BEFORE THE

PENNSYLVANIA PUBLIC UTILITY COMMISSION

Consultative Report on Application of	**)**	
Verizon Pennsylvania Inc., for FCC	**)**	**Docket M-00001435**
Authorization to Provide In-Region,	**)**	
InterLATA Service in Pennsylvania	**)**	

DECLARATION OF WILLIAM E. TAYLOR

ON BEHALF OF VERIZON PENNSYLVANIA INC.

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I. EXECUTIVE SUMMARY

1. From an economic perspective, Verizon Pennsylvania Inc.'s ("Verizon PA's") entry into the interLATA long distance business in Pennsylvania will unequivocally promote the public interest. Verizon PA's provision of long distance services would benefit consumers by enhancing competition in both local and long distance telecommunications markets. This increased competition will reduce prices, increase consumer choice, expand demand, and promote economic efficiency. In addition, Verizon PA's entry into the interLATA business in Pennsylvania will raise no significant risk to competition in local exchange or long distance markets.

2. Verizon PA's entry into the Pennsylvania long distance market will enhance competition in three critical respects:

a. *Verizon PA's entry will increase competition in the long distance market by adding a strong new competitor with sufficient resources to challenge the major three incumbent long distance carriers — AT&T, WorldCom and Sprint (the "Big Three").* As evidenced by actual market experience in New York (which is set out in greater detail in the Declaration of Maura Breen, President of Verizon Long Distance), allowing Verizon PA to enter the long distance market will provide consumers with more innovative calling plans and cheaper prices for long distance services. Thus, Verizon PA's entry into the market will have both price and non-price benefits. The most readily quantifiable portion of these benefits is the increase in consumer welfare stemming from greater price competition. Because of the high margins between the incumbent long distance carriers' prices and their costs, injecting new competition is likely to produce significant price decreases. And, because long distance demand is relatively price-elastic, the increase in market demand resulting from lower prices will lead to large consumer welfare gains.

b. *Verizon PA's entry also will add a strong new competitor to the market for* ***bundled packages*** *of services*. For many consumers, the ability to engage in one-stop shopping for a bundled package of communication services is viewed as a significant benefit. Today, the companies that are best positioned to provide these bundled packages are the incumbent long distance carriers and cable companies. Consumers are denied an additional choice since Verizon PA is barred from competing with bundled long distance and local services. When Verizon PA is permitted to provide long distance service, it will be able to assemble a comparable package of services and compete on the same terms as the major long distance and cable companies. Consumers will benefit from the greater competition, which is likely to reduce prices and increase service innovation of bundled packages of services.

c. *Verizon PA's entry into the long distance and bundled services markets also will spur additional competition for* ***local*** *services*. As Verizon PA begins to compete for the long distance carriers' customers and offer bundles of local and long distance services, the long distance carriers will have an increased incentive to compete vigorously for mass-market local exchange services. Indeed, since the FCC approved Verizon NY's application to provide long distance service in New York, local competition in New York has increased.

3. While Verizon PA's entry into the long distance market will enhance competition in both long distance and local exchange markets, there is no

significant risk that Verizon PA's entry will harm competition in any market. The current degree of competitive activity and actual market experience shows that the local exchange market is open, and competitors have entered — and are continuing to enter — on a large scale.

a. In the more than four and half years since the Telecommunications Act of 1996 ("the Act") was passed, the number of lines served by competitive local exchange carriers ("CLECs") in Pennsylvania has steadily grown. There are at least 673,000 competitive lines in Verizon PA's territory, which is more than 10 percent of Verizon PA's retail lines.

b. Local entry in Pennsylvania has been heavily facilities-based and dispersed widely across the state. Competitors have demonstrated their own belief that the local market is open by voting with their wallets, investing enormous sums in competing facilities. This entry is irreversible. Once a competitor makes these sunk investments, the competing facilities are in place and available for use to provide competing service even if some individual competitors decide to exit the market.

4. Contrary to the dire predictions of the long distance incumbents, there is no significant risk that Verizon PA's entry will harm long distance competition. To the contrary, actual market experience in previous instances where Verizon PA and other Bell companies have been allowed to compete in adjacent markets demonstrates that these speculative concerns are unfounded. And, in addition to requiring Verizon PA to open its local markets by satisfying the competitive checklist of Section 271, the Act itself established extensive regulatory safeguards to address any speculative concerns stemming from Verizon PA's status as an incumbent local exchange carrier.

5. In sum, Verizon PA's entry in the long distance market in Pennsylvania is in the public interest. It will benefit consumers by increasing competition in both the long distance and local markets. In addition, Verizon PA's entry into the long distance market will not harm competition. Instead, Pennsylvania consumers — like those in New York — are likely to pay less for long distance calls and less for local service once Verizon PA is authorized to provide interLATA services in Pennsylvania.

II. BACKGROUND AND CONCLUSIONS

6. My name is William E. Taylor. I am Senior Vice President and head of the Communications practice at National Economic Research Associates, Inc. ("NERA") at One Main Street, Cambridge, Massachusetts.

7. I have been an economist for about 25 years. I earned a Bachelor of Arts degree from Harvard College in 1968, a Master of Arts degree in Statistics from the University of California at Berkeley in 1970, and a Ph.D. from Berkeley in 1974, specializing in Industrial Organization and Econometrics. During this period, I have taught and published research in the areas of microeconomics, theoretical and applied econometrics (which is the study of statistical methods applied to economic data), and telecommunications policy at academic and research institutions. Specifically, I have taught at the Economics Departments of Cornell University, The Catholic University of Louvain in Belgium, and the Massachusetts Institute of Technology. I have also conducted research at Bell Laboratories and Bell Communications Research, Inc. I have participated in

telecommunications regulatory proceedings before many state public utility commissions and the Federal Communications Commission ("FCC"), concerning incentive regulation, price cap regulation, productivity, access charges, local competition, interconnection, pricing for economic efficiency, telecommunications mergers, and entry into the long distance market. I have also testified on market power and antitrust issues in federal court. I attach my *vitae* as Attachment 619. Verizon PA has asked me — as an economist — to assess the public interest implications of its proposed entry into the long distance market in Pennsylvania.

8. Verizon PA's entry into the interLATA long distance business in Pennsylvania unambiguously would promote the public interest. Verizon PA's provision of long distance services would benefit consumers by enhancing competition in local and long distance markets alike. This increased competition would reduce prices, increase consumer choice, expand demand and promote economic efficiency. In addition, Verizon PA's entry into the interLATA business would raise no significant risk to competition in local exchange or long distance markets.

III. VERIZON PA'S LONG DISTANCE ENTRY WILL BENEFIT CONSUMERS.

9. Residential long distance prices have risen substantially even as long distance costs (including carrier access charges) have fallen. These price increases have been greatest for low-volume customers. For example, from 1991 to July 1999, net of access charges and other fees, AT&T increased the interstate prices

paid by its basic-rate customers by 503 percent.[1] In addition, net of access charges and other fees, AT&T increased the interstate prices actually paid by its residential customers by 108 percent over the same period.[2] Although incumbent long distance carriers have offered volume discount plans, only a fraction of residential customers actually save money by subscribing to such plans. For example, only about 38 percent of AT&T's residential customers receive a discount from basic rates on their interstate calls.[3] In fact, as explained by Ms. Breen, many calling plans are effectively unavailable to many residential customers.[4] Once Verizon PA is permitted to enter the Pennsylvania long distance market, competition will increase significantly in the local and long distance markets. This competition will directly and immediately benefit Pennsylvania consumers.

A. Verizon PA's Provision of InterLATA Services Will Introduce an Important New Source of Long Distance Competition in Pennsylvania That Will Benefit Consumers.

10. As a major new facilities-based competitor, Verizon PA will spark competition in three key respects. First, Verizon PA will offer competitive pricing plans — which will help break the Big Three's pattern of increasing long distance

[1] William E. Taylor, Declaration, *Application by New York Telephone Company (d/b/a Bell Atlantic – New York), Bell Atlantic Communications, Inc., NYNEX Long Distance Company, and Bell Atlantic Global Networks, Inc., for Authorization to Provide In-Region, InterLATA Services in New York*, CC Docket 99-295 (September 29, 1999), ¶ 20 ("Taylor New York Declaration") (Attachment 601).

[2] *Id*., ¶ 19.

[3] *Id*., ¶ 14. Also, according to a study by the consumer group United Homeowners Association, 60.1 percent of households in the nation — customers of all long-distance carriers combined — pay basic rates. *See* Pradnya Joshi, "The Big Savings Maze," *Newsday* (January 11, 1998), p. F8. (Attachment 602).

[4] *See generally* Declaration of Maura C. Breen.

prices — while its presence in the long distance market will also spur the introduction of new and improved services. As the FCC recently observed, "the entry of the BOC interLATA affiliates into the provision of interLATA services has the potential to increase price competition and lead to innovative new services and marketing efficiencies."[5] Second, Verizon PA will serve as a new competitor in the market for bundling long distance service with other services. Third, the advent of a new competitor for long distance services and for bundled services will force other competitors to offer a full array of competing services, including local service. As a result, the entry of Verizon PA into the long distance market will increase competition for local services as well.

1. Verizon PA's entry will promote competition in the Pennsylvania long distance market.

11. Verizon PA is a more formidable competitor than any other potential long distance entrant in Pennsylvania. Verizon PA differs from other potential entrants in that it has a considerable customer base and market presence within the Commonwealth. When a new reseller (for example) undercuts the incumbent long distance carriers' prices, the long distance carriers do not have to respond because their loss of market share will be small. But if Verizon PA were to undercut their prices, the risk of market loss would be much greater, and the incumbent long

[5] *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, FCC, Second Report and Order in CC Docket No. 96-149 and Third Report and Order in CC Docket No. 96-61, released April 18, 1997, ¶ 92.

distance carriers would be unable to ignore such price-cutting. For these reasons, the FCC has recognized that:

> [T]he 1996 Act provides the best solution to any problem of tacit price coordination . . . by allowing for competitive entry in the interstate interexchange market by the facilities based BOCs . . . . [6]

12. In addition, Verizon PA has the size and resources to deploy and operate a facilities-based long distance network in Pennsylvania to challenge the incumbent long distance market leaders — AT&T, WorldCom, and Sprint — who compete on a facilities basis in national and global long distance markets. And Verizon PA has the customer base and market presence in its local service areas to counter the equally strong customer base and market presence enjoyed by AT&T, WorldCom, and Sprint.

13. Actual market experience where Verizon or other local exchange carriers have been permitted to provide long distance service in their local service areas demonstrates that Verizon PA's entry into the long distance market will increase competitive pressures and deliver benefits to Pennsylvania consumers. The best real-life example of the benefits consumers will enjoy is evidenced by the impact of Verizon NY's provision of long distance services in New York. Verizon NY's entry into the New York long distance market has already reduced long distance prices available to residential customers there. For most customers,

[6] *Policy and Rules Concerning the Interstate, Interexchange Marketplace Implementation of Section 254(g) of the Communications Act of 1934, as amended*, FCC, Notice of Proposed Rulemaking, CC Docket No. 96-61, 11 FCC Rcd 7141; 1996 FCC Lexis 1472, FCC 96-123, Adopted: March 21, 1996, Released: March 25, 1996, ¶ 81, footnote omitted.

Verizon's long distance prices in New York are lower than pricing options available from AT&T, WorldCom or Sprint.[7] According to the Telecommunications Research & Action Center ("TRAC") — an independent consumer group that, among other things, compiles information about long distance rates — there is a Verizon calling plan in New York cheaper than any AT&T, WorldCom or Sprint calling plan for all levels of customer usage, except for high volume callers.[8] These high volume callers constitute only 10 percent of the total number of customers.[9] Additionally, a more recent TRAC study, released on September 6, 2000, found that consumer savings for New York consumers who switched to Verizon's long distance was between more than $46 million and $120 million.[10]

14. Verizon's "Timeless" calling plan in New York — the most popular of the New York plans — is the plan in which customers are enrolled unless they specifically request another plan.[11] Under the Timeless plan, customers pay $0.10 per minute for direct-dialed interstate and intrastate calls and pay no

[7] *See* Breen Decl. ¶¶ 12-22.

[8] *See* "TRAC Releases Long Distance Chart Update to Guide New York Consumers through the New Competitive Environment; Six Months after the First Bell Company Enters the Long Distance Market, TRAC Research Indicates Residential Consumers Have More Competitive Choices" (June 27, 2000) (Attachment 502).

[9] *Id.*

[10] *See* "Telephone Competition Rings Up Big Savings for New York Consumers; New Yorkers Save About $220 Million a Year; TRAC Urges Industry & Regulators to Speed Up Competition," <http:trac.policy.net/proactive/newsroom/release.vtml?id=18541> (September 6, 2000) (Attachment 501).

[11] *See* Breen Decl. ¶ 19.

subscription charge or minimum usage charges.[12] Before the price reductions associated with the recent Coalition for Affordable Local and Long Distance Service ("CALLS") order took effect,[13] the interstate direct-dialed bills of 94 percent of AT&T's residential customers in New York would have been lower under Verizon's Timeless calling plan than under the most cost-effective of the available AT&T calling plans.[14] For these customers, Verizon rates averaged 35 percent less than the most cost-effective of AT&T plans. Confirming expectations that Verizon NY's entry into the long distance market in New York would especially benefit low-usage customers, the principal customers who would have paid less under Verizon's rates than the most cost-effective of AT&T's plans are those with less than 200 interLATA minutes a month.

15. In August 2000, AT&T adjusted its rates as required by the CALLS order. Since the FCC required AT&T to discontinue its $3 monthly minimum

[12] *See id*. ¶ 8. Verizon has additional calling plans with lower rates. For example, its e-Values plan, customers who sign up on the Internet, pay $0.09 per minute Monday through Friday and $0.05 per minute on weekends.

[13] In the CALLS proposal, major local exchange carriers, AT&T, and the FCC agreed to cut interstate access charges substantially, eliminate the carrier line charge (both the local exchange carrier charge to interexchange carriers and the interexchange carrier charge to customers), and increase the subscriber line charge. The CALLS proposal required AT&T to eliminate the $3.00 minimum monthly charge assessed to basic-rate customers, create a new calling plan with no minimum charge and no subscription fee, and inform basic-rate customers of their options.

[14] This analysis uses data on residential calling patterns from PNR and Associates, Inc. (now known as TNS Telecoms), *MarketShare Monitor*™, Version 2.0, April 23, 1999. For Verizon, my calculations are based on the $0.10 per minute rate for interstate calls under its Timeless plan, a $1.47 carrier line charge, and a 5.877 percent universal service charge. For AT&T, my calculations account for its carrier line charge of $1.53 per month and its universal service charge of 8.6 percent. The calculations also account for the $3 minimum usage requirement for basic-rate customers and for AT&T's One Rate plan customers. I allocate monthly calling plan subscription charges in proportion to each customer's interstate and intrastate minutes. For each customer, my calculations pick the plan yielding the lowest interstate bill among AT&T's One Rate plan, One Rate 7 Cents Plan, and One Rate 5 Cents Plan. I then compare that lowest bill with what Verizon-NY's Timeless plan rate would yield.

usage charge for basic-rate customers, and required both AT&T and Verizon's long distance service to discontinue their carrier line charges, customers with zero usage had the same bill from both companies — $0. However, most of AT&T's residential customers with some usage would reduce their bills by choosing Verizon. Of AT&T's residential customers with some interstate direct-dialed minutes, 77 percent could have a lower interstate bill by choosing Verizon's Timeless plan than by choosing the most cost-effective of AT&T's current plans.[15] Also, notwithstanding the CALLS order, low volume customers — i.e., those spending $10 or less per month on long distance calls — still save more under Verizon's Timeless calling plan than under AT&T's cheapest flat rate plan called "AT&T One Rate Basic." [16] TRAC estimates that the average New York residential customer who switched to Verizon long distance service from other interexchange carriers saved up to $10.04 per month. [17]

16. In fact, the difference in price between Verizon's initial interstate rates in New York and what AT&T's customers were actually paying last year in New York was substantial. Ninety-seven percent of AT&T's residential customers in New York would have paid less for their interstate direct-dialed calls

[15] This analysis uses calling data from *MarketShare Monitor*™, *op. cit*., and available calling plans from both Verizon and AT&T (as of September 10, 2000). The analysis is similar to the pre-CALLS analysis, except that it omits AT&T's $3.00 monthly minimum charge imposed on basic-rate customers and it omits carrier line charges. The analysis adds an AT&T calling plan charging $0.16 per minute, and it updates AT&T's basic rates.

[16] *See* Breen Decl. ¶ 15.

[17] Telecommunications Research and Action Center, "A Study of Telephone Competition in New York," September 6, 2000 (Attachment 501).

under Verizon's Timeless calling plan than they paid to AT&T in July 1999.[18] These customers would have saved an average of 46 percent off their AT&T interstate bill under Verizon's Timeless rates. As demonstrated by the experience in New York, allowing Verizon PA to compete in the Pennsylvania long distance market would provide Pennsylvania consumers with competitive alternatives to incumbent long distance carriers' higher prices.

17. Although AT&T, WorldCom and Sprint tout their supposedly low-priced calling plans by quoting plan rates of $0.05 or $0.07 per minute, these per-minute rates are misleading because many of these plans charge subscribers a monthly recurring fee that ranges from $4.95 to $8.95. This means that subscribers actually pay far more per minute than the advertised per-minute rate.[19]

18. Additionally, due to these monthly subscription fees or minimum usage charges, most of the Big Three's calling plans are unattractive to low-volume customers. For example, AT&T's "One Rate 5¢ Plan" carries with it a monthly fee of $7.95 (although AT&T will reduce this fee by a dollar for customers who sign up for AT&T local toll service), and its "One Rate 7¢ Plan" has a monthly fee of $4.95 (also reduced by a dollar for customers who sign up for AT&T local toll service). Although AT&T is quick to point out that its "5¢ Evenings Plan" has no monthly fee, it does have a $5.00 "monthly minimum

[18] This analysis is based on calling and billing data from *MarketShare Monitor*™, *op. cit*. My calculations of prices before the CALLS order include per-minute rates, carrier line charges ($1.47 for Verizon and $1.51 for AT&T), universal service charges, monthly minimum usage charges and calling plan subscription charges (allocated between interstate and intrastate minutes).

[19] Breen Decl. ¶¶ 16-18.

usage requirement," and customers who sign up for this plan must pay almost twice the advertised calling plan rate (9 cents per minute) from 7 a.m. to 7 p.m.[20] However, AT&T has stated that 47 percent of its residential customers spend ten dollars or less per month on long distance calls.[21] Thus, these monthly fees and/or monthly minimum usage requirements make these calling plans more expensive for many consumers.

19. If the interexchange market were truly competitive, then AT&T would have passed through the reductions in interstate access charges and other fees from which it has profited since 1991. Yet only one percent of AT&T's residential customers were recently paying prices that were as low as what AT&T's average rates would have been if only AT&T had passed through the reductions in access charges and other fees.[22] How might this result change because AT&T introduced the One Rate 7 Cents plan? Consider an extremely conservative scenario. Suppose that—unrealistically—every AT&T customer who could reduce her or his bill by subscribing to the One Rate 7 Cents optional calling plan did call AT&T to subscribe to the plan. I have calculated that no more than 12 percent of customers in this extreme scenario would pay a price as

[20] *Id*.

[21] *See* Affidavit of B. Douglas Bernheim, Janusz A. Ordover and Robert D. Willig, attached to Comments of AT&T, filed in *Bell Atlantic Communications, Inc., NYNEX Long Distance Company, and Bell Atlantic Global Networks, Inc., for Authorization to Provide In-Region, InterLATA Services in New York*, CC Docket No. 99-295 (1999).

[22] Taylor New York Declaration, ¶ 28 (Attachment 601).

low as what the average price today should be if AT&T had passed through access charge reductions, as we would expect in truly competitive markets.[23]

20. While comparisons between current Verizon and Big Three long distance prices are useful, a more important comparison is between long distance prices before and after Verizon NY's entry in New York. Verizon NY's entry in New York has reduced the prices paid by customers who continue to subscribe to Big Three long distance services. Industry analysts have characterized the Big Three's new calling plans as preemptive responses to the imminent entry of new competition by the Bell Operating Companies ("BOCs").[24] As AT&T CEO Michael Armstrong has confided, "as you get down to 7 cents a minute and 5 cents a minute, you certainly have less room for our RBOC . . . friends to come in and compete on price."[25] In the absence of long distance entry by Verizon and the other BOCs, it is unclear if even these limited rate reductions would have occurred or could be sustained.

21. Verizon's provision of long distance service in the northern New Jersey/New York and Camden/Philadelphia corridors provides a second example of the competitive benefits associated with permitting local exchange carriers to compete in the long distance market. Verizon has competed with the long distance

[23] Based on analysis of data from *MarketShare Monitor*, *op. cit*.

[24] Cable News Network Financial, *Market Coverage*, Lauren Thierry, "Telecom Sector Analysis," interview of Michael Mahoney, head of telecom investing at Dresdner RCM, August 9, 1999 (Attachment 603).

[25] *BOCs' Long Distance Desires Aren't Dampened by Price War*, Telecommunications Reports, Sept. 6, 1999, at 5 (Attachment 604).

carriers for interLATA traffic in these corridors since AT&T's divestiture in 1984.[26] Actual experience there shows that Verizon's presence will prompt additional price competition in the long distance market. In the northern New Jersey/New York corridor, Verizon NY's corridor rates have been about 26 percent lower than the average price that AT&T's New York residential customers paid for the same calls.[27] The additional price competition from Verizon was sufficiently vigorous that AT&T filed with the FCC for permission to reduce its rates just in the northern New Jersey-New York corridor where Verizon was allowed to compete — but not in other places where it could not — and WorldCom (formerly MCI) joined in the request so that it, too, could meet the competition.[28]

22. Another compelling example of the positive impact of an incumbent local exchange carrier's entry into the long distance market is the experience of Southern New England Telephone ("SNET"). SNET, the incumbent local exchange carrier for nearly all of Connecticut, now also offers long distance service. Thus, it provides a good example of the likely effects on consumers from allowing BOCs to compete with long distance carriers. Following SNET's entry

[26] The Modification of Final Judgment established the corridor exceptions to the interLATA service prohibition, "to continue [local carriers'] long-standing interstate service arrangement in two areas: (1) between New York City and Northern New Jersey; and (2) between Philadelphia and Camden, New Jersey." *United States. v. Western Electric Co*., 569 F. Supp. 990, 1002 (D.D.C. 1983).

[27] This comparison is based on my analysis of calling and billing data from *Market Share Monitor, op. cit*., and Verizon New York Tariff FCC No. 12, p. 107.

[28] AT&T, Petition for Waiver and Request for Expedited Consideration, *AT&T Petition for Waiver of Section 64.1701 of the Commission's Rules*, FCC, CC Docket No. 96-26, filed October 23, 1996, p. 3 fn. 3; MCI Comments, filed November 18, 1996, p. 1.

into the long distance market, and before Verizon NY's entry into the long distance market in New York, AT&T's Connecticut customers paid on average 24 percent less than its New York customers for the identical interstate direct dial service.[29] In addition, SNET's customers in Connecticut paid on average 36 percent less than AT&T's customers in New York did. Further information regarding the experience in Connecticut is provided in Attachment 605.

23. A final example is what happened after SBC's entry into the long distance market in Texas. Southwestern Bell Long Distance offers a calling plan that charges $0.09 per minute and has no monthly service charge or usage minimum. As a result of SBC's entry, AT&T has reduced its intrastate rate in Texas for calling-plan customers to $0.07 per minute. In contrast, in states in SBC's region in which it has not been authorized to provide long distance, AT&T's intrastate calling-plan rates are significantly higher than they are in Texas: in Arkansas this rate is $0.12 per minute, in Missouri[30] it is 0.15 per minute, and in Oklahoma [31]it is $0.10 per minute. This is true notwithstanding that

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[29] AT&T's New York residential customers paid an average of $0.193 per conversation minute for interstate direct-dial calls, while AT&T's Connecticut customers paid an average of only $0.146 per minute for such calls. *See* Attachment 605.

[30]http://www.shop.att.com/offer/isrf.jhtml;$sessionid$NORPYIAAAC1N05YAAAASEMA?planCode=or (Attachment 606). AT&T's intrastate rates quoted above are for calling-plan customers only. Its intrastate rates for basic-rate customers are substantially higher than those rates in both states.

[31]http://www.shop.att.com/offer/isrf.jhtml;$sessionid$NORPYIAAAC1N05YAAAASEMA?planCode=or5 (Attachment 607). AT&T's intrastate rates quoted above are for calling-plan customers only. Its intrastate rates for basic-rate customers are substantially higher than those rates in both states.

intrastate access charges in the latter states are equal to or less than intrastate access charges in Texas.[32]

2. Verizon PA's entry will spur competition for bundled services.

24. There is substantial evidence that consumers want, and would benefit from, bundled telecommunications services, i.e., packages of local, long distance and other services bundled in one offering from a single supplier. Perhaps the strongest evidence of this demand is the hundreds of billions of dollars in investments by the Big Three that are clearly aimed at offering bundled services to the most lucrative customers in the top markets. By way of example, one article on the growing prevalence of bundling reported that:

> Any carrier will tell you: "We bundle multiple telecommunications services to provide one-stop shopping for our customers."
>
> It's an action-oriented reaction to the countless surveys that say customers are crying out for bundled services — one bill for local and long-distance phone service, wireless service, Internet access and sometimes even cable television.[33]

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[32] Sharon L. Mullin, direct testimony on behalf of AT&T, before the Arkansas Public Service Commission, *Application of Southwestern Bell Telephone Company for Authorization to Provide In-Region InterLATA Service Pursuant to Section 271 of the Telecommunications Act of 1996 and for Approval of the Arkansas 271 Interconnection Agreement*, Docket No. 00-211-U, October 16, 2000, pp. 11-12; R. Matthew Kohly, direct testimony on behalf of AT&T, before the Missouri Public Service Commission, *Application of Southwestern Bell Telephone Company for Authorization to Provide Novice of Intent to File an Application for Authorization to Provide In-Region InterLATA Services Originating in Missouri Pursuant to Section 271 of the Telecommunications Act of 1996*, Docket No. TO-99-227 (August 28, 2000), pp. 11-12 (Attachment 608); Wuaneta B. Browne, direct testimony on behalf of AT&T, *Application of the Attorney General of the State of Oklahoma, AT&T Communications of the Southwest, Inc., Brooks Fiber Communications of Tulsa, Inc., Cox Oklahoma Telecom, Inc., MCI Telecommunications Corporation, and Sprint Communications, L.P. to Explore Southwestern Bell Telephone Company's Compliance with Section 271(c) of the Telecommunications Act of 1996*, Docket No. PUD 970000560 (August 27, 2000), p. 12 (Attachment 609).

[33] *See* S. Schmelling, "Bundling Takes on New Meaning," *Telephony*, July 13, 1998, p. 20 (Attachement 610).

25. The same article observed that the incumbent long distance carriers have recognized this trend and gotten a jump start on offering bundled packages of services:

> Sprint overcame a big hurdle for long distance carriers with its June announcement of its new Integrated On-Demand Network [ION]. Meanwhile, MCI has offered integrated MCI One packages for both residential and small business markets for more than two years. For small businesses, this means local toll, toll-free, MCI Internet, calling card, 800 number and international calling on one bill.
>
> Business customers are looking for simplicity, flexibility and a single point of contact, so AT&T offers several voice, data, wireless and Internet access services that can be packaged together. The carrier offers integrated billing for domestic private line and voice services, including local voice in some areas. It also offers one customer service number, which routes callers to experts.[34]

26. The long distance carriers' efforts go well beyond simple marketing programs. They include substantial investments in local facilities to provide bundled services to both business customers and — more recently — to high-volume residential customers. The evidence includes AT&T's $137 billion dollar investments to acquire McCaw's wireless network (for $11.5 billion), TCG's local business network (for $11 billion), TCI (for $52 billion) and MediaOne (for $62 billion) for the express purpose of offering bundled services to its most lucrative high-volume customers who are able to buy the full bundle of local, long distance, wireless, Internet, and cable TV offerings.[35] Similar motives have driven the

[34] *Id.*

[35] AT&T Press Release, "AT&T, TCI to Merge, Create New AT&T Consumer Services Unit," June 24, 1998, http://www.att.com/press/0698/980624 (Attachment 611); AT&T Press Release, "AT&T Completes TCG merger; TCG Now Core of AT&T Local Services Network Unit," July 23, 1998, http://www.att.com/press/0798/980723 (Attachment 612); "Big Mergers Revive Notion Of Bundled

MCI/WorldCom MFS/UUNet mergers and Sprint's PCS and broadband services investments.

27. Allowing Verizon PA into the Pennsylvania long distance market would add an important new competitor to the bundled services market. Verizon PA already offers a full array of local services. Allowing it to package those services with long distance would help meet consumer demand for such packages. Accordingly, Verizon PA's entry into the Pennsylvania long distance market will not only increase competition for long distance services alone, but it will also increase competition for bundled package offerings that include long distance service. As a result of such competition, it would be reasonable to expect lower prices, new and varied offerings for bundled packages of services, and greater choice — all to the benefit of consumers. The experience of consumers in New Year bears this out: in addition to saving money, these consumers are offered bundled services by the interexchange carriers that are not available to consumers in other states.

3. Verizon PA's entry into the long distance market would prompt still more local competition in Pennsylvania.

28. Verizon PA's entry into the long distance market will also increase competition for local services in Pennsylvania. This increase will occur because

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Telecom Services," excerpt from September 14, 1998, edition of Video Competition Report, http://127.0.01:15841/v1?catid=9661315&md5=-a973b42e877b80044cc4f8902503eeaa. AT&T's Chairman and Chief Executive C. Michael Armstrong has expressly stated that AT&T's recent announcement that it intends to split itself into four separate entities – Project Grand Slam – is not a "reversal or a repudiation of strategy." *AT&T's Earnings Best Expectations but Company Issues Dividend Warning*, Wall Street Journal, October 26, 2000.

long distance carriers will need to offer local service to retain their high-margin long distance customers and to attract the most valuable new customers. In addition, once Verizon PA can compete on equal terms by offering long distance, the incumbent long distance carriers will have a greater incentive to compete vigorously for a broader sector of mass-market local exchange customers. Incumbent long distance carriers will no longer be able to ignore these markets if they hope to retain their current customers in the face of Verizon PA's new bundles of local exchange and long distance services.

29. Actual market experience in New York shows that local competition, particularly competition for residential customers, has increased since Verizon NY has been in the long distance market. As of July 31, 2000, competitors served approximately 2.5 million lines in New York. In the first six months since Verizon NY's entry in New York, the number of access lines served by competitive local exchange carriers has increased 72 percent, including a 163 percent increase in UNE-platform lines. There has also been a 142 percent increase in stand-alone loops, a 70 percent increase in collocation sites, and a 33 percent increase in interconnection trunks. New York was also the first state where AT&T, Sprint and WorldCom began providing local service on a mass-market basis, with their entry coinciding with the final stages of Verizon NY's successful efforts to obtain long distance authority. For example, WorldCom began offering mass-market local service in February 1999, and now has more

than 400,000 customers, most of whom are residential.[36] Similarly, AT&T began offering mass-market local service in New York in December 1999, the same month the FCC approved Verizon NY 's New York 271 application, and now has more than 500,000 largely residential local customers.[37] And all of this expansion is in addition to the hundreds of thousands of primarily business customers that each of these carriers serves predominantly over its own facilities, and the numbers of these customers likewise have grown consistently since Verizon's entry. Likewise, SBC's entry into the long distance business in Texas has prompted the major long distance carriers to enter the local mass market in that state as well.

30. Given the increase in local competition in New York since Verizon NY entered the long distance market, it is likely that once Verizon PA enters the Pennsylvania long distance market, local competition in Pennsylvania will increase as well. Incumbent long distance carriers will have the same incentive to enter the Pennsylvania local market as they did the New York local market, once Verizon PA can compete for their long distance customers. As discussed below, Pennsylvania customers are already starting to see the payoff of increased local competition. Competitive local exchange carriers now serve at least 673,000 lines in Pennsylvania. In Pittsburgh, AT&T is now providing local phone service to thousands of users over this cable network. The viability of this strategy to

[36] *See* R. Krause, "Verizon's New York Fight Key to AT&T Challenge," *Investor's Business Daily*, August 15, 2000 (Attachment 613).

compete with Verizon is proven by the major investments made by AT&T to acquire cable TV systems:

> Indeed, MediaOne, coupled with the Comcast deal will reduce AT&T's earnings next year by 26 cents a share. Mr. Armstrong says the considerable cost is worth the risk. "**The whole strategy is to deliver a new digital world and to compete against the regional Bell operating companies**," he says.[38]

31. As in New York, therefore, the major long distance incumbents have positioned themselves for a further push into the local market once Verizon PA obtains long distance relief and can provide a bundle of services comparable to what the long distance incumbents can offer. Notwithstanding the competitive presence that exists in the Pennsylvania local market today, if Verizon PA is authorized to provide its own bundle of local and long distance services in Pennsylvania, the amount of local competition will undoubtedly increase.

32. AT&T and WorldCom recently announced plans for restructurings.[39] These restructurings do not signal that those companies have abandoned their local services entry strategies. For instance, AT&T's chairman and CEO C. Michael Armstrong said, "Each of these new companies will move faster in meeting customer needs, but they'll serve them under one of the world's most recognized

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[37] *Id.*

[38] R. Blumestein, L Cauley, "Ma Bell's Plan Is To Serve Up TV Phone via Cable," *Wall Street Journal*, May 6, 1999, p. B 11; *emphasis added.*

[39] AT&T Press Release, "AT&T To Create Family of Four New Companies; Company To Offer To Exchange AT&T Common Stock for AT&T Wireless Stock," http://www.att.com/press/item/0,1354,3420,00.html, October 25, 2000 (Attachment 614). *See also* WorldCom Press Release, "WorldCom to Realign Businesses, Create Two Tracking Stocks," http://www.worldcom.com/about_the_company/press_releases/display.phtml?cr/20001101, November 1, 2000 (Attachment 615).

and respected brands and they'll still be able to offer bundled services through inter-company agreements."[40] Further, according to AT&T's press release, "Armstrong stressed that the new companies will continue to collaborate. AT&T Business, for example, will continue to bundle the Wireless company's services into its offers for business customers. AT&T Business will continue to use AT&T Broadband's cable systems in serving some customers."[41] AT&T's Broadband unit also plans to continue its deployment of two-way digital communication and cable telephony.[42] AT&T will license its brand name to all the restructured business units. AT&T's restructuring clearly leaves its capabilities of providing both local and long-distance services to business customers unaffected. In addition, since AT&T's plan provides for common use of its brand name by all units, and since it emphasizes collaboration and bundled services, the restructuring should not decrease the intensity of AT&T's local services expansion and bundling for the consumer segment, either.

33. WorldCom plans to create two tracking stocks — one principally for the large business market segment and one principally for the consumer and small business market segment. Since each of the resulting companies can offer local

[40] Attachment 614.

[41] *Id*.

[42] "The pace at which we have been installing those services [two-way digital communication and cable telephony] has increased sharply throughout the year and will continue in the coming months." Dick Martin, AT&T VP, "AT&T Is Paving the Broadband Highway," *Business Week Online Edition*, http://www.businessweek.com/2001/01_02/c3714163.htm#b3714164 (accessed January 2, 2001).

and bundled services for its respective market segment, this restructuring should not reduce the aggressiveness of their local services entry programs.

IV. VERIZON PA'S LONG DISTANCE ENTRY WILL NOT HARM COMPETITION IN ANY MARKET.

34. In addition to the large, immediate, and real benefits that will flow from Verizon PA's entry into the Pennsylvania long distance market, there is no significant countervailing risk of harm to competition in any market. Actual market experience shows that the Pennsylvania local market has already been opened to competition. Because this entry has occurred in large measure through heavy investment in competing facilities, it also is irreversible. In addition, speculative assertions by long distance incumbents about supposed risks of harm to long distance competition are misplaced. Actual experience has proven these assertions wrong in every prior instance where BOCs have been allowed to compete in adjacent markets. And, in any event, the opening of the local market and the comprehensive safeguards that already are in place provide abundant assurance that no anticompetitive behavior is possible.

A. Actual Market Experience Confirms That the Pennsylvania Local Market Is Open.

35. As demonstrated in Mr. Whelan's declaration, actual market activity in Pennsylvania confirms that the local market is open. Competing carriers have entered the market on a large scale and are continuing to do so. As of October, CLECs have captured more than 10 percent of Verizon PA's retail lines.[43] Local

[43] *See* Whelan Decl., ¶ 9.

competitors are using all three modes of entry — facilities-based, UNEs (including the UNE-Platform), and resale — serving both business and residential customers and serving various regions throughout the Commonwealth. More specifically, by October 2000 more than 453,000 of the CLEC lines were over their own facilities (as measured using E911 listings),[44] approximately 54,000 were through unbundled network element platforms ("UNE-Platforms"), and more than 165,000 were through resale.[45] CLECs are also serving all three modes of competitive entry in all geographic areas of the Commonwealth.[46] These competitors have ported approximately 488,000 telephone numbers in Pennsylvania as of October, 2000.[47] Also as of October, 2000, CLECs have obtained approximately 310,000 interconnection trunks and more than 183,000 stand-alone unbundled loops.[48] As of November, 2000, through more than 1,500 collocation nodes completed or in progress, competitors have or will have access to approximately 88 percent of the lines served by Verizon PA in Pennsylvania.[49]

36. The pace at which competitive entry has occurred in Pennsylvania is a particularly strong indicator that the market is fully open. As set out in Mr. Whelan's declaration, between 1997 and 1999, the number of resold lines

[44] Since there can be multiple lines for each E911 listing, the number of CLEC E911 listings generally understates the number of CLEC lines. This figure excludes line sharing.

[45] *See* Whelan Decl., ¶ 9.

[46] *See* Local Competition Report at 1 (Attachment 101).

[47] *See Id*. at 4.

[47] *See Id*. at 1.

[48] *See Id*. at 4.

increased by over 300 percent, the number of interconnection trunks purchased by CLECs increased by approximately 475 percent, and the number of UNE loops purchased by CLECs increased by more than 550 percent.[50] The increases between September and October 2000 (the most recent month for which Verizon PA has data) followed this trend: hundreds of resold lines; thousands of additional interconnection trunks; thousands of additional loops; and almost a doubling of CLEC use the UNE-Platform.[51] Competition in the local market appears to be developing at a faster rate than competition developed in the long distance market.[52]

37. Because competitive entry in Pennsylvania is so heavily facilities-based, it is irreversible. This degree of entry is not necessary to establish that the market is irreversibly open to competition, although it clearly is sufficient. Because this facilities-based entry represents hundreds of millions of dollars invested in sunk facilities, it cannot simply go away. Even if individual competitors fail — which is highly unlikely given the size of major competitors such as AT&T and WorldCom — the investment remains in the ground and would inevitably be purchased and used by another competitor. And the fact that

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[49] *See Id*. at 3.

[50] Whelan Decl. ¶ 10.

[51] *Id*.

[52] *See* C. Yang, "Yes Virginia, There Is Phone Competition," Business Week, September 28, 1998, p. 6, which reported that, according to the FCC, "Competition in the local calling market is moving faster than the 1980's battle over long distance. Two years after the Act, rivals have captured 3.5% of local phone revenues from the Baby Bells, says Merrill. In contrast, two years after the 1979 court decision letting MCI sell long distance services, carriers had won only 1.4% of that market from AT&T, the FCC notes." (Attachment 616).

competitors are willing to invest such significant sums in competing local facilities reflects the fact that they themselves believe the local market is open and will remain that way, and that any additional issues are manageable.

B. There Is No Significant Risk That Verizon PA's Entry into Long Distance Will Harm Competition.

38. Despite the incumbent long distance carriers' repeated but unfounded claims, actual market experience in New York demonstrates that there is no legitimate argument that Verizon PA's entry into the long distance market will harm competition. To the contrary, consumers have benefited from Verizon NY's entry into the New York long distance market. The TRAC study concluded that New York consumers saved approximately $220 million as a result of the increased telephone competition that was brought about by Verizon NY's entry, with approximately one-half of these savings coming in the local markets.[53] In addition to what should be conclusive evidence from New York, in every other instance where BOCs have been allowed to compete in adjacent markets — including wireless, voice-messaging services and customer premises equipment — prices have fallen and competition has flourished. There are also sufficient safeguards already in place to provide redundant assurances that Verizon PA will be unable to use anticompetitive strategies in local exchange or long distance

[53] *See* Attachment 501.

1. Actual market experience demonstrates that speculative concerns over incumbent local exchange carriers engaging in anticompetitive conduct once allowed into the long distance market are unfounded.

39. A review of the New York long distance marketplace since Verizon NY began offering long distance service there demonstrates that the marketplace has not suffered from any anticompetitive conduct, but instead has thrived since Verizon NY gained entry. As previously discussed, consumers now have cheaper rates as well as more innovative service plans, including more bundled service packages, from all long distance carriers. Verizon has introduced the concept of automatically enrolling customers in discount calling plans with no monthly recurring fees or usage minimums rather than subjecting them to the more expensive basic rates that the major carriers inflict on unsuspecting consumers who do not choose a calling plan. To compete, the major long distance carriers have been induced to offer innovative bundled service plans in New York. Also, as discussed elsewhere in this declaration, local competition has grown dramatically since Verizon's long distance entry in New York. Regulators have also rigorously enforced standards of performance and competitive parity that Verizon must satisfy in serving its rivals.

40. The result in New York is consistent with previous instances where Bell operating companies have entered an adjacent market and have not harmed competition. Experience in the cellular, voice messaging and customer premises equipment markets all provide relevant examples of where BOCs' entry into an

adjacent market has not harmed competition. Local exchange carriers have provided cellular service in their local telephone service areas since 1983. These "wireline" providers have not come to dominate the market, as would be expected if they had subsidized these services from their local telephone services or discriminated against their competitors through their control of the local telephone network. Despite a late start, non-wireline competitors (i.e., companies that obtained cellular franchises without serving the area as an incumbent wireline local company) have market shares that are, on average, equivalent to those of the wireline affiliated cellular carriers.[54] In many cases, the non-wireline suppliers have the larger market share,[55] and output has grown rapidly as prices have fallen.[56] A long-time regulator has observed, "[i]n all my years as a state regulator, there was not one instance of the non-BOC cellular license holder arguing that the BOC discriminated in favor of its cellular affiliate."[57] AT&T sunk $11.5 billion into this market through its purchase of McCaw Cellular.

[54] Estimated from Paul Kagan Associates, Inc., *Wireless Market Stats*, No. 72, August 31, 1995, pp. 6, 13.

[55] P.S. Brandon and R.L. Schmalensee, "The Benefits of Releasing the Bell Companies from the Interexchange Restrictions," *Managerial and Decision Economics*, Vol. 16, No. 4, July-August 1995, pp. 349-364.

[56] Six years ago, the lowest average rate (including monthly fees) for 500 mobile phone minutes of use in the New York metropolitan area was over $0.45 per minute—assuming at the time 212 minutes of peak usage and 288 minutes of off-peak usage. (See Paul Kagan and Associates Inc., *Cellular Rates*, January 1994.) Today, three wireless providers—AT&T, Sprint, and Omnipoint—have 500-minute plans with an average usage rate of $0.10 per minute. (See, for instance, Point.com website, "Find a Service Plan - New York, NY," http://www.point.com/planlist/city/7/zipcode/10128.) The growth in the number of mobile phone subscribers has been equally impressive. In less than six years, the number of U.S. wireless subscribers more than quadrupled, from 24,134,000 at year-end 1994 to about 102,000,000 today. (CTIA website, The World of Wireless Communications, http://wow-com.com, Sept. 11, 2000.)

[57] Kenneth W. Gordon, Declaration on Behalf of Southwestern Bell Telephone Company, *Southwestern Bell Telephone Company – Texas' Compliance with Section 271 of the Federal Telecommunications Act of 1996*, before the Public Utility Commission of Texas (April 17, 1998), ¶ 16.

Further, AT&T, Sprint, a consortium of cable companies, and others spent additional billions for wireless spectrum in auctions to enable them to compete with the incumbent cellular carriers. These investments are powerful evidence that these companies do not view the supposed risk of anticompetitive exploitation of an exchange access "bottleneck" as real.

41. Local exchange carriers also have long been allowed to provide information services, and there is no evidence that competition in this market has been undermined. After the BOCs began offering voice messaging services ("VMS"), consumer welfare improved in at least two ways. First, the monthly retail charge dropped from $30 in 1990 to $5 – $15 in 1995. Second, the local exchange carriers began offering VMS to an untapped market segment — residential and small business customers. In the five years after they received permission to enter the information services market, the BOCs' participation in this market increased from zero to over six million subscriptions; yet, competitors thrived, and the Bell operating companies and the former GTE together accounted for just over 15 percent of total VMS revenues nationally.[58]

42. Finally, since 1984, the BOCs have been permitted to distribute customer premises equipment ("CPE"). The average market share of each of the Bell companies was less than one percent, and CPE output rose while prices fell.[59]

[58] J.A. Hausman and T.J. Tardiff, "Benefits and Costs of Vertical Integration of Basic and Enhanced Telecommunications Services," April 6, 1995. The authors present data on price trends and market penetration on pp. 5 and 9 and data on market shares on pp. 9 and 10.

[59] NATA, *1995 Telecommunications Review and Forecast*, Vol. 128, 1995.

Consequently, the U.S. Court of Appeals observed that the CPE market "has supported competition" even though the BOCs theoretically "posses[s] an incentive to discriminate in interconnection."[60]

43. In sum, regulators need not rely on either a priori reasoning or discussions of regulatory rules to conclude that permitting Verizon PA to enter the long distance market presents no danger of ILEC anticompetitive discrimination. Actual market experience from Verizon NY's entry into the New York market as well as years of historical experience of the ILECs' competing in other markets provide overwhelming evidence that competition flourishes when BOCs enter a market adjacent to their local service.

2. Existing safeguards are sufficient to prevent any harm to competition.

44. The opening of the local market largely eliminates any theoretical possibility that Verizon PA could impede competition through discrimination or cross-subsidy. In addition, the existing array of regulatory safeguards and its proven success at protecting against any risk of harm to competition in other adjacent markets effectively eliminate any meaningful risk of harm to long distance competition. The FCC has explicitly endorsed this view of the sufficiency of existing safeguards and affirmed that "sufficient mechanisms

[60] *United States v. Western Electric Co*., 900 F.2d 283, 303 (D.C. Cir. 1990), *cert. denied*, 498 U.S. 911 (1990).

already exist within the 1996 Act both to deter anticompetitive behavior and to facilitate the detection of potential violations of section 272 requirements."[61]

45. The opening of the local market by meeting the Section 271 competitive checklist prevents Verizon PA from using its position as an incumbent local exchange carrier to impede long distance competition. If Verizon PA were to attempt to discriminate against competing long distance carriers in the provision of existing access services, for example, it would merely prompt these competitors to switch to competing access providers or to accelerate their own entry into the market to bypass Verizon PA's local access services. Satisfying the requirements of the checklist also dramatically lowers the capital costs of local market entry and expansion by allowing competitors to enter the market using Verizon PA's own facilities. For example, competitors can establish an initial customer base using resale or unbundled network element platforms, then selectively build out their own network facilities supplemented with collocation and unbundled network elements. Using this approach, they can mass-market their services ubiquitously while avoiding large up-front outlays of investor-supplied capital, which greatly reduces the financial risk associated with market entry and expansion.

46. Such local market competition also eliminates the unlikely possibility that Verizon PA could cross-subsidize its long distance entry for the

[61] *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934*, as amended, FCC, First Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-149, released December 24, 1996, ¶¶ 13, 321 ("*Non-Accounting Safeguards*"); *Implementation of the Telecommunications Act of 1996: Accounting Safeguards of the Telecommunications Act of 1996*, FCC, Report and Order, CC Docket No. 96-150, released December 24, 1996, ¶ 275.

simple reason that there no longer would be any service from which to extract a subsidy. Any attempt to charge prices sufficiently high in local markets to subsidize long distance would merely cause competitors to target those high-priced local exchange services.

47. In addition, the conditions in the Pennsylvania market make anticompetitive pricing practices unprofitable for Verizon PA and therefore unlikely to occur. Even if Verizon PA could exercise market power in an unregulated carrier access market — and, of course, carrier access services remain regulated — that ability would not translate into market power — or market advantage — downstream, in long distance markets. In addition, the ability of CLECs to buy UNEs at rates set based on forward looking economic costs allows competitors to defeat efforts by Verizon to set anticompetitive access charges and terms by using Verizon's UNEs and/or their own networks. Use of UNE Platforms or unbundled loops with collocation and their own switches and transport allows carriers ubiquitously to avoid Verizon's carrier access services.

48. Theoretical anticompetitive pricing practices include predatory pricing and vertical price squeezes. Predatory pricing is generally considered to entail pricing a service below the variable cost of supplying the service with the intention of driving a rival from the market. A vertical price squeeze can occur where a vertically integrated firm controls an essential input required to supply a retail service for which it competes with others. A price squeeze occurs when the margin between the integrated firm's retail price and the price of the essential

input is too small — less than the difference in the incremental costs of supplying the retail service and the input — so that an equally efficient firm cannot purchase the input and still compete in the retail market. It is analytically the same as predatory pricing because the firm sacrifices profits whenever it supplies the retail service rather than the essential input.

49. For predatory pricing or a vertical price squeeze to be a successful competitive strategy, three conditions must hold: (i) the predator must be a dominant firm or likely to become one; (ii) the predator must suffer a loss (or lose profits) in order to eliminate its competitor; and (iii) the market structure must allow the predator to recoup at a later date the profits it has lost through predation. These conditions are not met in Pennsylvania.

50. First, the strategy requires that the predator have deeper pockets than the victims, and the "victims" in this case would be AT&T, WorldCom, and Sprint, each of which is a major national carrier that sells telecommunications services outside of Pennsylvania and would be unaffected by Verizon PA's pricing in Pennsylvania.

51. Second, the strategy would require that Verizon PA be able to control interLATA prices and maintain barriers to entry. Neither ability is present here. Verizon PA will enter the interLATA market with a negligible presence — i.e., only the limited dial-around interLATA service it provides in the Philadelphia-Camden corridor — to compete against some of the largest telecommunications firms in the world, whose names are household words and

who currently serve a substantial majority of the market. As discussed below, such a strategy makes no sense for Verizon PA in Pennsylvania.

52. Even if Verizon could drive the Big Three out of the Pennsylvania interLATA market, their capacity would remain in the market, so that other competitors could prevent Verizon PA from ever raising prices to recoup its lost profits. In addition, the networks of the Big Three would remain in and around Pennsylvania, providing services other than Pennsylvania interLATA toll, and all of that capacity would be poised to enter the market once Verizon PA attempted to raise prices. Thus, it is not plausible that Verizon PA could gain in the long run from setting predatorily low prices.

53. Third, federal and Commonwealth regulations prevent anticompetitive pricing through toll price floors and by imputing access charges in toll rates. The FCC held that it can control price squeezes and predatory behavior. It held that predatory behavior:

> could be adequately addressed through our complaint process and enforcement of the antitrust laws, coupled with the biennial audits required by section 272(d), . . . A BOC interLATA affiliate that charges a rate for its interLATA services below its incremental cost to provide service would be in violation of sections 201 and 202 of the Communications Act, if such a rate were sustained for an extended period. [62]

In particular, Section 272(e)(3) of the Act requires BOCs to purchase carrier access out of the same tariffs as their competitors and to impute those carrier

[62] Federal Communications Commission, Report and Order, *Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area*, CC Docket No. 96-149, and *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No. 96-61, FCC 97-142 (released April 18, 1997), ¶ 128.

access charges into their long distance prices, so that all competitors effectively pay the same price for the same carrier access services. This Commission has adopted an imputation rule for services that are deemed competitive and which are offered by a local exchange telecommunications company.[63] Even absent imputation, Verizon PA must recognize the access charges that competitors pay as an opportunity cost of supplying long distance itself: if Verizon PA serves the long distance customer, it gives up carrier access charges that AT&T would have paid to Verizon PA if AT&T won the customer.

54. The Courts also have generally been wary of predatory pricing claims of the type that underlie the long distance carriers' arguments.[64] The reasons for that wariness lies in the fact that to be successful at predatory pricing, a vertically integrated firm that supplies both an essential input and a downstream retail service would have to price the retail service below the sum of the incremental cost of the service and the foregone contribution (price less incremental cost) from the essential input (here, carrier access). Such a pricing strategy could have the anticompetitive effect of excluding a more efficient rival from the downstream market. However, at these retail and wholesale prices, the integrated firm generally would find it more profitable to supply the essential input than the retail service. The only circumstances in which such retail prices would ultimately be profitable are where the company engaging in the price squeeze —

[63] *See* 66 Pa. C.S.A. § 3005.

[64] *See, e.g. Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 226 (1993) (citations

the predator — could be assured that it could recoup its foregone revenues. But the circumstances necessary for such strategy to succeed do not hold in current telecommunications markets in Pennsylvania. (Attachment 620 addresses the economics of these issues in more detail.)

55. Recouping lost profits would be especially difficult in the markets at issue. AT&T, WorldCom, and Sprint are large and powerful competitors with national and international networks and a host of local networks in place that can be used to provide a wide variety of telecommunications services. Whenever Verizon PA tired of earning less money in the inter-LATA toll market — the locus of its supposed predation — than it could earn merely by providing access to other carriers, it might try to raise its toll price, but it would find its competitors still in place and ready to prevent it from recouping its lost profits.

56. Nor could Verizon PA make up its lost profits by raising prices of its local services. As noted above, even if the prices of those services were not subject to regulatory constraints, any attempt to raise those prices would merely prompt a competitive attack.

57. Three additional regulatory safeguards protect competition from possible Verizon PA discrimination in favor of its long distance affiliate or cross-subsidization of long distance services from regulated local revenues. First, cross-subsidizing long distance service cannot be a profitable strategy for Verizon PA because price cap regulation fundamentally breaks the link between accounting

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omitted) ("predatory pricing schemes are rarely tried and even more rarely successful.").

costs and prices.[65] Under traditional rate of return regulation, if the regulator were unable to detect the cost-shifting from a competitive affiliate to the regulated enterprise, then Verizon PA theoretically could raise regulated rates to cover the shifted costs, so that regulated services would be subsidizing the competitive operation. Under price cap regulation, however, Verizon PA cannot raise its regulated rates if it shifts costs from the competitive affiliate to the regulated enterprise. Thus, even if Verizon PA were determined to engage in predatory pricing or an anticompetitive price squeeze, it could not recoup its losses from regulated local services.[66]

58. Second, pervasive cost allocation rules separating costs between regulated and unregulated activities protect consumers from attempts to cross-subsidize. In economic theory, a service provided by a multi-service regulated company receives a subsidy if the additional revenue caused by provision of the service fails to cover the additional costs caused by supplying the service. Because these rules first assign costs — to the extent possible — on the basis of cost-causation, the resulting cost assignments ensure that at least incremental costs are assigned to each service and thus that unregulated services are, at a minimum, not subsidized. Regulators, however, have gone much further than that minimum and have enthusiastically assigned shared fixed and common costs to unregulated

[65] The FCC employs price cap regulation of the LECs' interstate services, which eliminates their ability to cross-subsidize services from carrier access revenues. The Commission has also approved a price cap plan for Verizon PA that achieves the same result at the state level through capped rates, which must be changed at specific times during the effective period of the plan.

[66] *See generally*, 66 Pa. C.S.A. § 3005.

services. Although economists deplore the inefficiency of such assignments of shared fixed and common costs, such rules provide redundant protection to keep prices for competitive services from being cross-subsidized.[67] Indeed, cost allocation rules — combined with decades of subsidizing residential basic exchange — imply that if there is a prevailing subsidy flow among telecommunications services, at current prices, it is going the other way.

59. Third, the Act requires BOCs to provide in-region interLATA services through a separate affiliate for three years after the date it is authorized to provide interLATA services, unless the requirement is extended by the FCC. A separate subsidiary requirement exposes inter-subsidiary transactions to even greater scrutiny than the FCC accounting rules would. In addition, the FCC's interpretation of the separate subsidiary requirement prevents BOC long distance affiliates from using existing BOC intraLATA networks as part of an integrated intra- and interLATA system, and the Commission has found that this provides additional protection to prevent misallocation of long distance facilities costs to the basic ratepayers.[68]

60. The Act also contains a set of audit and non-discrimination requirements, some of which must be maintained even after the separate affiliate

[67] *See, e.g.*, R.W. Crandall and L. Waverman, *Talk Is Cheap,* Washington: Brookings, 1995; A.E. Kahn, "The Uneasy Marriage of Regulation and Competition," *Telematics*, September 1984, pp. 1-2, 8-17; A.E. Kahn, "The Road to More Intelligent Telephone Pricing," *Yale Journal on Regulation*, Vol. 1, No. 2, Spring 1984, pp. 139-157 (Attachment 617); and D.L. Kaserman and J.W. Mayo, "Cross-Subsidies in Telecommunications: Roadblocks on the Road to More Intelligent Telephone Pricing," *Yale Journal on Regulation,* Vol. 11, No. 1, Winter 1994, pp. 119-147 (Attachment 618).

[68] *See Non-Accounting Safeguards*, 11 FCC Rcd. 21905 ¶¶ 16, 162 (1996).

requirement sunsets. The Act "sunsets" the separate affiliate requirement for BOC manufacturing and long distance after three years, unless the Commission extends the affiliate requirement by rule or order.[69] In terms of the auditing provisions, Verizon PA will be required to submit to detailed audits to ensure that they are complying with the Act's affiliate transaction rules and with the FCC's accounting safeguards. Thus, in addition to the continuing oversight of federal and Pennsylvania regulators and competitors, the Act adds an independent auditor to the list of those who will be monitoring Verizon PA's activity to ensure that there will be fair competition in the interLATA market. The FCC has found that the information available to regulators will be sufficient to prevent discrimination:

> We believe that the reporting requirements required by the 1996 Act, those required under state law, and those that may be incorporated into interconnection agreements negotiated in good faith between BOCs and competing carriers will collectively minimize the potential for anticompetitive conduct by the BOC in its interexchange operations. In addition to deterring potential anticompetitive behavior, these information disclosures will also facilitate detection of potential violations of the section 272 requirements.[70]

61. There is also no risk of successful discrimination in service quality. Successful discrimination in the quality of interconnection provided to competitors would require degrading a competitor's access service to reduce service quality sufficiently for customers to notice. Such behavior would be unlikely to escape the notice of the other long distance carriers or the Commonwealth and federal regulators. On the contrary, competitors would notice this degradation at least as

[69] *See* 47 U.S.C. § 272(f)(1).

soon as customers would, and they would certainly bring it to the attention of regulators. Firms such as AT&T, WorldCom, and Sprint have been interconnected with numerous LECs for years; they can easily compare interconnection service quality across the country and, thereby, detect discrimination. In addition to competitors, sophisticated multi-region customers also limit BOCs' ability to engage in anticompetitive actions. Such firms can compare the service quality from that BOC with the quality provided by other BOCs and use that information to seek regulatory or legal relief. They can also track changes in service quality over time. Long distance carriers can also subscribe to BOC retail services to compare the performance of BOC retail services to their own. While other information sources provide more than sufficient avenues to track service quality, Verizon PA is also still required to file ARMIS reports that provide a redundant source of information. ARMIS 43-05, 43-06 and 43-07 reports include the measures of service quality of greatest concern to competitors: installation and repair intervals for interexchange access, trunk blockage, total switch downtime, service quality complaints, dial-tone response, transmission quality, and call set-up time. Moreover, this Commission has required Verizon PA to provide extensive data on its performance, which makes Verizon PA 's performance obvious and pellucid.

62. Furthermore, service discrimination would be difficult to implement because Verizon PA could not degrade its competitors' service quality without

[70] *See Non-Accounting Safeguards*, 11 FCC Rcd. 21905 ¶ 327 (1996).

harming its own. Most of Verizon PA's access facilities — both switches and trunks — would be used jointly by Verizon PA, by its long distance affiliate, and by competing long distance carriers. In addition, to the extent that Verizon PA's long distance affiliate operates as a reseller, it could not degrade the access service provided to long distance carriers without risking the degradation of its own long distance services.

63. Finally, if discrimination were detected, competing long distance carriers are not limited to relief from regulators or the courts. As noted above, under the pro-competitive initiatives of this Commission, the Act and the FCC, the proliferation of competition for the total package of communications services purchased by residential and business customers in Pennsylvania described in Section III-A above puts immediate pressure on Verizon PA's carrier access service prices and quality. In Pennsylvania carrier access markets, it is inconceivable that discrimination by Verizon PA — even if it could occur — could disrupt or distort the competitive process in the market for long distance services.

V. CONCLUSION

64. For all the reasons outlined above, Verizon PA's entry into the long distance business in Pennsylvania will produce enormous public interest benefits with no significant risk of harm to competition in any market.

I verify that the foregoing is true and correct to the best of my knowledge and belief. This statement is made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).

_____/s/ William E. Taylor_____
William E. Taylor

Date: January 8, 2001