

**STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES**

In the Matter of the Board's Investigation
and Review of Local Exchange Carrier
Intrastate Exchange Access Rates

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VERIZON'S INITIAL BRIEF

November 13, 2009

PUBLIC VERSION

I. INTRODUCTION	1
II. BACKGROUND.....	4
A. Overview of Switched Access Rate Policy	4
B. Board Policy Regarding Verizon NJ's Switched Access Rates	5
III. THE BOARD SHOULD ESTABLISH A REASONABLE INTRASTATE ACCESS RATE BENCHMARK FOR ALL CARRIERS.....	7
A. Requiring All Local Exchange Carriers to Charge a Single Reasonable Benchmark Rate Would Increase Efficiency and Remove Distortions.....	7
B. Verizon NJ's Intrastate Switched Access Rate Is a Reasonable Benchmark.....	9
1. Verizon NJ's Rate Has Received More Scrutiny Than Any Other Carrier's Rate and Has Been Determined to Be Just and Reasonable	9
2. Verizon NJ's Rate Is Close to the Median Rate in New Jersey and Is In Line With Rates in Other States.....	9
C. There Is No Basis to Exempt CLECs from Charging Reasonable Switched Access Rates	10
D. Embarq Does Not Present Any Basis for Receiving Special Treatment.....	13
IV. ANY REDUCTION IN VERIZON NJ'S INTRASTATE SWITCHED ACCESS RATE MUST BE ACCOMPANIED BY MEASURES TO MITIGATE THE CONTINUING EFFECTS OF THE BOARD'S LEGACY ILEC REGULATION.....	14
A. Verizon NJ's Intrastate Access Rates Partially Offset the Losses Verizon NJ Incurs Under the Board's Policy Requiring It to Charge Below-Cost Rates for Basic Local Service.	15
1. The Board Has Consciously Set Verizon NJ's Switched Access Rate to Provide a Contribution to Local Service.....	15
2. The Evidence In This Proceeding Confirms the Continued Existence of a Contribution Flow to Basic Local Service.....	17
B. Reducing Verizon NJ's Intrastate Access Rates without Considering the Effects on Verizon NJ's Other Rate Regulated Services Would Result in Unjust and Unreasonable Rates.	19
C. Requiring Verizon NJ to Subsidize Its Regulated Services With Revenue from Competitive Services Would Violate New Jersey Law	20

D. The ILEC Reclassification Proceeding Did Not Provide Verizon NJ with Sufficient Retail Rate Flexibility to Eliminate the Need for Contribution from Switched Access.....	22
V. AT&T, SPRINT, AND RATE COUNSEL IGNORE THE UNIQUE CHARACTERISTICS OF THE NEW JERSEY MARKET.	23
A. New Jersey Consumers Are <i>Already</i> Receiving Much of the Benefit of the Competition that AT&T, Sprint, and Rate Counsel Claim Will Result from Their Recommendations.....	23
B. AT&T Ignores Unique Factors in New Jersey and Exaggerates the Urgency of Switched Access Reductions.....	24
VI. PRECEDENT IN OTHER STATES SUPPORT’S VERIZON’S POSITION	27
A. AT&T Misrepresents the Policies and Experiences of Other States	27
B. AT&T Misrepresents Verizon's Advocacy Elsewhere.....	29
C. AT&T <i>Elsewhere</i> Advocates a Balanced Approach to Switched Access Reform	30
VII. CONCLUSION	30

I. INTRODUCTION

There is no evidence supporting the claims of some parties that immediate massive reductions in the intrastate access rates of Verizon New Jersey Inc. (“Verizon NJ”) are critical for New Jersey’s telecommunications consumers. Even though Verizon NJ’s residential basic exchange rates remain among the lowest in the nation, Verizon NJ continues to invest hundreds of millions of dollars to bring New Jersey consumers the most advanced fiber-to-the-premises network in the country. Verizon NJ has not wavered in this commitment despite losing **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** of its access lines and access revenues to competition. Under these extraordinary circumstances, there is no basis for concluding that Verizon NJ’s intrastate switched access rates are unreasonable, such that immediately reducing them is crucial to ensure competitive intrastate toll pricing. On the contrary, data provided by AT&T confirm that New Jersey long distance consumers *already* pay substantially *lower* long distance prices than do consumers in most states, including in states AT&T points to as “models” New Jersey should follow—all the while benefitting tremendously from intense competition and Verizon NJ’s massive infrastructural investment to keep New Jersey’s communications infrastructure on the leading edge.

To promote access intrastate switched access reform in the way that best accommodates New-Jersey-specific conditions, Verizon has proposed that the Board should adopt a balanced two-step approach. The Board’s first step should be to establish a level playing field by capping the intrastate switched access rates of all local exchange carriers at the rate currently authorized for Verizon NJ. Verizon NJ’s switched access rate is a reasonable benchmark because it has been subject to more scrutiny than any other carrier’s, and is in the mainstream of switched access rates both in New Jersey and across the country. Fairness to all competitors mandates such a universal benchmark, and that first step would immediately increase economic efficiency

and benefit New Jersey consumers. As a second step, after evaluating the market-disciplining effect of establishing a reasonable benchmark based on Verizon NJ's access rate, the Board could consider reducing the uniform benchmark *but only if* the Board were at the same time also to eliminate the legacy regulatory burdens that have historically been supported through the implicit subsidies contained in these access charges.

Verizon is the only party to this proceeding to propose a balanced approach to switched access reform. Several other proponents of reform – Sprint, Rate Counsel, and AT&T – ask the Board to immediately require each New Jersey local exchange carrier (“LEC”) to mirror its own interstate switched access rate.¹ These parties exaggerate the benefits (and overlook the potential drawbacks) of the drastic changes they seek under the unique circumstances present in New Jersey. Moreover, their arguments about how to implement access reform with respect to ILECs are intellectually dishonest. In their haste to achieve an immediate reduction in access rates, they urge the Board to ignore the legacy regulatory policies that are supported by intrastate switched access charges – policies that cannot remain in place and unchanged if these rates are immediately reduced to the carrier's interstate switched access rate.

Instead of acknowledging the existence of a contribution flow from switched access service to price-regulated local retail service (which is the result of a deliberate decades-old Board policy), Sprint takes an unsupportable position: it argues that the Board should set Verizon NJ's basic local exchange rates based on Verizon NJ's *overall* revenue stream – including from non-regulated and highly competitive products such as broadband.² That extreme position ignores well-established, constitutionally-grounded regulatory principles that make clear

¹ Rate Counsel apparently supports even deeper access reductions – to levels that would be lower than rates charged by any LEC in any state – but its overall arguments appear to be the same as Sprint's and AT&T's.

² Paradoxically, however, Sprint urges the Board to ignore any losses from competitive products when setting basic local exchange rates.

the Board may not require a firm to subsidize a price-regulated service with earnings from competitive or non-regulated services.

AT&T does not go as far as Sprint. But AT&T also does not bother to straighten out Sprint's self-serving approach – even though AT&T supports a balanced approach to switched access reform *elsewhere*. Apparently content to let the Board implement unjust and counterproductive ILEC policy here (which AT&T resists in states where it has an ILEC presence), AT&T advances a less controversial but equally unsupportable theory: AT&T claims that the settlement of last year's ILEC Reclassification proceeding “set the stage” for the massive access reductions that AT&T is now seeking. As the Board knows, however, the settlement of the ILEC Reclassification proceeding simply adjusted New Jersey Jersey's retail rate caps for inflation from remarkably low levels (which had not been changed since 1985) to levels that are *still* below Verizon NJ's costs for providing basic local service.

While Sprint, AT&T and Rate Counsel exaggerate the urgency of reform and ignore the need to mitigate the legacy of past Board policies, other parties clamor to the other end of the spectrum. Embarq, the Joint CLECs, and Monmouth take positions that have long been rejected by regulators and serious economists. Monmouth and the Joint CLECs argue that the Board should not regulate CLEC access rates at all, and Embarq argues the Board should establish a permanent universal service fund so that Embarq can lock in its existing revenue stream while remaining insulated from competitive losses. Those arguments, like the arguments advanced by parties on the other side of Verizon's principled, centrist approach, are unfounded. The Board should not provide any company a guaranteed revenue stream, and no company should be allowed to use excessive intrastate switched access charges to gain an artificial competitive advantage over its competitors. The Board should reject these extreme positions and should

enact Verizon's proposal, which would immediately promote fairness and economic efficiency by reducing excessive switched access rates and placing all LECs on a level playing field.

II. BACKGROUND

A. Overview of Switched Access Rate Policy.

Switched access is a service provided by LECs to other carriers for originating or terminating interexchange or "toll" calls. Switched access charges generally apply to calls that begin and end in different local calling areas. Interstate access charges apply to calls that originate and terminate in different states, and intrastate access charges apply to calls that originate and terminate in different local calling areas within the same state. Intrastate access rates are regulated by state commissions and interstate access rates are regulated by the Federal Communications Commission ("FCC").³ Historically, the FCC and state regulators set switched access at levels above the costs for providing switched access services so that a contribution from switched access could subsidize local retail rates set at below LECs' costs of providing local retail service.

Although some parties in this proceeding resist the conclusion, the contemporary consensus among regulators and economists is that unreasonably high intrastate switched access rates create economic distortions that reduce economic efficiency and harm consumers. Accordingly, the FCC and numerous state public utility commissions have required LECs to reduce their excessive switched access rates.⁴ With respect to ILECs, however, such switched

³ See generally Joint Initial Testimony of Paul B. Vasington and Thomas J. Mazziotti on Behalf of Verizon, BPU Docket No. TX08090830 (February 13, 2009) ("Vasington/Mazziotti Direct") at 7.

⁴ See, e.g., *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long Distance Users; Federal-State Joint Board On Universal Service*, Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45, 15 FCC Rcd 12962 (May 31, 2000) ("*CALLS Order*") (requiring large ILECs to reduce their intrastate switched access rates).

access reductions have not been imposed without also considering the relationships between switched access rates and rates for other regulated services. Specifically, switched access reforms at both the federal and state level have involved evaluating whether the ILEC needs and uses a contribution from its switched access charges to provide retail local service at below the ILEC's costs for such local service. To the extent implicit subsidies are removed from switched access rates, ILECs have historically been authorized to collect a larger amount of their network costs from their own end users.⁵

B. Board Policy Regarding Verizon NJ's Switched Access Rates.

Verizon NJ's switched access rates have received more scrutiny than those of any other New Jersey telephone company, and the Board has intentionally set them above the costs of access in order to provide contribution to basic service. They were initially established in 1984, when the Board approved a proposal under which Verizon NJ's total access revenues were calculated to be \$96.8 million.⁶ Subsequently, in the 1993 proceeding on Verizon NJ's first plan of alternative regulation ("PAR-1"), the Board re-affirmed the justness and reasonableness of Verizon NJ's intrastate access rates based on the existence of a contribution to local service. In response to MCI's argument that Verizon NJ's intrastate switched access rates were unreasonable because they were in excess of Verizon NJ's cost to provide access, the Board

⁵ For example, when the FCC required the large ILECs to reduce their interstate switched access rates, it authorized them to offset the revenue reduction with increases in the flat "subscriber line charges" they charge their end users. See *CALLS Order*, ¶¶ 71-104. The FCC explained that authorizing ILECs to collect more of their network costs directly from their end users encourages "efficient competitive entry" (*id.*, ¶ 89) and is in line with cost causation principles (*id.*, ¶ 95).

⁶ *In the Matter of the Access Tariff Filings for New Jersey Bell Telephone Company, Continental Telephone Company of New Jersey, New Jersey Telephone Company, United Telephone Company of New Jersey, West Jersey Telephone Company, Hillsborough and Montgomery Telephone Company, and Warwick Valley Telephone Company*, Docket Nos. 8311-954, 8311-990, 8311-1030, 8311-1050, 8311-1103, & 841-11, Order Modifying Initial Decision (N.J. B.P.U. May 23, 1984).

found that intrastate access rates must be evaluated in the overall context in which those rates were set:

The Board believes that the issue of whether the plan will produce just and reasonable rates should be viewed with regard to the plan in its entirety over the life of the plan, rather than on an isolated, piecemeal basis. In viewing the plan in its entirety and considering its net effect, factors in favor of one party may be compensated by countervailing factors in some other respect.⁷

In 2000, intrastate access rates were reduced when the total annual amount Verizon NJ could collect from the common carrier line charge (“CCLC”)⁸ element of its intrastate access rate was decreased by \$25 million (*i.e.*, the CCLC revenue cap—discussed above—of \$37.8 million was reduced to \$12.8 million).⁹ In 2003, Verizon NJ sought approval of its second plan of alternative regulation (“PAR-2”), and the Board again found Verizon NJ's intrastate switched access rates to be just and reasonable, noting that Verizon NJ had reduced its intrastate access rates since the initial plan approved in 1993.¹⁰ Verizon NJ's current intrastate switched access rates are the same as those approved in the PAR-2 proceeding.

On the other hand, the Board has not systematically scrutinized the intrastate switched access rates of competitive local exchange carriers (“CLECs”) in New Jersey, and has not developed a consistent policy regarding them.

⁷ See *In the Matter of the Application of New Jersey Bell Telephone Co. for Approval of its Plan for an Alternative Form of Regulation*, Docket No. TO92030358, Decision and Order (Apr. 14, 1993) (“Initial PAR Order”) at 26-28.

⁸ The CCL is a usage based contribution element that is designed to recover a portion of the costs of non-traffic sensitive network elements used in the provisioning of switched access service.

⁹ See Tariff Filing, *Verizon NJ's Tariff Revision to Reduce the Revenue Cap Amount of Carrier Common Line in B.P.U.-N.J. No. 2 Access Service*, dated August 4, 2000.

¹⁰ See *In the Matter of the Application of New Jersey Bell Telephone Co. for Approval (i) of Its Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-Line Rate Regulated Business Services as Competitive Services, and Compliance Filing*, Docket No. TO01020095, Decision and Order (Aug. 19, 2003) (“PAR-2 Order”) at 41.

III. THE BOARD SHOULD ESTABLISH A REASONABLE INTRASTATE ACCESS RATE BENCHMARK FOR ALL CARRIERS.

A. Requiring All Local Exchange Carriers to Charge a Single Reasonable Benchmark Rate Would Increase Efficiency and Remove Distortions.

While there are questions about the magnitude of the effect switched access reductions will have in New Jersey given its special characteristics (*see* Section V, below), there is no serious debate that requiring all New Jersey LECs to charge reasonable switched access rates will benefit consumers and increase the efficiency of New Jersey's communications industry. Fundamental fairness as well as economic efficiency principles require a reasonable benchmark rate that caps what any carrier may charge for switched access services. As Verizon's witnesses testified, a benchmark at the level of Verizon NJ's rates would be a simple and effective means to quickly move the most excessive switched access rates in New Jersey to more efficient levels.¹¹

Such a benchmark will promote equity and competitive parity as well as reduce market distortions by prompting carriers with the highest access rates to recover more of their network costs from their own customers, rather than from other carriers and their customers through access rates. Allowing companies to shift an excessive amount of their costs to switched access purchasers places a disproportionate burden on other carriers in the state and ultimately their customers.¹² As the FCC explained when ordering CLECs to mirror the interstate switched access rates of the ILECs with which they compete, a benchmark approach to switched access regulation is both administratively efficient and good policy:

[A] benchmark provides a bright line rule that permits a simple determination of whether a CLEC's access rates are just and reasonable. Such a bright line approach is particularly desirable

¹¹ *See* Vasington/Mazziotti Direct at 15-21.

¹² *Id.*

given the current legal and practical difficulties involved with comparing CLEC rates to any objective standard of “reasonableness.” Historically, ILEC access charges have been the product of an extensive regulatory process by which an incumbent’s costs are subject to detailed accounting requirements, divided into regulated and non-regulated portions, and separated between the interstate and intrastate jurisdictions.¹³

The FCC’s benchmark rule was prompted by “persistent” concerns that CLEC access rates varied dramatically and were frequently well above the rates charged by ILECs operating in the same area – just as they are in New Jersey. The FCC’s price cap was, therefore, intended to prevent CLECs from imposing excessive access charges on interexchange carriers and their customers.¹⁴ Since the FCC’s CLEC Rate Cap Order, the dominant trend among state regulators is to adopt the FCC’s policy of requiring CLECs to mirror ILEC rates (which is exactly what Verizon is proposing here).¹⁵ Although caps have most often targeted CLEC access rates, the

¹³ *Reform of Access Charges Imposed by Competitive Local Exchange Carriers*, Seventh Report & Order and Further Notice of Proposed Rulemaking, 16 FCC Rcd 9923 (2001) (“CLEC Rate Cap Order”), ¶41.

¹⁴ *Id.* at ¶¶ 32-34.

¹⁵ See, e.g., *Order Instituting Rulemaking to Review Policies Concerning Intrastate Carrier Access Charges*, **California** D. 07-12-020 in Rulemaking 03-08-018, Final Opinion Modifying Intrastate Access Charges (Dec. 6, 2007) (capping CLEC rates at no higher than the rates of the two largest carriers, Verizon and SBC, plus 10%); *DPUC Investigation of Intrastate Carrier Access Charges*, Decision, **Connecticut** D.P.U. Docket No. 02-05-17 (2004), 2004 Conn. PUC Lexis 15, at *45 (capping CLEC rates at SBC’s then-current rate); **Delaware** Code, Title 26, § 707(e) (capping all service providers’ switched access rates at the level of the largest ILEC in the state); *TDS Metrocom, Inc., Petition for Arbitration*, Arbitration Decision, **Illinois** Comm. Comm’n Docket No. 01-0338, at 48-50 (Aug. 8, 2001) and *Arbitration Between AT&T Comm. of Illinois, Inc. and Ameritech*, Arbitration Decision, Illinois Comm. Comm’n Docket No. 03-0239, at 149-51 (Aug. 26, 2003) (a CLEC may not charge an ILEC more for terminating intrastate switched access than the ILEC charges the CLEC); 199 **Iowa** Admin. Code 22.14(2)(d)(1)(2) (prohibiting CLECs from charging a carrier common line charge if it would render the CLEC’s rate higher than the competing ILEC’s rate); **Louisiana** PSC General Order No. U-17949-TT, App.B, Section 301 (k)(4) (May 3, 1996) (CLECs must charge non-discriminatory switched access rates that do not exceed the competing ILEC’s rates); Code of **Maryland** Regulations § 20.45.09.03(b) (capping CLECs’ switched access rates at the level of the largest LEC in Maryland); *Petition of Verizon New England Inc. et al. for Investigation under Chapter 159, Section 14, of the Intrastate Access Rates of Competitive Local Exchange Carriers*, Final Order, **Massachusetts** Dept. of Telecom. and Cable D.T.C. 07-0 (June 22, 2009) (capping CLECs’ switched access rates of the level of Verizon New England’s intrastate rate); *Access Rates to Be Charged by Competitive Local Exchange Telecommunications Companies in the State of Missouri*, Report and Order, **Missouri** P.S.C. Case No. TO-99-596, 2000 Mo. PSC Lexis 996, at *28-31 (June 1, 2001) (capping CLEC access rates at the competing ILEC’s level); *In the Matter of the Commission, on Its Own Motion, Seeking to Conduct an Investigation into Intrastate Access Charge Reform and Intrastate Universal Service Fund*, **Nebraska** Pub. Serv. Comm’n Application No. C-1628/NUSF, Progression Order #15, at ¶ 9 (Feb. 21, 2001) (“absent a demonstration of costs, a CLEC’s access charges, in aggregate, must be reasonable comparable

principle underlying such caps applies equally to all LECs – that is, a company should not be able to charge above the prevailing rate in the market – which, in New Jersey, is Verizon NJ’s rate.

B. Verizon NJ’s Intrastate Switched Access Rate Is a Reasonable Benchmark.

1. Verizon NJ’s Rate Has Received More Scrutiny than Any Other Carrier’s Rate and Has Been Determined to Be Just and Reasonable.

As discussed above, Verizon NJ’s intrastate switched access rate has been set by the Board, and the Board has found it to be reasonable in the context of the Board’s policy of requiring a reasonable contribution from switched access rates to support below-cost local service.

2. Verizon NJ’s Rate Is Close to the Median Rate in New Jersey and Is in Line with Rates in Other States.

Verizon NJ’s average revenue per minute (“ARPM”) for its intrastate switched access service is approximately [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY].¹⁶ About half of all LECs in New Jersey have ARPMs that are higher than Verizon NJ’s, and some are substantially higher.¹⁷ The CLEC affiliates of AT&T and Sprint

to the ILEC with whom they compete”); **New Hampshire** PUC § 431.07 (CLECs cannot charge higher rates for access than the ILEC does); **New York** P.U.C. Case 94-C-0095, Order, at 16-17 (Sept. 27, 1995), N.Y. P.U.C. Opinion 96-13, at 26-27 (May 22, 1996), and N.Y. P.S.C. Opinion 98-10, 1998 N.Y. PUC Lexis 325, at 26-27 (June 2, 1998) (benchmarking CLEC access charges to the level of the largest carrier in the LATA); *Establishment of Carrier-to-Carrier Rules*, Entry on Rehearing, **Ohio** P.U.C. Case No. 06-1344-TP-ORD, at 16-18 (Oct. 17, 2007) (capping CLECs’ switched access rates at the level of the competing ILEC); 66 **Pennsylvania** Consolidated Statutes § 3017 (c) (prohibiting CLEC access rates higher than those charged by the incumbent in the same service territory, absent cost justification); **Texas** P.U.C. Subst. Rule § 26.223 (a CLEC may not charge a higher rate for intrastate switched access than the ILEC in the area served or the statewide average composite rates published by the Texas P.U.C. and updated every two years); *Amendment of Rules Governing the Certification and Regulation of CLECs*, Final Order, **Virginia** State Corp. Comm. Case No. PUC-2007-00033 (Sept. 28, 2007) (a CLEC’s switched access rate cannot exceed the higher of its interstate rate or the rate of the competing ILEC).

¹⁶ See Exhibit AT&T-41C. Because the specific rate elements that comprise switched access service can vary greatly from carrier to carrier, a common method for comparing carriers’ switched access rates is to calculate carriers’ ARPM for all switched access elements. Comparing ARPMs among LECs allows for a more apples-to-apples comparison than comparing specific switched access rate elements.

¹⁷ *Id.*

charge some of the highest switched access rates in New Jersey, with ARPMs more than 40% higher than Verizon NJ's, and a few CLECs charge rates that are about twice as high.¹⁸

Requiring those outliers (many of which have large volumes of traffic that create substantial economic distortions) to charge Verizon NJ's rate would have an immediate disciplining effect on New Jersey's switched access market that would benefit consumers.

Although within-state comparisons provide the most useful information for assessing the reasonableness of a carrier's intrastate switched access rates, the CLECs' own evidence shows that Verizon NJ's intrastate switched access rates are also in line with rates charged by RBOCs and large ILECs in other states. For example, the charts on pages 45-46 of the Initial Testimony of Dr. Ankum show that numerous states authorize AT&T, Qwest, and Verizon to charge intrastate switched access rates that are similar to or higher than Verizon NJ's rate. Indeed, the chart indicates that AT&T's switched access rate as an RBOC in at least one state – Missouri – is almost twice as high as Verizon NJ's rate. That Verizon NJ's rate is not an outlier compared to what other state regulators have authorized (and compared to other carriers' access rates in New Jersey), taken in context with Verizon NJ's infrastructure commitments in the state and the legacy policies of the Board, is an additional indication that Verizon NJ's rate is a reasonable benchmark for the Board to apply as the first step of switched access reform.

C. There Is No Basis to Exempt CLECs from Charging Reasonable Switched Access Rates.

The CLEC intervenors' arguments for why they should be exempted from switched access regulation are meritless. The CLECs first argue that the market for intrastate switched access is competitive. Specifically, their witness Ankum argues that a long distance company

¹⁸ *Id.* The LECs identified as [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] are the principal AT&T CLECs in New Jersey, and the LEC identified as [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] is Sprint's CLEC.

that considers a CLEC's switched access rate to be excessive can – through its own CLEC affiliate – “compete away” the CLEC's customer base, which supposedly will cause the CLEC to reduce its switched access rates to reasonable levels.¹⁹ However, Dr. Ankum did not even attempt to back up this assertion with empirical evidence.²⁰

Moreover, Dr. Ankum's theory that competition for CLEC *retail* customers will discipline CLECs' *switched access* rates over some indeterminate long run ignores the marketplace reality that carriers compete with each other for customers by offering the best *retail* price for a service. End-users care only about what *they* have to pay their chosen supplier, not what that supplier may be charging others for switched access service. In fact, a CLEC that wishes to avoid losing customers will have the incentive to maintain high switched access rates so it can make up for revenues lost from reducing its retail rates to win or keep customers.²¹

The CLECs also argue that their switched access may be justified by higher costs. Even if it were true that some CLECs have higher switched access costs than ILECs (which has not been borne out by the evidence), that fact would be irrelevant because there is no basis for regulators to permit CLECs to subsidize an inefficient cost structure by charging excessive switched access rates. CLECs should compete on the *same* playing field as the ILECs with which they compete (*i.e.*, without the artificial competitive advantage of higher switched access rates), and there is no evidence that CLECs have been unable to compete with ILECs in the wake

¹⁹ See Ankum Direct at 18.

²⁰ At hearing, Dr. Ankum was questioned extensively about whether he had attempted to develop empirical evidence to support his theory. Rather than respond, he regurgitated the same unsupported theory he had included in his written testimony. See, e.g., 10/20/09 Tr. at 41-50. The only “facts” he cited in support of his theory were general conversations he had had with CLEC salespersons regarding the general ability of large business customers to take services from the CLEC affiliates of carriers like AT&T and Verizon. *Id.* at 43-44.

²¹ Because regulation prevents one carrier from refusing to hand off access traffic to another carrier with excessive access rates, the market forces that would otherwise discipline high excessive access rates are not in effect.

of the CLEC Rate Cap Order requiring them to mirror ILEC interstate rates.²² In any event, as witnesses for Verizon, AT&T, and Rate Counsel explained in detail, the CLECs' "cost studies" in this proceeding have fundamental flaws that wildly exaggerated their switched access costs.²³

During the hearing, the Joint CLEC witnesses added a new argument: that differences in rates between CLECs can be justified by differences in the *quality* of switched access services they provide.²⁴ That assertion is frivolous. Despite having just studied his clients' networks in extensive detail to complete a cost study for each client, Mr. Starkey was unable to describe any differences in the attributes associated with his various clients' switched access services – despite the fact that there is a 5-to-1 ratio between the switched access rates of his client with the highest access rates (Conversent Communications) and his client with the lowest access rates (Level 3 Communications).²⁵ Similarly, the Joint CLECs' witness was unable to describe any market differences or product differences that explained the 5-to-1 ratio.²⁶ Indeed, the Joint CLECs' *written* testimony confirmed the straightforward conclusion that "functionally there are *no differences* for either the end user customer, or the IXC with regard to the access service provided by CLECs versus access service provided by a more traditional ILEC network."²⁷

²² See Vasington/Mazziotti Reply at 17. AT&T's witness also testified credibly on this point, explaining that "it would be inefficient to facilitate the survival of inefficient CLECs by providing a regulatory sanction for higher access prices." Aron Rebuttal at 56.

²³ See, e.g., Vasington/Mazziotti Reply at 23-28 (describing deficiencies in Monmouth's cost study). Vasington/Mazziotti Rebuttal at 14-19 (describing deficiencies in cost studies of the Joint CLECs).

²⁴ Mr. Starkey asserted that switched access rates are not "homogenous or a commodity in the marketplace." 10/19/09 Tr. at 220.

²⁵ 10/19/09 Tr. at 225-238. Similarly, Monmouth's witness, while asserting that there may be quality differences that would justify higher costs, was unable to provide any concrete examples of quality differences. *Id.* at 191.

²⁶ 10/20/09 Tr. at 58-61. Dr. Ankum eventually admitted that "I don't think the difference in the access charges between Conversent and others is explained necessarily by the difference in quality per se" (*id.* at 59), and instead attempted to explain Conversent's \$0.055 switched access rate by analogizing to markets for luxury goods like Prada pants (*id.* at 61) and BMWs (*id.* at 62).

²⁷ Fischer/Starkey/Webber Reply at 14.

D. Embarq Does Not Present Any Basis for Receiving Special Treatment.

Embarq should be allowed additional pricing flexibility if its intrastate access rates are reduced to the benchmark level of Verizon NJ's rates. Such pricing flexibility would ensure that Embarq can compete on a level playing field with Verizon NJ and other LECs.²⁸ Embarq, however, apparently does not want additional pricing flexibility. Rather than collect more of its costs from its own end users, Embarq apparently prefers to have it both ways: it apparently prefers to continue to charge below-market rates for retail local service, and it wants an "assured" recovery mechanism (including a permanent universal service fund ("USF")) with which to recover its network costs.²⁹

The Board should reject Embarq's request for special treatment. Based on sound regulatory principles, Embarq has a right only to a reasonable *opportunity* to recover its prudently incurred costs, not to assured cost recovery.³⁰ If Embarq is afforded the opportunity to recover its costs by the Board, but competition prevents it from doing so, the onus is on Embarq to find ways to reduce its costs – just like every other carrier operating in a competitive market.³¹ Moreover, Embarq is a large, sophisticated telephone company that markets a diverse set of products to its end users and that is capable to competing on the same playing field as Verizon NJ and the rest of its competitors in New Jersey.³²

²⁸ Embarq's local retail rates for residential service are \$1.00 per month lower than Verizon NJ's. See Stipulation attached to *I/M/O the Board's Investigation Regarding the Reclassification of Incumbent Local Exchange Carrier (ILEC) Services as Competitive*, Summary Order of Approval, BPU Docket No. TX07110873 (July 14, 2008) ("ILEC Reclassification Order").

²⁹ See Bonsick Reply Testimony at 15.

³⁰ See Vasington/Mazziotti Reply at 29.

³¹ See Vasington/Mazziotti Rebuttal at 12-14.

³² *Id.* At hearing, Embarq's witness did not seriously dispute that Embarq could collect more of its network costs from its own customers, whose average annual income exceeds \$100,000. Indeed, in the ILEC Reclassification Proceeding, Embarq had argued that its end users spend a "disproportionately small" share of their income on telephone service. See 10/19/09 Tr. at 146-47.

Embarq also argues that its purportedly higher costs for switched access services justify higher rates. As a starting point, Embarq failed to demonstrate that its switched access costs are higher than those of Verizon NJ's because Embarq's cost study was fundamentally flawed.³³ For example, Embarq asserted that its loop costs should be included in its costs for switched access, but it is well established that it is improper to include loop costs in the total service long run incremental cost ("TSLRIC") of switched access services because loop costs are not caused by usage-based services, such as intrastate switched access.³⁴ Loop costs would exist whether or not the firm offered switched access service, and therefore these costs are not properly attributable to intrastate switched access service.³⁵ In other words, there is no causative relationship between the provision of customer loops and the provision of switched access services. Accordingly, local loop costs are not properly attributable to switched access service.³⁶

Accordingly, there is no basis for exempting Embarq from the requirement that all LECs should compete on equal footing by charging the same reasonable benchmark rate.

IV. ANY REDUCTION IN VERIZON NJ'S INTRASTATE SWITCHED ACCESS RATE MUST BE ACCOMPANIED BY MEASURES TO MITIGATE THE CONTINUING EFFECTS OF THE BOARD'S LEGACY ILEC REGULATION.

AT&T, Sprint, and Rate Counsel advocate an immediate reduction in Verizon NJ's intrastate switched access rate – and they insist that such a reduction must occur without any consideration for the interrelatedness of the pricing of access services with the pricing of other rate-regulated services. That is a self-serving and overly simplistic proposal that is at odds with

³³ See generally, Vasington/Mazziotti Rebuttal at 15-16.

³⁴ See, e.g., Roth Direct at 4.

³⁵ See Vasington/Mazziotti Reply at 30.

³⁶ Vasington/Mazziotti Rebuttal at 15.

established Board policy and with the switched access reforms that the FCC and state regulators have enacted.

A. Verizon NJ's Intrastate Access Rates Partially Offset the Losses Verizon NJ Incurs Under the Board's Policy Requiring It to Charge Below-Cost Rates for Basic Local Service.

Both past Board findings and the evidence presented in this proceeding establish that Verizon NJ's current switched access rates generate a contribution to maintain the affordable basic exchange rates set by the Board. Accordingly, if the Board were to determine that a reasonable benchmark is lower than Verizon NJ's intrastate switched rate, the Board must "untie" Verizon NJ's hands – permitting it to collect more of its network costs from its own end users and removing the legacy regulatory obligations supported by access charges.

1. The Board Has Consciously Set Verizon NJ's Switched Access Rate to Provide a Contribution to Local Service.

As discussed above, Verizon NJ's intrastate switched access rates were initially set at a level designed to provide a contribution to local retail service. Since then, the Board has reaffirmed that policy. In the order approving PAR-1, the Board rejected MCI's claim that the contribution to basic exchange service from intrastate switched access service should be reduced or eliminated. There, the Board found that setting switched access rates above cost was just, reasonable and consistent with the Board's goal of maintaining affordable basic exchange rates:

Were the Board to reduce every service rate that is above cost, there would be no subsidy from any service to basic exchange service and universal service would be jeopardized. The Board has historically priced basic residential service on a residual basis, that is, after a revenue requirement has been quantified, rates have been increased for all services other than basic to the extent possible, and then basic has been increased as a last resort. This is a policy that has created affordable rates (in fact among the lowest in the nation) and universal service.³⁷

³⁷ See Initial PAR Order at 31 (emphasis added). The Appellate Division of the Superior Court of New Jersey affirmed the Initial PAR Order, finding that the above passage "bespeaks a reasoned conclusion." *In re.*

The Board elaborated on its position in its brief to the Appellate Division in response to an appeal of the PAR-1 order:

The Board considered but rejected MCI's argument that access charges should be lowered. Particularly in light of the Legislature's finding and declaration that it is the policy of the State to [m]aintain universal telecommunications service at affordable rates, the Board's determination not to adjust access rates so as not to jeopardize universal service was a reasonable exercise of its ratemaking authority and discretion.³⁸

In the 2003 PAR-2 order, the Board again stressed that access rates cannot be set in a vacuum, but rather must take into account the rates of Verizon NJ's basic exchange services. The Board rejected AT&T's request that Verizon NJ be required to reduce its intrastate switched access rates, stressing that Verizon NJ's rate for residential basic exchange service had not increased since 1985, whereas Verizon NJ's intrastate switched access charges had declined by \$25 million under PAR-1.³⁹ In finding that Verizon NJ's intrastate switched access rates were just and reasonable, the Board stressed that AT&T had failed to comprehend that intrastate access rates cannot be established in isolation:

Substantial evidence and expert testimony would have to have been presented regarding all of [Verizon NJ's] costs and revenues, cross-subsidization of service issues, rate rebalancing issues, [and] the impact of proposed rate changes on the demand for all services, ... on customers and on the Board's ability to promote Universal Service.⁴⁰

AT&T *continues* to request that the Board ignore its past policies and ignore the

Application of New Jersey Bell Telephone Co. (Now Bell Atlantic-New Jersey) for Approval of its Plan for Alternative Regulation, 291 N.J. Super. 77, 95 (N.J. App. Div. 1996).

³⁸ *In re Application of New Jersey Bell Telephone Co. (Now Bell Atlantic-New Jersey) for Approval of its Plan for Alternative Regulation*, Docket No. A-5013-5090-92T2, Brief on Behalf of Respondent Board of Regulatory Commissioners (N.J. App. Div. filed Oct. 26, 1994).

³⁹ See PAR-2 Order at 27 and 41.

⁴⁰ *Id.* at 41 (quoting with approval Verizon's witness's testimony).

factual record showing that that Verizon NJ needs and uses a contribution from switched access rates for local service. Just as the Board did in the PAR-1 proceeding, it should reject AT&T's self-serving, one-dimensional proposal.

2. The Evidence In this Proceeding Confirms the Continued Existence of a Contribution Flow to Basic Local Service.

The record here shows that revenues from Verizon NJ's basic exchange service are not sufficient to cover the total (combined direct, shared and common) costs to provide the service. Specifically, Verizon performed a comprehensive, forward-looking cost study for all of its rate-regulated services. For each rate-regulated service, Verizon developed a per-unit cost and multiplied each unit cost by its demand for 2008 to develop a total cost for the service. Verizon then compared the revenue for rate-regulated services to the total costs of providing the services. The total annual cost for rate-regulated services exceeds the revenue from these services by **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]**.⁴¹

Given that Verizon NJ's rate-regulated services earn revenue substantially lower than Verizon NJ's costs for providing the services, the Board cannot reduce Verizon NJ's intrastate switched access rates without simultaneously providing Verizon NJ the ability to offset such a reduction with greater pricing flexibility to for its other rate-regulated services and without simultaneously eliminating the legacy regulatory obligations supported by access charges that still burden Verizon notwithstanding that Verizon now operates in a hyper-competitive communications market.⁴² While some parties question the conclusion that Verizon NJ

⁴¹ See Vasington/Mazziotti Direct at 29-40.

⁴² This is particularly true given that the revenues Verizon NJ once generated to support basic exchange service and its legacy regulatory obligations have decreased significantly. Since 2001, Verizon NJ has experienced a **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** reduction in retail access lines, resulting in an annual revenue reduction in excess of **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]**. Similarly, due to retail line losses and usage displacement attributable to wireless service, since 2001, Verizon NJ's intrastate switched access revenue has declined by

continues to apply contribution from switched access to provide retail service to meet its legacy obligations, no party advances any *policy argument* for why Verizon NJ should not be permitted greater retail pricing flexibility to offset potential switched access reductions. That is because the policy arguments militate toward permitting rebalancing. It is well established that requiring (and, of course, authorizing) ILECs to collect a greater portion of their network costs from their own end users is an important corollary to switched access reform that increases economic efficiency.⁴³

AT&T's own witness admitted that it is "economically inefficient" for the Board to require a firm in a competitive market to charge a price lower than the prevailing market price.⁴⁴ She also admitted that AT&T itself (as a competitor to Verizon) would potentially benefit if Verizon NJ were no longer required to charge a below-market rate⁴⁵— a fact that further calls into question the reasonableness of AT&T's insistence that the Board divorce revenue recoupment from switched access reform.

In any event, Verizon's witnesses rebut each and every one of the criticisms leveled against its cost study.⁴⁶ Moreover, a simple "reality check" confirms the reasonableness of Verizon's position. Even when Verizon NJ maximizes the pricing flexibility granted in last year's ILEC Reclassification Proceeding, its regulated rate for residential basic service of \$16.35 will still be almost \$2.00 lower (on an inflation-adjusted basis) than the rate the Board had

[BEGIN VERIZON PROPRIETARY]
Vasington/Mazziotti Direct at 24.

[END VERIZON PROPRIETARY].

⁴³ See n.5, above.

⁴⁴ See 9/15/09 Tr. at 130-31.

⁴⁵ See 9/15/09 Tr. at 131.

⁴⁶ See Vasington/Mazziotti Rebuttal at 31-51.

authorized in the mid-1980's when Verizon NJ's switched access rate was initially established.⁴⁷

Given that Verizon NJ has lost nearly half of its access lines and that its intrastate switched access revenue has declined by [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY] annually just in the past eight years,⁴⁸ there is no basis to expect Verizon NJ to be able to cover its costs for basic local service without either applying a contribution from switched access or charging the price the competitive market will bear for the service.

B. Reducing Verizon NJ's Intrastate Access Rates without Considering the Effects on Verizon NJ's Other Rate Regulated Services Would Result in Unjust and Unreasonable Rates.

Verizon NJ's intrastate switched access services – along with its rates for residential basic exchange service, single-line business basic exchange service, directory assistance service and residential installation service – are regulated by the Board as “non-competitive.” Under New Jersey law, rates for services classified by the Board as “non-competitive” must be “just and reasonable.” Since the introduction of the “competitive” and “non-competitive” service classifications in 1987, the Board has monitored the reasonableness of rates for services classified as non-competitive by evaluating the aggregate revenues and costs for those services.⁴⁹ In other words, the rates of rate-regulated services, as a whole, must allow Verizon NJ an opportunity to earn revenues sufficient to cover total (*i.e.*, combined direct, shared and common) costs associated with providing these services. If the Board considers reducing any of Verizon NJ's rates for rate-regulated services, including intrastate access rates, the Board must evaluate

⁴⁷ See ILEC Reclassification Order at 4.

⁴⁸ See Vasington/Mazziotti Direct at 24.

⁴⁹ *I/M/O Petition of New Jersey Bell Telephone Company for Approval of a Proposal for a Rate Stability Plan and Relaxed Earnings Surveillance for Certain Competitive Services*, BPU Docket No. TO87050398, June 22, 1987 and *I/M/O the Application of New Jersey Bell Telephone Company for Approval of a Plan for an Alternative Form of Regulation*, BPU Docket No. TO92030358, May 6, 1993.

and understand the effect that reduction will have on Verizon NJ's opportunity to earn sufficient revenues to recover its total costs for this entire basket of services.⁵⁰

C. Requiring Verizon NJ to Subsidize Its Regulated Services With Revenue from Competitive Services Would Violate New Jersey Law.

Sprint and Rate Counsel, and to a lesser extent, AT&T, argue that “long distance, broadband, an expansive list of custom calling features, and video services” all provide revenues that can be used by ILECs to recover “their full basic network connection costs.”⁵¹ These witnesses are incorrect that non-jurisdictional service revenues should be included toward regulated cost recovery. Both sound policy and black letter law mandate that an ILEC may not be required to operate the segment of its business that remains subject to regulatory control at a loss on the theory that profits from competitive lines of business will make up the shortfall. As Justice Holmes explained in *Brooks-Scanlon Co. v. Railroad Comm'n*, 251 U.S. 396 (1920), the profits that an enterprise earns in competitive operations are private property, and the firm “no more can be compelled to spend that than it can be compelled to spend any other money to maintain [the enterprise] for the benefit of others who do not care to pay for it.” Moreover, in a competitive market, Verizon NJ cannot be expected to maintain prices at levels designed to generate contribution for rate regulated services.⁵²

Notably, Sprint did not use an economist or policy witness to attempt to support its proposal. Its witness attempted to justify his argument based on his understanding of how businesses are run in the absence of regulation:

⁵⁰ See Vasington/Mazziotti Direct at 22-23.

⁵¹ See Appleby Direct at 25-26. Mr. Appleby subsequently added interstate special access to his list of non-jurisdictional services that supposedly should contribute towards ILECs' local service. Appleby Reply at 30-31. Rate Counsel's witnesses endorse Mr. Appleby's proposal (see Baldwin/Bosley Reply at 110-11). AT&T's witnesses stop short, but appear to argue that revenues from jurisdictional competitive services should be considered. See Aron Reply at 24-25.

⁵² See Vasington/Mazziotti Rebuttal at 48.

Q: Sprint in this proceeding did not use an economist as a witness in order to support its position with respect to recovery of cost?

A: I'm a CPA and I understand financial concepts, and if someone were to ask me if a business was making money or not, I would look at all the services and revenues and all of the costs and do an analysis at that level. I wouldn't try to use the arcane allocations methodology which existed back in the monopolistic world.⁵³

The crucial point, of course, is that Verizon NJ *is* required to play by the “arcane” rules established during the “monopolistic world”: it is required to follow and apply the FCC’s cost accounting and allocation rules, its retail rates are capped at below its costs, and its obligation to comply with legacy regulatory obligations remains in full force. To the extent New Jersey ILECs continue to be required to offer rate-regulated services, the authorized rates for the entire bucket of rate- regulated services must be set in a manner that enables recovery of their total costs for those services. As the New York Public Service Commission correctly determined: “Investors do not typically continue to support one project simply because another unrelated project is profitable. We decline to rely on non-jurisdictional earnings to offset jurisdictional losses.”⁵⁴ This Board should similarly reject Sprint’s request that it subvert well-established, constitutionally-grounded regulatory principles.⁵⁵

⁵³ See 9/15/09 Tr. at 172.

⁵⁴ See Statement of Policy on Further Steps Toward Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings, *Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services*, CASE 05-C-0616 (N.Y. Pub. Serv. Comm’n issued Apr. 11, 2006), at 55 n.112.

⁵⁵ In addition to adopting an inappropriate policy framework, Sprint makes the fundamental conceptual error of counting only potential additional *revenues* from competitive services, but ignoring the costs of such services. See Vasington/Mazziotti Reply at 54-55.

D. The ILEC Reclassification Proceeding Did Not Provide Verizon NJ with Sufficient Retail Rate Flexibility to Eliminate the Need for Contribution from Switched Access.

Last year, Verizon NJ and Embarq requested that the Board reclassify certain retail mass market services as competitive. The Board approved a stipulation settling that proceeding that provided for some limited local rate increases for basic residential and single-line exchange service.⁵⁶ AT&T and Sprint suggest that in approving that stipulation, the Board anticipated the rate reductions AT&T and Sprint advocate here, and that the order approving the stipulation provided Verizon NJ and Embarq with the retail rate flexibility needed to remain whole in the wake of large reductions in their switched access revenue streams.⁵⁷

This suggestion is plainly wrong. In issuing the ILEC Reclassification Order, the Board did not – and indeed, could not – anticipate and accommodate any specific level of future rate reductions in the retail reclassification case.⁵⁸ That is because the Board did not attempt to develop a record in the ILEC Reclassification Proceeding that would allow it to anticipate and accommodate rate reductions that may result from this case. To the contrary, the Board ruled that switched access rates would not be considered in that proceeding, and it ordered that testimony about switched access rates be stricken from the record. AT&T and Sprint are misrepresenting the ILEC Reclassification Order by suggesting that it somehow set the stage for massive reductions in Verizon NJ's access rates without any consideration of Verizon NJ's overall structure of regulated rates.

⁵⁶ ILEC Reclassification Order.

⁵⁷ *See, e.g.*, Nurse//Oyefusi Direct at 24-25; Appleby Direct at 23-24.

⁵⁸ Verizon's witness in this proceeding, Mr. Vasington, was also Verizon's witness in the ILEC Reclassification Proceeding. He provides a detailed account of the ILEC reclassification proceeding in his testimony. *See* Vasington/Maziotti Rebuttal at 19-28.

Moreover, even if Verizon NJ were able to immediately take advantage of the full extent of pricing flexibility approved in the stipulation (which it is prohibited from doing until October 2010), and even under the (unlikely) assumption that Verizon NJ would experience no further line losses for basic residential service, Verizon has shown that the total costs for Residential Basic Exchange Service (“RBES”) would still exceed RBES revenues by approximately [BEGIN VERIZON PROPRIETARY] [END VERIZON PROPRIETARY].⁵⁹ Thus, there is no way that the additional revenue that Verizon NJ may derive from last year’s ILEC reclassification proceeding can be considered as having “set the stage” for reducing Verizon NJ’s intrastate access rates.⁶⁰

V. AT&T, SPRINT, AND RATE COUNSEL IGNORE THE UNIQUE CHARACTERISTICS OF THE NEW JERSEY MARKET.

A. New Jersey Consumers Are *Already* Receiving Much of the Benefit of the Competition that AT&T, Sprint, and Rate Counsel Claim Will Result from Their Recommendations.

While there is no serious debate that reducing intrastate switched access rate facilitates competition, there also is no serious debate that other factors affect the competitiveness of New Jersey’s telecommunications market and the prices New Jersey consumers pay. The Board is presiding over a period when New Jersey businesses and residents are reaping the benefits of intense competition among well-funded and sophisticated wireline and intermodal companies. Remarkably, New Jersey consumers are simultaneously benefitting from the aggressive and extensive deployment of next-generation technology while also enjoying prices for traditional wireline telecommunications services – including long distance and local service – that are among the very lowest in the country.

⁵⁹ See Vasington Mazziotti Reply at 44-45.

⁶⁰ *Id.*

There are very few states where the pricing consumers receive for the combination of local service and intrastate toll service comes close to what New Jersey consumers receive. First, although there are questions about their reliability, the data AT&T itself presented on its intrastate long distance prices confirm that New Jersey consumers *already* pay lower intrastate toll prices than consumers in most states – including in *nine* of the so-called “mirroring” states that AT&T holds out as “models” the Board should adopt.⁶¹ At the same time, Verizon NJ’s local residential rates are capped at levels below the national average – and substantially below the levels authorized by state commissions that have required interstate mirroring. For example, when Massachusetts and Maine required interstate mirroring, they simultaneously authorized rate rebalancing, which resulted in local basic residential service rates in those states between \$27.79 and \$29.95 per month.⁶² Those rates are nearly \$10.00 more than Verizon NJ’s current rates (including Verizon NJ’s pricing flexibility granted for 2008), and are substantially more than what Verizon NJ is authorized to charge under the ILEC Reclassification Order, even if one assumes no further rate increases in those other states.⁶³

B. AT&T Ignores Unique Factors in New Jersey and Exaggerates the Urgency of Switched Access Reductions.

Precisely because of the unique characteristics of the New Jersey market discussed above, the Board should be skeptical of exaggerated predictions about the likely consumer

⁶¹ See 9/15/09 Tr. at 104-06.

⁶² See Vasington/Mazziotti Direct at 45 (citing Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service, FCC Wireline Competition Bureau (2008), Table 1.4). At hearing, one AT&T witness, Mr. Nurse, made the unsupported argument (which he did not make in his written testimony) that Mr. Vasington’s direct testimony comparing local rates across states was unreliable because the FCC’s “Reference Book” on which Mr. Vasington relied does not take into account differences in the size of local calling areas. See 9/15/09 Tr. at 77-78. However, Mr. Vasington explained that the Reference Book does in fact provide an “apples-to-apples” comparison (see 9/17/09 Tr. at 65).

⁶³ Based on the data in the Reference Book, a few states with low toll rates have local retail rates in line with those of New Jersey. However, the ILECs in such states – such as Texas and Illinois – have local rate flexibility and/or access to USF funds, and many states’ local rates have gone up farther than Verizon New Jersey’s rate since the data were published.

benefits of reducing Verizon NJ's switched access rates. Only AT&T witness Aron attempted to study the likely effect of intrastate switched access reductions on intrastate toll prices in New Jersey, but she made no effort to control for factors such as the nature of competition in New Jersey or the nature of its infrastructure. Although Dr. Aron agreed at hearing that each state's long distance prices are affected by various factors, including the nature of competition in the state and the cost of facilities used by long distance companies,⁶⁴ she ignored such factors when analyzing New Jersey's long distance market.

The principal study Dr. Aron conducted for submission with her direct testimony not only ignored such factors, but involved *no analysis of the costs* long distance providers incur for switched access services. Instead, she submitted a study that classified states as "mirroring" or "non-mirroring" and concluded that prices in "mirroring" states are 15% lower than prices in "non-mirroring states."⁶⁵ At hearing, Dr. Aron admitted that she could have used actual data on her client's switched access costs to perform that study, but claimed she instead performed this study because it represents an "intuitive and easy to understand" look at the "relationship between mirroring and rates."⁶⁶ As Verizon's witnesses explained, Dr. Aron's mirroring study was unreliable because, among other things, it failed to take into consideration various factors – including AT&T's cost of access services and whether or not state USF funds are in place in particular states.⁶⁷

⁶⁴ 9/15/09 Tr. at 114-15.

⁶⁵ Aron Direct at 55-58. Dr. Aron also submitted a study purporting to show that prices in Maine fell by 25% after a mirroring policy was put in place (Aron Direct at 58). However, she admitted at hearing that she had no idea what AT&T's "before" and "after" switched access costs were or what other factors had affected prices in Maine. See 9/15/09 Tr. at 121. Importantly, Dr. Aron chose *not* to conduct a "time series" regression analysis to explore in a particular state how much long distance prices fall after switched access costs fall – even though that is obviously a central question in this proceeding. *Id.* at 120.

⁶⁶ 9/15/09 Tr. at 101.

⁶⁷ Vasington/Mazziotti Reply at 56-57.

Dr. Aron sought to remedy those deficiencies by performing two last-minute studies. First, Dr. Aron described in her rebuttal testimony a study that explored whether lower intrastate switched access rates were “associated” with lower retail long distance prices in the state.⁶⁸ Second, at the hearing she stated that she had performed another study (which also was not provided to the other parties) which she vaguely described as being based on New Jersey-specific data from the 1990’s.⁶⁹ Based on her two last-minute studies, she predicted that the “flow-through” in New Jersey of access rate reductions to intrastate toll prices would be “between eighty-three and one hundred fifteen percent.”⁷⁰ In other words, for every \$1.00 reduction in long distance providers’ input costs of switched access, the long distance prices paid by consumers supposedly will fall between \$0.083 and \$1.15.

In addition to the fact that Verizon has had no opportunity to review either last-minute study, there are at least two facial defects that should cause the Board to reject her predictions as they relate to the New Jersey market. First, Dr. Aron *still* made no attempt to statistically control for variables such as competition or whether a state USF affects long distance companies’ costs. Even after conducting her last-minute studies, Dr. Aron had no knowledge of the factors – such as long distance facilities costs and competitive structure – that she admits can affect long distance prices.⁷¹ The prediction that IXCs may pass through up to *one hundred and fifteen percent* of their reduced access costs confirms the testimony of Verizon’s witnesses that Dr. Aron failed to consider other factors affecting long distance prices.

⁶⁸ Aron Rebuttal at 17.

⁶⁹ 9/15/09 Tr. at 97-98.

⁷⁰ 9/15/09 Tr. at 98.

⁷¹ *See, e.g.*, 9/15/09 Tr. at 106-07.

Dr. Aron provided no basis to conclude that long distance companies would reduce long distance prices in New Jersey on a prospective basis by the magnitude she suggested. A simple “reality check” confirms that her prediction is highly unlikely. If New Jersey intrastate switched access rate are reduced in the manner AT&T requests, the per-minute reduction in the switched access costs of long distance companies would be \$0.023 per minute⁷² – which, under Dr. Aron’s higher-end estimate of 115%, would cause toll prices in New Jersey to fall by up to \$0.0265 per minute. But New Jersey’s intrastate toll prices are *already* at the highly competitive level of **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]**, so Dr. Aron’s predicted pass-through would result in an intrastate toll rate of **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** per minute. Such a low intrastate toll price would be *by far* the lowest in the country, and it would even be *45% lower* than the weighted average rate for what Dr. Aron calls “mirroring” states.⁷³ Because that outcome is unrealistic, Dr. Aron’s study is not credible as an estimate of the likely benefits of AT&T’s recommendations.⁷⁴

VI. PRECEDENT IN OTHER STATES SUPPORTS VERIZON’S POSITION

A. AT&T Misrepresents the Policies and Experiences of Other States.

AT&T’s witnesses attempt to create the impression that there is a trend among state public utility commission towards ordering the type of reform AT&T advocates. For example, Messrs. Nurse and Oyefusi assert that: “Numerous states, including major industrial states such

⁷² 9/15/09 Tr. at 98.

⁷³ See AT&T-41C.

⁷⁴ AT&T may argue that the lower range of her prediction – that long distance companies may pass through 83% of their savings – is more reasonable. The point is that Dr. Aron’s methods and data are unreliable as an estimate of likely benefits. In any event, even a pass-through rate of 83% is likely to be overstated for New Jersey: it would mean an intrastate toll rate of **[BEGIN VERIZON PROPRIETARY]** **[END VERIZON PROPRIETARY]** – which would still be the lowest in the country and substantially below the weighted average for mirroring states.

as Massachusetts, Illinois, Michigan and Texas, require local exchange carriers' intrastate switched access rates to mirror their interstate switched access rates, and have increased their competitiveness vis-à-vis New Jersey."⁷⁵ There are two flaws with that assertion.

As an initial matter, AT&T misrepresents what many other state commissions have done. For example, AT&T claims that Texas is a "mirroring state" – but there is no statute, order, or any other authority that requires any company in Texas to mirror its interstate rate. Rather, the Texas legislature passed a *comprehensive* deregulation statute providing AT&T with the *option* to choose a form of regulation under which AT&T would voluntarily mirror its interstate rate in exchange for *complete pricing flexibility* in exchanges deemed to be competitive.⁷⁶ That comprehensive reform package bears no resemblance to AT&T's proposal here.⁷⁷

Ironically, many of the states AT&T lists as "mirroring" states are ones where AT&T itself has initiated or intervened in complaint proceedings in order to support switched access reform. For example, AT&T claims that Wisconsin is a so-called "mirroring" state, but AT&T itself has intervened in recent switched access proceedings in that state to ask that CenturyTel, which is by far the largest collector of switched access revenue in Wisconsin, be required to mirror its own interstate rate.⁷⁸ Even more importantly, none or virtually none of the states AT&T holds up as models for New Jersey has undertaken switched access reform in a vacuum, as AT&T insists the Board should do. To the contrary, as discussed above, state regulators and

⁷⁵ Nurse/Oyefusi Direct at 43. The other states Messrs. Nurse and Oyefusi claim have "implement[ed] such policies" are: Alabama, Georgia, Indiana, Iowa, Kansas, Kentucky, Maine, Mississippi, Nebraska, Nevada, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, Tennessee, and Wisconsin. *Id.*

⁷⁶ See Tex. Util. Code Ch. 65 ("Deregulation of Certain Incumbent Local Exchange Company Markets").

⁷⁷ There are other important differences between Texas and New Jersey that AT&T ignores. One is that Texas has a USF fund – from which AT&T continues to draw.

⁷⁸ See, e.g., *Application of CenturyTel of the Midwest-Wisconsin LLC for Approval of an Alternative Regulation Plan*, Docket No. 4620-TI-103, AT&T's Comments on Staff's Commission Memorandum (filed Aug. 19, 2009); *Application of CenturyTel of the Midwest-Kendall LLC for Approval of an Alternative Regulation Plan*, Docket No. 2815-TI-105, AT&T's Comments and Request to Intervene (filed Feb. 24, 2009).

the FCC have consistently recognized that authorizing ILECs to collect more of their network costs from their own end users is an important corollary to switched access reform.

B. AT&T Misrepresents Verizon's Advocacy Elsewhere.

Quoting snippets from testimony and pleadings Verizon has filed in other states, AT&T and Sprint argue that what Verizon advocates elsewhere is consistent with what they seek here. That is flatly wrong. Verizon consistently advocates *the same* benchmark policy it advocates here, *i.e.*, that the rate of the ILEC that has undergone the most scrutiny (which is typically the RBOC) should be used as the benchmark rate for all telephone companies. That approach places all competitors on a level playing field, eliminating the economic distortions that arise where some LECs are permitted to charge more than others for the same switched access service. Moreover, Verizon has acknowledged elsewhere that to the extent ILECs present facts demonstrating they need and use a contribution from switched access to meet their unique regulatory obligations, which stem from a bygone monopoly era, ILECs should be required to collect more of their network costs from their own end users – just as Verizon advocates here.⁷⁹

The examples AT&T cites for Verizon's purportedly inconsistent advocacy demonstrate the correctness of Verizon's advocacy here. In Washington State, Verizon requested that Embarq be required to mirror the intrastate switched access rate of either Qwest (the RBOC) or Verizon Northwest, which are *well* above those carriers' interstate rates and are not dissimilar to the Verizon NJ's rate.⁸⁰ In that case, Verizon's witness devoted an entire section of his rebuttal testimony to arguing that Embarq is capable of offsetting intrastate switched access reductions

⁷⁹ At the same time, in states where Verizon has asked regulators to reduce excessive switched access rates to reasonable benchmark levels, Verizon has urged regulators to reject *unsupported* arguments by ILECs that they need a contribution from switched access to meet their legacy regulatory obligations. Unless an ILEC has presented facts – like Verizon NJ has done here – showing the existence of such a contribution flow, there is no need to consider rebalancing.

⁸⁰ See, e.g., Ankum Direct Testimony at 45 (showing Qwest's rates in various states).

by increasing its retail local service rates – just as Verizon argues here.⁸¹ Moreover, the benchmarks Verizon advocates in Washington (and in other states where Verizon has asked commissions to require carriers to mirror a reasonable benchmark rate) are not dissimilar to Verizon NJ’s intrastate switched access rate.⁸²

C. AT&T *Elsewhere* Advocates a Balanced Approach to Switched Access Reform.

As discussed above, many of AT&T’s own intrastate switched access rates – here in New Jersey and in other states – are substantially higher than Verizon NJ’s. That fact alone calls into question AT&T’s loud rhetoric about the purported urgency of immediate Board action. What further highlights AT&T’s intellectual dishonesty is the fact that *elsewhere* AT&T advocates a balanced approach to switched access reform which includes rate rebalancing. For example, AT&T advocates federal reform that will provide carriers with relatively low end-user rates “the regulatory freedom ... to increase end-user rates to mitigate any reduction in access revenues.”⁸³ The Board should pay attention to the balanced advocacy that AT&T has articulated elsewhere and should reject AT&T’s insistence that revenue recoupment must be divorced from switched access reform in New Jersey.

VII. CONCLUSION

For the foregoing reasons, to promote access intrastate switched access reform in the way that best accommodates New-Jersey-specific conditions, the Board should adopt Verizon’s proposed two-step approach (*i.e.*, cap all LEC intrastate switched access rates at the rate

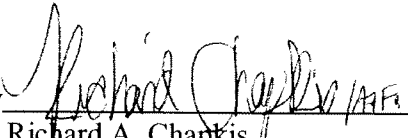
⁸¹ See Rebuttal Testimony of Paul B. Vasington on behalf of Verizon, *Verizon Select Services, Inc. et al. v. United Telephone Company of the Northwest*, Docket No. UT-081393 (June 5, 2009), Section III-D.

⁸² For example, the chart on page 45 of Dr. Ankum’s Initial Testimony shows the switched access rates Qwest charges in its footprint, including its rates in Washington and Minnesota – states where Verizon has brought switched access complaints against Embarq and other LECs.

⁸³ See Letter of Robert W. Quinn, Jr. on behalf of AT&T, *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92 (Fed. Comm. Comm’n filed July 17, 2008) (emphasis added).

currently authorized for Verizon NJ, and then evaluate whether further intrastate access rate reductions are necessary).

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