

STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

IN THE MATTER OF THE BOARD)
INVESTIGATION REGARDING THE)
RECLASSIFICATION OF INCUMBENT)
LOCAL EXCHANGE CARRIER (ILEC))
SERVICES AS COMPETITIVE)

DOCKET NO. TX 07110873

VERIZON NEW JERSEY INC.
JOINT REBUTTAL TESTIMONY OF
PAUL B. VASINGTON
AND
PATRICK A. GARZILLO

JANUARY 29, 2008

PUBLIC VERSION

Testimony of Paul B. Vasington and Patrick A. Garzillo

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.

A. My name is Paul B. Vasington. I am a Director-State Public Policy for Verizon. My business address is 185 Franklin Street, Boston, Massachusetts 02110.

My name is Patrick A. Garzillo. My title is Vice President - Service Costs and Analysis in Verizon Telecom's Finance Department. My business address is One Verizon Way, Basking Ridge, New Jersey 07920.

Q. MR. VASINGTON, DID YOU SUBMIT INITIAL TESTIMONY IN THIS PROCEEDING?

A. Yes. I submitted initial testimony on December 14, 2007.

Q. MR. GARZILLO, PLEASE BRIEFLY SUMMARIZE YOUR QUALIFICATIONS.

A. I received a Bachelor's Degree from the New York Institute of Technology, and a Master's Degree in Management Science from Polytechnic University. In addition, I have attended business, marketing and economic courses at Duke University, Columbia University, the Wharton School of Business and The Brookings Institute. I have over 37 years of experience with Verizon and its predecessor companies. During that time, I have held a variety of positions of increasing responsibility in various internal functional organizations, including Network Engineering, Service Costs, Carrier Access Services, Special Services Operations, Retail Product Management and Market Management, and Wholesale Market Development for Competitive Local Exchange Carriers. As Vice President - Service Costs and Analysis organization, I am responsible for managing and supervising the development, preparation and analysis of service cost studies for retail

1 and wholesale products and services, separations, and Part 64/cost allocations in all of
2 Verizon's serving areas.

3 **Q. WHAT IS THE PURPOSE OF YOUR JOINT REBUTTAL TESTIMONY?**

4 A. The purpose of our joint rebuttal testimony is to respond to testimony filed by
5 Ms. Susan M. Baldwin on behalf of the New Jersey Division of Rate Counsel ("Rate
6 Counsel"), and the testimony filed by Mr. James A. Appleby on behalf of Sprint
7 Communications Company, L.P., Sprint Spectrum, L.P., and Nextel of New York, Inc.
8 (collectively, "Sprint Nextel"). Our testimony demonstrates that ILEC-provided¹ retail
9 mass market services, which are not currently classified as competitive, meet the
10 statutory competitive classification criteria (presence of competitors; availability of like
11 or substitute services; and ease of market entry), and that neither Rate Counsel nor Sprint
12 Nextel have offered any credible evidence to contradict that fact.

13 **Q. IS EACH WITNESS PRIMARILY RESPONSIBLE FOR PARTICULAR**
14 **ASPECTS OF THE TESTIMONY?**

15 A. Yes. While both members of the panel have reviewed and support the testimony in its
16 entirety, each panel member assumes primary responsibility for specific aspects of the
17 testimony, and each panel member relies on facts developed by the other panel member
18 in his area of primary responsibility. Specifically, Mr. Vasington is primarily responsible
19 for evaluating the Rate Counsel's and Sprint's erroneous contentions that ILEC-provided
20 retail mass market services do not satisfy the statutory reclassification criteria.
21 Mr. Garzillo is primarily responsible for responding to Rate Counsel's and Sprint

¹ An "ILEC-provided" service is a service provided by an incumbent local exchange carrier.

1 Nextel's erroneous assertion that Verizon's intrastate competitive telecommunications
2 services are improperly subsidized by non-competitive services.

3 **Q. PLEASE SUMMARIZE YOUR CONCLUSIONS.**

4 A. A review of the evidence, in accordance with the reclassification statute, compels the
5 conclusion that mass market services meet the competitive classification criteria. The
6 record shows that there are a substantial number of competitors providing retail mass
7 market communications services in New Jersey, including cable companies, wireless
8 carriers, over-the-top voice-over-Internet-protocol ("VoIP") providers, and traditional
9 wireline competitive local exchange carriers ("CLECs"). The record further
10 demonstrates that these competitors offer like or substitute services that compete with
11 ILEC-provided retail mass market retail services. Evidence of Verizon's dramatic line
12 losses and the corresponding gains in subscribership by cable, wireless, VoIP and other
13 providers leave no doubt that New Jerseyans have a choice among a variety of
14 competitive mass market offerings, and that they are exercising that choice every day.
15 The record further demonstrates that there are no barriers to entering the market for retail
16 mass market services in New Jersey. That so many competitors have already entered the
17 market is conclusive proof of this fact.

18 Rate Counsel and Sprint Nextel largely ignore the existence of substantial and
19 credible evidence – which undermines their case – showing that numerous intra- and
20 inter-modal competitors have entered the market and are providing mass market services
21 in New Jersey. Instead, Rate Counsel and Sprint Nextel offer a host of erroneous
22 arguments to try to delay the appropriate regulatory treatment of ILEC-provided retail
23 mass market services. Rate Counsel and Sprint Nextel, for example, urge the Board to

1 depart from well-established reclassification criteria, and, in their place, adopt irrelevant
2 criteria that have already been rejected by the Board. Rate Counsel also encourages the
3 Board to ignore the relevant product market, and, instead, adopt its overly-narrow and
4 backward-looking definitions, because that is the only way Rate Counsel can avoid the
5 obvious conclusion that traditional mass market services are being displaced by intra-
6 and inter-modal alternatives. Finally, Rate Counsel and Sprint make a number of
7 arguments addressing issues that they consider to be important to this case – *e.g.*,
8 intrastate access charge levels and the FCC’s views on Verizon’s request for relief from
9 certain *wholesale* regulations – but these issues simply have no relevance to the Board’s
10 determination.

11 In sum, Rate Counsel’s and Sprint Nextel’s erroneous contentions do not – and
12 cannot – change the fact that *all* ILEC-provided retail mass market services should be
13 classified as competitive at the conclusion of this proceeding.

14 **II. RATE COUNSEL’S AND SPRINT NEXTEL’S ATTEMPTS TO**
15 **EXPAND THE STATUTORY RECLASSIFICATION CRITERIA ARE**
16 **CONTRARY TO BOARD PRECEDENT, RULINGS IN THIS CASE,**
17 **AND SOUND ECONOMIC PRINCIPLES**

18 **Q. DO RATE COUNSEL AND SPRINT NEXTEL SEEK TO EXPAND THE**
19 **STATUTORY RECLASSIFICATION CRITERIA?**

20 A. Yes. Rate Counsel urges the Board to expand the classification criteria beyond the three
21 statutory criteria, arguing that the Board *may* rely on criteria in addition to the statutory
22 reclassification criteria.² Rate Counsel then seeks to inject into the proceeding a host of
23 issues having no bearing on the statutory reclassification criteria. As an example, Rate

² Baldwin at 9-10.

Counsel's testimony includes an incorrect analysis on the private line and special access markets, which are certainly not related to competition for retail mass market services.³ Similarly, Sprint Nextel's testimony focuses almost exclusively on intrastate access issues that are unrelated to the issue of competitive classification for retail mass market services.

Q. SHOULD THE BOARD EXPAND THE SCOPE OF ITS INVESTIGATION BEYOND THE STATUTORY RECLASSIFICATION CRITERIA?

A. No. As explained in Verizon's initial testimony, the Board has consistently and appropriately relied on only the three statutory criteria without any other proofs or tests.⁴

Q. IS THE BOARD'S RELIANCE ON THE THREE STATUTORY COMPETITIVE CLASSIFICATION CRITERIA APPROPRIATE?

A. Yes. A market that satisfies the three statutory reclassification criteria is competitive. Two of the three criteria – the presence of competitors and the availability of like or substitute services – ensure that existing competitors already provide services that compete with Verizon's retail mass market services. If substitutes are available from competitors, customers can switch to those services if a firm attempts to raise its prices above competitive levels, thereby making the attempt unprofitable. The third criterion – ease of market entry – ensures that competitors can easily enter the market and/or expand the scale and scope of their operations. Even where no substitutes are currently available, a lack of barriers to entry means that an attempt to increase prices above competitive levels would stimulate market entry and thus render the attempt to raise prices above competitive levels unprofitable. Thus, a service should be considered competitive if

³ See, e.g., Baldwin at 97-100.

⁴ Vasington Direct at 8-9.

other competitors providing like or substitute services are present or there is ease of market entry.

Q. HAS THE BOARD RECENTLY REJECTED REQUESTS TO EXPAND THE SCOPE OF AN INVESTIGATION BEYOND THE STATUTORY RECLASSIFICATION CRITERIA?

A. Yes. The Board refused to expand the scope of its evaluation beyond the statutory criteria in the recent CLEC and Directory Assistance Services reclassification proceedings.⁵

Q. HAS THE BOARD ALREADY ESTABLISHED THE SCOPE OF REVIEW IN THIS PROCEEDING?

A. Yes. The order commencing this proceeding provides that the Board will examine the three statutory reclassification criteria:

[T]he Board deems it appropriate at this time, to conduct a full investigation of and hearing on the question of whether ILEC provided mass market retail services should be declared competitive pursuant to N.J.S.A. 48:2-21.19(b), after review and consideration of the necessary criteria. *Specifically the Board seeks to determine if ILEC mass market retail telecommunications services satisfy the necessary elements of ease of market entry, presence of other competitors, and availability of like or substitute services in the relevant geographic area.*⁶

Moreover, the Board's reconsideration order, affirming the order commencing the proceeding, confirms that the scope of review "will be based upon the same statutory

⁵ *In the Matter of the Board Investigation Regarding the Reclassification of Competitive Local Exchange Carrier Services as Competitive*, Docket No. TX 06120841, Order (NJ BPU June 29, 2007) ("CLEC Reclassification Order"); *I/M/O the Board's Review of the Classification of Verizon New Jersey Inc.'s Directory Assistance Services ("DAS") as Competitive*, Docket Nos. TX06010057 and TT97120889, Telecommunications Order (NJ BPU June 28, 2007) ("DA Reclassification Order").

⁶ *I/M/O of the Board Investigation Regarding the Reclassification of Incumbent Local Exchange Carrier Services as Competitive*, Docket No. TX070110873, Order, at 2 (NJ BPU Nov. 28, 2007) (emphasis added).

criteria contained in *N.J.S.A. 48:2-21.19*,” which the Board defines as “whether or not ILEC mass market retail telecommunications services satisfy the statutory elements of ease of market entry, presence of other competitors, and the availability of like or substitute services in the relevant geographic area.”⁷ The reconsideration order also makes clear that issues related to access charges, costs of service, profits, quality of customer service, and rate base/rate of return are outside the scope of this proceeding.”⁸

Q. WHAT WEIGHT SHOULD THE BOARD ASCRIBE TO ARGUMENTS AND ASSERTIONS THAT HAVE NO BEARING ON THE RECLASSIFICATION CRITERIA?

A. In light of past Board’s precedent, sound policy, and clear rulings in this case, the Board should accord no weight to testimony that fails to address the three statutory criteria.

III. RATE COUNSEL MISDEFINES THE RELEVANT PRODUCT MARKET

Q. PLEASE SUMMARIZE MR. VASINGTON’S INITIAL TESTIMONY ON THE RELEVANT PRODUCT MARKET?

A. In his initial testimony, Mr. Vasington explains that services are substitutes if *consumers* view them as *similar enough* that, in the face of a small but significant and non-transitory increase in the price of one good or service, a sufficient number of customers, over time, would switch to the other good or service.⁹ Applying this well-established product market definition to the facts, Verizon demonstrates that the product market for mass market services includes services provided by a variety of intra- and inter-modal carriers,

⁷ *I/M/O of the Board Investigation Regarding the Reclassification of Incumbent Local Exchange Carrier Services as Competitive*, Docket No. TX070110873, Order on Reconsideration, at 5-6 (NJ BPU Dec. 21, 2007) (“Reconsideration Order”).

⁸ *Id.*

⁹ Vasington Direct at 42.

1 including ILECs, CLECs, cable companies, wireless carriers, and VoIP providers. This
2 contention is supported by the fact that the demand for ILEC and CLEC mass market
3 services has been declining dramatically for some time, while the demand for intermodal
4 substitutes has been increasing considerably.¹⁰ For example, the most recent FCC report
5 on local competition shows that the total number of ILEC and CLEC lines combined in
6 New Jersey as of December 31, 2006 is 5,520,391, substantially fewer than the 7,207,018
7 wireless subscribers in the state.¹¹

8 **Q. RATE COUNSEL ARGUES THAT INTERMODAL ALTERNATIVES ARE NOT**
9 **LIKE OR SUBSTITUTE SERVICES FOR BASIC MASS MARKET SERVICES.¹²**
10 **IS THAT CORRECT?**

11 A. No. The Board should not accept Rate Counsel's overly narrow definition of the market
12 and overlook intermodal alternatives. Ms. Baldwin agrees that services need not be
13 identical to be considered substitutes, but contends that Verizon has not demonstrated
14 "that there is sufficient cross-elasticity of demand with households' primary lines to
15 justify considering intermodal services as acceptable substitutes for wireline service."¹³
16 Rate Counsel's argument about intermodal competition does not comport with the facts.
17 As discussed in more detail below, marginal gains in package lines have been more than
18 offset by losses in non-package lines, thus demonstrating that customers have found
19 alternatives for their basic services. Similarly, Verizon's line losses and the
20 corresponding line gains by intermodal carriers demonstrate that customers are actually

¹⁰ Vasington Direct at 66.

¹¹ FCC, "Local Telephone Competition: Status as of December 31, 2006," released December 2007, Tables 7 and 14.

¹² Baldwin at 15.

¹³ Baldwin at 55.

1 substituting intermodal alternatives for traditional wireline services. Moreover, the
2 volume of telephone numbers ported from Verizon to its facilities-based competitors
3 confirms that Verizon line losses are due to competition (a fact that Rate Counsel did not
4 even attempt to rebut). Undisputed evidence in the record shows that more than [BEGIN
5 VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY] numbers
6 have been ported completely off Verizon's network as of September 2007, with an
7 average of almost [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON
8 PROPRIETARY] numbers being ported off Verizon's network each month.¹⁴

9 **Q. RATE COUNSEL ARGUES THAT BUNDLED PACKAGES DO NOT**
10 **CONSTRAIN PRICES FOR À LA CARTE SERVICES.¹⁵ IS THIS ARGUMENT**
11 **CORRECT?**

12 A. No. This argument is wrong in concept, and it is contradicted by the facts. A customer
13 may be willing to purchase one service at a higher price from one competitor rather than
14 a similar service from another if the customer believes that the more expensive service is
15 higher in quality or offers a unique feature. For example, iPods are priced higher than
16 many other digital music players, yet many customers prefer iPods for the customer
17 interface and other features. The critical issue is whether the two services are similar
18 enough in the eye of the customer, not whether the two services have identical
19 characteristics.

20 Customers who purchase stand-alone basic service have decided that the value of
21 the additional components of a package (*e.g.*, unlimited long distance calling and vertical
22 features) is not equal to the additional cost. However, if the price of stand-alone basic

¹⁴ Vasington Direct at 64.

¹⁵ Baldwin at 63.

1 service were to increase, the price difference between stand-alone basic service and the
2 package would shrink, thus encouraging stand-alone customers to switch to a package.
3 In this way, packages constrain the prices of stand-alone basic service, ensuring that the
4 price for basic services does not exceed market levels.

5 To use an analogy, one may decide to purchase Budweiser for \$12 per case, even
6 though one prefers Sam Adams, because Sam Adams costs \$21 per case. But if the price
7 of Budweiser increases to \$16 per case, one may decide that the quality difference
8 between Budweiser and Sam Adams is worth more than the \$5 price difference.
9 Therefore, the availability of the premium product, even at a higher price, disciplines the
10 price of the more basic product.

11 Verizon's line losses to CLECs and intermodal competitors that focus on selling
12 bundled services are evidence that the à la carte and packaged services are in the same
13 market. Likewise, the intracompany shift within Verizon from à la carte services to
14 package plans shows that the two are in the same market. As the New York PSC recently
15 concluded:

16 ... bundled telecommunication services, VoIP, and wireless are all
17 in competition with unbundled wireline services, as the
18 incumbent's continuing loss of lines and access minutes strongly
19 suggests.¹⁶

20 It is also worth mentioning that the Virginia Commission recently found "that if a
21 cable company is presently offering local telephone service in a geographic market area,
22 *in any price or bundled configuration*, it meets the 'potential for competition'
23 standard ..." The Virginia Commission reasoned that "[s]ince that cable company has

¹⁶ Case 05-C-0616, *Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services. Statement Of Policy On Further Steps*

1 already invested the capital and human resources necessary to offer telephone service,
2 there are no significant barriers to entry to prevent that cable provider from competing
3 directly on price with Verizon for [basic service], should Verizon raise its [basic service]
4 prices.”¹⁷ This ruling confirms the well established principle that alternative providers do
5 not have to be currently offering an identical service at an identical price in order to be
6 considered “like or substitute” services.

7 **IV. RATE COUNSEL’S AND SPRINT NEXTEL’S CONTENTIONS**
8 **REGARDING EASE OF MARKET ENTRY ARE WRONG**

9 **Q. RATE COUNSEL CONTENDS THAT THE DECLINING USE OF UNES BY**
10 **CLECS SHOWS THAT THE MARKET IS NOT COMPETITIVE.¹⁸ IS THIS**
11 **CONTENTION CORRECT?**

12 A. No. While it is true that some volumes have waned, this does not prove the existence of
13 an entry barrier or a lack of competition. Both ILEC and CLEC traditional wireline
14 service is declining in the face of intermodal competition. From December 2003 through
15 September 2007, the number of retail lines sold by Verizon declined by nearly [BEGIN
16 VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY].
17 Although the number of resale and wholesale lines fell by about [BEGIN VERIZON
18 PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY] lines during that time
19 period, facilities-based competitors added over [BEGIN VERIZON PROPRIETARY]

Toward Competition In The Intermodal Telecommunications Market And Order Allowing Rate Filings (Issued and Effective April 11, 2006)(“NY PSC Intermodal Competition Order”), at 40.

¹⁷ See Case No. PUC-2007-00008 Application of Verizon Virginia Inc. and Verizon South Inc. For a Determination that Retail Services Are Competitive and Deregulating and Detariffing of the Same, “Order on Application” (dated December 14, 2007) (the “Virginia Deregulation Order”), at 20-21 (italics added). On January 17, 2007, Verizon VA filed an application and exhibits with the Virginia Commission for a determination that retail services are competitive and for deregulating and detariffing of its retail services. The Virginia Commission granted Verizon VA partial relief in its Deregulation Order. Subsequently, the Commission accepted Verizon VA’s petition for reconsideration, and an order regarding that petition is expected shortly.

¹⁸ Baldwin at 24, 29.

1 [REDACTED] [END VERIZON PROPRIETARY] estimated lines, and this does not even
2 include the substantial gain in wireless lines.¹⁹ Traditional CLECs remain as viable
3 competitors, but intermodal competitors are proving to be the most formidable
4 competitors in the market and are taking share from both Verizon and traditional CLECs.

5 **Q. RATE COUNSEL NOTES THAT THE VIRGINIA COMMISSION FOUND THAT**
6 **IT IS RESOURCE INTENSIVE FOR CABLE COMPANIES TO OFFER**
7 **TELEPHONE SERVICES.²⁰ IS RATE COUNSEL'S RELIANCE ON THIS**
8 **FINDING JUSTIFIED?**

9 A. No. Rate Counsel's reliance on this proceeding is misplaced. The *Virginia Deregulation*
10 *Order* states that 90% of Virginia households are passed by cable, but only 60% have
11 cable telephony available.²¹ In New Jersey, by contrast, 3.37 million of the 3.47 million
12 households have access to cable providers, and 96.5% of these homes have access to
13 cable telephony.²² Because cable telephony is ubiquitous in New Jersey, but not in
14 Virginia, the Virginia finding is of no relevance here. It bears mention, however, that the
15 Virginia Commission also found that where cable telephony is available, it constitutes a
16 substitute for traditional telephone services: "We agree with Verizon that where a cable
17 company has upgraded its network to provide telephone service, it represents a
18 competitive alternative to Verizon."²³ Thus, the Virginia decision supports Verizon's
19 contention that substitute services are widely available throughout New Jersey.

¹⁹ Vasington Direct at 65.

²⁰ Baldwin at 43, citing *Virginia Deregulation Order* at 19.

²¹ *Virginia Deregulation Order* at 19, n.50.

²² Vasington Direct at 15.

²³ *Virginia Deregulation Order* at 20.

1 **Q. RATE COUNSEL AND SPRINT NEXTEL CONTEND THAT EXISTING ILEC**
2 **INTRASTATE ACCESS RATES CONSTITUTE A BARRIER TO ENTRY OR**
3 **COMPETITION.²⁴ IS THIS CORRECT?**

4 A. No. A competitor's ability to enter or compete in the market for the services at issue in
5 this case is not affected by intrastate access rates, because intrastate access rates are not
6 paid on these services – *i.e.*, local exchange carriers assess access charges on
7 interexchange carriers for use of local exchange facilities to originate or terminate traffic
8 that is carried to or from a distant exchange; access charges are not imposed on basic
9 local exchange calls and the other services at issue here. Moreover, Sprint Nextel is not
10 the only carrier that pays intrastate access charges. Carriers, including Verizon, Embarq
11 and their affiliates, must pay access charges whenever terminating interexchange calls on
12 another carrier's network. Although access charges may fairly be characterized as a cost
13 of doing business, they are not a barrier to entry, as evidenced by the plethora of
14 providers offering like or substitute services in New Jersey.

15 **V. RATE COUNSEL'S CLAIMS REGARDING THE PRESENCE OF**
16 **COMPETITORS AND THE AVAILABILITY OF LIKE OR**
17 **SUBSTITUTE SERVICES SHOULD BE REJECTED**

18 **Q. RATE COUNSEL CONTENDS THAT VERIZON "DOMINATES" THE**
19 **TELECOMMUNICATIONS MARKET IN NEW JERSEY.²⁵ IS THIS**
20 **CORRECT?**

21 A. No. Contrary to Rate Counsel's claims, Verizon has presented overwhelming evidence
22 that an array of intra- and inter-modal competitors is offering substitutes for mass market
23

²⁴ Baldwin at 93; Appleby at 7.

²⁵ See, e.g., Baldwin at 23.

1 services throughout New Jersey. Rate Counsel's attempts to undermine this evidentiary
2 showing should be rejected.

3 **Q. RATE COUNSEL ARGUES THAT CABLE TELEPHONY IS NOT AVAILABLE**
4 **IN MANY NEW JERSEY WIRE CENTERS.²⁶ IS RATE COUNSEL'S**
5 **CONTENTION CORRECT?**

6 A. No. Rate Counsel's contention is based on a simple data mistake. Rate Counsel cites a
7 Verizon data request response (Proprietary Attachment Sprint-VNJ-20f) as the basis for
8 its contention that cable telephony is not available in many New Jersey wire centers.
9 However, Verizon's data request response is inconsistent with Rate Counsel's
10 conclusion. Rate Counsel appears to have considered only the *business* lines in the
11 attachment, but overlooked the *residential* lines.²⁷ Had Rate Counsel examined the
12 number of residential cable telephony lines in New Jersey, it would have seen that there
13 are cable residential telephony lines in [BEGIN VERIZON PROPRIETARY] [REDACTED]
14 [REDACTED] [END VERIZON PROPRIETARY] served by Verizon New Jersey, and
15 cable telephony is available to 96.5% of the households passed by cable providers (which
16 is 3.37 million of the 3.47 million households in the state). This is a fundamental
17 shortcoming in Rate Counsel's analysis.

²⁶ Ms. Baldwin states that "... in many wire centers, the cable presence is non-existent or negligible," stating that there are numerous examples and listing some wire centers "beginning with the letter 'm' ... [f]or the sake of illustration." Baldwin at 18.

²⁷ Verizon confirmed these data using the "pdf" attachments that Verizon provided in response to discovery, so the mistake was not due to the fact that Verizon did not supply Rate Counsel with Excel files containing these data.

1 **Q. RATE COUNSEL TRIES TO DOWNPLAY THE IMPORTANCE OF**
2 **COMPETITION FROM CABLE COMPANIES BY ARGUING THAT**
3 **TELEPHONE COMPANIES AND CABLE COMPANIES ARE A DUOPOLY.²⁸**
4 **PLEASE RESPOND.**

5 A. Rate Counsel's attempts to characterize the mass market as a "cable-telco duopoly" are
6 plainly wrong. First, New Jersey customers can and do choose from a host of separate
7 intra- and inter-modal providers, and the services offered by these providers constrain
8 Verizon's prices for both bundled and à la carte offerings.

9 Second, even if the market did contain only two competitors, this does not
10 necessarily mean that the market is not effectively competitive. The level of competition
11 in a market is influenced by the behavior of the providers more than the market structure
12 (e.g., duopoly or oligopoly). Competition in a market suffers only if the firms improperly
13 coordinate their activities through explicit or tacit collusion.²⁹ And there is no evidence
14 to suggest that New Jersey cable companies and ILECs have engaged in any coordinated
15 behavior. To the contrary, evidence of aggressive competition is pervasive, with
16 advertisements for cable and ILEC products and services permeating the airwaves, the
17 print media, and the Internet. As shown in Verizon's initial testimony, cable telephone
18 providers have experienced a gain of nearly [VERIZON PROPRIETARY BEGINS]
19 [REDACTED] [VERIZON PROPRIETARY ENDS] facilities-based residential lines from
20 December 2005 to September 2007.³⁰ In the same time period, Verizon has lost over

²⁸ Baldwin at 44.

²⁹ See Dennis W. Carlton; Perloff, Jeffrey M., "Modern Industrial Organization," 3rd Edition, Addison-Wesley, 2000, Chapter 5 ("Carlton Perloff").

³⁰ Vasington Direct at 69-70.

1 [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY]

2 residential lines in the State.³¹

3 Third, for cartels to control market prices, the two producers' price structures
4 need to be similar and the products and services need to be homogenous.³² This is not the
5 case here because cable companies and ILECs have different cost structures and provide
6 differentiated products.

7 Fourth, cable companies and ILECs both face competition for their core products:
8 cable companies must compete with wireline and satellite for video; and "telephone"
9 companies must compete with other wireline and wireless providers for voice; and, both
10 must compete against each other and fixed wireless and mobile wireless for broadband.
11 Thus, neither the market structure nor the prospect for coordinated pricing is as simple as
12 implied by Rate Counsel.

13 **Q. RATE COUNSEL HIGHLIGHTS "ATTRIBUTES OF WIRELESS SERVICE**
14 **THAT DISTINGUISH IT FROM WIRELINE SERVICE."³³ DOES THIS MEAN**
15 **THAT WIRELESS SERVICE IS NOT A SUBSTITUTE FOR WIRELINE**
16 **SERVICE?**

17 **A.** No. While wireline service has certain attributes that may be viewed as superior to
18 wireless service (*e.g.*, almost no dropped calls), and wireless service has attributes that
19 may be viewed as superior to wireline service (*e.g.*, mobility and multifunction handsets),
20 the fact that wireless and wireline services have different attributes does not preclude
21 them from being substitutes. In order for wireless service to provide a competitive threat
22 to wireline and provide pricing discipline, it is not necessary that every customer consider

³¹ Vasington Direct at 51.

³² See Carlton Perloff at 136.

³³ Baldwin at 53-54.

1 it to be an alternative under all circumstances—it is only necessary that enough
2 customers consider it to be an adequate alternative that it would be unprofitable in the
3 long term for Verizon to increase its prices above competitive levels. And, as Verizon’s
4 initial testimony shows, even in the absence of a price increase for landline service,
5 customers in increasing numbers have been “cutting the cord” (*i.e.*, dropping their
6 landline service in favor of wireless service).

7 **Q. RATE COUNSEL ARGUES THAT WIRELESS SERVICE IS NOT A**
8 **SUBSTITUTE FOR WIRELINE SERVICE BECAUSE ACCORDING TO RATE**
9 **COUNSEL, FEW CUSTOMERS ARE “CUTTING THE CORD” AND**
10 **RESORTING EXCLUSIVELY TO WIRELESS.³⁴ IS THIS CORRECT?**

11 A. No. This argument is wrong for several reasons.

12 First, it is flatly contradicted by evidence that wireless service has been
13 displacing wireline service. Consumers *are* cutting the cord in substantial *and growing*
14 numbers, as shown in Verizon’s initial testimony. The United States Centers for Disease
15 Control and Prevention (“CDC”) recently updated a survey cited in Verizon’s initial
16 testimony that estimates the level of wireless substitution.³⁵ The previous survey
17 determined that 12.8 percent of households had only wireless phones, and that this trend
18 has been increasing. The new survey, conducted in the first half of 2007, determined that
19 13.6% of households had only wireless phones, thus confirming the trend.

20 Second, estimates of how many customers currently have “cut the cord” do not
21 provide information about how consumers would respond if relative prices changed —
22 which is the fundamental question at issue in determining whether a service is a

³⁴ Baldwin at 51.

³⁵ Blumberg SJ, Luke JV. Wireless substitution: Early release of estimates from the National Health Interview Survey, January – June 2007. National Center for Health Statistics. Available from <http://www.cdc.gov/nchs/nhis.htm>. December 10, 2007.

1 substitute. That 13.6% of customers have “cut the cord” already strongly suggests that
2 many more customers would drop their wireline service entirely if a company were to
3 raise prices above market levels.

4 **Q. RATE COUNSEL NOTES THAT THE VIRIGINA COMMISSION DID NOT**
5 **VIEW A VERIZON WIRELESS AFFILIATE AS COMPETING WITH THE**
6 **VERIZON INCUMBENT.³⁶ SHOULD THE BOARD REACH A SIMILAR**
7 **CONCLUSION HERE?**

8 A. No. Even if gains by Verizon Wireless account for some of Verizon’s landline losses,
9 this movement still constrains landline pricing and is evidence that wireless is a substitute
10 for wireline services. If the Board were nevertheless to reach a similar conclusion, it
11 would make no difference to an evaluation of the presence of competitors in New Jersey.
12 Verizon showed in its initial testimony that 3,069,576 out of 3,092,474 New Jersey
13 households are in areas with three or more wireless service providers,³⁷ and Verizon New
14 Jersey is affiliated with only one wireless service provider, Verizon Wireless. So 99.3%
15 of New Jersey households have the option of at least two non-Verizon-affiliated wireless
16 service providers. Verizon could not risk raising landline prices above competitive levels
17 because even more customers would “cut the cord” and switch to a wireless carrier other
18 than Verizon Wireless.³⁸

³⁶ Baldwin at 59.

³⁷ Vasington Direct at 18-19.

³⁸ If Verizon were to attempt to price its mass market services above market levels (especially to the levels predicted by Rate Counsel), it is highly unlikely that those same customers would turn to other Verizon-branded services like Verizon Online DSL or Verizon Wireless. It is much more likely that customers would turn to non-Verizon alternatives, such as Comcast for broadband or wireline telephone, or AT&T for wireless.

1 **Q. RATE COUNSEL CONTENDS THAT THE BOARD “SHOULD NOT GIVE**
2 **MUCH WEIGHT TO” OVER-THE-TOP VOIP ALTERNATIVES BECAUSE**
3 **THEY ARE “MOSTLY PROVIDED THROUGH DSL OR CABLE MODEM**
4 **CONNECTIONS.”³⁹ IS THIS CONTENTION CORRECT?**

5 A. No. VoIP is an entirely separate application from the underlying broadband service.
6 Moreover, the broadband services underlying over-the-top VoIP services are widespread
7 and rapidly growing in New Jersey, which leads the nation in broadband lines per capita.
8 As pointed out in Verizon’s initial testimony, “[b]y December 2006, there were about 3.4
9 million broadband lines in service in New Jersey. New Jersey has more broadband lines
10 per capita than any other state in the country.”⁴⁰ Notably, 62% of the broadband lines in
11 New Jersey are purchased by residential customers. The many customers who have
12 already decided to obtain broadband services can add over-the-top VoIP services at low
13 prices. Data is not available to determine just how many customers in New Jersey
14 already subscribe to over-the-top VoIP services, but with the nation-leading deployment
15 of broadband services in New Jersey, it is clear that many more customers would
16 subscribe to VoIP if Verizon were to attempt to charge above-market prices for its mass-
17 market wireline services.

18 **Q. RATE COUNSEL CLAIMS THAT “BECAUSE A COMPETITIVE AND**
19 **AFFORDABLE BROADBAND PLATFORM DOES NOT YET EXIST,”**
20 **INTERMODAL ALTERNATIVES THAT RELY ON BROADBAND ACCESS**
21 **ARE NOT SUBSTITUTES FOR BASIC LOCAL EXCHANGE SERVICE.”⁴¹ IS**
22 **THIS CLAIM ACCURATE?**

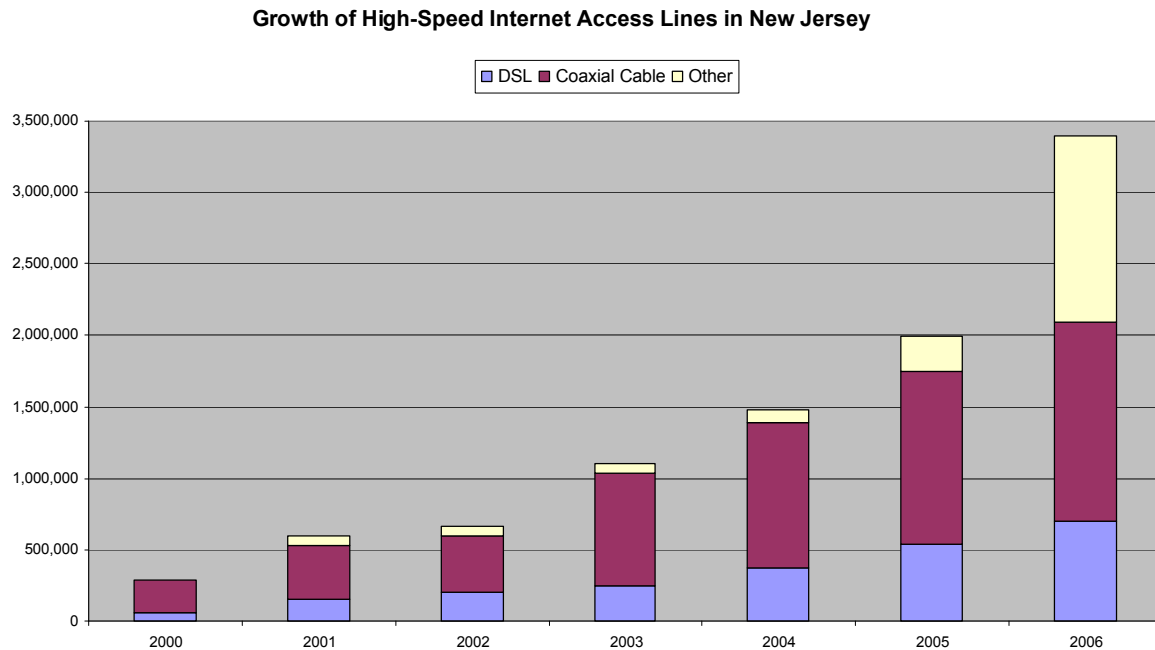
23 A. No. Rate Counsel does not define the term “affordable,” but the rapid increase in
24 broadband subscribership in the State contradicts this claim. Verizon’s initial testimony

³⁹ Baldwin at 49.

⁴⁰ Vasington Direct at 25 (footnote omitted).

⁴¹ Baldwin at 23.

includes the chart below showing the rapid growth of total high speed Internet access lines in New Jersey from 2000 to 2006.⁴² A service that shows such popularity and growth can hardly be considered to be unaffordable.



Note: "Other" assumed to be zero in 2000, as actual breakdown with cable is unavailable.
Source: FCC, *High-Speed Services for Internet Access: Status as of December 31, 2006-2006*.

Q. RATE COUNSEL URGES THE BOARD TO OVERLOOK THE OBVIOUS IMPORTANCE OF INTERMODAL COMPETITION BECAUSE SOME COMPETITION COMES FROM VERIZON AFFILIATES.⁴³ IS THIS POINT VALID?

A. No. As a threshold matter, Verizon faces substantial and increasing intermodal competition from non-affiliates. Cable modem is the largest single technology providing broadband service in New Jersey. Of the 3.4 million total lines: 1.4 million are served by

⁴² Note that these data include all residential and business high speed lines. Residential and small business lines account for the vast majority of those lines.

⁴³ Baldwin at 58-59.

1 cable modem, 710,000 by DSL, and the remainder by other technologies. Moreover,
2 Verizon Wireless is only one of several wireless providers operating in New Jersey.
3 Wireless carriers serving New Jersey include AT&T, Sprint/Nextel, and T-Mobile,
4 which, along with Verizon Wireless, are the largest wireless carriers in the country.⁴⁴
5 Regardless, it would be wrong to conclude that line losses to an affiliate do not constrain
6 Verizon's behaviour. As stated above, even if gains by Verizon affiliates account for
7 some of Verizon's landline losses, this movement still constrains landline pricing and is
8 evidence that the affiliates' intermodal products are substitutes for wireline services.

9 **Q. RATE COUNSEL CONTENDS THAT THE NUMBER OF CLEC-OWNED LINES**
10 **IN NEW JERSEY HAS DECLINED ALMOST 40% FROM DECEMBER 2004 TO**
11 **DECEMBER 2006.⁴⁵ IS THIS CONTENTION RIGHT?**

12 A. No. Rate Counsel's erroneous contention regarding the purported decline in CLEC lines
13 is based on another simple mistake. Rate Counsel cites FCC local competition reports as
14 the bases for Table SMB-1, which forms the basis of the contention. However, Rate
15 Counsel reversed the number of "resold" and "CLEC-owned" lines from an FCC report
16 (as of December 2004) in the table. When Rate Counsel's mistake is corrected, one can
17 see that the number of CLEC-owned lines in New Jersey declined by 6.5% – far from the
18 40% decline claimed by Rate Counsel. And even the corrected figures likely understate
19 the number of CLEC-owned lines today. In the FCC reports, CLEC lines include cable
20 telephony, but Rate Counsel confirms Verizon's conclusion that the FCC's local
21 competition report "only includes a portion of the cable telephony that is being provided

⁴⁴ As demonstrated in Verizon's initial testimony, almost 100 percent of households in the State are located in areas served by three or more mobile wireless carriers, and over 97 percent are in areas served by four or more wireless providers. Vasington Direct at 18-19.

⁴⁵ Baldwin at 30.

in the state,” so the CLEC-owned lines in the FCC report understate the actual number of facilities-based CLEC lines.⁴⁶

Q. RATE COUNSEL WANTS THE BOARD TO OVERLOOK CLECS THAT RELY ON INCUMBENTS TO PROVIDE RETAIL SERVICES BECAUSE, ACCORDING TO RATE COUNSEL, RECENT DECLINES IN UNE-P SUGGEST THAT ILEC LINE LOSSES TO CLECS MAY LEVEL OFF OR REVERSE.⁴⁷ DO YOU AGREE?

A. No. CLECs (not including MCI) still serve residential lines via resale and Wholesale Advantage in [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY] in New Jersey.⁴⁸ In last year’s CLEC deregulation order, the Board took a dim view of similar Rate Counsel arguments “disparaging” intramodal competition:

[T]his Board has certified numerous competitive providers to compete in the local exchange market, and put forth great effort in developing policies to effectuate the various unbundling and interconnection requirements, which have evolved since the initial passage of the 1996 Act. Rate Counsel's comments as to preferred methods of entry for competitors do not overcome the sheer reality of the substantial number of competitors which have received certification from the Board to provide service.⁴⁹

Moreover, although competition for mass market services using UNEs and resale has declined in recent years, this does not mean that Verizon will stop losing lines. As Verizon’s initial testimony makes clear, in New Jersey, there are currently about [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY]

⁴⁶ Baldwin at 28.

⁴⁷ Baldwin at 29.

⁴⁸ The [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY] without CLEC resale or Wholesale Advantage lines is [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY], which serves only [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY] Verizon retail residential lines.

⁴⁹ CLEC Deregulation Order at 9.

1 traditional CLECs, including AT&T, IDT, and Cavalier.⁵⁰ Many of these CLECs serve
2 mass-market customers in the Garden State – including [BEGIN VERIZON
3 PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY] that serve residential
4 customers and [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON
5 PROPRIETARY] that serve both residential and business customers. More important,
6 the data provided in Rate Counsel’s own testimony shows that Verizon has continued to
7 lose lines even though UNE-P volumes are down. The simple fact is that Verizon has
8 been losing lines to intra- and intermodal alternatives.

9 **Q. RATE COUNSEL CLAIMS THAT CONSUMERS FACE “HIGH TRANSACTION**
10 **COSTS” TO MIGRATE FROM ONE SUPPLIER TO ANOTHER.⁵¹ ARE**
11 **TRANSACTION COSTS A BARRIER TO MASS MARKET COMPETITION?**

12 A. No. Transaction costs exist to some extent in just about every industry, and yet
13 competition functions. For example, if you are shopping at Target and want to see if you
14 can get a better deal at Wal-Mart, you face the transaction cost of driving from one store
15 to another. Ms. Baldwin cites “the time and financial outlay for service installation,
16 equipment, and an e-mail address change” as transaction costs for telecommunications,
17 but these are hardly barriers to customer choice, as the evidence of Verizon line loss and
18 competitor gains conclusively show.⁵²

⁵⁰ Vasington Direct at 27. Verizon records show [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY] CLECs were serving residential or business customers in New Jersey as of September 2007.

⁵¹ Baldwin at 46-47.

⁵² *Id.* To the extent that an e-mail address change is a barrier to customer migration, this would be a significant benefit to cable companies, not to Verizon. 41% of high-speed Internet customers in New Jersey obtain their service via cable modem (*See* Vasington Direct at 25).

1 **Q. RATE COUNSEL SUGGESTS THAT PACKAGES ARE NOT SUBSTITUTES**
2 **FOR BASIC SERVICES.⁵³ DO YOU AGREE?**

3 A. No. The table below shows that from 2003–2007, Verizon lost stand-alone residential
4 lines, and gained packaged customers. However, the gain in package lines is not nearly
5 enough to offset the declines in stand-alone lines. If Ms. Baldwin is correct that “the
6 competitive threat faced by the telephone companies is in the provisions of *bundles* of
7 services ...”⁵⁴, then Verizon would not be experiencing such a dramatic decline in non-
8 package lines. Verizon’s residential loss of non-package lines demonstrates conclusively
9 that these customers have found alternatives, and the vast majority of the lines have gone
10 to competitive providers of “like or substitute” services.

11 **[BEGIN VERIZON PROPRIETARY]**

RESIDENTIAL LINES	4th Quarter 2003	4th Quarter 2007	Change
Packages	██████████	██████████	██████████
Non-Packages	██████████	██████████	██████████
TOTAL	██████████	██████████	██████████

13 **[END VERIZON PROPRIETARY]**

14 **Q. IS THE LOSS OF NON-PACKAGE LINES ATTRIBUTABLE TO A LOSS OF**
15 **ADDITIONAL LINES, AS OPPOSED TO PRIMARY LINES?**

16 A. No. Ms. Baldwin testifies that from December 2003 to September 2007, Verizon lost

17 **[BEGIN VERIZON PROPRIETARY] ██████████ [END VERIZON PROPRIETARY]**

⁵³ Baldwin at 63.

⁵⁴ Baldwin at 42 (*italics in original*).

1 additional residential lines in New Jersey.⁵⁵ Even if you assume that every one of these
2 additional lines was a non-package customer, there would still be [BEGIN VERIZON
3 PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY] primary,
4 non-package lines that were lost by Verizon. Therefore, it is beyond dispute that
5 Verizon's primary-line, non-package customers have like or substitute services available
6 to them in the State.

7 **VI. RATE COUNSEL'S ATTEMPTS TO DELAY THE PROPER**
8 **COMPETITIVE TREATMENT OF DIRECTORY ASSISTANCE**
9 **SERVICES SHOULD BE REJECTED**

10 **Q. WHAT DOES RATE COUNSEL SAY ABOUT WHETHER DIRECTORY**
11 **ASSISTANCE SERVICES SHOULD BE RECLASSIFIED AS COMPETITIVE?**

12 A. Rate Counsel argues that "Verizon fails to provide proof that the third criterion for
13 reclassification [i.e., availability of like or substitute services in the relevant geographic
14 area] is met."⁵⁶ As discussed below, the record contradicts this assertion, showing that
15 ILEC-provided DA services are competitive.

16 **Q. RATE COUNSEL CLAIMS THAT DA COMPETITION "HAS NOT CHANGED**
17 **SIGNIFICANTLY" SINCE THE BOARD LAST EVALUATED THE**
18 **COMPETITIVENESS OF DA SERVICES.⁵⁷ IS THIS CORRECT?**

19 A. No. As outlined in Verizon's initial testimony, *free* local and national DA competition
20 has increased substantially during this timeframe. Jingle Networks Inc. has surpassed the
21 200 million call milestone with its free local and national directory assistance service,
22 which is available to residence and business customers throughout New Jersey.⁵⁸

⁵⁵ Baldwin at 32.

⁵⁶ Baldwin at 133.

⁵⁷ Baldwin at 132.

⁵⁸ Jingle Networks, Inc. press release dated April 25, 2007 found at www.Free411.com/index.php

1 Furthermore, as of April 25, 2007, Jingle Networks notes that it has processed over
2 700,000 free DA calls per day – over 20 million DA calls per month, and maintains that
3 demand for its service has increased more than 400 percent since January 2006.
4 According to George Garrick, Jingle Networks' chief executive, "the service has grown
5 quickly because it doesn't cost anything or require customers to do anything
6 differently."⁵⁹

7 Other formidable free local and national DA providers have entered or expanded
8 in the DA marketplace over the past seven months. On October 30, 2007, AT&T began
9 providing *free* local and nationwide residential and business to *any and all* New Jersey
10 wireline and wireless customers throughout New Jersey regardless of their service
11 provider. Also in October 2007, Tellme™®, a Microsoft subsidiary, introduced free
12 local and nationwide DA available to *any and all* New Jersey wireline and wireless
13 telephone customers regardless of their service provider. Another notable entrant to the
14 free local and national DA marketplace is Google™ (1-800-GOOG-411), which currently
15 provides its free DA service to *any and all* New Jersey wireline and wireless customers
16 regardless of their service provider.

17 **Q. DO YOU AGREE WITH RATE COUNSEL'S CONCLUSION THAT FREE DA**
18 **PROVIDERS ARE NOT SUFFICIENTLY WELL KNOWN TO BE**
19 **CONSIDERED LIKE OR SUBSTITUTE SERVICES?**⁶⁰

20 **A.** No. To the contrary, AT&T, Microsoft, and Google are well established national brands
21 and invest significantly in print, broadcast, and Internet-based advertising. Google, for
22 example, has recently launched a roadside billboard campaign to advertise its free DA

⁵⁹ Pete Barlas, "Google, Microsoft Look to Connect in 411 Phone Business," INVESTOR'S BUSINESS DAILY, Jan. 15, 2008.

⁶⁰ Baldwin at 140.

1 service. Since its launch in October 2005, Jingle Networks, Inc. has become a leading
2 free DA service provider in the United States, and market research analysts predict its
3 growth rate to expand more than 200% per year. Jingle Networks was able to establish a
4 local and national DA brand presence by securing over 1,000 advertisers, including Avis,
5 American Express, AutoNation, CBS, Comcast, Joe Nerd, McDonald's, Nivea,
6 Paramount, Progressive Insurance, RCN, Service Magic, Service Master, 1-800-
7 FLOWERS, 1-800 DENTIST, 1-800-MATTRESS.⁶¹ Increasing numbers of consumers
8 across the country have used 1-800-FREE-411. In fact, a consumer from Pemberton,
9 New Jersey placed the 100 millionth call to 1-800-FREE-411 in November 2006, and
10 stated "I've told all my friends and family about it because it's just as useful as the paid
11 411 services, but it's free!"⁶² The growing popularity of 1-800-FREE-411 and the
12 service's ability to save money for consumers is in part due to being routinely featured on
13 consumer segments of national morning shows and TV news programs across the
14 country, which often tout the fact that 1-800-FREE-411 provides the same quality of
15 service as paid DA but for free.

16 **Q. DO YOU AGREE WITH RATE COUNSEL'S ASSERTION THAT A 411**
17 **OBSTACLE PERSISTS IN TODAY'S DA MARKETPLACE?"**⁶³

18 A. No. Verizon's initial testimony refers to numerous local and national DA competitors
19 who have entered the DA marketplace and are successfully using a variety of DA service
20 access methods, including dial around codes (e.g., 10-10-XXXX) and nationwide toll-

⁶¹ Jingle Networks press release dated April 25, 2007.

⁶² Jingle Networks press release dated November 30, 2006.

⁶³ Baldwin at 140.

1 free numbers (e.g., 1-800-FREE-411, 1-800-555-TELL, 1-800-GOOG-411) to provide
2 local and national DA service.

3 **Q. DOES THE 411 CODE GIVE VERIZON A COMPETITIVE ADVANTAGE BY**
4 **DISTINGUISHING VERIZON'S DA SERVICE FROM ALTERNATIVES, AS**
5 **RATE COUNSEL CLAIMS?⁶⁴**

6 A. No. While Verizon uses the 411 dialing code to provide local and national DA services
7 in New Jersey, many of its competitors do too. Virtually all wireless, VoIP, and cable
8 telephony providers use the 411 code. Furthermore, Verizon is required to provide
9 customized 411 routing, on a non-discriminatory basis, to any CLEC who wishes to use
10 the 411 dialing to provision of their DA service.

11 **Q. DO YOU AGREE WITH RATE COUNSEL'S CLAIM THAT IF VERIZON**
12 **ELIMINATES THE FREE ALLOWANCE AND RAISES THE DA RATE TO**
13 **\$1.50, THE "LOSS TO CONSUMERS WILL BE APPROXIMATELY**
14 **\$187,000,000" PER YEAR?⁶⁵**

15 A. No. Ms. Baldwin's revenue prediction is based on the unsupported assumption that *every*
16 Verizon line would account for four DA calls per month, whereas Verizon has
17 demonstrated that approximately 69% of its residential lines in New Jersey make no
18 Verizon DA calls per month.⁶⁶ Ms. Baldwin's estimate is also based on unsupported
19 assumptions that Verizon would eliminate any free call allowance and triple its current
20 rate, while experiencing no loss of demand for the service. Rate Counsel's estimate
21 should be given no weight, even if were relevant to one of the statutory criteria, which it
22 is not.

⁶⁴ Baldwin at 140.

⁶⁵ Baldwin at 145.

⁶⁶ See Attachment RC-VNJ-167.

Q. PLEASE DESCRIBE CURRENT DA CALLING VOLUMES IN NEW JERSEY.

A. Verizon continues to experience a sharp decline in DA calling volumes for residential and business services. The DA calling volume data for January through October 2007 demonstrates that consumers continue to look elsewhere for DA services. As of October 2007:

- Total residential DA calling volumes declined by [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY];
- Total billed residential DA calling volumes declined by [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY];
- Total business DA calling volumes declined by [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY]; and
- Total billed business DA calling volumes declined by [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON PROPRIETARY].

Q. SHOULD THE BOARD CONCLUDE THAT VERIZON'S DA SERVICES MEET THE STATUTORY CLASSIFICATION CRITERIA?

A. Yes. Verizon has demonstrated that its DA services meet the statutory criteria, and Ms. Baldwin's analyses and recommendations regarding DA are not consistent with the market evidence. First, contrary to Ms. Baldwin's claims, Verizon has demonstrated that there are numerous like or substitute DA services that provide the same or comparable DA service as Verizon's DA service.

Second, Ms. Baldwin's claim that alternatives to Verizon's DA service are "inferior, less accurate, often higher-priced, entail higher transaction costs, and are not

1 ubiquitously recognized”⁶⁷ are wrong. There is ample evidence showing that Verizon’s
2 DA competitors provide comparable DA service that is accurate; that these competitors
3 provide services that range in price from free, less than, equal to, or greater than
4 Verizon’s local DA rate of \$.50 per chargeable call; and that these competitors are widely
5 recognized by the general public – so much so, that on average 69% of Verizon’s
6 customers do not use Verizon’s DA services. In addition, while Verizon uses the 411
7 access code for its DA services, so do most wireless, VoIP, and cable telephony
8 providers. And all CLECs that wish to provide their own DA services using the 411 code
9 may do so on a non-discriminatory basis via customized routing, which is offered as an
10 UNE.

11 Third, Ms. Baldwin’s assumption that “residential consumers are far less likely to
12 invest time and resources to investigate [DA] alternatives”⁶⁸ is not based on any facts.
13 Rate Counsel has not submitted any studies or surveys to support this claim. To the
14 contrary, Jingle Network’s market success shows that residential consumers have
15 investigated alternative providers of DA services, which include AT&T, Microsoft, and
16 Google. These formidable national information service providers have recognized
17 consumer market potential by entering the DA marketplace.

18 Last, contrary to Ms. Baldwin’s claim that DA is an “integral component of basic
19 local exchange service,”⁶⁹ since 1984, Verizon’s DA has been tariffed as a separate and
20 distinct service and not part of basic local exchange service. While Verizon’s DA service
21 requires a customer to subscribe to Verizon’s basic exchange service, Verizon basic

⁶⁷ Baldwin at 147.

⁶⁸ Baldwin at 147-148.

⁶⁹ Baldwin at 148.

1 exchange customers have numerous like or substitute services to choose from for their
2 DA needs that do not require subscription to a particular service provider's exchange
3 service.

4 **Q. DO YOU HAVE ANY MORE COMMENTS OR OBSERVATIONS ON RATE**
5 **COUNSEL'S DISCUSSION REGARDING DA SERVICE COMPETITION IN**
6 **NEW JERSEY?**

7 A. Yes. Ms. Baldwin draws a conclusion that "it is implausible to assume that mass market
8 consumers would use one company for basic telephone service, and another specifically
9 for DA service,"⁷⁰ but the survey results summarized by Mr. Newman suggest otherwise.
10 A significant number of New Jersey customers are aware of numerous DA competitive
11 alternatives and are using these competitive alternatives.

12 **Q. DOES RATE COUNSEL ADDRESS THE CONSUMER SURVEY?**

13 A. Yes. Rate Counsel states that "Verizon NJ's survey exaggerates consumers' awareness
14 of DA alternatives."⁷¹ Mr. Newman's Rebuttal Testimony responds to the specifics of
15 Rate Counsel's analysis of the survey and results, but it bears mention that much of Rate
16 Counsel's criticism of the survey results is related to the presentation of the results, and
17 that is surely a case of elevating form over substance. Verizon commissioned the survey
18 to provide the type of data that the Board said it wanted to see as a demonstration of like
19 or substitute DA services in New Jersey, and Ms. Baldwin's criticisms do not undermine
20 the fact that the survey shows that a significant number of New Jersey customers are
21 aware of and have used alternative DA services. Furthermore, use and awareness of DA
22 alternatives should continue to increase given that some of largest technology and media

⁷⁰ Baldwin at 137.

⁷¹ Baldwin at 140.

companies in the world—AT&T, Microsoft, and Google—are now offering DA alternatives in New Jersey.⁷²

VII. RATE COUNSEL INTRODUCES IRRELEVANT ARGUMENTS AND ANECDOTES THAT HAVE NO BEARING ON THE THREE STATUTORY CLASSIFICATION CRITERIA

A. The FCC Forbearance Ruling is Not Relevant to This Proceeding

Q. RATE COUNSEL NOTES THAT THE FCC DENIED VERIZON’S REQUEST FOR FORBEARANCE FROM CERTAIN FEDERAL REGULATORY REQUIREMENTS IN SIX METROPOLITAN STATISTICAL AREAS.⁷³ DOES THE FCC DECISION HAVE ANY BEARING ON THIS CASE?

A. No. First, the FCC forbearance proceeding is based on a federal statutory standard that is very different from the statutory reclassification criteria at issue here.⁷⁴ Second, the FCC decision relates to *wholesale* services,⁷⁵ whereas the instant petition relates solely to *retail* services. The principal relief requested by the Verizon operating companies in the

⁷² Rate Counsel points to a recent decision of the West Virginia Public Service Commission finding that DA services are not “workably competitive” at this time (see Baldwin at 146-147), but ignores a contrary finding from Virginia in a decision that Ms. Baldwin cites numerous times in her reply testimony. The Virginia Corporation Commission found that “... competition or the potential for competition in the market place is or can be an effective regulator of the price – on a statewide basis – for DAS.” See *Virginia Deregulation Order* at 56.

⁷³ Baldwin at 68-78, citing FCC 07-212, Memorandum Opinion and Order, *In the Matter of Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas*, WC Docket No. 06-172, rel. December 5, 2007 (“*Verizon Forbearance Order*”).

⁷⁴ The FCC notes that “The [FCC] is required to forbear from any statutory provision or regulation if it determines that: (1) enforcement of the regulation is not necessary to ensure that the telecommunications carrier’s charges, practices, classifications, or regulations are just, reasonable, and not unjustly or unreasonably discriminatory; (2) enforcement of the regulation is not necessary to protect consumers; and (3) forbearance from applying such provision or regulation is consistent with the public interest. In making such determinations, the Commission also must consider pursuant to section 10(b) ‘whether forbearance from enforcing the provision or regulation will promote competitive market conditions.’” *Verizon Forbearance Order*, ¶ 19 (footnotes omitted), citing 47 U.S.C. § 160(a) and (b).

⁷⁵ Specifically, Verizon requested “forbearance ... from dominant carrier regulation of its mass market switched access services, section 251(c)(3) loop and transport unbundling obligations (UNE obligations), and all *Computer III* obligations (e.g., open network architecture (ONA) and comparably efficient interconnection (CEI) requirements).” *Verizon Forbearance Order*, ¶ 1 (footnotes omitted).

1 FCC proceeding was forbearance from unbundling regulation. Had that relief been
2 granted, in the requested MSAs, Verizon would no longer be required to provide UNE
3 loops, high-capacity loops, and transport facilities at TELRIC rates, but would instead
4 have to offer them at commercially-negotiated rates. Verizon also sought relief from so-
5 called “dominant carrier” regulation under federal law, but the dominant-carrier branch of
6 the Verizon petition was limited to interstate, mass-market, *switched access* services,
7 which also are wholesale services not relevant to this proceeding. Although Verizon
8 firmly believes that its request for unbundling relief was justified by applicable law, by
9 sound public policy, and by the record of the FCC proceeding, it would not be
10 unreasonable to conclude that such a change in wholesale regulation should be judged by
11 a different standard than would apply a request for retail pricing flexibility, even if there
12 were not a different statutory standard.⁷⁶ Therefore, the FCC’s evaluation for purposes of
13 wholesale relief is not relevant here because it employed a different standard and applied
14 that standard to wholesale services. It is worth noting, however, that the FCC did make a
15 finding that is relevant to this case, notably “... that Verizon is subject to intermodal
16 competition, particularly competition from cable operators in the 6 MSAs, primarily for
17 residential services.”⁷⁷

18 **Q. AFTER THE FCC RELEASED ITS FOREBEARANCE ORDER, THE VIRGINIA**
19 **COMMISSION ISSUED A DECISION ON COMPETITIVE CLASSIFICATION**
20 **OF RETAIL SERVICES. WHAT DID THE VIRGINIA COMMISSION FIND?**

21 A. Although the FCC’s forbearance decision denied forbearance of federal wholesale
22 regulation in the Virginia Beach MSA, the Virginia Commission classified basic

⁷⁶ On January 14, 2008, Verizon appealed the FCC’s decision to the D.C. Circuit Court of Appeals.

⁷⁷ FCC Forbearance Order, par. 23.

1 residential services as competitive in exchanges that represented an estimated 62% of
2 Verizon's residential lines in the state, including a number of exchanges in the Virginia
3 Beach MSA.⁷⁸ Also, the Virginia Commission classified "individual line" business
4 services as competitive in exchanges that represented an estimated 57% of Verizon's
5 individual business lines in the state, also including a number of exchanges in the
6 Virginia Beach MSA.⁷⁹ The Virginia Commission based its competitive classification
7 decision on a "two competitor" test,⁸⁰ which requires:

- 8 a) A minimum of 75% of the households in the telephone exchange area can
9 choose residential local telephone service from among at least two (2)
10 competitors to Verizon,⁸¹
11
- 12 b) A minimum of two (2) of the competitors to Verizon in part "a" must
13 offer residential local telephone service that may be purchased by the
14 residential consumer without a corresponding requirement to purchase
15 non-telecommunications services (e.g., video or broadband internet
16 service) from that competitor; and
17
- 18 c) At least 50% of the households in the telephone exchange area can
19 choose a facilities-based competitor that owns its own wireline network
20 facilities.⁸²
21

22 Verizon has asked the Virginia Commission to reconsider its order, in part because we do
23 not have access to all the information necessary to apply the full test, such as information

⁷⁸ *Virginia Deregulation Order* at 39-40.

⁷⁹ *Id.* at 43-44.

⁸⁰ *Virginia Deregulation Order* at 33. The business service test is comparable. *Id.* at 42.

⁸¹ The Virginia Commission notes that "Examples of an acceptable competitor in "a" above could be a cable company, CLEC, or any wireless provider not affiliated with Verizon which offers residential local telephone service." *Virginia Deregulation Order* at 34 (footnotes omitted). However, the Virginia Commission does not include CLEC resellers as acceptable competitors, and it only includes over-the-top VoIP competitors if at least 75% of households in the exchange area currently subscribe to broadband service. *Id.*

⁸² The Virginia Commission notes that "Examples of an acceptable facilities-based competitor in "c" above would include (1) a cable telephony provider that owns its own network, or (2) a CLEC provider that owns its own network and is not dependent on Verizon for leasing UNE-P or UNE-L facilities to the CLEC. Wireless or "over the top VoIP providers are not included as facilities-based providers for purposes of this Order..." *Virginia Deregulation Order* at 33.

on how many customers subscribe to broadband services offered by competitors. However, it is worth noting that applying the Virginia Commission's "two competitor" test to Verizon New Jersey's mass market services would likely result in statewide classification of services as competitive in New Jersey. As noted in Verizon's initial testimony, cable telephony is available to 96.5% of the households passed by cable providers in the State (3.37 million of the 3.47 million households), and 99.3% of New Jersey households have the option of at least two non-Verizon-affiliated wireless service providers. The wireless providers alone would likely satisfy the requirement in "a," and the cable providers would likely satisfy the requirement in "c," and both together would likely satisfy the requirement in "b" (Comcast and Time Warner for cable companies, but not Cablevision, which requires that telephone services be ordered in conjunction with other services).

Q. THE VIRGINIA COMMISSION MADE ITS COMPETITIVE CLASSIFICATION DECISION ON AN EXCHANGE BASIS. WHY IS THE RELEVANT MARKET AT LEAST THE ENTIRE STATE IN NEW JERSEY?

A. The relevant market in New Jersey is at least the entire state, for the reasons stated in Verizon's initial testimony:

- Many competitors already offer statewide or even nationwide pricing plans and market their services on broad scales, and consequently a competitive threat does not have to be present throughout the entire state to constrain behavior;
- Given the variety and geographic dispersal of competitors across the State, there is little doubt that supra-competitive pricing in any area would generate a competitive response from carriers operating in that area, adjoining areas, or elsewhere in New Jersey, and cable and wireless providers already offer telephone services to virtually all New Jersey customers;
- The granularity of the geographic market for telecommunications services may differ from state to state because the variety, geographic dispersal and

reach of competitors differ from state to state. New Jersey is the most densely populated state in the country – *less than one percent* of households reside in wire centers with population densities below 100 people per square mile (a threshold that the FCC has used to identify rural areas), and thus there are almost no “rural” areas in New Jersey.⁸³ As noted above, this is in marked contrast with Virginia.

- Technological factors, such as the advent of IP-based technology and VoIP, allow competitors with switches located hundreds of miles away to serve a New Jersey customer.

In summary, the evidence demonstrates that: (1) the presence of competitive facilities and regulatory requirements ensure that competitors can serve customers in any part of the State in response to an effort to charge supra-competitive prices in a part of the State they do not already serve; and (2) competitive conditions are similar enough in all parts of the State to treat the entire state as a single geographic market.

Q. RATE COUNSEL NOTES THAT THE FCC FOUND VERIZON’S MARKET SHARE TOO HIGH TO WARRANT FORBEARANCE.⁸⁴ WOULD IT BE APPROPRIATE TO USE MARKET SHARE TESTS OR MARKET POWER TESTS BASED ON MARKET SHARE TO ASSESS THE COMPETITIVENESS OF RETAIL SERVICES IN NEW JERSEY?

A. No. First, as noted above, forbearance from wholesale regulation is much different than determining whether to classify retail services as competitive. Second, market share is not one of the three statutory criteria, and, as discussed above, is relatively meaningless where, as here, the relevant market has multiple suppliers of like or substitute services and there are no significant barriers to market entry. It is also meaningless where a firm’s market share is the product of regulation, as opposed to competition.

⁸³ FCC, 10th CMRS Report, p. 37.

⁸⁴ Baldwin at 71.

When analyzing primarily retail regulation, the FCC itself has recognized the limitations of market share as a competitive indicator. *See Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, 20 FCC Rcd 18433, ¶ 74 (2005) (market share analysis “may misstate the competitive significance of existing firms and new entrants.”); *Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation for Consent To Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, 19 FCC Rcd 21522, ¶ 148 (2004) (“the presence and capacity of other firms matter more for future competitive conditions than do current subscriber-based market shares.”); *Price Cap Performance Review for Local Exchange Carriers*, Second Further Notice of Proposed Rulemaking in CC Docket No. 94-1, Further Notice of Proposed Rulemaking in CC Docket No. 93-124, and Second Further Notice of Proposed Rulemaking in CC Docket No. 93-197, 11 FCC Rcd 858, ¶ 143 (1995) (any analysis of “the level of competition for LEC services based solely on a LEC’s market share at a given point in time would be too static and one-dimensional.”).

Q. HAVE OTHER STATES REACHED SIMILAR CONCLUSIONS ON THE RELATIVE IMPORTANCE OF MARKET SHARE?

A. Yes. In the *Competition III Order*, the New York PSC rejected a static, backward looking approach based on current market shares, and instead adopted a forward-looking, dynamic framework that accounted for the ability of competitors to enter and expand supply in response to potential price increases. As the New York PSC explained, “dominant providers will refrain from monopoly pricing and cost cutting on service quality if competitors can quickly enter and take away a significant share of the

1 incumbent's customers in response to such supra normal profit seeking behaviors.”⁸⁵

2 Thus, the New York PSC rejected market-share-based arguments of the Consumer
3 Protection Board, finding that such arguments “misse[d] the point.”⁸⁶

4 In lieu of an approach based on market shares, the New York PSC relied on the
5 availability of multiple competing platforms — including cable telephony, wireless, and
6 application-based services delivered over broadband platforms, in addition to other
7 traditional wireline telephone providers — that served as enablers for competitive service
8 offerings. The New York PSC concluded that “in view of the dynamic nature of the
9 telecommunications market, Staff's competitive indicator and observations of market
10 trends provide a more meaningful picture of the state of the intermodal competitive
11 market than does the simple look at recent actual market shares that is embodied in the
12 [Herfindahl-Hirschman Index (‘HHI’)].”⁸⁷

13 Similarly, the Massachusetts Commission noted:

14 ...a high output market share reflects significant market power
15 only when the supply elasticity of other firms is relatively low.
16 As we have determined above that the supply elasticity of
17 competing firms in Massachusetts is high, we place less weight
18 on market share as an indicator of market power in our evaluation
19 of sufficient competition.⁸⁸

⁸⁵ *Competition III Order* at 40 n.93 (quoting Staff's 2006 White Paper at 40).

⁸⁶ *Id.* at 38 (footnote omitted).

⁸⁷ *Id.* The HHI (Herfindahl-Hirschman Index) is a measure of market concentration that is used by both the U.S. Department of Justice (“DOJ”) and the Federal Trade Commission in analyzing mergers. *See* DOJ's 1992 Horizon Merger Guidelines (the “Merger Guidelines”) § 1.51.

⁸⁸ D.T.E. 01-31, *Phase I Order* at 79 (May 2002). Mr. Vasington was a commissioner in Massachusetts at the time and participated in this decision.

1 **Q. DO ANY OF VERIZON'S COMPETITORS HAVE SIMILAR VIEWS ON THE**
2 **LIMITATIONS OF MARKET SHARE DATA IN ASSESSING ENTRY**
3 **BARRIERS?**

4 A. Yes. In the CLEC Reclassification Proceeding, Dr. Debra J. Aron testified on behalf of
5 AT&T that market share is not a good tool for assessing market power:

6 The existence of many competitors is itself evidence of ease of
7 entry. A large market share does not imply that a company
8 necessarily has significant market power or that there are barriers
9 to entry, however. If a company has a relatively large market
10 share in a market with relatively few providers, it is the
11 possibility that the company has significant market power that
12 calls for an assessment of ease of entry and expansion. Where
13 barriers to entry and expansion by potential competitors are low,
14 a company could not exercise significant market power, even if it
15 has a large market share.⁸⁹

16 **Q. RATE COUNSEL NOTES THAT THE FCC'S *FORBEARANCE ORDER* SAYS**
17 **THAT THE ABANDONMENT OF A RESIDENTIAL ACCESS LINE DOES NOT**
18 **NECESSARILY INDICATE CAPTURE OF THAT CUSTOMER BY A**
19 **COMPETITOR, BUT INSTEAD MAY INDICATE THAT THE CONSUMER**
20 **CONVERTED A SECOND LINE USED FOR DIAL-UP INTERNET ACCESS TO**
21 **AN INCUMBENT LEC BROADBAND LINE.⁹⁰ ARE VERIZON'S LINE LOSSES**
22 **IN NEW JERSEY PRIMARILY DUE TO A REDUCTION IN SECOND LINES?**

23 A. No. As shown in Verizon's initial testimony (page 64), from December 2003 through
24 September 2007, Verizon's primary residential line count decreased over [BEGIN
25 VERIZON PROPRIETARY] [END
26 VERIZON PROPRIETARY]. Therefore, while some line losses may have been due to
27 customers dropping second lines, it is without question that Verizon has experienced very
28 significant retail primary line losses due to competition.

⁸⁹ Docket No. TX06120841, "Direct Testimony of Dr. Debra J. Aron" ("Aron Direct"), filed January 9, 2007, at 52. Dr. Aron also answers with an unqualified "No" when asked whether there are significant entry barriers in the telecommunications marketplace today. *Id.* at 54.

⁹⁰ Baldwin at 74, citing *Verizon Forbearance Order*, ¶ 39.

1 **Q. RATE COUNSEL ARGUES THAT ILEC LINE LOSSES DO NOT**
2 **DEMONSTRATE A RISE IN WIRELINE COMPETITION BECAUSE “MUCH**
3 **OF VERIZON NJ’S RETAIL LINE LOSS IS ATTRIBUTABLE TO A DECLINE**
4 **IN DEMAND FOR ADDITIONAL RESIDENTIAL LINES”⁹¹ IS THIS**
5 **CORRECT?**

6 A. No. The data show that *both* trends are occurring. Verizon is losing primary lines as
7 well as additional lines. Ms. Baldwin notes that [BEGIN VERIZON PROPRIETARY]
8 [REDACTED] [END VERIZON PROPRIETARY] of the residential line loss experienced by
9 Verizon is due to declining demand for additional lines, but this hardly proves that
10 competition is not rising. If anything, the data highlighted by Ms. Baldwin show that
11 [BEGIN VERIZON PROPRIETARY] [REDACTED] [END VERIZON
12 PROPRIETARY] of Verizon line losses are due to competition (it would be illogical to
13 conclude that none of the additional line losses are going to competitors, particularly
14 since additional lines that are dropped by customers switching from dial-up Internet
15 access to broadband service have been more likely to use cable modem service).

16 **Q. RATE COUNSEL NOTES THAT IN THE *VERIZON FORBEARANCE ORDER*,**
17 **THE FCC DID NOT “RELY ON E911 DATA FOR PURPOSES OF ANALYZING**
18 **COMPETITION IN THE BUSINESS MARKET,”⁹² BECAUSE “CARRIERS MAY**
19 **HAVE SIGNIFICANTLY FEWER ACCESS LINES THAN WOULD BE**
20 **SUGGESTED BY THEIR E911 LISTINGS.”⁹³ PLEASE RESPOND.**

21 A. Yes. As a threshold matter, the FCC’s criticism is limited to the use of the E-911
22 database to estimate the number of *business* lines – not *residential* lines. Residential
23 listings and lines tend to be one-to-one, as do single-line business services. In the multi-
24 line business market, there is not an exact one-to-one correspondence between the
25 number of E-911 listings, which are associated with customer stations, and the number of

⁹¹ Baldwin at 31-32.

⁹² Baldwin at 74, citing *Verizon Forbearance Order*, ¶ 37, n.115.

⁹³ *Id.*

1 access lines that serve these stations. For business applications that employ trunk
2 arrangements, a number of stations with corresponding E-911 listings may be served by a
3 relatively small number of lines. CLECs serving customers through PBX arrangements
4 would certainly be a common example of a serving arrangement that would contribute to
5 a mismatch between listings and lines.

6 Verizon has employed an adjustment factor to account for this fact. As noted in
7 response to Information Request RC-VNJ-141, business E-911 listings were adjusted by
8 a factor of .63 to convert business E-911 listings to an estimate of business facilities-
9 based lines. This factor is based on an analysis of Verizon's E911 listings for retail,
10 resold (including former MCI), and Wholesale Advantage service (including former
11 MCI) for business end users, which shows a 1.59:1 ratio between listings and lines as of
12 the end of October 2007. Specifically, the analysis shows **[BEGIN VERIZON**
13 **PROPRIETARY]** [REDACTED] **[END VERIZON PROPRIETARY]** E911 listings for
14 business customers served on Verizon's network, as compared with **[BEGIN VERIZON**
15 **PROPRIETARY]** [REDACTED] **[END VERIZON PROPRIETARY]** business lines
16 **[BEGIN VERIZON PROPRIETARY]** [REDACTED] **[END VERIZON**
17 **PROPRIETARY]** retail lines; **[BEGIN VERIZON PROPRIETARY]** [REDACTED] **[END**
18 **VERIZON PROPRIETARY]** resale lines; and **[BEGIN VERIZON PROPRIETARY]**
19 **[REDACTED]** **[END VERIZON PROPRIETARY]** Wholesale Advantage lines. This
20 comparison results in a ratio of 1.59:1 between listings and lines, or a conversion factor
21 of 63%. Therefore, the FCC's issues with respect to E-911 data already have been
22 addressed by Verizon in this case, and, in any event, they are irrelevant to an examination
23 of competition for mass market services.

1 **Q. RATE COUNSEL NOTES THAT IN THE FORBEARANCE ORDER THE FCC**
2 **CONCLUDED THAT CABLE OPERATORS PLAY A COMPARATIVELY**
3 **LIMITED ROLE IN SERVING ENTERPRISE CUSTOMERS.⁹⁴ IS THAT**
4 **CONCLUSION RELEVANT IN THIS CASE?**

5 A. No. This case concerns *mass market* retail services in New Jersey, which include single-
6 line business customers, and the evidence shows that cable companies have targeted the
7 small business market and are already serving business customers in New Jersey.⁹⁵ As
8 demonstrated in Verizon's initial testimony, the E-911 database shows that, as of
9 September 2007, there are approximately [BEGIN VERIZON PROPRIETARY]
10 [REDACTED] [END VERIZON PROPRIETARY] business facilities-based lines for cable
11 companies in New Jersey. Verizon also demonstrated in its initial testimony that cable
12 companies themselves are optimistic about their current and future prospects in serving
13 business customers. For example, Comcast's COO recently explained that it is serving
14 commercial customers "now" and that this "business is going to ramp up very
15 substantially" because it already has "all the systems in place," including an "existing
16 footprint [that] goes against many, many small and medium-sized businesses" that
17 enables Comcast to "provide th[e] wire" to these businesses.⁹⁶ Since Verizon's initial
18 testimony was filed, a New Jersey news report highlighted the prospects for cable
19 companies in the business market:

20 AT&T Inc. and Verizon Communications Inc., the biggest U.S.
21 telephone companies, lost millions of consumers to cable
22 television providers. Small businesses, their most profitable
23 accounts, may be next. Comcast Corp., the largest U.S. cable-
24 television service, has snatched 3.8 million residential phone

⁹⁴ Baldwin at 75.

⁹⁵ Ms. Baldwin also notes the FCC's findings with respect to "lit buildings" and "fiber wholesalers," but these topics are related to enterprise competition, and thus are irrelevant to this proceeding. *See* Baldwin at 72.

⁹⁶ Thomson StreetEvents, *CMCSA – Comcast Corporation at Goldman Sachs Communicopia XVI Conference*, Transcript at 3 (Sep. 18, 2007 (statement of Stephen Burke, COO, Comcast)).

customers since 2004 and will spend \$3 billion to sign up 20 percent of small companies in its territories by 2012. Time Warner Cable Inc. is also pursuing businesses with fewer than 1,000 employees.

...

Cable providers, with less than 5 percent of the market, may seize one-third by 2012, said Sanjeev Aggarwal, vice president at consultant AMI-Partners in New York. AT&T and Verizon can cut prices to keep customers or sacrifice future sales by ceding market share. "Phone companies are underestimating the threat and the rapidity with which this is going to happen," Aggarwal said.⁹⁷

B. Evidence of Selected Rate Increases Do Not Demonstrate Insufficient Competition

Q. RATE COUNSEL CLAIMS THAT THE TELECOMMUNICATIONS SERVICE MARKET IS NOT COMPETITIVE BECAUSE THE PRICES OF SOME SERVICES HAVE GONE UP IN RECENT YEARS.⁹⁸ IS THIS CONTENTION CORRECT?

A. No. Ms. Baldwin cites examples where Verizon and CLECs have raised rates, and concludes erroneously that this is evidence of "Verizon NJ's market power."⁹⁹ At least for Verizon, however, Ms. Baldwin's examples concern multi-line business services, and thus have no bearing on the competitiveness of mass market services. Moreover, it is well settled that price increases alone are not evidence of market power – only sustained price increases above competitive levels can be considered evidence of market power. Rate Counsel provides no evidence that any of the selectively cited price increases are above market levels. More important, rate increases are not related in any way to the

⁹⁷ Harrison, Crayton, "Cable Providers Seize a Share of Telecom Market: Lower Prices Lure Small Businesses," The Record, December 26, 2007.

⁹⁸ Baldwin at 123-130.

⁹⁹ Baldwin Reply at 18 and 123-130.

1 three statutory criteria. And this is so for a very good reason: competition dictates that
2 some prices increase while others decrease. This is true in all industries, but especially in
3 industries subject to rapid market and technological changes, and in industries
4 transitioning from regulatory to market control. Rate Counsel made similar arguments in
5 the CLEC Reclassification Proceeding last year, and these arguments did not dissuade the
6 Board from reclassifying CLEC services as competitive.

7 **Q. IS RATE COUNSEL’S REVIEW OF RATE CHANGES COMPREHENSIVE?**

8 A. No. Rate Counsel’s analysis consists of selective price changes from a narrow period of
9 time and draws broad conclusions about the competitiveness of the market based on this
10 small sample. Rate Counsel did not list any price changes other than selected wireline
11 increases, and Rate Counsel ignored rate decreases or new service offerings that provided
12 consumers with more features or lower total bills. In addition, Rate Counsel ignored the
13 substantial number of industry promotional offerings that have resulted in value for
14 consumers. From 2003 to 2006, Verizon alone instituted 52 promotions and new
15 package filings. Moreover, Rate Counsel’s analysis ignores the fundamental dynamics of
16 competition between à la carte prices and bundles. These dynamics are exemplified by
17 Verizon’s competitive response to cable triple play and double play packages – i.e., when
18 cable introduced these packages, Verizon began introducing a number of its own
19 competitive offerings with low incremental charges for voice.

1 **Q. RATE COUNSEL ALSO CONTENDS THAT “RATES AND DEMAND FOR**
2 **DISCRETIONARY FEATURES PURCHASED BY À LA CARTE AND**
3 **BUNDLED CUSTOMERS PROVIDE EVIDENCE OF ILECS’ MARKET**
4 **POWER.”¹⁰⁰ PLEASE RESPOND.**

5 A. The pricing of discretionary services says nothing about market power, and Rate
6 Counsel’s conclusion is inconsistent with the data it cites in support of this contention.
7 Unlike basic services, discretionary services actually reflect efficient pricing since the
8 prices are based on demand elasticity. Under traditional regulatory pricing, discretionary
9 services were allowed to be priced at levels that reflected customers’ willingness to pay,
10 while regulated services were priced as low as possible. The reason for this policy was
11 that discretionary services were considered to be premium services, and customers’
12 access to essential telecommunications services did not require the use of discretionary
13 services.¹⁰¹ Pricing discretionary or premium services at customers’ willingness to pay is
14 a standard feature of competitive markets and thus does not represent the exercise of
15 market power. In the intensely competitive auto industry, companies often price their
16 optional features at levels that include significant margins over costs.

17 **Q. WHY DO YOU SAY ABOVE THAT RATE COUNSEL’S CONCLUSION IS**
18 **INCONSISTENT WITH ITS OWN DATA?**

19 A. Ms. Baldwin notes that Verizon’s prices for several discretionary services are higher than
20 Embarq’s prices for the same services and testifies that this “suppresses consumer
21 demand, and . . . provides evidence of Verizon NJ’s market power in the provision of

¹⁰⁰ Baldwin at 115.

¹⁰¹ In its Par I Order, the Board noted, “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. This Board policy and the accomplishments derived from it would be eliminated if all services were priced precisely at cost.” BPU Docket No. TO92030358, issued May 6, 1993, at 31.

1 stand-alone discretionary features.”¹⁰² The data Ms. Baldwin cites regarding demand for
2 these features between Verizon and Embarq shows just the opposite of what she argues.
3 In fact, the penetration rates she cites for Verizon’s vertical features are higher than the
4 penetration rates for the same features offered by Embarq.¹⁰³ Therefore, the difference in
5 prices between Verizon and Embarq does not suppress demand. And as mentioned
6 above, pricing discretionary or optional services at levels that vary between companies is
7 a common feature in competitive markets.

8 **C. Special Access and Private Line Markets Are Competitive and**
9 **Are Not Related to This Proceeding.**

10 **Q. PLEASE COMMENT ON RATE COUNSEL’S CLAIMS REGARDING SPECIAL**
11 **ACCESS AND PRIVATE LINE SERVICES?**

12 A. Rate Counsel argues that these markets are not competitive, and thus “impede” the
13 development of competition.¹⁰⁴ Rate Counsel introduced these arguments in support of
14 its December 14, 2007 testimony (which was stricken from the record), requesting that
15 multi-line business services be reclassified as non-competitive. Rate Counsel then
16 imported the arguments to this case with no credible explanation for how special access
17 and private line services have any relation to competition for mass market services, other
18 than the bare assertion that special access and private line services are essential network
19 inputs.¹⁰⁵ There is no evidence presented by Rate Counsel that Verizon’s inter- or intra-
20 modal competitors for mass market retail services rely on special access or private line
21 services to provide competition. Even if there were such evidence, Rate Counsel’s

¹⁰² Baldwin at 115.

¹⁰³ Baldwin at 118 and 121, Tables SMB-C-12 and SMB-13.

¹⁰⁴ Baldwin at 97.

¹⁰⁵ Baldwin at 100.

arguments would be refuted by the fact of the growing competitive presence described in Verizon's initial testimony. Although these arguments are not relevant, they are incorrect, and will be addressed below.

Q. PLEASE DESCRIBE RATE COUNSEL'S CONTENTION.

A. Rate Counsel contends that the FCC's conditions on the AT&T and BellSouth merger and a recent report issued by the General Accounting Office ("GAO") support its claim that private line and special access services are not competitive.¹⁰⁶

Q. DO EITHER THE REQUIREMENTS OF THE AT&T/BELL SOUTH MERGER OR THE GAO REPORT SUPPORT RATE COUNSEL'S CLAIM THE SPECIAL ACCESS AND PRIVATE LINE MARKETS ARE NOT COMPETITIVE?

A. No. Although Rate Counsel cites the GAO report as evidence that "the special access and private line" market is not competitive,¹⁰⁷ the report does not provide information on special access or private line services in New Jersey. In addition, the GAO Report does not address intrastate special access and private line services.

Q. WHAT DOES THE GAO REPORT RECOMMEND?

A. The GAO report states that the FCC should "better define effective competition and then collect meaningful data on the state of competition in the marketplace." But even that limited recommendation is based on a flawed analysis.¹⁰⁸ Indeed, the FCC, the Justice

¹⁰⁶ Baldwin at 97-99.

¹⁰⁷ Baldwin at 97.

¹⁰⁸ The GAO Report is replete with flaws. Because the report should have no bearing on the Board's analysis in this proceeding, Verizon will not elaborate upon the report's numerous flaws. If appropriate, Verizon will address the flaws in its post-hearing brief.

Department and Federal Courts have all recently reviewed the competitiveness of special access services using data unavailable to the GAO and reached different conclusions.¹⁰⁹

Q. DOES THE GAO REPORT FINDING REGARDING THE PERCENTAGE OF BUILDINGS WITH AT LEAST A DS-1 LEVEL OF DEMAND AND COMPETITIVE ALTERNATIVES SUPPORT A CONCLUSION THAT SPECIAL ACCESS IS NOT COMPETITIVE?

A. No. Demand for special access services is highly concentrated in business locations that have high demand for services. For example, the GAO Report concludes that competitors have a fiber-based presence in 24 percent of buildings with 2 DS-3s of demand.¹¹⁰ Thus, the absence of competitors in buildings that have little potential demand for special access, says nothing about the presence of competitors, availability of substitutes and ease of market entry.

Q. RATE COUNSEL CONTENDS THAT THE GAO REPORT SUPPORTS THE CONCLUSION THAT PRICES AND AVERAGE REVENUES ARE HIGHER IN PHASE II MSAS THAN PHASE I MSAS OR PRICE CAP AREAS.¹¹¹ IS THIS A FAIR CHARACTERIZATION OF THE REPORT'S FINDINGS?

A. No. The GAO Report explains that special access prices have fallen, not risen, in both Phase I and Phase II MSAs under pricing flexibility.¹¹²

Average revenue for channel terminations and dedicated transport for DS-1 and DS-3 has generally decreased over time, although the decline in average revenue for channel terminations is larger in phase I areas compared with phase II areas. Comparing average revenue across price-cap areas, phase I areas, and phase

¹⁰⁹ *In the Matter of SBC Communications Inc. and AT&T Corporation Applications for Approval of Transfer of Control*, FCC WC Docket No. 05-65 (rel. Nov. 17, 2005); and Memorandum Opinion and Order, *In the Matter of Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, FCC WC Docket No. 05-75 (rel. Nov. 17, 2005). references to the Verizon-MCI merger. Federal Court reference: *WorldCom, Inc. v. FCC*, 238 F.3d 449 (D.C. Cir. 2001). See also *Covad Communications Co. v. FCC*, 450 F.3d 528 (D.C. Cir. 2006).

¹¹⁰ GAO Report at 12

¹¹¹ Baldwin at 97-98.

¹¹² GAO Report at 14, 27-28, 32.

1 II areas as of 2005—the most recent period available—we found
2 that average revenue in the 27 phase II areas is higher, on
3 average, than it is in the 29 phase I areas and not statistically
4 different that average revenue in areas that are still under a price
5 cap.¹¹³

6 Thus, contrary to Rate Counsel’s claims, the GAO Report shows that market forces are
7 constraining interstate special access prices in the MSAs no longer under price cap
8 regulation.

9 **Q. RATE COUNSEL CLAIMS THAT THE FCC’S AT&T/BELLSOUTH MERGER**
10 **ORDER INCLUDES SPECIFIC MEASURES INTENDED TO ADDRESS**
11 **SPECIAL ACCESS, AND THE ROLE THAT SPECIAL ACCESS HAS IN**
12 **FACILITATING COMPETITIVE ENTRY.¹¹⁴ PLEASE COMMENT.**

13 A. The AT&T/BellSouth merger conditions are completely unrelated to this case. There has
14 been absolutely no showing that the concerns those conditions were intended to remedy
15 exist here. Rate Counsel quotes from Commissioners Copps and Adelstein in support of
16 the conditions, but ignores the reactions of the two other participating commissioners
17 (Chairman Martin and Commissioner Tate) – both of whom did not see a need for these
18 conditions on the merged company.¹¹⁵ Chairman Martin and Commissioner Tate issued a
19 joint statement on the merger approval, saying, among other things:

20 Although we believe that this transaction offers significant
21 benefits to consumers, we have reservations about some of the
22 voluntary commitments offered by the merger applicants. Like
23 the review by the Department of Justice, nineteen states, and three
24 foreign countries, the order we adopt today does not find there to
25 be any public interest harms resulting from the merger. Unlike the
26 Department of Justice and these other entities, however, we

¹¹³ GAO Report at 14

¹¹⁴ Baldwin at 78.

¹¹⁵ “AT&T’s concessions come after weeks of negotiations with the FCC, which reached an impasse with two Democrats on the five-member commission pushing for additional conditions and the two remaining Republicans opposing them.” Schatz, Amy and Grant, Peter, “AT&T Yields to Seal BellSouth Deal,” *The Wall Street Journal*, December 29, 2006, Page A3.

1 nevertheless impose a number of conditions on the merging
2 parties.
3

4 Some of the conditions will certainly provide additional consumer
5 benefits. We find the imposition of some of the conditions,
6 however, to be unnecessary. And, some of the conditions impose
7 burdens that have nothing to do with the transaction, are
8 discriminatory, and run contrary to Commission policy and
9 precedent.
10

11 Given that the AT&T/BellSouth merger conditions were not even supported by a
12 majority of FCC commissioners, it is wrong for Rate Counsel to conclude that the
13 absence of the same conditions on Verizon will affect the willingness of businesses and
14 consumers to remain in New Jersey.¹¹⁶ The market for communications services in New
15 Jersey is intensely competitive and consumers are reaping considerable benefits from this
16 competition and the enhanced investments that such competition brings about. Merger
17 conditions from a transaction unrelated to the New Jersey market have no bearing here,
18 even if they had anything to do with the three statutory criteria, which they do not.

19 **D. Verizon's Policy on Copper Plant Retirement Does Not**
20 **Represent Market Power**

21 **Q. RATE COUNSEL CONTENDS THAT "VERIZON IS ABANDONING ITS**
22 **COPPER PLANT, WHICH IT CAN DO BECAUSE OF ITS MARKET**
23 **POWER."**¹¹⁷ **IS THIS CONTENTION CORRECT?**

24 **A.** No. First, it mischaracterizes Verizon's policy. As Verizon continues to build out its fiber
25 to the premises ("FTTP") network, Verizon also serves customers who choose not to
26 subscribe to its FiOS services. Verizon continues to serve these customers over its
27 existing copper-based network and provides unbundled access to copper facilities to

¹¹⁶ Baldwin at 82.

¹¹⁷ Baldwin at 82-87.

CLECs offering competing services. Verizon anticipates that it will continue to maintain much of its copper network for the foreseeable future. However, if Verizon does decide to remove legacy copper facilities from service (which may or may not involve physically removing copper cables), there are FCC disclosure rules that apply to the retirement of copper plant that has been overbuilt by fiber. In existing service areas where Verizon is deploying fiber facilities, FCC rules require the company to either maintain the existing copper network for CLEC access or provide CLECs access to a 64 kbps channel on the fiber network (a channel capable of providing voice service).

Second, Verizon's efforts to upgrade its network are a direct response to competitive pressure and consumer demand. Moreover, Verizon still has a strong incentive to maintain the quality of its copper network because traditional wireline customers will not buy advanced services from Verizon if the company fails to meet or exceed their expectations. Given that Verizon's future success is built in large part on the perceptions of its traditional wireline customers, recent trends reflect market pressures and consumer demand, not a market failure.

E. Verizon's Wholesale Services are Correctly Priced and Do Not Represent A Barrier to Entry

Q. RATE COUNSEL CLAIMS THAT "ILECS' ESSENTIAL ELEMENTS ARE MIS-PRICED" AND THAT THIS CREATES BARRIERS TO ENTRY.¹¹⁸ PLEASE RESPOND TO THIS ALLEGATION.

- A. The "essential elements" that Ms. Baldwin says are mispriced are intrastate switched access and UNEs. These elements are not mispriced and are not a barrier to entry. First, the Board already has ruled that access rates are not within the scope of this proceeding.

¹¹⁸ Baldwin at 90.

1 Second, both switched access and UNE rates are Board-approved, and the evidence of
2 extensive competition in New Jersey belies any claim that there are barriers to entry from
3 this or any other source. Third, Ms. Baldwin’s comparison of UNE loop rates to retail
4 rates is incomplete. She compares Verizon’s Density Zone 2 loop rate of \$10.42 to
5 Verizon’s price for a flat-rated residential line of \$8.95, and concludes that the “mis-
6 alignment of wholesale and retail rates is a barrier to entry.”¹¹⁹ But she fails to include
7 the federal Subscriber Line Charge (“SLC”) of \$6.29, which is designed to cover a
8 portion of the loop costs that are allocated to the federal jurisdiction, and is imposed on
9 all residential lines. If one includes the SLC along with the retail rate, Verizon’s retail
10 charges do not create a barrier to entry in Ms. Baldwin’s example. Finally, Ms. Baldwin
11 makes no attempt to show that Verizon’s intrastate toll charges are below intrastate
12 access charges. Therefore, there is no evidence that these wholesale prices create a
13 barrier to entry in New Jersey. Rather, the evidence is overwhelming that there are no
14 entry barriers.

15 **F. Rate Counsel’s Prediction of “Consumer Harm” Is Baseless**

16 **Q. RATE COUNSEL STATES THAT “THE PREMATURE CLASSIFICATION OF**
17 **MASS MARKET SERVICES AS COMPETITIVE COULD LEAD TO RATE**
18 **INCREASES OF MORE THAN 500 MILLION DOLLARS PER YEAR.”¹²⁰**
19 **PLEASE COMMENT.**

20 **A.** The exaggerated nature of this “prediction” is self-evident. Rate Counsel’s analysis of
21 likely effects is based on the notion that Verizon would be able to increase its prices for
22 residential and business exchange service by \$23.09 and \$27.00, respectively, per month,

¹¹⁹ Baldwin at 91.

¹²⁰ Baldwin at 149.

1 and that such a drastic increase would result in the loss of *not a single customer*.¹²¹ There
2 is not a bit of evidence in this proceeding, or in the experience of other states that have
3 already granted pricing freedom for residential services, to suggest that Verizon would
4 price its basic services up to the level of packages. The evidence shown above and in
5 Verizon's initial testimony clearly demonstrate that there is ease of entry, presence of
6 competitors, and the availability of like or substitute services throughout New Jersey.
7 And this market structure has unquestionably resulted already in the loss of mass market
8 lines by Verizon to competitors, primarily competitors using alternative networks.
9 Verizon has lost these lines in spite of the fact that its prices for retail mass market
10 services are heavily regulated and are among the lowest in the country. The notion that
11 Verizon will not lose lines if it were to attempt such a rate increase as that contemplated
12 by Rate Counsel defies common sense and should be summarily rejected by the Board.

13 **VIII. VERIZON'S NEW JERSEY INTRASTATE COMPETITIVE**
14 **TELECOMMUNICATIONS SERVICES ARE NOT BEING**
15 **SUBSIDIZED BY ANY OTHER SERVICE.**

16 **Q. PLEASE COMMENT ON RATE COUNSEL'S AND SPRINT NEXTEL'S CLAIM**
17 **THAT PAR-2 REQUIRES THE SUBMISSION OF COST STUDIES FOR**
18 **SERVICES THAT ARE THE SUBJECT OF A RECLASSIFICATION**
19 **REQUEST.**¹²²

20 **A.** The Board's Order adopting PAR-2 clarified that Verizon does not have to present a
21 "cost of service" analysis in reclassification proceedings:

22 *The Board also rejects the Advocate's related claim that VNJ*
23 *should be required to present a "cost of service" analysis on the*
24 *services proposed for reclassification. As required by the Board in*
25 *its December 22, 2000 Order that presented guidelines for the*

¹²¹ Rate Counsel makes a similar (and similarly absurd) prediction related to Directory Assistance services (Baldwin at 145).

¹²² Baldwin at 154, Appleby at 16.

1 filing of the petition in this proceeding, VNJ provided an analysis
2 showing that its rate-regulated business services as a group, are not
3 subsidized by the VNJ's remaining rate-regulated services. As we
4 have already noted, the *Board believes that the three requirements*
5 *for reclassification are sufficient and appropriate, and we will not*
6 *adopt any requirement that compels a cost of service analysis of*
7 *services proposed for reclassification as a condition for that*
8 *reclassification.*¹²³
9

10 Similarly, since PAR-2, the Board has repeatedly indicated that a "cost of
11 service" analysis is not required in reclassification proceedings. *See DA Reclassification*
12 *Order* ("VNJ's argument that the requested cost data is not relevant is compelling. As
13 noted by VNJ, the cost of the service is not one of the statutory requirements, and is not,
14 in this circumstance, likely to lead to admissible evidence.");¹²⁴ and *CLEC*
15 *Reclassification Order* ("Issues related to costs of service, profits, or quality of customer
16 service are outside the scope of this review.")¹²⁵

17 **Q. PLEASE COMMENT ON THE ALLEGATION THAT THE NEW JERSEY**
18 **TELECOMMUNICATIONS ACT REQUIRES A PARTY REQUESTING**
19 **RECLASSIFICATION OF SERVICES DEMONSTRATE THAT COMPETITIVE**
20 **SERVICES ARE NOT SUBSIDIZED BY NON-COMPETITIVE SERVICES.**¹²⁶

21 A. The New Jersey Telecommunications Act does not require an entity seeking the
22 reclassification of its services to make such a demonstration. All that is required for the

¹²³ *I/M/O the Application of Verizon New Jersey Inc. for Approval (i) of a New Plan for an Alternative Form of Regulation and (ii) To Reclassify Multi-Line Rate Regulated Business Services as Competitive Services, and Compliance Filing*, Docket No. TO01020095, Telecommunications Decision and Order, at 154 (NJ BPU Aug. 19, 2003) (the "PAR-2 Order").

¹²⁴ *I/M/O of the Board's Review of the Classification of Verizon New Jersey's Directory Assistance Services as Competitive and Associated Service Quality*, Docket Nos. TX06010057 and TT97120889, Discovery Order, at 5 (July 17, 2006) (the "DA Reclassification Discovery Order").

¹²⁵ *I/M/O of the Board Investigation Regarding the Reclassification of Competitive Local Exchange Carrier Services as Competitive*, Docket No. TX06120841, Order on Motions to Compel, at 3 (NJ BPU Feb. 27, 2007) (the "CLEC Reclassification Discovery Order").

¹²⁶ Appleby at 16.

1 approval of the reclassification of a service is that the party requesting reclassification
2 demonstrate that the three criteria in the reclassification statute are satisfied, i.e., (1)
3 presence of competitors; (2) availability of like or substitute services, and (3) ease of
4 market entry by competitors. While it is clear that the New Jersey Telecommunications
5 Act provides that competitive services should not be subsidized by non-competitive
6 services, that requirement is in a section of the Act unrelated to service reclassification.
7 Thus, the ongoing requirement that competitive services not be subsidized by non-
8 competitive services is similar to other ongoing legal requirements in Title 48 and need
9 not be examined during a service reclassification proceeding.

10 **Q. HAVE YOU CONDUCTED AN ANALYSIS IN RESPONSE TO RATE COUNSEL**
11 **AND SPRINT NEXTEL'S CLAIM THAT THE RECLASSIFICATION OF MASS**
12 **MARKET RETAIL SERVICES WOULD RESULT IN COMPETITIVE**
13 **SERVICES BEING SUBSIDIZED BY NON-COMPETITIVE SERVICES.**

14 A. Yes. Although there is no legal requirement that a party seeking reclassification of
15 services from non-competitive to competitive demonstrate that its competitive services
16 are not subsidized, in response to the Interveners' allegations we conducted an analysis of
17 costs and revenues for competitive services. The purpose of our review was to assess
18 whether competitive services, in the aggregate, would be subsidized by non-competitive
19 services after the reclassification of retail mass-market services. Our analysis
20 demonstrates that Verizon's intrastate competitive telecommunications services, as a
21 group, *will not* be improperly subsidized by non-competitive services *after* mass market
22 retail services are classified competitive.

Q. PLEASE EXPLAIN YOUR ANALYSIS.

A. We performed a cross-subsidy analysis comparing total revenues for existing competitive services and services that are the subject of this reclassification proceeding to the total direct costs for those services. The purpose of the comparison is to determine whether the revenues for those services cover the direct costs for those services. The method we used in determining whether competitive services are being subsidized by non-competitive services is to compare total competitive service revenues to total direct costs for competitive services. If total revenue exceeds total direct costs, then competitive services as a group are not being improperly subsidized by non-competitive services.

Q. WHAT ARE THE RESULTS OF THE CROSS-SUBSIDY ANALYSIS?

A. Our analysis demonstrates that Verizon's competitive telecommunications services (both current and proposed) are not subsidized because they will generate revenue in excess of their direct costs. A summary of the results of the cross-subsidy analysis follows:

[BEGIN VERIZON PROPRIETARY]

Total Competitive Services Revenue

██████████

Total Competitive Services Costs

██████████

[END VERIZON PROPRIETARY]

Q. EXPLAIN HOW YOU CONDUCTED YOUR ANALYSIS?

A. We first identified the annual revenues for all competitive services and services that are subject to reclassification in this proceeding. The total competitive services revenue was calculated by taking year end 2006 total revenue and removing the non-competitive revenue of intrastate switched access, unbundled network elements and non-service

1 related. Next we identified the total direct costs for competitive services and the services
2 that are the subject of the Board's reclassification inquiry.

3 For services reclassified as competitive in the PAR-2 proceeding, we utilized the
4 total service long run incremental cost ("TSLRIC") results filed in the PAR-2 proceeding.
5 To produce current direct costs using those studies, we applied an adjustment factor that
6 captures the changes in investment and expenses from the time period when the PAR-2
7 cost studies were completed through 2006. The adjustment factor was developed based
8 on the changes in investment as reflected in Verizon NJ's ARMIS 43-03 Reports for
9 1999 and 2006. We also updated the annual cost factors used in our studies to reflect
10 changes from those used in the PAR-2 cost studies to the 2006 expense levels.

11 For services that were classified as competitive prior to and subsequent to PAR-
12 2, we utilized the most current direct cost studies available. For a small number of
13 competitive services for which costs are not readily available or easily developed through
14 traditional TSLRIC costing methods, we assumed, conservatively, that costs of the
15 services were equal to revenues for the services. These additional services account for
16 approximately 5% of total competitive service revenues.

17 **IX. Conclusion**

18 **Q. PLEASE SUMMARIZE YOUR TESTIMONY**

19 A. Verizon has demonstrated that the three statutory criteria governing classification of
20 services as competitive have been met in New Jersey, and nothing presented by Rate
21 Counsel or Sprint Nextel undermines that conclusion. Rate Counsel's and Sprint
22 Nextel's arguments and anecdotes are incorrect, backward-looking, and largely related to
23 factors that are beyond the scope of this proceeding. The Board should apply the

1 statutory criteria to the evidence presented and conclude that ILEC retail mass market
2 services meet the statutory test and result in reclassification of these services as
3 competitive.

4 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

5 A. Yes.