BEFORE THE
STATE OF NEW JERSEY
BOARD OF PUBLIC UTILITIES

I/M/O the Consultative Report on the Application of Verizon New Jersey, Inc., for FCC Authorization to Provide In-Region, InterLATA Service in New Jersey	:	BPU Docket No. TO01090541

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

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PROLOGUE

The Board of Public Utilities (Board) is the regulatory agency in New Jersey with broad statutory powers which includes the obligations of "safe, adequate and proper service" of all utility service to all ratepayers. N.J.S.A:2-23. The courts have recognized that these services are lifeline services and have liberally interpreted this statutory grant of jurisdiction broadly. For the last 100 years, the New Jersey Board and most other state and federal utility regulatory agencies, were previously concerned with filings of rate request applications, and their attention was rooted in rate-setting determinations.

We are now in a new paradigm of Commission responsibility. While public interest concerns such as safe, adequate and proper service at affordable rates, were always continuing Board obligations, these public interest concerns rise to on even more important level as we enter the new era of deregulation and competition. In the restructuring of the energy marketplace there are express directions for implementation of public policy issues relevant to competition, which include level playing field for all competitors, inter affiliate standards for all utilities, consumer protection standards, alongside a mandate for a safety net in the form of a Universal Service Plan.

New Jersey legislation which initiated the beginning of the deregulation of the telecommunications marketplace, through dividing the marketplace into competitive and rate regulated services, remains replete with references to public interest concerns. Attention must be given to the enormous unbundled power of the traditional dominant monopoly if the goals of competition and choice are to be realized. There can be no competition without choice, and no choice or competition, unless the marketplace provides the proper signals for competitors to enter

New Jersey and provide service to ratepayers. Competitiors will not enter New Jersey unless they have the opportunity to service customers and offer products, at a profit.

The current failure of the competitive energy marketplace in New Jersey is not in dispute. There is no energy competition and no choice of energy providers for ratepayers. Let's not repeat this scenario with the telecommunications marketplace.

In passage of the federal Telecommunications Act of 1996 by Congress, an ambitious agenda was set in place. The goal was a competitive marketplace with choice. A road map was put in place. The dominant local exchange carrier would be permitted entry into the long distance marketplace when there was proof that there was competition and choice for consumers in the local exchange marketplace. Additionally the related public interest concerns of the federal Telecommunications Act placed great importance on Universal Service with benefits for low income ratepayers, schools and libraries and high cost areas. An ambitious agenda with ambitious goals - with overriding targets of choice, universal service and performance assurance plans for ratepayers.

So - is New Jersey ready for Section 271 approval for Verizon New Jersey? This current Board with its statutory obligation to consider the public interest of all New Jersey consumers, would be abdicating this responsibility if it were to recommend approval at this time. Verizon remains a local exchange monopoly. There is no choice for consumers and there are no competitive providers offering local service. A universal service fund is still not in place.

What do we have -- we have the harbinger of a ripe and ready marketplace. The Board has set new UNE rates - and the third party testing of Verizon's OSS has been completed. Let's make sure they work. Give competition a chance to emerge. New Jersey is now open for business -- let’s herald the competitors to the state. Let’s not give up on choice for consumers. Let’s make sure the competitors are there to serve them.

Congress recognized that it would require road maps for both competition and the concomitant overriding concern of universal service. Congress recognized that it would have to put mechanisms in place to create choice and competition for consumers - while preserving universal service in a competitive environment. In the federal Act Congress directed both the FCC and the states with the road map to achieve there goals. The public interest concerns combine the new with the old - concern that every utility customer is provided with safe, adequate and proper service - at affordable rates - now however within the paradigm of the new competitive marketplace, with the promise of even more affordable rates, choices and new technologies.

The voyage on the New Jersey road map has begun. New UNE rates have been set. The stage is set; let’s see how it works in the real marketplace. If it works - Verizon should refile for 271 approval and the Board should grant approval. The Ratepayer Advocate will be there with encouragement and support.

The position of the Ratepayer Advocate is clear. We welcome Verizon New Jersey's entry into the long-distance market – when the time is right for consumers. Unfortunately, the time is not ripe now because competition does not yet exist in the local telephone market. Consumers do not have affordable choice – in fact, they do not have any choice – for their basic local telephone service.

-Ratepayer Advocate Blossom A. Peretz.
T.17:21-18:6 (11/05/01) (opening statement).

I. INTRODUCTION

The crux of the instant proceeding is whether the Board of Public Utilities (the "Board") will follow the construct of the Telecommunications Act of 1996 ("1996 Act") and require Verizon New Jersey, Inc. ("Verizon-NJ") to irreversibly open its local telecommunications markets to competition before it recommends Verizon-NJ's entry into the lucrative long distance market. 47 U.S.C. §§ 151 *et. seq.*, Pub. L. No. 104-104, 110 Stat. 56 (1996). As the Ratepayer Advocate will show in this brief, the record supports only one conclusion: *Today*, Verizon-NJ has *yet* to demonstrate that its local markets are irreversibly open to competition. Thus, it is premature for the Board to endorse Verizon-NJ's section 271 application.

A. Preliminary Statement

In the instant proceeding – Verizon-NJ's is requesting section 271 authority to provide long distance telecommunications services in its local service areas in the State of New Jersey. The 1996 Act requires the Board to examine whether the local telecommunications market is irreversibly open to competition in order to provide a recommendation to the Federal Communications Commission ("FCC") on Verizon-NJ's section 271 application. Specifically, until Verizon-NJ has opened its local market, it may not receive long distance authority. *Id*.

Unfortunately, the New Jersey local market is not *yet* irreversibly open to competition. Rather, today Verizon-NJ still retains monopoly control, particularly in the residential market. Competitive carriers provide local service to less than two percent (2%) (*i.e.*, less than 60,000) of the approximately 4.4 million residential access lines in New Jersey. Selwyn Declaration ¶ 27; *see* Bone Declaration ¶ 8; *see also* Martha McKay, *BPU Opens Hearings on Verizon Expansion*, THE RECORD, Nov. 6, 2001, at L-6 (*see* Attachment 1). At most, 280 lines are provided by competitors using their own facilities. Selwyn Declaration ¶ 27; *see* Bone Declaration ¶ 8. Indeed, when a Ratepayer Advocate staff member attempted to obtain local residential service from a competitive carrier, not a single such carrier was offering residential service. T:19:12-20:5 (11/05/01).

Moreover, the recent rash of bankruptcies by competitive carriers, including voice providers WinStar and Teligent and advanced services providers NorthPoint, Rhythms and Covad, further diminishes the current prospects of competition in New Jersey. *See, e.g.*, Andrew Backover, *As Dot-coms and Telecoms Crash, the Fallout Lands on Main Street*, USA TODAY, June 25, 2001, at B.01 (*see* Attachment 1); Dinah Wisenberg Brin, *Covad Bankruptcy Latest in Series for DSL Wholesalers*, DOW JONES NEWS SERVICE, Aug. 7, 2001 (see Attachment 1). Thus, until evidence of the existence of actual competition in the local exchange market is presented, it is premature for the Board to support Verizon-NJ's section 271 application.

The other two outstanding cases important to the New Jersey telecommunications marketplace – the UNE rate case and the PAR-II case – present the Board with the opportunity to irreversibly open the local market to competition. Indeed, in the UNE rate proceeding, the Board has already taken an important first step. The Board ordered key UNE rates, including the local loop rate, reduced by approximately forty percent (40%). *See* November 20 Board Meeting. As the Director of the Board's Division of Telecommunications explained when commenting on the rate reductions, "[h]opefully this will stimulate the [competitors] to enter into the market in New Jersey." David P. Willis, *Cuts in Rates May Give Verizon Competition*, ASBURY PARK PRESS, Nov. 21, 2001 (statement of Anthony Centrella) (*see* Attachment 1).

However, the ordering of proper UNE rates does not in and of itself create irreversibly open local telecommunications markets. It will take competitive providers several months to adjust their business plans and devote the resources necessary to enter the market (assuming they choose to do so). *See* Martha McKay, *Phone Network Fees Slashed to Spur Competition*, THE RECORD, Nov. 21, 2001, at B-1, B-8 ("Phone Network Fees Slashed") (*see* Attachment 1). Similarly, until Verizon-NJ implements the new rates in its billing systems and the performance of these systems is analyzed, it will be impossible to evaluate Verizon-NJ's compliance with the Board's order.

Thus, while the Ratepayer Advocate expects that these new rates will help encourage local competition, it is presently too soon to know if the lower UNE rates will enable this dream to finally become a reality. The Ratepayer Advocate remains "'hopeful that now that we have cleared this major impediment, competition will finally come to New Jersey's local exchange market.'" Joseph Picard, *BPU Cuts Verizon's UNE Rate*, THE HOME NEWS TRIBUNE, Nov. 21, 2001 (quoting Ratepayer Advocate Blossom A. Peretz) (*see* Attachment 1). The Board should, therefore, wait at least six months to evaluate whether the new rates have led to the creation of an irrevocably open local market. *Ratepayer Advocate Applauds BPU for Lowering Rates Verizon Charges Competitors*, Ratepayer Advocate Press Release, Nov. 20, 2001 (*see* Attachment 1); *see*

Phone Network Fees Slashed at B-8. Additionally, the Board can take affirmative steps to open local markets to competition in the PAR-II proceeding. Alternatively, the Board could order structural or functional separation in the instant case.

Accordingly, while the Board appears on the road to opening Verizon-NJ's local telecommunications market to competition, because the local market is not *yet* open to competition, the Board should provide a negative evaluation of Verizon-NJ's section 271 application.[1]

B. Executive Summary

In this proceeding, the Board is examining whether to support Verizon-NJ's section 271 application for authority to provide long distance telecommunications services in its local service areas in the State of New Jersey. This brief begins by establishing the proper context for the Board's analysis – the status of competition in the local market. In Section II, the brief sets forth the proper legal standard for the Board's analysis, focusing on the public interest requirements of this standard. In particular, in order to satisfy the public interest criteria of section 271 of the 1996 Act, Verizon-NJ must, among other things, demonstrate that its local market is irreversibly open to competition, and must do so independent of the fourteen point checklist. As explained below, Verizon-NJ's petition also fails to satisfy the fourteen point checklist, most notably checklist item ii. *Id*.

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[1] The Ratepayer Advocate reminds the Board of its pending motion to dismiss Verizon-NJ's section 271 application. *Consultative Report on the Application of Verizon New Jersey Inc. for FCC Authorization to Provide In-Region, InterLATA Services in New Jersey*, Docket No. TO01090541, Motion to Dismiss of the Ratepayer Advocate (filed Oct. 22, 2001). The positions and arguments raised in that motion remain valid and the Ratepayer Advocate urges the Board to grant the motion.

This brief will then show that Verizon-NJ failed to satisfy its public interest burden. Today, there is neither sufficient residential competition of any sort nor sufficient geographic distribution of business competition to show that the local market is open, and the new UNE rates have not yet been put into effect and therefore cannot provide evidence of existing local competition in New Jersey. In addition, because there is insufficient competition, Verizon-NJ's operational support systems have not been subject to actual, real world testing. Moreover, if granted premature long distance authority, Verizon-NJ effectively will be encouraged to exploit its joint marketing opportunities to prevent local competitive entry. Further, Verizon-NJ cannot meet its public interest burden until the Board establishes a state universal service fund. The overwhelming number of states with 271 authority, including the neighboring commonwealth of Pennsylvania, have in existence a state universal service fund. *Id*.

Finally, the Ratepayer Advocate submits that, notwithstanding our position that Verizon-NJ's 271 application is premature at this time, should the Board recommend approval to the FCC, the Board should order structural separation or apply a code of conduct to Verizon-NJ in order to encourage the development of competition and effectively separate Verizon-NJ's wholesale and retail functions to provide proper safeguards and incentives to prevent Verizon-NJ from remonopolizing the long distance market. *Infra* Section IV.

II. SECTION 271 IMPOSES A STRICT LEGAL STANDARD UPON VERIZON-NJ

A. Verizon-NJ Must Satisfy All Section 271 Requirements

Section 271 of the 1996 Act sets forth specific criteria that regional bell operating companies ("RBOCs" or "BOCs"), in this case Verizon-NJ, must satisfy for permission to provide in-region, interLATA telecommunications services. 47 U.S.C. § 271. The purpose of section 271 is for RBOCs to first open their local markets to competition in order to subsequently receive permission to enter the competitive long distance market. *E.g.*, *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 ¶ 3 (1997) ("FCC MI 271 Order"). The FCC has explicitly recognized the key Congressional goal that RBOCs must irreversibly open their local markets. "In order to effectuate Congress' intent, we must make certain that the BOCs have taken real, significant, and irreversible steps to open their markets." Id. ¶ 18. Congress required this sequence of events because any other would be fundamentally unfair to a RBOC's competitors.

> The Bell operating companies are not now free to go out and compete with the long distance companies because they have a monopoly in most places in local service. It is not fair for the Bell operating companies to have a monopoly in local service, retain that monopoly and get involved in competitive circumstances in long distance service.

141 Cong. Rec. S8057 (1995) (statement of Sen. Dorgan) (quoted in Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Louisiana, 13 FCC Rcd 20599, CC Docket No. 98-121, FCC 98-271, Memorandum Opinion and Order ¶ 3 n. 6 (1998) ("FCC LA II 271 Order").

This logical progression of the 1996 Act – first the RBOC opens its local market, then it is permitted to enter the long distance market – has long been recognized by the FCC as a crucial predicate to the success of the 1996 Act.

> Through this statutory provision [Section 271], Congress required BOCs to demonstrate that they have opened their local telecommunications markets to competition *before* they are authorized to provide in-region long distance services. Section 271 thus creates a critically important incentive for BOCs to cooperate in introducing competition in their historically monopolized local telecommunications markets.
>
> By requiring BOCs to demonstrate that they have opened their local markets to competition before they are authorized to enter into the in-region long distance market, the 1996 Act enhances competition in both the local and long distance markets.
>
> . . .
>
> If the local market is not open to competition, the incumbent will not face serious competitive pressure from new entrants, such as major interexchange carriers. In other words, the situation would be largely unchanged from what prevailed before the passage of the 1996 Act. . . . Although Congress replaced the MFJ's structural approach, Congress nonetheless acknowledged the principles underlying that approach – that BOC entry into the long distance market would be anticompetitive unless the BOCs' market power in the local market was first demonstrably eroded by eliminating barriers to local competition. This is clear from the structure of the statute, which requires BOCs to prove that their markets are open to competition before they are authorized to provide in-region long distance services.

FCC MI 271 Order ¶¶ 14-15, 18 (footnotes omitted) (emphasis in original); *see* FCC LA II 271 Order ¶ 3; *Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region, InterLATA Service in the State of New York*, 15 FCC Rcd 3953, CC Docket No. 99-295, FCC 99-404 ¶ 3 (1999) ("FCC NY 271 Order"). Thus, Verizon-NJ must not be granted long distance authority in New Jersey until it has opened its local markets to competition.

Section 271 approval is contingent upon Verizon-NJ's demonstration that: (1) either it faces facilities-based competition in both the residential and business markets ("Track A") or, if no such competitors exist, it is offering generally available terms and conditions under which facilities-based residential and business competitors could provide competitive services ("Track

B"), 47 U.S.C. §§ 271(c)(1)(A-B); (2) it complies with each of the fourteen (14) point checklist items, 47 U.S.C. § 271(c)(2)(B); (3) it would implement the requested long distance authority in accordance with the separate affiliate and other safeguards of section 272, 47 U.S.C. § 272; *and* (4) its provision of long distance services would be fully "consistent with the public interest, convenience, and necessity," 47 U.S.C. § 271(d)(3)(C). FCC LA II 271 Order ¶ 13; FCC MI 271 Order ¶ 9; FCC NY 271 Order ¶ 18; *Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, IntraLATA Services in Arkansas and Missouri*, CC Docket No. 01-194, FCC 01-338, Memorandum Opinion and Order at App. D ¶ 3 (rel. Nov. 16, 2001) ("FCC AK/MO 271 Order"); *Application of Verizon Pennsylvania Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc. for Authorization to Provide In-Region, InterLATA Services in Pennsylvania,* CC Docket No. 01-138, FCC 01-269, Memorandum Opinion and Order at App. C ¶ 3 (rel. Sept. 19, 2001) ("FCC PA 271 Order"). Thus, according to the express language of the statute, *each* of these criterion is an essential element to section 271 approval, and each of these criterion must necessarily be reviewed by this Board.

Accordingly, the FCC requires that an RBOC prove by a preponderance of the evidence that it has fully met each criterion. *See* FCC MI 271 Order ¶ 45; FCC LA II 271 Order ¶ 59; FCC NY 271 Order ¶ 47; *see also* 47 U.S.C. § 271(d)(3). In its analysis of all previously filed section 271 applications, the FCC repeatedly emphasized that the burden of persuasion falls firmly in the lap of the applicant. "Section 271 places on the applicant the burden of proving that all of the requirements for authorization to provide in-region, interLATA services are satisfied." FCC MI 271 Order ¶ 43; *see id.* ¶ 43 n. 84 (burden of persuasion); *e.g.*, FCC NY 271 Order ¶¶ 47-48.

Moreover, this burden is absolute. The FCC mandates that "[a] BOC must plead, with appropriate supporting evidence, facts which, if true, are sufficient to establish that the requirements of section 271 have been met." FCC LA II 271 Order ¶ 52. In fact, this burden is so heavy that an RBOC can fail to satisfy it even if its section 271 application is unopposed.

> Because Congress required the Commission affirmatively to find that a BOC application has satisfied the statutory criteria, the ultimate burden of proof with respect to factual issues remains at all times with the BOC, even if no party opposes the BOC's application.

FCC MI 271 Order ¶ 43; FCC LA II 271 Order ¶ 51 (re-emphasizing same); FCC NY 271 Order ¶ 47; FCC PA 271 Order, App. C ¶ 5; Joint Application by SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, IntraLATA Services in Kansas and Oklahoma, 16 FCC Rcd 6237, CC Docket No. 00-217, FCC 01-29, Memorandum Opinion and Order ¶ 46 (rel. Jan. 22, 2001) ("FCC KS/OK 271 Order"). Thus, failure by Verizon-NJ to prove any one of these criteria requires that Verizon-NJ's section 271 application be denied. 47 U.S.C. § 271(d)(3) ("The Commission shall not approve the authorization requested . . . unless it finds that" these criteria are met); FCC LA II 271 Order ¶¶ 11, 13 ("The statute directs that the Commission 'shall not approve' the requested authorization unless it finds that the criteria specified in section 271(d)(3) are satisfied."); see FCC MI 271 Order ¶ 6.

Finally, Verizon-NJ must prove that each criterion is satisfied at the time the filing is made. *E.g.*, *Procedures for Bell Operating Company Applications Under New Section 271 of the*

Communications Act, FCC 96-469, 11 FCC Rcd 19706, 19709, Public Notice (Dec. 6, 1996) ("FCC Dec. 6 Notice"). Evidence submitted after the initial application is generally to be accorded no weight, and *promises of future compliance may not be relied upon*. *Id.* at 19709; FCC MI 271 Order ¶¶ 51, 55.

> [W]e find that a BOC's promises of *future* performance to address particular concerns raised by commenters have no probative value in demonstrating its *present* compliance with the requirements of section 271. Paper promises do not, and cannot, satisfy a BOC's burden of proof. In order to gain in-region, interLATA entry, a BOC must support its applications with actual evidence demonstrating its present compliance with the statutory conditions for entry, instead of prospective evidence that is contingent on future behavior.

FCC MI 271 Order ¶ 55. Moreover, Verizon-NJ must demonstrate not only that it is in full compliance at the time it files its application, but it must show that it will remain in compliance with section 271 if its application is granted.

> It is not enough that the BOC prove it is in compliance at the time of filing a section 271 application; it is essential that the BOC must also demonstrate that it can be relied upon to remain in compliance.
>
> FCC MI 271 Order ¶ 22

As fully demonstrated below, Verizon-NJ has failed to prove today that the grant of its section 271 application satisfies the statute. Verizon-NJ has not demonstrated that it faces residential competition, as required under Track A. Verizon-NJ also did not prove that it satisfies checklist item ii of the fourteen-point checklist.[2] Finally, and most alarmingly, Verizon-NJ failed to show that the grant of its application would be in the public interest. As the FCC has recognized, the failure to satisfy any one of the four criteria individually requires rejection of a

[2] While the record evidence of several of the parties in this proceeding demonstrates that Verizon-NJ also failed to meet checklist items i, iii-vi and xiii., the only checklist item that this brief will focus on is item ii.

section 271 application. *See id.* ¶ 6; FCC LA II 271 Order ¶¶ 11, 13, 48. That Verizon-NJ fails to satisfy three criteria simply reinforces the result called for by the statute. The Board should reject the application and provide a negative recommendation on any Verizon-NJ 271 application with the FCC at this time. *See* FCC MI 271 Order ¶ 6; FCC LA II 271 Order ¶¶ 11, 13, 48.)

B. The Board Plays a Critical Role in Evaluating Verizon-NJ's Section 271 Application

As the Board correctly recognized in its October Procedural Order, it will play a crucial role in analyzing Verizon-NJ's section 271 application. *Consultative Report on the Application of Verizon New Jersey Inc. for FCC Authorization to Provide In-Region, InterLATA Service in New Jersey*, Docket Nos. TO01090541, TX98010010, TO97030166, Procedural Order (Oct. 9, 2001) ("October Procedural Order"). Section 271 requires the FCC to consult with the Board before the FCC renders any decision on Verizon-NJ's anticipated federal section 271 application. 47 U.S.C. § 271(d)(2)(B); *see* Selwyn Declaration ¶ 5.

The FCC has indicated that, where the state commission provides the FCC with detailed factual findings after conducting "an exhaustive and rigorous investigation" of the RBOC's averred compliance with section 271, only then would the FCC give the state commission's recommendation even greater weight than it is required by section 271(d)(2)(A) to give to the Department of Justice's evaluation. FCC NY 271 Order ¶ 51. In such cases, the FCC will view evidence put forth by the state commission as similar in weight to that of an "expert witness." *Id*. Specifically, the FCC stated that it intends to rely heavily on the state commission to develop a full factual record, and, in particular, "to develop a comprehensive, factual record regarding the opening of the BOC's local networks to competition." FCC MI 271 Order ¶ 30; *see also* FCC

LA II 271 Order ¶ 22. Since the state commission is in the best position to evaluate local conditions, the FCC relies heavily on the state commission in the FCC's section 271 determination. FCC MI 271 Order ¶ 30.

1. The Board's role in evaluating Verizon's petition is not limited to the fourteen (14) point checklist

Contrary to Verizon-NJ's assertions, the 1996 Act requires more than mere unsupported assertions as to Verizon-NJ's compliance with checklist items, and the Board's review must therefore be inclusive of items in addition to those related to the 271 checklist. Verizon's filing necessarily triggers public interest concerns and therefore the Board's review of such concerns independent of the federal checklist requirements. Not only is the Board required to examine Verizon's filing under the federal public interest requirements, but it is also required to review the filing under its own statutory public interest mandate. In regulating telecommunications services, the New Jersey Legislature intended to "safeguard the interest of the utilities and the public" and ensure that the "statutes governing public utilities reflect legislative recognition that public interest in proper regulation of public utilities...must be entrusted to an agency whose continually developing expertise will assure uniformly safe, proper and adequate service by utilities throughout the state."[3] In keeping with the New Jersey Legislature's intent, the Board is charged with considering public interest factors when reviewing Verizon's Section 271 filing.[4] The

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3 *See Bergen County v. Department of Public Utilities,* 117 N.J. Super. 304, 284 A.2d 543 (A.D. 1971).

4 It is also significant that the New Jersey Legislature's intent was so broad as to require the Board to examine all utility filings in light of whether they are in the public interest. For instance, in furtherance of competition in the energy market, N.J.S.A. 48:3-50 (b) requires elimination of the traditional electric monopolies, and sets out certain parameters for the Board to follow in developing a competitive market. Specifically, N.J.S.A. 48:3-50 (b)(8) states that the legislature finds that the "electric power generation marketplace and gas supply marketplace should be subject to appropriate consumer protection standards that will ensure that all classes of customers in all regions of this State are properly and adequately served." Additionally, N.J.S.A. 48:3-50(c) sets out regulations

Legislative intent is clearly seen in the Board's authority to protect the public interest while bringing competition to the interexchange telecommunications marketplace for the benefit of all consumers. Specifically, N.J.S.A. 48:2-21.16(a) provides that among the policies of the state, is to "[m]aintain universal telecommunications service at affordable rates;" and to "[p]rovide diversity in the supply of telecommunications services and products in telecommunications markets throughout the State." Furthermore, N.J.S.A. 48:2-21.16(b)(5) expressly grants to the Board the ability to determine whether it is "in the public interest to relieve interexchange telecommunications carriers from traditional utility regulation."

Because the FCC will rely heavily upon the Board for an analysis of local conditions in New Jersey, the Board must include an analysis of Verizon-NJ's compliance not just with the federal law requirements of section 271, but with New Jersey state requirements, as well. *See* Selwyn Declaration ¶ 7. Just as there is a federal public interest criterion under section 271, there is also a state public interest test in New Jersey law. N.J.S.A. §§ 48:2-21.16(a), 21.16(b)(5); *see* Selwyn Declaration ¶ 7; *see also* N.J.S.A. § 48:3-50(b), 50(c) (setting forth public interest test in electric utility industry). In particular, in regulating telecommunications services, the New Jersey Legislature granted the Board broad powers to assess the public interest. *See Bergen County v. Dep't of Public Utils.*, 117 N.J. Super. 304, 284 A.2d 543 (A.D. 1971). Such analysis of state law by the Board is precisely the type of analysis desired by the FCC.

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that expressly require the Board to act in the public interest by authorizing the Board to "permit competition in the electric generation and gas marketplace and such other traditional utility areas as the board determines, and thereby reduce the aggregate energy rates currently paid by all New Jersey consumers;" and "[p]rovide for regulation of new market entrants in the areas of safe, adequate and proper services and customer protection."

> We would also want to know about state and local laws, or other legal requirements, that may constitute barriers to entry into the local telecommunications market, or that are intended to promote such entry.

FCC MI 271 Order ¶ 396.

Accordingly, it is incumbent upon the Board to provide the FCC with a detailed public interest analysis of Verizon-NJ's section 271 application, including an examination of the status of local competition in the State of New Jersey.

C. The Public Interest Test Is Crucial to the Board's Section 271 Evaluation

One of the four criteria (see above) that Verizon-NJ must satisfy in order to receive section 271 authority is the public interest test. *See* 47 U.S.C. § 271(d)(3). As the FCC has consistently and repeatedly stated in its section 271 orders, the public interest test is fully *independent* of the fourteen (14) point checklist and the other section 271 criteria, but equally necessary to section 271 analysis in compliance with the 1996 Act. For example, in its analysis of Verizon Pennsylvania's section 271 application, the FCC reiterated that "the public interest analysis is an independent element of the statutory checklist and, under normal canons of statutory construction, requires an independent determination." FCC PA 271 Order, App. C ¶ 71; *see, e.g.*, FCC NY 271 Order ¶¶ 422-423; FCC MI 271 Order ¶¶ 389-390; *see also* Selwyn Declaration ¶ 6. Moreover, in its deliberations preceding the enactment of the 1996 Act, Congress expressly rejected an amendment that would have enabled compliance with the checklist in and of itself to satisfy the public interest test. FCC MI 271 Order ¶ 389 n. 1004 and accompanying text (citing 141 Cong. Rec. S7971, S8043 (1995)). Rather, the FCC found that checklist compliance (which does not exist in this proceeding) does not guarantee that barriers to entering the local telecommunications market have been eliminated.

> In making our public interest assessment, we cannot conclude that compliance with the checklist alone is sufficient to open a BOC's local telecommunications markets to competition.

Id. ¶¶ 389-390.

Thus, it is critical that the Board evaluate whether Verizon-NJ's application satisfies the public interest, convenience and necessity.[5] Indeed, Congress intended the public interest test to form the basis of the Communications Act, including the 1996 Act amendments.

> The public interest, convenience and necessity standard is the bedrock of the 1934 Act, and the Committee does not change that underlying premise through the amendments contained in this bill.

S. Rep. No. 23, 104th Cong., 1st Sess. 44 (1995) (quoted in FCC MI 271 Order ¶ 385 n. 992).

The public interest inquiry contained in section 271 is an expansive one. FCC MI 271 Order ¶ 385; *see also* FCC LA II 271 Order ¶ 365. In carrying out this inquiry, the Board has broad discretion to consider any factor relevant to attaining the goals and objectives of the 1996 Act. *See* FCC MI 271 Order ¶¶ 383-422; FCC LA II 271 Order ¶ 362. The FCC has specifically requested that state commissions identify any factor they deem relevant to the public interest determination.

> We encourage interested parties, including the Department of Justice and the relevant state commission, to identify other factors that we might consider in the context of a specific application, and the weight that we should attach to the various factors, in making this assessment.

FCC MI 271 Order ¶ 398.

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[5] The Ratepayer Advocate notes that Verizon-NJ failed to address the public interest standard of 47 U.S.C. §271(d)(3) in its initial filing, instead raising it only in reply. Indeed, the words "public interest" occur not once in its initial declarations. The Board, in its Procedural Order affirmatively states that it would consider comments "of a factual, legal and policy nature." *See* October 9 Procedural Order at 6.

The FCC has provided substantial guidance as to some of the possible areas in which it desires detailed input from state commissions as part of its public interest evaluation. *E.g.*, FCC MI 271 Order ¶¶ 383-422; FCC PA 271 Order, App. C ¶ 71. The public interest evaluation should include an examination of whether the local telecommunications market is irrevocably open to competition. *E.g.*, FCC PA 271 Order, App. C ¶ 71; *see also* Selwyn Declaration ¶ 5. Further, the public interest review must include an analysis of whether competition currently exists and will continue to exist in the local market before entry into the long distance market is granted. FCC LA II 271 Order ¶ 361. Moreover, this evaluation should analyze the actual amount of competitive services being provided "to different classes of customers (residential and business)," and the scope of competition "in different geographic regions (urban, suburban, and rural)." FCC LA II 271 Order ¶ 391. For instance, in its evaluation to the FCC the Massachusetts Department of Telecommunications and Energy ("DTE") predicated its conclusion that Verizon Massachusetts' section 271 application was in the public interest on the fact that there was significant residential competition. *Application of Verizon New England Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions) and Verizon Global Networks Inc., for Authorization to Provide In-Region, InterLATA Services in Massachusetts*, CC Docket No. 00-176, Evaluation of the Massachusetts DTE at 657 (filed Oct. 16, 2000).

Accordingly, an analysis of the state of local competition in New Jersey is not only appropriate, it is essential. FCC MI 271 Order ¶ 402. Failure to include such an examination would fatally undermine the Board's public interest analysis. This, in turn, would render the

Board unable to conclude that Verizon-NJ satisfied section 271(d)(3) of the 1996 Act, one of the four distinct, mandatory section 271 criteria.

III. THIS BOARD SHOULD OPPOSE VERIZON'S PETITION FOR SECTION 271 AUTHORITY BECAUSE VERIZON FAILS TO MEET THE REQUIREMENTS SECTION 271(C)(1(A) ["TRACK A"]

Section 271(c)(1)(A) of the Telecommunications Act of 1996 ("1996 Act") requires the Commission to make various findings before approving a Bell Operating Company's ("BOC") entry into the interLATA market. The BOC must show that it satisfies the requirements of either Section 271 (c)(1)(A) known as Track A, or Section 271 (c)(1)(B), known as Track B.[6] Here, Verizon has filed under Track A which requires that, in addition to meeting each and every competitive checklist requirement, a BOC must first show that it provides access to one or more unaffiliated competing providers of telephone exchange service to residential and business subscribers. The section further specifies that the competing carrier's telephone exchange service may be offered either exclusively over its own telephone exchange service facilities or predominantly over its own telephone exchange service facilities in combination with the resale of the telecommunications services of another carrier to meet this requirement.[7] The Board is, therefore, not limited in its review of Verizon's filing to the 14-point checklist items listed in the 1996 Act.

In its Michigan Order, the FCC defined facilities-based competition to include services provided by CLECs over their own networks, UNEs, and UNE-Ps. *See* FCC Michigan Order at

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6 Section 271 (d)(3)(A).

7 Michigan Order at para. 8.

paras.92-103. Services over resale are not considered facilities-based and, contrary to Verizon's assertions, are not to be included in meeting the section 271(c)(1)(A) requirement. The FCC further defined the section 271(c)(1)(A) requirement by stating that "[a]lthough there has been considerable dispute in the record regarding the exact number of residential customers served by these carriers, we conclude that a sufficient number of residential customers [must be] served by competing LECs through the use of their own facilities to demonstrate that there is an 'actual commercial alternative '" available. *See* Kansas/ Oklahoma Order at para. 42. Although the FCC did not provide a set number of facilities-based residential lines that would meet this requirement, the FCC stated that to meet the section 271(c)(1)(A) requirement, a BOC must show that at the very least, "more than a *de minimis* number of residential customers are served..."over its own facilities. Id.

According to the FCC "residential customers" are defined as those that are served on a commercial basis. In its 1997 Oklahoma Order Denying SBC's applications for 271 authority in paragraph 17, the FCC explicitly stated that:

> We conclude that Brooks' provision of local exchange service on a test basis, at no charge, to the homes of four of its employees does not qualify Brooks as a "competing provider[ ] of "telephone exchange service . . . to residential . . . subscribers." The term "subscribers" suggests that persons receiving the service pay a fee. The term "telephone exchange service" also requires that there be payment of a fee. For the purposes of section 271(c)(1)(A), the competing provider must actually be in the market, and, therefore, beyond the testing phase. Hence, we agree with the Department of Justice that "[t]he provision of service on a test basis does not make Brooks a 'competing provider' of service to residential 'subscribers,' in the absence of any effort on Brooks' part to provide service on a commercial basis.

In light of the above, Verizon's burden to meet the section 271(c)(1)(A) requirement is fourfold: (1) Verizon must demonstrate that CLECs offer residential local service over their own facilities (excluding via resale), (2) that the number of local residential customers served over CLEC facilities constitute more than a *de minimis* number, (3) that such service is currently being provided as an "actual" rather than a theoretical future "commercial alternative", and (4) that to be considered local residential customers served on a commercial basis over CLEC facilities, the local residential customers must be persons receiving the service for a fee rather than employees of the CLECs or test lines. In short, Verizon fails miserably on all four points and therefore cannot meet the section 271(c)(1)(A) requirement.

First, Verizon has not provided sufficient evidence upon which this Board can determine that any CLEC offers facilities based local residential service in New Jersey. In an attempt to meet this requirement, Mr. Bone declares that currently there are 280 residential lines being served over UNEs, and an additional 400 lines being served via UNE-Ps. Bone Declaration at 8. However, when examined in more detail, Verizon has not provided any support for these numbers. For instance, in response to RPA discovery request 17, Verizon stated that this 280 number is actually 275 that are served over UNEs. Further, in response to RPA discovery request 26, Verizon states that eight CLECs provide local residential service over UNEs and ten CLECs provide residential service over UNE-Ps. However, according to these same CLECs in their responses to VNJs own discovery requests, RPA Exhs. 8, 9; VNJ-ATT 3, VNJ-CLEC 3, VNJ-RCN 1, VNJ-COVAD-1, VNJ-CVL 3, these CLECs do not provide local residential services through their own facilities in New Jersey.

Second, Verizon fails to provide evidence that its 680 supposed facilities-based CLEC local residential lines constitute a more than a *de minimis* amount required to meet section 271(c)(1)(A). Although as shown below, Verizon fails to demonstrate that these 280 UNE lines are provided on a commercial basis by CLECs, even if we were to take this number at face value, it constitutes at most .0064% of Verizon's local residential lines. See Selwyn Declaration at 27, See also Tr: 1270:5-23 [Where Dr. Taylor admits that this number is a small percentage.] Even if we were to add the other 400 UNE-Ps, these supposed 680 total CLEC facilities-based lines constitute at most, .015% of Verizon NJ's local residential market. When compared to the level of competition based on CLEC facilities-based lines in other states, this .015% figure does not rise to the level of *de minimis* standard. Thus, Verizon cannot demonstrate compliance with section 271 (c)(1)(A) on this basis alone.

Third, since Verizon must prove that CLECs are currently and actually providing local residential services over their own facilities, its evidence regarding existing collocation arrangements, sunk investments, and the alleged ability of CLECs to enter into the local market in the future is irrelevant in determining Verizon's compliance with section 271(c)(1)(A). Verizon attempts to mislead the Board into believing that all it has to prove is that a market is open to competition rather than provide evidence specific to section 271(c)(1)(A). Contrary to Verizon's belief, the section 271(c)(1)(A) requirement is in addition to the 14 point checklist and the requirement that the local market be irreversibly competitive. Indeed, Verizon's failure to meet section 271(c)(1)(A) is in itself fatal to its request for long distance authority, regardless of whether Verizon meets the checklist requirements or not. President Hughes understood this when expressly permitting cross on section 271 (c)(1)(A). See Tr. 1477:3-18. As shown above, Verizon has offered no proof that any CLECs are currently and actually providing local residential services over their own facilities.

Fourth, Verizon fails to provide any evidence that even a single one of its supposed 680 facilities based CLEC local residential lines are provided by CLECs on a commercial basis for a fee. In fact, on Cross by the Ratepayer Advocate, when asked whether he knew if any of the 280 UNE and 400 UNE-P local residential lines are being provided to customers for a fee rather than for free to CLEC employees, Mr. Bone stated he did not know and that this was simply based on a "common sense conclusion" and that "its basically the way this industry works." See Tr. 1431:2-7, 1431:15-23 and 1432:3-6. Thus, Verizon simply assumed that these lines are being provided for a fee. Further, Dr. Taylor even went so far as to state that "its really non of Verizon's business how the CLEC is selling or giving away its service to its customers or friends." See Tr. 7-10. However, Verizon is well aware that at all times in this proceeding, it maintains the ultimate burden of proof. The FCC was clear that the "*BOC applicant retains at all times the ultimate burden of proof that its application satisfies section 271.*" *See* Michigan Order at para. 44. Thus, contrary to Dr. Taylor's assertion, it is entirely Verizon's "business" to prove that CLECs are providing facilities based local residential services for a fee on a commercial basis. Failure to provide this evidence necessarily warrants that this Board not support Verizon's petition for section 271 authority.

IV. VERIZON-NJ DOES NOT MEET CHECKLIST ITEM 2 - NONDISCRIMINATORY ACCESS TO UNES

A. Commercial Testing of Verizon-NJ's OSS is Required Prior to Granting Verizon-NJ's 271 Petition

The ability of competitors to provide effective service to their customers and competition to Verizon-NJ depends heavily upon nondiscriminatory access to OSS functions. Such nondiscriminatory access is required by item ii of the section 271 checklist. 47 U.S.C. §271(c)(2)(B)(ii). Its crucial importance has been recognized many times over by both federal and state regulators. Specifically, the FCC has noted that without such nondiscriminatory access, "a competing carrier will be severely disadvantaged, if not precluded altogether, from fairly competing in the local exchange market." FCC NY 271 Order at ¶81 (internal quotation marks omitted). The Board itself recognized the overriding importance of nondiscriminatory access to OSS in its Local Competition Report:

> The Board finds that 'Operations Support Systems' are the single most important 'major barrier to competition' affecting New Jersey's local landline residential and small business markets … [W] ithout effective CLEC access to the ILEC's OSS large volumes of residential customers cannot be switched to CLECs quickly enough to allow for mass marketing by CLECs.

Investigation Regarding Local Exchange Competition for Telecommunications Services, Docket No. TX98010010 (July 1998) ("Local Competition Report") at 19.

In evaluating whether a section 271 application complies with checklist item ii, the FCC has determined that evidence drawn from *actual commercial usage* is the most probative form of evidence. *Application by SBC Communications, Inc., Southwestern Bell Telephone Co., and Southwestern Bell Communications Services, Inc. d/b/a Southwestern Bell Long Distance, Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Service in Texas*, CC Docket No. 00-65, Memorandum Opinion and Order at ¶102 (June 30, 2000) ("FCC TX 271 Order"). The New York and Pennsylvania PSCs have concurred. FCC NY 271 Order ¶89; *see Consultative Report on Application of Verizon Pennsylvania, Inc. for FCC Authorization to Provide In-Region, InterLATA Service in Pennsylvania*, Docket No. M-00001435, Procedural Order, Pennsylvania Public Utility Commission at 12 (November 29,

2000) ("PA Procedural Order"). The Board has likewise recognized the importance of actual OSS usage data, describing nondiscriminatory access as requiring the provision of OSS to competitors in "substantially the same time and manner" as is provided to retail affiliates. FCC LA II 271 Order ¶87 (quoted in *In the Matter of the Investigation Regarding Local Exchange Competition for Telecommunication Services*, Order Approving Revised Guidelines, Docket No. TX95120631 at 1 (Nov. 9, 2001)). Such information can only be obtained from real world data involving the actual provision of OSS by Verizon-NJ to competitors. Indeed, the disparity between hypothetical and actual testing of OSS has recently been recognized by the Public Service Commission of the District of Columbia ("DC PSC"). The DC PSC recently approved modifications to Carrier-to-Carrier metrics governing OSS such that they measure "actual (as opposed to simulated) transactions … to provide a more accurate representation of the responsiveness of Verizon DC's OSS interfaces to CLEC requests." I/M/O Development of Local Exchange Carrier Quality of Service Standards for the District, Formal Case No. 990, Order No 12230 at 2 (Nov. 9, 2001).

Despite its import, Verizon-NJ's Petition fails to provide any evidence of actual commercial usage by which the Board can evaluate the ability of Verizon-NJ's OSS systems to sustain a realistic level of demand in a competitive market. Selwyn Declaration ¶19. Instead, Verizon-NJ relies exclusively on KPMG's OSS testing results, derived from tests conducted in an artificial environment and of questionable relevance to real world provisioning of OSS.[8] This is

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[8] Indeed, AT&T's Panel on OSS provided a thorough critique of KPMG in its role as a "pseudo-CLEC," demonstrating that third party testing is not, in fact, comparable to OSS provisioning in the real world. AT&T OSS Panel Declaration ¶¶37-62. Even so, the Ratepayer Advocate elicited at hearing that KPMG received shoddy treatment from Verizon-NJ. T.1547:6-16 (11/20/01).

inconsistent with 271 analyses conducted in other jurisdictions. For example, in New York Verizon provided actual commercial usage data pertaining to the provision of nondiscriminatory access to its application interfaces for all of the pre-ordering functions that it provides to itself. FCC NY 271 Order ¶¶130, 133. In Pennsylvania, the PUC allowed three months of actual commercial usage to assist it in its review of Verizon's section 271 application in that state. PA Procedural Order at 12. Verizon-NJ's OSS must be tested using actual competitor transactions in order to confirm the adequacy of the system for a competitive environment and comply with the nondiscriminatory access requirements of section 271 checklist item ii. Both New York and Pennsylvania have stated that, although OSS test results were valuable to their examination, "the most probative evidence that OSS functions are operationally ready is actual commercial usage." FCC NY 271 Order ¶89; *see* PA Procedural Order at 12.

The importance of actual commercial usage of OSS is underscored by the recent Board approval of the Performance Assurance Plan ("PAP"). *In the Matter of the Board's Investigation Regarding the Status of Local Exchange Competition in New Jersey—Performance Standards and Remedies*, BPU Docket N. TX98010010—Item 4B, BPU Agenda Meeting (October 12, 2001). The PAP is designed to prevent Verizon-NJ from discriminating against competitors through the imposition of monetary penalties for failures under the New Jersey Carrier-to-Carrier Guidelines. As the PAP was implemented on November 1, 2001, Verizon-NJ's Petition contained no data regarding its performance in the provision of OSS to competitors. Selwyn Declaration ¶21. The absence of real world testing of penalties prevents the Board from developing a full record such as that sought by the FCC in section 271 proceedings. More importantly, neither consumers nor competitors have yet been able to discern whether the PAP will prove sufficient to ensure nondiscriminatory treatment by Verizon-NJ. *Id*. Verizon-NJ must also demonstrate that it is able to perform under the recently established PAP. The Ratepayer Advocate suggests that Verizon-NJ be required to demonstrate compliance with the PAP for at least three months before the Board contemplates a recommendation on Verizon-NJ's Petition. Motion to Dismiss at 12.

1. The Board should suspend approval until the competitive impact of the newly established UNE rates can be determined

The fact that the competitors and ratepayers of New Jersey have not had experience with brand new UNE rates also prevents its compliance with section 271 checklist item ii. 47 U.S.C. §271(c)(2)(B)(ii). The Board approved new UNE rates on November 20, 2001. State of New Jersey Board of Public Utilities, Board Meeting, Item 4A, *In the Matter of the Board's Review of Unbundled Network Elements Rates, Terms and Conditions of Bell Atlantic-New Jersey, Inc.* (Nov. 20, 2001) ("November 20 Board Meeting"). In that meeting, Board President Hughes astutely recognized the essential nature of UNE rates to other Board proceedings, including the instant one: "we really do want to have [UNE rates] in place, we have other issues on the table that are somewhat dependent upon this[.]" November 20 Board Meeting 42:22-25.

Yet, without actual implementation of the rates as approved, competitors cannot be certain that they are receiving "nondiscriminatory access to network elements," as required by the section 271 checklist. 47 U.S.C. §271(c)(2(B)(ii). While the development of TELRIC-based rates is certainly a prerequisite to a grant of section 271 authority, it is the implementation of those rates by the incumbent that determines whether competitors are receiving nondiscriminatory access to UNEs.[9] For example, Verizon-NJ might disadvantage its competitors by

[9] Moreover, the November 20 Board Meeting transcript suggests that the Board may consider issuing a Summary Order, to be followed by a Final Order, to implement UNE rates as quickly as possible and to avoid legal wrangling

unintentionally, but improperly, "double billing" a given type of service order. This type of action would very effectively disadvantage competitors and undermine the development of competition. As Ratepayer Advocate Blossom Peretz stated upon the release of new UNE rates for New Jersey,

> The next step is to see whether this new UNE rate actually works and serves as an incentive to telephone companies to come to New Jersey to offer local service in competition to Verizon's near monopoly. We should know by next spring whether we will have irreversible competition in the local telephone market.

Blossom Peretz, "Ratepayer Advocate Applauds BPU for Lowering Rates Verizon Charges Competitors," Press Release (November 20, 2001) (Attachment 1).

Indeed, subsequent to the FCC NY 271 Order granting Verizon interLATA authority competitors noted an "unconstrained aggressiveness" in Verizon's attempts to dismantle competition and put them into a price squeeze. *See, e.g.*, New York Module 3 Recommended Decision at 23. The Board must realize that, as competition in New Jersey lags significantly behind that in New York, a grant of section 271 authority in New Jersey risks even more serious problems as Verizon-NJ will be able to more effectively exercise its market power in local services. Verizon-NJ recognizes this because in its Bone/West/Taylor Reply, Verizon-NJ states it could use its local presence to become a "formidable" competitor in long distance. *See* Bone/West/Taylor Reply, Att. 103.

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over Verizon-NJ's rerun of several outputs of its model. November 20 Board Meeting 41-43. However, competitors will not be able to determine whether they are, in fact, receiving nondiscriminatory access to UNEs until the Final Order is issued and the Verizon-NJ reruns are approved. Thus, any decision on Verizon-NJ's Petition should be delayed until there is at least adequate time for parties to assess final, and not interim final, UNE rates.

Without an affirmative showing that the new UNE rates are nondiscriminatory as implemented, Verizon-NJ cannot meet the nondiscriminatory access requirements of 47 U.S.C. §271(c)(2)(B)(ii), and its Petition should not be considered until such certainty as to nondiscriminatory access is achieved.[10]

V. VERIZON-NJ'S PETITION FAILS THE PUBLIC INTEREST TEST

Verizon-NJ's Petition does not meet the statutory public interest requirement established by section 271(d)(3)(C) of the 1996 Act, and as such the Board should dismiss it. Moreover, a number of the public interest failures of Verizon-NJ's Petition also violate the competitive checklist, especially 47 U.S.C. § 271(c)(2)(B)(ii). Verizon-NJ fails to demonstrate any level of competition in local exchange, much less that such competition is "irrevocable," as required by the FCC. *See, e.g.*, FCC MI 271 Order ¶386. Indeed, the lack of actual experience with both OSS and new UNE rates precludes any inference at this time that competition will develop under a grant of section 271 authority. In addition, Verizon-NJ fails to provide any evidence of the geographic distribution of competition in New Jersey, implying that consumers in most areas of the state are denied access to competitively provided local exchange services. As a result, Verizon-NJ cannot demonstrate that a grant of section 271 authority at this time is in the public interest. 47 U.S.C. § 271(d)(3)(C). These failures preclude satisfaction of the public interest requirement.

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[10] As reflected in the Ratepayer Advocate's December 3 letter to the Board, the Ratepayer Advocate supports Worldcom's request to file supplemental testimony addressing the impact of new UNE rates on this proceeding. The Ratepayer Advocate additionally proposed a six-month review period within which Verizon-NJ would be required to demonstrate compliance with the new UNE rates. Parties to this proceeding would be able to comment upon Verizon-NJ's compliance during the course of the review period. Letter from Blossom A. Peretz, Esq., Ratepayer Advocate to Henry Ogden, Acting Secretary, Board of Public Utilities (December 3, 2001).

Reliance on competition to replace regulation is the fundamental tenet of both the New Jersey 1992 Act and the 1996 Act. Indeed, competition is exactly what section 271 is designed to ensure. Before the Board permits Verizon-NJ to provide unregulated interLATA services, it must be sure that Verizon-NJ truly faces effective competition in local exchange services. Until consumers have access to effective competition in local services, Verizon-NJ will have the opportunity to use its market power to the detriment of New Jersey ratepayers through increased prices and lower service quality. In addition, Verizon-NJ will have the added incentive *and ability* to leverage its monopoly in local exchange services to remonopolize the market for interLATA services. In the absence of regulation, only effective competition would give Verizon-NJ the proper incentives to lower prices and increase service quality and innovation.

Competition has yet to become a reality for New Jersey ratepayers. Verizon-NJ continues to dominate the local telecommunications market to the exclusion of competitive providers and to the detriment of consumers. As Ratepayer Advocate Blossom A. Peretz stated, five years after the enactment of the 1996 Act and nine years after the New Jersey 1992 Act,

> New Jersey consumers are still waiting [for] competition and innovation. All efforts to date to facilitate the development of that competition in New Jersey's local telephone exchange market have prove[n] futile. Verizon's competitors have captured only a small and insignificant fraction of the local exchange market. Right now, here in New Jersey, ratepayers have no choice.

PAR-II, Hearing, T.33:9-19 (8/13/01).

Without either effective local competition or the kinds of incentives provided by section 271, Verizon-NJ will be able to use its market power to stifle competition. Indeed, the situation in New York, where Verizon New York, Inc. was granted section 271 authority in 1998, proves instructive on this point. Following Verizon New York’s section 271 approval in New York, competitors reported renewed attempts to derail competition on the part of the incumbent. *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 (May 16, 2001) ("New York Module 3 Recommended Decision") at 23. Possessing even less competition than was evident in New York at the time, New Jersey will face even more severe competitive problems subsequent to a grant of section 271 authority. For these reasons, more specifically described below, the Ratepayer Advocate requests that the Board dismiss Verizon-NJ's Petition and/or recommend against a grant of section 271 authority at the FCC.

A. A Grant of Section 271 Authority Is Not Presently in the Public Interest

> The BPU should be in no hurry to approve Verizon's bid for long distance, not until there is more competition in the local market. That is one way to help ensure Verizon will keep the faith on some of the service issues involved in the way its network connects with the competition.

Editorial, *BPU Answers the Call*, THE STAR LEDGER (Nov. 27, 2001) (*see* Attachment 1).

1. There is no competition in the residential local exchange market

The FCC has stated that, to meet the public interest requirement of 47 U.S.C. § 271(d)(3)(C), a filing must contain "data on the nature and extent of *actual* local competition." FCC MI 271 Order at ¶391 (emphasis added). Unfortunately, despite a number of legislative and regulatory efforts at both the federal and state levels to encourage the development of competition in local exchange, such competition has yet to develop fully. Selwyn Declaration ¶4. This fact cannot be hidden, even by Verizon-NJ. Verizon-NJ cannot demonstrate any level of competition in local exchange; indeed, such competition is less likely absent actual experience with OSS systems and new UNE rates. Moreover, the failure to establish the existence of facilities-based competition in residential local exchange precludes "Track A" compliance under the 1996 Act. 47 U.S.C. §271(c)(1)(A). Absent these showings of competition in local exchange, Verizon-NJ cannot meet the public interest standard.

As explained below, the level of local facilities-based competition alleged by Verizon-NJ does not meet the FCC's *de minimis* standard when compared to the level of local facilities-based competition experienced in other states prior to their section 271 approval. *See* FCC KS/OK 271 Order ¶ 42. Moreover, Verizon-NJ relies solely upon the unsupported opinion of Mr. Bone to establish competition in the relevant services, without any factual information regarding actual competition, as required by the FCC. Finally, the RPA demonstrated in discovery, and Verizon-NJ acknowledged at hearing, that, according to information supplied by the competitors themselves, Verizon has not provided evidence that there is even a single local residential line in New Jersey being served by a competitor. RPA Exhs. 8, 9; VNJ-ATT 3, VNJ-CLEC 3, VNJ-

RCN 1, VNJ-COVAD-1, VNJ-CVL 3. Thus, Verizon-NJ's Petition does not meet the requirements of 47 U.S.C. § 271(d)(3)(C).

New Jersey is the most densely populated state in the nation. Considering the potential revenues, one would think that it would therefore be a haven for local services competition. However, according to the FCC Report on Local Telephone Competition, as of December 31, 2000, competitors in New Jersey served 323,680 end user lines, amounting to a paltry 5 percent of the total. Federal Communications Commission, *Local Telephone Competition Status as of December 31, 2000*, Table 6 (May 21, 2001). In contrast, at the point of section 271 authorization in other Verizon states, competition (measured as a percentage of local lines served by CLECs) was significantly more developed. In Pennsylvania, competitors served 10 percent of the total number of residential lines. *FCC Report on Status of Local Telephone Competition*, Table 6, December 31, 2000 (rel. May 21, 2001). In Massachusetts, the corresponding number was 11 percent. *FCC Report on Status of Local Telephone Competition*, Table 6, May 21, 2000 (rel. Dec. 31, 2000). And in New York, competitors enjoyed a market share of 9.8 percent, or nearly double that of competitors in New Jersey. *NYPSC Analysis of Local Exchange Service Competition in New York State* (rel. Dec. 31, 2000). Thus, Verizon-NJ's argument that the doors of competition are open fails, given the clearly more significant levels of residential competition in states that have already granted section 271 authority.

In its Petition, Verizon-NJ relies on the naked assertions of Mr. Bone to demonstrate the existence of competition in the residential local exchange market. Mr. Bone in turn relies upon a count of actual, pending and/or expired interconnection agreements in asserting that competitors to Verizon-NJ are actually providing service to New Jersey ratepayers. Bone Declaration ¶6.

This information, however, does not, despite Mr. Bone's naked assertion to the contrary, demonstrate that CLECs in New Jersey provide local residential service. This will not do. As the Board is aware, an "expert" opinion unsupported by the requisite facts is inadmissible in court. *Smart v. Fair Lawn Bd. of Adj.*, 152 N.J. 309, 321, 334 (1998).

2. There is no evidence of the geographic distribution of competition in New Jersey

Absent evidence that each and every geographic region in New Jersey is sufficiently open to competition, approval of Verizon-NJ's Petition risks a state-sanctioned local service monopoly in most of New Jersey. The New York PSC recognized this fact in its own proceeding on section 271. And while Verizon addressed the New York PSC's concern through a demonstration of competition in each of seven separate geographic regions of the state, Verizon-NJ has included no similar analysis in this proceeding. Because a showing of competition in every geographic region of the state is required to protect consumers in high cost areas, the Board should dismiss Verizon-NJ's Petition as inadequate.

Prior to the approval of Verizon's 271 application in New York, the New York PSC investigated the extent of competition in seven separate geographic regions of the state.[11] *See* New York Public Service Commission, *Analysis of Local Exchange Service Competition in New York State*, as of December 31, 2000; Selwyn Declaration ¶23. Within each region, the New York PSC examined the ILECs and CLECs serving each region and the numbers of access lines (residential and business) that each was serving. The detail provided to the New York PSC as a

[11] The regions included New York Metro, Albany, Binghamton, Buffalo, Poughkeepsie, Rochester, and Syracuse. New York Metro was further divided into Manhattan; Bronx; Staten Island, Brooklyn and Queens; Long Island; and Northern.

result of this examination allowed it to definitively determine whether each geographic region of the state was subject to competition.

A showing of residential competition in each geographic area of the state is a necessary prerequisite to a determination that 271 authority will not disadvantage vulnerable areas of a given state, leaving ratepayers to face an unregulated local exchange monopoly. Selwyn Declaration at 21. Rather than make a factual showing by geographic area in this proceeding, however, Verizon-NJ attempts to give the appearance of such competition where none exists. Specifically, Mr. Bone states that competitors are currently providing 280 residential lines via their own facilities, 400 residential lines via UNE-P and approximately 59,000 resold residential lines.[12] Bone Declaration ¶8. Mr. Bone then proceeds to conclude, again without the requisite evidence, that "CLECs are serving business and residential customers in *each* area of the State." *Id.* However, absent evidence of the geographic distribution of competition, the Board must consider the very real possibility that the residential line figures recited by Mr. Bone are all contained within a single area code, leaving the vast majority of the state subject to a Verizon-NJ monopoly in local services. Selwyn Declaration ¶23 n. 32. At hearings Mr. Bone conceded that he could not confirm whether the millions of telephone numbers that he claimed were assigned to competitors were actually being used by customers today. *See* Tr.1447-1448. If Verizon-NJ is granted section 271 authority, these consumers will be left without any realistic hope of local

[12] While UNE-P and resale are cited by Verizon-NJ as sources of competition, its parent corporation apparently considers them not a threat to Verizon's ongoing monopoly in local exchange. Verizon CEO Ivan Siedenberg was widely reported as publicly denigrating UNE-P and resale competitors, and calling "this whole scheme of CLEC interconnection a joke." *See* AT&T Exh. 47, "Seidenberg Lashes Out Against UNE-P Competitors."

competition and without the benefit of the section 271 incentive to ensure nondiscriminatory treatment of actual or potential competitors.

Thus, significant numbers of New Jersey ratepayers are likely to be harmed by a grant of section 271 authority. Despite repeated discovery requests by the Ratepayer Advocate, Verizon-NJ has provided the Board with meager evidence of facilities-based competition in the separate geographic regions of the state. *See, e.g.*, RPA Exh. 2, Verizon-NJ response to RPA-21; *see also* Motion to Dismiss at 6-9. The Board should therefore dismiss Verizon-NJ's Petition until it can definitively establish that competition exists in every geographic region of the state.

B. The Board Should Not Approve Verizon-NJ's Petition Until the Board Establishes a State Universal Service Fund

The establishment of a state Universal Service Fund ("USF") is an essential element of the public interest requirement of section 271. Such a program ensures the availability of affordable service to all the state's low income ratepayers, telecommunications discounts for schools and libraries, and the benefits of competition to those persons in high cost geographic areas. *See* Selwyn Declaration ¶ 24. To date, seven of the nine states in which the RBOC was granted section 271 approval – Connecticut, Kansas, Oklahoma, New York, Pennsylvania, Arkansas, and Texas – had established a state USF prior to endorsing section 271 approval. *See* State Universal Service Fund Summaries, (visited Oct. 22, 2001) <http://www.neca.org/susfa.htm>. In fact, the Pennsylvania Commission, in its comments to the FCC supporting Verizon-PA's Section 271 application, specifically noted that a key issue resolved prior to its Section 271 consideration was the creation of a state USF. *Application of Verizon Pennsylvania Inc., Verizon Long Distance, Verizon Enterprise Solutions, Verizon Global Networks Inc., and Verizon Select Services Inc. for*

Authorization to Provide In-Region, InterLATA Services in Pennsylvania, CC Docket No. 01-138, Consultative Report of the Pennsylvania Public Utilities Commission at 8-9 (filed June 25, 2001). Accordingly, the absence of a Board decision establishing a state USF in New Jersey raises substantial public interest concerns with Verizon-NJ's section 271 petition at this time.

The 1996 Act expressed a strong commitment to the maintenance and expansion of universal service. Congress expanded the law's universal service requirements because it recognized that unfettered competition in the local telecommunications marketplace alone might not deliver universal service. As noted in a report by the National Regulatory Institute:

> Congress, in drafting the Act, may have been looking toward a rosy future of vibrant competition, but Congress also expected that the future would include an expansion of the universal service achievements of the past. . . . *In the future envisioned by the Act, the role of the regulator is to maintain, and even expand, universal service, but do so in a competitive environment.*

National Regulatory Research Institute, *Balancing Competition and Universal Service* at 2-3 (March 2001) (emphasis added).

Pursuant to Congress' universal service mandate, the FCC established a federal USF. *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 12 FCC Rcd 87 (rel. Nov. 8, 1996) ("FCC Universal Service Order"). The federal USF was created to (among other things): (1) assist low income individuals by providing discounts which would reduce their telephone charges; (2) enable both competitive new entrants and incumbent local companies to provide service in high cost areas by providing them with financial support;(3) provide schools and libraries with special discounts on telecommunications services, Internet access, and internal networking; and (4) ensure that health care providers serving rural communities receive discounts for telecommunications services necessary for the provision of health care. *Id.* ¶¶ 7-10. Although the federal USF is intended to provide funding to every state that demonstrates a need, there is no guarantee that the funding provided by the federal USF will suffice to accomplish the universal service goals of that particular state. *See* Consumer Energy Council of America Report, *Universal Service Policy Issues for the 21st Century* at pp. 15, 23. Armed with this knowledge, the Ratepayer Advocate called on the Board to take action in this matter and create a state USF to ensure that New Jersey has adequate funding for its USF programs.

Verizon-NJ's petition heightens the need for the Board to resolve this issue. It is critical that the Board evaluate the need for a state USF as part of the section 271 public interest analysis. The FCC has explicitly found that a section 271 evaluation must necessarily consider "local conditions and experience." FCC MI 271 Order ¶ 30. An examination of "local conditions and experience" in New Jersey should begin with the goals and requirements of the state's legislation, which includes a universal service mandate: "it is the policy of the state to: (1) [m]aintain universal telecommunications service at affordable rates." N.J.S.A. § 48:2-21.16a(1). In light of this legislative policy and consistent with the Ratepayer Advocate's mandate to represent the interests of all New Jersey ratepayers, the Ratepayer Advocate has consistently recommended, at least as far back as the Board's initial attempt to implement the 1996 Act, *Investigation Regarding Local Competition for Telecommunications Services,* Docket No. TX95120631 ("Local Competition Proceeding"), that the Board create a state USF to ensure adequate funding for the USF programs in New Jersey. *See* Selwyn Declaration ¶ 24.[13]

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[13] In the 1997 Local Competition Proceeding, the Ratepayer Advocate recommended a Low Income Fund of $11 million and a High Cost Fund of $16 million. Local Competition Proceeding, Crane Direct at 14-15, 17-20 (Sept. 16, 1997) (*see* Attachment 2).

The fact that New Jersey citizens face universal service difficulties is well documented. In the Board's Local Competition Proceeding, Dr. Mark Cooper testified that "New Jersey has been doing a poor job in promoting universal service, compared with the rest of the nation." Local Competition Proceeding, Cooper Direct at 5 (Sept. 16, 1997) (*see* Attachment 4). The creation of a state USF remains essential today. *See* Selwyn Declaration ¶ 24.

First, a state fund is required to provide discounts for telecommunications services for schools and libraries because the FCC cap on total annual federal universal service spending means that some New Jersey schools may not receive any discount from the federal USF. Local Competition Proceeding, Cooper Direct at 5-6. (Aug. 19, 1997) (*see* Attachment 3). Furthermore, a state fund could provide additional support for schools that have a greater need. Moreover, although the current Access New Jersey ("ANJ") program aids in enabling K-12 schools and libraries to acquire discounted access to communications services and equipment, the program is scheduled to expire in 2002. Yet, many school classrooms and libraries, continue to lack quality communications access and equipment.[14] Furthermore, many New Jersey schools and libraries are old and require expensive renovations to install the necessary wiring for Internet services. PAR-II, Colton Direct at 28-29. Because federal universal service funding for schools and libraries will not be adequate to meet the needs that exist in New Jersey, it is incumbent on the Board to establish a state USF to provide supplemental funding to those schools and libraries

[14] For example, only 84.0% of all New Jersey classrooms have Internet access. Moreover, only 58.8% of instructional computers are in New Jersey classrooms, and few New Jersey schools have high-speed internet access. Furthermore, while 76.8% of all New Jersey schools report that they have distance learning capabilities, few have high-speed distance learning capabilities. New Jersey Department of Education's 2001 Public School Technology Survey (June 2001); PAR-II, Colton Direct at 27.

in New Jersey with special needs. Thus, there must be some permanent state program in place to ensure schools and libraries continued access to telecommunications discounts.

Second, a state USF would give added assistance to low income households by providing the matching funds necessary to ensure that New Jersey's low income households receive full Lifeline support and, in so doing, would encourage more such households to acquire telephone service through use of the Lifeline program. *See* Selwyn Declaration ¶ 24. Today, Lifeline participants in New Jersey only receive $7.00 per month in assistance rather than the maximum amount allowed of $10.50. This maximum benefit can only be achieved if Verizon-NJ increases its Lifeline commitment to $3.50 per month. *See* PAR II, Colton Direct at 9. It is notable that other states, such as Idaho, are already providing the maximum benefits available under the Lifeline program to their low-income customers. *See* Idaho Code § 56-901(1). Moreover, while the Board has previously directed Verizon-NJ to modify its Lifeline program to increase participation, *The Board's Inquiry into Bell Atlantic-New Jersey, Inc.'s Progress and Compliance with Opportunity New Jersey, as Accelerated by Order Dated June 10, 1997,* Docket No. TX99020050 at 9 (March 30, 2001) ("ONJ Order"), participation remains considerably low, when compared to the number of households presently living at or below 175% of the federal Poverty Level,[15] estimated at 513,000. PAR-II, Colton Direct at 14. These shortcomings of New Jersey's Lifeline program can easily be remedied by the creation of a state USF.

[15] There is a strong correlation of telephone penetration to income. As Mr. Colton explained, staying above the poverty level significantly increases a family's chances of maintaining telephone service. PAR-II, Colton Direct at 8.

Third, a state USF will ensure the availability of affordable service from multiple providers to consumers in high cost geographic areas. *See* Selwyn Declaration ¶ 24. The federal support that New Jersey currently receives to achieve this objective is simply not enough. A state USF is vital if New Jersey intends to remove the disincentive for competitive service providers to serve only those areas where costs are below the statewide average. *See id.* The Ratepayer Advocate believes that a state USF will provide the necessary incentive for competitive carriers to provide service in high cost areas.

Despite these compelling needs for a state USF, to date, no action has been taken by the Board. *See id.* Accordingly, given the public interest served by a state USF and the requirement that the section 271 public interest evaluation examine local conditions, the creation of a New Jersey state USF is a critical predicate to any Board determination that Verizon-NJ's 271 application is in the public interest. *See id*. In the absence of a state USF, New Jersey consumers run the considerable risk of continued reduced universal service benefits once Verizon is granted entry into the long distance market.

VI. THE BOARD SHOULD NOT ENDORSE SECTION 271 AUTHORITY FOR VERIZON-NJ WITHOUT APPROPRIATE SAFEGUARDS

A. Section 271 Authority Would Allow Verizon-NJ to Exploit Joint Marketing to Thwart Competition

1. Verizon-NJ should not be permitted to offer inter-LATA service and engage in joint marketing while it has a monopoly of local exchange service

If Verizon-NJ is granted authority under Section 271, it will be allowed to engage in joint marketing of local and long distance service. 1996 Act § 272(g)(3). The prospect of that joint marketing should be a crucial consideration in the Board's determination in this proceeding, and should persuade the Board to recommend that the FCC reject Verizon-NJ's application. As long as Verizon-NJ retains its monopoly of local exchange service, its ability to engage in joint marketing will create anticompetitive preferences and illegal subsidies, and will likely enable Verizon-NJ to rapidly re-monopolize the long distance market in New Jersey, destroying any local competition and resulting in higher prices for New Jersey ratepayers. Selwyn Declaration ¶4. Such a situation would be contrary to the public interest and would defeat the fundamental purposes of section 271.

The key to any grant of section 271 authority is the presence of local exchange competition to constrain the BOC's ability to leverage a monopoly in that market into the long distance market. The 1984 Modified Final Judgment ("MFJ") prohibited BOCs from offering long distance service in order to prevent the use of their local exchange monopoly to block competition in the interexchange services market that the Bell System had monopolized for so long. Selwyn Declaration ¶25. Section 271 of the 1996 Act created a vehicle for replacing the MFJ's structural remedy, establishing a process through which incumbents could enter the interexchange market *if and only if* their local markets were irreversibly open to competition. *Id*.

When local competition fails to develop, however, – as it has thus far in New Jersey – section 271 authority will restore to Verizon-NJ both the incentive and the ability to use its market power in the local exchange market to remonopolize the long distance market. Joint marketing will be one of Verizon-NJ's most potent weapons in this process of remonopolization. As Ratepayer Advocate witness Selwyn explained:

> the larger the BOC's share of the local market, the greater will be its opportunity to preemptively market its affiliate's long distance service. And if customers exhibit a disproportionate propensity to select the BOC as their long distance carrier as a result of this 'first to get there' opportunity, then over time the BOC's long distance market share would also be expected to grow *directly and specifically as a consequence of its ability to preempt competing long distance carriers in signing up new customers.*

Id. ¶78 (emphasis in original).

The FCC has recognized the danger that if a BOC with local exchange monopoly power receives 271 authority, it will be in an ideal position to monopolize the long distance market as well:

> Indeed, given the BOCs' strong brand recognition and other significant advantages from incumbency, advantages that will particularly redound in the broad-based provision of bundled local and long distance market and, in particular, in the market for bundled local and long distance services, we expect that the BOCs will be formidable competitors in the long distance market and, in particular, the market for bundled local and long distance services. The recent successes of Southern New England Telecommunications Corporation (SNET) and GTE in attracting customers for their long distance services illustrates the ability of local carriers to garner a significant share of the long distance market rapidly.

FCC MI 271 Order ¶ 15.

Congress clearly did not intend that section 271 and the 1996 Act's related permission to conduct joint marketing would enable BOCs like Verizon-NJ to recreate the anticompetitive conditions and long distance monopoly that the MFJ ended. Approval of the instant application, however, would likely have just that result. As discussed in the succeeding section, moreover, allowing Verizon-NJ to engage in joint marketing would create cross-subsidies that violate both federal and New Jersey law, further illustrating that 271 authority for Verizon-NJ would not be in the public interest.

2. Joint marketing by Verizon-NJ could result in illegal and anticompetitive cross-subsidization

Joint marketing of local and long distance service as it is being proposed by Verizon-NJ will create massive subsidies flowing from Verizon-NJ's monopoly local service to its long distance service. This will violate state and federal statutes designed to require arm's length transactions between affiliates and prohibit cross subsidization. The Ratepayer Advocate respectfully submits that the Board should take steps to prevent this illegal result by imposing strict remedies, including accounting requirements, to prevent these subsidies.

Even after a grant of section 271 authority, incumbents are subject to the separate affiliate provisions of section 272(b), including the requirement to "conduct all transactions … on an arm's length basis[.]" Selwyn Declaration ¶46 (*citing* 47 U.S.C. §272(b)). In addition, section 254(k) of the 1996 Act prohibits cross subsidization of services that are not subject to competition. 47 U.S.C. §254(k). Similarly, New Jersey statutes provide additional safeguards. N.J.S.A. §48:2-21.16(a)(3) requires that the Board "[e]nsure that rates for noncompetitive telecommunications services do not subsidize the competitive ventures of providers of telecommunications service."

Despite these clear prohibitions, Verizon-NJ's joint marketing plan, as revealed in the Verizon Long Distance Marketing and Sales Agreement, Selwyn Declaration Att. 3, would create a subsidy flowing from Verizon-NJ's non-competitive local exchange operations to its long distance service. Historically, Verizon-NJ's evaluation of the costs of joint marketing attributable to interexchange service has, and will in this case, fall far short of full value, resulting in cross subsidization of that service by revenues from local exchange via the joint marketing function. *Id.*

¶¶ 59-67. Moreover, the Verizon Long Distance Marketing and Sales Agreement contemplates extensive use of Verizon-NJ personnel to support most of the functions of Verizon's long distance affiliate. It is instructive that, despite its position as the fourth largest long distance provider in the nation (with six million subscribers), Verizon's long distance affiliate officially employs only 452 people. The balance (and most likely the majority) of the workload is carried out by local exchange employees. *Id.* ¶68.

As discussed in the preceding section, the prospect of these subsidies and their likely anticompetitive effect strongly counsel against a grant of 271 authority. Before recommending any such grant, moreover, the Board should put in place regulatory mechanisms, in particular strong, effective accounting requirements, to ensure that any joint marketing by Verizon-NJ does not result in anticompetitive subsidies. These measures would not only vindicate the public interest, as required for 271 authorization, but would be required in any event by the anti-subsidy provisions of N.J.S.A. §48:2-21.16(a)(3). The Ratepayer Advocate discusses these measures below, in connection with its recommendation for structural separation of Verizon-NJ.

B. Without Structural Separation, Inter-LATA Authority for Verizon-NJ Would not be in the Public Interest

As long as Verizon-NJ's wholesale and retail operations are combined as they are today, the Board should decline to recommend that the FCC authorize Verizon-NJ to provide inter-LATA service. If this combination of retail and wholesale functions persists, Verizon-NJ cannot meet the public interest test of section 271, which requires, among other things, that the local telecommunications market be irrevocably open to competition. *E.g.*, FCC PA 271 Order ¶ 71; *see also*, Selwyn Declaration ¶ 5. The current structure of Verizon-NJ gives it the incentive and ability to favor its own retail operations at the expense of competitors and competition. The best means – and a proven means – for ensuring the ongoing competitive conditions required by section 271 is full structural separation of Verizon-NJ's wholesale and retail operations. In the alternative, the Ratepayer Advocate recommends that the Board consider functional/structural separation accomplished through a strong code of conduct supported by strict penalties and accounting safeguards. The Board is currently considering these options in its PAR-II proceeding. PAR-II, Order of Approval (June 20, 2001); *see also* PAR-II, AT&T, Answer and Verified Cross-Petition (February 27, 2001); PAR-II, Direct Testimony on Structural Separation of Lee L. Selwyn (August 3, 2001); PAR-II, Direct Testimony on Structural Separation of Scott Hempling (August 3, 2001). The Ratepayer Advocate urges the Board to act favorably on the requests for structural separation in the PAR proceeding before it acts on Verizon-NJ's application under section 271.

1. To support a grant of section 271 authority, the Board must take steps to eliminate Verizon-NJ's incentive and ability to discriminate against competitors and thwart competition

Under section 271, Verizon-NJ must show not only that competition and competitive conditions exist at the time inter-LATA authority is granted (a showing it has not made), but that those conditions will continue to exist. The FCC has held that:

> we need to ensure that the market opening initiatives of the BOCs continue after their entry into the long distance market. . . . The section 271 approval process necessarily involves viewing a snapshot of an evolving process. We must be confident that the picture we see as of the date of filing contains all the necessary elements to sustain growing competitive entry into the future.

FCC MI 271 Order ¶ 22. Without such an assurance, a grant of inter-LATA service authority will deprive Verizon-NJ of any incentive to promote competition, and leave only its natural incentive to retard competition by discriminating against rivals. *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, First Report and Order, 11 FCC Rcd. 21905 ¶ 11 (December 23, 19960); Selwyn Declaration ¶ 45. As a prerequisite for authorization under section 271, therefore, the Board must take positive steps to minimize Verizon-NJ's incentive and ability to thwart competition through discriminatory behavior.

The combination of Verizon-NJ's wholesale and retail operations in a single business unit gives Verizon-NJ the incentive and ability to restrain competition in a way that offends the public interest requirement of section 271. A firm with a dominant position in a wholesale market has powerful incentives and a unique ability to use that position to disable competitors by favoring its retail business units. *See* Selwyn Declaration ¶ 97; Pennsylvania Public Utilities Commission, *Joint Petition of Nextlink Pennsylvania, Inc.; Senator Vincent J. Fumo; Senator Roger Madigan; Senator Mary Jo White; the city of Philadelphia; The Pennsylvania Cable & Telecommunications Association; RCN Telecommunications Services of Pennsylvania, Inc.; Hyperion telecommunications, Inc.; ATX Telecommunications; CTSI, Inc.; MCI WorldCom; and AT&T Communications of Pennsylvania, Inc. for Adoption of Partial Settlement Resolving Pending Telecommunications Issues; Joint Petition of Bell Atlantic Pennsylvania, Inc., Conectiv Communications, Inc.; Network Access Solutions; and the Rural Telephone Company Coalition for Resolution of Global Telecommunications Proceedings*, Docket Nos. P-00991648, P-00991649, Opinion and Order ("Pennsylvania Global Order") at 235 (August 26, 1999). This results in preferences and advantages for the incumbent's retail business to the detriment of competition and would-be competitors. In addition, this type of discrimination is difficult to prevent because it is difficult to detect. Therefore anticompetitive conduct must be prevented and not allowed to take root. Selwyn Declaration ¶ 97.

2. Structural separation or functional/structural separation under a strong Code of Conduct is necessary to eliminate Verizon-NJ's incentive and ability to discriminate against competitors and thwart competition

Real-world results establish the need for a structural approach to ensuring competitive conditions. As Ratepayer Advocate witness Selwyn explained:

> Intense competition has developed in virtually every segment of the US telecommunications industry in which the RBOCs do not maintain some form of bottleneck control over essential facilities, either because such control has been expressly prohibited by legislative, judicial or regulatory fiat, or in which the RBOCs have themselves had minimal involvement (e.g., and at least up to now, dial-up access to the Internet). *On the other hand, where RBOCs have been permitted to engage in retail operations in markets in which they also control essential facilities (e.g., local exchange service), competition has failed to develop.*

Selwyn Declaration ¶ 98 (emphasis added). The prime example of this is the Bell System divestiture, in which the separation of AT&T's long-distance business from the RBOCs monopoly business allowed long-distance competition to thrive in a way that it never had under previous regulatory regimes. *Id.* ¶ 10. While the Board is not considering the complete divestiture that brought competition to long distance markets, the lesson remains. When steps are taken to separate the competitive side of a business from the monopoly side, the incentive and ability to quash competition diminish, and results can be expected that far surpass the results of behavioral regulation.

Full structural separation would create a separate corporation responsible only for wholesale operations. This would greatly decrease incentives to discriminate in favor of Verizon-

NJ's retail arm, since wholesale employees and managers would be focused on and measured by their provision of wholesale service, not the success of Verizon-NJ's retail segment. *Id.* ¶ 97. In addition, the separate identities of the affiliates providing wholesale and retail services would enhance the Board's ability to detect instances of improper favoritism toward Verizon-NJ's retail arm. Structural separation would create a situation in which "Verizon-NJ-retail would be required to deal with Verizon-NJ-wholesale in exactly the same manner and under the same terms, conditions, and operational interfaces as its nonaffiliated retail competitors." *Id.* ¶ 99.

Functional/structural separation under a code of conduct would be designed to make the wholesale-retail relation resemble full structural separation through a strict code of conduct designed to eliminate all favoritism toward Verizon-NJ-retail. *Id.* ¶ 102. The code would be designed to ensure that Verizon-NJ's retail competitors have completely equal, non-discriminatory access to the same resources Verizon-NJ provides its retail business unit. *Id.* ¶ 106. The relation between Verizon-NJ's wholesale and retail operations would be made as transparent as possible through strict accounting rules. Cost accounting provisions would recognize and measure all transfers of value between those operations, including transfers that are not now accounted for and the joint use of assets. *Id.* ¶ 104. Finally, the code of conduct should be reinforced by strict penalties, swiftly applied, and should order that if Verizon-NJ does not abide by the code of conduct, formal structural separation will follow. *Id.* ¶ 107.

Separation of Verizon-NJ's wholesale and retail operations is necessary because past regulatory efforts have not brought widespread, meaningful competition to New Jersey. Selwyn Declaration ¶¶ 26-44. CLECs' current market penetration is minuscule, *Id.* ¶¶ 27, 30, and the financial condition of these would-be competitors is weak and declining. *Id.* ¶¶ 41-44, Tables 1,

2. This bleak competitive picture, moreover, is not the result of a lack of effort on the part of CLECs, which have invested heavily in efforts to compete with Verizon-NJ. *Id.* ¶ 30. Rather, CLECs' competitive difficulties flow largely from their need to rely on access to Verizon-NJ's network, and from the disadvantages they face in trying to compete with Verizon-NJ's retail operations. *Id.* ¶ 41. Efforts to level the playing field by enforcing the requirements of sections 251 and 252 of the 1996 Act and the procompetitive commands of New Jersey's 1992 Act have not brought anything like the vibrant competition envisioned by the framers of those statutes. Clearly, future competition for Verizon-NJ requires structural separation – an approach that addresses the fundamental causes of the distress in which we find the competitive segment of today's telecommunications industry.

Numerous aspects of Verizon-NJ's operations exemplify the artificial competitive advantages its retail arm enjoys. Verizon-NJ's advocacy in this very proceeding illustrates the edge that Verizon-NJ gains through its integrated structure. Using the E911 database to which it has exclusive access, Verizon-NJ has provided information purporting to show the competitive position of its rivals in New Jersey. Although that information does not demonstrate that competition exists in New Jersey, the E-911 data show that Verizon-NJ has exclusive access to granular information of great value about its retail competitors' activities. Selwyn Declaration note 44.

We have discussed above the anticompetitive advantages that Verizon-NJ would gain from joint marketing of monopoly local exchange and competitive long distance services. Any plan for structural separation should address this situation with, among other things, accounting requirements designed to accurately identify and rectify the subsidies inherent in that situation. *See Id.* ¶¶ 59-60.

A further example of the anticompetitive advantages that structural separation will cure is Verizon-NJ retail's ability to use the Verizon brand name. That name is well known to consumers – and thus valuable – because it is associated with the telephone service that has been consumers' only option for many decades, and because it has been the object of extensive promotion funded by ratepayers. Alone among retail competitors, Verizon-NJ's retail arm derives great value from that brand name, but pays no compensation to Verizon-NJ to reflect that value. *Id.* ¶ 67. Properly designed structural separation would help give true competition room to breathe by eliminating this and other unfair advantages.

C. Precedent Strongly Supports Structural Separation or a Strong Code of Conduct

There is ample authority, both in New Jersey and elsewhere, to support the Board's imposition of structural separation or a code of conduct. The New Jersey Legislature has recognized the value of structural separation as means of replacing regulation with competition. In the Electric Discount and Energy Competition Act, 1999 N.J. Laws 23 ("EDECA"), the Legislature confirmed the propriety of functional or structural separation in the electric and gas industries. In that Act, the Legislature recognized the Board's power to require that a utility provide competitive services through a business unit that is functionally separate from the unit providing monopoly services or from a structurally separate affiliate. N.J.S.A. 48:3-56.f(4) (electric utilities); N.J.S.A. 48:3-58.k(4) (gas utilities). Under the statute's functional separation provisions, the competitive business unit must use a separate corps of employees and separate assets to provide its services. *Id.*

The Board has likewise recognized the benefits of functional/structural separation in its treatment of electric and gas utilities. *See generally* Selwyn Declaration ¶ 93. The Board's Affiliate Relations Standards provide detailed guidance on the relationship between the wholesale and retail operations of electric and gas utilities. N.J.A.C. 14:4-5.1-5.6 (2000). These Standards address the same structural concerns that are relevant to Verizon-NJ's situation. They strictly prohibit discrimination against competitors in favor of competitive business segments. N.J.A.C. 14:4-5.3. This prohibition more particularly covers access to wholesale products and services, N.J.A.C. § 14:4-5.3(b)2, discounts or fee waivers, N.J.A.C. 14:4-5.3(f), processing of requests for wholesale service, N.J.A.C. § 14:4-5.3(j), and other matters. Under the Affiliate Relations Standards, if an electric and gas utility shares proprietary information with a competitive segment of its business, it must make the information equally available to competitors. N.J.A.C. § 14:4-5.4(a); *see also* N.J.A.C. § 14:4-6(m)2 (non-discriminatory sharing of market information). The Standards also impose a general prohibition on sharing office facilities between wholesale and retail business units. N.J.A.C. § 14:4-5.5(e). In addition, the Affiliate Relations Standards require that electric and gas utilities keep separate accounts for each competitive product or service and file related reports with the Board. N.J.A.C. § 14:4-5.6(n), -(p)-(r). Finally, there are stiff penalties for violating the Standards. N.J.A.C. § 14:4-5.9. The Affiliate Relations Standards covering the electric and gas industries provide a useful model for the Board to follow in its efforts to inject competition into New Jersey's telecommunications markets.

The Board's consideration of FirstEnergy Corporation's acquisition of Jersey Central Power and Light Company reiterated and reinforced the competitive merit of a strong code of conduct. *Joint Petition of FirstEnergy Corp. and Jersey Central Power and 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*, BPU Docket No. EM00110870, Order of Approval (Oct. 9, 2001) ("FirstEnergy Order"). There, the Board established a code of conduct to regulate dealings between the competitive and non-competitive business units of the merged firm. *Id.* at 14, 17-18, Att. A ¶¶ 1-10. To prevent any unfair competitive advantage, the First Energy Order requires that the firm's non-competitive units transact business with the firm's competitive units in the same manner as they deal with unaffiliated competitors. *Id.* at 14, 17-18, Att. A ¶ 1(a). This ensures, among other things, that FirstEnergy's non-competitive wholesale business units will not give any preference to its retail affiliates and will provide competitive information to affiliates and non-affiliates contemporaneously and on the same basis. *Id.* at 15, 17, Att. A ¶¶ 1(b), -(c). In addition, the FirstEnergy Order requires that the firm conduct its wholesale and retail operations as separate corporate entities, with separate staffs below the senior officer level, and in physically separate locations. *Id.* at 17, Att. A ¶ 2.

In the telecommunications field, the Pennsylvania Public Utilities Commission affirmatively endorsed using a code of conduct to promote competition. The Commission had ordered full structural separation in an earlier proceeding. Pennsylvania Global Order. After a proceeding meant to implement that decision, the Commission gave Verizon a choice of either Commission consideration of full structural separation or functional/structural separation accomplished via a strict code of conduct. *Bell Atlantic-Pennsylvania Inc.*, Docket No. M-00001353 (Pa. P.U.C.

April 11, 2001) at 29. Verizon-PA opted for functional/structural separation under a code of conduct. This approach would include accounting requirements to prevent cross-subsidization and rules requiring non-discriminatory treatment of retail competitors. *Id.* at 30.

The Pennsylvania PUC is still considering the details of its code of conduct, but in general the code is expected to be similar to what the Ratepayer Advocate supports here. *Id.* at 30; *Rulemaking Re Generic Competitive Safeguards Under 66 Pa. §§ 3005(b) and 3005(g)(2), Implementation of the Telecommunications Act of 1996; Imputation Requirements for the Delivery of IntraLATA Services by Local Exchange Carriers,* Dkt. Nos. L-00990141, M-00960799, Public Meeting November 30, 2001, Motion of Commissioner Terrance J. Fitzpatrick (Pa. P.U.C. November 30, 2001) (adopting for comment proposed code of conduct rules; approved by 4-0 vote). The Chairman of the Pennsylvania PUC identified what should be every regulator's goal in formulating such a code:

> [T]he proposed rules are designed to prevent unfair competition and unlawful cross-subsidization, and to assure that incumbent local exchange carriers ("ILECs") provide adequate and nondiscriminatory wholesale services to competitive local exchange carriers ("CLECs"). I support these goals whole-heartedly and believe they are necessary in order to allow effective local telephone competition . . ..

Id., Statement of Chairman Glen R. Thomas.

The Public Utilities Commission of Ohio has required that telephone companies operating in long distance markets be subject to formal structural separation. Thus, the Ohio Commission ordered United Telephone, which provided both local and long distance service, to conduct those operations through separate, independent corporate entities. *Application of United Telephone Long Distance, Inc. for Authority to Furnish Interexchange Telecommunications Services Within* *the State of Ohio,* Case No. 86-2173-TP-ACE, Summary of Finding and Order (December 7, 1988). The Commission required that the two affiliates have separate officers and employees, and that they use separate technical resources and equipment unless they made shared resources equally available to competitors. *Id.* at 37-38. The Ohio Commission took this step to eliminate the "potential for cross-subsidization and anti-competitive practices." *Id.*; *see also* Selwyn Declaration ¶ 96.

The Board can rely, therefore, on established regulatory policy, the declarations of the New Jersey Legislature, this Board's own actions in other industries, and the actions of other state regulators for authoritative support and practical guidance in imposing either full structural separation or functional/structural separation through a code of conduct and strict accounting controls. Either of these approaches would be measured, viable means to ensure that Verizon-NJ and its retail competitors compete on a full, fair and equal basis. The Ratepayer Advocate regards either of these approaches as a minimum requirement for satisfying the public interest test for a grant of section 271 authority. Accordingly, the Ratepayer Advocate respectfully urges the Board not to recommend a grant of inter-LATA service authority unless and until it provides for structural separation of Verizon-NJ's retail and wholesale operations.

> The structural and institutional changes that hallmark the new regulatory environment have motivated state public utility commissions to reexamine their relationships with consumers, utilities, billing agents, federal utility commissions, other government agencies, consumer protection agencies, stakeholder organizations (CBOs). In doing so, it has motivated them to reexamine both their roles and responsibilities and the very essence of who the are.
>
> Intrinsic to the question of who they are, lies the challenge of state public utility commissions to maximize consumer welfare and protect consumers form market abuses. Conclusions indicate that as we move forward within the new competitive environment, it will be important for state public utility commissions to conduct market monitoring to ensure that safeguards are in place to adequately protect consumers from market abuses, as well as ensure that all classes of consumer reap the benefits, not the growing pains, of competition.
>
> “The *Consumer Response to Public Utility Competition”*
> *The National Regulatory Research Institute*
> *June 2001*, p. 49

VII. CONCLUSION

For the aforementioned reasons, the Ratepayer Advocate urges the Board to deny Verizon-NJ’s current 271 petition and revisit these issues in six months following implementation of the new UNE rates, the Board’s implementation of PAR-II (including structural separation), commercial testing of Verizon-NJ’s OSS and the creation of a state universal service fund. This time is necessary to determine whether the Board’s decisions and Verizon-NJ’s OSS will irrevocably open the local market to competition.

Respectfully submitted,

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On the Brief