BEFORE THE
STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

In the Matter of the Application of Verizon New Jersey Inc. For Approval (i) of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-line Rate Regulated Business Service as Competitive Services, and Compliance Filing :	BPU Docket No. TO01020095

REPLY BRIEF ON BEHALF OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

REDACTED VERSION

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I. INTRODUCTION AND EXECUTIVE SUMMARY

This proceeding, which will establish the plan for alternative regulation of Verizon-NJ for the foreseeable future, has great importance for New Jersey's ratepayers. Two aspects of the current telecommunications market only serve to heighten this importance. First, local competition has been exceedingly slow to develop in New Jersey and, indeed, the current economic and investment climate makes it unlikely that competitive conditions will improve in the near term. Second, Verizon-NJ may soon cease to be subject to the constraining force of section 271 of the federal Telecommunications Act of 1996, Telecommunications Act of 1996, Pub. L. 104-104, Feb. 8, 1996, 110 Stat. 56, codified at 47 U.S.C. § 151 *et seq.* ("1996 Act"). The former point was repeatedly recognized by the Board in its Consultative Report to the FCC, while the latter arises as a result of the Board's favorable recommendation in that Report. *I/M/O Implementation of the Consultative Report of the Application of Verizon New Jersey, Inc. for FCC Authorization to Provide In-Region, InterLATA Service in New Jersey*, Docket No. TO01090541, CC Docket No. 01-347, Consultative Report of the New Jersey Board of Public Utilities (filed Jan. 14, 2002) ("Consultative Report").

The transition to a competitive telecommunications market is taking longer than either the competitors or the Board expected. *See* Consultative Report at 86. At this time when the hard won gains of competitors in New Jersey are threatened with elimination, it is even more important that the Board remain vigilant in its regulation of Verizon-NJ. As recently stated by an economist in an Op-Ed article in the New York Times,

> Deregulation is not the same as no regulation. Experience in other nations shows that competition … works if there is a strong, but carefully circumscribed, role for regulators – especially during the heady, uncertain transition phase.

Vijay Vaitheeswaran, Op-Ed, "Electricity Deregulation Is Still Sound Policy," THE NEW YORK TIMES, Dec. 15, 2001. This is still, despite appearances, the transition phase. It is thus the Board's duty in this proceeding to ensure that the ongoing deregulation of Verizon-NJ does not lead to no regulation and a situation in which the ratepayers of New Jersey are subject to the monopoly power of Verizon-NJ especially in a state where there is no competition in the local exchange marketplace.

The goal of the 1996 Act was to help constrain the regional Bell operating companies' ("RBOCs" such as Verizon-NJ) natural incentive to discriminate against competitors. The "carrot" of In-Region, InterLATA authority should have made it worthwhile for Verizon-NJ, as wholesaler, to at least nominally treat competitors in a manner comparable to the way it treated its own retail operations. If Verizon-NJ gains section 271 authority, its incentive to discriminate against competitors will grow. To constrain any potential acts of aggression, the Board must establish a plan for alternative regulation that both encourages the incumbent to improve efficiency and develop new services, and requires that it continue to share the revenues that it gains as a result of its position as the monopoly provider of local service. The Ratepayer Advocate has proposed several tools to effect this purpose, further described herein, and respectfully urges the Board to implement them.

As an initial matter, the Board should reject Verizon-NJ's last-minute contention that it alone has the right to propose a plan for alternative regulation. The statute clearly contemplates the input of interested parties, and Verizon-NJ's attempt to undercut that input by leaving only its own self-serving plan on the table is improper. Moreover, the Board should adopt a plan that continues the basic construct included in PAR-1 and complies with statutory provisions governing the PAR. *Application of New Jersey Bell Telephone Company for Approval of its Plan for an Alternative Form of Regulation, Decision and Order*, Docket No. TO92030358 (May 6, 1993) ("1993 Order");

N.J.S.A. § 48:2-21.18a (1)-(8). Unlike Verizon-NJ, the Ratepayer Advocate, as a statutory party designated to represent and protect the public interest of all ratepayers pursuant to N.J.S.A. 13:1D-1, has proposed a plan that protects and continues key mechanisms of PAR-1, with minor modifications designed to address the current lack of competition in New Jersey. Verizon-NJ, on the other hand, seeks to eliminate these provisions. Specifically, the Ratepayer Advocate's proposed plan includes a rate cap and sharing requirements that will continue to ensure affordable service and allow New Jersey consumers to share in the significant earnings enjoyed by Verizon-NJ, through rate reductions.

In addition, the Ratepayer Advocate proposes an expansion of local calling areas (via rate center consolidation) as a vehicle for passing the merger and earnings sharing benefits on to basic service consumers. While both Verizon-NJ and AT&T attack this plan because it will have a negative impact on their toll revenues, neither party proposes an alternative mechanism by which excess earnings and merger benefits might accrue to ratepayers. Similarly, while both Verizon-NJ and AT&T argue against the Ratepayer Advocate's plan to create a state universal service fund and improve the Lifeline program to remedy the declining affordability of services, neither carriers' arguments have merit. The Ratepayer Advocate's universal service proposal is well supported by the record evidence in this proceeding and represents sound public policy, as intended by Congress in passage of the 1996 Act.

Finally, the Ratepayer Advocate urges the Board to tightly monitor Verizon-NJ's service quality during the transition to competition. If Verizon-NJ is granted section 271 relief by the FCC, one of its greatest incentives for maintaining service quality to both competitors and consumers will have disappeared. Thus, the responsibility for regulatory assurance of service quality will once again

rest solely with programs implemented by the Board. The Ratepayer Advocate demonstrates that monetary incentives and penalties are needed to ensure that high quality service is provided.

In regard to Verizon-NJ's Petition for Reclassification of multi-line business services, the Ratepayer Advocate demonstrates that Verizon-NJ fails to comply with any of the statutory requirements governing reclassification. As fully explained below, Verizon-NJ improperly attempts to demonstrate the presence of competitors by reference to potential entry, fails utterly to recognize that entry barriers in the local exchange market remain high, and fails to separately show the availability of substitute services, as required by statute. For these reasons alone, the Board should reject Verizon-NJ's petition. Moreover, the Board should, as required by N.J.S.A. 48:2-21.19(b), initiate a formal proceeding to develop a complete list of reclassification criteria. A more thorough analysis under a complete list of criteria would permit Verizon-NJ to demonstrate that the alleged competition in those services is not only a mirage. For this reason, among others, the Board should initiate a proceeding to focus its reclassification inquiry on the criteria for existence of effective competition and an examination of relative market shares. Also, Verizon-NJ retains the ability to effectively raise its price well above cost, to the decided disadvantage of New Jersey ratepayers at any time.

Finally, the Ratepayer Advocate urges the Board to adopt structural separation of Verizon-NJ's retail and wholesale divisions. While Verizon-NJ objects on a variety of grounds to structural separation, its challenges are untimely and without merit. In addition, Verizon-NJ argues that existing regulatory measures are sufficient to promote local competition. This position ignores the reality that New Jersey ratepayers have awaited effective local competition for years under the existing regulatory framework, without significant results. Verizon-NJ also asserts that structural separation would be

excessively costly, but only succeeds in demonstrating the advantages that Verizon-NJ's retail operation would lose if treated like its competitors. Finally, Verizon-NJ fails to make any substantial response to the Ratepayer Advocate's alternative proposal of functional/structural separation through a strong code of conduct.

II. VERIZON-NJ'S PROPOSED PAR IS A RADICAL DEPARTURE FROM PAR-1; THE RATEPAYER ADVOCATE'S PROPOSAL IS A REVISION OF PAR-1 THAT PRESERVES ESSENTIAL MECHANISMS

A. There Is No Merit To Verizon-NJ's Claim That Only It May Propose The Terms Of A PAR

In its brief Verizon-NJ for the first time asserts that the Ratepayer Advocate's proposed PAR is "inappropriate" because a plan proposed by another entity cannot apply to Verizon-NJ without Verizon-NJ's consent. Verizon-NJ Initial Brief at 10, 37. The authority that Verizon-NJ offers for this proposition is N.J.S.A. § 48:2-21.18a, which provides that a local exchange telecommunications company may petition to be made subject to a plan of alternative regulation. That same section, however, also provides without limitation that the Board may modify the proposed plan after notice and hearing. *Id.* The existence of this power to modify, along with the notice and hearing requirement, necessarily implies that parties to the evidentiary proceeding other than Verizon-NJ may propose to the Board alternative provisions for the plan. Verizon-NJ cannot seriously contend that the Board must arrive at modifications to Verizon-NJ's proposed plan either by devising them itself or waiting for Verizon-NJ to volunteer them.

The Ratepayer Advocate's role is not limited to individual ratemaking cases; rather it is statutorily authorized to play an *active role in policymaking*. "...[T]he Ratepayer Advocate will be empowered to represent, protect, and advance the interests of all consumers of utility services,

including residential, small business, commercial and industrial ratepayers, in an effort to protect and promote the economic interests of all New Jersey ratepayers." N.J.S.A. 13:1D-1. The Ratepayer Advocate's participation in this proceeding has not been questioned, and the scope of its participation is similarly not a matter for debate. The statutes authorizing the Ratepayer Advocate are clear to the point that it is to assist the Board in policymaking. Any argument to the contrary must be dismissed for being in contravention of clear statutory directive.

The Ratepayer Advocate has proposed an alternative to Verizon-NJ's proposed PAR. That alternative, like Verizon-NJ's proposal, has been subjected to extensive scrutiny through discovery and hearings. It is particularly untimely for Verizon-NJ at the last minute to assert that none of that analysis should have happened, because of Verizon-NJ's view that it alone has the right to propose terms for a PAR. Worse, if Verizon-NJ's view were to prevail, it would mean that the Board would not consider the Ratepayer Advocate's proposals, which preserve the principle mechanisms of the existing PAR, albeit with some revisions. The only proposal on the table would be Verizon-NJ's bid to radically reshape the PAR and abandon its most important protections. The Board should reject Verizon-NJ's meritless effort to control the debate in this way.

B. Verizon-NJ's Plan Does Not Comply With The New Jersey Statute

Contrary to Verizon-NJ's claims, its proposal does not comply with the statutory requirements for an alternative form of regulation. N.J.S.A. § 48:2-21.18a (1)-(8). As discussed below and in the Ratepayer Advocate's Initial Brief, without a firm rate cap the PAR will not "ensure the affordability of protected services." N.J.S.A. § 48:2-21.18(1) (2001); *see* RPA Initial Brief at 29-51, 73-75; *infra* Sections II.C.2, E.1. Verizon-NJ argues that its Lifeline proposal will ensure affordability, but a state Universal Service Fund, a Verizon-NJ Lifeline contribution that triggers the

full federal Lifeline contribution, and improved eligibility and enrollment criteria are necessary to meet that objective. RPA Initial Brief at 73-92; *infra* Section II.E.

Verizon-NJ claims that under its proposal rates will be "just and reasonable", as required by N.J.S.A. § 48:2-21.18(2) (2001). In support of this claim, Verizon-NJ cites, among other things, its proposal to eliminate earnings sharing. Verizon-NJ Initial Brief at 21. It cannot be just and reasonable, however, for a regulated firm to retain earnings attributable to its monopoly power when effective competition would return those earnings to ratepayers in the form of lower prices. RPA Initial Brief at 25-28; *infra* Section II.C.

Contrary to Verizon-NJ's assertion, moreover, the Verizon-NJ plan would "prejudice or disadvantage" customers and competing providers. N.J.S.A. § 48:2-21.18(3) (2001). The Verizon-NJ plan would threaten subscribers and competitors by giving Verizon-NJ the ability to reshape existing offerings as "new services" and restructure its rates without sufficient Board review. RPA Initial Brief at 49-50. By the same token, these proposals for new service offering procedures and rate restructuring would not "reduce regulatory delay and costs," N.J.S.A. § 48:2-21.18(4) (2001); *see* RPA Initial Brief at 49-50. In addition, eliminating the exogenous events provisions as Verizon-NJ proposes would increase regulatory delay and costs. RPA Initial Brief at 50.

Verizon-NJ's proposals will not enhance economic development in New Jersey. N.J.S.A. § 48:2-21.18(6) (2001). Rather, they will leave Verizon-NJ a monopolist but subject only to an inadequate level of regulatory scrutiny. For these reasons, the Verizon-NJ plan would not be in the public interest. N.J.S.A. § 48:2-21.18(7) (2001).

C. The Ratepayer Advocate's Proposed Sharing Of Earnings And Merger Savings Are Appropriate Measures To Ensure That New Jersey Ratepayers Share In The Efficiency And Productivity Initiatives That They Support As Captive Ratepayers

1. Verizon-NJ's Attacks on the RPA's Proposed Plan as Being Rate-of-Return Regulation are a Distortion of Earnings Sharing and the Board's Findings on this Issue

Contrary to Verizon-NJ's assertions, rather than reverting back to rate-of-return regulation, earnings sharing is an important component of incentive regulation in today's monopoly market. Verizon-NJ attempts to mischaracterize earnings sharing as a deviation from incentive regulation by arguing that it will discourage investment and productivity. Verizon-NJ Initial Brief at 37-40. This is simply not true.

Indeed, the Board specifically included earnings sharing when it abandoned rate of return regulation and adopted PAR-1. 1993 Order at 39. In its 1993 Order, the Board found that earnings sharing was an appropriate mechanism for ensuring just and reasonable rates. Specifically, the Board stated that earnings sharing is a "reasonable and appropriate means of establishing and maintaining over the life of the plan a balance between providing reasonable and affordable prices for NJ Bell's customers." 1993 Order at 39. Rather than reverting back to rate of return regulation as Verizon-NJ asserts, the Board reasoned that earnings sharing *avoided* the "inefficiency, expense and delay of traditional rate base, rate of return regulation." 1993 Order at 39. Thus, the Board has previously found that earnings sharing is not a component of rate of return regulation, but is an important and appropriate element of incentive-based regulation.

Moreover, Verizon-NJ's attempt to eliminate earnings sharing is a complete reversal from the position its predecessor, Bell Atlantic, took before the Board. During the PAR-1 proceeding, New

Jersey Bell argued that earnings thresholds provided a reasonable check and balanced the need to "eliminate inefficiencies and expense of traditional rate base, rate of return regulation" with the provision of reasonable rates and productivity incentives. 1993 Order at 33 (*quoting* New Jersey Bell Brief at 12). Thus, Bell Atlantic recognized that earnings sharing was an appropriate component in incentive based regulation.

2. Earnings Sharing Does not Create Economic Disincentives for Verizon

Notwithstanding Verizon-NJ's assertions in this proceeding, Verizon-NJ Brief at 37-39, earnings sharing does not discourage investment or productivity efficiencies. Indeed, the Board has already found that just the opposite is true. According to the Board, earnings sharing provides the Company with "the incentive to contain costs and to commit capital and accomplish accelerated deployment of an enhanced telecommunications network in as efficient a manner as possible." 1993 Order at 39. Moreover, Verizon-NJ has been operating under earnings sharing for the past several years and has made substantial investments, including its mergers with NYNEX and GTE, designed to save costs and enhance revenues. In fact, Verizon-NJ argues that New Jersey ratepayers have already benefitted from these mergers through Verizon's re-investment of the cost savings and revenue enhancements into its infrastructure. Verizon-NJ Initial Brief at 139-40. Clearly, the existing earnings sharing in PAR 1 did not stop Verizon-NJ from investing in productivity and innovative enhancements. Likewise, an earnings sharing component in PAR-2 will not discourage investment or productivity.

3. The Ratepayer Advocate's Conservative Earnings Sharing Proposal is Necessary to Replicate the Results of Competition in Today's Monopoly Market

Contrary to Verizon-NJ's bald assertions throughout this proceeding, competition has yet to take hold in New Jersey. Without competitive pressure, Verizon-NJ has no incentive to pass productivity and efficiency benefits to New Jersey's ratepayers. *See* RPA Initial Brief at 26-27. Earnings sharing will replicate the results of a competitive market that has yet to materialize.

Moreover, the Ratepayer Advocate's graduated earnings sharing proposal of 10% is conservative when compared to Verizon-NJ's "robust" returns of over 30% over the last decade. *See* RPA Initial Brief at 37-38, *citing Final Report on the Review of the Financial Integrity of Verizon New Jersey*, The Liberty Consulting Group at 31 (Oct. 19, 2001) ("Liberty Audit"). A 10% sharing threshold is more than reasonable compared to Verizon-NJ's substantial returns on its rate regulated services ranging from **[BEGIN VERIZON-NJ PROPRIETARY]**

[END VERIZON-NJ PROPRIETARY] Liberty Audit at 11. These monopoly earnings highlight the need for Board ordered earnings sharing. Indeed, the discrepancy between these returns raises serious concerns regarding Verizon-NJ's cost allocation methodology. One could surmise that Verizon-NJ was able to earn such high rates of return by over-allocating costs to its rate regulated services thereby increasing its margins in its competitive services. Moreover, it is conspicuous that given these returns, Verizon-NJ has consistently escaped any sharing obligation over the last ten years. *Id.* at 10-12. Clearly, Verizon-NJ has enjoyed high rates of returns while New Jersey ratepayers have been denied their fair share of these earnings. In addition, given the monopoly level rates of return, there is serious doubt whether those Verizon-NJ services classified as "competitive" are truly competitive.

4. **The Ratepayer Advocate's Proposed Sharing of Merger Savings is Sound Public Policy**

Verizon-NJ suggests that the Board has rejected the argument that the company should share in any merger benefits realized from either the NYNEX or GTE mergers. Verizon-NJ Initial Brief at 127-30. This is simply not true.

As the Ratepayer Advocate explained in its initial brief, the Board fully contemplated that Verizon would share its merger benefits with New Jersey ratepayers and only left open the issue of to *what extent* such savings should be shared with ratepayers. RPA Initial Brief at 43, *citing* GTE Merger Order at 8. Indeed, the Board noted that it must ensure that "New Jersey ratepayers will have *access to a share of any benefits* relating to this merger." *I/M/O Board's Review of the Amended and Restated Agreement and Plan of Merger*, Order, Docket No. TM96070504 (May 22, 1997) at 2 (emphasis added). Indeed, at the time of the NYNEX merger, Bell Atlantic's CEO, Len J. Lauer, did not dispute that a sharing of these benefits was appropriate. Indeed, Mr. Lauer assured the Board that Verizon-NJ would implement an "appropriate sharing of benefits" with New Jersey ratepayers. *I/M/O Board's Review of the Amended and Restated Agreement and Plan of Merger*, Supplemental Statement, Docket No. TM96070504 (February 5, 1997) at 7-8 ("Lauer Supplemental Statement").

a. **New Jersey Ratepayers Have Not Yet Received Their Fair Share of Merger Benefits**

Perhaps recognizing the Board's precedent for sharing of savings in these mergers, as well as mergers in other industries, Verizon-NJ then shifts its position by arguing that ratepayers have already realized benefits from the NYNEX and GTE mergers and that to award "additional benefits" would constitute "bad public policy." Verizon-NJ Initial Brief at 139-40. What Verizon-NJ refuses to realize, however, is that New Jersey ratepayers have supported Verizon-NJ for decades. RPA

Initial Brief at 42-44. Indeed, Verizon-NJ has enjoyed substantial returns on both its rate regulated and competitive services subscribed to and paid for by New Jersey ratepayers. Indeed, as explained elsewhere in this brief, Verizon-NJ's incredible high returns on its competitive services raises serious doubts as to whether these services are truly competitive.

Nevertheless, even in the face of these inflated returns, Verizon-NJ continues to refuse to share any of the benefits of these mergers with ratepayers. Verizon-NJ Initial Brief at 139-40. As explained above, Verizon-NJ's position today stands in stark contrast to its assurances to the Board when it sought regulatory approval for its mergers. *See, e.g.,* Lauer Supplemental Statement at 7-8. To date, Verizon-NJ has refused to pass through any of these savings; it is time it did so.

b. In Calculating Merger Benefits the Board Should Include Revenue Enhancements and Exclude Transaction Costs

In a further attempt to avoid sharing any merger benefits, Verizon-NJ argues that the Ratepayer Advocate has miscalculated the benefits by including revenue enhancements. Verizon-NJ Initial Brief at 141-42. According to Verizon-NJ revenue enhancements should not be included in any merger benefit analysis because it has not calculated and reported on any enhancements. Verizon-NJ Initial Brief at 141-42.

The Board should not permit Verizon-NJ to avoid sharing of these savings because of its scant reporting. Specifically, Verizon-NJ refused to provide certain information on cost savings and revenue enhancements. RPA Initial Brief at 46-48. The ratepayers of New Jersey should not be denied the benefits of these savings and enhancements simply because Verizon-NJ failed to provide sufficient information. Liberty Consulting explained that while Verizon-NJ has not tracked or reported these synergies to the Board, "when it sought approval for the merger it identified expected

capital synergies in detail to the New Jersey level." Liberty Audit at 56. Verizon-NJ does not dispute that it has realized revenue enhancements as a result of its NYNEX merger. Verizon-NJ Initial Brief at 141-42. Nevertheless, Verizon-NJ seeks to avoid inclusion of any revenue enhancements because it claims not to have calculated these increases. The Board should not allow such self-serving reporting discrepancies to deny ratepayers their fair share of merger benefits. Since Verizon-NJ refused to provide this information, the Board should use an estimate of these figures, such as Mr. Rothschild's use of proxy statement from the GTE merger. RPA Initial Brief at 47.

Moreover, the numbers that Verizon-NJ did provide are inflated in that they improperly include transaction costs for executing the merger. Transaction costs, include, for example legal and financial services necessary for executing the merger. It is therefore inappropriate for Verizon to force its captive ratepayers to fund these expenses. Indeed, Liberty Consulting independently confirmed that a proper calculation of merger benefits should exclude these costs. Liberty Audit at 53.

There is strong precedent in New Jersey that these costs should be excluded from any merger benefit analysis. In the stipulation governing the merger of Lyonnaise American Holding and United Water Resources, the parties agreed that "no costs associated with this transaction (e.g., financial, legal, severance payments and investment services) or the purchase price of UWR's stock shall be passed on to, recovered from, or funded by" New Jersey customers. *I/M/O Joint Petition of Lyonnaise American Holding, Inc. and United Water Resources, Inc. for Approval of a Change in Ownership and Control of the New Jersey Operating Utilities*, Docket No. WM99110853, Stipulation of Statement (June 23, 2000) at 7; *In the Matter of the Joint Petition of FirstEnergy Corp. and Jersey Central Power & Light Company, D/B/A GPU Energy, For Approval of a Change*

in Ownership and Acquisition of Control of a New Jersey Public Utility and Other Relief, Order of Approval, BPU Docket No. EM00110870 (October 9, 2001) at 19, 22. Thus, these costs should not be included as offsets to the substantial merger savings that Verizon enjoys.

Until Verizon-NJ provides full and accurate reports that include revenue enhancements and exclude transaction costs, the Board should rely on Mr. Rothschild's conservative estimates of Verizon-NJ's benefits from the NYNEX and GTE mergers. RPA Initial Brief at 45-49. Mr. Rothschild's estimates are based on Verizon-NJ's exhibits as well as public documents and capture both the historical and going forward merger benefits. After properly allocating these benefits to Verizon-NJ's intrastate rate regulated services, the New Jersey ratepayers' 50% share equals $43 million in a one time refund for historical savings and $92 million in a permanent rate reduction to reflect going-forward merger savings. *Id.*

5. Verizon-NJ's Proposal to Eliminate the Rate Cap Would Jettison a Critical Aspect Of PAR-1; the Ratepayer Advocate Urges the Board to Continue the Rate Cap for 5 Years

Verizon-NJ never mentions the rate cap as such, instead noting that it is *not now* proposing an increase in the basic rate. Verizon-NJ Initial Brief at 17. The Board's cap on the rate for basic residential service, however, has been too important a protection for *all* New Jersey consumers to abandon now. Verizon-NJ does not state explicitly what its plans are for this rate, but both history and the implications of its positions here are ominous. The troublesome history is Verizon-NJ's bid as part of its CTP to effect a major increase in the basic rate. In the CTP, Verizon-NJ sought approval of a bundled rate for local and vertical services with no choice of an unbundled basic plain old telephone service ("POTS") rate. The current position of concern is Verizon-NJ's contention that the basic rate is among the rates that have been set below cost, and its proclamation of the

economic efficiency of moving such rates closer to cost, *i.e.*, increasing them. West-Taylor Rebuttal at 46. The context for these statements, moreover, is Verizon-NJ's defense of its proposal to limit the Board's review of its "revenue neutral rate restructuring" proposals. *Id.* If, as seems to be the case, Verizon-NJ is contemplating an increase in the basic residential rate, now is the time for the Board to reassure New Jersey's ratepayers with a clear statement that that rate will remain at its current level, for the next five years.

Verizon-NJ did not commit itself to any rate on a going-forward basis, leaving open the possibility that a basic service rate increase could be imposed immediately upon approval of the PAR-2, or soon thereafter. This possibility evinces a clear lack of consumer protection. In this context, it is instructive that other Verizon serviced states have agreed with the appropriateness of the imposition of rate caps. The Virginia PAR mandates that basic local exchange rates are capped until January 1, 2004. *Application of Verizon South, Inc., for Approval of its Plan for Alternative Regulation*, Order Approving Plan, Case No. PUC000265, Commonwealth of Virginia State Corporation Commission (Dec.21, 2000). Verizon Maine, too, is subject to a price cap. In June 2001, the Maine Public Utilities Commission ordered that rates for basic exchange service be frozen until Verizon Maine can establish that reasonable competition exists. The Maine Commission extended this ban to include a rate freeze on directory assistance and operator services rates. *Investigation into Verizon Maine's Form of Regulation*, Maine Public Utilities Commission, Docket No. 99-851, Order (Part 2) (2001) ("Maine Alt. Reg. Order"). The Ratepayer Advocate's call for a rate cap guarantee is equally appropriate. New Jersey consumers deserve no less protection. With no cost of service study to demonstrate that even the "going in" rates are just and reasonable, Verizon has offered no assurance that rates will remain at such levels on a going forward basis. The

Ratepayer Advocate respectfully submits that the Board should impose the assurance that the Company has refused to provide.

D. The Board Should Reject Verizon-NJ's And AT&T's Attacks On The Ratepayer Advocate's Proposal To Consolidate Rate Centers And Expand Local Calling Areas

The Board should give no credence to Verizon-NJ's and AT&T's attacks on the Ratepayer Advocate's rate center consolidation and local calling area expansion plan because these attacks fail to acknowledge the benefits to consumers and to local competition that the plan will bring. *See* Verizon-NJ Initial Brief at 44-51; AT&T Initial Brief at 79-82. First and foremost, reducing the number of Verizon-NJ rate centers from 180 to 21 and concomitantly establishing county-wide local calling areas (except where LATA boundaries require otherwise) is the best way to return to ratepayers the $148 million in Verizon-NJ merger savings and excess earnings. Neither Verizon-NJ (unsurprisingly) nor AT&T proffer any option for returning this $148 million to ratepayers.

Verizon-NJ and AT&T inappropriately oppose the Ratepayer Advocate's proposal because it will cause them to lose intraLATA toll revenues. Verizon-NJ Initial Brief at 45; AT&T Initial Brief at 80-81. Both companies, however, fail to recognize that the Board's responsibility is not only to protect their corporate profits, but to also protect New Jersey consumers, particularly during the critical transition from local monopoly to competition. Because New Jersey has the smallest local calling areas in the country, West-Taylor Direct at 9-10, the Board expressly sought to examine the "geographic expansion of local calling areas and the collapsing of toll bands" in this proceeding. *Application of Bell Atlantic-New Jersey, Inc., for Approval of a Modified Plan for an Alternative Form of Regulation and to Reclassify All Rate Regulated Services as Competitive Services*; *Application of Verizon New Jersey, Inc., for Approval of an Extension of its Plan for an Alternative*

Form of Regulation, Order, Docket Nos. TO99120934, TO92030358, TO00120955 (Dec. 22, 2000) at 6 ("December 22 Order"). Yet, nowhere in its order did the Board require, or even contemplate, that any expansion of local calling areas and collapsing of toll bands would maintain the intraLATA toll revenues of Verizon-NJ or AT&T. *See* RPA Initial Brief at 54-55, 63-65. Instead, Verizon-NJ and AT&T improperly added this requirement. As the Ratepayer Advocate demonstrated in its initial brief, if local rates are to remain at their current levels, any local calling area expansion / rate center consolidation plan would necessarily lead to a reduction in toll revenues. RPA Initial Brief at 54-55, 63-65. Accordingly, the Board has already endorsed, at the very least implicitly, a reduction in intraLATA toll revenues so that consumers can benefit from larger local calling areas.

Also, contrary to the assertions of Verizon-NJ and AT&T, increasing the geographic size of local calling areas and collapsing toll bands should increase competition in the local exchange marketplace, particularly residential competition. *See* Verizon-NJ Initial Brief at 45; AT&T Initial Brief at 80-81. Because local calling areas are the smallest in the country, the local market is correspondingly small. While this has not been a significant issue for Verizon-NJ because Verizon-NJ was initially granted – and still maintains – a monopoly presence in almost all local calling areas in New Jersey, it is a significant impediment to the development of local competition. The small size of local calling areas leads to a small overall market for local telecommunications, thereby discouraging stand alone entry into the local exchange market place.

Moreover, Verizon-NJ admits that small local calling areas have undermined local competition in its FCC section 271 application. There, Verizon-NJ stated:

> [t]he unusually large size of the intraLATA toll market in New Jersey has meant that competition for residential service in New Jersey has

focused disproportionately on local toll service rather than on basic local exchange service.

Application by Verizon New Jersey Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), Verizon Global Networks Inc., and Verizon Select Services Inc., for Authorization to Provide In-Region, InterLATA Services in New Jersey, CC Docket No. 01-347, Application by Verizon New Jersey for Authorization to Provide In-Region, InterLATA Services in New Jersey (filed Dec. 20, 2001) at 86 (citing Taylor FCC Decl. ¶ 28) ("Verizon-NJ FCC 271 Application"). By implication, the local calling area expansion/rate center consolidation plan of the Ratepayer Advocate would increase local residential competition in New Jersey. *See* RPA Initial Brief at 56-57. Therefore, rather than conflicting with prior Board policy as AT&T alleges, AT&T Initial Brief at 81-82, the Ratepayer Advocate's plan would promote the very Board goal AT&T cites to – increasing local competition.

Further, Verizon-NJ's allegation that it would incur significant one-time network costs to implement the Ratepayer Advocate's plan is unsupported by the record. *See* Verizon-NJ Initial Brief at 47, 49-50. Rather, Verizon-NJ repeatedly admitted that it "has not conducted any analysis of the costs to implement the Ratepayer Advocate's plan." RPA Exh. 57, VNJ-RPA 396; *see* T.1777:17-22 (8/31/01). Such unsubstantiated allegations should be given no credence by the Board.

Moreover, Verizon-NJ undermines this assertion by claiming that optional calling plans are sufficient for those consumers that desire, and are willing to pay a fee for, larger local calling areas. Verizon-NJ Initial Brief at 44. Fully **[BEGIN VERIZON-NJ PROPRIETARY]**

[END VERIZON-NJ PROPRIETARY] of New Jersey subscribers utilize optional calling plans. Verizon-NJ Initial Brief at 44; West-Taylor Rebuttal at 49. Since the majority of Verizon-NJ's

local residential customers already use optional calling plans, then (1) most of the supposed one-time network costs to expand local calling areas must already have been incurred by Verizon-NJ, and (2) there is acknowledgment of a strong, existing demand by New Jersey consumers for larger local calling areas.

Consequently, with the existence of $148 million in merger savings and excess earnings and with this clear demand for larger local calling areas, the logical step for the Board to take would be to adopt the Ratepayer Advocate's local calling area expansion / rate center consolidation plan.

E. The Board Should Reject Verizon-NJ's And AT&T's Attacks On The Ratepayer Advocate's Proposal To Establish A State Universal Service Fund And To Maximize The Assistance Available From, And Ease To Enroll In, The Lifeline Program

1. Verizon-NJ's Critique of the Ratepayer Advocate's Affordability Analysis is Flawed and Should Be Rejected by the Board

Verizon-NJ's affordability analysis and its critique of the Ratepayer Advocate's showing that telephone service has become less affordable for the poorest New Jersey residents, Verizon-NJ Initial Brief at 16-17, ignore the record and are instead based on improper analysis. RPA Initial Brief at 73-75; AT&T Initial Brief at 7, 52. Accordingly, Verizon-NJ's plan contravenes the1992 Act and the 1996 Act by failing to ensure the affordability of service. 48 N.J.S.A. § 48:2-21.18(a)(1); 47 U.S.C. § 254(b)(1); *see* RPA Initial Brief at 73; AT&T Initial Brief at 7, 52. Thus, the Board should reject Verizon-NJ's plan and should adopt the Ratepayer Advocate's analysis to create a state universal service fund ("USF") and improve the Lifeline program to remedy the declining affordability of services. *Infra* Section II.E.2, -3.

Verizon-NJ's remarkable claim that "[i]t is beyond dispute that these [residential basic exchange services] rates are 'affordable' under the New Jersey Act, and have become considerably

more so since 1985," Verizon-NJ Initial Brief at 16, ignores the record. Verizon-NJ's affordability analysis rests solely on its incomplete claim that rates have not increased while per capita incomes doubled and are among the highest in the country. Verizon Initial Brief at 16. This conclusion ignores the evidence presented by the Ratepayer Advocate that, while average per capita income increased, per capita income for the poorest New Jersey residents actually decreased by 7.1%. Colton Direct at 7; *see* RPA Initial Brief at 74-75. Moreover, Verizon-NJ ignores the FCC's conclusion that an affordability analysis has both a comparative (*i.e.* relative) and an absolute aspect. *Federal-State Joint Board on Universal Service*, 12 FCC Rcd 8776, CC Docket No. 96-45, FCC 97-157 ¶¶ 110-126 (1997) (internal citations omitted) ("FCC Universal Service Order"); Colton Direct at 4. Instead, Verizon-NJ only looked at changes in absolute per capita incomes, and utterly failed to perform a relative affordability analysis that specifically examined the poorest New Jersey ratepayers.

To address this failure, Verizon-NJ alleges that "[t]he RPA is simply wrong" in stating that Verizon-NJ failed to perform a relative affordability analysis because (1) Verizon-NJ proposed making minimal improvements to the Lifeline program, and (2) the Ratepayer Advocate purportedly "has offered no data that protected services are not affordable." Verizon-NJ Initial Brief at 16. Both of these assertions are false. Regarding the Lifeline program, as shown by the Ratepayer Advocate in its Initial Brief (RPA Initial Brief at 85-92) and in this Reply Brief (*infra*, Section II.E.3), Verizon-NJ's proposals are inadequate. Moreover, the Lifeline program, (*infra*, Section II.E.3) as well as a state USF (*infra*, Section II.E.2), are solutions to the problem of a lack of affordable telecommunications services to low-income residents. The existence of these programs is not evidence of the relative affordability of services. Thus, Verizon-NJ proposes a solution (albeit an

inadequate one) – minimal improvements to the Lifeline program – without admitting that there is a problem – lack of affordable services for low-income residents.

Verizon-NJ's allegation that the Ratepayer Advocate presented "no data" is simply wrong. Verizon-NJ Initial Brief at 16. The Ratepayer Advocate analyzed actual income data, including a LIHEAP report to Congress and U.S. Census data. Colton Direct at 6-7, Exhs. RDC-7, RDC-8. Rather, it was Verizon-NJ that failed to introduce any data on the relative affordability of service; yet, the burden to submit such data and analysis resides with Verizon-NJ, the petitioning party. 48 N.J.S.A. § 48:2:21-18(a). Since the Ratepayer Advocate, rather than Verizon-NJ, presented an affordability analysis based on actual data that complies with the FCC's evaluation criteria, the Board should adopt the Ratepayer Advocate's conclusions and order the creation of a state USF and a significant expansion of the Lifeline program. *See infra*, Sections II.E.2, -3.

2. The Board Should Reject the Critiques of Verizon-NJ and AT&T and Instead Order the Creation of a State USF to Aid Low-Income Ratepayers, Schools and Libraries, and Ratepayers Living in High Cost Areas

The state USF should contain a low-income component, a schools and libraries component and also a high cost area component. The Ratepayer Advocate has explained in detail the reasons necessitating the creation of a state USF. RPA Initial Brief at 75-84. Verizon-NJ's opposition to the creation of a state USF is contained entirely in a single footnote in its initial brief. Verizon-NJ Initial Brief at 32-33 n. 95. Verizon-NJ's inability or unwillingness to provide the Board with any detailed reasons for its position, particularly when combined with Verizon-NJ's flawed affordability analysis, simply fails to provide the Board with any legitimate alternative to establishing a state USF.

AT&T's criticisms of the high cost component of the Ratepayer Advocate's proposal are similarly without merit and should be rejected. AT&T Initial Brief at 82-83. First, AT&T's claim that state universal service issues do not belong in this proceeding, but rather in Docket No. TX95120631, ignores the Board's December 22, 2000 procedural order in this case, which specifically included universal service issues in this proceeding. December 22 Order at 4-5. Nevertheless, if the Board were to give AT&T's argument any credence, the Ratepayer Advocate would support the creation of a state USF in Docket No. TX95120631 rather than in this docket, but only if the Board were to issue an order creating a state USF in that proceeding contemporaneously to its issuing an order in the instant case. The Board has yet to issue a decision and order in that proceeding. Second, none of the alleged flaws that AT&T identifies with the high cost aspect of the Ratepayer Advocate's proposal, AT&T Initial Brief at 82-83, provides any rational for not creating a high cost fund. For example, AT&T's criticism that the Ratepayer Advocate based its residential service cost on overstated information provided by Verizon-NJ, AT&T Initial Brief at 83, does not undermine the basic need for high cost support. Rather, even if AT&T is correct, at most it shows that the Ratepayer Advocate's high cost fund calculations would need to be adjusted. Thus, AT&T's criticisms at most warrant adjustments to, not the elimination of, the Ratepayer Advocate's high cost proposal.

Finally, with regard to the Ratepayer Advocate's proposals to create a state USF that includes a schools and libraries component and to continue to fully fund the Access New Jersey ("ANJ") program, except for Verizon-NJ's lone footnote (see above) no party opposed these proposals, and

XO New Jersey Inc. supports them. XO Initial Brief at 2, 7-8.[1] Thus, there is no basis in the initial briefs of any party for any action by the Board other than for it to adopt the Ratepayer Advocate's proposals regarding schools and libraries.

3. The Board Should Reject Verizon-NJ's Attempts to Minimize the Effectiveness of the Lifeline Program to Aid Low-Income New Jersey Residents

As is so often the case, Verizon-NJ's criticisms of the Ratepayer Advocate's Lifeline proposals are based on unsupported hyperbole and misapplication of the law. First, contrary to Verizon-NJ's assertion that the Ratepayer Advocate's Lifeline proposals are "unsupported," Verizon-NJ Initial Brief at 18, the Ratepayer Advocate submitted detailed testimony grounded in FCC and other state commission (including New York and Ohio) precedent. Colton Direct at 9-23.

Second, Verizon-NJ's criticisms of the Ratepayer Advocate's automatic Lifeline enrollment proposal are disingenuous. Verizon-NJ makes no mention in its Initial Brief of the woefully small number of eligible New Jersey residents who are actually enrolled in Lifeline. *See* RPA Initial Brief at 86-89. Instead, Verizon-NJ distorts the Ratepayer Advocate's proposal to increase enrollment by establishing an automatic enrollment process for those eligible due to their participation in certain public assistance programs. Verizon-NJ claims that an automatic enrollment program would force low-income residents to limit the vertical features they may obtain even if they were willing to pay for them without a discount. Verizon-NJ Initial Brief at 19. In essence, Verizon-NJ expects the Board to reject entirely an automatic enrollment process because New Jersey ratepayers with incomes

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[1] While XO opposes the ANJ program because Verizon-NJ is the only carrier that can participate in it, the Ratepayer Advocate believes that XO would not oppose ANJ if a fully equivalent program was available under which XO could offer comparable services at comparable rates to schools and libraries as Verizon-NJ can under ANJ. *See* XO Initial Comments at 1-7. The Ratepayer Advocate believes that this position is consistent with XO's support of the Ratepayer Advocate's state USF. *Id.* at 2, 7-8.

below the poverty line may want features such as call forwarding or return call. Verizon-NJ fails to mention, however, a much simpler solution to the alleged demand by low-income residents for vertical features, and one that does not conflict with automatic enrollment. Low-income residents could choose to opt out of the Lifeline program if they want vertical features that are not available through the Lifeline program. The Ratepayer Advocate does not object such an opt-out feature. Moreover, the Board statements on automatic enrollment on which Verizon-NJ relies, Verizon-NJ Initial Brief at 18-19, were based on Board action from 1999 that predates the agreement by Verizon, and requirement by the FCC, to implement automatic enrollment throughout its service territories.

In addition, Verizon-NJ errs when it claims that "[t]he RPA also ignores fundamental privacy concerns" implicated by an automatic enrollment process. Verizon-NJ Initial Brief at 19. Verizon-NJ never presented a valid privacy concern. Rather, in response to numerous requests, Verizon-NJ failed to produce a single piece of written documentation to substantiate its assertion. T.911:18-912:12 (08/30/01); T.51:3-22 (10/01/01) (statement of Mr. James Dieterle, State Director, AARP New Jersey); *see* RPA Initial Brief at 90-92. In fact, privacy concerns have not prevented automatic enrollment from being implemented in New York and Ohio. *Id.* at 90.

Further, Verizon-NJ's unsupported statements that its Lifeline proposal is better than the Ohio Plan and that therefore it should not be held to the automatic enrollment aspect of the Ohio Plan ignore FCC requirements that were voluntarily agreed to by Verizon. Specifically, one of the conditions imposed by the FCC, and accepted by Verizon, during the evaluation of the merger between Bell Atlantic and GTE required that all Verizon state affiliates, including Verizon-NJ, offer a Lifeline plan consistent with the Ohio Plan. *Application of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee for Consent to Transfer Control of Domestic and International*

Sections 214 and 310 Authorization and Application to Transfer Control of a Submarine Cable Landing License, 15 FCC Rcd 14032, CC Docket No. 98-184, FCC 00-221, Memorandum Opinion and Order ¶¶ 325-326, Conditions for Bell Atlantic/GTE Merger ¶ 50 (2000). The Ohio Plan contains an automatic enrollment feature. Colton Direct at 10-12, 16-17; *Application of Ameritech Ohio (Formerly Known as the Ohio Bell Telephone Company) for Approval of an Alternative Form of Regulation*, Ohio PUC Case No. 93-487-TP-ALT, Opinion and Order (2000) at 7-8. Consequently, Verizon-NJ is *required* to offer an automatic enrollment Lifeline feature in New Jersey, and one should be ordered by the Board.

Consistent with an appropriate affordability analysis that shows that telephone service has actually become more expensive for the poor, *supra* Section II.E.1, Verizon-NJ's attempt to limit the amount of Lifeline assistance available to low-income residents should be rejected. Verizon-NJ Initial Brief at 18-19. Instead, for reasons expounded in the Ratepayer Advocate's initial brief, a state component should be added to the Lifeline program, thereby increasing the amount of available assistance to $10.50 per month for low-income residents. RPA Initial Brief at 86.

The Consumer Energy Council of America in its March 2001 report to policy-makers, stated its belief that

> ...automatic enrollment is the best tool for states to use for enrolling eligible low-income consumers...While automatic enrollment is an excellent policy option for assisting eligible consumers, it must be complemented with outreach and consumer education programs that explain the benefits of the Low-Income program for those without service.

Consumer Energy Council of America Report, *Universal Service Policy Issues for the 21st Century* at 35. Outreach efforts can undertaken through

* Bill stuffers from carriers;
* Television, radio, and print commercials;
* Information detailed on tax returns;
* Door to door, literally extending the message by word of mouth;
* Through web pages, such as the Coalition for Affordable Local and Long Distance Service (CALLS) website;
* Information distributed through educational and social service agencies; and
* Direct mailing to qualified customers.

Id. at 53. Consumer outreach is vital to a successful Lifeline program.

F. The Board Should Tightly Monitor Verizon-NJ's Provision Of Services During The Critical Transition From Monopoly To Competition, Including Establishing Monetary Incentives To Ensure That High Quality Service Is Provided To New Jersey Ratepayers

The Board should not give credence to Verizon-NJ's flawed critique of the Ratepayer Advocate's service quality proposal. Verizon-NJ Initial Brief at 51-71. Throughout this proceeding, Verizon-NJ has adamantly opposed any comprehensive review of the 1987 performance metrics, including the methods used by the Board to track and respond to Verizon-NJ's actual service quality performance. *See* Verizon-NJ Initial Brief at 51-56. This opposition serves no legitimate purpose. Rather, it is an attempt by Verizon-NJ to prevent any changes that might result in more vigorous monitoring of Verizon-NJ's performance, improvements to the definitions of the key performance areas, and the improved performance that should result from higher performance standards. *See* Phillips Rebuttal at 6, 9, 12, 15-17; Verizon-NJ Initial Brief at 98-99; Alexander Direct at 7-10, 24-25; RPA Initial Brief at 98-99. In other words, Verizon-NJ's approach to service quality issues in this proceeding is to urge the Board to allow Verizon-NJ to remain in control of its service quality destiny for the vast majority of its customers.

Verizon-NJ's claim that there is no need for more stringent standards because it has largely met the service quality measurements that the Board established in 1987, Verizon-NJ Initial Brief at

52-54, misses the point. The Board required that the new plan of alternative regulation contain a *new*, *comprehensive* service quality plan. December 22 Order at 5; *see* N.J.S.A. § 48:2-21.18(a)(7).

In evaluating any such plan, it is crucial that the Board focus on the following key underlying issues:

1. Does the 1987 retail service quality metrics address all the necessary performance areas of importance to residential and small business customers today?

2. Should the 1987 retail service quality standards be revised to reflect actual performance by Verizon in New Jersey and in other "sister" states?

3. Once the necessary changes are made with respect to the metrics and the performance standards, how should the Board monitor and enforce compliance with the service quality standards?

See Alexander Direct at 3-4, 6-31. By focusing on these issues, the Board should recognize, as AT&T did (AT&T Initial Brief at 75), that the Ratepayer Advocate's plan directly responds to these concerns by proposing (1) metrics and standards designed to ensure that New Jersey ratepayers receive a high level of service quality based on today's communications environment, and (2) economic incentives for Verizon-NJ to provide this level of service. Alexander Direct at 3-4, 13-34, Exh. BA-2, BA-3; Alexander Supplemental at 1-2; RPA Initial Brief at 92, 96-100.

1. Verizon-NJ Failed to Propose a New, Comprehensive Service Quality Plan

Verizon-NJ's claim that it "proposed a new comprehensive set of retail service quality metrics and standards equivalent to the standards set forth in all applicable Carrier-to-Carrier metrics," Verizon-NJ Initial Brief at 51, is disingenuous. Most of the Carrier-to-Carrier wholesale performance standards require Verizon-NJ's wholesale performance to be at "parity" with the performance actually delivered to retail customers. *I/M/O the Board's Investigation Regarding the Status of Local*

Competition in New Jersey, New Jersey Board of Public Utilities, Docket No. TX98010010, Order (July 13, 2000) at 2, 6. It is at best circular for Verizon-NJ to claim that the retail performance standards reflect stringent wholesale standards when there are no *independent* wholesale standards. It therefore follows that more stringent retail standards will benefit both retail and wholesale customers.

Verizon-NJ's service quality proposal is nothing more than the existing 1987 service quality plan with some minor changes. Verizon-NJ Initial Brief at 54-56; Alexander Direct at 13-14. In sum, these minor changes are: the change in the definition for one metric (measuring Out of Service reports based on 24 hours rather than 48 hours), adding two metrics (Percent Subsequent Trouble Reports and Mean Time to Repair), and proposing monthly rather than quarterly reporting to the Board. Verizon-NJ Initial Brief at 54-56; Alexander Direct at 13-15. With respect to enforcement, Verizon-NJ does not recommend any automatic or self-effectuating penalties, Verizon-NJ Initial Brief at 54, 69-71, even though this approach is the hallmark of the Performance Assurance Plan for wholesale standards recently adopted by the Board. *I/M/O the Investigation Regarding Local Exchange Competition for Telecommunications Services*, New Jersey Board of Public Utilities, Docket Nos. TX95120631, TX98010010, Order Approving Incentive Plan (January 10, 2002).

2. The Attacks on the Ratepayer Advocate's Criticisms of Verizon-NJ's Service Quality Proposal Are Without Merit

Verizon-NJ fundamentally fails to understand the Ratepayer Advocate's criticisms of Verizon-NJ's service quality proposal. This lack of comprehension led Verizon-NJ to claim incorrectly that "[t]he RPA has offered no evidence" against Verizon-NJ's plan. Verizon-NJ Initial Brief at 56. Rather, the Ratepayer Advocate submitted detailed testimony showing the flaws in Verizon-NJ's

proposal. Alexander Direct at 15-23; RPA Initial Brief at 93-95. For example, the current 1987 service quality plan does not include certain key service and reliability criteria. Alexander Direct at 14. Such shortcomings of the 1987 plan include its failure to track customer outages, actual call center performance, and Verizon-NJ's handling of customer complaints. Alexander Direct at 19-21. Furthermore, Verizon-NJ internally captures important service quality performance data that is not currently tracked or measured by the Board. Alexander Direct at 15. For example, at hearings in this case, the Ratepayer Advocate discovered that Verizon-NJ internally tracks customer complaints that it does not report to the Board. T.1409:17-23 (9/7/01). The current plan's failure to measure and track these critical aspects of Verizon-NJ's provision of telecommunications services today, when coupled with Verizon-NJ's general ability to meet the 1987 metrics levels, demonstrates that the current plan masks Verizon-NJ's true performance. Only when Verizon-NJ's performance is measured against an updated plan, such as the Ratepayer Advocate's, that tracks all critical areas of performance, can the Board determine whether New Jersey consumers are receiving high quality service.

Verizon-NJ's casual dismissal of the Ratepayer Advocate's reliance on the activities of other state commissions is similarly misplaced. Verizon-NJ Initial Brief at 57. Other state commissions have analyzed service quality proposals for Verizon-NJ sister companies' plans of alternative regulations. *See* Alexander Direct at 6, 12-13. The analyses performed by these commissions are available to the Board, and should be used by the Board to supplement its own expertise. Verizon-NJ has offered no compelling reason to ignore the work performed by other commissions. Rather, Verizon-NJ simply disagrees with the outcomes in many of these states. For example, in alternative regulation proceedings, the New York, Massachusetts, Rhode Island, Vermont, and Maine

commissions adopted specific service quality performance plans that contain service quality standards and enforcement tools similar to those recommended by the Ratepayer Advocate in this proceeding. *Investigation into an Alternative Regulation Plan for New England Telephone and Telegraph Company a/b/a Bell Atlantic-Vermont*, Vermont Public Service Board, Docket No. 6167, Order Attachment A (2000); *In Re: NYNEX Form of Regulation; Service Quality Docket*, Rhode Island Public Utilities Commission, Docket No. 2370, Order Appendix B (1996); *Investigation by the Department of Telecommunications and Energy of Verizon New England, Inc's Fifth Annual Price Cap Compliance Filing*, Massachusetts Department of Telecommunications and Energy, Docket No. 99-102, Order (2000); *Proceeding on Motion of the Commission to Investigate Performance-Based Incentive Regulatory Plans for New York Telephone Company*, New York Department of Public Service, Case No. 92-C-0665, 01-C-0491, Third Quarter 2001 Service Quality Report (2001); Maine Alt. Reg. Order; Alexander Direct at 12-13.

3. The Criticisms of the Ratepayer Advocate's Service Quality Plan Are Unfounded

Verizon-NJ's criticisms notwithstanding, the Ratepayer Advocate's service quality proposal would ensure that Verizon-NJ provides New Jersey ratepayers with high quality services or, if Verizon-NJ fails to do so, subject Verizon-NJ to stiff penalties for any performance failures. Alexander Direct at 3-4, 13-34, Exhs. BA-2, BA-3; Alexander Supplemental at 1-2; RPA Initial Brief at 92, 96-100. As expressed in the Ratepayer Advocate's Initial Brief (at 93-95) and in the testimony of Ms. Barbara Alexander (Direct at 14-31, Supplemental at 1-2), Verizon-NJ's proposal fails to achieve either of these goals. Verizon-NJ's criticisms of the Ratepayer Advocate's plan fails to rehabilitate its plan or to undermine the Ratepayer Advocate's proposal.

First, Verizon-NJ's allegation that the Ratepayer Advocate seeks to undermine the Board's goal of preventing service quality failures, Verizon-NJ Initial Brief at 58, could not be farther from the truth. Verizon-NJ's claim has no basis in the record; nor is it a reasonable interpretation of the Ratepayer Advocate's position. Rather, the Ratepayer Advocate's recommendations are expressly designed to improve the Board's ability to maintain high service quality and to prevent service deteriorations. *See* Alexander Direct at 21, Exh. BA-3.

Second, contrary to Verizon-NJ's criticisms that the individual measurements and standards proposed by the Ratepayer Advocate are unsupported or otherwise flawed, Verizon-NJ Initial Brief at 58-68, the Ratepayer Advocate's proposals are fully supported by the testimony of its expert, Barbara Alexander, and are superior to the approach proposed by Verizon-NJ. Alexander Direct at 21-25, Exh. BA-2; Alexander Supplemental at 1-2. For example, with respect to the recommended change in the baseline standard for the Percent Service Order Processing Completed within 5 Working Days, the Ratepayer Advocate's recommendation of a 94% baseline is premised on record evidence showing that Verizon NJ's performance routinely exceeds the current 88% surveillance and 90% exception levels in the current plan. Alexander Direct at 16-17; Alexander Supplemental at 2. In fact, Verizon-NJ's own reports to the Board demonstrate that the 1994-2000 average annual performance is 94%. Alexander Direct at 16-17; Alexander Supplemental at 2. Verizon-NJ failed to meet this standard only once in 2000, and that was caused by an event that normally excludes data consideration in a service quality plan, the strike and its lingering impact on service quality beyond the August 2000 event. *See* Alexander Supplemental at 2. Thus, a 94% Percent Service Order Processing Completed within 5 Working Days standard is reasonable and reflective of Verizon-NJ's recent historical performance.

Similarly, the Ratepayer Advocate's proposed changes to the maintenance of service metrics and standards are supported by the record and are superior to Verizon-NJ's proposals. The differences between Verizon NJ's proposals and those of the Ratepayer Advocate are primarily related to the proper baseline performance standard. Verizon-NJ seeks to retain the two-tiered 1987 performance standards, and generally rejects any effort to establish forward looking baseline standards that reflect its actual performance in the last 5-6 years. *See* Verizon-NJ Initial Brief at 54-56, 61. Under this approach, Verizon-NJ would retain baseline performance standards that were established prior to technological improvements in Verizon-NJ's network, prior to the investment program to improve and maintain service quality (the existence of which Verizon-NJ repeatedly reminds the Board), and prior to any analysis of performance standards in effect elsewhere. *See* Verizon-NJ Initial Brief at 61; *see* Alexander Direct at 17-18. Under the Ratepayer Advocate's approach, baseline performance standards should be reviewed during the establishment of the new PAR. This is the approach taken by the Maine Commission in its recent revision of Verizon-ME's plan of alternative regulation. Maine Alt. Reg. Order § E. Thus, the Board's review should reflect a careful analysis of Verizon-NJ's actual performance, the effect of recent technological changes and investments in the network, and performance standards to which Verizon is being held accountable in other states.

Further, for the maintenance metrics and standards, each of the Ratepayer Advocate's proposed revised standards took these criteria into account. *See* Alexander Direct At 21-23, Exh. BA-3. For example, with regard to clearing Out of Service Trouble Reports within 24 hours, the current Verizon NJ performance is not reasonable. Alexander Direct at 21-23, Exh. BA-3. According to FCC ARMIS data, Verizon-NJ's performance has gradually declined over the past

several years to the point that, over the last 5-6 years, Verizon-NJ has cleared only 73.8% of these reports within 24 hours. Alexander Direct at 17. Other states require considerably higher levels of performance. Alexander Direct at 17-18. Verizon-NJ has offered no reason why New Jersey consumers should not receive the same level of performance that consumers receive in other jurisdictions.

Some of the standards proposed by the Ratepayer Advocate seek to prevent Verizon-NJ from altering its performance for certain standards. For example, the Ratepayer Advocate's proposed "busy signal" metric will measure the percentage of busy signals received by callers trying to reach Verizon-NJ's customer service. This metric will reveal whether Verizon-NJ is increasing the percentage of calls answered by its customer service representatives by blocking incoming calls that enter the queue. Alexander Direct at 20. This is yet another attempt by the Ratepayer Advocate to recommend specific metrics and standards which will provide the highest level of service quality to New Jersey customers.

4. The Opposition to Self-Effectuating Enforcement Mechanisms Lacks Merit

The imposition of self-effectuating enforcement mechanisms for performance failures is not an attempt, as Verizon-NJ claims (Verizon-NJ Initial Brief at 68-71), to abandon the preventative service failure aspects of a service quality plan. Rather, the Ratepayer Advocate seeks to supplement the preventative aspects by creating significant economic incentives for Verizon-NJ to maintain a high level of service quality. Alexander Direct at 7-10, 25-31; RPA Initial Brief at 92, 97-99. The economic incentive plan proposed by the Ratepayer Advocate is no less different than plans already in place in other states in Verizon's footprint which respond to deficiencies in service quality

performance measures. VNJ-RPA 499. Verizon-NJ's proposal would only have it initially report failures to the Board. Verizon-NJ Initial Brief at 34, 54, 69. This approach, when combined with the lax 1987 performance standards endorsed by Verizon-NJ, does not reflect the risks associated with service quality deterioration with the onset of a new multi-year PAR. The Ratepayer Advocate, rather than seeking to "abandon" prevention, seeks to establish meaningful performance standards that are accompanied by pre-established penalties so that Verizon-NJ has the proper incentive to achieve the performance standards. Alexander Direct at 7-10, 25-31; RPA Initial Brief at 92, 97-99.

If, as Verizon-NJ states, its service quality performance has been generally "good", the imposition of pre-established penalties should not pose any threat. *See* Phillips Rebuttal at 6, 9, 19; RPA Exh. 46, VNJ-RPA 492; RPA Initial Brief at 98-99. If, however, the Company is refusing to perform in the future according to its clearly demonstrated ability to perform at the recommended baseline performance standards recommended by the Ratepayer Advocate, Verizon-NJ "doth protest too much." *See* Phillips Rebuttal at 6, 9, 19; RPA Exh. 46, VNJ-RPA 492; RPA Initial Brief at 98-99. Either the Company can perform and is willing to risk shareholder funds to assure future performance, or it is not willing to report meaningful data and risk meaningful penalties to assure its promises to New Jersey customers. *See* Phillips Rebuttal at 6, 9, 19; RPA Exh. 46, VNJ-RPA 492; RPA Initial Brief at 98-99.

Finally, Verizon-NJ's claim that the Ratepayer Advocate's recommended customer rebate proposal is "wholly impractical," Verizon-NJ Initial Brief at 71, is belied by the facts. Customer rebates are presently in place in other states, such as Ohio. Alexander Direct at 31. There, Ohio's Minimum Telephone Service Standards require all local exchange carriers to respond to individual customer service quality failures with rebates or bill credits in the event of a failure to keep an

appointment, to repair service within a service time period, or to install service on time. Alexander Direct at 31. Verizon-NJ offers no reason why incumbent carriers can comply with a rebate plan in Ohio, but Verizon-NJ cannot.

III. THE BOARD SHOULD FIND THAT VERIZON-NJ HAS FAILED TO SATISFY THE EXISTING STATUTORY CRITERIA FOR RECLASSIFICATION AND SHOULD INITIATE A PROCEEDING TO IMPLEMENT ADDITIONAL CRITERIA AS REQUIRED BY THE STATUTE

A. Verizon-NJ Fails To Meet The Statutory Criteria For Reclassification

The requirements of N.J.S.A. 48:2-21.19 are clear. In order to reclassify rate regulated services as competitive, Verizon-NJ must establish, at a minimum, the presence of other competitors, ease of market entry, and the availability of like or substitute services. N.J.S.A. 48:2-21.19(b). Just as clear is the fact that Verizon-NJ has failed to carry its burden in this proceeding on each of the three minimum criteria.

Throughout its initial brief, Verizon-NJ repeatedly attempts to meet its burden on the presence of competitors by resorting to speculation on potential entry by carriers both within and without the state. Verizon-NJ Initial Brief at 83-84. Further, Verizon-NJ does not, and indeed it can not, provide evidence of ease of entry in the New Jersey market for multi-line business services because entry barriers remain high. Verizon-NJ Initial Brief at 84-87; RPA Initial Brief at 122-123. Finally, Verizon-NJ fails to make the required separate showing of the availability of like or substitute services. Verizon-NJ Initial Brief at 87-89; RPA Initial Brief at 121-122. For these reasons, more specifically described below, the Board should deny Verizon-NJ's Petition for Reclassification. *I/M/O Application of Verizon New Jersey, Inc. for Approval (i) of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-line Rate Regulated Business Services as*

Competitive Services, and Compliance Filing, Petition and Compliance Filing of Verizon New Jersey, Inc., Docket No. TO01020095 at 4-6 (February 15, 2001) ("Petition for Reclassification").

1. Verizon-NJ Improperly Attempts to Demonstrate the Presence of Competitors Through the Potential for Market Entry

The very language of N.J.S.A. 48:2-21.19 establishes that potential market entrants are not to be considered in establishing the "*presence* of other competitors" within the markets for which reclassification is sought. N.J.S.A. 48:2-21.19(b). Nevertheless, because it cannot establish any appreciable number of competitors actually serving the market,[2] Verizon-NJ repeatedly resorts to "evidence" of the potential entry of hypothetical competitors. *See, e.g.,* Verizon-NJ Initial Brief at 83. In so doing, Verizon-NJ creates an untenably broad criterion that is in perfect opposition to the statute. Moreover, in supporting its specious argument, Verizon-NJ misinterprets the Department of Justice Merger Guidelines to its advantage.

For example, Verizon-NJ states, without any basis in law or fact, that "[c]ompetitors are also present in a market if they have existing customer relationships that permit them to diversify from a related product or adjacent geographic market into the market in question." Verizon-NJ Initial Brief at 83. Under this rationale, Verizon-NJ hopes to include both carriers that are present in New Jersey but who do not currently provide the services proposed for reclassification, and carriers that are not present in New Jersey, but who are present in adjacent geographic markets. *See* Verizon-NJ Initial Brief at 83. However, Verizon-NJ neither demonstrates that such entrance would occur within a

[2] The Ratepayer Advocate noted a number of problems with Verizon-NJ's data on actual competition in its Initial Brief. Among others, (1) Verizon-NJ relies upon line loss rather than customer loss in its Petition, RPA Initial Brief at 110-112; (2) Verizon-NJ improperly relies upon collocation as a method by which to establish competition, RPA Initial Brief at 112-113; (3) Verizon-NJ presents inflated E911 data for its competitors, RPA Initial Brief at 113-114; and (4) Verizon-NJ's survey failed to ask relevant questions about the actual state of competition. RPA Initial Brief at 114-115. None of these concerns have been allayed by Verizon-NJ's Brief.

reasonable time frame nor proves that it is economically feasible for carriers to enter product markets in which Verizon-NJ retains monopoly control of the essential facilities. Thus, its statements are no more than speculation. More importantly, Verizon-NJ's professed "competitors" are in no sense "present" in the relevant market as required by the statute. *See* Selwyn Direct at 101.

Moreover, Verizon-NJ improperly attempts to use the U.S. Department of Justice Merger Guidelines to buttress its argument. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines, 1992 FTC Lexis 176 (April 2, 1992). However, even a cursory examination of the Merger Guidelines reveals that Verizon-NJ is misleading the Board by representing that the Department of Justice considers potential entrants to be actual competitors. *See, e.g.,* Verizon-NJ Initial Brief at 84. In fact, the Merger Guidelines clearly state that "[i]f a firm has the technological capability to achieve … [a] supply response, but likely would not (*e.g.*, because difficulties in achieving product acceptance, distribution, or production would render such a response unprofitable), *that firm will not be considered to be a market participant*." Merger Guidelines at 27 (emphasis added). The well-documented difficulties that competitors face in "production" of services as a result of incumbent control of essential facilities are exactly the type of issues to mitigate supply response contemplated by the Merger Guidelines.

In addition, the Merger Guidelines explicitly disallow consideration of potential entrants where entry requires a significant sunk investment. Merger Guidelines at 27. Verizon-NJ itself quotes the FCC as stating that local competition, as demonstrated by collocation, requires "a substantial sunk investment." Verizon-NJ Initial Brief at 82 (quoting *I/M/O Access Charge Reform*, 14 F.C.C.R. 14221, 1999 WL 669188, Fifth Report and Order and Further Notice of Proposed Rulemaking, ¶80 (1999)). Given the current economic and investment climate in telecommunications,

an inference that carriers would not expand into adjacent product and geographic markets is appropriate. Moreover, Verizon-NJ presented absolutely no evidence on the prospective supply response of potential competitors.[3]

In sum, Verizon-NJ cannot meet its statutory burden to demonstrate the presence of competitors without the improper inclusion of potential entrants from adjacent product and geographic markets. However, both the language of the statute and the Merger Guidelines require that potential competitors be excluded from the Board's consideration. As such, Verizon-NJ cannot meet its burden under N.J.S.A. 48:2-21.19(b), and its Petition for Reclassification should be denied.

2. Contrary to Verizon-NJ's Assertions, Entry Barriers for Competitors in New Jersey Remain High

a. Verizon-NJ Recognizes that Resale and UNE-P Do Not Provide "Real" Competition

While Verizon-NJ repeatedly alleges in its Brief that the availability of UNE-P and resale results in a perfectly competitive environment, inconsistent statements in its Brief, as well as prior statements by its CEO, Ivan Seidenberg, demonstrate that such is not the case. In fact, Verizon-NJ does not consider resellers to be true competitors, and both resale and UNE-P serve no more than a transitional role in permitting carriers to acquire customers while building out their own facilities. As such, they should be considered less significant than facilities-based competitors in this proceeding.

While UNE-P and resale are repeatedly cited by Verizon-NJ as sources of competition, *see, e.g.*, Verizon-NJ Initial Brief at 87, its parent corporation considers them not to be a threat to

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[3] Verizon-NJ's failure to conduct studies of demand and supply elasticities for the relevant markets is discussed further in Section III.A.2.c, *infra.*

Verizon-NJ's ongoing monopoly in local exchange. Recently, Verizon CEO Ivan Seidenberg was widely reported as publicly denigrating UNE-P and resale competitors, and calling "this whole scheme of CLEC interconnection a joke." *See* James K. Glassman, Op-Ed, "Verizon Exploited a National Tragedy," THE WASHINGTON TIMES, Oct. 23, 2001 at A19. These statements should be viewed as an institutional attitude toward the efforts of the FCC and this Board to encourage competition through resale.

More to the point, Verizon-NJ should not be able to utilize as support for its Petition for Reclassification that same competition that it considers to be "a joke." In fact, given the low margins that are available, competitors cannot generally survive as pure resellers or UNE-P providers; rather, as Verizon-NJ states in its Brief, "UNE-P or resale can provide a bridge to serve customers during the construction of a CLEC's own facilities." Verizon-NJ Initial Brief at 126. For that very reason, resale is not included in the examination of competition required by section 271. 47 U.S.C. § 271; *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, 12 FCC Rcd 20543, CC Docket No. 97-137, FCC 97-298, Memorandum Opinion and Order ¶¶ 92-103 (1997).

Thus, even Verizon-NJ recognizes that resale and UNE-P do not provide viable alternatives to facilities-based competition. As such, the Board should focus its analysis upon facilities-based providers, and the substantial barriers to entry that they face, in its consideration of Verizon-NJ's Petition for Reclassification.

b. Verizon-NJ's Assertions to the Contrary, Failure of Competitors Does Not Indicate Market Entry and Industry Consolidation Does Not Signal Increased Competition

The high entry barriers facing facilities-based entrants into New Jersey are demonstrated by the current high rate of CLEC failure. The financial strain of struggling against Verizon-NJ simply depletes new carriers before they are able to obtain a critical mass of customers. As the Ratepayer Advocate noted in its Initial Brief, since the initiation of this proceeding, fully five of the competitors alleged by Verizon-NJ have gone bankrupt. RPA Initial Brief at 16. And a number of competing services have been discontinued. *Id.* It is therefore surprising, to say the least, that Verizon-NJ claims that such failures indicate market entry and support its claims for reclassification.

Specifically, Verizon-NJ claims that "financial difficulties simply do not contradict the fact that facilities construction … demonstrates market entry. Indeed, even if a facilities-based carrier is bought by another carrier, its facilities remain in place to be used in competition with Verizon-NJ's facilities." Verizon-NJ Initial Brief at 124-125. Thus, Verizon-NJ apparently believes that corporate failure is a demonstration of profit potential and industry consolidation is a sign of healthy competition. The Ratepayer Advocate is confident that the Board will not be influenced by this erroneous position. Indeed, such embellishment of the actual situation faced by carriers in New Jersey should cause the Board to question the reliability of other evidence provided by Verizon-NJ in this proceeding.

Verizon-NJ well knows that competition has never developed in New Jersey. RPA Initial Brief at 14-18. And, despite its disclaimers, Verizon-NJ also knows that its bottleneck control of essential facilities is a direct cause of the failure of competitors, in spite of the market opening measures adopted by the FCC and this Board. As stated by Dr. Selwyn, the costs of dealing with

Verizon-NJ create“low profit margins [which] work to create the condition where there is little opportunity for effective, price-constraining competition to occur[.]” Selwyn Direct at 94. Moreover, competitors have not yet been granted access to essential systems, such as “VNJ’s OSS at a level that is in all material respects equivalent to that which is available to VNJ’s own customer service representatives, back office, and network provisioning personnel.” Selwyn Direct at 109-110. Verizon-NJ’s attempt in this proceeding to turn its own anti-competitive behavior into evidence of competition to support its bid for reclassification is impudent.

c. While Holding it up as the Keystone Element in a Determination on Reclassification, Verizon-NJ Failed to Conduct Studies on Demand and Supply Elasticities in the Relevant Markets

The fact that entry barriers remain high is borne out by the fact that competitors have captured a relatively insignificant share of the market. In order to lessen the impact of this undeniable fact on the Board, Verizon-NJ expends a great deal of ink and energy attempting to persuade the Board that a market share analysis is not necessary where it can be shown that competitors and consumers will respond to a sustained increase in price. For example, Verizon-NJ’s Reclassification Panel states, “[i]f substitute services are available … [and i]f enough customers would respond to … a price increase by shifting to one or more substitute services …, then … the firm would not be able to charge prices above competitive levels.” Verizon-NJ Initial Brief at 88 (*quoting* VNJ Exh. 3 at 11 (SWT Rebuttal)). Verizon-NJ thus establishes that, in order to demonstrate its inability to sustain a significant price increase, it must prove both the willingness of competitors to enter the market at lower prices (supply elasticity) and the willingness of consumers to switch providers (demand

elasticity).[4] In spite of these statements of economic theory, Verizon-NJ conducted no studies of the supply and demand elasticities in preparation for (or even during) this proceeding.[5] Verizon-NJ thus fails to satisfy even its own soft (and inaccurate) criterion.

3. Verizon-NJ Fails to Make a Separate Showing of the Availability of Like or Substitute Services

Verizon-NJ incorrectly states that "the same types of evidence may demonstrate satisfaction of both" the presence of competitors and the availability of like or substitute services. Verizon-NJ Initial Brief at 112. Evidence of the availability of like services may not be inferred. Rather, according to the language of the statute, for each service for which it requests reclassification, Verizon-NJ is obligated to make a separate showing of the availability of like or substitute services. N.J.S.A. 48:2-21.19(b).

However, Verizon-NJ relies exclusively upon a count of tariffed services that it has determined are "similar" to the services proposed for reclassification. In point of fact, Verizon-NJ has no idea whether competitors are actually providing these services or, indeed, whether they are

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[4] In his initial testimony, Dr. Selwyn astutely recognizes that demand elasticity is germane to the analysis when he points out that "[t]he mere presence of competitors does not translate into the presence of price-constraining competition, which is the more relevant standard upon which the Board should rely in considering … reclassification[.]" Selwyn Direct at 98.

[5] Instead, Verizon-NJ attempts to prove the relevant elasticities of supply and demand by means of largely anecdotal evidence:

> the Reclassification Panel has demonstrated the existence of competition by assessing measures that reflect *supply*—i.e., where companies are present in the market and what they are doing, including their efforts to market to a wide range of customers—and/or *demand*—i.e., the extent to which customers have actually purchased like or substitute services, their awareness of alternatives, and their willingness to take services from newer, sometimes lesser known companies, as well as from established competitors such as AT&T and WorldCom.

This will not do. Absent objective, empirical evidence of the willingness of competitors and consumers to respond to a price increase in multi-line business services, the Board must deny Verizon-NJ's Petition for lack of required factual support. Verizon-NJ Initial Brief at 95.

able to provide such services. As a result, Verizon-NJ is once again forced to rely upon the possibility of the provision of like services by competitors. *See* Selwyn Direct at 117. And once again, this feeble attempt to carry its burden is insufficient. N.J.S.A. 48:2-21.19(b) requires an affirmative demonstration of the present availability of like or substitute services, a standard which Verizon-NJ's Petition for Reclassification does not even approach. The Board should therefore deny Verizon-NJ's Petition for Reclassification.

B. The Board Should Augment The Criteria For Reclassification As Envisioned By The Legislature

The possibility that Verizon-NJ may well be granted section 271 authority by the FCC underscores the importance of this proceeding and continued Board regulation of Verizon-NJ. Experience in other jurisdictions has shown that, absent the incentive provided by section 271, Verizon becomes increasingly intransigent *vis-à-vis* its competitors. *See, e.g.*, *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, Case 98-C-1357, New York Public Service Commission, Recommended Decision on Module 3 Issues, 2001 N.Y. PUC LEXIS 293 at 23 (May 16, 2001); Order Directing Market Adjustments and Amending Performance Assurance Plan, N.Y.P.S.C. Case 00-C-0008, et al. (Mar. 23, 2000); FCC Release, "FCC Ensures Bell Atlantic Compliance With Terms of Long Distance Approval; Bell Atlantic Agrees to Pay Up to $27 Million," (Mar. 9, 2000). Should Verizon-NJ be granted section 271 authority by the FCC (based, in part, upon this Board's positive recommendation), New Jersey will face an increased risk of anti-competitive conduct as against competitors or an exercise of market power as against ratepayers by Verizon-NJ. Thus, the Board's

vigilance at this critical juncture is essential to protect consumers and to permit the development of local competition.[6]

As part of that increased vigilance, as well as to satisfy the mandate of the Legislature, the Board should promulgate additional criteria for reclassification proceedings. Indeed, a focus upon the three minimum criteria specified in the statute has led to a situation in which Verizon-NJ continues to earn disproportionate revenue from its "competitive" services, while escaping altogether the regulatory eye of the Board. The Board should augment the minimum statutory criteria to focus upon a demonstration of definite and enduring competition in each service proposed for reclassification. Moreover, the Board has precedent for the inclusion of such additional criteria. Specifically, the Board considered evidence of both effective competition and relative market share in its determination on the reclassification of intraLATA toll services. *I/M/O Investigation of IntraLATA Toll Competition For Telecommunications Services On a Presubscription Basis*, Docket No. TX94090388 (1997). Using that proceeding as a guide, the Ratepayer Advocate respectfully recommends that the Board initiate a proceeding to definitively determine the criteria applicable to questions of reclassification, as directed by N.J.S.A. 48:2-21.19(b).

1. The Disparity Between Verizon-NJ's Competitive and Rate Regulated Service Earnings Data Raises Doubts About the Purported Level of Competition in New Jersey

It is well understood that a defining characteristic of markets with little competition is the excessive rate of return earned by dominant firms in those markets. F.M. Scherer & David Ross, Industrial Market Structure and Economic Performance at 415-416 (3d ed. 1990). Based on the

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[6] Indeed, the Board noted in several instances that it was not satisfied with the paltry level of local competition that was proven in its consultative proceeding on Verizon-NJ's compliance with section 271. *See, e.g., Consultative Report* at 86.

information presented by Verizon-NJ in this proceeding, it enjoys a rate of return of **[BEGIN VERIZON-NJ PROPRIETARY] [END VERIZON-NJ PROPRIETARY]** on rate regulated services, and an astonishing **[BEGIN VERIZON-NJ PROPRIETARY] [END VERIZON-NJ PROPRIETARY]** on competitive services. Hall Direct, Exhibits A-5, A-6, A-7; *see also*, T.4800:2-4805:14 (12/20/01). Such numbers indicate that the supposed competition is no more than a mirage, and that the principal beneficiary of reclassification has been Verizon-NJ itself. Absent the incentive provided by section 271 of the 1996 Act, the Board should proceed with great caution before it reclassifies services in the hope that competition will yield benefits for consumers. Indeed, a focus upon actual competition, as demonstrated by relative market share, is warranted now more than ever.

2. The Board Has Used Additional Criteria Focused Upon Effective Competition and Market Share to Make Reclassification Decisions in the Past

Verizon-NJ incorrectly states that "[b]oth the FCC and the Board have in prior proceedings rejected the use of market share indicators in evaluating the extent of competition for reclassification purposes." Verizon-NJ Initial Brief at 91. Even a cursory read of the FCC statements quoted by Verizon-NJ reveals that the FCC determined only that a market share analysis was administratively burdensome for that proceeding alone. *Id.* More egregious, however, is Verizon-NJ's misstatement that the Board has eschewed demonstrations of effective competition and market share in previous proceedings. In point of fact, the Board has used both measures of effective competition and market share in making reclassifications decisions in the past.

Verizon-NJ states, "the Board in 1997 approved the reclassification of intraLATA toll services as competitive based *solely* on satisfaction of the three statutory criteria[.]" Verizon-NJ

Initial Brief at 92 (citing *I/M/O Investigation of IntraLATA Toll Competition For Telecommunications Services On a Presubscription Basis*, Docket No. TX94090388, Decision and Order (May 28, 1997)) (emphasis added). However, the cited Order says nothing about the Board's decision having been limited to the three minimum criteria in the statute. Moreover, in an earlier order in the same proceeding, the Board expressly relied upon evidence of both "effective competition" and "market share loss" in proposing reclassification of intraLATA toll service:

> With regard to the second issue of whether the statutory criteria set forth in the Act have been met, the Board believes that the record adequately shows that effective competition for intraLATA toll services will exist in New Jersey upon implementation of presubscription … *The record indicates that since 10XXX toll competition was approved effective July 1, 1994, BA-NJ has experienced some market share loss and that with presubscription this market share loss will likely grow.* The Board agrees with BA-NJ's comments regarding the presence of other competitors, the ease of market entry, and the availability of like services. Therefore, the Board finds that the minimum standards set forth in the Telecommunications Act of 1992 appear to have been met and that intraLATA toll service should be deemed competitive[.]

I/M/O Investigation of IntraLATA Toll Competition For Telecommunications Services On a Presubscription Basis, Docket No. TX94090388, Slip Opinion (Dec. 14, 1995) (emphasis added). Verizon-NJ thus appears to have misread the Board's reasoning in this proceeding.

In a Notice of Proposed Rulemaking ("NPRM") released by the FCC on December 20, 2001, the FCC is seeking comments on whether incumbent local exchange carriers ("ILECs") possess individual market power and are likely to exercise such power. *In the Matter of Review of Requirements for Incumbent LEC Broadband Telecommunications Services*, CC Docket 01-337, Notice of Proposed Rulemaking at paras. 28-32 (rel. Dec. 20, 2001). The FCC cites two ways in which an ILEC could exercise market power. First, a carrier could raise prices by restricting its own

output. *Id.* at para. 28. Second, a carrier could raise prices by increasing its rivals' costs or by restricting its rivals' output by controlling access to bottleneck facilities that its rivals need to offer services. *Id.* This NPRM makes it clear that the FCC recognizes that an ILEC has the ability and the incentive to use its market power in the local exchange market to the detriment of their competitors.

Contrary to Verizon-NJ's assertions, the Board clearly has relied upon evidence of effective competition and market share in making previous reclassification determinations. The Board should do likewise in this proceeding. Moreover, in order to ameliorate any confusion on the matter, the Board should comply with its statutory duty by instituting a formal proceeding to promulgate reclassification criteria. *See* N.J.S.A. 48:2-21.19(b).

The Ratepayer Advocate respectfully recommends that the Board establish a separate proceeding to determine once and for all the complete list of criteria to be used in determinations of reclassification. Promulgation of additional criteria will fulfill the Board's statutory duty under N.J.S.A. 48:2-21.19(b) and will ensure that no service is prematurely reclassified as competitive. In addition, the Ratepayer Advocate requests that the Board consider the following additional criteria in that proceeding: (1) the presence of effective competition, including the ability of competitors to offer services at competitive prices, terms and conditions; (2) UNE rates that reflect economic cost; (3) compliance with the section 271 checklist; (4) service-by-service examination of any proposed reclassification; (5) a showing of the likely impact of reclassification on other services; (6) prompt and effective dispute resolution; and (7) "air tight" service quality measures. Selwyn Direct at 128-134; RPA Initial Brief at 124-134. The addition of these criteria will not only satisfy the statutory mandate, but will permit the Board to focus upon the real issue: whether effective competition

protects New Jersey's ratepayers and curtails Verizon-NJ's ability to keep competition out of the market through an improper exercise of monopoly power.

IV. THE BOARD SHOULD IMPLEMENT STRUCTURAL SEPARATION AS PART OF THE PAR-2

Verizon-NJ objects on a variety of grounds to structural separation and functional/structural separation, remedies that, in the Ratepayer Advocate's view, are necessary to ensure fair and equal treatment of all retail competitors and thus promote competition for New Jersey's consumers. Verizon-NJ Initial Brief Section VII. Verizon-NJ mounts a variety of legal challenges to structural separation, but these challenges are untimely and devoid of merit. *Id.,* Sections VII. A.2,-.3. In addition, Verizon-NJ argues that structural separation is not called for because existing regulatory measures are sufficient to promote competition. *Id.,* Section VII.A.1.c. This position ignores the reality that these measures have been in place for years, and yet competition remains at best minimal for a few consumers and non-existent for most. RPA Initial Brief Section II. Verizon-NJ also asserts that structural separation would be excessively costly, but does nothing to substantiate this claim. *Id.,* Section VII.A.4. Verizon-NJ's list of the "costs" of structural separation, moreover, is nothing more than a catalog of the advantages that Verizon-NJ's retail operations would lose if they were treated like those of competitors. Finally, Verizon-NJ does not really contest the Ratepayer Advocate's alternative proposal of functional/structural separation through a strong code of conduct with strict accounting requirements and penalties. *Id.,* Section VII.B.

A. The Board Should Reject Verizon-NJ's Claim That It May Not Legally Order Structural Separation

Verizon-NJ belatedly argues that the Board has no authority to order structural separation under New Jersey law, and that structural separation would violate the 1996 Act. *Id.,* Sections

VII.A.2.,-3. Verizon-NJ could have raised these claims in its initial response to AT&T's Petition seeking structural separation, but did not do so. *I/M/O Application of Verizon New Jersey, Inc. for Approval (i) of a New Plan for an Alternative Form of Regulation and (ii) to Reclassify Multi-line Rate Regulated Business Services as Competitive Services, and Compliance Filing,* Letter from Barry S. Abrams, Vice President, General Counsel and Secretary, Verizon, to Frances L. Smith, Secretary, Board of Public Utilities, Docket No. TO01020095 (February 15, 2001). Now that this proceeding, and the issue of structural separation, have been fully litigated, the Board should reject these last-minute arguments as untimely or waived. In addition, the Board should recognize that even if Verizon-NJ's attacks on its authority to order full structural separation had merit, they would not affect the Board's ability to order functional/structural separation, an alternative supported by the Ratepayer Advocate.

Verizon-NJ's arguments that the Board's governing statute does not allow structural separation lack merit. The Board has broad power to fashion remedies in the public interest. N.J.S.A. § 48:2-13 (Board has "general supervision and regulation of and jurisdiction and control over all public utilities as defined in this section and their property, property rights, equipment, facilities and franchises so far as may be necessary for the purpose of carrying out the provisions of this Title'); *see also Valley Road Sewerage Co.*, 154 N.J. 224, 235 (1998). The Electric Discount and Energy Competition Act, 1999 N.J. Laws 23 ("EDECA"), does not, as Verizon-NJ contends, diminish that power by implication. That statute sets out in great detail a scheme for restructuring and deregulating New Jersey's energy markets, specifying numerous aspects of that restructuring and deregulation. Among the many specifics is a provision under which the Board could structurally separate electric utilities. EDECA § 11. Verizon-NJ argues that the presence of this provision implies

that the Board lacks power to order structural separation in any other area. Verizon-NJ Initial Brief at 160. There is an equally plausible reading of the statute, however, that leads to the opposite conclusion. Under that reading, the Legislature included a structural separation provision in EDECA to avoid the implication that that remedy – otherwise within the Board's power – was not available under the statute in light of the many other detailed regulatory mechanisms the Act specifies.

Verizon-NJ claims that structural separation is illegal under the 1996 Act because it is inconsistent with that Act. This claim is erroneous; there is no such inconsistency. Verizon-NJ first notes this alleged inconsistency in the fact that Congress did not choose a broad structural remedy in the 1996 Act. Verizon-NJ Initial Brief at 162. That circumstance, however, cannot make structural separation "inconsistent" with the 1996 Act. This Board takes many perfectly valid actions that the 1996 Act does not encompass, possibly including actions of a type that the framers of that Act rejected, but those Board actions are not "illegal" under the 1996 Act. 47 U.S.C. § 152(b) states

> nothing in this chapter shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with any intrastate communications service by wire or radio of any carrier ..."

The PAR affects local, intrastate service issues, and is the subject matter of state, rather than Federal, regulation.

Verizon-NJ further argues that structural separation is "inconsistent" with the 1996 Act based on the FCC's withdrawal of certain facilities from the list of UNEs. Verizon-NJ Initial Brief at 162-163. Verizon-NJ describes it as "strange" and inconsistent with the principles of structural separation that under structural separation Verizon-NJ wholesale would own and operate withdrawn UNEs (operator services, for example) that only Verizon-NJ retail could purchase. *Id.* at 163. We confess

some difficulty in understanding Verizon-NJ's argument, but do not see the situation it posits as fatally offensive to the goals of the 1996 Act. To the extent that anomalous situations do arise, moreover, the Ratepayer Advocate is confident that the Board can be flexible enough to resolve them without sacrificing the benefits of either structural separation or the provisions of the 1996 Act.

Verizon-NJ also asserts that structural separation would violate 1996 Act § 253(a) by prohibiting Verizon-NJ wholesale from providing retail telecommunications services. Verizon-NJ Initial Brief at 163. That section forbids states and others to prohibit "any entity" from providing telecommunications services. Since Verizon-NJ wholesale is an "entity," Verizon-NJ argues, structural separation violates section 253(a). Verizon-NJ's argument fundamentally misinterprets the statute. Section 253(a) was designed to promote competition by eliminating state-created barriers to entry. There is no basis for regarding that section as reaching state regulation of corporate structure. With or without structural separation, Verizon-NJ will be able to provide retail telecommunications services in New Jersey. Regulating the subsidiaries through which the Verizon-NJ "entity" provides those services does no violence whatsoever to the purposes or operation of section 253(a).[7]

Verizon-NJ finally argues that structural separation would be inconsistent with 1996 Act § 253(b), which provides that section 253 does not reach certain state requirements if they are imposed "on a competitively neutral basis." This argument fails for several reasons. Since section 253(b) is only a proviso, it imposes no obligations on the states or anyone else. Even if the 1996 Act required competitive neutrality, moreover, Verizon-NJ fails to establish that structural separation is not

[7] The Wisconsin Legislature will soon consider proposed legislation to implement structural separation of Ameritech. *See* Press Release dated June 27, 2001, "Robson, Powers Announce Bill to Jump Start Phone Competition," <http://www.legis.state.wi.us/senate/sen15/news/PR2001-54.htm>.

"competitively neutral." For Verizon-NJ the beginning and end of the competitive neutrality analysis is that structural separation would impose burdens and costs on it. But competitive neutrality surely encompasses far more than that. It includes at a minimum consideration of the market power of regulated entities, which alone can justify measures to control that power. Competitive neutrality, indeed, is best seen as demanding, not forbidding, measures that ensure equal treatment of all competitors by a dominant wholesale provider, and as encouraging structural mechanisms that provide incentives for such pro-competitive behavior. In short, competitive neutrality is wholly consistent with structural separation of the type the Ratepayer Advocate supports.

In sum, Verizon-NJ has failed to show that the Board is precluded by either federal or state law from ordering structural separation.

B. Verizon-NJ Has Not Substantiated Its Claim That Structural Separation Would Be Excessively Costly, And Has Not Considered The Competitive Benefits Of Structural Separation In Its Analysis

Verizon-NJ argues that structural separation is excessively costly, but it has provided no testimony or other evidence to quantify or substantiate this claim. Verizon-NJ Initial Brief Section VII.A.4. Verizon-NJ lists a few costs that, it asserts, will result from structural separation. Verizon-NJ Initial Brief at 165. These costs, however, are for the most part costs that CLECs bear as a matter of course. Thus, for example, Verizon-NJ complains that its retail arm will have to develop negotiation, customer care, order tracking and billing systems, *id.,* but that is exactly what each of its competitors does uncomplainingly. Verizon-NJ also complains about the need for a separate retail arm to learn how to provide service through UNEs, *id.*, never considering that that is a principal way that CLECs to do business. Verizon-NJ's contention that these requirements will result in new costs to its retail operation belies its repeated claims that its retail competitors have been receiving equal

treatment. When Verizon-NJ bemoans the prospect of having to rely on UNEs to provide retail service, it betrays the emptiness of its claim that merely making those UNEs available to competitors is enough to fully open the local market to competition. Verizon-NJ's catalog of costs, far from suggesting that the Board should avoid structural separation, vividly illustrates that the competitive situation cries out for such a measure.

C. Verizon-NJ Makes No Substantial Argument Against Functional/Structural Separation With A Strong Code Of Conduct

Verizon-NJ offers little in the way of substance to respond to the Ratepayer Advocate's alternative proposal of functional/structural separation. Verizon-NJ does reassert its argument that applying this remedy to it alone would "be in violation of" 1996 Act § 253(b), but the argument fares no better here. That sub-section is a proviso that imposes no obligation, and in any event the "competitive neutrality" to which the sub-section refers is fully consistent with encouraging equal treatment for all retail competitors.

V. CONCLUSION

For the reasons explained in this Reply Brief, as well its Initial Brief, the Ratepayer Advocate urges the Board to adopt the following measures.

PAR-2

Rate Cap: The Ratepayer Advocate recommends that the Board require that the existing monthly rate for basic residential service be maintained for at least five years.

Earnings sharing: The Ratepayer Advocate recommends that the Board require that Verizon- NJ share with ratepayers an amount based on the sum of 25% of Verizon-NJ's return on equity in excess

of ten per cent and 25% of total shareholder return in excess of ten per cent, adjusted on the basis of Verizon-NJ's market share.

Merger savings: The Ratepayer Advocate recommends that the Board require that Verizon-NJ share with ratepayers savings from the Bell Atlantic-NYNEX and Bell Atlantic-GTE mergers.

Refund: The Ratepayer Advocate recommends that the Board order a one-time refund of $43 million to return to ratepayers merger savings that have already been realized.

Rate reduction: The Ratepayer Advocate recommends that the Board effectuate an overall rate reduction of $148 million by consolidating rate centers and expanding local calling areas.

Local Calling Areas: The Ratepayer Advocate recommends that the Board reduce the number of Verizon-NJ local calling areas from one hundred eighty (180) to twenty-one (21), creating rate centers in each county and local calling areas covering each county and the counties bordering it.

Residential Service Subsidy: The Ratepayer Advocate supports including all attendant local services in performing a subsidy analysis for residential service. The Ratepayer Advocate recommends that, because this subsidy analysis reveals that residential service generates a considerable contribution, the Board return excess revenues and merger savings to ratepayers.

Universal Service:

State Universal Service Fund: The Ratepayer Advocate recommends that the Board establish an independent state universal service fund. This fund should include components for (1) low-income residents; (2) schools and libraries; and (3) residents located in high cost areas of the state. Specifically with regard to schools and libraries, support programs should be available for all schools and libraries regardless of their location within New Jersey and all incumbent and competitive carriers should be able to participate in such programs.

Lifeline Program: The Ratepayer Advocate recommends the following improvements be made to the Lifeline program: (1) the maximum amount of assistance available to program participants should be increased to federal maximum level of $10.50; (2) eligibility requirements should be expanded to include all households with incomes at or below one hundred seventy-five percent (175%) of the federal poverty level; and (3) enrollment in the program should be simplified, with those participating by virtue of their enrollment in an existing public assistance program automatically enrolled and those enrolling by virtue of their incomes permitted to self-certify.

Access New Jersey: The Ratepayer Advocate recommends expanding the Verizon-NJ specific Access New Jersey program by (1) increasing its funding to $47 million annually; (2) deepening the discounts for Asynchronous Transfer Mode services and maintaining all other discounts; and (3) extending the program indefinitely.

Service Quality: The Ratepayer Advocate supports adopting a new, comprehensive service quality plan that (1) includes additional categories of measurements to capture important areas of customer service and reliability not measured by current standards; (2) replaces the current surveillance and

exception level standards with baseline performance standards; (3) establishes self-effectuating penalties for situations where Verizon NJ fails to satisfy these baselines; and (4) includes a code of conduct governing the relationship of Verizon NJ with its affiliates.

Reclassification of Multi-line Business Services

Requirements for Reclassification: The Ratepayer Advocate recommends a proceeding to provide for, at the very least, the addition of the following minimum criteria for reclassification under N.J.S.A. 48:2-21.19(b): (1) the presence of effective competition, including the ability of competitors to offer services at competitive prices, terms and conditions; (2) a requirement that UNE rates be at levels that reflect economic cost; (3) compliance with the section 271 competitive checklist; (4) a requirement for service-by-service reclassification; (5) the absence of any adverse effect on other services; (6) the availability of prompt and effective dispute resolution for competitors; and (7) the existence of "air tight" service quality measures.

Alternative Dispute Resolution: The Ratepayer Advocate recommends that the Board promulgate proposed rules to govern the resolution of disputes between all telecommunications carriers.

Verizon-NJ's Petition for Reclassification: The Ratepayer Advocate recommends that the Board deny Verizon-NJ's Petition for Reclassification at this time because a) there is no effective competition, b) barriers to entry remain high, and c) like or substitute services for each service sought to be reclassified do not exist.

Structural Separation

Full Structural Separation: The Ratepayer Advocate recommends that the Board order the structural separation of Verizon-NJ's wholesale and retail business units. Verizon-NJ's wholesale and retail operations should be provided by separate corporate affiliates, and the wholesale affiliate should be subject to requirements under which it will treat its retail affiliate and all other retail competitors exactly alike.

Functional/structural separation: The Ratepayer Advocate recommends as an alternative to full structural separation that the Board require that Verizon-NJ operate under a strong code of conduct, backed by strict accounting measures and penalties. The code of conduct should require completely non-discriminatory treatment of Verizon-NJ's retail competitors. Verizon-NJ retail should not be allowed to use the corporate name in its marketing, nor to share or have privileged access to any other Verizon-NJ assets or employees.

Respectfully submitted,

Dated: January 23, 2002

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