



STATE OF NEW JERSEY
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102
www.nj.gov/bpu/

TELECOMMUNICATIONS

IN THE MATTER OF THE BOARD INVESTIGATION) REGARDING THE RECLASSIFICATION OF INCUMBENT) LOCAL EXCHANGE CARRIER (ILEC) SERVICES AS) COMPETITIVE)	ORDER DOCKET NO. TX07110873
I/M/O THE APPLICATION OF UNITED TELEPHONE) COMPANY OF NEW JERSEY INC. d/b/a EMBARQ FOR) APPROVAL OF A PLAN FOR ALTERNATIVE) REGULATION)	DOCKET NO. TO08060451

(SERVICE LIST ATTACHED)

BY THE BOARD:

By Order dated November 28, 2007, in response to a request from Verizon New Jersey Inc. ("Verizon"), the New Jersey Board of Public Utilities ("Board") commenced this proceeding to investigate the competitiveness of retail mass market services¹ provided by incumbent local exchange carriers in New Jersey ("ILECs"). This Order provides the reasoning for the action taken by the Board by Summary Order of Approval dated July 14, 2008 with respect to Verizon, and sets out the Board's determinations with respect to a stipulation of settlement and a plan for alternative regulation proposed by the United Telephone Company of New Jersey, Inc. d/b/a/Embarq ("Embarq").

Procedural History

Pursuant to N.J.S.A. 48:2-21.19(b), prior to determining whether a service is competitive, the Board must evaluate 1) the ease of market entry, 2) the presence of competitors, and 3) the availability of like or substitute services in the relevant geographic area. To provide a full record and allow for an inclusive and transparent process, the Board invited input from any and all interested parties, including but not limited to all registered telecommunications providers in the State, other parties that may have an interest in the matter, and the Department of the Public Advocate, Division of Rate Counsel ("Rate Counsel"). The Order also set a procedural schedule

¹Retail mass market services include services such as local exchange service, associated calling features such as CallerID and Call Waiting, residential directory assistance, and installation of residential services.

including discovery, prefiled testimony and evidentiary hearings, and designated Commissioner Frederick F. Butler as the presiding commissioner.

By letter dated December 3, 2007, Rate Counsel filed a motion seeking reconsideration of the Board's November 28, 2007 Order contending, among other things, that the schedule set by the Order did not provide sufficient time to develop an adequate record, and did not provide for needed public hearings. By Order dated December 21, 2007, the Board modified the schedule to include three public hearings and moved the last date for discovery responses from February 12, 2008 to February 13, 2008. Rate Counsel's remaining requests were denied.

Various motions for admission *pro hac vice* of counsel were filed. On December 6, 2007, Sprint Communications Co. LP, Sprint Spectrum and Nextel of New York Inc. ("Sprint"), moved for admission *pro hac vice* of Garnet Goines, Esq. and Benjamin J. Aron, Esq. On December 13, 2007, Embarq, filed a motion to permit the appearance *pro hac vice* of Zsuzsanna E. Benedik, Esq. and Jeanne W. Stockman, Esq. These motions were granted by Commissioner Butler by Order dated December 19, 2007. On December 14, 2007, Verizon filed a motion seeking admission *pro hac vice* of Richard A. Chapkis, Esq. By letter dated December 17, 2007, XO New Jersey, Inc. filed a motion with the Board to permit the appearance *pro hac vice* of Brian A. Nixon, Esq., Kevin C. Halm, Esq., and T. Scott Thompson, Esq. On December 19, 2007, Commissioner Butler issued an Order in response to the motion filed by Sprint granting admission *pro hac vice* of Ms. Garnet Goines, Esq. and Mr. Benjamin J. Aron, Esq. By letter dated December 18, 2007, Cablevision Systems Corporation (Cablevision), filed a motion seeking admission *pro hac vice* of Cherie R. Kiser, Esq. Commissioner Butler granted the motions of Cablevision and Verizon in an Order dated January 4, 2008, and granted a motion filed by Embarq seeking admission *pro hac vice* of Jeanne W. Stockman, Esq. on February 4, 2008.

In accordance with the November 28 Order, Commissioner Butler ruled on intervention and participation. By order dated December 18, 2007, the Commissioner granted intervenor status to Verizon, Embarq, Sprint, and Rate Counsel, and granted participant status to Cablevision, the New Jersey Cable Telecommunications Association ("NJCTA"), and to AT&T Communications of New Jersey, L.P. ("AT&T"). While Commissioner Butler originally granted XO Communications Services, Inc. ("XO") intervenor status, he later granted XO's request to modify its status from intervenor to participant.

On December 14, 2007, Messrs. Paul Vasington and William Newman filed initial testimony on behalf of Verizon in support of reclassifying ILEC-provided retail mass market services as competitive. On the same date, Dr. Brian Staihr filed testimony on behalf of Embarq in support of reclassifying these services. The ILEC witnesses testified that, as required by the statutory reclassification criteria set out in N.J.S.A. 48:2-21.19(b), there are a substantial number of competitors providing retail mass market communications services in New Jersey, including cable companies, wireless carriers, over-the-top voice-over-Internet-protocol ("VoIP") providers, and traditional wireline competitive local exchange carriers ("CLECs"). The ILECs' witnesses also testified that these competitors offer like or substitute services that compete with ILEC-provided retail mass market retail services, and that there are no barriers to entering the market for retail mass market services in New Jersey.

By letter dated December 21, 2007, Rate Counsel requested a Hearing Officer's decision and Order adopting a confidentiality /non-disclosure agreement for the parties to sign in this matter. Accordingly, because the parties could not reach agreement on the form of a confidentiality agreement, Commissioner Butler issued an Order dated December 27, 2007,

requiring the parties to utilize and execute the confidentiality agreement that was executed *I/M/O the Board Investigation Regarding the Reclassification of Competitive Local Exchange Carrier Services As Competitive*, Docket No. TX06120841.

By letter dated December 18, 2007, Verizon moved to strike the initial testimony of Susan Baldwin filed on behalf of Rate Counsel, contending that the testimony addressed the competitiveness of multi-line business services which is beyond the scope of the proceeding. On December 27, 2007, Rate Counsel responded to Verizon's motion maintaining that the motion lacked merit. By Order dated January 4, 2008, Commissioner Butler granted Verizon's motion finding that those portions of Ms. Baldwin's testimony relating to reclassification of multi-line business services were outside the scope of this proceeding, but permitted Rate Counsel to incorporate any remaining portions of Ms. Baldwin's testimony in to the reply testimony which was due on January 10, 2008.

On January 8, 2008, Sprint filed a motion to compel Verizon to provide data, information, and documents requested by Sprint in its first and second set of Interrogatories and Requests for Production of Documents to Verizon served on December 13, 2007 and December 21, 2007. On January 9, 2008, Sprint filed a Motion to Compel Embarq to provide data information and documents requested by Sprint in the First and Second Set of Interrogatories and Requests for Production of Documents which were propounded to Embarq on December 14, 2007 and December 21, 2007. Commissioner Butler issued a ruling on both discovery motions on January 29, 2008.

Rate Counsel propounded and Verizon responded to discovery requests, and, on January 10, 2008, Ms. Susan Baldwin filed reply testimony on behalf of Rate Counsel opposing the reclassification of ILEC-provided retail mass market services. Sprint propounded and Verizon responded to discovery requests, and, on January 10, 2008, Mr. James Appleby filed reply testimony on behalf of Sprint opposing the reclassification of ILEC-provided retail mass market services.

By letter dated January 10, 2008, Rate Counsel filed a motion to compel discovery and to require Verizon to identify the sponsoring witness for each response given and provide full and complete data, information and documents requested by Rate Counsel, and where applicable, in EXCEL spread sheet format. Commissioner Butler ruled on the motion on January 30, 2008, denying it in part and granting it in part.

On January 15, 2008, Rate Counsel filed a motion to have the Board open a plenary proceeding and consolidate this case with a pending proceeding filed by AT&T seeking intrastate access rate relief, *I/M/O/ Petition of AT&T Communications of New Jersey, LLP Regarding Access Payments to Verizon N.J. Inc., BPU Docket No. TR03100767*, and a case pending at the Office of Administrative Law, *I/M/O AT&T Communications for Determination of Compliance by Bell Atlantic-N.J. Inc's Selective Calling and Intra Municipal Calling Services with Imputation Requirements (the "SELEX" case)*. Both Verizon and Embarq opposed the motion. In addition, on January 16, 2008, Verizon and Embarq jointly filed a motion to strike the testimony of James A. Appleby submitted on behalf of Sprintl. On February 13, 2008, Commissioner Butler issued an Order denying the motion to consolidate the instant proceeding with the AT&T intrastate access rate petition and the SELEX case, and struck from the record the portions of the testimony of Mr. Appleby addressing the level of intrastate access rates but admitted into the record testimony relating to the questions of whether access charges are a barrier to entry and whether there is an issue of cross subsidization.

On January 17, 2008, Rate Counsel filed a motion to compel discovery from Verizon regarding proprietary material. After receipt of Verizon's opposition dated January 28, 2008, Rate Counsel withdrew the motion on January 31, 2008.

By letter dated January 16, 2008, Verizon and Embarq jointly moved to strike the testimony of James A. Appleby filed on behalf of Sprint as addressing intrastate access rates and cost issues that they maintained were outside the scope of this proceeding, and on January 24, 2008 they moved to strike Ms. Baldwin's reply testimony filed on behalf of Rate Counsel claiming that portions of her testimony address costs, access charges and revenues which are outside the scope of this proceeding. By Order dated February 15, 2008, Commissioner Butler granted the motions in part and denied them in part.

On January 29, 2008, Messrs. Paul Vasington, Patrick Garzillo, and William Newman filed rebuttal testimony on behalf of Verizon, and Dr. Brian Staihr filed rebuttal testimony on behalf of Embarq. The ILECs' witnesses maintained that the record shows that ILEC-provided retail mass market services, which are not currently classified as competitive, meet the statutory criteria for reclassification as competitive, and that neither Rate Counsel nor Sprint has offered any credible evidence to contradict that fact.

By letter dated February 4, 2008, Sprint requested that the Board modify the procedural schedule in this matter. Commissioner Butler issued an Order on February 15, 2008 denying the motion.

Pursuant to the Board's directive, newspaper notice was published for three public hearings, which were conducted at different locations across the State on February 11, 13, and 14, 2008. At the public hearings, members of the public commented on whether the Board should reclassify the services at issue.

On February 20, 2008, Rate Counsel moved to strike portions of the December 14, 2007 and January 29, 2008 testimony of Paul Vasington filed on behalf of Verizon contending that Mr. Vasington was not qualified to testify as an expert, and that he had failed to provide sufficient evidence to support his testimony. Also, Rate Counsel moved to compel Verizon to provide full and complete data, information and documents as requested in discovery. On February 21, 2008, Rate Counsel also moved to strike portions of the December 14, 2007 and January 29, 2008, testimony of Embarq's witness Dr. Brian Staihr as "net opinions," and to compel Embarq to provide full and complete data, information and documents as requested in discovery. Commissioner Butler orally ruled on the motions at the beginning of evidentiary hearings on February 25, 2008, and issued an order memorializing those rulings on March 3, 2008, admitting into the record the testimonies of Mr. Staihr and Mr. Vasington, and denying the motions to compel.

The evidentiary hearings were conducted before Commissioner Butler on February 25 and 26, 2008.² At these hearings, witnesses for the parties appeared under oath and were

²Exhibits

VNJ-1 Direct Testimony of Paul Vasington, Public

VNJ-2 Direct Testimony of Paul Vasington, Confidential

VNJ-3 Joint Testimony of Paul Vasington and Patrick Garzillo, Public version

VNJ-4 Joint Rebuttal Testimony of Paul Vasington and Patrick Garzillo, Confidential

VNJ-5 Direct Testimony of William Newman

VNJ-6 Rebuttal Testimony of William Newman

available for cross-examination on the subjects covered in their pre-filed testimony. On March 14, 2008 Verizon, Rate Counsel, Embarq and Sprint filed Initial Briefs and on March 28, filed Reply Briefs.³

By this Decision and Order, the Board HEREBY AFFIRMS all decisions made by Commissioner Butler during the course of this proceeding for the reasons stated in the Orders.

Summary of Positions of the Parties

Verizon

Verizon contends that the communications industry has evolved, and that now there is a broad selection of communications options available to New Jersey consumers. VNJ-IB at 1. Verizon argues that the convergence of communications technologies has resulted in the ILEC provided services being in direct competition with services offered by competitive local exchange carriers (“CLECs”) and other non-traditional competitors, including but not limited to wireless carriers, cable companies and voice over Internet protocol (“VoIP”) providers. Id. As described by Verizon, the New Jersey Legislature understood that regulated traditional carriers should be permitted “to compete on a level competitive playing field with unregulated, non-traditional competitors, like cable, wireless and VoIP companies.” Id. Accordingly, Verizon contends, the Legislature set up a simple but effective test to determine when to remove unnecessary regulation and classify services as competitive, and Verizon claims it has met its obligations under the statutes in this record. Id. at 2. The record, in Verizon’s opinion, demonstrates that retail mass market services are offered by many competitors and that these alternative providers and the services that they provide satisfy the three criteria set forth in the statute. VNJ RB at 1.

RC- 1 Reply Testimony of Susan Baldwin, Proprietary version
RC-1A Reply Testimony Susan Baldwin, Public version
RC-2 LRIC Study and Meachan Affidavit
RC-3 Response to RC-VNJ -201
RC-4 Cable Facts 2005
RC-5 RC-VNJ-2
RC-6 Verizon FCC Form 477
RC-7 Verizon Tariff filing dated February 14,2008
RC-8 Press Release/ FCC approves VNJ-MCI merger
RC-9 Hand out—Various Tariffs
RC-11 Embarq FCC Form 477
EQ-1 Direct Testimony of Brian Staihr
EQ-2 Direct Testimony of Brian Staihr proprietary version
EQ-3 Rebuttal Testimony of Brian Staihr
Sprint -1 Testimony of James Appleby
Sprint-2 Decision by Massachusetts DTE
³Rate Counsel Initial Brief- RC-IB, Rate Counsel Reply Brief-RC-RB
Verizon Initial Brief-VNJ-IB, Verizon Reply Brief-VNJ-RB
Embarq Initial Brief-EMB-IB, Embarq Reply Brief-EMB-RB
Sprint Initial Brief-Sprint-IB, Sprint Reply Brief-Sprint-RB

Ease of Market Entry

Verizon contends that the component of the competitive classification test, ease of market entry, is met through the existence of intra- and inter-modal mass market competitors who have advanced in the marketplace. VNJ IB at 4. Verizon argues that “there are no legal, regulatory or technical barriers to entry in the mass market, as evidenced by (1) the considerable number of mass-market service providers active in the market; (2) the wide-array of competitive substitutes available for traditional wireline services; and (3) the fact that existing mass market competitors have expanded the scope and scale of their businesses.” VNJ IB at 21 and 51. As examples, Verizon provides that there are “a myriad of CLECs, cable companies, wireless providers, and Broadband and VoIP providers have entered the mass market in past years.” VNJ IB at 51. Further, Verizon’s initial brief claims substantial line losses translate into gains to these competitors, which effectively demonstrates no significant barriers to entry. Id.

Verizon refutes Sprint’s and Rate Counsel’s claim that intrastate access rates constitute a “barrier to entry.” Verizon argues that “the market is replete with mass market competitors.” VNJ IB at 52. Specifically, Verizon contends mass market service competition is not affected by intrastate access rates. Id. Verizon supports this finding by stating, “[I]ntrastate access rates are not paid on these services – *i.e.*, local exchange carriers assess access charges on interexchange carriers for use of local exchange facilities to originate or terminate traffic that is carried to or from a distant exchange; access charges are not imposed on basic local exchange calls and the other mass market services that are the subject of this proceeding.” VNJ IB at 53. Verizon describes interstate access charges as a charge paid by all carriers terminating interexchange calls on another carrier’s network. Id. Accordingly, Verizon does not view access charges as a barrier to entry. VNJ- 4 at 13; VNJ IB at 53. Verizon disagrees with Rate Counsel’s witness’s statements that UNEs also are mispriced and are also a barrier to entry. VNJ IB at 57.

Verizon asks that the Board remain focused on the statutory requirements necessary for a determination regarding competitive status, and that it be consistent in its finding that access rates are not within the scope of this proceeding. Verizon notes that complete regulatory review of switched access and UNE rates has already been undertaken by the Board. Misdirecting the attention of the Board away from the evidence of extensive competition in New Jersey is unwarranted, according to Verizon. Id. Further, Verizon contends that “Ms. Baldwin’s comparison of UNE loop rates to retail rates is incomplete. She compares Verizon’s Density Zone 2 loop rate of \$10.42 to Verizon’s price for a flat-rated residential line of \$8.95, and concludes that the “mis-alignment of wholesale and retail rates is a barrier to entry.”⁴ But she fails to include the federal Subscriber Line Charge (“SLC”) of \$6.27, which is designed to cover a portion of the loop costs that are allocated to the federal jurisdiction, and is imposed on all residential lines. If one includes the SLC along with the retail rate, Verizon’s retail charges do not create a barrier to entry in Ms. Baldwin’s example.” VNJ IB at 57. In sum, Verizon claims Rate Counsel’s arguments are flawed, and that there is no evidence that these wholesale prices create a barrier to entry.⁵

⁴RC-1 at 91.

⁵VNJ-4 at 51-52.

Presence of Competitors

Verizon asserts that the statutory requirement of presence of competitors is met by evidence demonstrating that there exists a wide variety of competitors, including traditional CLECs, cable companies, wireless carriers, and VoIP providers, who serve mass market customers throughout the State. Verizon submits:

- “Cable providers have passed over 3.37 million of the 3.47 million housing units in New Jersey, and cable telephony is available to 96.5% of those housing units.
- Every one of the more than 500 municipalities in the New Jersey has at least four wireless carriers offering service.
- *Every* zip code in New Jersey is served by at least four broadband providers, and thus VoIP over existing broadband connections is available to consumers throughout the State.
- There are now many traditional CLECs offering service to customers in New Jersey.”
VNJ IB at 2.

According to Mr. Vasington and Dr. Staihr, in New Jersey there is available a “full range of voice telecommunications services to mass market customers.” The providers of these services include cable companies, wireless carriers, VoIP companies, CLECs, and ILECs. Vasington Direct Testimony at 9: 19-20 and 10: 1-2. Moreover, Verizon in its brief states, “the competitive threat from cable companies is ubiquitous: cable companies: pass over 3.37 of the 3.47 million housing units in New Jersey; cable modem service is available to 98.3% of those housing units; and cable telephony is available to 96.5 percent of the residential households passed.”⁶

Wireless service is also widely available in New Jersey and penetration rates are high, per Verizon. VNJ IB at 24. Verizon cited that “as of December 2006, there were about 7.2 million wireless subscribers in New Jersey, a State with a population of about 8.7 million.” Id. Verizon also noted that “there are 41 broadband providers in New Jersey, and, as of December 2006, *every* zip code area in New Jersey was served by at least four broadband providers and 97 percent of zip codes in the State had access to five or more broadband providers.” Id. Verizon stated that “by December 2006, there were about *3.4 million* broadband lines in service in New Jersey – more broadband lines per capita than any other state in the country.” Id. at 26.

Verizon cites the widespread presence of broadband as significant because, in addition to displacing voice service through e-mail and instant messaging, broadband can be used to provide VoIP telephony service. VNJ IB at 27. Verizon claims that “companies such as Vonage, AT&T, Lingo, Net2Phone, BroadVox, and Level 3 provide VoIP over broadband services to New Jersey households and businesses. Client-based VoIP services provided by Skype, MSN, Yahoo Messenger, Google Talk and AOL Phoneline are also available throughout New Jersey.” Id. Verizon proffers in its brief, that “by early 2007, New Jersey-based Vonage served approximately 2.45 million lines, and client-based VoIP service providers such as Skype, Yahoo, MSN and Google served approximately 5 million lines.” VNJ IB at 28.

⁶VNJ-2 at 15.

In addition to intermodal mass market service providers, there are a significant number of traditional CLECs in New Jersey, including AT&T, IDT and Cavalier.⁷ These CLECs serve both residential and business customers.⁸ The above, Verizon contends provides ample proof of the presence of competitors throughout New Jersey.

Availability of Like or Substitute Services

With respect to the availability of like or substitute services, Verizon contends that it has established that demand for substitutes, like CLEC, cable, wireless, and VoIP services, has been increasing:

- “Recently (2001 to 2006), the CLEC share of the wireline market has grown from 4 to 17 percent.
- New Jersey wireless subscribership has more than tripled from year end 1999 to December 2006, growing from 2.3 million to 7.2 million subscribers.
- Since year end 2004, wireless subscribers have outnumbered switched access lines in the State.
- A significant percentage of households (12 – 17%) are “cutting the cord” in favor of wireless-only service and this trend is projected to increase (projected at 27% by year-end 2010).” VNJ IB at 3.

Further, Verizon contends customers are moving away from Verizon’s retail mass market services in ways set forth as follows:

- From year end 2000 to year end 2006, Verizon lost about 2.5 million retail voice lines, 1.7 million of which are residential (despite population and economic growth in the State).
- As of September 2007, the volume of telephone numbers ported from Verizon to its facilities-based competitors demonstrates that Verizon line losses are due to competition.
- From December 2003 through September 2007, Verizon’s primary residential line count decreased dramatically and thus it is without question that Verizon has significant retail primary line losses due to competition.
- Analysts estimate that cable, VoIP, and wireless substitution rates are growing and taking around 7 to 8% share annually from the telephone companies. Id.

⁷VNJ-4 at 22.

⁸VNJ-4 at 23.

Verizon points out that from the end of 2003 to the end of 2007, Verizon lost a significant number of non-package residential lines, VNJ IB at 10, VNJ 3 at 24, even though the price for basic service has not changed since 1984. Mr. Vasington testified that “customers who purchase a la carte basic service have decided that the value of the additional components of a package (e.g., unlimited long distance calling and vertical features) is not equal to the additional cost.” VNJ IB at 10.

Verizon disagrees with Rate Counsel’s claims that intermodal alternatives must not only be available to all customers, they must actually displace a large share of customers to be considered valid substitutes for traditional mass market services. Id. at 11. Verizon contends that broadband services are widespread and growing in New Jersey, which leads the nation in broadband lines per capita. Id., VNJ- 4 at 19. Mr. Vasington testified that “[b]y December 2006, there were about 3.4 million broadband lines in service in New Jersey. New Jersey has more broadband lines per capita than any other state in the country.” Vasington Direct Testimony at 25:18-20; VNJ IB at 11.

Verizon disagrees with Rate Counsel’s view that in order for a service to be considered a viable substitute every customer must consider it as an alternative under all circumstances. VNJ IB at 12. Verizon states that there exists 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 cable modem, 710,000 by DSL, and the remainder by other technologies. Id. at 13.⁹

Verizon in its brief contends that it has lost a significant number of mass market customers to other providers. Verizon lost residential lines in the State, while, during this same period, the availability of cable telephone services in the State dramatically increased from approximately 1.0 million to 3.3 million households.¹⁰

Data provided by Verizon also claims that in six years, ILEC retail lines in the State declined while CLEC retail lines increased. VNJ IB at 37. Verizon also has identified declines in wireline usage. Id. Verizon ARMIS data shows that approximately 1.7 million residential lines were lost between year-end 2000 and 2006, and that Verizon’s residential and general business lines have declined since year-end 2003.¹¹

Verizon states that significant loss of non-package lines is evidence of available substitutes. Further, the gain in package lines does not offset the declines in stand-alone lines. Verizon contends that residential loss of non-package lines demonstrates customer alternatives. Verizon opines that cable voice services are substitutes for traditional wireline services. The record, Verizon contends, shows that cable companies aggressively promote their voice service as a reliable substitute. VNJ IB at 2. In addition to cable, Verizon argues widespread wireless growth in New Jersey. Verizon claims, “As of December 2006, there were approximately 7.2 million wireless subscribers in New Jersey, as compared to 5.5 wireline access lines in the State.”¹² Verizon cites, “wireless subscribers in the U.S. increased by approximately 40 million

⁹VNJ-4 at 20-21.

¹⁰VNJ-2 at 51-52.

¹¹VNJ-2 at 63.

¹²VNJ-4 at 8.

between June 2005 and January 2007.”¹³ Verizon cited, “minutes of use nearly doubled to one trillion minutes between June 2004 and June 2007.”¹⁴

Verizon disputes Rate Counsel’s argument that services must be virtually identical to be effective substitutes, and that inter-modal services are not substitutes for traditional mass market services because the services are not identical. VNJ IB at 7. Verizon argues that “a service need not be equivalent in all respects to another service to be a substitute for that service; the key is whether two services are similar enough in the eye of the customer 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.” Id.

Verizon also disputes Rate Counsel’s claims that bundled services are different from individual services and are in distinct product markets. Id. at 9. Verizon proffers that CLECs and cable companies offer stand-alone telephony service according to witness Vasington. Vasington Tr. 137:15-23. Verizon concludes that its loss of customers and the increase in wireless subscribership prove that wireless substitution is evidence of a competitive market. VNJ IB at 43-44. Verizon also contends that broadband providers serve as a substitute for ILEC services, including but not limited to, Vonage, AT&T, Lingo and Net2Phone. Id. at 45.

According to Verizon, the record demonstrates that CLEC-provided services are also substitutes for the mass market services offered by ILECs and inter-modal providers. Many CLECs serve *both* residential and business customers in New Jersey.¹⁵

Verizon challenges the assertions of Rate Counsel discounting broadband as a substitute. Verizon argues that “when a customer disconnects a second line and replaces it with broadband, the customer’s actions demonstrates that broadband service is a competitive substitute for basic local service.” VNJ RB at 13. Further, Verizon disputes Rate Counsel’s claim that Verizon’s customer loss is attributable to second lines and not primary lines. Id. at 14. Also, Rate Counsel’s contention that Verizon’s single-line business customers are moving to private line or special access services is not supported by fact, according to Verizon. Id.

- There are 41 companies providing broadband service in New Jersey, and, as of December 2006, every zip code was served by at least four broadband providers, and 97 percent of zip codes were served by five or more broadband providers.¹⁶
- Of customers passed by cable systems, 100% have access to cable modems and 87% of ILEC lines have access to DSL.¹⁷
- By December 2006, there were about 3.4 million broadband lines in service in New Jersey – more broadband lines per capita than any other state in the country.
- Approximately 2.1 million mass market New Jersey customers already subscribe to broadband services, and can thus add VoIP service for a minimal incremental cost.¹⁸

¹³ Id.

¹⁴ Id., citing http://files.ctia.org/pdf/CTIA_Survey_Mid_Year_2007.pdf (accessed November 30, 2007).

¹⁵ VNJ-2 at 60.

¹⁶ VNJ IB at 24, citing VNJ-2 at 22.

¹⁷ VNJ-2 at 21-22.

- New forms of broadband using different last mile technologies—such as wireless (fixed and mobile) and satellite are spurring the proliferation of broadband.¹⁹
 - From June 2005 to December 2006, mobile wireless broadband added more lines than DSL and cable modem combined, and grew by over 5,670 percent in that time, while fixed wireless grew by over 132 percent.²⁰
- VNJ RB at 20.

Verizon’s witness Vasington contends that residential and single-line business exchange services should be considered as part of the same product market. Vasington Direct Testimony at 5:9-15. Verizon contends that residential customers demand essentially the same services as small business customers; services can be provided in essentially the same way as small business services; companies that offer residential services typically provide similar services to small business customers; services are sold using essentially the same marketing channels; and these services are provided using the same network platforms. VNJ IB at 5-6. Verizon added that “the FCC recognizes that residence and small business services are part of the same mass market.” Id. at 6. Verizon cites, “State commissions have also found that residence and small business services are in the same mass market.” Id. According to Verizon, in the Verizon-MCI merger proceeding, the Board treated residence and small business customers as a single group of “mass market customers.” Id.

Verizon argues, “[u]sage and vertical features associated with residence and small business services must be included in the same product market as residence and small business exchange services because these features and services are ancillary (or subordinate) to the primary line.” Id. Further, Verizon contends, usage and vertical features on the primary line should not be divided into uneconomic submarkets. Id. Verizon quotes the California Public Utilities Commission (“CPUC”) which concluded that these services should not be included in separate product markets:

We find that the historic practice of ***defining each telecommunications service as constituting a separate “market” is no longer relevant in today’s technologically diverse telecommunications environment.*** Concepts like “Basic Local Exchange Service,” “long distance service,” “call waiting service,” “call forwarding service,” and “pay phone service,” make little sense in an era dominated by telecommunications sold through bundled services. Id. at 7.

¹⁸VNJ-2 at 20 and 26, *citing* Federal Communications Commission, Industry Analysis and Technology Division, Wireline Competition Bureau, *High-Speed Services for Internet Access: Status as of December 31, 2006*, Table 13.

¹⁹VNJ-1 at 22. See FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, *High Speed Lines for Internet Access: Status as of December 31, 2006*. Table 1, High Speed Lines.

²⁰VNJ-2 at 23-25.

Verizon believes that the record bears out that the demand for ILEC and CLEC mass market services has been declining dramatically, while the demand for intermodal substitutes has increased markedly yet, Rate Counsel erroneously excludes intermodal services and packages from the relevant product market. Id. at 8.

The Relevant Geographic Area

In dealing with the issue of the relevant product market, Verizon concludes that the market includes “intra- and inter-modal competitors’ mass market services and Verizon’s residential basic exchange service, single-line business exchange service, associated local usage, vertical features, and DA services.” VNJ IB at 15. To establish its point, Verizon describes how many telecommunications providers offer statewide, nationwide pricing plans and qualify as competitors. Id.

Verizon quotes the NY PSC Staff findings:

Most service packages are offered by carriers on a territory- or region-wide basis, as opposed to by wire center. . . . To the extent carriers offer packages on a region-wide or territory-wide basis, the competitive threat need not be ubiquitous or uniform to effectively constrain carrier pricing decisions. For these reasons, Staff believes it is appropriate to gauge competition on a carrier's overall territory and to recalibrate regulatory policies in view of, and consistent with that perspective.²¹

Verizon also noted that the Board, in its CLEC Order, stated that “CLECs face competition from the ILEC in any given market in which they serve.”²² Conversely, Verizon states that the same holds true for Verizon, which faces competition from CLECs, wireless, cable, and VoIP in any given area in New Jersey.²³

Verizon pointed out that New Jersey is densely populated and thus competitive conditions in general, are similar throughout the State. Id. at 16. Moreover, Verizon claims, “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.” Id. In response to Rate Counsel’s rejection of Verizon’s definition of the relevant geographic market, Mr. Vasington testified that Rate Counsel’s analysis was formulated based upon a data mistake, which Rate Counsel subsequently corrected at the evidentiary hearings. Id. at 17.

In sum, Verizon argues that the relevant geographic area should be at least the entire State. Id. at 18.

²¹VNJ-2 at 39, *citing* 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*, White Paper Prepared by the State of New York Department of Public Service Staff (“PSC Staff White Paper”), dated September 21, 2005, at 30 – 31.

²²CLEC Order at 10-11.

²³VNJ-2 at 40.

Directory Assistance

Verizon contends that there are a variety of providers who offer residential directory assistance (“DA”) services in New Jersey. Verizon claims that subsequent to the last DA proceeding before the Board, new competitors, such as Microsoft and Google, have entered the market. Id. at 30. Verizon lists free DA service providers such as Jingle Networks Inc. as a competitor offering services since September 2005. In addition Verizon cites wireless carriers, Internet-based DA providers, CLECs, inter-exchange carriers (“IXCs”), alternative directory assistance providers (“ADAPs”), directory publishers, and electronic media companies, as market competitors. Id.

Verizon further indicates that “on October 30, 2007, AT&T began providing *free* local and nationwide residential and business DA services to *any and all* New Jersey wireline and wireless customers throughout New Jersey regardless of their service provider.” VNJ IB at 31. Another example of a DA competitor providing free local and nationwide DA service since October 2007 is Tellme™®, a Microsoft subsidiary, according to Verizon. Id. Lastly, Verizon noted Google™ now provides its free DA service to *any and all* New Jersey wireline and wireless customers regardless of their service providers. Id. Verizon also names wireless carriers, such as AT&T, Sprint/Nextel, T-Mobile, Verizon Wireless, as well as other smaller companies, along with Internet based providers, namely, AT&T’s Anywho.com, Switchboard.com, Reach411.com, Four11.com, InfoSpace.com, Whitepages.com, WhoWhere.com(a/k/a Lycos), 411Locate.com, 411metro.com, and free411.com as those who compete with Verizon’s DA services. Id. at 32. “Further, web search engines such as Google, Yahoo, and Ask.com, among others, all have web links to free directory assistance listings and services web sites,” per Verizon. Id.

Verizon contends that white and yellow page paper telephone directories are provided free of charge to business and residence customers. These alone, Verizon argues “account for almost 9 million directories being distributed free of charge to business and residence customers across the State.” Id.

Traditional CLECs are also active providers of DA service throughout the State. Those who do rely on Verizon’s platform (e.g., Verizon’s wholesale DA customers) are able to access Verizon’s DA database and provide customers with the same DA information that Verizon provides to its retail customers.²⁴

Also, Verizon contends that National IXCs offer directory information. VNJ IB at 33. Further, according to Verizon, ADAPs offer “local and national directory assistance services to mass market customers and wholesale customers in New Jersey.” Id. Specific survey results set forth in Mr. Newman’s testimony claim that “99% of mass market customers are aware of at least one other option for getting telephone numbers in addition to their local telephone company.” Id. at 33, Direct Testimony of Neuman at 7:3-5.

²⁴ See VNJ-2 at 34-35. Verizon also continues to offer customized routing on a non-discriminatory basis as required by the FCC to CLECs who provide their own DA services. Verizon’s customized routing enables a CLEC’s end users to dial “411” and have the CLEC provide DA services through the CLEC’s own operator services or via a third party (e.g., an ADAP). *Id.*

According to Verizon, regarding DA services, the competitive criterion is met for the following reasons: there are a number of available print services, computer-based services, and electronic media services. *Id.* at 45. Verizon asserts that cable companies provide DA service competition in the State through their cable telephone and broadband services. Verizon states that Cablevision offers its customers free local and national DA service, and Comcast offers a variety of DA services, including local, long-distance and international number assistance; local and long-distance connections; “movie listings and show times; and interactive, turn-by-turn directions to any destination provided by a live operator.” VNJ RB at 26.

Unlike its competitors, Verizon DA volumes have been declining – further demonstrating that customers are substituting away from Verizon’s DA service. From 2002 through 2006, DA calling volumes declined significantly.²⁵

Finally, as discussed earlier, the customer awareness survey conducted by Mr. Newman shows that, because a significant number of customers are aware of DA alternatives, and are willing to use those services, any attempt by Verizon to charge above market prices for its own DA services would not be profitable.²⁶ Significantly, Verizon’s consumer awareness survey demonstrates that New Jersey consumers are aware of and regularly use many of these competitive alternatives.²⁷ The survey results show that 99 percent of customers surveyed were aware of at least one other option for obtaining telephone numbers in addition to their local telephone company, and almost 90 percent of the respondents had used alternatives in the past six months.²⁸ VNJ RB at 27.

Since the Board’s earlier decision, Verizon has submitted new evidence showing the presence of new competitors and the availability of additional substitute services.²⁹ Further, Verizon has submitted updated DA calling volumes showing that Verizon DA calls continue to decline steadily. VNJ RB at 29.

Other Issues

Verizon addresses Rate Counsel’s interpretation of the *Telcor* case *Telecor Communications, Inc. et.al. v Southwestern Bell Telephone Company*, 305 F. 3d 1124 (10th Cir. 2002), as restraining the Board from reclassifying a service absent elasticity studies. Verizon argues that the antitrust test is more flexible than as described by Rate Counsel. Verizon RB at 7. Verizon cites the *Telcor* case findings that payphones and wireless phones were deemed interchangeable without a cross elasticity study. Verizon RB at 7. Further, as Verizon describes them, the DOJ Merger Guidelines do not prohibit consideration of evidence that buyers have moved or considered moving to other products based on price or other variables. VNJ RB at 8. Similarly, Verizon contends that “the FCC did not exclude VoIP from the product market.” *Id.*

²⁵VNJ-2 at 78.

²⁶VNJ-2 at 84-85.

²⁷VNJ-2 at 85.

²⁸VNJ-2 at 85; Ninety-seven percent of PAAD-eligible customers are aware of at least one other option for getting telephone numbers in addition to their local telephone company. *Id.*

²⁹VNJ-2 at 80-85; VNJ-4 at 25-27.

Verizon strongly opposes Rate Counsel's efforts to have the Board expand the classification criteria beyond the three statutory criteria, arguing that the Board *may* rely on criteria in addition to the statutory reclassification criteria. VNJ IB at 19. As cited by Verizon, Board precedent as well as the Board's defined scope of review in the instant proceeding adopted the criteria in N.J.S.A. 48:2-21.19, which is appropriately ease of market entry, presence of other competitors, and the availability of like or substitute services in the relevant geographic area. Id.

Verizon asks that the Board discount Rate Counsel's and Sprint's argument that it is necessary for the Board to depart from the well-established reclassification criteria, and to replace them with criteria previously rejected by the Board in other proceedings. VNJ IB at 4. Also, Verizon disputes Rate Counsel's and Sprint's attempt to argue issues beyond this case – e.g., intrastate access charge levels and the Federal Communications Commission's ("FCC's") opinions on Verizon's filings concerning certain *wholesale* regulations. Id.

Verizon argues that Rate Counsel inappropriately gives significant weight to the FCC's December 5, 2007 *Forbearance Order*³⁰ wherein the FCC denied Verizon's petition for reclassification of ILEC-provided mass market services.³¹ Verizon contends that the FCC's *Forbearance Order* addressed different issues and criteria upon which relief was sought. VNJ IB at 54. According to Verizon, the *Forbearance Order* deals with wholesale services while this petition deals with retail services. Id. Therefore, the FCC's evaluation for purposes of wholesale relief is not relevant here because it employed a different standard and applied that standard to wholesale services. Id.

In response to the charge that there is cross subsidization which should bar reclassification, Verizon characterizes the record as devoid of evidence suggesting that Verizon's stand-alone basic exchange services are subsidized by non-competitive services.³² VNJ RB at 31. Verizon argues that its competitive services "generate sufficient revenues to cover their direct costs." VNJ RB at 36. According to Verizon, Sprint has failed to show that the services at issue in this proceeding are subsidized. Id. According to Verizon's interpretation of the statutes, Verizon is not required to perform a subsidy analysis on each service versus competitive services as a group. According to Verizon, "the New Jersey Act states that "[n]o local exchange telecommunications company may use revenues earned or expenses incurred in conjunction with noncompetitive *services* [plural] to subsidize competitive *services* [plural]."³³ The Board, as Verizon understands the statutes to read, requires "that competitive services as a *group* may not be subsidized." Id. Verizon describes the findings in the PAR-2 order to hold that when assessing whether an improper cross-subsidy exists, the focus of the evaluation is "whether, *in the aggregate*, the *total* revenue for VNJ's competitive services exceed the *total* direct cost of those services."³⁴ VNJ RB at 37.

³⁰*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, FCC 07-212, Memorandum Opinion and Order (rel. December 5, 2007) ("*Forbearance Order*").

³¹RC-1 at 68-78.

³²VNJ-4 at 53-57.

³³*N.J.S.A. 48:2-21.18* (emphasis added).

³⁴PAR-2 Order at 54 (emphasis supplied).

Verizon goes on to state, “Sprint Nextel relies on snippets from a Baumol and Sidak article for the proposition that, if the analysis includes more than two services, the subsidy analysis should include joint and common costs.”³⁵ Verizon disputes the validity of the article in that it is not supported by a witness nor has it been subject to examination. VNJ RB at 39. Also Verizon states “the article does not support the claim that shared and common costs should be included in Verizon’s competitive services subsidy analysis.” *Id.* Verizon points to Mr. Garzillos’ testimony, which it states includes “all annual revenues for all competitive services and services that are subject to reclassification in this proceeding.”³⁶ Moreover, the analysis includes the total direct costs for competitive services and the services that are the subject of the Board’s reclassification inquiry.³⁷ In response to Rate Counsel’s arguments to the contrary, Verizon says its analysis does include non-recurring cost studies. VNJ RB 39-40.

Verizon refutes Rate Counsel’s challenges to its witness claiming, “Mr. Vasington qualifies as an expert due to his special knowledge, skill, experience and training.”³⁸ Moreover, Verizon avers, New Jersey laws do not require testimony to be sponsored by an economist. Verizon claims the current rules in, *N.J.A.C.* 1:1-15.8 provide that every person is qualified to be a witness, and that witnesses may testify regarding matters within their personal knowledge, or special experience, training or education. VNJ RB at 46.

Rate Counsel also claims that Mr. Vasington is incompetent to testify because, according to Rate Counsel, his testimony should be based on “extensive data and information about the competitive markets,” such as “supply/demand elasticity studies” that must be performed and interpreted by an economist.³⁹ Verizon argues that the 1992 Act does not require such studies, nor has the Board required them in prior reclassification proceedings. VNJ RB at 47.

Verizon remarks that the Board has consistently held that an analysis concerning the competitiveness of a service rests on the presence of competitors, the presence of like or substitute services, and ease of market entry. The Board has not considered market share relevant in past reclassification proceedings. Verizon claims, “[I]t is also meaningless where a firm’s market share is the product of regulation, as opposed to competition.”⁴⁰

Finally, Verizon disputes Rate Counsel’s claim that the schedule in this proceeding was accelerated, and points to the schedule in the CLEC reclassification case as an example of a case with a similar schedule. VNJ RB at 50. Verizon argues that Rate Counsel filed hundreds of requests within the allotted timeframe, and was therefore not prejudiced in any way. Further, the Hearing Examiner’s rulings, which Rate Counsel objects to, have not been appealed by Rate Counsel. *Id.* The allegations by Rate Counsel that the Hearing Examiner should have required Verizon to perform studies in response to discovery requests by Rate Counsel is not supported in fact. *Id.* at 51. With respect to the transcript request that Rate Counsel complains of, Verizon believes the ruling was appropriate in light of the fact that the request was for information which

³⁵Sprint Nextel Brief at 20-22.

³⁶VNJ-5 at 54-56.

³⁷VNJ-5 at 54-57.

³⁸*I/M/O the Board Investigation Regarding the Reclassification of Incumbent Local Exchange Carrier Services as Competitive*, BPU Docket No. TX07110873, Order on Motions to Strike and to Compel at 3 (Mar. 3, 2008).

³⁹RC IB. at 49 (emphasis added).

⁴⁰*Id.*

went to the question of FiOS being part of the subsidy analysis, which was already addressed by Verizon witness Garzillo, who stated it was not. Id. at 52.

Embarq

Embarq argues the record is replete with overwhelming evidence demonstrating ease of market entry, presence of other competitors, and the availability of like or substitute services in the relevant geographic market. EMB IB at 3. Embarq relies upon the following testimony of its witness, Brian Staihr stating:

- “Wireless service is available in 99.8% of the land area of Embarq's New Jersey market and to 100% of Embarq's New Jersey customers. Embarq Staihr testimony at 18.
- 96% of all consumers in Embarq's service territory can choose from three or more wireless providers. Staihr Testimony at 18.
- Measured in square miles, the cable companies' service footprint covers more than 99% of the geographic area that comprises Embarq exchanges. Staihr Testimony at 20
- Comcast now offers digital cable, high speed Internet access and digital telephone service to approximately 57,300 households in Embarq's exchanges. That represents 57% of all the households in Embarq's New Jersey market. Staihr Testimony at 23
- Approximately 97% of all households will be passed by cable companies offering telephone service [when Service Electric begins offering cable telephony to Embarq exchanges]. Staihr Testimony at 24
- CLECs purchase wholesale services for resale in all 26 of Embarq wire centers, and purchase unbundled network elements in 21 wire centers representing 93% of Embarq's access lines. Staihr Testimony at 30
- ...competitors are actively positioning themselves as offering replacements—that is, substitutes—for retail mass market services in Embarq's New Jersey market. Staihr Rebuttal Testimony at 38-39
- A customer in New Jersey can take voice service from Embarq and a bundle of video and data from Comcast, or voice service and video from Comcast and high-speed data from wireless, or voice service and high speed data from Embarq and video from satellite, or voice service and high speed data from wireless and video from satellite.” Staihr Rebuttal at 43.

According to Embarq, competition is thriving in New Jersey, particularly intermodal competition which has resulted in consumers substituting cable, wireless, and wireline services in the ILEC retail mass market. EMB IB at 3. As a result, Embarq believes that the Board should approve the reclassification of mass market retail services and its multi-line business services. Id.

Barriers to Entry

Embarq also, contends that there are no legal, regulatory or technical barriers to market entry in New Jersey. Dr. Staihr testified, “The presence of multiple competitors offering substitutable services in Embarq wire centers is ample evidence of this fact.” Staihr Direct Testimony at 31; EMB IB at 12.

Embarq supports the Board's previous findings that there were no barriers to entry when considering reclassification of CLEC services, and its conclusion that services should be deemed competitive. I/M/O the Board Investigation Regarding The Reclassification Of Competitive Local Exchange Carrier Services As Competitive, Dkt. No TX06120841, June 29, 2007 ("CLEC Order"). Staihr Direct Testimony at 31. Embarq believes the large number of competitors evidenced in this record should lead to the same favorable finding concerning the issue of market entry herein, "given that CLECs and ILECs operate in the same market and compete to provide substitutable services to the same customers." EMB IB at 12.

Dr. Staihr listed the following alternatives for consideration by the Board:

- Wireless service is available in every Embarq exchange;
- Non-facilities VoIP is available in every Embarq exchange;
- CLEC offerings are available in every Embarq exchange; and
- Cable telephony is available in over 57% of Embarq exchanges. Staihr Rebuttal Testimony at 33 : 7-14.

In addressing the issues raised by the opposition, Embarq states that the statute does not require a party seeking reclassification to prove that "no barriers" exist. EMB RB at 2. Further, Embarq argues that if the Board were to accept the arguments put forward by Rate Counsel, it would be limited in that it could only find ease of market entry in an environment where "wholesale rates constrain retail rates and only in the absence of market power as Rate Counsel defines." However, Embarq contends, these are not elements required by statute for consideration by the Board. EMB RB at 22.

Embarq contends that subsidies are not relevant to a competitive classification. EMB RB at 35. Highlighting Sprint's misplaced relevance of access charges, Embarq states, "intrastate access service is not used to provide residential or business exchange service." Id. at 36. Further, Embarq challenges Sprint's allegations, and claims Sprint has not presented evidence that the statute expressly or impliedly requires subsidies be removed if they exist before a service is classified as competitive. Id.

Presence of Competitors

Embarq, in its brief, relies on the Board's CLEC Order wherein the Board held "existence of each authorized CLEC provider clearly provides evidence of competitors in the local exchange market." CLEC Order at 9. Further, Embarq argues, evidence of competitors exists due in part to numerous intermodal providers in New Jersey, specifically in the Embarq service territory. Embarq claims, "the most prevalent competitors in the provision of retail mass market services in Embarq's service area are: (1) Wireless providers, (2) Cable television companies, (3) Non-fixed VoIP providers, and (4) Traditional CLECs." Id.

With respect to wireless providers, Dr. Staihr, on behalf of Embarq testified that FCC data shows "as of June, 2006, there were more than eight million wireless subscribers in New Jersey—a number which represents 93% of the total population of the State." Staihr Rebuttal Testimony at 32 ; EMB IB at 15. According to Embarq, "[i]n the Embarq service territory, Sprint Nextel, T-Mobile, AT&T and Verizon Wireless are the predominant providers, with service available to 100% of Embarq's customers."⁴¹ In the Embarq service territory 96% of all

⁴¹ Id., at p. 31.

consumers in Embarq's market can choose from three or more wireless providers.⁴² EMB IB at 16.

Dr. Staihr testified that the record supports a finding of competitiveness as FCC reports indicate there are "at least three high speed Internet access providers in each of the 26 zip codes that comprise Embarq's market."⁴³ and multiple CLECs are present in each and every exchange. EMB IB at 17-18.

Dr. Staihr's analysis indicates that due to competition, Embarq's customer base has decreased by approximately 100,000 residential access lines. Id. at 19. According to Dr. Staihr, Embarq serves approximately 116,000 residential access lines and absent competition, estimated that number would increase to approximately 223,000 lines. "The impact competition has had on Embarq amounts to a decrease by almost half of its market in New Jersey," according to Dr. Staihr. Id.

Embarq disagrees with Rate Counsel's arguments that the statute should be read to include language which, according to Embarq, does not exist. Embarq suggests that Rate Counsel interprets the statute as follows: "presence of other competitors for residential service on a stand alone basis." Embarq RB at 25. This is wrong, contends Embarq. Id. In addition, Embarq opines that Rate Counsel goes even further interpreting the statutes to include "presence of other competitors for residential service on a stand-alone basis but only if no market power exists and CLECs constrain the ILEC's rates." Id. Instead of interjecting new requirements, Embarq asks that Rate Counsel take notice of the evidence in the record which comports with the existing statute.

Availability of Like or Substitute Services

With respect to the issue of what constitutes a substitute service, Dr. Staihr, on behalf of Embarq, defines substitutability as "functional equivalence or reasonable interchangeability of use." EMB IB at 21. "Two services can be considered substitutes if they are functionally equivalent: that is, if they do the same thing and do it in the same way."⁴⁴ EMB IB at 21. Embarq also contends that :

"two products can also be substitutes if they satisfy a similar customer demand. In these cases, services that act as substitutes will exhibit reasonable interchangeability of use.⁴⁵ An example of services that exhibit reasonable interchangeability of use would be voice service provided by a cable company or a wireless carrier and voice services provided by Embarq—these services satisfy a similar customer demand but do so using completely different technologies." EMB IB at 21.

Dr. Staihr proposes the "reasonable interchangeability of use" concept since it covers all degrees of substitutability while recognizing that quality differences can exist between substitutes, and because it acknowledges that even though the services are not identical or functionally equivalent they can still compete with each other. EMB IB at 22. Dr. Staihr provided a test question when considering substitutability: "Do two services have the ability—actual or

⁴² Id., at p. 31.

⁴³ Id., at p. 34.

⁴⁴ Staihr Direct, at p. 5.

⁴⁵ Id., at p. 6 (referencing the standard used in *Brown Shoe Co. v. United States*, 370 U.S. 294, 325 (1962)).

potential—to take away significant amounts of business from each other. If they do, they are in the same market.”⁴⁶ EMB IB at 22. Embarq opines that bundles are substitutes for stand-alone services since they take business away from each other. Staihr Rebuttal Testimony at 26 L16-19, 28 :1-3. Embarq submitted for the record that the number of households in its service territory has increased consistently and steadily between 1990 (93,130) and 2007 (111,835), while the same cannot be said for Embarq’s residential access lines. EMB IB at 24.

The Relevant Market

On the issue of the correct definition of the product market, Embarq references the CLEC proceeding, where the Board determined the “relevant area” was appropriately defined as the State of New Jersey. EMB IB at 20. In this proceeding, Embarq argues that the service territory of the respective ILECs should define the relevant geographic area. Id. Embarq discounts the notion of wire centers as the relevant geographic area. Id. As Dr. Staihr noted, competitors could enter the Trenton market and not recognize they have entered the Trenton, Mercerville, and Morrisville (PA) wire centers; therefore, the use of wire centers is inappropriate and should be rejected. EMB IB at 20.

Embarq cited the Board’s finding in its CLEC Order that “there is no statutory or other requirement that every means of competing be used in every wire center to provide each of the like or substitute services for which reclassification is sought.”⁴⁷ EMB IB at 21. Also, Embarq noted the Board’s decision “that there is no statutory or other requirement that a party seeking reclassification demonstrate that every method of competing with its services is present in every wire center.” EMB RB at 18 citing, *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 Filings*, Docket No. TO01020095, Order, Sept. 22, 2005, at 144.

Further, Rate Counsel’s depiction of protected services as local service, meaning only plain old telephone service, is inconsistent with the 1992 Act according to Embarq since the definition of protected services included in the Act provides for touch tone, toll and access services. EMB RB at 3. Embarq argues that if the legislature wanted to limit the Board’s ability to define product markets, it would have stated so in the statutes. EMB RB at 3.

Other Issues

Embarq believes Rate Counsel has not established the relevancy of the ATT/SBC Merger Order and other FCC orders which it cites to bolster its arguments against reclassification. EMB RB at 4. In addition, the DOJ Merger Guidelines cited by Rate Counsel do not apply to this situation, according to Embarq, as customers change from stand alone to bundled service even absent a change in price. Id. Therefore, Embarq claims, Rate Counsel’s arguments are irrelevant and should not be accepted.

In addition, Embarq claims that “contrary to Rate Counsel’s suggestion, it is not reasonable to believe that the loss of over 30% of Embarq’s residential access lines in a six-year period can be attributed to the death of customers, or job losses by customers—particularly when the number of households has continued to grow steadily.” Staihr Direct Testimony at Attachment BKS – 2; EMB IB at 25.

⁴⁶ Id., at p. 7.

⁴⁷ CLEC Order at 11.

Embarq submitted information that it lost a significant number of access lines to Patriot Cable and Comcast, and that the number of lost customers continues to grow. EMB RB at 12. In addition to wireless, “fifty-three percent of New Jersey’s zip codes have at least five high speed Internet access providers.” EMB RB at 15. Embarq points out that it is their understanding that “at least 13 CLECs, which are not cable companies, wireless mobile or non-facilities based VoIP companies” provide service in Embarq’s area. EMB RB at 16. Also, “the number of CLECs in each Embarq wire center range from two to seven.” EMB RB at 16.

Accordingly, Embarq believes it has presented sufficient credible evidence that intermodal competitors offer stand alone service and that bundles and stand alone services share the same market and compete for customers. EMB RB at 7; Tr at 49. Moreover, Dr. Staihr testified that: when a customer chooses wireless over the purchase of a second line; or uses yellowpages.com to find a number instead of calling Directory Assistance; when dial up access to the internet is replaced with cable modem; and when customers choose voice over cable or wireless only, that meets the statutory criteria for a like substitute service. EMB RB at 9; EQ-1 at 8. Rate Counsel’s contention that Embarq’s position as a rate of return regulation company must be taken into account is wrong as that is irrelevant to the determination of whether Embarq’s retail mass market services are competitive. EMB IB at 7. Embarq’s argument is founded in the principles set forth in the statutes particularly, the New Jersey’s Telecommunications Act of 1992 which it claims “does not support any sequential regime of regulation as a condition of the Board’s classifying Embarq’s retail mass market services as competitive. N.J.S.A. 48:2-21.19 is a separate statutory provision from the remaining provisions of the Act.” EMB IB at 3. Further, Embarq also notes that N.J.S.A. 48:2-21.19 does not address the issue of subsidies. EMB IB at 9.

In sum, Embarq describes Rate Counsel’s arguments as an attempt to “supplement the statutory requirements by imposing unnecessary and self-proclaimed requirements to the criteria.” EMB RB at 5. “Rate Counsel would erroneously require a quantitative measurement of the price and cross-price elasticity of two products/services as proof of the product/service market,” yet this is not required, relevant or reasonable. Id.

On procedural issues, Embarq disputes Rate Counsel’s allegations that Dr. Staihr’s testimony is “net Opinion” with no support. Dr. Staihr, according to Embarq, is qualified with a Doctorate in Economics and has testified in matters before Congress in addition to other states. EMB RB at 30. The skills Dr. Staihr possesses enable him to speak to the issues in this case. Id. at 31. Further, an expert economist does not have to rely on surveys and studies, under NJSA 48:2-21.19(b). Id. Embarq states the residuum rule relied upon by Rate Counsel is misapplied since Dr. Staihr has special knowledge and skill along with experience in the areas he testified about, and as such it is not hearsay. EMB RB at 32. More importantly, Embarq notes that the Board is not bound by the rules of evidence. N.J.S.A. 52:14B-10(a).

Embarq argues that the Hearing Officer did not err in his decisions not to mandate special studies in this case. EMB RB at 33. Also, Embarq contends there was no due process violation in the ruling to exclude the requested exhibit containing many CLEC tariffs, when the record included some but not all of the tariffs sought in proving the matter asserted. EMB RB at 34. Embarq supports the rulings and stated that Rate Counsel was provided ample time to cross examine witnesses in this case. Id.

Rate Counsel

Rate Counsel argues that ILECs' mass market retail services should not be deemed competitive. Thus, Rate Counsel in its Initial Brief pleads with the Board to continue to regulate protected local telephone services and other basic services. RC IB at 6. Rate Counsel believes that insufficient competition exists to ensure affordable rates. Id. In fact, Rate Counsel submits expert testimony that, if deregulated, rates could increase up to a total of one half billion dollars. RC IB at 5. Rate Counsel argues that "[r]esidential customers could see increases up to \$360 million per year if companies raise rates close to the charge for bundled services." Id. Also, Rate Counsel points out that the (4) four free calls for Directory Assistance that customers are accustomed to, will be eliminated, resulting in an increase of \$187 million dollars. Id.

Overwhelming evidence exists, according to Rate Counsel, that if granted the regulatory relief sought through this filing, Verizon and Embarq would be in a position to exercise significant market power and thus be able to raise rates. RC IB at 6. Rate Counsel argues that it is important to examine market power, consistent with Board rules, in monitoring competition. RC IB at 9, citing N.J.A.C. 14:10-5.7(b)(2). "Market power is the ability to raise price by restricting output, ... [t]he ability of one or more firms profitably to maintain prices above a competitive level for a significant period of time" RC IB at 10, citing United States Department of Justice Merger Guidelines (1984), reprinted in 4 Trade Reg. Rep. (CCH) Section 13,103 at 20,556.

Barriers to Entry

Rate Counsel does not believe the record supports reclassification. Rate Counsel claims that "ILECs' essential elements are mis-priced" and that this creates barriers to entry.⁴⁸ Rate Counsel believes barriers do exist which include: "above cost intrastate access rates, misalignment between wholesale retail rates, flawed interstate access regimes, failure to resolve intercarrier compensation, and separation reform issues." RC IB at 20. Specifically, Rate Counsel argues that Verizon has not met its burden to establish that non-competitive services do not serve as a subsidy for competitive services. Id. Rate Counsel also claims that Verizon has tremendous market power which negatively impacts competition. Id. at 21.

Rate Counsel asserts, because intrastate access rates are above costs, Verizon has created a barrier to entry and has market power. Rate Counsel concludes that high intrastate access rates create a barrier and a subsidy for local service, and that, in turn, subsidies create a barrier to entry for competitors. Id. at 26.

Presence of Competitors

Rate Counsel asserts that the record is devoid of the necessary proofs to establish the presence of competitors for local only service. RC IB at 27. There has been no evidence submitted, per Rate Counsel, showing competitors can provide service at or below Verizon's rates. Id. Rate Counsel opposes Dr. Stair's representations that competitors serve mass market customers, and believes they serve enterprise customers instead. Id. The proffer of bundled service providers as competitors, in Rate Counsel's opinion, does not meet the statutory criteria.

⁴⁸RC-2 at 90.

Rate Counsel objects to Verizon's failure to submit studies explaining line losses which Verizon attributes to the presence of competitors in the market. Id. at 30. Rate Counsel proposes that Verizon does not address the fact that customers may remain Verizon customers via affiliate services. Id. Contrary to Verizon's claims, Rate Counsel argues that a line loss in one column does not always equate to a lost account. Id. The same can be said of Embarq, according to Rate Counsel, regarding the relevance of line loss without any analysis or data supporting the proposition that the loss is due to competition. Rate Counsel submits that a recent ARMIS Report found Embarq's lines almost doubled from 2002-2006. Id. at 31.

Rate Counsel notes that Verizon witness Vasington, testified that "competitors" generally do not provide local only service. RC IB at 22, citing Vasington testimony, T. 136:12-18. Accordingly, Rate Counsel argues that there are no like substitutes available for local only service, and no analysis has been submitted in support of a finding of a like substitute. RC IB at 32. Rate Counsel reiterates that bundles are not substitutes, as they include additional services not wanted by customers. Id. at 33-34. Further, VoIP is not a valid substitute, according to Rate Counsel, since rates are significantly higher than local phone service rates. Id. at 34. Cable voice services are offered as part of a package per Rate Counsel, at a higher cost. Id. at 35. Stand alone service is not offered by cable companies, and Rate Counsel therefore finds little competition exists. Id. at 36.

Availability of Like or Substitute Services

In addition, rates of inter-modal services which are offered as evidence of substitutes by Embarq witness Staihr are not considered viable to Rate Counsel due to their price and lack of interchangeability. Id. at 36. Specifically, VoIP does not qualify as a substitute per Rate Counsel because of the required connections. Id. at 39. Also, it is Rate Counsel's understanding that Dr. Staihr's testimony does not support wireless as a substitute for stand alone local service. Id. at 40. Rate Counsel further argues that Verizon did not provide the essential economic analysis necessary to show that bundles are substitutes. Id. at 42. T.114:21-25;115:3;120:3-14.

Rate Counsel asserts that cable, wireless and resale are not viable competitors in the retail mass market. Id. at 45. Moreover, Rate Counsel notes that Verizon did not provide quantitative economic analysis to support its assertions regarding viable substitutes. RC RB at 18. Rate Counsel dismisses the parties' evidence as opinion, not backed by actual evidence, studies or proofs. RC IB at 20. When local exchange service is placed in its own product market, Rate Counsel avers, there are few competitors and no like or substitute services. Id. As an example, Rate Counsel describes voice, data and video packages as having high transaction costs associated with migration and one year contracts with early termination fees, long term commitment requirements and email addresses that are not portable. RC IB at 39. As far as wireless is concerned, Rate Counsel argues, coverage is questionable, and it requires effort on the part of the consumer to charge the battery and it does not connect to Tivo. RC IB at 41. Put succinctly, Rate Counsel says intermodal services are not affordable, are not interchangeable, and therefore do not serve as substitutes. Id. at 36.

Rate Counsel cites Telecor, supra, wherein the Court held relevant market depends upon the available substitutes. RC IB at p 11. Further, Rate Counsel cites the Court's findings that "reasonable interchangeability" is synonymous with cross elasticity. RC IB at p 11 citing to Brown Shoe Co. v United States, 370 U.S. 294, 325 (1962). Rate Counsel contends a market is cross-elastic if when prices rise, consumers switch to a different product. Id., citing Telecor.

The Relevant Market

Contrary to the position held by Verizon and Embarq, Rate Counsel argues relevant product market, as interpreted by the FCC in I/M/O SBC Communications and AT&T Corp. Applications for Approval of Transfer of Control, WC Docket No. 05-65, FCC 05-183, (SBC Merger Order) at Para 95, does not include VoIP, and bundled local and long distance services are separate product markets from local service. RC IB at 12.

Rate Counsel refutes Verizon's claim that there is one relevant product market which includes bundles comprised of local, long distance and toll. RC IB at p 14. Rate Counsel disagrees with Verizon's premise that reclassification is appropriate because cable carriers, wireless and VoIP providers, as well as CLECs, offer bundled services which include local. Id. at 14.

By misdefining the relevant product market, Rate Counsel asserts that Verizon's statement that the statutory criteria for competitiveness have been met becomes fatally flawed. For instance, according to the FCC, over the top VoIP services are not part of the local market. Thus, Verizon's reliance upon VoIP as a substitute for local service fails. RC IB at 17. The evidence submitted by Verizon, according to Rate Counsel excludes 54 of the services for which Verizon is seeking reclassification. Id.

Embarq too, has not proposed an accurate definition of the relevant market per Rate Counsel. Id. at 18. Embarq offers no studies or economic data, notes Rate Counsel, to support its arguments concerning relevant product market. Also, Rate Counsel contends both companies erroneously define relevant geographic market as the entire state. Id.

Rate Counsel asserts that the arguments proposed by Verizon and Embarq are simply false. Rate Counsel claims that contending that the entire state is the relevant market and that conditions throughout the state are similar, is wrong. Rate Counsel says competition does not exist throughout the state, and argues the more critical wire center analysis of the market is appropriate. In support of its argument, Rate Counsel states that both the National Regulatory Research Institute and the FCC determined that the wire center is the relevant geographic market. RC RB at 7, Baldwin Reply testimony at 35-36. See also, I/M/O Petition of ACS of Anchorage, Inc., etc., FCC WC Docket No. 05-281 Memorandum Opinion and Order, Released January 30, 2007, at Para 14.

Other Issues

Rate Counsel contends that N.J.S.A. 48:2-21.19(b) sets forth minimum criteria, and urges the Board to look beyond the three statutory elements and consider the N.J.A.C. 14:10-5.7 rules when making its determination. RC IB at 9. Also, Rate Counsel notes that the 1992 Act addresses the issue of market forces and monitoring the competitiveness of a service, and that the Board should address this issue in its analysis regarding mass market retail service. Rate Counsel argues that Verizon and Embarq must satisfy the three criteria and also prove that they are precluded from the exercise of market power. RC. IB at 19. Rate Counsel contends that when local service is considered as a stand alone market, Verizon and Embarq have not provided evidence that there are no barriers to entry or that there are more than a few competitors and that there are like or substitute services. Id. at 20. Specifically, Rate Counsel avers that Verizon and Embarq misread the statute to exclude the word "minimum" and include the word "only" for their own benefit. RC RB at 9.

Rate Counsel argues that Verizon and Embarq failed to present sufficient evidence of competition in the DA market. Embarq, Rate Counsel states, did not offer any evidence regarding whether or not DAS meets the statutory criteria to deem the service competitive. RC Id. at 64. The alternatives proposed by Verizon, Rate Counsel alleges, cost more, require additional equipment are unknown, and are not comparable to traditional DAS. RC IB at 65. The main handicap of alternatives is that they don't enjoy the 411 dialing convention that Verizon has, according to Rate Counsel. Id. at 66. Rate Counsel states no new evidence was submitted to persuade the Board to alter its recent decision concerning DA, or to show that the Board erred in its previous findings. RC RB at 20. Therefore, Rate Counsel contends that the Board should not find DAS competitive.

Rate Counsel argues that the Federal Communications Commission denied Verizon's petition for deregulation of wholesale services in six Metropolitan Statistical Areas (MSA) and that this proves that competition does not exist. RC IB at 5. Based on Rate Counsel's analysis, the FCC held that it would continue to consider Verizon's dominant carrier status in the MSAs including New Jersey. Id. at 45.

Rate Counsel states that the statutes prohibit subsidization of rate regulated service by competitive services. N.J.S.A. 48:2-21.16(a)(3). RC IB at 68. Rate Counsel contends that a fully distributed cost analysis is appropriate under the circumstances, and that a direct cost analysis does not suffice as provided in the joint rebuttal testimony of Vasington and Garzillo on behalf of Verizon. Id. Rate Counsel challenges Verizon's grouping of services together for purposes of analyzing costs. Id. at 70. Additionally, Rate Counsel points out that when cross examined, Garzillo stated he did not consider all costs in his review. Id. Lastly, Rate Counsel avers that Verizon failed to present data for all services, along with the costs and revenues relevant to each service. Id. at 73.

Rate Counsel argues that if Verizon and Embarq's reclassification request is granted while intrastate access charges go unchanged, the statutory bar concerning cross subsidization will have been violated. RC RB at 14. Rate Counsel states, "...the subsidy analysis sponsored by Mr. Garzillo is not reliable, fails to include all costs, and is not fully distributed cost analysis and otherwise lacks support...." Id.

On procedural issues, Rate Counsel argues that Verizon's witness, Mr. Vasington does not qualify as an expert and therefore his testimony should be excluded or given very little weight. RC IB at 51. Also, Rate Counsel believes the Dr. Staihr's testimony is a net opinion. Id. at 52. In support of its argument, Rate Counsel contends, "Dr. Staihr offered no economic or quantitative analysis to support his opinion that local service and bundled service are the appropriate relevant product market. No studies, analyses or surveys are provided to support Dr. Staihr's conclusions that wireless, VoIP and cable are viewed as substitutes by consumers." Id. at 53. Thus, Dr. Staihr's testimony as described by Rate Counsel is a "net opinion" based on generalizations, and is therefore inadmissible. Id.

Rate Counsel contends that the denial of its various motions to compel discovery violated its rights to information necessary to support its theory of the case. The information sought was in the control of Verizon and Embarq, and by not being granted access to that information, Rate Counsel was prevented from fully establishing its arguments. RC IB at 77. Rate Counsel believes access to cost data of the incumbents is essential to its case, and discovery of these documents was not permitted. Id. Rate Counsel also sought work papers and models which Verizon did not provide. Id. Generally, Rate Counsel argues that its fundamental right to discovery and due process was violated. Id. at 78. In addition, Rate Counsel claims "it

was not afforded an opportunity to rebut assertions made for the first time in rebuttal.” Id. Also, evidentiary rulings prevented it from “exercising its right to cross examine and develop a response to ILECs’ positions.” Id. Exclusion of tariffs from the record, Rate Counsel argues, was “legal error causing prejudice to Rate Counsel.” Id. at 79. Rate Counsel disputes the ruling on the transcript request regarding households with FiOS, and believes “the denial of this information was error and prejudicial.” Id. at 79.

In sum, Rate Counsel argues that erroneous evidential rulings, the accelerated schedule, the failure of Verizon and Embarq to provide full and timely responses to discovery, in effect result in a denial of due process. Id. at 80.

Sprint

Sprint contends that it has submitted evidence of the existence of barriers to entry into the retail mass market, and therefore, the statutory criteria supporting reclassification have not been met. Sprint IB at 1. ILEC access charges, Sprint argues, impose a high cost on competitors and provide a subsidy to the ILECs. Id. at 3. The cross subsidy that access charges provide to the ILECs is prohibited by statute and as such, Sprint argues, reclassification must be denied.

Barriers to Entry

Sprint asserts that both Verizon and Embarq witnesses Vasington and Staihr “equate ease of market entry with the lack of barriers to entry.” VNJ 1 at 9:7-11:16 Vasington; EQ 1 at 3:1-23 Staihr; Sprint IB at 4. Sprint argues that a market barrier in fact exists due to the high cost access charges place on competitors which provide an unfair competitive advantage to ILECs. Id. at 5. Sprint states that Verizon itself has claimed harm from high access charges. Id. at 6. Sprint cited Verizon comments in Minnesota that “the anti consumer results of inefficient rate structures and high access charges include suppression of demand for services of other carriers that must bear the cost and reduced incentives for local entry by firms that might be able to provide service more efficiently than the LEC.” Sprint 1 at 13:3-9, quoting Comments of the Verizon Companies, dated March 16, 2007 at 4 in *In the Matter of the Request for Comments of the Minnesota Public Utilities Commission Relating to a Rule to Modify Telephone Access Charges*, Docket No. P-000/R-06-51 (Minn. Public Utilities Commission). Sprint IB at 6.

Sprint believes access charges serve as a subsidy to the ILECs, and provide them with an unfair advantage in the marketplace. Sprint 1 at 5:22-6:2, Sprint IB at 7. Sprint, refutes Verizon’s claim that affiliates bear the same access costs. Sprint IB at 8. As Sprint describes, when “Verizon’s wireless and long distance affiliates pay Verizon New Jersey Inc. tariffed access rates for switched access traffic, Verizon Corporation realizes a corresponding revenue stream (to the Verizon ILEC) and expense entry (from the long distance and wireless affiliates) of equal amounts.” Id.

Sprint, in support of its positions, claims that Embarq did not offer evidence to refute its showing that a barrier to entry exists. Id. at 9. Further, Sprint contends that Mr. Vasington, on behalf of Verizon, testified that bundles serve to compete with basic exchange service and restrain prices. Id. at 10. Similarly, Mr. Staihr testified that bundles are substitutes for basic exchange service. EQ-1 at 10:20-21. Thus, Sprint concludes, competitors pay intrastate switched access charges to enable them to provide the same services that ILECs do. It is reasonable to find, therefore, that a barrier to entry exists, per Sprint. Id. As has been the case

in other jurisdictions, Sprint seeks access relief prior to reclassification. Sprint RB at 8.⁴⁹ Sprint IB at 12, footnote 8.

Cross Subsidization

Sprint submits that the Board must consider that markets thrive when “cost barriers like inflated access charges that provide a subsidy to ILECs” are removed. Sprint RB at 7. Sprint contends that Verizon conceded its basic services received a cross subsidy. Sprint RB at 10. Thus, Sprint argues, reclassification is barred until such time as access relief is granted by the Board. Id. Sprint goes on to state that Verizon admits that subsidies must stop. Sprint RB at 12, citing Vasington and Garzillo Rebuttal testimony.

Sprint cites the statutes, specifically, N.J.S.A. 48:2-21.18(c) and 2-21.16(a)(3), which it states provide that “[n]o local exchange telecommunications company may use revenues earned or expenses incurred in conjunction with noncompetitive services to subsidize competitive services.” Sprint IB at 14. Sprint asserts that the ILECs have not met the burden of proof required to disclaim a subsidy exists, and therefore, the Board must deny the relief requested for reclassification. Id. at 13.

Additionally, Sprint argues it is customary that in order to disprove a cross-subsidy, “each service by itself must at least cover its corresponding long-run average incremental cost (i.e. its direct costs).” Sprint IB at 16 footnote 10. Sprint believes that Verizon and Embarq have not presented the requisite proofs to discount its subsidy argument. Further, Mr. Appleby testified that both Verizon and Embarq receive substantial revenues from intrastate switched access charges. Id. at 17. In sum, Sprint states the record shows ILECs receive a subsidy through access charge revenues. Id.

Sprint concludes, that Verizon based upon the testimony presented by Mr. Garzillo, admits its basic revenues do not cover costs. Sprint IB at 18; 1T95:19-96:7, 114A:17-2 Garzillo. In addition, Sprint quotes Dr. Stair’s testimony that “Embarq’s current \$8.55 retail local rate, fixed in 1991: is ‘extraordinarily low’, below the national average” thus proving it is a subsidized service. Id.

In sum, Sprint argues that Verizon failed to show that its basic service is not subsidized, admitted its basic service is priced below direct cost, and therefore will violate the statutory cross subsidy prohibition upon reclassification. (1T95:19-96.7, 97A:17-2, Garzillo; Sprint RB at 15.) Furthermore, Verizon failed to provide an analysis of all services it seeks to have reclassified, including shared and common costs, according to Sprint. Sprint RB at 16.

⁴⁹Specifically, Sprint cites, “Kansas, Wisconsin and Georgia all required LECs to reduce access rates at the same time as granting authority for price flexibility.” See, e.g., K.S.A. 66-2005 (requiring local exchange carriers to reduce intrastate access charges over three year period and at the same time giving the Kansas Commission authority to grant further price flexibility). See also, Wisconsin Statute 196.196 (requiring utilities with more than 150,000 access lines to reduce intrastate switched access rates at the same time giving LECs further price flexibility); Georgia Code O.C.G.A. section 46-5166(f) (permitting local exchange companies to become subject to alternative regulation provided they reduce their intrastate access rates).

The Settlements

Upon the close of the hearings, the parties entered into settlement negotiations in an attempt to amicably resolve the issues addressed in this matter. After extensive and intensive discussions, stipulations were signed by Board Staff and Rate Counsel with each of the ILECs to address the issues raised in the reclassification proceeding (the "Stipulations"). As previously stated, the Verizon settlement, described below, was approved by the Board in a Summary Order dated July 14, 2008. This Order sets out in more detail the Board's reasoning underlying its determinations with regard to that settlement. The proposed Embarq settlement, also described below, and its companion request for approval of an alternative plan of regulation ("PAR"), remain subject to Board review in this Order.

The Verizon Settlement

On May 30, 2008, Verizon, on behalf of itself, Board Staff and Rate Counsel (the "Parties"), submitted a proposed stipulated settlement to the Board for approval. While relevant portions of the agreement are summarized below, the Stipulation of Settlement is attached hereto and is incorporated in this Order as if it were fully set forth herein.

A public hearing was held on June 24, 2008, at the Board's Newark Office to receive public comment on the proposed agreement. In total 11 parties participated in the public hearing included AT&T and Sprint; the Newark Regional Business Partnership, the Metropolitan Trenton African American Chamber of Commerce, the Greater Elizabeth and Middlesex County Chambers of Commerce, the Association of Independent Colleges and Universities, New Jersey Citizen Action, Catholic Charities of the Archdiocese of Newark, and the New Jersey Alliance for Action (the "Organizations"); and Hilda Harris on her own behalf. In addition, the Board received written comments from three parties. At the hearing, AT&T stated that it did not oppose the settlement, but requested that the Board next address intrastate access rates. Sprint echoed the request that the Board commence a proceeding to review intrastate access charges. The Organizations all supported the Stipulation, especially, the provisions which would continue the availability of Lifeline services. Teletruth, submitted written comments opposing the Stipulation, asserting that Verizon continues to provide misleading data, and that the Stipulation, if approved, will harm residential and small business wireline customers.

Stipulated Findings for Verizon

Based on the record, Rate Counsel, Staff and Verizon have agreed to the following facts:

- (1) The Verizon NJ mass market retail services at issue in this proceeding are listed in Exhibit A attached to the stipulation. These services include, but are not limited to, residential basic exchange service; single-line business basic exchange service; residential directory assistance service; and residential installation service.
 - (a) Verizon NJ has not raised the price of its residential basic exchange service (including touch tone) since 1985, when the price of this service for the highest rate group was \$9.18 per month. The current statewide price of this service is \$8.95 per month. If the price of this service were

adjusted for inflation under the Consumer Price Index Inflation Adjuster, from 1985 to 2008, the price of the service would be \$18.22 per month.

- (b) In 1985, the price of Verizon NJ's single-line business basic exchange service (including touch tone) for the highest rate group was \$14.83 per month. The current statewide price of this service is \$15.00 per month. If the price of this service were adjusted for inflation under the Consumer Price Index Inflation Adjuster, from 1985 to 2008, the price of the service would be \$38.43 per month.
 - (c) In 1985, Verizon NJ's non-recurring charges for installation of residential services were \$42.00. These charges are currently \$42.35. If these charges were adjusted for inflation under the Consumer Price Index Inflation Adjuster, from 1985 to 2008, they would be \$83.35.
 - (d) Verizon currently offers (4) four free DA calls per month, and charges \$.50 cents per chargeable DA call after the monthly call allowance has been exceeded. In the majority of states, the average rate is \$1.25 per chargeable residential DA call. In New Jersey, telephonic DA providers price their services from "free" to \$2.49 per call without a free call allowance.
- (2) With the exception of Verizon's residential basic exchange service including usage, single-line business basic exchange service, non-recurring charges for installation of residential services, and residential DA service, the Parties agree that the remainder of Verizon's mass market retail services will be classified as competitive.
 - (3) Verizon's residential basic exchange service, single-line business basic exchange service, element charges for installation of residential services, and residential DA service shall remain rate regulated. The parties agree, however, that Verizon NJ should be permitted to adjust the rates for these services in accordance with the rate caps agreed to, and that the resulting rate caps will produce rates that are affordable and just and reasonable under the standards in PAR-2 and N.J.S.A. 48:2-21.17.

Settlement terms and conditions for Verizon

- (1) Verizon's residential basic exchange service, single-line business basic exchange service, non-recurring charges for installation of residential services, and residential DA service shall remain rate regulated. Upon Board approval of this Stipulation and Agreement and upon effective date of the appropriate tariffs, Verizon shall be authorized to charge no more for these services than the authorized rate caps set forth below:
 - (a) Residential basic exchange service: Verizon shall charge no more than \$11.95 per month for the first year after the effective date of the appropriate tariffs; no more than \$14.45 per month for the second year; and no more than \$16.45 per month for the third year.

- (b) Single-line business basic exchange service: Verizon shall charge no more than \$18.50 per month for the first year after the effective date of the appropriate tariffs; no more than \$22.00 per month for the second year; and no more than \$25.50 per month for the third year. Notwithstanding the above, the parties agree that the actual rates for single-line business exchange service shall not exceed these caps or the multiline business rates in effect until the conclusion of the proceeding referenced in paragraph five (5) below, whichever is lower.
 - (c) Non-recurring charges for installation of residential services: Verizon shall charge no more than \$45.00 for the first year after the effective date of the appropriate tariffs; no more than \$47.50 for the second year; and no more than \$50.00 for the third year.
 - (d) Residential DA service: Callers shall receive two (2) free call(s) per month. Once the monthly free call allowance has been exceeded, Verizon shall charge no more than \$1.25 per chargeable DA call for the first year after the effective date of the appropriate tariffs; no more than \$1.50 per chargeable DA call for the second year; and no more than \$1.50 per chargeable DA call for the third year.
- (2) Any increases to Verizon's residential basic local exchange service are not applicable to Verizon's Lifeline services which remain regulated and may not be increased absent Board approval. Verizon will continue its outreach efforts to enroll eligible New Jersey residents in the Lifeline program.
 - (3) Verizon shall also continue the following social services programs – in their current form, and, to the extent applicable at current rates – pending the proceeding identified in paragraph five (5) below:
 - (a) A 25% discount on local message units and intrastate intra-LATA message charges for hearing-impaired persons.
 - (b) The Link-Up America program, which provides discounts on service connection charges for qualified low-income customers.
 - (c) Free DA calls for consumers with a visual or physical impairment who submit proper certifications to Verizon NJ.
 - (d) Repair priority given to consumers with serious illness or physical disability.
 - (e) Call block features offered at no charge to all customers.
 - (4) With the exception of the services discussed in paragraphs one (1) through three (3), the remainder of Verizon's mass market retail services, listed in Exhibit A, shall be classified as competitive within the meaning of N.J.S.A. 48:2-21.19. Although competitive and not otherwise rate regulated, Verizon has voluntarily agreed that in order to reach an amicable resolution of this matter and to avoid rate shock and to otherwise ensure reliable service, the services listed

immediately below shall be subject to rate caps until the conclusion of the proceeding referenced in paragraph five (5):

- (a) Caller Identification with Name: Verizon NJ shall charge no more than \$9.25 per month for the first year after the effective date of the appropriate tariff filings; no more than \$11.00 per month for the second year; and no more than \$12.75 per month for the third year.
 - (b) Non-Published Listings: Verizon NJ shall charge no more than \$2.20 per month for the first year after the effective date of the appropriate tariff filings; no more than \$2.95 per month for the second year; and no more than \$3.70 per month for the third year. Customers who have obtained a court order of protection shall receive non-published listings at no charge.
 - (c) Call Trace: Verizon NJ shall charge no more than \$1.25 per attempt for the first year after the effective date of the appropriate tariff filings; no more than \$1.50 per attempt for the second year; and no more than \$1.75 per attempt for the third year.
- (5) The Board shall initiate a proceeding to re-evaluate the competitiveness of the services identified in paragraphs 1, 2 and 3, within ninety days after the third anniversary of the issuance of the effective date of the appropriate tariffs reflecting the first year increases. The rate caps shall remain in effect until the conclusion of that proceeding.
 - (6) Verizon shall continue to abide by all provisions and obligations contained in PAR-2, N.J.S.A. and N.J.A.C. Verizon shall continue to file and maintain tariffs for competitive services unless the Board determines that tariffs are not required for particular services.
 - (7) Until the proceeding identified in paragraph five (5) is commenced, no party to this Stipulation and Agreement shall petition the Board to modify the rate caps in paragraphs one (1) through four (4) above. However, if the Board issues an order reducing intrastate access charges that Verizon is permitted to charge, Verizon may request that the Board adjust the rate caps established in the Stipulation and Agreement upon written request to the Board, after hearing, upon notice, wherein Verizon shall have the burden of proof to show that the increase, change, or alteration is just and reasonable given the reduction in access charges. Prior to any such rate adjustment, Verizon shall also demonstrate that the requested rates for residential basic exchange service will be affordable within the meaning of PAR-2. Rate Counsel reserves its right to oppose any such petition filed by Verizon. Moreover, any party may seek to modify the provisions of the Stipulation and Agreement, including the rate caps identified in paragraphs one (1) and four (4), in the proceeding identified in paragraph five (5).
 - (8) Verizon shall provide Rate Counsel with several competitive reports currently filed with the Board.

- (9) Within 30 days of the Board's approval of the Stipulation and Agreement, and the effective date of the appropriate tariffs, Verizon shall withdraw its appeal with prejudice of the CLEC Reclassification Order Dkt. No. TX06120841 and the DA Reclassification Order Dkt. Nos. TX06010057 and TT97120889.

The Proposed Embarq PAR

On June 27, 2008, Embarq filed a request with the Board for approval of a proposed PAR as authorized by N.J.S.A. 48:2-21.8, and a companion proposed stipulation of settlement of the reclassification proceeding on behalf of itself, Board Staff and Rate Counsel.

Under Embarq's proposed PAR, Embarq would no longer be subject to traditional utility rate base, rate of return regulation. In evaluating Embarq's request, the Board must consider whether the proposed PAR: (1) will ensure the affordability of protected telephone services; (2) will produce just and reasonable rates for telecommunications services; (3) will not unduly or unreasonably prejudice or disadvantage a customer class or providers of competitive services; (4) will reduce regulatory delay and costs; (5) is in the public interest; (6) will enhance economic development in the State while maintaining affordable rates; (7) contains a comprehensive program of service quality standards, with procedures for board monitoring and review; and (8) specifically identifies the benefits to be derived from the alternative form of regulation. N.J.S.A. 48:2-21.18(a). The plan, if approved, would replace rate base/rate of return regulation for Embarq.

According to Embarq, there is significant overlap between the legal and factual matters in the reclassification proceeding and the legal and factual matters underlying the PAR petition. Given these common legal and factual issues, Embarq requested that the Board incorporate the record from the reclassification proceeding into the record of the PAR proceeding. To facilitate the Board's review, Embarq prepared Exhibit B (attached to the petition) which enumerates the statutory findings the Board must make pursuant to N.J.S.A. 48:2-21.18(a) and which contains specific citations that Embarq maintains support approval of its proposed PAR.

Embarq contends that its request for a PAR is clearly in the public interest. Embarq argues that the competitive landscape in the telecommunications industry has changed radically in recent years, particularly as a result of new market entrants (e.g., wireless carriers, VoIP) that are not regulated by the Board. Most recently, the Board acknowledged this fact when it deemed retail services provided by competitive local exchange carriers ("CLECs") in New Jersey⁵⁰ to be competitive. Indeed, when the Board initiated the ILEC Reclassification Proceeding, it "noted that the competitive environment in the telecommunications industry appears to be undergoing considerable change and modification."⁵¹ Embarq argues that it faces the same competitive pressures identified in the CLEC proceeding and in the Reclassification Proceeding; thus, it is important that the Board's regulation of Embarq provide the Company with sufficient flexibility to respond to market changes. Embarq believes its proposed PAR represents a balancing of the Company's need for market flexibility with a

⁵⁰See I/M/O the Board Investigation Regarding the Reclassification of Competitive Local Exchange Carrier (CLEC) Services as Competitive, BPU Docket No. TX06120841, Final Order (dated June 29, 2007).

⁵¹See I/M/O the Board Investigation Regarding the Reclassification of Incumbent Local Exchange Carrier (ILEC) Services as Competitive, BPU Docket No. TX07110873, Order (dated November 28, 2007), at 1.

continuing commitment to provide customers with high quality, reliable telecommunications services.

Embarq further requested that the Board review its PAR petition on an expedited basis, along with its Stipulation and Agreement in the ILEC Reclassification Proceeding.

Embarq contends that its rates will remain affordable even in the face of an increase, if granted, due in part to the fact that Embarq's rates have remained at current levels since 1991. EMB PAR filing at 3. Embarq further argues that no customer is unduly or unreasonably prejudiced or disadvantaged by adoption of the PAR, and such adoption serves to level the playing field of competitors. According to Embarq, approval of the PAR reduces regulatory delay and costs in that it balances the need for regulatory flexibility with continued quality service for customers. Embarq cites the CLEC case as a basis for approval of its alternative plan to enable it to face competitive pressures imposed by CLECs in the market. EMB PAR filing at 5. Specifically, Embarq argues that each of the eight criteria for adoption of a PAR under N.J.S.A. 48:2-21.18(a) is satisfied as follows:

1. Adoption of the PAR Will Ensure the Affordability of Protected Telephone Services

Embarq states that it addressed the affordability of its services in the Rebuttal Testimony of Brian K. Stahr in BPU Docket No. TX07110873 at pp. 8-13 ("EQ 3").⁵²

Although the concept of "affordability" can be difficult to define, the FCC has provided some guidance in this area. In its very first Report and Order on universal service following the passage of the Telecommunications Act of 1996, the FCC stated that the definition of affordability included both an *absolute* component and a *relative* component. [Footnote omitted] The *absolute* component reflects the purely factual aspect of having (or not having) sufficient funds to purchase something. The *relative* component reflects a somewhat more subjective aspect of a potential "burden," in the sense of whether or not the cost can be borne without serious detriment. If the cost can be borne without serious detriment, the item is "affordable." This relative component can be examined in the context of spending on other goods and services—i.e. are consumers spending a disproportionate share of their income on a particular good or service.

First, household income in Embarq's New Jersey market is *extraordinarily* high. As Embarq noted in testimony submitted to the New Jersey Board in 2005, the average household income in Embarq's New Jersey market is over **twice** the median household income for the country as a whole. The median annual household income in Embarq's New Jersey market is over \$100,000, while the median annual household income for the U.S. as a whole is approximately \$48,000. [Footnote omitted.]

Second, retail rates for basic service in Embarq's New Jersey market are *extraordinarily* low. The basic rate for service in Embarq's New Jersey market is \$7.80 plus \$0.75 for U-touch, or \$8.55[minus \$.60 for 1986 tax credit, or \$7.95]. According to the FCC, the national average monthly rate for flat rate service (including touchtone) is \$15.03 [in October 2006]. [Footnote omitted.]

⁵²See also, VNJ Vasington Direct at 48, 56, and 59; Sprint Appleby Reply Testimony at 27, Exhibits JAA-5 and JAA-6.

When we put these two facts together, and return to our test of affordability, we find that residents of Embarq's New Jersey market are actually spending a disproportionately **small** share of their income on telephone service. ...

Next, we acknowledge that the rates for Embarq's customers have been frozen at their current levels since 1991, when United Telephone of New Jersey had its last rate case. This means that rates for basic service have not even kept pace with inflation for 17 years. If Embarq's rates *had* simply kept pace with inflation, with no other adjustments, then according to the U.S. Bureau of Labor Statistics the rate for basic service including U-touch today would be approximately \$13.00. [Footnote omitted.] As the table below shows, even if such an inflation adjustment were made, Embarq's New Jersey customers would *still* be spending a **disproportionately small** share of their income on telephone service. ...

Using the FCC's criteria, clearly there is no way that a case could be made—even in the face of an inflation adjustment [...]—that Embarq's New Jersey customers would find telephone service unaffordable. Even in the face of an inflation adjustment, [...] Embarq's New Jersey customers would be paying a **disproportionately small portion** of their income of telephone service, and telephone service would remain more affordable than in almost any state in the country.

Further, Embarq maintains that the proposed PAR preserves and enhances Embarq's Lifeline program as set forth in the PAR itself, and in the Stipulation. Embarq's commitment to Lifeline is reiterated in Dr. Staihr's Rebuttal Testimony:

Q. On the subject of affordability, if Embarq's request for competitive classification is granted would this have any impact on the existing Lifeline and Link-Up support that goes to extremely low-income customers in New Jersey?

A. None at all. At year end 2007, approximately 950 Embarq customers subscribed to Lifeline service. Embarq remains fully dedicated to those specific programs which provide targeted support to households in need.

(EQ 3 at pp. 11-12.) Significantly, the PAR expands upon Embarq's Lifeline commitment by providing for automatic enrollment in the Program for new and existing Lifeline-eligible Embarq customers. (PAR at Section II.C.) In addition, Embarq's proposed PAR states that Embarq's Lifeline Program will provide for the self-certification of low income senior customers (ages 65 and over) at or below 150% of the Poverty Level (PAR at Section II.C). Thus, the needs of low income and elderly households are addressed through Embarq's continuation and enhancement of the Lifeline and LinkUp programs assuring affordable service to all customers in need throughout the State.

With existing competitive forces at work, the Board can oversee the telephone market, and make adjustments if needed (See Item 7, *infra*). Consumers will obtain service elsewhere if Embarq sets its prices too high or does not introduce the new products and services they demand, or if the quality of service slips in any way. As Dr. Staihr observed, "One vendor's gain is the other vendor's loss." Initial Testimony of Dr. Brian K. Staihr in BPU Docket No. TX07110873 at 11 (EQ 2).

Affordability of rates for protected services can also be found based upon the fact that Embarq's local exchange rates have remained flat since 1991, while other price indicators such as Social Security income, the Consumer Price Index, the cost of food, and postal rates have risen significantly since 1991. Affordability of rates for protected services can also be found based upon the fact that the Stipulation and Agreement contains rate caps for numerous services, including basic residential service.

Furthermore, only retail mass market rates are affected by the proposed rate caps. Non-retail rates are not impacted by the proposed PAR or the Stipulation. The affordability of rates for protected service is satisfied as the only changes made to protected rates are those subject to caps that the Board is reviewing in this Order.

2. Adoption of the PAR Will Produce Just and Reasonable Rates for Telecommunications Services

According to Embarq, evidence supporting a finding that Embarq's rates for rate regulated services under the proposed PAR and the Stipulation and Agreement are affordable also supports that a finding that such rates are just and reasonable. As noted above, Embarq has not raised rates since its last rate case in 1991. See, EQ 3 at 10. In addition, at the hearing, Dr. Staihr testified and demonstrated that rates should at least keep pace with inflation to be considered "just and reasonable." Dr. Staihr testified:

Q. Are you saying that Embarq rates aren't fair, just, and reasonable at their current levels?

A. They are certainly not just and reasonable with regard to Embarq because normally what is a just and reasonable price does keep pace with inflation. EQ's rates are not just and reasonable because they haven't kept pace with inflation.

Trans. Feb. 26, at 106.

Moreover, the Stipulation and Agreement demonstrates how the rates for Embarq's rate regulated services will remain just and reasonable. Under an alternative form of regulation, rates may be based on, among other things, "the use of an index, formula, price caps or zone of rate freedom." N.J.S.A. 48:2-21.17. Embarq's rates for rate regulated services throughout the term of the PAR will remain below national averages for those services published by the Federal Communications Commission, as adjusted for inflation as measured by the United States Department of Labor's Consumer Price Index. As discussed above, Lifeline rates will remain at current levels, which the Board has already been found to be just and reasonable.

In addition, any adjustments to the rates set forth in the Stipulation and Agreement must be approved by the Board. Thus, the Board retains complete authority to ensure that Embarq's rates for its rate-regulated services remain just and reasonable.

Given the evidentiary record of like or substitute services in the geographic market as provided in the testimony of Dr. Staihr, incorporated herein, along with the Stipulation and Agreement, adoption of the proposed PAR will produce just and reasonable rates for the rate regulated services under the Stipulation and Agreement.

3. Adoption of the PAR Will Not Unduly or Unreasonably Prejudice or Disadvantage a Customer Class or Providers of Competitive Services

Embarq asserts that the proposed PAR does not unduly or unreasonably prejudice or disadvantage any customer class because the rates set forth in the Stipulation are affordable and just and reasonable. The PAR does not unduly or unreasonably prejudice or disadvantage providers of competitive services; to the contrary, it will help level the competitive playing field between Embarq and its alternatively regulated and unregulated competitors.

Alternative regulation and competitive classification will provide increased ability for Embarq to respond to free market forces in the face of existing competition from unregulated entities.⁵³ As Dr. Staihr testified: “CLECs purchase wholesale services for resale in all 26 of Embarq wire centers and purchase unbundled network elements in 21 wire centers representing 93% of Embarq’s access lines.” EQ Initial Testimony at 30. The record adduced in this docket supports a finding that alternative regulation will make the competitive playing field more level as between Embarq and its unregulated and non-traditional competitors.

According to Embarq, the record demonstrates that neither competitive classification nor this PAR will prejudice or disadvantage a customer class or providers of competitive services. Indeed, the Board has already concluded that retail local exchange services provided by CLECs should be deemed competitive.⁵⁴ For competitive services, the Board shall not regulate, fix or prescribe the rates, tolls, charges, rate structures, terms and conditions of service, rate base, rate of return, and cost of service, of competitive services. N.J.S.A. 48:2-21.19(a). Thus, no prejudice or disadvantage to a customer class or providers of competitive services arises when all competitors in the market are on a level playing field. Through this PAR, Embarq can adjust rates for the services that remain rate regulated within the ranges and otherwise as set forth in the Stipulation and Agreement. Thus, no prejudice or disadvantage to a customer class arises as Embarq can only adjust rates up to the Stipulation and Agreement’s specified rate caps. Furthermore, as discussed above, this PAR maintains Embarq’s Lifeline rates at current levels and enhances Embarq’s commitments to the Lifeline program, which will ensure that those least able to pay for telephone service can get it at reduced rates. Providers of competitive services are not prejudiced under the terms of the PAR. Rather, the PAR helps to level the competitive playing field vis-à-vis Embarq and its CLEC and non-regulated competitors.

4. Adoption of the PAR Will Reduce Regulatory Delay and Costs

According to Embarq, the proposed PAR will reduce regulatory delay and costs. As set forth in PAR Section III.A, the PAR enables Embarq to introduce new services on a streamlined basis, which will lessen regulatory delay. As Dr. Staihr noted in his Initial Testimony, “[c]ustomers are best served when competition takes place on a level playing field, where all providers—including Embarq—have the freedom to act nimbly in the market place, responding to ever-changing demands and preferences.” EQ Initial Testimony at 32. The flexibility afforded by the PAR, in addition to competitive classification, will greatly reduce regulatory delay and costs associated with Embarq’s ability to act nimbly in the market place. Implementing the PAR will also obviate the need for time-consuming and burdensome rate case proceedings that place

⁵³“Customers are best served when competition takes place in a level playing field where all providers including Embarq have the freedom to act nimbly in the marketplace and responding to ever changing demands and preferences.” EQ Initial Testimony at 32.

⁵⁴*I/M/O with Board Investigation Regarding the Reclassification of Competitive Local Exchange Carrier (CLEC) Services as Competitive*, BPU Docket No. TX06120841, Order (dated June 29, 2007), at 11.

a strain on limited administrative resources. As a result, this PAR reduces regulatory delay and lessens regulatory costs.

Further, as the Board noted in Verizon's PAR-2, this element is also satisfied by statutory recognition that traditional rate of return regulation can be costly and inefficient, imposing significant administrative burdens that are substantially lessened by alternative regulation. Streamlined introduction of new services while the Board retains authority to investigate and suspend is pro-competitive, reduces current barriers to bring new products to market, and assures that customers are afforded the opportunity to benefit from new services without unnecessary delay.

This PAR is consistent with the alternative regulation plan approved by the Board for Verizon. Verizon has been subject to alternative rate regulation for several years. With this PAR, Embarq and Verizon both will be subject to alternative rate regulation. Administrative economies and regulatory consistency are thereby achieved from the Board's oversight and review of incumbent local exchange carriers. Meanwhile, Embarq's ability to adjust rates within the transitional rate caps will reduce costs and regulatory delay associated with unnecessary regulatory oversight for rate adjustments within capped levels. Additionally, Embarq has agreed to specific comprehensive reporting requirements. See PAR Section V and Stipulation and Agreement Exhibit C. These reports will provide the Board and Rate Counsel with relevant, timely information with which to monitor Embarq and the competitive marketplace.

5. Adoption of the PAR Is in the Public Interest

According to Embarq, the PAR is in the public interest. The PAR preserves affordable rates that are just and reasonable. The PAR does not unreasonably prejudice any class of customers or competitors. The PAR reduces regulatory costs and delays. As Dr. Staihr observed in his Initial Testimony:

[T]he role of regulation in the state must be 1) to ensure that the telecommunications market remains open to entry, and 2) to ensure that one provider does not receive state-sponsored advantages over another provider. By requesting competitive classification Embarq seeks the same freedom its competitors have to price and package services in ways that meet customer desires and expectations. Customers are best served when competition takes place on a level playing field, where all providers—including Embarq—have the freedom to act nimbly in the market place, responding to ever-changing demands and preferences. EQ Initial Testimony at p. 32.

Further, as set forth in subsection 6 below, the PAR includes important extensions of Embarq's Bona Fide Retail Request ("BFRR") program and Embarq's discount program for schools and libraries, while enhancing Embarq's commitment to its Lifeline program.

6. Adoption of the PAR Enhances Economic Development in the State While Maintaining Affordable Rates

Embarq maintains that the PAR will enhance economic development in New Jersey while maintaining affordable rates by facilitating increased competition among the variety of telecommunications services providers in the state on a more level playing field. The record demonstrates the availability of like or substitute services. Dr. Staihr's initial and rebuttal

testimonies are replete with the descriptions of the variety of competitors (i.e., substitute services) present in the telecommunications marketplace. See e.g., EQ Initial Testimony at 15-30. Through PAR, Embarq will be afforded the flexibility to adjust rates for rate regulated services consistent with the Stipulation and Agreement. As Dr. Staihr testified:

Citigroup estimated that by 2010 the market share of incumbent carriers such as Embarq will decrease to 45%. There is simply no way to suggest that Embarq's New Jersey market is not fully and effectively competitive when Embarq is expected to serve less than half of the market in approximately two years. ...

And *because* competition is an economic fact, the role of regulation in the state must be 1) to ensure that the telecommunications market remains open to entry, and 2) to ensure that one provider does not receive state-sponsored advantages over another provider. By requesting competitive classification Embarq seeks the same freedom its competitors have to price and package services in ways that meet customer desires and expectations. EQ Initial Testimony at 32.

Under the PAR, Embarq, as a competitor no longer subject to rate of return regulation, will be able to efficiently offer like or substitute services currently available in the competitive marketplace.⁵⁵ Competitive classification and alternative rate regulation for Embarq enhances economic development within Embarq's service territory. The PAR will enable Embarq to compete more effectively and efficiently in the marketplace, which, in turn, will promote competition and enhance economic development in the State.⁵⁶

The PAR contains several elements that will enhance economic development in the State while maintaining affordable rates. As previously addressed, the record demonstrates that the PAR will maintain affordable rates in New Jersey. In addition, this PAR contains commitments whereby Embarq will extend its Bona Fide Retail Request ("BFRR") Program for broadband deployment through the duration of this PAR. Similarly, the record demonstrates PAR extends Embarq's Schools and Libraries Discount Program. Embarq will continue its discount program for schools and libraries for services (including ATM; Frame Relay, and PRI data services) provided by Embarq through the duration of this PAR. By promoting deployment of advanced telecommunications equipment and services in schools and libraries, Embarq is helping to bring the benefits of technology to the public which, in turn, will enhance economic development in the State.

7. The PAR Contains a Comprehensive Program of Service Quality Standards, with Procedures for Board Monitoring and Review

According to Embarq, the PAR contains numerous reporting requirements to enable the Board to monitor Embarq's service quality and regulatory compliance. PAR Section V.B requires Embarq to make annual filings to ensure that rate regulated services are not

⁵⁵ "The Telecommunications Act of 1996 ensures ease of entry by making Embarq's network available to competitors through discounts off retail prices, the availability of unbundled network elements, and collocation." EQ Initial Testimony at 31. See also, VNJ Vasington Direct at 10 LL 6-17, 11 LL 3-5, 22 LL 1-4

⁵⁶ "There are a total of eight CLECs to which Embarq provides these services in New Jersey. One CLEC is collocated in three Embarq switching offices. CLECs purchase wholesale services for resale in all 26 of Embarq wires centers, and purchase unbundled network elements in 21 wire centers representing 93% of Embarq's access lines." EQ Initial Testimony at 30.

subsidizing competitive services. Further, PAR Section V.A requires Embarq to file tariffs for competitive services and to make unpublished rates available under certain conditions. Embarq is currently subject to numerous service quality measures and reporting requirements as set forth in the Board's rules and regulations that will continue under PAR. There is no evidence in the record that the retail mass market services under review in the ILEC reclassification proceeding are in any way inadequate from a service quality standpoint, but the reporting requirements in the PAR and in the Stipulation and Agreement will enable the Board to monitor Embarq's services to ensure they remain of high quality.

The PAR sets forth reporting requirements which will enable the Board to monitor and review the quality of service Embarq is providing to its subscribers. The record demonstrates that competition, along with Embarq's compliance with the Board's service quality regulations for rate regulated services, will yield a comprehensive program of service quality standards and procedures for Board monitoring and review under the PAR. Finally, the Stipulation and Agreement establishes a review proceeding in approximately three (3) years in which the Board will re-evaluate the competitiveness of Embarq's rate regulated services.

8. The PAR Specifically Identifies the Benefits to be Derived from the Alternative Form of Regulation

According to Embarq, the benefits of PAR are set forth above and in Embarq's proposed PAR. The availability, affordability and reasonableness of Embarq's rate regulated services have been demonstrated in the record. As Dr. Staihr in part explained, "Embarq seeks the same freedom its competitors have to price and package services in ways that meet customer desires and expectations. Customers are best served when competition takes place on a level playing field, where all providers—including Embarq—have the freedom to act nimbly in the market place, responding to ever-changing demands and preferences." EQ Initial Testimony at 32. The PAR accomplishes this, while preserving affordable rates that are just and reasonable (see subsections 1 and 2 supra), while reducing regulatory delay and cost (see subsection 4 supra), while enhancing economic development in the State, (see subsection 6), and while enabling Board monitoring and review of service quality (see subsection 7). This PAR levels the competitive playing field vis-à-vis Embarq and its CLEC and non-regulated competitors. In addition, the PAR strengthens Embarq's existing Lifeline program by instituting a new automatic enrollment program and establishing self-certification for low-income seniors. PAR Section II.C. Thus, the PAR and the record in the ILEC proceeding support the Board's finding that the PAR will meet the eight (8) statutory criteria and should be expeditiously approved.

The Proposed Embarq Settlement

In addition, by letter dated June 27, 2008, Embarq also submitted a proposed settlement of all Embarq issues in Docket No. TX07110873 for Board approval. Under the terms of the proposed settlement, some of Embarq's retail mass market services would be declared competitive and no longer subject to rate regulation by the Board, while others would remain regulated. Rate increases are requested for the services that would remain subject to regulation under Embarq's proposed PAR. The services that would remain rate regulated are residential basic exchange service; basic business service; residence directory assistance service; and non-recurring charges for installation of residence service.

Stipulated findings for Embarq

Based on the record, Rate Counsel, Staff and Embarq have agreed to the following facts:

- (1) The Embarq mass market retail services at issue in this proceeding are listed in Exhibit A attached to the stipulation. These services include, but are not limited to, residential basic exchange service; single-line business basic exchange service; residential directory assistance service; and residential installation service
 - (a) Embarq has not raised the price of its residential basic exchange telephone service since March of 1991. See, Decision and Order, BPU Docket No. TR90070726J. Embarq's current rate for residential basic exchange service (including touch tone and the 1986 tax credit) is \$7.95. The Federal Communications Commission reports that the national average monthly rate for basic exchange service (including touch tone) is \$15.03 (as of October 2006).⁵⁷ If the national average price were adjusted for inflation under the Consumer Price Index Inflation Adjuster from 2006 to 2008, the national average price of the service would be \$16.02.
 - (b) Embarq has not raised the price of its single-line business exchange service since March of 1991. See, Decision and Order, BPU Docket No. TR90070726J. Embarq's current rate for single-line business exchange service (including touch tone and the 1986 tax credit) is \$16.40. The Federal Communications Commission reports that the national average monthly rate for business exchange service (including touch tone) is \$33.54 (as of October 2006). If the national average price were adjusted for inflation under the Consumer Price Index Inflation Adjuster from 2006 to 2008, the national average price of the service would be \$36.04.
 - (c) Embarq has not raised the price of its non-recurring charge for installation of residential service since March of 1991. See, Decision and Order, BPU Docket No. TR90070726J. Embarq's current non-recurring charge for installation of residential service is \$25.00. The Federal Communications Commission reports that the national average monthly non-recurring charge for installation of residential service is \$39.44 (as of October 2006). If this charge were adjusted for inflation under the Consumer Price Index Inflation Adjuster from 2006 to 2008, the charge would be \$42.38.
- (2) With the exception of Embarq's residential basic exchange service, business basic exchange service, non-recurring charges for installation of residential services, and residential DA service, the Parties agree that the remainder of Embarq's mass market services shall be classified as competitive.
- (3) Embarq's residential basic exchange service, business basic exchange service, non-recurring charges for installation of residential services, and residential DA service shall remain rate regulated. The parties agree, however, that Embarq

⁵⁷Rebuttal Testimony of Dr. Brian K. Staihr at p. 9 (citations omitted).

should be permitted to adjust the rates for these services in accordance with the rate caps set forth below, and that the resulting rate caps will produce rates that are affordable and just and reasonable under the standards set forth in *N.J.S.A. 48:2-21.17*.

I. The Proposed Settlement terms and conditions for Embarq

- (1) Upon Board approval of this Stipulation and Agreement, Embarq is authorized upon the effective date of the appropriate tariff to combine rate elements applicable to residential basic local exchange service and single-line business local exchange service as follows:
 - (a) Residential basic local exchange service rate: to \$7.95 per month (\$7.80/month plus the U-Touch rate of \$.75/month minus \$.60 monthly tax credit); and
 - (b) Single-line business local exchange rate: to \$16.40 (\$15.50/month plus the U-Touch rate of \$1.50/month minus \$.60 monthly tax credit).

- (2) Embarq's residential basic exchange service, business basic exchange service, non-recurring charges for installation of residential services, and residential DA service shall remain rate regulated. Upon Board approval of this Stipulation and Agreement, approval of the PAR, and upon the effective date of the appropriate tariffs, Embarq shall be authorized to charge no more for these services than the authorized rate caps set forth below:
 - (a) Residential basic local exchange service: Embarq shall charge no more than \$10.95 per month for the first year after the effective date of the appropriate tariffs, no more than \$13.45 per month for the second year, and no more than \$15.45 per month for the third year.
 - (b) Business exchange service: Embarq shall charge no more than \$19.20 per month for the first year after the effective date of the appropriate tariffs, no more than \$22.00 per month for the second year, and no more than \$25.50 per month for the third year.
 - (c) Non-Recurring charges (Embarq's Residence Primary Charge for Service Connection and Installation): Embarq shall be permitted no more than a 20 percent, or \$5.00, increase over a period of three (3) years after the effective date of the appropriate tariff (*e.g.*, the 20 percent increase can be effected immediately, or it can be taken in steps at Embarq's discretion, as long as the total increase is no more than 20 percent).
 - (d) Residence Directory Assistance: Callers shall receive two (2) free call(s) per month. Once the monthly free call allowance has been exceeded, Embarq shall charge no more than \$1.25 per chargeable DA call for the first year after the effective date of the appropriate tariffs; no more than \$1.50 per chargeable DA call for the second year; and no more than \$1.50 per chargeable DA call for the third year.

- (3) Any increases to Embarq's residential basic local exchange service are not applicable to Embarq's Lifeline services which remain regulated and may not be increased absent Board approval. Embarq will continue its outreach efforts to enroll eligible New Jersey residents in the Lifeline program.
- (4) Embarq shall also continue the following social services programs – in their current form, and, to the extent applicable at current rates – pending the conclusion of the proceeding identified in paragraph (6) below:
- LinkUp (non-recurring charges);
 - Directory Assistance and Directory Assistance Call Completion to residential customers with a visual or physical inability to use a directory or directory source;
 - Non-list Service to those residential customers who provide a Protective Order;
 - Non-Pub Service to those residential customers who provide a Protective Order;
 - Residential Call Trace, per call;
 - Residential Per Call Blocking;
 - Residential Per Line Blocking;
 - Residential 700/900 Blocking;
 - Residential Toll Block/Operator Screening;
 - Residential Billed Number Screening;
 - IntraLATA MTS Service to hearing impaired residence customers;
 - Intra-Municipal Calling
- (5) With the exception of Embarq's services discussed in paragraphs (2) through (4), the remainder of Embarq's mass market retail services, listed in Exhibit A, shall be classified as competitive within the meaning of *N.J.S.A. 48:2-21.19*. Although competitive and not otherwise rate regulated, Embarq has voluntarily agreed that in order to reach an amicable resolution of this matter and to avoid rate shock and to otherwise ensure reliable service, the services listed immediately below shall be subject to the following rate caps until the conclusion of the proceeding referenced in paragraph (6):
- a) Caller ID: Embarq shall charge no more than \$8.60 per month for the first year after the effective date of the appropriate tariff; no more than \$10.20 per month for the second year; and no more than \$11.80 per month for the third year.
 - b) Non-Published Residential Telephone Service (Directory Listing): Embarq shall charge no more than \$0.85 per month for the first year after the effective date of the appropriate tariff; no more than \$1.15 per month for the second year; and no more than \$1.45 per month for the third year. Customers who have obtained a court order of protection shall receive non-published listings at no charge.

- (6) The Board shall initiate a proceeding to re-evaluate the competitiveness of the services identified in paragraphs (2) through (4) within ninety (90) days after the third anniversary of the effective date of the appropriate tariffs reflecting the first year increases. The rate caps shall remain in effect until the conclusion of that proceeding. As part of that proceeding, Rate Counsel may seek reclassification of any retail mass market competitive services listed in Exhibit A.
- (7) Embarq shall abide by all provisions and obligations contained in its PAR, and applicable statutory and regulatory obligations set forth in Title 14 of the New Jersey Administrative Code. This Stipulation and Agreement shall not change Embarq's service quality obligations under its PAR and shall continue to file and maintain tariffs for competitive services unless the Board determines that tariffs are not required for particular services. Either party may seek to modify these obligations in the proceeding identified in paragraph (6).
- (8) Until the proceeding identified in paragraph (6) is commenced, except as set forth in this paragraph, no party to this Stipulation and Agreement shall petition the Board to modify the rate caps. However, if the Board issues an order reducing intrastate access charges that Embarq is permitted to charge, Embarq may request that the Board adjust the rate caps established in this Stipulation and Agreement upon written request to the Board, after hearing, upon notice, wherein Embarq shall have the burden of proof to show that the increase, change, or alteration is just and reasonable given the reduction in access charges. Prior to any such rate adjustment, Embarq shall also demonstrate that the requested rates for residential basic exchange service will be affordable as required by law. Rate Counsel reserves its right to oppose any such petition filed by Embarq. Moreover, any party may seek to modify the provisions of this Stipulation and Agreement, including the rate caps in the proceeding identified in paragraph (6).
- (9) This Stipulation and Agreement shall supersede the limitations on rate increases applicable to Embarq set forth in Paragraph 1 of Attachment A to the Stipulation of Settlement in BPU Docket No. TM05080739.

Approval of a new proposed plan for alternative regulation and of rate adjustments for regulated services are only permitted after notice, hearing and Board review, and determination that the rates for regulated services remain just and reasonable. Accordingly, to aid the Board in its review of the proposed settlement and of Embarq's proposed PAR, a public hearing was held on August 7, 2008, to receive input from the public on both the proposed alternate form of regulation and the proposed Stipulation and Agreement.

In total 9 parties participated in the public hearing which included Atif Malik on behalf of Citizen Action, Bonnie Duncan on behalf of United Way, Mary Emilius on behalf of Sussex County Economic Partnership, Robert Goltz on behalf of Warren County Regional Chamber of Commerce, Marjorie Nathanson on behalf of Hunterdon Art Museum, Kelly Ospina on behalf of Hunterdon Hispanos, Karen Widico on behalf of Hunterdon Prevention Resources, Chamber of Commerce, Donna Gapas on behalf of Hunterdon County Department of Social Services, Warren Buckleitner on behalf of Media Technology. The organizations all supported the Stipulation and PAR, specifically those provisions which continue the availability of Lifeline services.

AT&T submitted written comments on July 30, 2008, in support of the settlement but requesting intrastate access rate reductions. Sprint submitted written comments on August 5, 2008, also in support of the settlement and PAR currently before the Board upon condition that the Board initiate a proceeding to address alleged subsidies provided in Embarq and Verizon's intrastate switched access rates.

DISCUSSION AND ANALYSIS

I. Embarq's Proposed Plan For Alternative Regulation

Before the Board can approve a PAR, it must address the tests prescribed by N.J.S.A.48:2-21.18(a) requiring that the Board find that the proposed plan provides all of the following: 1) that it will ensure the affordability of protected telephone services; 2) that it will produce just and reasonable rates; 3) that it will not unduly or unreasonable prejudice or disadvantage a customer class or providers of competitive services; 4) that it will reduce regulatory delay and costs; 5) that it is in the public interest; 6) that it will enhance economic development in the State while maintaining affordable rate; 7) that it contains a comprehensive program of service quality standards with procedures for Board monitoring and review; and that it specifically identifies the benefits to be derived from the PAR. Each of these will be discussed below.

A. Will the PAR Ensure the Affordability of Protected Telephone Services?

After careful review of the record, the Board **FINDS** that Embarq's PAR will ensure the affordability of rates for protected telephone services as required by N.J.S.A. 48:2-21.18(a)(1). The Board considers the fact that the rates charged for protected services have not been changed since 1991, and the Board found those rates to be affordable at that time. Embarq's rates for basic residential service in New Jersey have not increased since 1991, and they are among the lowest rates in Embarq's territories throughout the nation. The Board notes that residential basic exchange service will continue to be fully regulated by the Board under this PAR and the proposed Stipulation, and that any potential future changes in the rates for rate regulated services will continue to be subject to Board review and approval as well as the caps contained in the Stipulation, if approved. Moreover, because of the enhanced Lifeline program, the needs of low-income and elderly households are clearly being addressed, thereby assuring affordable service to all customers in need throughout the State. In addition Embarq's schools and libraries program, extended in the PAR, will continue to provide affordable access to telecommunications technology to the State's schools and libraries.

Further, the Board is persuaded by Embarq's assessment that the average household income in its territory is twice the national average and its rates are low. Therefore, its New Jersey customers are, and under the terms of the Stipulation if approved, will continue to spend a disproportionately small share of their income on telephone service.

In addition, the Board believes that, in assessing satisfaction of the "affordability" requirement, it is relevant to inquire into the behavior of other price indicators. Accordingly, we find persuasive the fact that residential basic rates have remained unchanged since 1991, while other price indicators such as Social Security income, the Consumer Price Index, the cost of food, and postal rates have risen steadily. As stated above, we also find persuasive Embarq's contention that, after considering New Jersey's per capita income, rates for protected services have become more affordable over time. Therefore, the Board **FINDS** that the rates for protected services under the proposed PAR are affordable. Finally, after reviewing the record

relating to assistance programs, we **FIND** that the Company's expanded and enhanced Lifeline program will provide additional assurances of continued affordability for elderly and low-income customers.

B. Will the PAR Produce Just and Reasonable Rates for Telecommunications Services?

Having reviewed the record, the Board **FINDS** that Embarq's PAR satisfies the requirements of N.J.S.A. 48:2-21.18(a)(2) that a plan of alternative regulation produce just and reasonable rates for telecommunications services. As explained above, the rates for residential basic exchange service have not increased since 1991, and these rates were found by the Board to be just and reasonable at that time. Under this PAR, rate adjustments for regulated services will be subject to caps and will be permitted only upon notice and Board review and determination that such rates are just and reasonable. The Board therefore **FINDS** that rates under this PAR are and will remain just and reasonable.

The Board is also persuaded that Embarq's rates for rate regulated services throughout the term of the PAR will remain below national averages for those services as published by the Federal Communications Commission, and as adjusted for inflation as measured by the United States Department of Labor's Consumer Price Index. In addition, Lifeline rates will remain at current levels, which the Board has already been found to be just and reasonable.

In addition, any adjustments to the affected rates must be approved by the Board. Thus, the Board retains complete authority to ensure that Embarq's rates for its rate-regulated services remain just and reasonable.

The Board therefore **FINDS** that Embarq has demonstrated that relevant rates under this PAR are just and reasonable, and that the Board's continuing jurisdiction over any potential future efforts by Embarq to raise the rates of regulated telecommunications services will ensure the continuation of rates that are just and reasonable.

C. Will the PAR Unduly or Unreasonably Prejudice or Disadvantage a Customer Class or Providers of Competitive Services?

Based on the record, the Board **FINDS** that Embarq's PAR satisfies the statutory criterion of N.J.S.A. 48:2-21.18(a)(3), which requires that it demonstrate that the PAR does not unduly or unreasonably prejudice or disadvantage a class of customers or providers of competitive services.

The Board concurs with Embarq that the record supports a finding that adoption of the proposed alternative regulation will make the competitive playing field more level between Embarq and its unregulated and non-traditional competitors. We agree that no prejudice or disadvantage to a customer class or providers of competitive services arises when all competitors in the market are on a level playing field. Through this PAR, Embarq can adjust rates for the services that remain rate regulated within the ranges set forth in the Stipulation and Agreement, if adopted. Thus, no prejudice or disadvantage to a customer class arises as Embarq can only adjust rates up to the Stipulation and Agreement's specified rate caps.

Finally, we find further support for our conclusion that the PAR meets the requirements of this criterion in its express requirement that, in order to be approved, the Board must find that a proposed revenue neutral rate restructure does not unduly disadvantage one class of customers over another.

D. Will the PAR Reduce Regulatory Delay and Costs?

The Board **FINDS** that Embarq's PAR satisfies the N.J.S.A. 48:2-21.8(a)(4) requirement that adoption of the PAR will result in reduced regulatory delay and costs. The 1992 New Jersey Act expresses, and our implementation of the Act since 1992 recognizes, underlying policy that traditional rate of return regulation can be costly and inefficient, imposing significant administrative burdens that are substantially lessened by alternative regulation plans. We **FIND** that Embarq's PAR will further reduce regulatory delay and costs by (1) streamlining the introduction of new services or the re-pricing of existing services, and (2) retaining only necessary reporting requirements.

The provisions of PAR streamline the introduction of new services, while retaining the Board's authority to investigate and suspend, if necessary, all non-conforming aspects of any new service. We concur with Embarq's contention that the provision is clearly pro-competitive, in that it reduces barriers currently undermining its ability to bring new products to market, and ensures that customers are afforded the opportunity to benefit from new services without unnecessary delay.

E. Will the PAR Enhance Economic Development in New Jersey While Maintaining Affordable Rates?

The Board **FINDS** Embarq's PAR will enhance economic development in the State while maintaining just and reasonable rates. We **FIND** that Embarq's PAR extends its Schools and Libraries program, which will enable schools, libraries and other institutions to have access to telecommunications equipment and services at substantially reduced rates, which will be a catalyst to economic development in New Jersey. We **FIND** that this program will enhance economic development in many of the same ways and for many of the same reasons as set forth in both Verizon PAR Orders.

Finally, because the PAR does not impose any earnings sharing constraint and permits rapid introduction of new services, Embarq should realize increased incentives to invest in the infrastructure needed to implement and market new products and services. The Board is hopeful that these investments will further encourage competition and enhance economic development in the State.

F. Does the PAR Contain a Comprehensive Program of Service Quality Standards?

The Board **FINDS** that the current service quality standards applicable to Embarq meet the 1992 New Jersey Act's requirement that its plan of alternative regulation contain a comprehensive program of service quality standards, with procedures for Board monitoring and review.

The Board agrees with the company that Embarq is currently subject to numerous service quality measures and reporting requirements as set forth in the Board's rules and regulations which will continue under the proposed PAR. We agree that there is no evidence in the record that Embarq's retail mass market services under review in the ILEC reclassification proceeding are inadequate from a service quality standpoint. However, the reporting requirements in the PAR and in the Stipulation and Agreement, to be discussed below, will enable the Board to monitor and review Embarq's services to ensure they remain of high quality. We agree that the record demonstrates that competition, along with Embarq's

compliance with the Board's service quality regulations for rate regulated services, will yield a comprehensive program of service quality standards and procedures for Board monitoring and review under the PAR.

G. Does the PAR Specifically Identify the Benefits to be Derived?

The Board **FINDS** that Embarq's PAR satisfies the requirement that it specifically identify the benefits to be derived from its implementation. We **FIND** that the following benefits constitute specifically identifiable benefits, which separately and collectively meet the Acts' mandate:

1. Continuation of affordable rates, in particular rates for residential basic exchange service;
2. Continuation of Embarq's commitment to universal service with enhancements to Lifeline service, including expanded eligibility criteria, easier enrollment procedures, and a customer outreach program;
3. Continuation of economic development fostered by continued advanced infrastructure deployment under the BFRR;
4. Continuation of benefits to schools and libraries;
5. Continuation of a comprehensive program of service quality standards;
6. Assurance that competitors are not disadvantaged or unduly prejudiced; and
7. Promotion of efficiency by reducing regulatory delay and increasing incentives to innovate and invest in the network.

H. Is the PAR in the Public Interest?

The Board **FINDS** that Embarq's PAR is in the public interest. In satisfying the requirements of the Act, the proposed plan provides specific benefits to the State and its citizens. The PAR ensures affordable and reasonable rates going forward, particularly in light of the Board's continuing oversight over any future rate changes for rate regulated services. The PAR strengthens Embarq's commitments to universal service by expanding substantially the current Lifeline program. The PAR extends infrastructure commitments, and provides substantial benefits to the State's educational system. These benefits are real and reasonably support a finding that the PAR is in the public interest. In conclusion, the Board **FINDS** that Embarq's PAR is clearly in the public interest, based on its many benefits to the State and its citizens, as discussed above and in the petition.

Therefore, the Board **CONCLUDES** that Embarq's plan satisfies the criteria set forth in N.J.S.A. 48:2-21.18 and otherwise complies with the Telecommunications Act of 1992. Accordingly, the Board **HEREBY APPROVES** the attached plan for an alternative form of regulation applicable to Embarq. The Board emphasizes that, except as expressly set forth herein or in the Telecommunications Act of 1992, all other provisions of Title 48 and Board regulations, Orders and policies will remain applicable to Embarq, unless the law hereinafter provides otherwise or the Board hereinafter orders or directs otherwise.

II Reclassification of ILEC Mass Market Retail Services and Adoption of the Stipulations and Agreements

Before the Board can adopt a proposed stipulation and agreement, it must examine the record to determine whether the proposal is a reasonable resolution of the issues in controversy, is in the public interest and is in accordance with law. Where, as here, the

proposed settlements are non-unanimous, the Board has the power to rely upon the stipulations as fact finding tools, but must also independently examine the record after providing an opportunity for any nonconsenting party to be heard. I/M/O the Petition of Public Service Electric and Gas Company for Approval of an Increase in Electric and Gas Rates, 304 N.J. Super 247 (App. Div. 1997)(“PSE&G”). That opportunity to be heard was provided by the public hearings held on June 24, 2008 and on August 7, 2008, and through the opportunity to provide written comments.

The proposed Stipulations were described earlier. As adoption of those stipulations would result in reclassification of a majority of both Embarq’s and Verizon’s retail mass market services, the Board must review the record to determine whether such reclassification is warranted. The New Jersey Telecommunications Act of 1992, N.J.S.A. 48:2-21.16 et seq., authorizes the Board to determine, after notice and hearing, whether a telecommunications service is competitive based on, at a minimum, three criteria: (1) ease of market entry; (2) presence of competitors; and (3) the availability of like or substitute services in the relevant geographic area. N.J.S.A. 48:2-21.19(b). Based on the evidence presented in the record, for the reasons outlined below, the Board **FINDS** that Verizon and Embarq’s mass market retail services as enumerated in the Stipulations, meet the statutory reclassification criteria under N.J.S.A. 48:2-21.19 (*i.e.*, ease of market entry, presence of competitors, and availability of like or substitute services in the relevant geographic area), and therefore are appropriately reclassified as competitive.

Ease of Market Entry

Evidence of ease of entry is shown by many factors, including the number of carriers which have received certification from the Board to operate as CLECs in New Jersey. According to the evidence presented, there are currently over 100 traditional CLECs offering service to customers in New Jersey. The number of competitors that have already entered the market highlight the lack of difficulty as exhibited by CLECs using the Board’s “well-established, clearly defined” certification process. Those competitors include not only CLECs, but wireless, cable and VoIP providers, none of which need Board authority to enter the New Jersey market.

Testimony submitted by the witnesses on behalf of Verizon and Embarq demonstrated the success of competitors in gaining entry into the market in New Jersey, noting the expanding service offerings which residential and business customers in New Jersey may avail themselves of. In addition, parties noted the reduction of barriers to entry since the passage of the Telecommunications Act of 1996 (the “1996 Act”), as well as evolving technological advances contributing to declining costs of entry, which serve as yet another testament to the lack of any significant barriers to entry for competitors. Thus, the evidence provided sufficiently proves the ability of competitors to avail themselves of the opportunities provided by the 1996 Act and its implementing regulations for providers to compete in New Jersey, including CLECs, in addition to cable, wireless and VoIP providers.

The record reflects the ability of competitors to utilize the methods of entry embodied in the 1996 Act, under which the ILECs such as Verizon and Embarq are required to resell their services, interconnect with competitors’ facilities, offer UNEs and collocation, and provide intraLATA dialing parity and number portability. Pursuant to these requirements, this Board has certified numerous competitive providers to compete in the local exchange market, and put great effort into developing policies to effectuate the various unbundling and interconnection requirements, which have evolved since the initial passage of the 1996 Act.

Sprint has argued that the reclassification of basic retail telephone services should be reviewed in conjunction with a review of intrastate access charges arguing that high access charges create a barrier to entry. According to Sprint, basic retail services have always been provided as a regulated monopoly while access charges were established at high levels decades ago to subsidize low rates for basic services as part of an overall regulatory scheme. Sprint cites the Telco Act of 1992 as authority for prohibiting the Board from reclassifying basic rates without reviewing switched intrastate access rates. Using this as a pivot for its discussion, Sprint argues that intrastate access charges are a barrier to entry and that access charges cross subsidize basic services.

The Board disagrees with both arguments put forth by Sprint. As a preliminary matter, the Board's Order issued on December 21, 2007, identified the scope of this proceeding. Specifically, the Board stated that the investigation was initiated to determine whether ILEC provided 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. Therefore, the issue of access charges was not identified as an issue in the proceeding. In fact, there were several rulings by Commissioner Butler that affirmed that determination. His rulings went on to state that access charges will, if necessary, be addressed in a separate proceeding on the Board's own motion or in response to a legitimate request. In any event, the Board **FINDS** that the record is devoid of any evidence that the level of access charges has or does create a barrier to entry. Sprint's presence in New Jersey, in addition to the 100 plus other competitors that have entered the market, supports a finding that no entry barriers exist. Second, Sprint has failed to show any evidence that cross subsidies from rate regulated services (access charges) to competitive services exist. To the contrary, the ILECs have included evidence in this record that no cross subsidy exists. The Board is satisfied, and **HEREBY FINDS** that, in the aggregate, competitive service revenues exceed competitive service costs and therefore no cross subsidies exist.

Based upon our review of the record developed in this proceeding, as referenced above, the Board **FINDS** that there are no barriers to entry that would preclude the reclassification of Verizon's and Embarq's mass market services as articulated in the Stipulations.

Presence of Competitors

Sufficient evidence was presented in this proceeding reflecting the existence of many competitors in the local exchange market. As noted previously in the discussion above on the ease of market entry, the Board has granted authorization to over 100 CLECs to offer service. Evidence presented in the proceeding on the ease of market entry is also supportive in the analysis of whether there are competitors. The existence of each authorized CLEC provider clearly provides evidence of competitors in the local exchange market. Various parties also pointed to FCC reports that a significant number of CLECs have reported that they are actively providing service in New Jersey. Additionally, as of December 31, 2007, 111 CLECs filed a "Statement of Gross Intrastate Revenue from Operation" Form AR3-1 with the Board evidencing earnings from operations within the State during the preceding year.

In addition to data provided on CLEC authorizations and CLEC service providers in New Jersey, parties also highlighted the pivotal fact that Verizon and Embarq are subject to competition from various intermodal competitors as well. As noted by the companies, they face competition from a combination of wireless, cable and VOIP competitors in all areas in which they provide service. Evidence in the record as to number and growth of participants in the competitive local exchange market, combined with the presence of CLECs, wireless, cable and

VOIP competitors in every market they operate in, provides a sufficient basis for the Board to find that there is a presence of competitors to both Verizon and Embarq in the local exchange market in New Jersey.

Thus, the Board may conclude that Verizon and Embarq's mass market services, as articulated in the Stipulations, are competitive under the statutory criteria based on the presence of competition faced by ILECs from CLECs, wireless, cable and VOIP providers.

No party directly refuted the evidence presented in the proceeding as to the presence of competitors to mass market services in the local exchange market. The Board, therefore, **FINDS** that there is sufficient evidence of the presence of competitors, such that the underlying evidence satisfies this criterion for reclassification.

Availability of Like and Substitute Services in the Relevant Geographic Area

The ILECs also argue that they satisfied the third criterion, availability of like or substitute services in the relevant geographic area, by evidence showing that the demand for substitutes, like CLEC, cable, wireless, and VoIP services, has been growing throughout the State. In making their arguments, the ILECs provided statistics which revealed not only the availability of substitutes, but increases in lines offered by its competitors. Although competitive conditions may vary throughout the State, the Board is satisfied that there is sufficient competition throughout the State to merit the findings that Verizon and Embarq's mass market retail services, as articulated in the Stipulation, are competitive. The evidence overwhelmingly shows that competitors offer substitutes to the ILECs' voice services. CLEC, cable, VOIP, and wireless providers all offer either stand alone and/or packages of services that consumers may, and do, purchase to replace ILEC services. The Board therefore **FINDS**, based on the evidence in the record, that like or substitute services are available in the relevant geographic area.

CONCLUSION

In reviewing the data submitted by the parties in the case, it is evident that sufficient competition exists to relieve both Verizon and Embarq from the Board's existing regulations for the mass market retail services articulated in the Stipulations. Therefore, based upon a thorough review of the record and the facts in this case, the Board **FINDS**, that there is sufficient evidence of the ease of entry into the market, of the existence of competitors in this market, and of the availability of like or substitute services to declare the retail mass market services, as described in the Stipulations, as competitive. Accordingly, for the reasons discussed above, the Board **FINDS** that sufficient evidence has been provided such that the Board **HEREBY FINDS** that those services are deemed competitive pursuant to N.J.S.A. 48:2-21.19, subject to the terms and conditions of the Stipulations as agreed to by the signatories. The Board notes that its finding for the reclassification of the services described above is limited to those retail services only, and does not affect any wholesale services, including access services.

As the Board has previously stated, in complex and technical cases, the adversary parties are often in the best position to work out the framework of a reasonable resolution of the issues. PSE&G, supra at 259. After review of the record, the Board also **FINDS** that the other provisions of the Stipulations are reasonable, are in the public interest and are in compliance with the law. As previously described, the Stipulations provide that residential basic exchange service, single-line basic business exchange service, non-recurring charges for installation of residential services, and residential DA service shall remain rate regulated, and subject to defined limits on any rate increases for the next three years. Additionally, both Stipulations

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

DOCKET NO. TX07110873

John DeLuca
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102
John.deluca@bpu.state.nj.us

Anthony Centrella, Director
Division of Telecommunications
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102
Anthony.centrella@bpu.state.nj.us

Stefanie A. Brand, Esq.
Division of Rate Counsel
31 Clinton Street, 11th Floor
P.O. Box 46005
Newark, NJ 07102
sbrand@rpa.state.nj.us

Jose Rivera-Benitez, Esq.
Division of Rate Counsel
31 Clinton Street, 11th Floor
P.O. Box 46005
Newark, NJ 07101
jrivera@rpa.state.nj.us

Collen A. Foley, Esq.
Saul Ewing
One Riverfront Plaza
Newark, NJ 07102
cfoley@saul.com

Christopher J. White, Esq.
Division of Rate Counsel
31 Clinton Street, 11th Floor
P.O. Box 46005
Newark, NJ 07101
cwhite@rpa.state.nj.us

Jeanne W. Stockman, Esq.
United Telephone Company of New Jersey,
Inc.
d/b/a Embarq
14111 Capital Blvd.
Wake forest, NC 27587-5900
jeanne.w.stockman@embarq.com

Mark A. Keffer
Philip S. Shapiro
AT&T Communications
3033 Chain Bridge Road
Oakton, VA 22185
mkeffer@att.com
psshapiro@att.com

Garnet Goins, Director & Attorney
Benjamin J. Aron
State Reg. Affairs, Northeast
Region
Sprint Nextel Corp.
2001 Edmund Halley Drive
Reston, VA 20191
Garnet.goins@sprint.com
benjamin.aron@sprint.com

Ava Marie Madcam
Verizon New Jersey, Inc.
540 Broad Street, 20th Floor
Newark, NJ 07102
avamarie.p.madcam@verizon.com

Lawanda Gilbert, Esq.
Carol Artale, Esq.
Counsel's Office
New Jersey Board of Public Utilities
Two Gateway Center
Newark, NJ 07101
Lawanda.gilbert@bpu.state.nj.us
Carol.artale@bpu.state.nj.us

Patricia Campbell
Division of Telecommunications
New Jersey Board of Public Utilities
Two Gateway Center
Newark, NJ 07101
Patricia.campbell@bpu.state.nj.us

James F. Murphy
Division of Telecommunications
New Jersey Board of Public Utilities
Two Gateway Center
Newark, NJ 07101
James.murphy@bpu.state.nj.us

Harold Bond
Division of Telecommunications
New Jersey Board of Public Utilities
Two Gateway Center
Newark, NJ 07101
Harold.bond@bpu.state.nj.us

Thomas Chu
Division of Telecommunications
New Jersey Board of Public Utilities
Two Gateway Center
Newark, NJ 07101
Thomas.chu@bpu.state.nj.us

Mark Beyer
Division of Economist
New Jersey Board of Public Utilities
Two Gateway Center
Newark, NJ 07101
Mark.beyer@bpu.state.nj.us

William Agee
New Jersey Board of Public Utilities
Two Gateway Center
Newark, NJ 07101
William.agee@bpu.state.nj.us

Susan M. Baldwin
17 Arlington Street
Newburyport, MA 01950
smbaldwin@comcast.net

Ralph V. Lee, Esq.
Richard Chapkis, Esq.
Vice President & General Counsel
Verizon NJ
540 Broad Street, 20th Floor
Newark, NJ 07102
Ralph.v.lee@verizon.com
Richard.chapkis@verizon.com

Nicholas Pascaretti
J. Stoerber
Warwick Valley Telephone Company
47-49 Main Street
Warwick, NY 10990
n.pascaretti@wvvc.com
j.stoerber@wvc.com

Murray E. Bevan
William K. Mosca
Bevan, Mosca, Giuditta & Zarillo, P.C.
776 Mountain Blvd.
Watchung, NJ 07069
mbevan@bmgzlaw.com
wmosca@bmgzlaw.com

Martin C. Rothfelder, Esq.
Bradford M. Stern, Esq.
Rothfelder Stern, L.L.C.
625 Central Avenue
Westfield, NJ 07090
mrothfelder@rothfelderstern.com
bmstern@rothfelderstern.com

Russell R. Gutshall
EMBARQ
240 North Third Avenue
Suite 201
Harrisburg, PA 17101
Russell.r.gutshall@embarq.com

Babette Tenzer, DAG
Division of Law
124 Halsey Street, 5th Floor
Newark, NJ 07101
babette.tenzer@dol.lps.state.nj.us

K.C. Halm, Esq.
Davis Wright Tremaine LLP
1919 Pennsylvania Ave., N.W.
Suite 2001
Washington, DC 20006
kchalm@dw.com

Cherie R. Kiser, Esq.
Ernest Cooper, Esq.
Mintz, Levin, Cohn, Ferns, Glovaky &
Popeo, PC
701 Pennsylvania Ave., N.W.
Washington, DC 20004
ckiser@mintz.com
eccooper@mintz.com

Paul Flanagan, Assistant Director
Division of Rate Counsel
31 Clinton Street, P.O. Box 46005
Newark, NJ 07101
pflanagan@rpe.state.nj.us

Richard A. Hrip
EMBARQ
240 North Third Ave., Suite 201
Harrisburg, PA 17101
Richard.a.hrip@embarq.com

Maria T. Novas-Ruiz, Esq.
Division of Rate Counsel
31 Clinton Street, P.O. Box 46005
Newark, NJ 07101
mnovas-ruiz@rpa.state.nj.us

Geoffrey Gersten
Jessica Campbell
Deputy Attorney General
Division of Law-Board of Public Utilities
124 Halsey Street
PO Box 45029
Newark, NJ 07101-5029
geoffrey.gersten@dol.lps.state.nj.us
jessica.campbell@dol.lps.state.nj.us

Hesser McBride
Wilentz Goldman & Spitzer
90 Woodbridge Center Drive
Suite 900 Box 10
Woodbridge, NJ 070953-0958
hmcbride@wilentz.com

Kate Tasch, Esq.
Vice President
Legislative and Regulatory Affairs
New Jersey Cable Telecommunications
Association
124 West State Street
Trenton, NJ 08608
ktasch@cablenj.org

Elana Shapochnikov
Senior Regulatory Counsel
Government Affairs
Cablevision Lightpath, Inc.
1111 Stewart Avenue
Bethpage, NY 11714-3581
eshapoch@cablevision.com

James C. Meyer
Riker, Danzig, Scherer, Hyland &
Perretti, LLP
Headquarters Plaza
One Speedwell Ave.
Morristown, NJ 07962
jmeyer@riker.com