chase that down." Instead, Mr. Whiteacre suggested that the companies would compete on the basis of who offers more services in their packages.[93] This is hardly comforting to consumers who wish to buy relatively inexpensive basic exchange telephone

[92]/ F. M. Scherer, Industrial Market Structure and Economic Performance, Rand McNally & Company, (1970), at 157; *see also* discussion at 131 through 157. *Also see* Mas-Colell, Andreu, Michael D. Whinston and Jerry R. Green, Microeconomic Theory (New York: Oxford University Press, 1995), at 387 through 427.

[93]/ Roger Chang, "AT&T CEO Backs View of Double-Digit Adjusted EPS Growth," *The Wall Street Journal Online*, May 31, 2006.

lines.

Q: Should the Board give weight to other intermodal alternatives such as "over-the-top" VoIP or wireless?

A: No. The Board should not give much weight to "over the top" VoIP alternatives to basic local exchange service"Over the top" VoIP telephony requires a broadband connection, which, at this time, is mostly provided through DSL or cable modem connections.[94] The product supplied by Vonage, for example, requires that subscribers provide their own broadband Internet access. In its *Verizon/MCI Merger Order*, the FCC excluded over-the-top VoIP services from the relevant product market and confirmed this decision earlier this year in its Order approving the merger of AT&T and BellSouth, stating:

> The varieties of over-the-top VoIP differ significantly in their service characteristics, including quality of service and price. The extent to which consumers view these services as substitutes for traditional wireline local service may vary based on these differences. In addition, the requirement that a consumer have broadband access to be able to use certain over-the-top VoIP services affects its substitutability. Specifically, for consumers who do not already have broadband access service, the subscription fee to obtain it must be added to the subscription fee for the over-the-top VoIP service when weighing it against the price of traditional wireline local service, which could make substitution uneconomical. Even for consumers who have broadband service, their willingness to subscribe to over-the-top VoIP service instead of wireline local service will vary with the attributes of the service and their willingness to trade service characteristics for lower prices.[95]

Verizon NJ suggests that because "100% of the zip codes are served by at least one

---

94 / FCC, Wireline Competition Bureau, Industry Analysis and Technology Division, *High-Speed Services for Internet Access: Status as of December 31, 2006*, October 2007, at Table 2.

95/ *FCC AT&T/BellSouth Merger Order*, at para. 94 (notes omitted). See, also, *FCC Verizon/MCI Merger Order*, broadband provider, VoIP over existing broadband connections is available to mass market customers throughout New Jersey."[96] Mr. Vasington suggests that consumers "need only compare the incremental cost of VoIP to the cost of Verizon local and long distance service when purchasing local service."[97] However, some consumer groups are advising consumers to continue to subscribe to a basic landline telephone service even when utilizing VoIP services. Consumer Reports, in its February 2008 issue, advises: "If you're switching to cable telephone service . . . consider spending about $20 a month to retain basic landline service. A landline is more reliable for 911 calls and will continue to work in power outages."[98]

Q: Didn't the FCC, in its order approving the AT&T/BellSouth merger, acknowledge that wireless service is a substitute for ILECs' local service?

A: Not exactly. The FCC stated in pertinent part:

> Even if most segments of the mass market are unlikely to rely solely upon wireless services instead of wireline local services today, our product market analysis only requires that there be evidence of sufficient substitution for significant segments of the mass market to consider it in our analysis. Based on the factors discussed in this section, we conclude that mobile wireless services should be included within the product market for local services *to the extent that customers rely on wireless services as a complete substitute for,*

---

at para. 89;

96 / Vasington (Verizon NJ), at 20.

97 / *Id.*

98 / "Internet, TV, phone bundling can cut bills," *Consumer Reports*, February 2008, at 34. See also *Virginia Competition Order* at 25, stating that "present-day reliability and public safety concerns with VoIP cannot be ignored."

rather than a complement to, wireline services.[99]

As I understand the FCC's language, only those instances where customers have indeed substituted wireless service for wireline service should be included in the relevant product market. In other words, if, for example, 6% of consumers have "cut the cord," all other wireless consumers should be *excluded* from the relevant product market.[100]

Q: But demand for wireless service has been increasing dramatically. Isn't that growth in wireless demand relevant to the local market?

A: Wireless telecommunications services indisputably are prevalent, but their relevance to this proceeding is limited to those instances where customers have determined that wireless service is a substitute for rather than complement to basic local service. Evidence suggests that consumers are not "cutting the cord" (*i.e.* subscribing to wireless service in lieu of wireline service) in substantial numbers. In its order approving the merger of AT&T and BellSouth, the FCC found that approximately six percent (6%) of households rely on wireless services for all of their telecommunications needs (*i.e.,* six percent have "cut the cord").[101] The FCC also cited its prior conclusion that "the record does not present credible evidence that mobile wireless services have a price constraining effect on all consumers'

---

99 / *FCC AT&T/BellSouth Merger Order*, at para. 96 and footnote 282 (citing In the Matter of AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control, Federal Communications Commission WC Docket No. 06-74, sponsored declaration of Susan M. Baldwin and Sarah M. Bosley on behalf of the New Jersey Division of the Ratepayer Advocate, filed June 5, 2006) (emphasis added).

100 / *See also,* Verizon Six MSA Forbearance Order, Appendix B (which explains the FCC's calculation of market shares).

101/ *FCC AT&T/BellSouth Merger Order*, at para. 96.

demand for primary line wireline services."[102] In addition, the Commission observed that the "average cost for mobile wireless services appears to be higher than for wireline local service"[103] which "may not make it price competitive for consumers."[104] More recently, as noted in Mr. Vasington's testimony, the United States Centers for Disease Control and Prevention ("CDC") release a study indicating that 12.8% of household in the U.S. may now have "cut the cord."[105] Of course, this still leaves that vast majority of consumers connected to the public switched telephone network via a landline. An NRRI report stated that "growth in wireless and broadband do not, by themselves, provide conclusive evidence of competition with or substitutability for wireline service."[106]

Q: Dr. Staihr states that parents buying wireless phones for their teenagers instead of purchasing a second line shows that "wireless and wireline products are in the same market."[107] Is that what increasing wireless subscriptions demonstrate?

A: No. His example simply shows that when wireless substitutes for wireline it most frequently substitutes for additional, not primary lines, or supplements a consumers' landline service. In addition, in support of his contention that wireless is a like or substitute service for

102/ *Id.*, at fn 273, citing *SBC/AT&T Merger Order* at fn 276.

103/ *Id.*, at para. 95.

104/ *Id.*, at fn 275.

105 / Vasington (Verizon NJ), at 53-55, citing Blumberg SJ, Luke JV. Wireless substitution: Early release of estimates based on data from the National Health Interview Survey, July – December 2006. National Center for Health Statistics. Available from http://www.cdc.gov/nchs/nhis.htm. May 14, 2007. See, also, Staihr (Embarq), at 16.

106 / *NRRI Report*, at 48.

107 / Staihr (Embarq), at 8.

wireline service, Dr. Staihr compares T-Mobile's lowest priced plan available in New Jersey, which he describes as including call waiting, caller identification, conference calling and unlimited weekend minutes for $29.99 with Embarq's "most popular bundle in New Jersey, Basic Home Phone," which is priced at $30 and which includes local calling, caller identification, enhanced call waiting, three-way calling, and call forwarding features. [108] Contrary to Embarq's assertion that the mere possibility that a customer currently paying less than $30 (that is, a customer who does not subscribe to Embarq's Basic Home Phone) might migrate to the higher-priced bundle (when she sees that she "can get all this with wireless"[109]), the offering does not constrain adequately the price for Embarq's stand-alone voice service. Exhibit SMB-C-28, which reproduces Embarq's response to RC-EM-31, shows that **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>** of Embarq's residential lines subscribe to some type of package. A significant portion of customers do not subscribe to bundles, and, do not necessarily want to subscribe to bundles.

Q: Are there non-price attributes of wireless service that distinguish it from wireline service?

A: Yes. There are numerous attributes of wireless service that distinguish it from wireline service. Among other things, wireless service requires the consumer to charge the battery for the cellular telephone; it suffers from spotty coverage (or "dead zones"); it fails to provide

[108] / Staihr (Embarq), at 19, citing www.Embarq.com.

[109] / Staihr (Embarq), at 19.

connections to Tivo; and it fails to provide connections to facsimile machines. It was recently reported that:

> Overall consumer satisfaction with wireless services remains relatively low, according to a survey of more than 47,000 "Consumer Reports" online subscribers. The magazine says that fewer than half of respondents said they were completely or very satisfied with their service, which makes mobile phone offerings among the lower-rated services the magazine surveys - the same result since the first survey was conducted six years ago.[110]

Q: What about Verizon NJ's contention that wireless subscribership is greater than wireline subscribership?

A: This line of reasoning is unpersuasive and is akin to observing that the demand for I-Pods is greater than consumer demand for stationary home stereo equipment or that the demand for picnic coolers may be greater than the demand for refrigerators. Wireless demand in many instances represents new demand and new uses, often associated with being away from one's home or office. For example, if I am at the grocery store and need to know if there is an adequate supply of garlic in my kitchen, I may use my wireless telephone to gain information so that I can make a more efficient purchasing decision. Before I acquired a wireless telephone, however, I would have made my purchasing decision based on imperfect information. This and countless other examples illustrate ways in which wireless service supplements wireline service and meets a new demand that did not previously exist.

[110] / *TR Daily,* November 30, 2007.

Q: Do products need to be identical to be substitutes and do all consumers need to view all products as substitutes in order for intermodal services to be considered economic substitutes?

A: Certainly not. I am not arguing that each intermodal service must be identical to Verizon NJ's or Embarq's local exchange service. However, Verizon NJ bears the burden of proof that intermodal services provide effective competition, including a demonstration, for instance, that there is sufficient cross-elasticity of demand with households' primary lines to justify considering intermodal services as acceptable substitutes for wireline service.

Q: Has the Board previously examined intermodal competition?

A: Yes. The Board undertook its own analysis of the state of competition in New Jersey as part of its investigation of the proposed merger Verizon/MCI merger. In its Order approving the merger,[111] the Board found that intermodal technologies does not currently serve as an economic substitute for wireline services in New Jersey's local market for either enterprise or mass market customers.[112] The Board acknowledged the Petitioners' position that price constraining competition takes place at the margins, and thus intermodal competition need not reach all consumers, but the Board faulted the Petitioners for failing to "actually opine as to how large a percentage of 'early adopters' is required for pricing discipline to occur."[113] In

---

[111]/ *In the Matter of the Joint Petition of Verizon Communications Inc. and MCI, Inc. for Approval of Merger*, New Jersey Board of Public Utilities Docket No. TM05030189, *Order of Approval*, April 12, 2006 ("NJ BPU Verizon/MCI Merger Order").

[112]/ *Id.*, at 33-35, 36.

[113]/ *Id.*, at 36.

reviewing the evidence, the Board made the following conclusions with respect to the mass market:

> In the case of the aforementioned technologies except wireless, market penetration rates are very low. Thus, we are not willing to accept on this record that intermodal technologies such as VoIP, WiFi, WiMAX and cable telephony currently constrain Verizon's wireline pricing to a meaningful degree. [114]

The Board also found the rate at which consumers were "cutting the cord" was insufficient to constrain Verizon's wireline pricing. Though wireless penetration is certainly larger than the penetration of other technologies mentioned above, the Board agreed with the Rate Counsel in finding that "wireless service is currently viewed by the majority of its users as a supplement to wireline service rather than a substitute."[115]

Q: What did the Board find with respect to intermodal competition for business services?

A: With respect to the small businesses, the Board found that none of the intermodal technologies put forth by the Petitioners as substitutes for enterprise wireline services sufficiently disciplined Verizon NJ's behavior in the market. The Board concluded that the various technologies identified by Verizon and MCI are either not true economic substitutes (*e.g.,* wireless and VoIP) or have not been adopted by enough subscribers to provide price constraining competition (*e.g.,* cable, WiFi).[116] The Board stated:

> . . . acknowledging the increasing presence of such technologies is not the

---

[114]/ *Id.*

[115]/ *Id.*

[116]/ *NJ BPU Verizon/MCI Merger Order*, at 33-35.

> same as concluding that they sufficiently mitigate competitive harms created by the merger by constraining ILEC wireline pricing. In fact, we conclude that in New Jersey such alternative technologies have not yet had this effect in the business market.[117]

Verizon NJ and Embarq similarly fail in this proceeding to sufficiently make a showing that a sufficient number of "marginal" consumers are choosing (or have the option to choose) alternative providers to provide competitive pressure on ILECs' service quality and pricing.

Q: But doesn't the "marginal" customer, that is, the consumer with the highest demand elasticity and who seeks out a bargain, create pressure on Verizon NJ to lower its rates, thereby benefiting all consumers?

A: In considering the role of the marginal customer, it is essential to consider the relevant product. Certainly, the consumer seeking the best price on a can of tuna fish may help to discipline grocery store prices, and benefit all who buy canned tuna fish. This analogy, however, does not extend to telecommunications. A price of $99 for a triple play (voice, data, and video), for example, does not constrain the price of an à la carte basic service any more than the price of caviar constrains the price of canned tuna fish.

Q: Dr. Staihr provides as an example of "reasonable interchangeability" cross-city bus services and cross-city subway service, and states that these two services meet a similar consumer demand.[118] Please comment.

---

[117]/ *Id.*, at 35.

[118]/ Staihr (Embarq), at 6.

A: I agree that two services need not be identical to be like or substitute services, and I further concur that cross-city bus and cross-city subway services are reasonably interchangeable. However, when considering, for example, cable telephony priced at $44.95 and basic local exchange service priced at $8.95 (for Verizon NJ) and $7.80 (for Embarq)[119], the relevant analogy would be cross-city bus service and limousine service. Although both modes of travel meet a similar customer demand, they cannot be considered like or substitute service because they differ significantly in price. The price of a limousine does not discipline the price of a bus.

Q: What is your conclusion regarding Verizon NJ's assertions that the presence of competition from intermodal services obviates the need for Commission regulation of the prices and service offerings of Verizon NJ?

A: There is insufficient evidence to suggest that competition from intermodal providers -- or wireline competition, for that matter -- provides sufficient pressures to discipline adequately Verizon NJ's pricing and service quality or to deter anticompetitive behavior. The evidence suggests that many intermodal services act as supplements to wireline service instead of substitutes. The vast majority of consumers continue to rely on wireline service. Finally, I would note that the "competition" from intermodal services that Verizon NJ faces is often

[119] / United Telephone Company of New Jersey, Inc. Tariff No. B.P.U. – No. 3, second revised page 12 issued March 31, 1994, effective June 7, 1994. Rate is for residence individual line.

from its own affiliates (*e.g.,* when a consumer drops a second telephone line in favor of DSL or uses Verizon Wireless services).

Q: Please explain.

A: As Table SMB-5 shows, the loss of a Verizon retail wireline often translates into the gain of a wireless or broadband connection. Also, although Table SMB-5 does not include data about private lines, losses of switched access lines can also translate into gains in demand for private line and special access service. So, though Verizon NJ may suggest that it has lost lines to competitors, some portion of that line "loss" just migrated to other Verizon services. To the extent that the marginal customer is choosing to drop a wireline in favor of wireless service; an additional line used for dial-up in favor of DSL service; or a wireline in favor of DSL broadband and an over-the-top VoIP providers, Verizon still captures that consumer. In Virginia, state regulators, in assessing "acceptable competitors" required the wireless carrier not to be affiliated with Verizon to "result in a more accurate indicator of actual or potential competition to Verizon's landline service."[120]

[120] / *Virginia Competition Order*, at 34, note 87.

Table SMB-5

Verizon NJ Affiliates "Compete" with Verizon NJ

	9/30/2004	9/30/2005	9/30/2006	9/30/2007
Total Switched Access Lines	52,983,000	49,689,000	45,973,000	42,316,000
Wholesale Lines	6,661,000	5,841,000	3,621,000	3,046,000
Total Broadband Connections	3,184,000	4,531,000	6,573,000	7,971,000
Verizon Wireless Total Customers	42,118,000	49,291,000	56,747,000	63,699,000
Total Connections (Wireline, Wireless, and Broadband)	**104,946,000**	**109,352,000**	**112,914,000**	**117,032,000**

Notes: All Data are nationwide. Total Broadband Connections includes FiOS.

Sources: Verizon *Investor Quarterly* for Oct. 27, 2005, Oct 30, 2006, and Oct 29, 2007.

Q: Did Rate Counsel seek data regarding the number of New Jersey *customers* that Verizon Wireless serves either on an à la carte basis or a bundled basis?

A: Yes, but Verizon NJ objected because the question sought information about Verizon Wireless, which is not a party to this case.[121] Rate Counsel also sought information about the quantity of wireless telephone *numbers* in New Jersey that Verizon Wireless serves, and, similarly, Verizon NJ did not provide the requested information.[122]

Q: Why would this information be relevant to this proceeding?

A: Verizon NJ portrays retail landline line loss as evidence of competition, but certainly those

[121] / Verizon NJ response to RC-VNJ-16.

[122] / Verizon NJ response to RC-VNJ-17.

customers that substitute a Verizon Wireless line for an additional Verizon NJ landline can hardly be considered to represent erosion of Verizon's market power. Verizon Wireless and Verizon NJ share a corporate parent. Furthermore, Verizon NJ indicates that it does not track information regarding residential customers who disconnect wireline voice service in order to subscribe to DSL, FiOS, or Verizon Wireless.[123]

Q: Has Verizon NJ provided information regarding the availability of and demand for DSL?

A: Yes. Verizon NJ provided information by wire center regarding the number of lines that are "qualified" for DSL and the number of lines that are engineered to provide DSL. As used by Verizon NJ, qualified locations "are those for which Verizon has the technical capability to offer DSL" and "DSL provisioned lines are those engineered to provide DSL service and is not equivalent to DSL Billable Lines in Service." Verizon NJ states that billable lines in service are not available by wire center.[124] Verizon NJ, however, did not provide comparable information for its FiOS service, that is it did not provide requested data about the percentage of households that can subscribe to FiOS on a wire center level and on a statewide level.[125]

Q: Why is DSL and FiOS availability relevant to this proceeding?

A: Consumers' access to and use of broadband platforms directly bear on their ability to avail themselves of alternative technologies. For example, **<<<BEGIN PROPRIETARY** [redacted]

---

[123] / Verizon NJ response to RC-VNJ-23 (Exhibit SMB-C-29).

[124] / Verizon NJ response to RC-VNJ-11, including proprietary attachment (Exhibit SMB-C-30).

[125] / Verizon NJ response to RC-VNJ-42.

[redacted] **END PROPRIETARY>>>**[126] Triple play products and VoIP products do not provide substitutes for those customers that have not chosen to subscribe to DSL (or cable modem service). Broadband availability does not render broadband-based voice alternatives affordable.

Q: Does Verizon NJ offer stand-alone DSL?

A: Yes. Verizon NJ provides **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>** stand-alone DSL lines as of September 30, 2007.[127] However, the merger condition, effective April 12, 2006, that requires Verizon NJ to deploy and offer stand-alone DSL (*i.e.*, without requiring customers to purchase voice telephone service) is only a two-year commitment, and, according to Verizon NJ, "[m]arket demand, and not the outcome of this proceeding, will influence Verizon's decision to continue offering stand-alone DSL."[128] The significance of stand-alone DSL to this proceeding is that it represents another way for consumers to obtain broadband access, yet, with the expiration of the merger commitment occurring within three months, Verizon NJ could eliminate this alternative.

Q: Did Verizon NJ provide information about demand for its FiOS-based services?

A: Yes. Exhibit SMB-C-32, which reproduces Verizon NJ's response to RC-VNJ-41, shows

---

126 / Verizon NJ response to RC-VNJ-11, including proprietary attachment (Exhibit SMB-C-30).

127 / Verizon NJ response to RC-VNJ-9, including attachments (Exhibit SMB-C-31).

128 / Verizon NJ response to RC-VNJ-13.

that the quantity of FiOS customers **<<<BEGIN PROPRIETARY** [redacted]**.END PROPRIETARY>>>** This growth is consistent with Verizon NJ's pursuit of triple play customers.

Á la carte and bundled offerings are not in the same product market.

Q: Verizon NJ[129] and Embarq[130] contend that bundled packages constrain prices for "à la carte" services. Do you agree?

A: No. As Table SMB-C-12 and Table SMB-C-13 show in Section VI of my testimony, many customers purchase few or no discretionary features, and, therefore, bundled packages do not constrain the rates for their services. Instead, if the Board classified mass market services as competitive, the opposite effect would be likely: Verizon NJ would have an incentive to *increase* à la carte rates in order to encourage migration to bundled offerings. Therefore, not only would bundled services fail to discipline the rates for stand-alone offerings, Verizon NJ's strategic interest in selling bundled offerings likely would cause Verizon NJ to *raise* rates for à la carte services.[131]

Mr. Vasington also states that even if consumers "don't purchase a formally

---

[129] / Vasington (Verizon NJ), at 47.

[130] / Staihr (Embarq), at 10-11.

[131] / In a recent proposed order in Maryland the Hearing Examiner rejected Verizon's proposed tariff filings, including a filing in which Verizon Maryland combines services of its affiliates with those of Verizon Maryland. In the Matter of the Commission's Investigation into Verizon Maryland, Inc.'s Affiliate Relationships, Maryland Public Service Commission Case No. 9120, Proposed Order of Hearing Examiner, January 7, 2008

marketed 'bundle,' they build their own homemade bundles."[132] However, there is a substantial difference between being able to construct one's own "homemade bundle" and the possibility of being required to purchase from among Verizon-determined bundles. Exhibit SMB-C-28, which reproduces Embarq's response to RC-EM-31, shows that **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>** of Embarq's residential lines subscribe to some type of bundle. Conversely, there remains a significant portion of customers that do not subscribe to bundles, and, do not necessarily want to subscribe to bundles.

Q: Are à la carte and packaged services in the same market?

A: No. A Verizon NJ tariff change last year provides evidence of carriers' ability to segment markets in order to retain those customers with the greatest price elasticity. On February 1, 2007, Verizon filed a tariff for a promotional offering for business customers, between February 2, 2007 and May 2, 2007 which:

- Subscribe to no fewer than two business exchange lines;
- Spend no less than $60 per month for total billed revenue (based on a three-month average spend);
- Have been identified by Verizon NJ as likely to disconnect service "based upon criteria determined by Verizon NJ Inc."; and

[132] / Vasington (Verizon NJ), at 47.

- Either subscribe to or are willing to subscribe to at least one voice term plan.[133]

Under Verizon NJ's promotional plan, eligible customers "who agree not to disconnect their dial tone service" will receive either a $5 credit for six months or a $10 credit for six months if they "have or agree to purchase, at least one non-regulated service as determined by" Verizon NJ.[134] Verizon NJ does not offer any rate reduction for other business customers.

Q: What is the significance of this particular Verizon NJ tariff filing?

A: This proposal provides compelling evidence of Verizon NJ"s ability and willingness to engage in price discrimination. Price discrimination is not, *per se*, harmful (indeed airlines use this form of pricing frequently), but when a company offers regulated and non-regulated offerings, price discrimination raises the possibility of improper cross-subsidization. Furthermore, Verizon NJ's promotional plan provides compelling evidence of Verizon NJ's tactic of targeting those customers with the greatest price elasticity, that is, those "likely to disconnect service." Although this particular tariff filing concerns multiline business customers, it provides evidence of the type of

---

133 / Verizon NJ Promotional Offering, filed February 1, 2007, TT07020070, included as Attachment F-3. *See also,* TT07020074 (concerning another promotional offering by Verizon NJ for customers "who proactively contact Verizon NJ during the promotional period and state they intend to disconnect their dial tone service").

134 / *Id.*

pricing strategy in which Verizon NJ is likely to engage if granted competitive classification.

Q: How many customers purchase each of Verizon NJ's bundled offerings?

A: Verizon NJ did not provide the information requested by Rate Counsel regarding quantities of customers subscribing to each of Verizon's bundled services or packages.[135] Many customers do not subscribe to bundled offerings and not all customers subscribe to discretionary features. Verizon NJ's response to RC-VNJ-46 (Exhibit SMB-C-33) shows the demand by à la carte customers for six different discretionary features. The response does not indicate overlapping demand, that is, some of the demand shown for call waiting could be from the same customers(s) who subscribe to caller identification. Verizon NJ's response to RC-VNJ-47 (Exhibit SMB-C-34) provides demand by customers of bundles for the same six discretionary features.

On average, customers who purchase stand-alone services from Verizon NJ purchase **<<<BEGIN PROPRIETARY** [redacted]**.END PROPRIETARY.**[136] These are among the customers most vulnerable to a premature reclassification of mass market services as competitive. By comparison, Verizon NJ customers of bundled services purchase **<<<BEGIN PROPRIETARY** [redacted]**.END**

[135] / Verizon NJ response to RC-VNJ-38.

[136] / Verizon NJ response to RC-VNJ-49 (Exhibit SMB-C-35).

PROPRIETARY[137]

Q: Have you compared the demand for discretionary features by bundled and à la carte customers?

A: Yes. Section VI includes data regarding the stratification of demand for discretionary features by those customers who purchase stand-alone services and those who purchase bundled packages. These tables show that many customers purchase only a few or no discretionary features, and, therefore, the rate shock from going to approximately $10 to a $30 bundle would be substantial.

Q: What is the significance of consumers' demand for discretionary features?

A: Verizon NJ's excessive rates for à la carte services allow it to subsidize its entry into triple play and other bundled offerings and also encourage customers to migrate to bundled offerings.

Q: Do you have evidence about Verizon NJ's strategic plans to segment the market or serve particular customers?

A: Rate Counsel sought the business, marketing, and/or strategic plans for New Jersey prepared by or on behalf of Verizon or Verizon NJ during the past three years, but Verizon NJ did not provide the requested information [138] Also, Verizon NJ failed to provide copies of surveys prepared by or on behalf of Verizon Corporate or Verizon NJ regarding mass market

[137] / Verizon NJ response to RC-VNJ-52 (Exhibit SMB-C-36).

[138] / Verizon NJ response to RC-VNJ-70 (Exhibit SMB-37).

consumer demand and/or choice of providers.[139] Certainly, for a company purportedly facing robust competition it is improbable that Verizon has not examined the issue.

Q: Does Verizon NJ intend to grandfather any services that it now provides on an à la carte basis or to raise the rates for any of its mass market services?

A: Verizon NJ indicates that "it has made no decision regarding rates for mass market services."[140] Verizon NJ indicates also, however, that it "requires flexibility to change rates in response to rapidly changing market conditions."[141] Verizon NJ also states that it "cannot predict the market conditions that will exist if and when its services are reclassified and therefore does not know whether it will grandfather [à la carte basic service and à la carte discretionary services] at that time."[142]

The FCC's recent order in which it denied Verizon's petitions for forbearance in six Metropolitan Statistical Areas includes analyses and findings that are germane to this proceeding.

Q: Ms. Baldwin, are you familiar with the FCC's recent order regarding Verizon's petitions for forbearance?

A: Yes. On December 4, 2007, the FCC denied Verizon's petitions for forbearance in six MSAs for numerous reasons.[143] Much of the reasoning and market analysis that the FCC describes

---

139 / Verizon NJ response to RC-VNJ-104.

140 / Verizon NJ response to RC-VNJ-76 (Exhibit SMB-38).

141 / Verizon NJ response to RC-VNJ-82 (Exhibit SMB-39).

142 / Verizon NJ response to RC-VNJ-89 (Exhibit SMB-40).

143 / *Verizon Six MSA Forbearance Order*. Verizon sought forbearance from "the following dominant carrier regulations to the extent that they apply to its mass market interstate switched access services: tariffing requirements, price cap regulation, and dominant carrier requirements concerning the processes for acquiring lines, discontinuing

in its order is directly relevant to the Board's assessment of relevant markets in New Jersey. I have included the order as Attachment C to this testimony.

Q: Do any of the six MSAs include areas within New Jersey?

A: Yes. The six MSAs include two MSAs (New York and Philadelphia) that include portions of New Jersey. Therefore, the FCC's analysis is germane to the Board's investigation of the level of competition that Verizon NJ's services confront in New Jersey. Specifically, the New York-Northern New Jersey-Long Island, NY-NJ-PA Metropolitan Statistical Area includes the New Jersey counties of Middlesex, Monmouth, Ocean, Somerset, Bergen, Hudson, Passaic, Hunterdon, Morris, Sussex and Union. The Philadelphia-Camden-Wilmington, PA-NJ-DE-MD Metropolitan Statistical Area includes the New Jersey counties of Burlington, Camden and Gloucester.[144]

Q: What were the FCC's findings?

A: The FCC found that granting Verizon's forbearance petition would be inconsistent with section 10 of the Act, stating:

> Verizon claims that competition in Boston, New York, Philadelphia, Pittsburgh, Providence, and Virginia Beach MSAs is even more advanced than competition in the Omaha MSA, and that the level of facilities-based competition in the 6 MSAs "ensures that market forces will protect the

services, assignment or transfers of control, and acquiring affiliations." *Id.*, at para. 21. The mass market is defined as residential consumers and small business customers. *Id.*, at footnote 78.

[144] / http://www.census.gov/population/www/estimates/metro_general/2006/List4.txt. Exhibit 1 to my direct testimony in the Board's "impairment" proceeding (BPU Docket No. TO03090705), which corresponds with Verizon NJ's proposed "TRO relief" area, lists the New Jersey density zone 1 and density zone 2 wire centers that these two MSAs encompass. Because Verizon NJ did not seek TRO relief for Density Zone 3 wire centers, my exhibit in the "impairment" proceeding does not identify Density Zone 3 wire centers in these two MSAs.

> interests of consumers, and that the regulations at issue are no longer necessary." Based on the record evidence, however, we find that the criteria of section 10 are not satisfied to justify forbearance from the relevant dominant carrier requirements, UNE requirements, and *Computer III* obligations. We therefore deny the 6 Verizon Petitions in their entirety.[145]

With regard to competition in the MSAs in general, the FCC stated:

> We find that Verizon is subject to competition in the 6 MSAs from both intra- and intermodal competitors. The record indicates that a number of competitive LECs (i.e., intramodal competitors) compete with Verizon for mass market customers in certain areas of the 6 MSAs. The evidence also shows, however, that in serving mass market customers many of these intramodal competitors rely on access to Verizon's last-mile network facilities, including UNEs, and Verizon's other wholesale services in all 6 MSAs. We also find that Verizon is subject to intermodal competition, particularly competition from cable operators in the 6 MSAs, primarily for residential services. We do not include providers of "over-the-top" or nomadic voice over Internet Protocol (VoIP) services in our competitive analysis because there are no data in the record that justify finding that these providers offer close substitute services.[146]

The FCC calculated a market share for cable operators (which is proprietary) and a market share for cable operators plus wireless "cut the cord" competition, and competition using resale and Verizon's Wholesale Advantage (which is also proprietary) and determined that Verizon's market share remained high enough to warrant continued regulation.

> In particular, Verizon's market shares in the MSAs at issue, measured consistent with our approach in the *Qwest Omaha Forbearance Order* and *ACS Dominance Forbearance Order*, are sufficiently high to suggest that competition in these MSAs is not adequate to ensure that the "charges, practices, classifications, or regulations . . . for [] or in connection with that . .

[145] / *Verizon Six MSA Forbearance Order*, at para. 11.

[146] / *Id.*, at para. 23, notes omitted.

> . telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory" absent the regulations at issue.[147]

The FCC further concluded that "[t]here is no evidence to suggest that UNEs constrain the prices of Verizon's Wholesale Advantage service, and we note that switching is not available at TELRIC rates, which tends to support this conclusion."[148] The FCC relied, in part, on the absence of a showing that facilities-based competitors had a significant share of the market to deny Verizon's forbearance request, noting: "we do not find the limited evidence regarding competition in the 6 MSAs based on resale and Verizon's Wholesale Advantage service sufficient to overcome the significantly less convincing evidence regarding Verizon's market shares and the success of its facilities-based competitors than was present in the *Qwest Omaha Forbearance Order* and *ACS Dominance Forbearance Order*."[149]

Q: What are some of the other key analyses and findings in the FCC's order?

A: Among the FCC's findings are the following:

- *High market share.* The FCC concluded that Verizon's market shares in the six MSAs, measured consistent with its approach in the *Qwest Omaha Forbearance Order* and *ACS Dominance Forbearance Order*, were sufficiently high to indicate that competition was inadequate "to ensure that the 'charges, practices, classifications, or regulations . . . for [] or in connection with that . . . telecommunications service are just and reasonable and are not unjustly or unreasonably discriminatory' absent the regulations at issue."[150]

---

147 / *Id.*, at para. 27, note omitted.

148 / *Id.*, at footnote 89.

149 / *Id.*, at footnote 100.

150 / *Id.,* at para. 27, footnote omitted.

- *Lack of competitors' excess capacity.* The FCC determined that although there was some evidence about cable operators' competitive facilities deployment used to provide mass market telephone service, that the deployment "does not approach the extensive evidence of competitive networks with significant excess capacity relied upon in the *AT&T Nondominance Orders.*"[151]

- *Lack of facilities-based competition.* The FCC concluded, based on its review of the evidence in the proceeding, that "Verizon is not subject to a sufficient level of facilities-based competition in the 6 MSAs to grant relief under the Commission's *Qwest Omaha* and *ACS UNE* precedent."[152]

- *Decline in retail lines does not demonstrate that a market is competitive.* The FCC rejected Verizon's attempt to demonstrate competition in MSAs based on the calculation of the percentage reductions in retail lines.[153]

- *Lists of fiber wholesalers and counts of competitive networks are not reliable as indicators of competition.* The FCC determined that the number of route miles, lists of fiber wholesalers, and counts of competitive networks were "not informative for identifying where any unbundling relief would be warranted or where a competitive carrier might serve a substantial number of buildings within a wire center."[154]

- *Verizon's lists of lit buildings are not reliable indicators.* The FCC concluded that it could not rely on the lists of lit buildings in Verizon's petitions to support its request for forbearance.[155]

I discuss other aspects of the FCC's order that are relevant to this investigation in more detail below. Also, among other things, unlike in the *Qwest Omaha* and *ACS UNE* orders, the FCC did not find that relief was warranted in any wire centers.

Q: Did the FCC make any findings with respect to consumer protection?

[151] / *Id.,* at para. 30, footnote omitted.

[152] / *Id.,* at para. 36.

[153] / *Id.*, at para. 39, footnote omitted.

[154] / *Id.*, at para. 40.

A: Yes. The FCC determined that it could not grant Verizon forbearance from UNE obligations because "UNEs are still necessary for the protection of consumers in these MSAs. There is insufficient competition from other last-mile facilities-based providers for us to determine that consumers will be protected if we forbear from Verizon's unbundling obligations."[156] Thus, the FCC found that forbearing from UNE obligations was not in the public interest given that they were still necessary for protection of consumers and to ensure just and reasonable and non discriminatory rates, terms, and conditions.[157] As I discuss in more detail below, the FCC determined, among other things, that Verizon continues to possess exclusionary market power (that is it can raise the cost of inputs upon which its rivals rely),[158] cable providers have a limited role in serving enterprise customers,[159] and its competitors serve relatively few buildings.[160]

Q: Does the FCC's Order address particular types of evidence that Verizon NJ has used in past proceedings or in this proceeding to assert that the market is competitive?

A: Yes. Importantly, as noted previously, the FCC rejects Verizon's reliance upon evidence of "line loss" to demonstrate a competitive market. The FCC rejected Verizon's calculations of percentage reductions in retail lines, stating: "There are many possible reasons for such

---

155 / *Id.*, at para. 41.

156 *Id.*, at para. 43.

157 / *Id.*, at para. 44.

158 / *Id.*, at para. 45.

159 / *Id.*, at para. 37.

160 / *Id.*, at para. 41. *See,* also, *ex parte* filing by XO Communications, LLC, November 9, 2007, "Data

decreases unrelated to the existence of last-mile facilities-based competition. For example, as the Commission explained in the *ACS UNE Forbearance Order*, the abandonment of a residential access line does not necessarily indicate capture of that customer by a competitor, but may indicate that the consumer converted a second line used for dial-up Internet access to an incumbent LEC broadband line for Internet access."[161]

Also, the FCC expressed concerns about Verizon's use of E911 data and concluded that the record evidence "casts significant doubt on the reliability" of the E911 data and "suggests that carriers may have significantly fewer access lines than would be suggested by their E911 listings."[162] Verizon NJ has relied in part on E911 data in this proceeding.[163]

Q: What does the FCC conclude about enterprise competition?[164]

A: The FCC notes that evidence does suggest that cable operators have deployed facilities that meet the 75 percent coverage threshold [used in the Qwest Omaha and Anchorage forbearance analyses] in some wire centers. However, the FCC expressly rejects Verizon's argument that the FCC has previously granted forbearance "based simply on cable coverage." The FCC concludes instead that the most important factor in the Qwest Omaha Forbearance

---

Demonstrating the Insignificance of Facilities-Based Competition in Verizon UNE Forbearance Markets."

161 / *Verizon Six MSA Forbearance Order*, at para. 32. *See*, also, *Id.*, at para. 39.

162 / *Id.*, at footnote 115. The FCC also rejects Verizon's use of fiber route maps and concludes that the maps have "little probative value." *Id.*, at para. 40. The FCC also rejects Verizon's use of list of lit buildings from the GeoResults Building Database noting that Verizon does not provide any comparative data for the number of buildings it serves and the percentage of all buildings that competitors serve "is extremely small on a relative basis." *Id.*, at para. 41.

163 / *See, e.g.,* Exhibit SMB-HC-17.

Order was "evidence of 'successful' facilities-based competition."[165] The FCC asserts that "[i]n measuring such success, the Commission did not look solely at facilities coverage."[166] Furthermore, the FCC concludes that the evidence suggests that cable operators play a "comparatively limited role" in serving enterprise customers.[167] As stated by the FCC:

> Most of the cable operators state that their networks are primarily in residential areas and their provision of services to enterprise customers are still in the initial stages. For example, Comcast states that its cable networks are primarily in residential areas and to the extent small businesses are in the areas, Comcast does make its services, including voice to those entities in the Boston, Pittsburgh and Philadelphia MSAs. Comcast Comments at 4. Comcast further states that commercial phone has not been a focus until 2006 and it "has not, to date, made any significant or sustained entry into the business market and enterprise markets." *Id.* at 5. Both Charter and Verizon recognize that Charter's network only passes in largely residential areas. Charter Reply at 4; Boston Petition at 18 n.25. Similarly, RCN, in the Boston, Philadelphia, and New York MSAs indicates that it provides **[REDACTED]**. Letter from Philip J. Macres, Counsel for RCN Telecom Services, Inc., to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-172, Exh. 2 at 1-3 (filed Oct. 9, 2007). While Time Warner Cable indicates that it has built out facilities enabling the provision of voice service to most households in the portions of the New York MSA in which it operates, Time Warner Cable explains that it is unable to reach most enterprise customers using its own last-mile facilities. Time Warner Cable Comments at 17. Overall, in all of the 6 MSAs, it appears that cable operators are presently making some competitive gains against Verizon by providing voice service to consumers in the residential markets, however competition from cable operators does not yet present a sufficient basis for relief. *See generally* Letter from Thomas Jones and Jonathan Lechter, Counsel for Time Warner Telecom *et al.*, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 06-172 Attach. at 5-10 (filed Nov. 16, 2007) (summarizing cable business share

---

164 / The enterprise market is defined as medium-sized and large business customers. *Id.*, at footnote 78.

165 / *Id.*, at footnote 113 and paras. 36-37.

166 / *Id.*, at footnote 113, citing *Qwest Omaha Forbearance Order*, at paras. 66-67.

167 / *Id.*, at para. 37.

> data). We nevertheless recognize that the cable operators are emerging sources of competition, and do not prejudge what future competitive evidence might show. However, the present record does not justify forbearance.[168]

Q: Did the FCC address Verizon's request for forbearance from *Computer III* requirements?

A: Yes. The FCC declined to grant Verizon the requested forbearance from the nonstructural safeguards of *Computer III*, stating:

> The record here does not demonstrate that Verizon no longer possesses exclusionary market power, and thus as in the *Section 272 Sunset Order*, we must assume that Verizon still possesses such market power. Verizon's exercise of exclusionary market power could both lead to "charges, practices, classifications, or regulations . . . for[] or in connection with" Verizon's interexchange services are unjust, unreasonable, or unjustly or unreasonably discriminatory" and could harm consumers. Such results would be contrary to the public interest. We thus are unable to find on this record that forbearance from the *Computer III* requirements satisfy any of the criteria of section 10(a).[169]

Q: What conclusions do you recommend that the Board draw from the FCC's denial of Verizon's forbearance petitions?

A: The market is not yet sufficiently competitive to warrant deregulation. The determination by the FCC that it should not grant Verizon forbearance from dominant carrier regulation, Section 251 unbundling obligations and *Computer III* requirements is significant. Despite finding that there was some intermodal competition (mainly in the form of cable competition

---

[168] / *Id.*, at footnote 116.

[169] / *Id.*, at para. 45. Exclusionary, or "Bainian", market power is defined as "the ability of a firm profitably to raise and sustain its price significantly above the competitive level by raising its rivals' costs and thereby causing the rivals to restrain their output." *Id.*, at footnote 144.

for residential consumers),[170] the FCC concluded that Verizon's market share was significant.[171] The Commission determined that: Verizon continues to possess exclusionary market power;[172] there is little evidence of facilities-based competition; and that competition which does exist often relies upon Verizon's own facilities.[173] Verizon NJ's exclusionary market power limits the prospects for competition in the mass market.

Q: Did individual Commissioners express specific concerns in their statements accompanying the Verizon Six MSA Forbearance Order which warrant consideration by the Board?

A: Yes. In addition to concerns about the apparent cable/telco duopoly that I note above, Commissioner Adelstein also observed that the types of data utilized to analyze competitive conditions needs improvement:

> There will always be imperfections in the data available to outside parties, but I would have preferred that the Commission take a finer look at specific geographic and product markets in this Order. In a welcome break from many recent Commission Orders, this Order does not place unwavering reliance on "predictive judgments" about our hopes for the development of competition but, instead, takes a closer look at the facts on the ground. In order to restore integrity to the forbearance process, the Commission simply must require petitioners to come forward with credible evidence regarding

---

[170] / *See*, *e.g.*, Verizon Six MSA Forbearance Order, at footnote 116. Also, a portion of the intermodal competition is from Verizon's own affiliates. In calculated Verizon's market share, the FCC calculates a portion of the wireless customers that have cut the cord as Verizon market share based on an estimate of Verizon wireless market share in the wireless market. *Id.*, at Appendix B, footnotes 6 and 7.

[171] / *Id.*, at para. 27. The actual market share calculations are considered proprietary.

[172] / *Id.*, at para. 45.

[173] / *Id.*, at para. 37.

competitive conditions for the products and markets at issue.[174]

Q: Have you reviewed the proprietary version of the FCC's order?

A: No. However, I recommend that the Board require Verizon NJ to make the proprietary order available with the appropriate proprietary treatment to provide the Board with a more complete record in this investigation.

Q: Ms. Baldwin, you have discussed some of the salient aspects of the FCC's recent order denying Verizon's petitions for forbearance in six MSAs. Are there other FCC orders that are relevant to the Board's consideration of the role of special access in the business market?

A: Yes. The conditions incorporated in the FCC's approval of the AT&T/BellSouth merger include specific measures that are intended to address special access, and the critical role that special access has in facilitating competitive entry. As a threshold matter, as Commissioner Copps explained in his statement concerning the AT&T/BellSouth merger:

> Finally, before accumulating enormous additional market power in the special access market, the company should address the well documented concern that businesses are being charged inflated prices for high-volume voice and data services—behavior that retards small business growth, inhibits America's international competitive posture, and eventually trickles down to consumers in higher costs.[175]

---

[174] / *In the Matter of Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. §160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas*, FCC WC Docket No. 06-172, *Memorandum Opinion and Order*, FCC 07-212, released December 5, 2007, Statement of Commissioner Jonathan S. Adelstein, Concurring.

[175] / Statement of Commissioner Michael J. Copps, Concurring, *In the Matter of AT&T and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, December 29, 2006 ("Copps Statement on AT&T/BellSouth merger"), at 2.

Q: Please describe the relevant conditions regarding special access in more detail.

A: Commissioner Adelstein summarizes some of the conditions. An excerpt from his statement regarding special access services follows:

> *Special Access Services*. It is clear that many business customers and wholesale carriers rely heavily on the applicants' special access services for their voice and high-speed connections. Independent wireless companies, satellite providers, and long distance providers also depend on access to the applicants' nearly ubiquitous network and services to connect their networks to other carriers. In addition, many small rural providers depend on these services to connect to the Internet backbone. So, if the applicants were to raise prices as a result of diminished competition, such action would directly impact the cost and availability of services for large and small businesses, schools, hospitals, government offices, and independent wireless providers. Particularly in light of DOJ's inaction, I believe it is imperative to adopt measures to protect against the loss of competition. The Order includes modest provisions to reduce the applicants' prices for special access services in areas where the Government Accountability Office (GAO), in its recent report on special access services, raised the most significant concern, and the Order includes a price freeze for the remainder of the applicant's special access services across the entire 22 state territory of the new company.
>
> The Order also addresses some of the terms and conditions that have been called into question by GAO. For example, it eliminates on a going forward basis at least one condition that restricts the ability of wholesale providers to buy from other channels. While I would have supported, and many commenters have strongly urged the Commission to adopt, more stringent safeguards in this area, we have attempted to provide a modest level of stability for 48 months for these many consumers of special access services. I do note that the Commission has a long-pending proceeding on special access services and, with fresh motivation from GAO's report, it will be even more critical that the Commission tackle these issues as comprehensively and expeditiously as possible. I will continue to push for action on this long-overdue proceeding. [176]

---

[176] / Statement of Commissioner Jonathan S. Adelstein, Concurring, *In the Matter of AT&T and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, December 29, 2006 ("Adelstein Statement on AT&T/BellSouth merger"), at 5-6.

Q: Are the conditions that govern AT&T in its home region stronger than those that govern Verizon in its home region?

A: Yes. Attachment D to my testimony reproduces the letter from AT&T submitted on December 28, 2006 to the FCC which describes the many conditions to which AT&T and BellSouth agreed.[177] Attachment E to my testimony reproduces the conditions upon which the Commission relied in its approval of the Verizon/MCI merger.[178] In the AT&T/BellSouth order, the FCC relied in part on the GAO Report (which I discuss earlier in this testimony), and which was released *after* the FCC approved the Verizon/MCI merger, which may explain, at least in part, why the conditions in the AT&T/BellSouth merger order are more comprehensive than those in the FCC's Verizon/MCI merger order. A cursory comparison of these documents demonstrates that consumers and competitors in New Jersey lack many of the special access protections afforded their counterparts in AT&T's home region. The consequence is that the malfunctioning special access services market enables Verizon NJ to exercise market power in the market for multi-line business customers. Although the Board cannot remedy the flawed interstate special access market, I urge the Board to consider the existence of this flaw as one of the factors that prevents the

[177] / Letter from Robert W. Quinn, Jr., Senior Vice President Federal Regulatory, AT&T to Ms. Marlene H. Dortch, Secretary, Federal Communications Commission, Re: Notice of *Ex Parte* Communications *In the Matter of Review of AT&T Inc. and BellSouth Corp. Application For Consent to Transfer of Control*, WC Docket No. 06-74, December 28, 2006.

[178] / *In the Matter of Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, FCC WC Docket No. 05-75, *Memorandum Opinion and Order*, Rel. November 17, 2005, at Appendix G: Conditions.

development of effective competition in New Jersey.[179]

Q: Why is special access relevant to a proceeding regarding the competitive classification of mass market services?

A: Verizon NJ's and Embarq's rates, terms, and conditions for special access bear directly on the ability of CLECs to compete profitably in New Jersey's markets. Those CLECs that choose to serve residential and business customers, or those CLECs that enter the market to serve business customers and then later expand their offerings to service residential customers are affected directly by the reasonableness of the ILECs' special access offerings.

Q: Is the FCC's special access regulatory regime the only federal regulatory issue impeding the development of effective competition in New Jersey?

A: No. Among other key unresolved federal regulatory issues that are preventing the economically efficient evolution of competition in New Jersey are separations reform[180] and designing a unified intercarrier compensation regime.[181] In Section V of this reply testimony, I discuss unresolved state regulatory issues including, intrastate access charges, and how they hamper the development of effective competition.

---

179 / On July 9, 2007, the FCC released a Public Notice asking parties to "refresh the record" in the Commission's Special Access proceeding. Federal Communications Commission, Public Notice, "Parties Asked to Refresh Record in the Special Access Notice of Proposed Rulemaking," WC Docket No. 05-25, RM-10593, FCC 07-123, released July 9, 2007 ("Public Notice").

180 / *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, *Order and Further Notice of Proposed Rulemaking*, released May 16, 2006 ("FNPRM"). This matter is still pending FCC review.

181 / *Comment Sought On Amendments To The Missoula Plan Intercarrier Compensation Proposal To Incorporate A Federal Benchmark Mechanism*, Public Notice, CC Docket No. 01-92, DA 07-738, Released February 16, 2007

Q: Please summarize the significance for New Jersey's economy, consumers, and competitors of the relatively weak FCC conditions on Verizon.

A: As a result of the less effective FCC conditions, Verizon NJ is able to exercise its market power easily to continue to extract supracompetitive profits in its interstate and intrastate special access and private line rates from businesses. These exorbitant rates, in turn, raise the cost of doing business in New Jersey, which translates into higher costs for goods and services for consumers and businesses, which in turn affects the willingness of residences and businesses to remain in New Jersey. The unresolved FCC investigation into interstate special access rates (Docket 05-25) allows market distortions to persist, and, although these distortions are partially addressed for consumers and competitors in AT&T's territory as a result of the FCC's order approving the AT&T/BellSouth merger, their existence in New Jersey contributes to Verizon NJ's ability to exert market power.

Verizon's corporate policy of retiring copper plant prematurely is evidence of its market power.

Q: Do Verizon NJ's network infrastructure plans shed light on its market power?

A: Yes. Verizon is abandoning its copper plant, which it can do because of its market power. Its FiOS-based ventures divert company resources from serving basic local exchange service, while, at the same time, relying on the company's near-monopoly position in supplying basic local services to New Jersey consumers. Consumers are harmed through unnecessarily high rates and poor service quality.

Q: What is the basis of your assertion that Verizon NJ is abandoning its copper plant?

A: Verizon's financial reports indicate that it is retiring copper plant at a higher rate than in the past. Specifically, effective January 1, 2005, Verizon shortened the depreciation life on outside plant: copper cable, from 15-19 years to 13-18 years.[182] Verizon also shortened the asset lives of other plant categories, including digital switches and circuit equipment. This change, according to Verizon, was "based on Verizon's plans, and progress to date on those plans, to deploy fiber optic cable to homes, replacing copper cable."[183] Of course, shortening depreciation lives means that the cost of accelerated depreciation potentially could be passed on the consumers.[184] At a minimum, the increased rate of depreciation serves to raise Verizon NJ's expenses on paper and lower estimates of rate of return.

Q: Do Verizon NJ's copper plant plans affect the prospects for competition in New Jersey?

A: Yes. For example, several CLECs filed a petition for rulemaking ("CLEC Copper Petition") with the FCC on January 18, 2007 regarding ILEC retirement of copper loops and copper

---

[182] / Verizon New Jersey, Inc. Consolidated Financial Statements as of December 31, 2005 and 2004 and for the years then ended, provided in response to RC-38, at 10, in Docket No. TX0612084.

[183] / *Id.*

[184] / Alternative regulation plans have governed Verizon NJ's retail rates since 1993, and, therefore, the depreciation rates and lives that Verizon NJ adopts for financial reporting and internal capital budgeting plans have no impact on Verizon NJ's retail rates. *See, In the Matter of The Application of New Jersey Bell Telephone Company for Approval of its Plan for an Alternative Form of Regulation*, New Jersey Board of Public Utilities Docket No. TO92030358, *Decision and Order*, May 6, 1993; *In the Matter of the Application of Verizon New Jersey Inc. For Approval (i) of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-line Rate Regulated Business Services as Competitive Services, and Compliance Filing*, New Jersey Board of Public Utilities Docket No. TO01020095, *Decision and Order*, August 19, 2003. The Board, however, investigated Verizon NJ's depreciation rates in order to set wholesale rates for unbundled network elements, and, in that investigation, rejected Verizon NJ's proposed use of GAAP-based depreciation rates. *In the Matter of the Board's Review of Unbundled Network Elements Rates Terms and Conditions of Bell Atlantic-New Jersey, Inc.* Docket No. TO00060356, *Decision and Order*, May 7, 2004. Furthermore, if the Board were to

subloops.[185] The CLECs assert that:

> [t]he rules currently in place for retirement of copper loops and copper subloops do not adequately safeguard against discriminatory and anticompetitive modifications to incumbent LEC networks that effectively eliminate access to unbundled network elements ("UNEs") used by competitive LECs to provide broadband services to retail consumers and to business customers. The elimination of copper network facilities inhibits network competition and the deployment of competitive and innovative broadband services to millions of consumers over alternative networks. This practice runs counter to the letter and spirit of the Telecommunications Act of 1996.[186]

The CLECs assert the ILECs are "gaming" the current rules.[187] The CLECs further assert that the narrowband transmission, provided by the ILECs over fiber facilities to CLECs, does not allow for the same types and range of services the CLECs can offer over existing copper loops.[188] The CLEC Copper Petition proposes changes to the FCC's current rules to address these issues, including a formal process for review and approval by the FCC of any proposed retirement of copper loops and subloops, "including a critical presumption that such retirement does *not* service the public interest."[189] Copper retirement affects competitive alternatives, which, in turn, affects whether sufficient competition exists for business

---

investigate Verizon NJ's rates and costs, Verizon NJ's depreciation rates would be subject to Board review.

[185] / In the Matter of Petition of XO Communications, LLC, Covad Communications Group, Inc., NuVox Communications and Eschelon Telecom, Inc. for a Rulemaking to Amend Certain Part 51 Rules Applicable to Incumbent LEC Retirement of Copper Loops and Copper Subloops, Petition for Rulemaking, filed January 18, 2007 ("CLEC Copper Petition").

[186] / *Id.*, at 1.

[187] / *Id.*, at 4.

[188] / *Id.*, at 5, 10.

[189] / *Id.*, at 6.

customers with two or more lines.

Q: How does Verizon's copper retirement plan relate to consumers?

A: As noted by the petitioners, the copper facilities in question were "subsidized by monopoly regulation."[190] The CLEC petition states: "Incumbent LECs cannot be permitted to exercise their control over legacy copper loop facilities unilaterally, in a fashion intended to undermine competition."[191] The CLEC Petition also asserts that the ILECs are currently engaging in more costly behavior than is necessary:

> Indeed, the incumbent LECs must incur substantial and potentially non-recoverable costs to dismantle legacy copper networks and to reconfigure embedded copper facilities to accommodate specific copper loop and copper subloop retirements. Conversely, the Commission's rules do no impose on incumbent LECs any obligation to maintain, in serviceable condition, existing copper loops and copper subloops, except to the extent that such facilities are requested by competitive LECs as UNEs, pursuant to Section 251(c)(3) of the Act. When facilities are unbundled, incumbent LECs are appropriately compensated at rates established by state commissions pursuant to Section 252(d) of the Act and the Commission's TELRIC pricing rules. Thus, retirement of copper loops and copper subloops needlessly results in the incumbent LECs incurring substantial expenses and foregoing significant revenue opportunities. Such behavior is uneconomic and likely unlawful.[192]

Q: Have others raised concerns about ILECs' copper loop retirement?

A: Yes. Among others, the National Association of State Utility Consumer Advocates

---

[190] / *Id.*, at 4. The CLECs also raise the public interest argument stating that redundancy in networks is critical from a public safety standpoint and assert that copper loops are not subject to failure during power outages the same way fiber loops are. *Id.*, at 15-17.

[191] / *Id.*, at 12.

[192] / *Id.*, at 18 (notes omitted). See, also discussion on page 19 arguing that there is no need for copper loop retirement as this is not a precondition for construction of fiber facilities. "Retirement of copper loops and copper subloops entails additional and potentially unrecoverable costs and foregone revenues that in no way contribute to the direct funding of incumbent LEC fiber loop deployment." *Id.*, at 18.

("NASUCA") filed comments urging the Commission to address this matter. In an *ex parte* filing last month, NASUCA stated:

> Under the current regulatory structure, ILECs can retire their copper loops with virtually no oversight, and CLECs effectively have the burden to demonstrate why the loops should not be retired. The ILECs can thus use the process to thwart competition by indirectly denying consumers this competitive alternative.[193]

NASUCA stated further, "[t]he Commission should expeditiously open a rulemaking so that ILECs -- at the very least -- are not incented to push retirements due to FCC inaction."[194]

Q: Please explain the FCC's rules regarding copper retirement.

A: The FCC adopted the current rules regarding copper retirement in 2003 in its Triennial Review Order.[195] In considering the issue of incumbent Fiber-to-the-Home ("FTTH") overbuild deployment whereby the incumbent constructs fiber parallel to, or in replacement of, existing copper plant, a situation the FCC then described as "largely theoretical," the FCC concluded:

> The record indicates that deployment of overbuild FTTH loops could act as an additional obstacle to competitive LECs seeking to provide certain services to the mass market. By its nature, an overbuild FTTH deployment

---

193 / *In the Matter of Policies and Rules Governing Retirement of Copper Loops By Incumbent Local Exchange Carriers; Petition of XO Communications, LLC, et al., for a Rulemaking to Amend Certain Part 51 Rules Applicable to Incumbent LEC Retirement of Copper Loops and Copper Subloops; Petition of BridgeCom International, Inc. et al., Petition for Rulemaking and Clarification*, RM-11358, *Ex Parte* Communication, NASUCA, November 5, 2007, at 2.

194 / *Id.*

195 / *Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338; *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98; *Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, Rel. August 21, 2003. *See*, *e.g.*, paras. 281-284 where the FCC modifies its notification of network modification rules. 47 U.S.C. § 251(c)(5); 47 C.F.R. §§ 51.325-.335.

> enables an incumbent LEC to replace and ultimately deny access to the already-existing copper loops that competitive LECs were using to serve mass market customers. In this regard, incumbent LECs potentially have an entry barrier within their sole control (*i.e.*, the decision to replace pre-existing copper loops with FTTH.[196]

The FCC declined to prohibit the retirement of copper loops or subloops when they are replaced with FTTH, but instead determined that its existing network modification notice rules provided adequate safeguards. Competitors have the right to file objections to the ILEC's notice of retirement, but those oppositions are denied unless the Commission takes specific action within 90 days of the notice of retirement.[197]

Q: Please summarize your concerns about Verizon's copper retirement as they relate to this proceeding.

A: Verizon NJ's unilateral acceleration of the replacement of its copper plant is evidence of its market power. Moreover, by hastening the depreciation of copper plant, Verizon NJ's pursuit of FiOS raises unnecessarily its intrastate regulated costs. Furthermore, by removing the plant upon which new entrants rely in order to compete, Verizon NJ is thwarting the development of competition. Finally, its abandonment of copper plant may jeopardize basic service quality.

Q: Should the Board classify mass market local exchange service as non-competitive?

A: No. As my reply testimony demonstrates, economic substitutes do not exist; barriers have

[196] / *Id.*, at para. 277.

[197] / *Id.*, at paras. 282-283.

not been eliminated; and competitive suppliers are not present throughout relevant markets. Furthermore, circumstances have changed in recent years, yielding greater market concentration than when the Board examined Verizon NJ's request to classify local service to business customers with between 2 and 4 lines as competitive. Among other things, Verizon NJ's chief competitors, AT&T and MCI, have left the market as a consequence of being acquired by Bell operating companies.

Verizon NJ and Embarq have failed to demonstrate that the statutory criteria for competitive classification have been satisfied.

Q: After reviewing the evidence, what do you conclude with respect to the three statutory criteria?

A: Verizon NJ and Embarq have failed to demonstrate that the services for which they are seeking competitive classification fit the three statutory criteria. As I demonstrate above, entry is not easy, Verizon NJ and Embarq have not demonstrated that the presence of competitive suppliers for affordable stand-alone mass market services, and consumers lack like or substitute services in relevant geographic and product markets. The Board's finding in its DAS Order is instructive:

> The Board is given ample discretion to interpret the statutes and the requisite factors for consideration in meeting the requirements of the same. In so doing, inherent in our charter is the obligation to ensure that no customer is excluded from protection. While the Board concedes that alternative suppliers may exist, to whom they provide service and at what cost are relevant factors for consideration in this case, in seeking to determine whether a service provided by those carriers is in fact a like or substitute service. The underlying issue of affordability with respect to DAS is relevant

> in evaluating its competitiveness, especially when dealing with the residential consumer. While an undisputed alternative, a significantly higher priced option cannot reasonably be construed as a substitute. Therefore, the higher priced alternatives to Verizon DAS, suggested by Verizon , do not constitute legitimate substitutes. Taking these facts into consideration, the Board must conclude that this requirement of the statue has not been adequately met.[198]

Competition does not yet exist to discipline the rates, terms, and conditions of Verizon NJ's and Embarq's mass market services. Declining CLEC demand for UNE-P (now being provided as Wholesale Advantage) and Verizon's acquisition of MCI (previously a chief rival) have altered the structure of the local mass market. The emergence of intermodal alternatives does not yet constrain the rates, service quality, or terms and conditions for local exchange service. The recent order released by the FCC in which it denied Verizon's petition for forbearance in six MSAs includes analyses and findings that confirm my analysis.

---

[198] / *In The Matter of The Board's Review Of The Classification Of Verizon New Jersey Inc.'s Directory Assistance Services As Competitive,* Docket Nos. TX06010057 and TT97120889, *Telecommunications Order*, June 28, 2007), ("DA Reclassification Order"), at 18.

V. MARKET DISTORTIONS

Until pricing distortions and price squeezes are remedied, local competition cannot evolve.

Q: Do the rates that Verizon NJ and Embarq charge for wholesale facilities affect the prospects for local competition?

A: Yes. If competitors must pay excessive rates for essential inputs, then the high rates will thwart the development of economically efficient competition. Furthermore, if wholesale rates exceed retail rates, then competitors will confront a price squeeze, whereby they cannot compete with the ILECs.

Q: Are rates for ILECs' essential elements mis-priced?

A: Yes. This section of my reply testimony demonstrates that pricing distortions persist in New Jersey's markets, creating barriers to entry. Until the Board addresses these distortions, local markets cannot be found to be competitive.

The mis-alignment of wholesale and retail loop rates prevents the development of effective competition.

Q: Ms. Baldwin, isn't it true that Verizon NJ and Embarq sell portions of their network to competitors, which, in turn, contributes to the development of local competition?

A: Yes. However, the rates at which the ILECs sell these network elements are so high that they create a price squeeze, which eliminates the opportunity for competitors' profit.

Q: Can you be more specific?

A: Yes. Table SMB-6 shows the rates that Verizon NJ and Embarq NJ charge for wholesale loops,[199] as well as for their own retail local exchange service.[200] As Table SMB-6 shows, Embarq's rates for wholesale unbundled loops range between $18.31 and $35.52, which exceed substantially Embarq's retail local exchange service rates of $7.80 for residential customers and $15.50 for business customers. The wholesale-retail mis-alignment exists in Verizon NJ's territory as well, although not to the same degree. For example, the rate that a competitor must pay for a Density Zone 2 loop from Verizon NJ is $10.42, which exceeds Verizon NJ's charge of $8.95 to its retail residential customers. The consequence of the mis-alignment of wholesale and retail rates is a barrier to entry in Verizon NJ's and Embarq's markets.

[199] / In the Matter of the Board's Review of Unbundled Network Elements, Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., New Jersey Board of Public Utilities Docket No. TO00060356, Decision and Order, May 7, 2004 ("UNE Order"), page 38; In the Matter of the Investigation Regarding Local Exchange Competition for Telecommunications Services, Docket No. TX95120631, Telecommunications Decision and Order, December 2, 1997.

[200] / Verizon New Jersey, Inc., Tariff B.P.U.-N.J.-No. 2, Exchange and Network Services, A5. Exchange Services, 5.2.1.C.1, 13th Revised page 30, Effective February 1, 2007.; United Telephone Company of New Jersey, Inc. Tariff No. B.P.U. – No. 3, second revised page 12 issued March 31, 1994, effective June 7, 1994.

Table SMB-6

Wholesale-Retail Price Squeeze

Verizon NJ

	Wholesale	**Retail**		**Wholesale : Retail**	
Density Cell	Res. & Bus.	Res.	Bus.	Res.	Bus.
Density Cell 1	$8.81	$8.95	$15.00	98%	59%
Density Cell 2	$10.42	$8.95	$15.00	116%	69%
Density Cell 3	$11.82	$8.95	$15.00	132%	79%
Statewide Average	$10.32	$8.95	$15.00	115%	69%

Embarq NJ

	Wholesale	**Retail**		**Wholesale : Retail**	
Density Cell	Res. & Bus.	Res.	Bus.	Res.	Bus.
Density Cell 1	$18.31	$7.80	$15.50	235%	118%
Density Cell 2	$24.02	$7.80	$15.50	308%	155%
Density Cell 3	$35.52	$7.80	$15.50	455%	229%
Statewide Average	$27.32	$7.80	$15.50	350%	176%

Sources: In the Matter of the Board's Review of Unbundled Network Elements, Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., New Jersey Board of Public Utilities Docket No. TO00060356, Decision and Order, May 7, 2004, page 38; Verizon New Jersey Inc., Tariff BPU NJ No. 2, Exchange and Network Services, Fourteenth Revised Page 30, Issued: January 25, 2007, Effective: February 1, 2007; In the Matter of the Investigation Regarding Local Exchange Competition for Telecommunications Services, Docket No. TX95120631, Telecommunications Decision and Order, December 2, 1997; United Telephone Company of New Jersey, Tariff NJ BPU No. 3, Second Revises Page 12, Issued: March 31, 1994, Effective: June 7 2004.

Q: What are the consequences of the fact that Embarq's wholesale rates for unbundled loops substantially exceed Embarq's retail local exchange service rates?

A: The price squeeze makes entry by "traditional" CLECs unprofitable. Embarq's highly proprietary response to RC-EM-19 shows empirically the impact of this market distortion on CLECs' entry.[201]

Over-priced intrastate switched access charges represent a barrier to competitive entry and also distort the market.

Q: Are there other network elements for which wholesale pricing thwarts competition?

A: Yes. Intrastate switched access rates exceed their underlying cost, which thwarts competition in New Jersey's telecommunications markets.

Q: What are Verizon NJ's plans for intrastate switched access rates?

A: Verizon NJ indicates that it "has no current plans regarding intrastate switched access rates."[202]

Q: Is there evidence that intrastate access charges are priced above their costs?

A: Yes. Several years ago, AT&T Communications of NJ, L.P., (legacy AT&T), filed a petition seeking, among other things, the reduction of Verizon NJ's access charges to a cost-based level, and in the interim to a level no higher than the interstate access charges.[203] Among other things, the AT&T Petition states the following:

- "In other words, the effective retail rates for many of Verizon's long distance offerings,

---

[201] / Embarq response to RC-EM-19 is attached as Exhibit SMB-HC-20 to the Embarq highly confidential version of my reply testimony.

[202] / Verizon NJ response to RC-VNJ-95 (Exhibit SMB-41).

[203] / AT&T Petition, filed October 2, 2003.

like its bundled 'unlimited' long distance calling plans, leave the IXCs essentially no room to compete above the inflated wholesale access rate that they must pay in cash to VNJ."[204]

- "…a comprehensive resolution of the market distortions created by VNJ's excess intrastate access rates must be found expeditiously."[205]
- "Verizon's interstate rates are roughly one-quarter of VNJ's average intrastate access rate."[206]

The large discrepancy between intrastate and interstate access charges and the large discrepancy between intrastate access charges and TELRIC-determined usage cost provide evidence of the excessive rates presently charged for intrastate switched access.

Q: Please compare Verizon NJ's interstate and intrastate switched access charges.

A: The interstate access charge is only $0.002264 per end per minute.[207] However, Verizon NJ's intrastate switched access rates are $0.008934 for originating usage and $0.008934 for terminating usage (or more than six times the TELRIC cost results) and also include a carrier common lines access charge of $0.0242 per minute.[208] There is no cost basis for this vast

[204] / AT&T Petition, at 4, footnote omitted.

[205] / AT&T Petition, at 5-6.

[206] / AT&T Petition, at 17, footnote omitted.

[207] / The Verizon Telephone Companies, Tariff FCC No. 1, Access Service, Section 6.9.2 (A), 5th Revised Page 6-364, Issued June 15, 2007, Effective June 30, 2007.

[208] / Verizon New Jersey B.P.U.-N.J.-No. 2, Access Service, Section 6.8.3(A), Sixth Revised Page 108,

discrepancy between FCC-regulated interstate switched access charges and Board-regulated intrastate switched access charges.

Q: How do intrastate switched access charges compare with the Board-established cost results?

A: The rates for intrastate switched access service substantially exceed the TELRIC results. In its Order issued in 2004, the Board set the following cost-based unbundled network element rates for Verizon NJ's switching: Monthly Port charge: $2.72; Originating Usage $0.001399; Terminating Usage $0.001364.[209]

Q: Please describe Embarq's intrastate switched access charges.

A: Embarq's intrastate switched access rates are $0.014488 for originating and terminating usage.[210] Embarq's Carrier Common Line Access charge is $0.0295 per minute.[211] By contrast, Embarq's interstate switched access rates are $0.003892 per originating and terminating minute.[212]

Q: Has the Board reviewed Embarq's switching costs?

Effective October 1, 1999; Verizon New Jersey B.P.U.-N.J.-No. 2, Access Service, Section 3.8, 5th Revised Page 15, Effective October 1, 1999.

209 / In the Matter of the Board's Review of Unbundled Network Elements, Rates, Terms and Conditions of Bell Atlantic New Jersey, Inc., New Jersey Board of Public Utilities Docket No. TO00060356, Decision and Order, May 7, 2004, page 38.

210 / United Telephone Company of New Jersey, Tariff N.J. B.P.U.-No. 4, Access Service, Sections 6.8.3, First Revised Page 141, Effective January 23, 2003.

211 / United Telephone Company of New Jersey, Tariff N.J. B.P.U.-No. 4, Access Service, Sections 3.7, First Revised Page 17, Effective January 23, 2003.

212 / Embarq Local Operating Companies, Tariff FCC No. 1, Section 6.8.3, Original page 6-516, Effective May 2, 2006.

A: More than ten years ago the Board examined Embarq's costs. In its Order issued in 1997, the Board approved Embarq's approach of establishing a flat rate port charge broken into four rate bands with no usage sensitive charges.[213] To the best of my knowledge, Embarq's UNE rates have not been re-examined by the Board since 1997.

Q: What is the consequence for New Jersey markets of excessive intrastate switched access charges?

A: Above-cost rates artificially suppress demand and create a price squeeze for those firms that rely on the incumbent local exchange carriers for essential network inputs. Where rates for goods exceed their underlying costs, demand will be less than that which might otherwise occur. Furthermore, above-cost rates for essential inputs are evidence of exclusionary market power, that is, of an incumbent carrier's ability to raise the cost of inputs upon which its rivals rely or to sustain the rates of such inputs at levels that exceed their underlying costs. Price squeezes, such as that which occurs when Verizon NJ and Embarq charge theirs rivals more for intrastate switched access than they likely impute for their own bundled packages, inhibit the development of effective competition, thus harming consumers by denying the benefits of competition that would otherwise ensue.

Q: Are other state regulatory bodies examining this issue?

A: Yes. Although I have not undertaken a comprehensive survey, I am aware of two other

---

[213] / In the Matter of the Investigation Regarding Local Exchange Competition for Telecommunications Services, Docket No. TX95120631, Telecommunications Decision and Order, December 2, 1997, at 158-159. Basic port charges are $10.30. Id., at Attachment 2, page 1.

states that are examining the reasonableness of access rates. In Wisconsin, Verizon North is asking the Wisconsin Public Service Commission to continue an examination initiated last year and to open a generic docket to investigate the reasonableness of CLECs' intrastate switched access rates.[214] State regulators in Virginia recently determined that "the access charge levels of Verizon and other ILECs in Virginia should be reviewed, and, where and if found appropriate, access charges should be adjusted, to promote increased competition."[215] I urge the Board to reach a similar finding in this proceeding.

The special access and private line markets are not competitive, which, in turn, impedes the development of competition.

Q: Is there evidence that the special access and private line markets are not competitive?

A: Yes. There is ample evidence of failures in the special access and private line market. A GAO report concludes that less than 6% of buildings with at least a DS-1 level of demand for special access services have a competitive alternative other than the incumbent LEC.[216] The GAO also found after reviewing data from the FCC and the four major price cap incumbents that "prices and average revenues are higher, on average, in phase II MSAs – where competition is theoretically more rigorous – than they are in phase I MSAs or in areas where

[214] / *In the Matter of Sprint Communications Company, L.P., Against US Xchange of Wisconsin, LLC, d/b/a One Communications, f/k/a Choice One*, Wisconsin PSC Docket No. 6023-TI-103, Verizon's Response to Joint Motion for Dismissal, January 8, 2008.

[215] / *Virginia Competition Order*, at 59.

[216] / United States Government Accountability Office, Report to the Chairman, Committee on Government Reform, House of Representatives, *FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, GAO-07-80, November 2006, at 12.

prices are still constrained by the price cap."[217]

Moreover, in filings to the FCC regarding its review of the proposed merger of AT&T and BellSouth, AT&T and BellSouth blamed the frozen level of separations for the seemingly exorbitant returns the RBOCs report from special access. A reply declaration submitted by AT&T and BellSouth in their merger proceeding observes that the "FCC's cost allocation rules relating to these services are based on cost studies from the late 1990s and have been frozen since 2001. Since that time, however, there has been a substantial divergence in demand for special access and switched access revenues."[218] The declaration also quotes comments filed by legacy SBC in a different proceeding stating, among other things:

> ARMIS results . . . understate the costs an ILEC incurs to provide any service that has experienced significant growth in volumes. The costs for interstate special access services are particularly susceptible to this understatement because demand has increased dramatically over the past several years with the explosive growth in data services. The result is a mismatch between costs which do not properly reflect current utilization and volumes and revenues which do. This mismatch, of course, will overstate the calculated rate of return.[219]

---

[217] / *Id.*, at 13. The report further concluded that the FCC failed to monitor the market deregulating and that in order "to better meet its regulatory responsibilities" it should "collect more meaningful data" and also "needs a more accurate measure of competition." *Id*. at 15.

[218] / *In the Matter of AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control*, WC Docket No. 06-74, Reply Declaration of Dennis W. Carlton and Hal S. Sider, June 19, 2006, at para. 30.

[219] / *Id.,* at para. 32, quoting comments of David Toti, then the Executive Director – Regulatory Accounting for SBC.

The ILECs are positing inconsistent views. In one proceeding, industry members acknowledge the cost-revenue mismatch arising from the explosive growth in data services as a way to "excuse" high interstate rates of return,[220] and in other proceedings, seek to preclude states from correcting this mismatch. The consequence of these two simultaneous industry arguments, if unaddressed by regulators, would be exorbitant *interstate* special access rates and excessive *intrastate* regulated rates. The purpose of separations is to prevent incumbent LECs from recovering the same costs in both the interstate and intrastate jurisdictions. The industry is gaming the process to avoid lowering either interstate or intrastate rates. The market failure associated with interstate special access precludes sufficient competition in the market for businesses with two or more lines. In the absence of resolution and remedy by the FCC in its pending special access proceeding (Docket 05-25), and for other reasons discussed in this testimony, the reclassification of business local exchange service offered to customers with two or more lines as non-competitive is warranted.

[220] / *In the Matter of Special Access Rates for Price Cap Local Exchange Carriers*, WC Docket No. 05-25; *AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, RM-10593, Comments of Qwest Communications International, Inc., June 13, 2005, at 4, 11; Comments of the United States Telecom Association, June 13, 2005, at 11-13; Comments of Verizon, June 13, 2005, at 21.

This revenue-cost mismatch, which the FCC has not yet addressed, provides another example where regulatory delay perpetuates market distortions, which, in turn, prevent the development of effective competition.

Q: What are the implications of the mis-priced interstate special access services for intrastate business markets?

A: Based on the distortions in the interstate market, it is particularly important for the Board to regulate intrastate switched access and private line rates. Furthermore, it is critical that the Board recognize the existence of these pricing distortions, which, in turn, mean that the market cannot be relied upon to discipline ILECs' rates. Because Verizon NJ and Embarq can raise the rates for access to their essential network inputs, they possess exclusionary market power, which, in turn, impedes the development of effective competition. Until these pricing distortions and market failures are addressed, the classification of mass market services as competitive is not warranted.

VI. VERIZON'S AND EMBARQ'S EARNINGS AND COMPETITION

High profits undermine Verizon NJ's assertions regarding competition.

Q: Should the Board consider the earnings of an ILEC as part of its assessment of the competitiveness of markets?

A: Yes. High profits are evidence of a carrier's ability to sustain supra-competitive rates and to thwart competitive entry.

Q: Have you examined Verizon's profitability?

A: Yes. Verizon's most recent investment advisory quarterly report, for the third quarter of 2007, shows that:

- Verizon earned $23.8 billion in revenues in the quarter, an increase of 5.8% over the third quarter of 2006,[221]
- Verizon earned $4.2 billion in operating income in the quarter, an increase of 19.0% over one year before,[222] and
- Operating income margin from the wireline segment of Verizon's business grew from

[221] / Verizon *Q3 2007 Investor Quarterly*, October 29, 2007, at 4.

[222] / *Id.*

8.8% in the third quarter of 2006 to 9.4% in the third quarter of 2007.[223]

Although Verizon NJ may lament the loss of retail lines in the context of a regulatory proceeding, the profitability of its corporate parent is healthy and growing. In many instances, the loss of retail wireline translates into the gain of wireless, DSL, FiOS, and other new lines of business.

Q: But Ms. Baldwin, the Board does not regulate Verizon Corporate. Why are these data relevant in a state proceeding?

A: Verizon Corporate's ability to leverage the name recognition, assets, and expertise of its local telephone companies directly contributes to Verizon Corporate's profitability. Furthermore, the assignment and allocation of costs among Verizon NJ and its affiliates directly affects the earnings of Verizon NJ. Unless and until the Board examines comprehensively Verizon NJ's costs (and the assignment and allocation of common plant and expenses), one cannot determine the profitability and earnings of Verizon NJ. For these reasons, the earnings and profitability of Verizon Corporate shed relevant light on the degree to which Verizon NJ is actually confronting competition.

Q: What does the FCC's ARMIS reporting mechanism show in terms of profitability?

A: ARMIS reporting shows that both Verizon NJ and Embarq NJ earn a healthy return. The table below shows the operating profit margins for the two companies for the past four years.

---

[223] / *Id.*, at 17.

Furthermore, earnings likely would be substantially higher if a fair share of loop and common costs were assigned to the ILECs' DSL and growing interstate special access services.[224]

Table SMB-7

Operating Profit Margins, 2003-2006

	Verizon NJ	Embarq NJ
2003	10%	23%
2004	17%	22%
2005	18%	23%
2006	15%	29%

Note: Operating profit margin is calculated by subtracting operating expenses from operating revenues, and dividing this amount by operating revenues.

Source: FCC ARMIS Report 43-01, Table I, Rows 1090 and 1190. Data accessed on January 8, 2008.

Verizon's supracompetitive profits provide evidence of its market power.

Q: Is Verizon NJ earning supracompetitive profits?

A: Yes. Based on the data available, it is likely that Verizon NJ is earning supracompetitive returns. The financial statements that Verizon NJ provides for its intrastate operations[225]

[224] / *See*, *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, sponsored affidavit on behalf of the National Association of State Utility Consumer Advocates and the New Jersey Division of Rate Counsel, filed August 22, 2006.

[225] / Verizon NJ provided this non-proprietary data in its response to a Rate Counsel discovery request (RC-VNJ-38)

understate its return on investment for its regulated intrastate operations for several reasons:

- Verizon NJ overstates intrastate regulated plant in service and expenses because it fails to attribute a fair portion of these costs to its DSL line of business.
- Verizon NJ's overstates expenses because its depreciation line item corresponds with a corporate strategy of prematurely retiring copper plant in order to pursue FiOS (see earlier discussion), and, therefore, is too high.
- Verizon NJ likely has not assigned and allocated sufficient plant to its interstate private line services, and, therefore, the net plant that it reports to the Board is too high.

Q: Have you computed a corrected return on investment?

A: Yes, in part. The major flaw in Verizon NJ's representation of its intrastate earnings is its failure to assign and allocate sufficient common plant and resources to its new lines of business. As a result, Verizon NJ's financial statement implies that its profitability on its intrastate operations is far worse than it actually is. Table SMB-8 estimates the impact of assigning and allocating plant and expenses to Verizon NJ's new lines of business. The approach that is based on my calculation of a "Broadband ratio" represents the "bare minimum" correction necessary. This approach, however, still significantly understates the return on assets, however, for the following reasons:

  - Broadband demand continues to increase, which means that an increasing portion

in the proceeding *In the Matter of the Board Investigation Regarding the Reclassification of Competitive Local Exchange Carrier (CLEC) Services as Competitive*, NJ BPU Docket No. TX0612084. The data response consists of financial statements for Verizon NJ for the years 2003, 2004, and 2005. Rate Counsel requested more recent financial data in this proceeding, which Verizon NJ did not provide. Verizon NJ response to RC-VNJ-96 (Exhibit SMB-42).

of common plant and resources should be assigned to unregulated lines of business.

- My analysis does not correct for the under-assignment of plant to interstate private line services.
- My analysis does not correct the overstated depreciation expenses, which result from the premature retirement of plant.
- Table SMB-8 does not shift a share of the expenses and plant upon which Verizon relies to pursue FiOS, Freedom packages and other lines of business.

Q: Please explain the rationale for the other methodology shown in Table SMB-8, under the column heading "based on 50% cost causation."

A: This methodology corrects the present separations factor of 25% (whereby Verizon allocates 75% of local loop costs to the intrastate jurisdiction and only 25% of local loop costs to the interstate jurisdiction). I compute the impact of using a more proper factor of 50% to separate local loop costs. The ILECs' unique ability to leverage their ubiquitous network (financed through an historic stream of revenues from intrastate regulated noncompetitive services), enables them not only to offer broadband, but more importantly to attract and lock in triple-play customers with bundles of local, long distance, cable and Internet access services. Assigning costs solely based on broadband demand would represent movement in the right direction, but would still clearly understate the fair share of the network that should be assigned and allocated away from intrastate regulated services. Verizon NJ should allocate at least half of the common local loop away from intrastate regulated services.

Q: Ms. Baldwin, what is the magnitude of the common plant that should be shifted away from Verizon NJ's intrastate operations?

A: As Table SMB-8 shows, correcting the outdated separations factor for the local loop would shift approximately one billion dollars out of intrastate regulated rates.

Q: Please explain your rationale for modifying the data in Verizon NJ's financial statement as is shown in Table SMB-8.

A: The present system is grossly unfair because DSL, FiOS, Freedom bundles, and other services get a "free ride" on Verizon NJ's common plant. Furthermore, as I discuss below, these new lines of business also unnecessarily raise Verizon NJ's expenses, by, for example, raising depreciation expenses. Under the present, flawed system, Bells assign and allocate the vast majority of cable and wire investment to their regulated operations.

Table SMB-8

Correction to 2005 Intrastate Financials: Reallocating Local Loop Costs to New Lines of Business Demonstrates that Verizon New Jersey Is Earning Supracompetitive Profits

		Corrected Financials	
Income	**As Reported in 2005 Financials**	**Based on 16.8% Broadband Ratio**	**Based on 50% Cost Causation**
Operating Revenues	$3,513,000,000	$3,513,000,000	$3,513,000,000
Total Operating Expenses	$2,806,000,000	$2,334,592,000	$1,403,000,000
Operating Income	$707,000,000	$1,178,408,000	$2,110,000,000
Net Income	**$366,000,000**	**$654,477,696**	**$1,224,612,000**
Assets	**As Reported in 2005 Financials**	**Based on 16.8% Broadband Ratio**	**Based on 50% Cost Causation**
Net Plants, Property, and Equipment	$4,105,000,000	$3,582,565,570	$3,068,423,750
All Other Assets	$1,588,000,000	$1,588,000,000	$1,588,000,000
Total Assets	**$5,693,000,000**	**$5,170,565,570**	**$4,656,423,750**
Return on Assets	**6.4%**	**12.7%**	**26.3%**

Notes: The above corrections likely understate the adjustments necessary to correct fully Verizon NJ's financial statements because they exclude the effect of higher depreciation rates due to early retirement of copper plant, FiOS-related expenses improperly assigned to intrastate accounts, and interstate special access investment improperly assigned to intrastate accounts.

Sources: Verizon New Jersey Response to RC-38 (NJ BPU Docket No. Docket No. TX06120841); ARMIS Report 43-04, Table I "Separations and Access Data," Row 1455 "C&WF Cat. 1 - Exch. Line - Joint Use," Data Run Date 1/9/2008.

Q: Please explain your calculations in Table SMB-8 in more detail.

A: Table SMB-8 is based on Verizon NJ's financial statements for 2005, public data on broadband demand, public data on Verizon and Verizon NJ's switched access lines, and ARMIS data. Table SMB-8 summarizes the results of (1) a "partial" correction to Verizon NJ's financial statement, based on broadband demand and (2) a more complete correction to Verizon NJ's financial statement based on the use of a more reasonable separations factor for the local loop than Verizon NJ now uses.

Q: Please explain further the minimum correction, which relies on DSL demand.

A: Using public data, I compute a "Broadband ratio" of 16.8% percent (meaning that broadband connections account for 16.8% of the total connections in New Jersey, where "total connections" is the sum of broadband connections and switched access lines). Table SMB-8 shifts away expenses and costs, as reported by Verizon NJ, based on that broadband ratio. The result of this partial and preliminary correction is that the resulting return on assets increases from 6% (as reported) to 13% (adjusted for broadband).

Q: Does this approach correct adequately the allocation of Verizon NJ's plant?

A: No. The analysis is preliminary because it does not address the fact that Verizon NJ's ubiquitous network and common resources provide an invaluable platform for many lines of business. For that reason, the second column relies on the 50% separations factor I discuss above.

Q: Please discuss the result of your further analysis.

A: The result of this preliminary correction (*i.e.,* correcting the local loop separations factor) is that Verizon NJ's net income increases from $366 million to $1.225 billion. In addition, Verizon NJ's total intrastate assets decline from $5.7 billion to $4.7 billion. This means that the resulting return on assets, expressed on a *post-tax* basis, increases from 6% (as reported) to 26% (corrected by using a more reasonable local loop separations factor than that reflected in Verizon's reported intrastate financial statement).

Q: Please explain the ARMIS data upon which you rely further.

A: I rely on public data that Verizon submits to the FCC as part of its ARMIS reporting, and specifically ARMIS Report 43-04.[226] The primary account where the Bells burden intrastate regulated services customers, while failing to assign and allocate adequate costs to DSL services, is the Cable and Wire Facilities Account, which supports the local loop. The relevant investment includes those facilities in "Category 1" which includes those facilities between local central offices and subscriber premises.[227] Row 1530 of the ARMIS Report 43-04 includes the total Cable & Wire Facilities investment.[228] Within this category, the relevant subcategory is Category 1 (Row 1460) which corresponds with all exchange line

---

226 / I rely on ARMIS Report 43-04, which provides "post Part 64" data because the "pre Part 64" ARMIS Report 43-03 does not provide relevant cost data for the local loop. Part 64 is the process by which local carriers separate regulated and unregulated costs and revenues.

227 / 47 CFR § 36.152(a)(1).

228 / ARMIS Access Report, 43-04, Table 1, Separations and Access Data, This amount corresponds roughly to the amount provided in ARMIS Joint Cost Report 43-03, Table 1, Regulated/Non-regulated, Row/Account 2410 (cable and wire facilities), column m ("subject to separations"). ARMIS Report 43-03 includes data for regulated and nonregulated operations. ARMIS Report 43-04 includes data for regulated accounts subject to separations.

investment.[229] Subcategory 1.3 corresponds with the "[s]ubscriber or common lines that are jointly used for local exchange service and exchange access for state and interstate exchange services."[230]

Q: Please explain further.

A: Verizon NJ's total unseparated local loop investment for New Jersey is $4,146,305,000. By way of comparison, Verizon NJ reports intrastate (*i.e.,* post-separations) net plant, property and equipment at $4,105,000,000 in its intrastate financial statement. The amount that appears in Verizon NJ's intrastate financial statement (*i.e.*, approximately $4.1 billion) includes not only local loop investment but also investment in other plant (*e.g.,* switches).

Q: What do you conclude based on your analysis of the information that is available?

A: If Verizon NJ were to assign and allocate a fair share of joint and common expenses and network plant to its interstate operations and to its unregulated operations, it would be clear that Verizon NJ is earning a supracompetitive return on its New Jersey assets. A partial correction shows that Verizon NJ's return on assets is more than 13%, nearly twice the return on assets that Verizon NJ reports. Correcting more fully using a 50% local loop allocation shows that Verizon NJ is earning at least a 26% return on its intrastate assets. Further

---

[229] / Verizon NJ reports $4,146,305 in Row 1455 of its ARMIS Report 43-04, for the amount subject to separations in 2005. This amount corresponds with that portion of Category 1 investment designated as "Joint Use" and which represents the vast majority of exchange line Cable & Wire Facilities investment. Cable & Wire Facilities, in turn, represent a significant portion of Total Telephone Plant Investment – All Categories (Row 1540).

[230] / 47 CFR § 36.154(a).

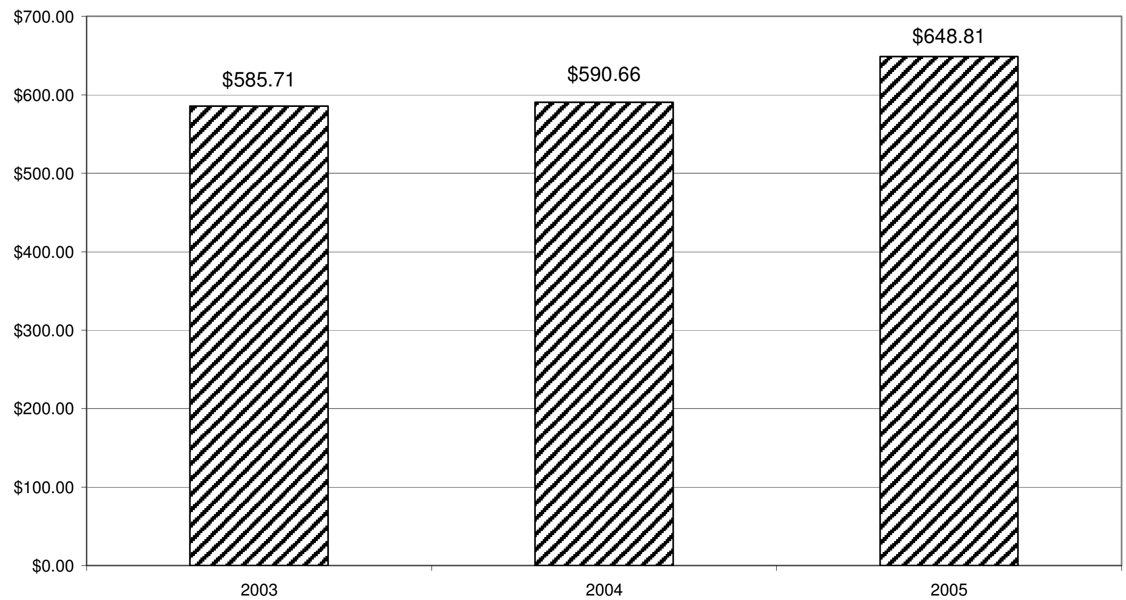
corrections are necessary, however, to address, among other things, disproportionate growth in interstate special access services, Verizon's pursuit of FiOS using common resources, Verizon's sale of bundled offerings, and Verizon's premature retirement of copper plant. If one were to make these further adjustments, the return on investment would be significantly more than the post-tax 26% return on investment that I was able to compute based on the limited data available. For example, if Verizon NJ fails to attribute a proper share of revenues from its Freedom packages to its intrastate operations, its return on investment will be incorrectly understated.

Q: Is there further evidence of Verizon NJ's ability to extract monopoly profits from consumers in New Jersey?

A: Yes. Figure SMB-2 shows that Verizon NJ's operating revenues per switched access line have been increasing steadily. In 2003, they were $585.71 per line, and in 2005, they had increased to $648.81 per line. Verizon NJ's ability to derive increasing revenues is evidence of its market power.

Figure SMB-2

**Verizon New Jersey Intrastate Operating Revenues
Provide Evidence of Market Power**



Sources: Verizon New Jersey Response to RC-38, Verizon NJ Financial Statements 04-03, at page 3, and Verizon NJ Financial Statements 05-04, at page 3; FCC Report 43-08, Table II, Row 410.

Q: Ms. Baldwin, why are you considering revenues in isolation of expenses?

A: In this instance, I am analyzing revenues because there are many reasons that Verizon NJ's expenses, as reported, are misleadingly high, and, therefore, unreliable. As I discuss above, investment costs are excessive because they include plant that should be allocated to interstate private line services, to DSL, and to FiOS based services. Furthermore, the expenses shown in Verizon NJ's financial statements include excessive depreciation expenses and other expenses that track investment. Verizon NJ's sale of discretionary features, for which it incurs costs of pennies yet charges monthly rates of multiple dollars, for example, provide it with supracompetitive returns.

The proper assignment and allocation of special access investment to the interstate jurisdiction would likely increase Verizon NJ's return on its intrastate operations significantly.

Q: Ms. Baldwin, you indicate that your re-calculation of Verizon NJ's intrastate return on its investment understates its true return because, among other reasons, the net plant likely includes investment that belongs in the interstate jurisdiction. Please elaborate.

A: Demand for *interstate* special access has been increasing significantly. As Table SMB-9 shows, demand for interstate special access lines increased from 2,702,027 in 2001 to 16,398,117 in 2006. The number of lines shown in Table SMB-9 represents the number of DS0 equivalents, *i.e.*, a DS1 circuit is multiplied by 24 and the DS3 circuit is multiplied by 672.[231] The investment necessary, however, for a DS3 circuit is unlikely to be 672 times the investment necessary for that required for a DS0 circuit. Nonetheless, demand for interstate special access vastly exceeds that for intrastate special access and private lines, and, therefore, one would expect that, all else being equal, Verizon NJ would be assigning and allocating increasingly higher percentages of total private line investment to the interstate jurisdiction.

[231] / FCC, ARMIS Report 43-08 – Report Definition, December 2005, at page 22.

Table SMB-9

Verizon NJ Interstate Special Access Lines

(2001 – 2006)

Year	Number of Special Access Lines
2001	2,702,027
2002	2,857,599
2003	3,904,150
2004	4,221,393
2005	13,386,855
2006	16,398,117

Source: FCC ARMIS Report 43-08, Table III, Row 410, Data Run Date 1/9/2008.

Verizon's supracompetitive profits from its interstate special access services result from its market power.

Q: Is there other evidence of Verizon NJ earning supracompetitive profits?

A: Yes. Special access rates yield supracompetitive returns for Verizon NJ. Table SMB-10 shows that Verizon's return on its interstate special access services in New Jersey increased from 26% in 2001 to 104% in 2006.

Table SMB-10

Verizon NJ's Phenomenal Returns on Its Interstate Special Access Service Demonstrate Its Market Power

	Average Net Investment (ARMIS Row 8040)	Net Return (ARMIS ROW 8041)	Rate of Return (Row 8041/Row 8040)
2001	$633,274,000	$164,691,000	26%
2002	$612,437,000	$214,572,000	35%
2003	$511,166,000	$191,459,000	37%
2004	$435,648,000	$223,837,000	51%
2005	$352,473,000	$269,974,000	77%
2006	$321,981,000	$335,596,000	104%

Source: FCC ARMIS Report 43-04, Table 1. Separations and Access Data, Data Run Date 1/9/2008.

Data for Verizon New Jersey Special Access services.

Rates and demand for discretionary features purchased by à la carte and bundled customers provide evidence of ILECs' market power.

Q: Ms. Baldwin, is there other evidence of the status of competition in relevant markets that the Board should consider?

A: Yes. As discussed above, Verizon NJ's and its corporate parent Verizon's ability to generate substantial returns provides compelling evidence of the lack of effective competition. Rates for call waiting, three-way calling, caller identification vastly exceed their underlying cost. Table SMB-11 shows that Verizon NJ's rates for discretionary features exceed those of Embarq, which, in turn, suppresses consumer demand, and which, also, provides evidence of Verizon NJ's market power in the provision of stand-alone discretionary features. There is no apparent cost justification for Verizon NJ's higher rates for discretionary features than those charged by Embarq and no apparent reason that Verizon NJ's customers should pay more to use the features of telephone switches than Embarq's customers do.

Table SMB-11

Above-Cost Pricing of Discretionary Services Provides Evidence of Market Power: Verizon NJ's Rates Exceed Embarq's Rates, Suppressing Consumer Demand

	Embarq NJ	Verizon NJ	Verizon Premium
Three-way calling	$1.50	$2.30	53%
Call Forwarding	$1.50	$2.30	53%
Call Waiting	$3.00	$4.59	53%
Caller ID with Name	$7.00	$7.50	7%

United Telephone Company of New Jersey, d/b/a Embarq, Tariff NJ BPU No. 3, Sixth Revised Page 69, Sixth Revised Page 69.1.1, and Eighth Revised Page 69.2, Issued March 6, 2007, Effective March 7, 2007. Verizon NJ Tariff B.P.U.-N.J.-No. 2, Exchange and Network Services, A5. Exchange Services, 17th Revised page 53.1 and 13th Revised page 59, Effective November 22, 2004.

Q: Have you compared the demand of à la carte and bundled customers for discretionary features?

A: Yes. The following tables (Table SMB-C-12 and Table SMB-C-13) show that **<<<BEGIN PROPRIETARY** [redacted] **END PROPRIETARY>>>** and therefore would be harmed if the Board grants the ILECs' requests for competitive classification. The purported substitutes for basic local exchange service (that is, bundled packages), are priced substantially above basic local exchange service and their purchase is only justified for customers with high demands for services and features incremental to basic local exchange service. If granted competitive classification, the ILECs may seek to raise basic rates substantially to encourage consumers to migrate to bundled offerings. Table SMB-C-12 and Table SMB-C-13 show that bundled offerings priced above $30 are not reasonably interchangeable with the "homemade" [232] basic local services that many à la carte customers now purchase.

[232] / Vasington (Verizon NJ), at 47.

Table SMB-C-12

Reclassification Could Jeopardize Rates for Low Volume Customers If Verizon NJ Raises Stand-Alone Rates to Encourage Sales of Bundled Offerings[233]

<<<BEGIN PROPRIETARY

[redacted]

END PROPRIETARY>>>

233 / Verizon NJ proprietary responses to RC-VNJ-22 (Exhibit SMB-C-11), RC-VNJ-46 (Exhibit SMB-C-33),

Q: Have you also analyzed consumer demand by Embarq's à la carte and bundled customers for discretionary features?

A: Yes. Table SMB-C-13 below shows the consumer demand for Embarq's discretionary features by à la carte and bundled customers.

RC-VNJ-47 (Exhibit SMB-C-34), RC-VNJ-48 (Exhibit SMB-C-43), RC-VNJ-50 (Exhibit SMB-C-44) and Vasington (Verizon NJ), at 48.

Table SMB-13

Reclassification Could Jeopardize Rates for Low Volume Customers If Embarq Raises Stand-Alone Rates to Encourage Sales of Bundled Offerings[234]

<<<BEGIN PROPRIETARY

[redacted]

---

[234] / Embarq Proprietary Responses to RC-EM-31 (Exhibit SMB-C-45), RC-EM-34 (Exhibit SMB-C-46), RC-EM-35 (Exhibit SMB-C-47), and RC-EM-36 (Exhibit SMB-C-48).

END PROPRIETARY>>>

Q: How is your analysis of the comparative rates and demand for Verizon NJ's and Embarq's discretionary features relevant to this proceeding?

A: My analysis is relevant for at least two reasons. First, artificially high rates suppress demand, which leads to loss of consumer welfare. Second, if Verizon NJ's and Embarq's requests are granted, they may raise rates yet higher for discretionary stand-alone features, which would suppress demand inefficiently and would contribute to ILEC efforts to aggressively market bundled offerings to consumers.

Q: Ms. Baldwin, you assert that cost of vertical features is negligible. Do you have any support for that assertion?

A: Yes. Although Verizon NJ would not provide the results of its most recent TELRIC study for the costs for vertical features offered to mass market customers,[235] there is other evidence from other jurisdictions. In a TELRIC proceeding in Massachusetts, for example, Verizon proposed "monthly feature port additive costs that, for individual lines, range[d] between $0.03 (for anonymous call rejection) and $1.48 (for remote call forwarding)."[236] Therefore, based on Verizon's cost study, the incremental cost of vertical features ranges between $0.03

---

[235] / Verizon NJ response to RC-VNJ-54 (Exhibit SMB-49).

[236] / Massachusetts Department of Telecommunications and Energy D.T.E. 01-20, *Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Pricing, based upon Total Element Long-Run Incremental Costs, for Unbundled Network Elements and Combinations of Unbundled Network Elements, and the Appropriate Avoided-Cost Discount for Verizon New England, Inc. d/b/a Verizon Massachusetts' Resale Services in the Commonwealth of Massachusetts*, July 11, 2003, citing Exh. VZ-39.

and $1.48.[237] It is unlikely that Verizon's cost of providing discretionary features differs significantly among its jurisdictions.[238]

Q: Why is the cost of vertical features relevant to this proceeding?

A: The ILECs' ability to sustain rates at supracompetitive levels is evidence of market power. The large gap between the cost and rates for discretionary features demonstrates the ILECs' market power.

Numerous rate increases and industry attempts to impose new charges on consumers provide compelling evidence of the lack of sufficient competition in New Jersey markets.

Q: Is there other evidence that markets are not sufficiently competitive in New Jersey?

A: Yes. During the past two years, Verizon NJ and numerous CLECs have *raised* rates on numerous occasions, and have also sought to impose new fees such as for "regulatory compliance" and for "billing statements." Attachment F to my testimony includes tariff pages that provide examples of rate increases and new fees.[239] Verizon NJ's and CLECs' ability to raise rates and to impose new charges demonstrates their ability to extract supracompetitive rates from consumers. During an era of sweeping changes in the

---

[237] / Furthermore, because Verizon did not meet its burden of proof to substantiate these feature port additive costs, the DTE directed Verizon to "eliminate the feature port additive costs from its cost study." *Id.*, at 295.

[238] / The Board reviewed Verizon NJ's costs for discretionary features in 2004. *UNE Order*, at 36-37; *In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic – New Jersey, Inc.*, Docket No. TO00060356, *Decision and Order on Motions for Reconsideration and Request for Limited Reopening and Motions to Strike*, September 22, 2004, at 38-41.

[239] / Attachment F consists of several sub-parts, which correspond with tariff pages that I included as attachments to my initial, reply, and rebuttal testimony in the Board's earlier investigation of the competitive classification of CLECs (Docket No. TX0612084) and additional tariff pages filed by Verizon NJ during 2007.

telecommunications industry, Board oversight of industry rates and practices is essential, particularly to protect those customers who are least familiar with their options.

Q: Please elaborate on these rate increases.

A: Among other things, as Table SMB-14 shows, subsequent to obtaining competitive reclassification in September 2005, for lines provided to business customers with between two and four lines,[240] Verizon NJ raised rates in 2006. During 2006, Verizon raised business local message unit charges for customers with two or more lines from $0.066 to $0.075 per message unit, an approximate 14% increase.[241] Verizon NJ's ability to sustain a rate increase belies its contention that business local exchange markets are competitive. Furthermore, as a result of the "revenue-neutral" proceeding,[242] Verizon NJ consolidated four different business rate groups into a statewide uniform rate of $15.00, which represented an increase for all business customers. Also, Verizon NJ raised rates for business directory assistance four times between 2002 and 2006, from $0.35 to $1.25.[243] Verizon NJ's ability to sustain profitably these price increases is evidence of its market power.

---

[240] / *In the Matter of the Application of Verizon New Jersey, Inc. for Approval (I) of a New Plan for an Alternative Form of Regulation and (II) to Reclassify Multi-Line Rate Regulated Business Services as Competitive Services, and Compliance Filing*, New Jersey Board of Public Utilities Docket No. TO01020095, *Decision and Order*, September 22, 2005.

[241] / See Attachment F-1.

[242] / *In the Matter of Verizon New Jersey, Inc. For a Revision of Tariff B.P.U.-N.J. – No. 2 Providing for a Revenue Neutral Rate Restructure Including a Restructure of Residence and Business Basic Exchange Service and Elimination of $.65 Credit*, New Jersey Board of Public Utilities Docket No. TT04060442.

[243] / *In the Matter of the Board's Review of the Classification of Verizon New Jersey's Directory Assistance Services ("DAS") as Competitive and Associated Service Quality*, Docket No. TX06010057, *In the Matter of the Filing by Verizon New Jersey Inc. for the Reclassification of Existing Rate Regulated Services – Directory Assistance Services as*

Q: Did Verizon NJ raise business rates in 2007?

A: Yes. On February 1, 2007, Verizon NJ raised the monthly local exchange service rate for business customers with two or more lines to $17.00 and raised the message unit rate to $0.08.[244] Business customers, as a result of the Board's competitive reclassification (which removed regulatory oversight over the rates) and the lack of competition, are now paying 13% more for business lines than they did two years ago (when the monthly rate was $15.00) and are paying 21% more for message units than they did two years ago (when the message unit rate was $0.066). Based on numerous cost studies that I have reviewed over the years, it seems highly unlikely that the cost to Verizon NJ of originating and terminating local business calls has increased 21%, and, indeed, it is highly likely that even at the time of the competitive reclassification of multi-line business customers message units were priced in excess of cost.

These rate increases imposed on multi-line business customers may be healthy for Verizon NJ's bottom line, but they certainly do not contribute to economic growth in New Jersey, nor do they appear to represent cost-based rates that would prevail in a competitive marketplace. Instead, these continuing rate increases are compelling evidence of Verizon NJ's market

---

Competitive, Docket No. TT97120889, hearing transcript, September 28, 2006, at 86, ll. 21-23.

[244] / Verizon New Jersey Inc., Tariff B.P.U.-N.J. No. 2, A5. Exchange Services, Fourteenth Revised Page 30, effective February 1, 2007. See Attachment F.

power.[245]

[245] / These rate increases, combined with Verizon NJ's introduction in August 2007 of a new unlimited business dial tone line package also may be evidence of Verizon NJ's strategy of encouraging customers to migrate away from à la carte services to bundled offerings. Verizon New Jersey Inc., Tariff B.P.U.-N.J. No. 2, A5. Exchange and Network Services, Original Page 41.4.28 through Original Page 41.4.37, effective August 13, 2007. See Attachment F.

Table SMB-14[246]

**Rate Increases During 2006
Provide Evidence that Markets Are Not Competitive
(Illustrative List)**

Carrier	Rate Increase	Effective Date
Verizon NJ	MU rate from $0.066 to $0.075 for business accounts with 2 or more lines	April 17, 2006
Verizon NJ	Regional Essentials rate increases from $27.00 to $32.04	December 1, 2006
Verizon NJ	Regional Value rate increases from $17.00 to $22.04	December 1, 2006
CTC Communications Corp.	Reclassifies PICC from interstate to intrastate	June 19, 2006
BullsEye Telecom, Inc.	Increases rate for local and intraLATA DA	December 1, 2006
MCI (Verizon NJ)	Increases rates for various plans	August 30, 2006
AT&T	Increases rates for several All In One Service rate plans	July 1, 2006
AT&T	Increases the overtime rate for the AT&T Monthly Minutes plan	July 1, 2006
AT&T	Increases rates for Commercial Long Distance Service, Custom Network Services, and PRO WATS/Plan Q Service	July 1, 2006
Access Point, Inc.	Adds a PICC charge	June 10, 2006
MCI (Verizon NJ)	Increases rates for various residential services	June 1, 2006
MCI (Verizon NJ)	Increases rates for various services	September 1, 2006
MCI (Verizon NJ)	Increases Residential RLA Service	October 1, 2006
MCI (Verizon NJ)	Increases various residential and business rates	September 1, 2006
MCI (Verizon NJ)	Increases rates for various services	July 1, 2006
PNG Telecommunications, Inc.	Increases various rates and imposes various charges for residential services	
Verizon NJ	Late payment charge of 1.5%	
Cordia Communications Corp.	Restructures inside wire charges	
Comtel Telcom Assets L.P.	Rates, terms and conditions potentially harm consumers	
Custom Teleconnect, Inc.	Imposes "regulatory compliance fee" and "bill statement fee"	
New Horizons Communications Corp.	Prepaid packages	

[246] / See Attachment F-1 for illustrative tariff pages and customer notices.

Q: Ms. Baldwin, much of your previous discussion concerns *business multi-line* customers. Why is your discussion relevant to this proceeding?

A: Verizon NJ's pricing decisions for its multiline business customers is directly relevant because these actions convey important information about the likely actions that Verizon NJ would pursue if the Board grants Verizon NJ's request for competitive classification of its mass market services. In other words, Verizon NJ sought and obtained competitive classification of its business multiline services. Subsequent to this reclassification, Verizon NJ *raised* rates. Therefore, the Board should be extremely concerned about similar price increases being imposed on mass market consumers. With rising oil and gasoline costs, and declining housing values, this does not seem like a prudent time to risk prematurely granting Verizon NJ's request for competitive classification, particularly if the outcome would be price increases that fall disproportionately on those consumers who have chosen to purchase a limited number of telecommunications services on an à la carte basis. Consumers, particularly those who seek to limit their expenditures, should not be vulnerable to Verizon NJ's efforts to raise rates for stand-alone services as part of some larger strategy to compete in the triple-play market. Providers' increases in prices should correspond with increases in their underlying costs and not instead relate to possible corporate objectives to cause customers to buy bundled offerings.

Q: But perhaps Verizon NJ's costs have increased and they need to raise rates to cover their costs?

A: It is my understanding that the Board does not intend to examine cost data in this proceeding, and therefore, absent any showing by Verizon NJ that its costs have increased, there is no basis to assume that Verizon NJ needs to raise rates to cover its costs. Indeed, as Section VI of my reply testimony demonstrates, the evidence suggests that Verizon is earning healthy profits. Furthermore, regulators in other Verizon-served states determined that Verizon was over-earning.[247] For these various reasons, it is hard to conceive of why Verizon NJ requires the flexibility to raise rates to meet competition.

Q: HasVerizon NJ continued to raise rates for services other than the ones you describe above during 2007?

A: Yes. An *ex parte* filing in the FCC's investigation of Verizon's petitions for forbearance in six MSAs (Docket 06-172) includes numerous instances of rate increases in other Verizon-served jurisdictions,[248] many of which likely have been replicated in New Jersey.

Q: What do these rate increases indicate about the market?

---

[247] / In a report issued May 9, 2007, the Hearing Examiner in a major alternative regulation proceeding in Maine, determined that Verizon was over-earning by $32.4 million. Maine Public Utilities Commission Docket No. 2005-155, *Investigation into New Alternative Form of Regulation for Verizon Maine Pursuant to 35-A M.R.S.A. Sections 9102-9103,* Examiner's Report (Revenue Requirement and Service Quality Issues), May 9, 2007, at 274. In a proceeding in which the Vermont Public Service Board adopted an alternative regulation plan for Vermont, the Board found that Verizon's rates exceeded just and reasonable rates by $8.18 million. Verizon was ordered to reduce rates accordingly and to further reduce rates by $1.26 million effective July 1, 2007, and $1.80 million effective July 1, 2007, unless Verizon delivered an offsetting benefit to Vermont telecommunications consumers. Vermont Public Service Board Docket No. 6959, *Investigation into a Successor Incentive Regulation Plan for Verizon New England Inc., d/b/a Verizon Vermont*, September 26, 2005. The *Order Adopting Amended Plan* of April 27, 2006 modified the settlement.

[248] / *In the Matter of Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. §160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas*, FCC WC Docket No. 06-172, *Memorandum Opinion and Order*, *ex parte* filing, Pennsylvania Office of Consumer Advocate, November 7, 2007. The following is a link to these comments:

A: One would not anticipate a pattern of rate increases in a competitive market. Verizon NJ's ability to raise and sustain rate increases profitably is evidence of its market power. Although rates can increase in a competitive market (where, for example, suppliers face increases in the costs of inputs, such as oil), Verizon NJ has not provided any evidence of increases in its costs of providing basic business local exchange service. Instead, Verizon NJ's ability to provide its lucrative DSL over its local loops and the increasing demand for interstate special access service relative to intrastate special access service are among the reasons that Verizon NJ's costs for its intrastate regulated services (if properly assigned and allocated) likely have declined substantially.

The three explicit statutory criteria are the "minimum" factors relevant to an assessment of whether services are competitive.

Q: The three criteria that the statute sets forth for assessing requests for the competitiveness of services do not encompass Verizon's earnings. Why then are you raising this issue in your testimony?

A: The statute does not preclude the Board's reliance on other factors, but rather states, in pertinent part:

> [I]n making such a determination [about the competitiveness of a telecommunications service], the [B]oard shall develop standards of competitive service which, *at a minimum*, shall include evidence of ease of market entry; presence of other competitors; and the availability of like or substitute services in the relevant geographic area.[249]

---

http://fjallfoss.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6519810330

[249]/ *N.J.S.A.* 48:2-21.19(b) (emphasis added).

I urge the Board to reject Verizon NJ's unduly narrow interpretation of the statute. Instead the Board should consider all relevant factors, which include, among other things, Verizon NJ's ability to earn supracompetitive profits.

Even if the Board limits its criteria to the three explicit statutory criteria, Verizon NJ and Embarq have not met their burden of proof to demonstrate that mass market services should be classified as competitive.

Q: If Board decides not to consider other factors, has Verizon NJ met its burden of proof?

A: No. Even if the Board limits its review to the three explicit statutory criteria, neither Verizon NJ nor Embarq have met their burden of proof regarding their requests for competitive classification of mass market services.

VII. DIRECTORY ASSISTANCE

Verizon NJ fails to support its request to classify directory assistance for residential customers as competitive.

Q: Verizon NJ asserts that Directory Assistance services for mass market customers should be reclassified as competitive.[250] Please comment.

A: Verizon NJ repeats many of the arguments it made in the Board's 2006-2007 investigation of Verizon NJ's DA. Last year, the Board denied Verizon NJ's request to reclassify DA services as competitive.[251] As this reply testimony demonstrates, the competitive situation has not changed significantly in the subsequent seven months. Therefore, the Board again should reject Verizon's request to classify DA services as competitive.

Q: Please summarize your understanding of Verizon NJ's reasons that DA services should be reclassified as competitive.

A: Verizon NJ relies on the presence of competitors to show ease of market entry, and to support its argument that DA services should be reclassified as competitive.[252] However, Verizon NJ fails to show that alleged alternatives can reasonably be considered "like or substitute" services, the third essential criterion. The Board previously stated:

---

250 / Vasington (Verizon NJ), at 28-38 and 71-85.

251 / *In The Matter of The Board's Review Of The Classification Of Verizon New Jersey Inc.'s Directory Assistance Services As Competitive,* Docket Nos. TX06010057 and TT97120889, Telecommunications Order (NJ BPU June 28, 2007) ("*DA Reclassification Order*"). See also *DA Reclassification* proceeding, Docket Nos. TX06010057 and TT97120889, *Reply Testimony of Susan M. Baldwin on Behalf of the New Jersey Division of Ratepayer Advocate*, filed May 12, 2006, in which Ms. Baldwin addressed many of the same issues discussed herein.

252 / Vasington (Verizon NJ), at 28-38.

> While the Board has acknowledged the presence of competitors, *whether an alternative is a like or substitute service is critical.* Access to directory information must be widely available, of the same quality as that produced by Verizon and not requiring anything other than a basic telephone to access. For residential DAS, the alternatives presented do not satisfy the criteria related to the availability of like or substitute services.[253]

The alternatives that Verizon NJ identifies[254] cost significantly more than Verizon's DA service, require additional equipment, are relatively unknown to consumers, or suffer other weaknesses in comparison to traditional DA services. For these reasons, the alternatives cannot be considered like or substitute services. Verizon fails to provide proof that the third criterion for reclassification is met. Therefore the Board should not classify DA services as competitive.

Q: Verizon NJ shows that DA services are available through interexchange carriers ("IXCs") and alternative directory assistance providers ("ADAPs"). Please comment.

A: Mr. Vasington produces lists of national IXCs and ADAPs that offer DA service,[255] which are similar to those that Verizon NJ produced for the DA Reclassification proceeding. The IXC examples provided, however, suffer from the same weakness that they had during the 2006-2007 proceeding: all of the DA services offered by IXCs are more expensive than Verizon NJ's DA, and in the case of Sprint, are *five times more expensive*, than Verizon NJ's

[253] / *DA Reclassification Order*, at 17 (emphasis added).

[254] / Vasington (Verizon NJ), at 28-38.

[255] / *Id.,* at 29-33.

DA service,[256] as Table SMB-15 shows. The Board's rationale in its previous order applies here, namely that "a significantly higher priced option cannot reasonably be construed as a substitute."[257] The Board's conclusion also applies: "Therefore, the higher priced alternatives to Verizon DAS, suggested by Verizon, do not constitute legitimate substitutes."[258]

Table SMB-15

Interexchange Carriers' Rates for DA

IXC	Rate	Access Number
AT&T	$1.99	NPA-555-1212, 10-10-att-00
Sprint	$2.49	NPA-555-1212 or 411
Cogniphone	$0.60	NPA-555-1212
VarTec/Comptel	Varies	10-10-297-NPA-555-1212
IDT	$0.95	NPA-555-1212
XO	$1.25	411

Source: Vasington (Verizon NJ) Testimony, at 29-30.

Q: Please address the role of ADAPs further.

A: As shown in the table on pages 30-33 of his testimony, the ADAPs that Mr. Vasington depicts as alternatives for mass market consumers are clearly targeted toward corporate, government, and wholesale customers - not residential customers. One need look no further than the table's column heading "Type of Customers," and follow it through each suggested

[256] / *Id.,* at 29-30.

[257] / *DA Reclassification Order*, at 18.

[258] / *Id.*

alternative, to confirm that these services are not meant for retail residential consumers. *Not even one* ADAP claims to serve mass market residential customers. These "alternatives" are irrelevant to the residential consumer, and therefore should be afforded no weight by the Board.

Q: Does Mr. Vasington show that wireless operators provide DA services?

A: Yes. Mr. Vasington repeats the listing of the wireless carriers that operate in New Jersey previously provided in the *DA Reclassification* proceeding.[259] However, wireless DA is not comparable to Verizon's traditional DA because wireless DA is typically priced substantially higher than Verizon NJ's DA services, and, therefore, does not in any sense rein in the pricing practices of Verizon NJ. A price, for example, of $1.79 for Sprint wireless DA[260] can hardly be considered to "constrain" Verizon NJ's price of $0.50 for residence DA or even $1.25 for business DA. Higher-priced options could not discipline Verizon NJ's pricing practices if the Board reclassifies DA services as competitive.

Q: Please respond to Verizon NJ's discussion regarding the presence of CLECs and cable operators in New Jersey.

A: Mr. Vasington provides statistics showing that some CLECs resell Verizon's DA services.[261]

---

[259] / Vasington (Verizon NJ), at 33-34.

[260] / See http://www.nextel.com/en/services/calling/nextel411.shtml for Sprint DA pricing, accessed January 4, 2008.

[261] / Vasington (Verizon NJ), at 34.

Other CLECs provide DA service using their own data, or data from other sources.[262] However, the argument that CLECs and cable telephony providers can discipline Verizon's DA pricing is unpersuasive for two reasons. First, as discussed more thoroughly in Section IV of this testimony, most New Jersey consumers use Verizon NJ for telephone service rather than services offered by competitors.[263] Furthermore, it is likely that many or most of the CLECs target business customers, and not residential customers. According to the FCC's most recent *Local Competition Report,* only 33% of CLEC lines in New Jersey are provisioned to residential customers, in contrast with 61% for ILECs.[264] Finally, as Verizon NJ acknowledges, many CLECs rely on Verizon NJ's DAS in order to serve their customers: CLECs' resale of Verizon NJ's wholesale DAS does not constrain the prices or quality of Verizon NJ's retail DAS. The Board stated in its 2007 DA Reclassification Order:

> The overarching responsibility that rests with the Board is to balance the need of the customer and the utility. The public interest must weigh heavily in cases where a service is being granted competitive status, since as a result pricing regulation by the Board will be discontinued. Alternatives to Verizon DAS that charge ratepayers substantially more to obtain cannot be held to

---

262 / *Id*., at 34-35.

263 / According to the most recent data from the FCC, CLECs served 18% of end-user switched access lines in New Jersey as of December 31, 2006. FCC Local Competition Report, at Table 7. The incumbents dominate the vast majority of the local market either directly through their own retail services or indirectly by leasing their wholesale facilities to its competitors (*i.e.*, the non-facilities-based competition that occurs through resale, UNE-P, and UNE loop). Even if viewed solely on a retail basis (which would be misleading because it would mask CLECs' reliance on the incumbent carrier's facilities), the incumbents dominates over 82 percent of New Jersey's local market. CLECs owned about 145,000 (or less than 3%) of the total 5.5-million end-user switched access lines in service in New Jersey as of December 31, 2006. *Id*., at Tables 7 and 11. CLECs provided approximately 977,000 end-user access lines, over half (520,812) provided through resale arrangements. CLECs also provided 310,872 lines through the use of UNEs, and provided just 145,439 facilities-based lines. *Id.*

264 / FCC Local Competition Report, at Table 12.

> satisfy the statutory requirement of a like or substitute service.[265]

Second, Verizon NJ's argument that CLECs and others provide alternative sources of DA services for mass market consumers implies that Verizon NJ's many consumers might use a different telephone or cable company solely for DA services. It is implausible to assume that mass market consumers would use one company for basic telephone service, and another specifically for DA service.

Q: Verizon NJ relies on VoIP as additional support for its position that the New Jersey DA market is competitive. Please comment.

A: Mr. Vasington identifies several VoIP providers that offer DA service.[266] The Board should dismiss VoIP-based DAS because it is not a like or substitute service. DA service is available through these VoIP companies only if a consumer uses VoIP technology, which requires a computer and broadband Internet connection. By contrast, access to Verizon's DA service does not require either a computer or a broadband connection, and therefore, VoIP-based DA cannot be consider a like or substitute service. Last year, the Board stated:

> Some of the alternatives presented by the Company require the purchase of additional equipment, such as a computer, to access the directory information. For residential DAS, the alternatives presented do not satisfy the criteria related to the availability of like or substitute services.[267]

The Board's reasoning continues to apply. VoIP cannot be considered a like or substitute

---

265 / *DA Reclassification Order*, at 18.

266 / Vasington (Verizon NJ), at 37-38.

267 / *DA Reclassification Order*, at 17.

service because it requires equipment beyond a standard telephone.

Q: Verizon NJ asserts that like or substitute DA services are available from other sources. Please comment.

A: Verizon NJ contends that like or substitute DA services are available from print services, computer-based services, and electronic media services.[268] Verizon NJ, however, neglects to identify the deficiencies that render each of these alternatives to be poor substitutes for Verizon's DA service. Paper directories do not provide consumers with a like or substitute service to the instantaneous, straightforward access to up-to-date, comprehensive directory listings that "411" DAS provides. Paper directories are primarily local directories (*i.e.*, they provide listings for a customer's local calling area), while Verizon NJ's "local" DAS provides numbers for listings throughout a LATA, which includes numerous communities. Furthermore, additions to and deletions from Verizon's DA database occur every day, throughout the year, while the printed directories are "frozen in time" at the closing date before printing. The paper-based directories are necessarily out of date by the time consumers receive them, which renders them an entirely inadequate substitute for DAS.

Q: Please address computer-based alternatives.

A: Of course some persons use the computer to look up telephone numbers, using either services via the Internet, or other electronic-based media such as CD-ROMs. However, as the Board previously affirmed, those alternatives to Verizon NJ's DA services that require additional

[268] / Vasington (Verizon NJ), at 72-76.

equipment, in this case a computer and Internet connection, cannot be considered like or substitute services. The Board also stated,

> Available alternatives must in fact be legitimate substitutes for residential customers and not for just a select group of consumers who have the knowledge, equipment, and expertise to seek them out.[269]

Also, Verizon NJ's representation that the service provided by infoUSA is an alternative for residential mass market consumers[270] is as unpersuasive in this proceeding as it was in last year's DA proceeding. InfoUSA is a sales and marketing tool, clearly geared toward business customers, and clearly very expensive (over one hundred dollars per month). Info USA is not a product similar to DA services in any way that an ordinary mass market consumer would recognize. According to infoUSA's website,

> The principal use of our databases is to find new customers and grow their sales. That is why the logo of infoUSA bears the mark "Sales Solutions".
>
> infoUSA has an extensive distribution channel into medium sized businesses, small businesses, small office/home office (SOHO) markets and sales executives.
>
> All of our databases can be accessed on a subscription basis for a flat price of $180.00 per month. Sales Genie also has a basic contact management software and mapping ability. A small business can get all the sales leads and mailing lists for only $180.00 per month.[271]

The Board should reject Verizon NJ's ill-supported assertion that infoUSA is a like or substitute service.

---

269 / *DA Reclassification Order*, at 18.

270 / Vasington (Verizon NJ), at 75.

271 / http://ir.infousa.com/phoenix.zhtml?c=96263&p=irol-homeProfile&t=&id=& (visited 1/4/2008).

Q: Are the free DA services offered by AT&T, Google, Microsoft, and Jingle Networks like or substitute services?

A: No. Verizon NJ has not demonstrated that these services are sufficiently well-known to be considered like or substitute services. As the Board has previously determined, "Consumer awareness of the alternatives is as important as the availability of the service itself."[272] Moreover, these services suffer the same weakness as some other alternative DA services, namely, each has a unique, less well-known access number that must necessarily compete with the incumbent's well-known "411". The Board previously found that Verizon's 411 gives it a leg-up on competitors:

> In reviewing the given alternatives, the Board believes "411" provides Verizon with an extraordinary market advantage that skews the residential DAS market in favor of Verizon. The significant advantage that Verizon's control over "411" provides is considered an obstacle of like or substitute services, required by statute in order for a service to be deemed competitive.[273]

Q: Does the "411" obstacle persist in today's market?

A: Yes. The advantage that the "411" code gives Verizon NJ continues to distinguish Verizon NJ's DA service from alternatives.

Verizon NJ's survey exaggerates consumers' awareness of DA alternatives.

Q: What is your understanding of the purpose of the consumer survey that Verizon NJ submitted in support of its request for DA to be classified as competitive?

---

272 / *DA Reclassification Order*, at 19.

273 / *Id.*, at 18.

A: In its 2007 Order, the Board stated,

> Based on the foregoing, DAS shall not be reclassified as competitive at this time. Notwithstanding, the Board may in the future consider the following factors in reviewing a petition for reclassification of DAS:
> a) results of a consumer survey, implemented under the supervision of the Board staff, and funded by Verizon, that demonstrates consumer awareness of Directory Assistance alternative;
> b) implementation of a 411 pre-subscription; and/or,
> c) the 411 dialing convention is eliminated and all providers are required to use a similar dialing convention.[274]

As described by Verizon NJ, the purpose of the survey is to "obtain estimates of awareness and use of various methods of obtaining telephone number information by residential customers in New Jersey."[275]

Q: Please describe the survey briefly.

A: Verizon NJ, through TMR, a market research company, conducted a survey of 501 New Jersey residential consumers. In the survey, consumers were asked if they were aware of various methods of finding telephone numbers, and if so, whether they had ever used those methods. Respondents who answered that they had used those methods were asked if they had used them within the previous six months. The survey also recorded demographic and income information to determine if the respondents met income guidelines for a New Jersey pharmaceutical assistance program, PAAD.[276]

Q: How does Verizon NJ present the results of the survey?

---

[274] / *DA Reclassification Order*, at 21.

[275] / Newman (Verizon NJ), at 3.

A: Verizon NJ presents its calculations of percentages of consumers who are aware of various alternatives sequentially as is explained in footnote 3 of Mr. Newman's testimony:

> The percentages are calculated sequentially. For example, 71.7% of all respondents are aware that they can look up telephone numbers on the Internet. Of those who aware of Internet sources, 69.1% have used this option, and of those who have used this option, 85.1% have done so in the past six months.[277]

In other words, Verizon NJ repeatedly narrows the universe of survey respondents with each successive question, first by quantifying awareness of the existence of a potential alternative; then, of those who are aware, the survey asks how many have ever used the alternative; and finally, of those who have used the alternative, the survey asks how many have used the service in the past six months. Verizon ends up with some impressively large percentages – for example, showing that 85.1% of consumers are aware that they can get telephone numbers from the Internet.[278]

Q: Does this methodology for presenting survey results present the Board with clear results?

A: No. This methodology is misleading. It allows Verizon to inflate the popularity of alternatives, in this instance spotlighting a rather large "85.1%", when in fact the raw results

---

[276] / *Id.*, at 3-5.

[277] / *Id.*, at footnote 3.

[278] / *Id.*

of the survey clearly show that only *42.1%* of the survey respondents have used the Internet to find phone numbers in the past six months.[279]

Exhibit SMB-50 to my reply testimony reproduces Verizon NJ's survey results. Exhibit SMB-51 shows the end results that Verizon NJ's testimony obscures, and shows the actual percentages of survey respondents who have used the suggested alternatives in the past six months. In comparison with the "successive" calculations shown in Verizon NJ's testimony, Exhibit SMB-51 shows the actual percentages of total respondents who are aware of, and have used, the particular DAS alternatives.

Q: Are there other deficiencies in Verizon's survey?

A: Yes. Even though the survey targets residential customers, there is nothing in the survey questions that limits respondents' answers to actions taken inside the home. For example, when asked if she has ever used the Internet to look up a phone number, a respondent might reasonably say "yes" even if she doesn't own a computer. She could simply have used a computer at work, for business purposes. This activity would be properly described as "Business DA," not "Residential DA." However, nothing in the survey question would lead a respondent to limit her responses to actions taken at home.[280] The survey conflates the use of alternatives by residential consumers *at home* with the use of alternatives by residential

[279] / See Exhibit SMB-51.

[280] / Newman (Verizon NJ), at Exhibit 1: "Verizon NJ Directory Assistance Survey." Question 1 reads: "Are you aware that you can look up telephone numbers on the Internet at sites like Google, Yahoo, Ask, Verizon and

consumers *in any location*. Clearly, if the intent of the survey is to show awareness of mass market residential consumers, the questions should have been formulated in such a way as to focus responses on mass market residential activity.

Q: What is the significance of including Pharmaceutical Assistance for the Aged and Disabled ("PAAD") eligibility in the survey?

A: Verizon apparently seeks to demonstrate that the old and/or infirm are as aware as the general population is of alternatives to Verizon's DA services.[281] As Verizon presents the survey results, it appears that PAAD-eligible respondents (apparently a proxy for all types of vulnerable populations) are nearly as aware of alternatives to Verizon's DA services as the general population. A look at the raw data shows a significant disparity in awareness of and use of alternatives between the general population and more vulnerable populations. For example, while 42.1% of all survey respondents have used the Internet to find a telephone number in the past six months, only 9.4% of the PAAD-eligible respondent have.[282] While 33.5% of the total respondents have used wireless 411 in the past six months, only 14.4% of PAAD-eligible respondents have.[283] While 15.5% of total respondent have used free 411 services in the past six months, only 11.9% of PAAD-eligible respondents have.[284] Clearly

others? (a) Have you ever done that? (b) Have you done that in the last six months?"

[281] / Newman (Verizon NJ), at 3-4.

[282] / See Exhibit SMB-51.

[283] / *Id.*

[284] / *Id.*

PAAD-eligible respondents differ from the survey group as a whole. Instead of proving Verizon's point, this survey actually shows quite clearly that vulnerable populations are less aware, and make less use of, alternatives to Verizon's DA services.

Q: Ms. Baldwin, you have discussed your analysis and rationale for denying Verizon NJ's request to classify DAS as competitive. If, contrary to your recommendation, the Board approves Verizon NJ's request, should the Board address the consequences for residential consumers of classifying DAS as competitive?

A: Yes. If the Board classifies DAS as competitive, it is probable that Verizon NJ will eliminate or reduce the DA allowance. Verizon NJ also may increase the per-call rate for residential DA from $0.50 to $1.25 to mirror the business DA rate structure or as high as $1.50 based on rates charged by other DA providers. Based on public ARMIS data, there are 2,600,936 residential lines.[285] If Verizon NJ eliminates the DA allowance and then raises the DA rate to $1.50, the loss to consumers will be approximately $187,000,000.[286] Verizon NJ has not provided any cost justification to warrant this potential, approximate $200 million loss of value for consumers.

Q: Please summarize your analysis and recommendations regarding the classification of residential DAS.

---

285 / FCC ARMIS Report 43-01, Table II, year end 2006 (accessed 1/6/08).

286 / Four calls time $1.50 times twelve months times 2,600,936 residential access lines.

A: Verizon NJ again has failed to provide adequate support for its proposed classification of DAS as competitive. In its previous DA Reclassification Order, the Board stated, "Verizon has failed to provide sufficient New Jersey specific data that is both reasonable and quantifiable to persuade the Board that actual substitution for residential customer DAS currently exists …"[287] The testimony of Mr. Vasington and Mr. Newman, and the results of the flawed DA awareness survey fail to demonstrate why the Board should revisit its decision issued last year. As the Board previously stated,

> … the record does not support a finding that the alternatives proffered by Verizon satisfy the criteria of the statute due to the differences inherent in the types of services presented. Additionally, the Board finds that the record lacks credible evidence to support Verizon's fundamental premise that its reduced DAS call volume establishes evidence of overwhelming competition providing substitute services in the DAS market.[288]
>
> In viewing the record evidence, the Board may not select one category of residential customers i.e. those able to afford upwards of $1.79 per directory assistance call, who own computers, and/or subscribe to wireless providers and at the same time find that the substitute services meet the criteria of the statute.[289]

The Public Service Commission of West Virginia also recently determined that Verizon's directory assistance services cannot be deregulated at this time because it has not been

[287] / *DA Reclassification Order*, at 16.

[288] / *Id.,* at 17.

[289] / *Id.*, at 18.

deemed "workably competitive."[290] I urge the Board to reject Verizon NJ's request to classify DA service as competitive.

Summary of analyses and recommendations regarding DA.

Q: Please summarize your major analyses and recommendations regarding Verizon NJ's DA.

A: Based on my review and analysis of Verizon NJ's testimony and data responses I conclude that:

- Verizon NJ has failed to demonstrate that DAS is competitive, and therefore, the Board should regulate Verizon NJ's DAS as a non-competitive, rate-regulated service. The alternatives that Verizon NJ describes are not like or substitute services that constrain Verizon NJ's market power.
- The purported alternatives to Verizon NJ's DAS are inferior: they are less accurate, often higher-priced, entail significantly higher transaction costs, and, unlike "411" are not ubiquitously recognized.
- Verizon NJ uniquely controls the "411" code, which represents an insurmountable barrier to entry.
- Residential customers' demand for DAS differs from that for business customers: most use DAS infrequently and are far less likely to invest the time and resources to

290 / *MCImetro Access Transmission Services, LLC, DBA Verizon Access Transmission Services - Petition for consent and approval for the Commission to cease regulation of rates charged by Verizon Access Transmission Services for certain services previously determined to be workably competitive*, West Virginia PSC Case No. 07-2 183-T-PC, Commission Order, January 7, 2008, at 3.

investigate alternatives.

- Verizon NJ failed to submit cost data: its ability to raise rates and its history of so doing demonstrate its market power.
- DAS is an integral component of basic local exchange service. Any decrease in the DA allowance or increase in the DA rate would implicitly raise the rate for residential consumers.
- If the Board, contrary to my recommendation, classifies Verizon NJ's DAS as competitive, the Board should:
  - Continue to protect the DA four-call allowance as an integral component of basic service;
  - Require Verizon NJ to reduce basic local exchange service rates to offset any new revenue stream associated with any increase to residence DA; and
  - direct Verizon NJ to conduct a comprehensive customer notification and education plan, subject to Board and Ratepayer Advocate review.

VIII. CONSUMER HARM

The premature classification of mass market services as competitive could lead to rate increases of more than 500 million dollars per year.

Q: Ms. Baldwin, in the previous sections of your reply testimony, you provided evidence regarding the lack of effective competition in the local exchange and directory assistance markets. If the Board, nonetheless, were to approve the ILECs' request for competitive classification of its mass market and DA services, would consumers be harmed?

A: Yes. The premature classification of mass market and DA services would allow Verizon NJ and Embarq to raise rates. Verizon NJ presently charges $8.95 and $15.00, respectively, for residential and business local exchange service.[291] If these services were classified as competitive, Verizon NJ, in an attempt to encourage customers to purchase "triple play" and "quadruple play" could raise à la carte rates up to the rates for its lowest-priced bundles. For example, for residential customers, Verizon NJ might raise the rate by $23.09 to the existing rate of $32.04 for "Regional Essentials."[292] For business customers, Verizon NJ might raise

---

291 / Tariff B.P.U.-N.J.-No. 2, Exchange and Network Services, A5. Exchange Services, 5.2.1.C.1, 13th Revised page 30, Effective February 1, 2007. A message rate that includes 75 local message units and additional local message units at 0.065 each is $7.40/month. Id. Tariff B.P.U.-N.J.-No. 2, Exchange and Network Services, A5. Exchange Services, 5.2.1.C.1, 13th Revised page 30, Effective February 1, 2007.

292 / Tariff B.P.U.-N.J.-No. 2, Exchange and Network Services, A2. General Regulations, 2.3.5.T., 5th Revised page 41.4.26, Effective August 20, 2007. Verizon Regional Essentials includes flat rate residential exchange service; waiver of element charges; unlimited intraLATA direct distance dialed toll calling and up to three premium exchange services from a specified list (call waiting, caller id with name, call forwarding busy line/don't answer, or call forwarding busy line, or call forwarding don't answer).

the rate by $27.00 to $42.00 for its unlimited local and toll usage package.[293]

Q: Have you calculated a revenue impact of these potential rate increases?

A: Yes. Residential consumer increases would be approximately $360,000,000 and business consumer increases would be approximately $19,700,000.[294] Including the $187 million impact of eliminating four free DA calls per residential line (and assuming that Verizon NJ sets the DA rate at $1.50 per call) yields a total annual consumer loss of $567 million.

Q: Would this revenue increase be in the public interest?

A: Over a five-year period, the potential shift in revenues from consumers to Verizon NJ's shareholders would be more than $2.5 billion. At a time of rising oil prices, rising gasoline prices, and declining housing values, straining consumers' budgets further without any apparent reason would seem ill-advised. I am unaware of any regulatory constraints on Verizon NJ's ability to lower rates for its bundled offerings in those markets where it is seeking to compete with cable companies and other providers in the pursuit of high-volume triple play customers. I cannot fathom a public interest in enabling Verizon NJ to raise the

---

[293] / Tariff B.P.U.-N.J.-No. 2, Exchange and Network Services, A2. General Regulations, 2.3.5.O., 4th Revised page 41.4.18, Effective July 1, 2006. Unlimited local usage does not include the business exchange access line rate (see page 41.4.19). The total package price would be $15.00 plus $27.00, or $42.00.

[294] / Based on public ARMIS data, Verizon NJ serves 2,600,936 residential lines and 60,841 single business lines. FCC ARMIS Report 43-01, Table II, year end 2006 (accessed 1/6/08). The calculation of residential rate increases assumes that half of the Verizon-served lines already subscribe to bundled offerings. *See*, *e.g*., Direct Testimony of Harold E. West, III on behalf of Verizon Washington, DC, Inc. in DC PSC Case No. 1057, In the Matter of Verizon Washington, DC Inc.'s Price Cap Plan 2007 for the Provision of Local Telecommunications Services in the District of Columbia, at page 69, citing IDC Market Analysis, "U.S. Bundled Services 2007-2011 Forecast," October 2007, at p. 1. For proprietary data regarding quantities of residential lines, single business lines, and the percentage of residential customers subscribing to bundled offerings, see Vasington (Verizon NJ), at 48, and 52; and Verizon NJ proprietary Attachment to its response to RC-VNJ-22 (Exhibit SMB-C-11).

rates for à la carte, low volume mass market customers who do not want or require bundled offerings, which are priced at more than three times the rate of basic local exchange service.

Q: Might rate increases be justified by Verizon NJ's increasing costs of supplying mass market telecommunications services in New Jersey?

A: I am unaware of any increase in Verizon NJ's costs that would justify its earning this new substantial stream of revenues, and, as I demonstrate in Section VI, Verizon NJ is already enjoying exorbitant earnings from its intrastate operations in New Jersey.

Q: Ms. Baldwin, you have repeatedly referred to the prospect of rate increases. Has Verizon NJ provided any information about its intention to raise mass market rates?

A: I am unaware of any such stated intentions. However, as I show in Section VI, Verizon NJ has raised rates in the past, subsequent to obtaining competitive classification of its services. Moreover, other than being able to raise rates unilaterally, it is unclear to me why Verizon NJ would be seeking to classify mass market services as competitive. Certainly if Verizon NJ wants to lower rates in order to meet competitive pressures, it would be hard to imagine that the Board would deny such a request. Also, if Verizon NJ seeks simply to be able to lower and then raise rates back to existing levels, presumably it could structure a petition whereby it sought authority to change rates within a band, but with that band capped at today's rates.

Q: Does your estimate of the half billion dollar revenue increase reflect all the harms to consumers that would follow from a competitive reclassification of the ILECs' mass

market services?

A: No. First, my estimate of the revenue impact focuses on Verizon NJ. If Embarq were to raise its residence rates to $30.00[295] from the current à la carte rate of $7.80,[296] the annual revenue impact would be $15,479,000 assuming the same 50% already purchasing bundles as I use for Verizon.[297] Also, the distortions in the market that I describe in Section VI above combined with the premature classification of mass market services as competitive would prevent the development of effective competition in New Jersey and the consumer benefits from competition that would otherwise result. Finally, the classification of mass market services as competitive could lead to the degradation of the quality of basic local service offered to residential and single-line business customers.

If the Board grants Verizon NJ's request and if PAR-2 continues, the outcome of this proceeding should be treated as an exogenous event, and earnings sharings should occur.

Q: If the Board, contrary to your recommendation, grants Verizon NJ's request for competitive classification of its mass market services, would that, in your view, terminate the PAR-2?[298]

---

295 / Dr. Staihr cites Comcast and Patriot Media bundles as comparing "favorably" to Embarq's Basic Home Phone package priced at approximately $30. Staihr (Embarq), at 25.

296 / United Telephone Company of New Jersey, Inc. Tariff No. B.P.U. – No. 3, second revised page 12 issued March 31, 1994, effective June 7, 1994. Rate is for residence individual line.

297 / Embarq served 116,215 residential access lines as of the end of year 2006. Staihr (Embarq), Attachment BKS-2.

298 / In the Matter of the Application of Verizon New Jersey Inc. For Approval (I) of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-Line Rate Regulated Business Services as Competitive Services, and Compliance Filing, New Jersey Board of Public Utilities Docket No. TO01020095, Decision and Order, ("PAR-2 Order") August 19, 2003.

A: Yes because at that point, all services would be deemed to be competitive.

Q: Does the Board agree with your view that the competitive classification of services would terminate PAR-2?

A: No. In its Order on Reconsideration, the Board stated that "[u]nless and until a request for a modification or elimination of PAR-2 is proposed, the Plan remains unaffected by the ultimate decision in this matter."[299]

Q: If the Board grants Verizon NJ's request and also does not terminate PAR-2, what should be the consequences under PAR-2?

A: As I have demonstrated in this reply testimony, the granting of competitive classification for mass market and DA services could yield an annual revenue windfall for Verizon NJ of more than $500 million. The classification, therefore, should be considered an exogenous event and the Board should institute earnings sharing for all consumers. In the absence of earnings sharing, Verizon NJ should commit to offer DSL to all consumers at a monthly rate of no more than $10.00.[300] However, Verizon NJ should commit to offer DSL at a speed faster

---

[299]/ Order on Reconsideration, December 21, 2007, at 5.

[300]/ The commitments, outlined in the FCC's AT&T/BellSouth order approving the transaction, include the following:

- By December 31, 2007, AT&T/BellSouth will offer broadband Internet access service (*i.e.*, speeds in excess of 200 kbps in at least one direction) to 100 percent of the residential living units in the AT&T/BellSouth in-region territory.
- Within six months of the Merger Closing Date, and continuing for at least 30 months from the inception of the offer, AT&T/BellSouth will offer to retail consumers in the Wireline Buildout Area, who have not previously subscribed to AT&T's or BellSouth's ADSL service, a broadband Internet access service at a speed of up to 768 Kbps at a monthly rate of $10 per month.
- Within twelve months of and for forty-two months after the Merger Closing Date,

than the limited speed of 768 kbpbs applicable to AT&T, as a result of the merger conditions.

Q: Are there are other requirements set forth in PAR-2 that bear on this proceeding?

A: Yes. The Board should resolve several related issues before addressing VNJ's reclassification requests. The PAR-2 Order requires VNJ to:

> provide annual financial reports to the Board so that it may monitor the revenue and costs of its competitive services, and determine whether, in the aggregate, the total revenues for VNJ's competitive services exceed the total direct costs of those services, and (2) eliminate reports from the EAS system, and to provide annual financial reporting of its rate regulated services and to work together with Staff and the Advocate to determine the format for such annual financial reporting on its rate regulated services, and to ensure, as much as reasonably possible, that the format is consistent with similar reporting in other Verizon jurisdictions.[301]

Until the Board has had the opportunity to review this important financial information, it would be premature to approve Verizon NJ's reclassification request. Furthermore, PAR-2 states that "[i]n connection with any filing to make a service Competitive, Verizon NJ will file with the Board direct cost data."[302] Verizon NJ has failed to provide the requisite cost data for the services for which it seeks competitive classification, and, therefore, has not met its burden of proof. Similarly, Embarq should provide comparable cost data for the services

---

AT&T/BellSouth will deploy and offer within the BellSouth in-region territory ADSL service to ADSL-capable customers without requiring such customers to also purchase circuit switched voice grade telephone service.

- Within twelve months of the Merger Closing Date, AT&T/BellSouth will make available in its in-region territory an ADSL service capable of speeds up to 768 Kbps to ADSL-capable customers without requiring such customers to also purchase circuit switched voice grade telephone service.

301 / *PAR-2 Order*, at 54.

302 / *Id.*, at 168.

for which it seeks competitive classification.

VIII. CONCLUSION

Recommendations

Q: Please summarize your analyses and conclusions.

A: Among the major conclusions that I reach in my reply testimony are the following:

- Neither "traditional" CLECs nor intermodal providers discipline the rates, terms, and conditions of Verizon NJ's and Embarq's mass market services.
- Neither Verizon NJ nor Embarq have satisfied the three statutory criteria for classifying services as competitive.
- Market conditions have changed dramatically, with Verizon NJ's parent company acquiring MCI, a major rival, and with the elimination of cost-based UNE-P as a viable CLEC strategy.
- The relevant geographic market is the wire center, and not the entire state (nor the entire territory served by Embarq). Competitive conditions vary widely throughout the state.
- Bundles and àla carte services are in separate product markets. The proliferation of bundles does not represent competition for à la carte services, but instead creates pressure on the ILECs to raise rates for stand-alone services in order to encourage customers to migrate to bundled offerings.
- Market distortions persist, including mis-aligned wholesale and retail rates for local loops and over-priced intrastate switched access. These market distortions represent

barriers to entry and to the development of local competition.

- High earnings by Verizon NJ and Embarq undermine their assertions of a competitive local market.
- Verizon NJ has failed to demonstrate that the statutory criteria have been met for classifying residential DA as competitive.
- The premature classification of mass market and DA services as competitive would yield a windfall of more than a half billion dollars each year for Verizon NJ and Embarq, which corresponds with an unwarranted shift in monies from consumers to shareholders.

Q: Please summarize your major recommendations.

A: Based on my analyses described in my reply testimony and the information provided thus far in this proceeding, I recommend that the Board:

- Reject Verizon NJ's and Embarq's requests to classify mass market services as competitive.
- Reject Verizon NJ's request to classify DA as competitive.
- Open a separate proceeding in which it exercises its regulatory authority to investigate the way in which Verizon NJ and Embarq assign and allocate joint and common costs to their DSL, FiOS, bundled offerings, and other non-competitive lines of business.

Conclusion

Q: Does this conclude your testimony?

A: Yes. However, I reserve the right to supplement my testimony based on further review of the data that Verizon NJ provided. Although Rate Counsel requested data in Excel format, Verizon NJ provided much data in PDF format. The lack of an Excel format means that my data analyses are preliminary and may need to be supplemented.