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December 31, 2010

Honorable Howard A. Jack
Administrative Law Judge
New York State Department of Public Service
Three Empire State Plaza
Albany, New York 12223

Re: Case 09-M-0527

Dear Judge Jack:

Attached please find the Initial Panel Testimony of Verizon New York Inc.

Respectfully submitted,

A handwritten signature in black ink that reads "Joseph A. Post". The signature is written in a cursive, flowing style.

Joseph A. Post

cc: Active Party List
Honorable Jaclyn A. Brillling

**STATE OF NEW YORK
PUBLIC SERVICE COMMISSION**

**Proceeding to Examine Issues
Related to a Universal Service Fund**

Case 09-M-0527

INITIAL PANEL TESTIMONY OF VERIZON NEW YORK INC.

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HAROLD E. WEST, III**

Panel Members

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December 31, 2010

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1 **I. INTRODUCTION**

2 Q. What is the purpose of this testimony?

3 A. This testimony is submitted by Verizon New York Inc. (“Verizon”) to
4 explain why the Commission should *not* create a new fund to provide
5 financial support for certain independent telephone companies (“ITCs”)¹
6 following the depletion of the “Transition Fund” that was authorized by the
7 Commission in 2003.² The testimony also proposes alternative measures
8 that the Commission might take to address potential universal service
9 issues in the ITC service areas, and discusses the manner in which a
10 fund should be designed and operated if — contrary to the views set forth
11 in this testimony — one is established.

12 Q. Does this testimony address each of the issues set forth in Appendix A to
13 Judge Jack’s November 18, 2010 “Ruling on Phase II Procedures”?

¹ The term “ITC” is generally used to refer to incumbent LECs other than former Regional Bell Operating Companies or their successors in interest. Thus, in New York, the term would refer to all ILECs other than Verizon. However, we use the term here as a convenient designation for potential fund recipients, reflecting the fact that this proceeding has its roots in a petition filed by a group of ITCs urging the establishment of a state Universal Service Fund. In using the term, Verizon is *not* assuming that every ITC in the State would be eligible for participation in a fund (if one is created), or that non-ITC companies would *not* be eligible to participate. Issues related to eligibility for funding are discussed elsewhere in this testimony.

² The Transition Fund was approved by the Commission on December 23, 2003 as part of a comprehensive plan to phase out the State’s Intrastate Access Pool. See Case 02-C-0595, “Order Adopting Comprehensive Plan” (issued and effective December 23, 2003) (the “*Transition Fund Order*”).

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1 A. Yes. Exhibit A to this testimony summarizes Verizon's position on each of
2 the issues identified in Judge Jack's Appendix, and lists the sections in
3 this testimony where each such position is discussed.

4 Q. Who are the members of the witness Panel sponsoring this testimony?

5 A. The members of the Panel are Mr. Paul B. Vasington and Mr. Harold E.
6 West III.

7 Q. Mr. Vasington, please describe your background and experience.

8 A. I am a Director – State Public Policy for Verizon Services Corp. I have a
9 Bachelor of Arts degree in Political Science from Boston College and a
10 Master's degree in Public Policy from Harvard University, Kennedy
11 School of Government. I have been employed by Verizon since February
12 2005.

13 Before my employment with Verizon, from September 2003 to February
14 2005, I was a Vice President at Analysis Group, Inc. Prior to that, from
15 May 2002 to August 2003, I was Chairman of the Massachusetts
16 Department of Telecommunications and Energy ("MDTE"). I also served
17 as a Commissioner at the MDTE from March 1998 to May 2002. Prior to
18 my term as a Commissioner, I was a Senior Analyst at National Economic
19 Research Associates, Inc. from August 1996 to March 1998. Before that,
20 I was in the Telecommunications Division of the Massachusetts
21 Department of Public Utilities, first as a staff analyst from May 1991 to

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1 December 1992 and then as telecommunications division director from
2 December 1992 to July 1996.

3 Q. Mr. West, please describe your background and experience.

4 A. I am employed by Verizon Services Corp. as Director – Regulatory
5 Support. I graduated from Princeton University in 1980 with a Bachelor of
6 Sciences in Engineering. In 1991, I completed an Executive Masters
7 program at the University of Pennsylvania and received a Master of
8 Sciences in engineering. I began working for New Jersey Bell (a
9 predecessor of Verizon’s affiliate Verizon New Jersey Inc.) in 1980 as a
10 central office equipment engineer. I then held positions of increasing
11 responsibility in Service Costs, Rates, Product Management, Sales, and
12 Regulatory. I began my current position in December 1994. In this
13 position, I have testified before public utility commissions across the
14 country, as well as the Federal Communications Commission (“FCC”), on
15 various marketing, policy and pricing issues associated with competitive
16 entry into telecommunications markets.

17 Q. Please provide a brief outline of this testimony.

18 A. This testimony begins by showing that a fund is not necessary and should
19 *not* be created simply to provide financial assistance to ITCs, in order to
20 protect the companies themselves or their investors. As we demonstrate,
21 robust facilities-based competition exists in virtually all areas of the State,

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1 and so a fund is not needed to preserve universal service. Moreover, a
2 fund would have a number of undesirable effects, including the
3 deterrence of competition in ITC service areas, the creation of
4 inappropriate incentives for the ITCs themselves, and the imposition of
5 unfair burdens on other regulated carriers and their customers.

6 Accordingly, the Commission should not create a new fund to replace the
7 Transition Fund.

8 We go on to discuss measures that the Commission might take *without*
9 creating a fund in order to protect the financial integrity of troubled ITCs
10 (if the Commission determines that to be a legitimate objective), and to
11 ensure that ITC functions, if any, that are necessary to the continued
12 existence of universal service are maintained.

13 Finally, although Verizon opposes the creation of a fund, the testimony goes
14 on to consider how a fund should be designed and operated if one were to be
15 created. For example, we explain why any funding made available to ITCs
16 should be strictly limited to what is necessary to address specific, defined
17 universal service objectives. Funding should not be a blank check that
18 guarantees that an ITC will be able to realize its “revenue requirement” and
19 thereby achieve a rate of return as specified in a traditional rate case, or that
20 it will be made whole for past or ongoing competitive revenue losses.

21 Q. Does the testimony address all issues relevant to the creation of a fund?

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1 A. No. In particular, this testimony is limited to factual and policy issues, but
2 there are also important legal issues bearing on the creation and
3 operation of a fund. These include the extent of the Commission's
4 authority to create and require contributions to a fund, and the question of
5 whether requiring contributions from companies that are themselves not
6 earning a reasonable return would violate § 97 of the Public Service Law
7 or the constitutional prohibition on takings without just compensation.
8 Such issues will be addressed in the briefs submitted by the Company in
9 this proceeding.³

10 Q. As a matter of sound regulatory policy, who should bear the burden of
11 proof on issues relating to the establishment and operation of a fund?

12 A. The burden should be on the parties who support the creation of such a
13 fund.

14 Q. Why?

15 A. A universal service fund providing explicit financial support to "high cost"
16 ITCs would be a new feature of the New York regulatory landscape.
17 Proposals to create some form of high-cost funding arrangement have
18 been put before the Commission on a number of occasions over the last

³ To the extent that statements as to Verizon's positions on matters of law are included in this testimony, they will be addressed and justified in Verizon's legal briefs. They are not offered as factual or policy conclusions of the Panel members.

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1 two decades, and the Commission has consistently declined to adopt
2 them.⁴ Although in 1998 the Commission created a fund known as the
3 Targeted Accessibility Fund, or “TAF,” the TAF has the narrow purpose of
4 advancing a limited number of clearly-defined public policy objectives by
5 providing support for E911, Telecommunications Relay Service, and
6 Lifeline. It does not provide general financial support for ITCs with
7 purportedly high costs, low revenues, or inadequate rates of return.
8 In view of this history, as well as the competitive markets that now exist
9 throughout the State, the burden should be on the proponents of a fund to
10 demonstrate the need for and appropriateness of such a significant
11 change in direction by the Commission.

12 Q. Doesn't the Transition Fund provide a precedent for the creation of a
13 fund?

14 A. No. The Transition Fund was explicitly created as a temporary device
15 utilizing a fixed source of funding. Moreover, it was known that the

⁴ See, e.g., Case 28425, “Opinion and Order on Pooling, Collocation and Access Rate Design” (Op. No. 92-13) (issued and effective May 29, 1992), at 5 (leaving “some matters for future resolution, including . . . whether to establish a ‘high cost fund’ to ensure that secondary carriers with high costs will not have to charge access rates significantly above the statewide average”); Cases 94-C-0095 and 28425, “Order Resolving Issues Related to Independent Telephone Companies’ Access Charges, the 1998 Ice Storm and Other Matters” (issued and effective December 4, 1998), at 9 (finding no need to “begin development of a rate affordability fund at the present time”); Case 05-C-0616, “Statement of Policy on Further Steps Toward Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings”

(continued . . .)

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1 Transition Fund would likely be fully spent within a limited period of time.
2 The very name “Transition Fund” indicates the expectation that the Fund
3 would mediate a transition to financial self-reliance on the part of the
4 funded companies. Although the settlement that created the Transition
5 Fund also established a process (the “Fund Track”) for considering
6 possible successor arrangements, there was no guarantee that any such
7 arrangement would be put in place. Indeed, one of the issues listed for
8 consideration in such a future proceeding was the fundamental one of
9 whether a successor fund should be created at all.⁵ The Commission
10 specifically noted that it had approved the settlement creating the
11 Transition Fund:
12 without any prejudgment of the need for or nature of a longer-
13 term universal service fund that might follow exhaustion of the
14 Transition Fund The Plan defers all such matters to the
15 Fund Track . . . and recognizes . . . that all parties reserve their
16 rights as to the positions they will take in the Fund Track.
17 Accordingly, we need not comment further on those matters.⁶

(. . . continued)

(issued and effective April 11, 2006) (“*Competition III Order*”), at 75-76 (agreeing with Staff’s conclusion that a state high cost fund “is unnecessary at this point . . .”).

⁵ See Case 02-C-0595, “Comprehensive Plan, Phase II” (attached to *Transition Fund Order*), ¶ 10(a) (“A separate Fund Track will be established to address all issues associated with the need for, establishment of, administration of, and recovery of disbursements from any funding arrangement designed to replace the Transition Fund described herein.”); *id.* ¶ 10(b) (“The Issues to be addressed in this Fund Track include, but are not limited to, the following:
1. Should a fund be established?”).

⁶ *Transition Fund Order* at 11.

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1 Thus, the mere existence of the Transition Fund provides no guarantee of or
2 justification for the creation of a successor fund.

3 **II. THE PURPOSES OF A FUND**

4 Q. If a fund is to be created, what purpose should it serve?

5 A. Proponents of high-cost funding arrangements have generally argued that
6 financial support for ITCs is necessary to ensure the maintenance of
7 universal service — in other words, the continued provision of service to the
8 ITCs' customers by the ITCs. In reality, however, the issues of financial
9 support for ITCs and universal service for customers are separate and
10 distinct. While the universal availability of some form of telephone service at
11 a just and reasonable price may be an appropriate public policy goal, given
12 the many facilities-based competitive carriers that are ready, willing, and able
13 to provide service in the ITCs' service areas, external funding for the
14 business model of one particular group of providers — the incumbent ITCs —
15 is not necessary to ensure the continuation of universal service for the benefit
16 of consumers. Reliance on existing competition, and encouraging the entry
17 of new competitors, are far better mechanisms for protecting universal
18 service than the creation of a new fund to support incumbent providers.

19 Q. Is the protection of existing service providers a sufficient justification for the
20 creation of a fund, if a fund is not necessary to preserve universal service?

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1 A. No. There can be no policy justification (and, as Verizon will show in its
2 briefs, no legal justification) for creating a fund merely in order to protect
3 service providers or their investors from the financial consequences of
4 competition. Moreover, as we demonstrate in this testimony, such a fund
5 would have a number of undesirable side-effects, including unfair impacts on
6 other service providers, deterrence of legitimate competition, and the creation
7 of inappropriate incentives for the funded companies.

8 . If the Commission concludes that there are legitimate interests of existing
9 providers that need to be addressed, they should be dealt with through other
10 Commission initiatives, or through Commission forbearance. For example,
11 inadequate rates of return can be addressed, to the extent feasible, through
12 the standard rate-case mechanism. If the financial problems of the ITCs are
13 attributable to legacy regulatory obligations, certainly those obligations
14 should be relaxed or eliminated as responsibility for serving customers
15 passes to the competitive market. The Commission should also be cautious
16 about impairing existing revenue streams on which carriers have historically
17 relied to support legacy regulatory burdens, where the associated rate levels
18 are just and reasonable.

19 However, the Commission has recognized that ILECs must take predominant
20 responsibility for their own financial well-being by containing costs and
21 pursuing revenue growth opportunities in response to secular declines in

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1 their traditional wireline business. Providers must also recognize the risks of
2 a competitive market and cannot expect a guaranteed rate of return which, in
3 any event, the Commission no longer has the power to ensure through the
4 rate-case mechanism. As the Commission observed over fourteen years
5 ago:

6 As we move toward a more competitive environment, local
7 telephone companies must be ready to compete effectively
8 with entrants to their markets who are able to successfully price
9 at or below the incumbents' costs. Thus, the incumbents must
10 institute, now, revenue enhancing and cost-cutting measures.
11 Incumbent carriers should also have the flexibility to meet their
12 competition.⁷

13 Therefore, no provider can claim to have been caught unawares by changes
14 in technology, competition, and consumer demand, and there should be a
15 heavy burden on any company that claims a new fund should be created in
16 order to provide it with external financial help today and going forward.
17 To the extent that the Commission wishes to address the financial problems
18 of ITCs, it should do so using mechanisms that do not involve the creation of
19 a new fund. A proposal for such a mechanism is discussed in Section IV of
20 this testimony.

⁷ Case 94-C-0095, "Opinion and Order Adopting Regulatory Framework" (Op. No. 96-13) (issued and effective May 22, 1996) ("*Framework Order*"), at 13.

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1 **III. CREATION OF A FUND IS NOT NECESSARY IN ORDER TO**
2 **PRESERVE UNIVERSAL SERVICE, AND WOULD HAVE A**
3 **NUMBER OF UNDESIRABLE CONSEQUENCES**

4 **A. The Widespread Availability of Competitive Alternatives**

5 Q. Is support of incumbent ITCs necessary to preserve universal service in New
6 York?

7 A. It is not. Intermodal providers offer facilities-based alternatives to the
8 services provided by incumbent LECs in virtually every part of the State.

9 Q. What evidence is there of this?

10 A. In a study based on 2004 data conducted in connection with the
11 Commission's *Competition III* proceeding, Staff concluded that 89.53% of
12 New Yorkers had at least two facilities-based, *i.e.*, intermodal, alternatives
13 available to them.⁸ In 2007, Staff, "as a follow-up to the Comp III
14 Proceeding," carried out a statistically-validated telephone survey of
15 approximately 1,500 residential consumers in New York.⁹ Using a modified,
16 "more granular" approach based on that survey, Staff concluded that the

⁸ See Case 05-C-0616, Department of Public Service, "Telecommunications in New York: Competition and Consumer Protection" (September 21, 2005), Appendix E, Table 1.

⁹ See New York State Department of Public Service, "New York State Residential Telecommunications Consumer Survey" (April 20, 2007), at 3.

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1 percentage of consumers with two or more intermodal options had increased
2 to 95%.¹⁰

3 In late 2009, Staff conducted a study in this proceeding and concluded that
4 “most of New York’s 19 million residents have alternative phone options.”¹¹

5 One of Staff’s analyses, for example, found that only about one-half of one
6 percent of upstate property locations has no cable modem or wireless service
7 available.¹²

8 Q. Other than Staff’s studies, is there any other evidence of the widespread
9 availability of intermodal competition in New York?

10 A. Yes. Exhibit B describes a new analysis of competition in the ITC service
11 areas. This study utilized: (a) Census Bureau data and related
12 geospatial data sets to identify the locations of households in the service
13 areas of the ITCs¹³; (b) data from the State Office of Cyber Security to
14 identify the areas in which cable modem service or fixed wireless
15 broadband service is available; and (c) American Roamer data to identify

¹⁰ *Id.* at 3-4, 7-9, 40-43. The survey results were conservative since Staff’s telephone survey of State residents excluded cellular numbers — thus by fiat eliminating a significant group of customers utilizing a competitive alternative to traditional wireline service.

¹¹ Case 09-M-0527, “Preliminary Staff Report on Cable and Wireless Phone Coverage” (December 22, 2009), at 2.

¹² *Id.* at 7.

¹³ Specifically, Verizon’s study was based on the group of ITCs who, under the NYSTA umbrella, are supporting the creation of a fund in this proceeding (*i.e.*, the “NYSTA Smaller ILECs”).

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1 CMRS service areas. The study demonstrates that over 99 percent of the
2 households in the ITC service areas have at least one intermodal
3 alternative available to them, and over 82 percent have at least two
4 alternatives. A detailed description of the methodology and results of the
5 study is provided as Exhibit B to this testimony.

6 Q. What implications do these findings have for this proceeding?

7 A. The studies show that competitive services are available to all but a *de*
8 *minimis* percentage of customers throughout the ITC service areas —
9 including the areas served by the ITCs that are likely to seek financial
10 support if a new fund is created. In fact, the percentage of households
11 currently without intermodal alternatives is less than the percentage of
12 customers without telephone service in 2008 (2.1 percent — see
13 Response to CTANY-DPS-1 — a level that is generally considered
14 sufficient to constitute “universal service”). Thus, the findings and study
15 demonstrate that the goal of universal service in the ITC territories in New
16 York is not dependent on the services of the ITCs themselves, and that
17 subsidizing those providers to ensure the continuation of universal
18 service is unnecessary. At a minimum, external financial support for an
19 ITC would be a significantly overbroad regulatory response to the
20 problem of ensuring the continued existence of universal service, a

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1 problem that technology and competition have already solved in any
2 event.

3 Q. How should the Commission assess whether the alternatives examined in
4 these studies (principally wireless service and cable modem service)
5 provide adequate substitutes, for universal service purposes, for the
6 circuit-switched landline service provided by the ITCs?

7 A. The adequacy of alternatives to traditional providers should be judged by the
8 test of the market — *i.e.*, whether there is substantial consumer acceptance
9 of the alternative. No other test is as accurate, as meaningful, and as
10 consistent with the Commission's stated policy favoring market discipline
11 through competition — where competition exists — over market discipline
12 through traditional regulation. Competition is about the primacy of *customer*
13 choice; it is a mechanism that enables customers to decide for themselves
14 what they want and to "vote with their feet," rather than having regulators
15 decide for them what features, functionalities, and services they want or
16 "need."

17 The NYSTA Smaller ILECs question the relevance of alternative services to
18 the issues in this case on the grounds that such services:

19 are not subject to the Commission's telecommunications
20 service regulatory oversight, may not be the same level of
21 voice grade communications provided by the NYSTA Smaller
22 ILECs, are not provided on a common carrier (or, in some
23 instances, a Commission overseen intrastate common carrier)

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1 and carrier of last resort basis, and are not provided by entities
2 like the NYSTA Smaller ILECs that have demonstrated and
3 continue to demonstrate their universal service commitment
4 within their respective service areas.¹⁴

5 However, it is clear that the consumers themselves do not agree with the
6 ITCs' perception that only their own tightly-regulated services could possibly
7 meet consumer needs. The telecommunications market has been
8 transformed by network convergence and, from a consumer's viewpoint, the
9 relevance of technological or regulatory distinctions between service
10 providers has evaporated. Cable companies and other broadband providers
11 compete with traditional telephone services and facilitate competition by VoIP
12 providers. Wireless mobile companies now compete for voice services, as
13 well as for data services, and text messages substitute for both voice
14 messages and e-mail. The changing consumer preferences that this
15 revolution in communications technology has fostered must be taken into
16 account in determining whether intermodal services are adequate substitutes
17 for traditional services. In fact, the Commission has noted the importance of
18 consumer acceptance to the question of whether a service can be
19 considered a viable alternative:

¹⁴ Response to VZ-NYSTA-7.

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1 Our experience and the record in this proceeding reveal that
2 competition in New York's telecommunications markets has
3 evolved dramatically over just the past few years.

4 . . . Every month tens of thousands of customers in New York
5 switch from their incumbent local exchange service providers to
6 intermodal competitors to obtain savings and innovative, value-
7 added services.¹⁵

8 . . . We find that these services are widely available in New
9 York and that from the perspective of customer demand *they*
10 *are sufficiently close substitutes* for traditional wireline local
11 service.¹⁶

12 Thus, the Commission should *not* require that alternative providers or
13 technologies be subject to the regulatory framework established for
14 traditional wireline POTS service (tariffing, service quality metrics, intra-
15 and interLATA equal access, etc.) in order to "count" for universal service
16 purposes. That test, which could be applied only by ignoring actual
17 market evidence, would also impose an artificial and unreasonable barrier
18 to new and innovative technologies, and would be unnecessary to ensure
19 just and reasonable rates and service. Indeed, in a wide range of
20 competitive industries across the economic spectrum, it is the market, not
21 regulation, that determines the acceptability of alternative services and
22 service providers.

¹⁵ *Competition III Order* at 4.

¹⁶ *Id.* at 33 (emphasis supplied; footnote omitted).

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1 Q. Do commercially available wireless and VoIP services meet this market-
2 based test?

3 A. Yes. At a minimum, wireless service and VoIP service (both fixed and
4 nomadic) have achieved widespread consumer acceptance and indeed in
5 some areas are achieving deployment levels equal to or exceeding those of
6 incumbent providers. Almost five years ago, in the *Competition III Order*, the
7 Commission stated:

- 8 • “We note that the FCC also recently concluded that facilities-based
9 digital phone and wireless are sufficiently close substitutes for wireline
10 local service. . . . Although the FCC found the record inconclusive
11 regarding application based VOIP services (i.e., ‘over-the-top’ VOIP),
12 in part because customers must separately obtain broadband access,
13 it noted that some proportion of mass market consumers may view
14 these services as substitutes for wireline local service.”¹⁷
- 15 • “In our judgment, consumers view these offerings as close substitutes
16 to wireline local service.”¹⁸
- 17 • “Regarding application-based VoIP services, we recognize that they
18 have different service characteristics, like self installation, and may not
19 be viewed widely as close substitutes. But given that in excess of
20 35% of New Yorkers already subscribe to some kind of high speed
21 broadband service, these customers could subscribe to an application
22 based VoIP service being offered by a number of providers such as
23 Vonage without an additional subscription to broadband. Moreover,
24 the FCC recently required that these interconnected VoIP services
25 provide E911 capability similar to that offered by traditional carriers.
26 Vonage, for example, offers an unlimited calling plan for \$24.99 per
27 month. In view of the potential significant cost savings, and the FCC’s

¹⁷ *Id.* at 33 n.72.

¹⁸ *Id.* at 34.

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1 requirement that such providers offer E911, we believe these services
2 can also serve as a close substitute for traditional wireline service for
3 a significant number of New York consumers.”¹⁹

4 • “Subscriptions to wireless services have increased dramatically in the
5 past few years. Although the [Staff] White Paper recognized that not
6 all customers will view wireless service as a complete substitute for
7 traditional wireline service, we agree with the White Paper that a
8 growing number of customers are willing and able to consider wireless
9 as a close substitute for wireline service. A recent survey reported
10 that about 9.4% of US wireless subscribers already use a wireless
11 phone as their primary phone.”²⁰

12 Developments since 2006, when the *Competition III Order* was issued,
13 corroborate the Commission’s conclusions. With respect to wireless service,
14 one such development is the growing percentage of “cord-cutters” who
15 forego landline service altogether in favor of wireless alternatives. According
16 to the most recent report on cord-cutting by the Centers for Disease Control,
17 “More than one of every four American homes (26.6%) had only wireless
18 telephones . . . during the first half of 2010 — an increase of 2.1 percentage
19 points since the second half of 2009. In addition, nearly one of every six
20 American homes (15.9%) received all or almost all calls on wireless
21 telephones despite having a landline.”²¹ The percentage of households with

¹⁹ *Id.* at 34-35 (footnotes omitted).

²⁰ *Id.* at 35 (footnotes omitted).

²¹ Blumberg S.J., Luke J.V., “Wireless substitution: Early release of estimates from the National Health Interview Survey, January-June 2010” (National Center for Health Statistics, December

(continued . . .)

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1 only landline service has decreased from 23.8% (in the first half of 2007) to
2 only 12.9% (in the first half of 2010).²² The trend toward wireless-only
3 households will only accelerate as the segment of the population that never
4 subscribed to wireline service continues to grow. Indeed, more than half of
5 adults aged 25-29 (51.3%) now live in households with only wireless
6 telephones,²³ and as of June 2009, there were 18.2 million wireless
7 subscribers in New York, and only 10.9 million wireline and VoIP subscribers,
8 combined.²⁴

9 Whatever conclusions may be drawn from the ubiquitous availability of
10 wireless service in other regulatory contexts, it is clear from market
11 experience that wireless service meets the minimal standards for addressing
12 universal service requirements. That wireless carriers are often treated as
13 Eligible Telecommunications Carriers in the federal universal service
14 program is further evidence that wireless service is adequate for this social
15 policy purpose.

(. . . continued)

2010) (the “*CDC Study*”), available at
<http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless201012.htm>.

²² *CDC Study*, Table 1.

²³ *Id.* at 2.

²⁴ FCC, “Local Telephone Competition: Status as of June 30, 2009,” Tables 8 and 17 (rel. Sept. 2010), available at
http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db1122/DOC-301310A1.pdf.

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1 With respect to VoIP, the Commission's conclusions are supported by
2 data on the increasing consumer acceptance enjoyed by VoIP-based
3 telephony in general, and cable company "digital voice" products in
4 particular:

- 5 • As of June 30, 2009, interconnected VoIP services provided by
6 non-ILECs in New York represented about 25% of the total of all
7 switched access and interconnected VoIP lines in the State.²⁵
- 8 • Cable companies served more than 22 million residential voice
9 customers as of the end of 2009.²⁶ Analysts predict that the
10 number of mass market customers switching to cable voice
11 services will continue to increase and that cable companies will
12 serve an estimated 23-24 million residential voice subscribers by
13 the end of 2010, and 25 million subscribers by the end of 2012.²⁷
- 14 • The cable industry itself trumpets that telephone consumers are
15 now benefiting from "true competition": "A quarter century after the
16 initial breakup of the original AT&T telephone monopoly, true
17 competition has come to the market for phone service, thanks to
18 cable's facilities-based offering. Gaining both powerful features
19 and cost efficiency by utilizing digital Voice over Internet Protocol
20 (VoIP) technology on the same hybrid fiber-coaxial network that

²⁵ *Id.*, Table 9.

²⁶ See *March 2010 Bundle Report* (22.3 million subscribers as of the end of 2009); Timothy Horan *et al.*, Oppenheimer, *1Q10 Wireline Preview*, at 14, Exhibit 12 (Apr. 13, 2010) (21.4 million subscribers as of the end of 2009); Christopher King *et al.*, Stifel Nicolaus, *3Q09 Battleground Report: Telcos vs. Cable*, at 11 (Nov. 16, 2009) (22.3 million subscribers as of 3Q09).

²⁷ Timothy Horan *et al.*, Oppenheimer, *1Q10 Wireline Preview*, at 14, Exhibit 12 (Apr. 13, 2010) (estimating cable will serve 22.8 million voice subscribers by the end of 2010 and 24.8 million voice subscribers by the end of 2012); see *March 2010 Bundle Report* at 12 (estimating that cable will serve 24 million voice subscribers in 2010).

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1 carries video and Internet data signals, cable telephone service is
2 high in both quality and affordability.”²⁸

3 • Vonage, the largest over-the-top VoIP provider, serves
4 approximately 2.4 million subscribers nationwide, a more than six
5 hundred percent increase from December 2004.²⁹ Clearwire offers
6 voice and Internet bundles over its extensive 4G WiMax network
7 covering more than 34 million people in 27 U.S. markets.³⁰
8 Clearwire reported that as of the Fourth Quarter of 2009, it had
9 approximately 688,000 retail and wholesale subscribers, and
10 expects that its 4G network will cover up to 120 million people in
11 2010 and also anticipates that its 4G subscriber level will triple.³¹
12 Skype’s “SkypeOut” service, which allows customers to make
13 VoIP-originated calls to wireline and wireless phones for a fee, has
14 grown from 4.1 billion minutes in 2006 to 10.6 billion minutes in
15 June 2009.³²

16 Indeed, even some governmental agencies, hospitals, and emergency
17 service providers — the types of customers who would be most likely to be
18 sensitive to reliability and service quality concerns — have chosen to switch
19 to competitive alternatives in recent years. See Exhibit C to this testimony.

²⁸ NCTA 2007 Industry Overview at 13.

²⁹ See Vonage Press Release, “Vonage Holdings Corp. Reports Fourth Quarter and Full Year 2009 Results” (Feb. 25, 2010), available at <http://ir.vonage.com/releasedetail.cfm?ReleaseID=447133>; Vonage Press Release, “Vonage Crosses 400,000 Line Mark” (Jan. 5, 2005), available at <http://ir.vonage.com/releasedetail.cfm?ReleaseID=194545>.

³⁰ See Clearwire News Release, “Clearwire Reports Fourth Quarter and Full Year 2009 Results” (Feb. 24, 2010), available at <http://investors.clearwire.com/phoenix.zhtml?c=198722&p=irol-newsArticle&id=1394717>.

³¹ *Id.*

³² See eBay Inc., Form 10-Q at 20 (SEC filed July 29, 2009) (data for minutes 1H09 and 1H08); eBay Inc., Form 10-K at 51 (SEC filed Feb. 20, 2009) (data for 2006 and 2008).

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1 Q. Has the Commission addressed the standards that a service must meet in
2 order to “count” for universal service purposes?

3 A. Yes. The Commission has specifically identified the features and
4 functionalities that constitute the “basic service” whose ubiquitous availability
5 is the goal of the State’s universal service policy. In its 1996 *Framework*
6 *Order*, the Commission stated:

7 As the competitive transition evolves, we will continue to
8 ensure the provision of basic telephone service, at an
9 affordable rate, to New York’s customers. Basic service is a
10 dynamic term that refers to those telephone services deemed
11 essential to minimally acceptable access to, and use of, the
12 public telecommunications network. Those services deemed to
13 be basic should be made universally available.³³

14 The Commission went on to conclude that the list of basic services should
15 include these features and functionalities:

- 16 • Single Party Access Line
- 17 • Access to Local/Toll Calling
- 18 • Local Usage
- 19 • Tone Dialing
- 20 • Access to Emergency Services
- 21 • Access to Assistance Services
- 22 • Access to Telecommunications Relay Services

³³ *Framework Order* at 9.

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- 1 • Directory Listing
- 2 • Privacy Protections

3 Q. Do wireless and VoIP services provide these functionalities?

4 A. VoIP and wireless service obviously provide the equivalent of a single-party
5 access line, as well as access to local and toll calling, local usage, and tone
6 dialing. Moreover, both wireless and VoIP providers are required to provide
7 access to emergency services, access to relay service, and privacy
8 protections.³⁴
9 Although intermodal providers do not necessarily list their customers' names
10 in White Pages directories by default, consumers no longer believe that a
11 default White Pages listing is necessary or even a particularly important
12 aspect of their service.³⁵ (If they did believe this, so many of them would not

³⁴ See, e.g., Wireless Communications and Public Safety Act of 1999, Pub. L. No. 106-81, 113 Stat. 1286 (1999); and New and Emerging Technologies 911 Improvement Act of 2008, Pub. L. No. 110-283, 122 Stat. 2620 (2008), *codified in relevant part at* 47 U.S.C. § 222. See also 47 C.F.R. § 20.18; 47 C.F.R. §§ 9.1 *et seq.*; *Implementation of the NET 911 Improvement Act of 2008*, WC Docket No. 08-171, Report and Order (rel. Oct. 21, 2008); 47 U.S.C. § 255; *Implementation of Sections 255 and 251(a)(2) of The Communications Act of 1934, as Enacted by the Telecommunications Act of 1996: Access to Telecommunications Service, Telecommunications Equipment and Customer Premises Equipment by Persons with Disabilities; Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, WC Docket No. 04-36, *et al.*, Report and Order, 22 FCC Rcd 11275 (rel. June 15, 2007). See also 47 C.F.R §§ 64.2001 *et seq.*; and *Implementation of the Telecommunications Act of 1996; Telecommunications Carriers' Use of Customer Proprietary Network Information and Other Customer Information; IP-Enabled Services*, CC Docket No. 96-115, WC Docket No. 04-36, Report and Order and Further Notice of Proposed Rulemaking (rel. Apr. 2, 2007).

³⁵ See Case 10-C-0215, "Order Granting Waiver with Conditions" (issued and effective October 15, 2010), at 10 ("Customers today have many options in terms of locating telephone

(continued . . .)

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- 1 be “cord-cutting” and migrating to wireless service only.) The Commission
2 should no longer require this as an aspect of universal service.
- 3 Similarly, access to live-operator-based “assistance” services should no
4 longer be required as an aspect of universal service. Customers can place
5 calls or obtain information in a wide variety of ways, and competing providers
6 should be willing to offer alternatives and compete for customers based (in
7 part) on the convenience and quality of the alternatives that they provide.
- 8 Q. Does the fact that some intermodal providers may not offer Lifeline service
9 mean that their services are not adequate for universal service purposes?
- 10 A. No. First of all, some wireless carriers do provide discounted Lifeline service
11 in New York utilizing federal subsidies.³⁶ Moreover, the wide variety of price
12 plans and price points offered by wireless carriers enables customers to
13 obtain service at affordable rates with or without specially discounted Lifeline
14 service. In any event, the existence of customers with special needs, such as

(. . . continued)

numbers. Statistics suggest that telephone directories are not nearly as valuable as they were even a decade ago.”); Michael Felberbaum, “Dark Days for White Pages: Companies Yank the Cord on Residential Phone Books as Use Fades,” AP Newswires (Nov. 11, 2010) (“Fewer people rely on paper directories for a variety of reasons: more people rely solely on cell phones, whose numbers typically aren’t included in the listings; more listings are available online; and mobile phones and caller ID systems on land lines can store a large number of frequently called numbers.”).

³⁶ See the Universal Service Administrative Company website at www.lifelinesupport.org/li/tools/disbursements. (Lifeline disbursements to New York carriers can be identified by selecting “NY” as the State and using the “Find” button.) Among the carriers listed are Tracfone and Virgin Mobile.

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1 Lifeline customers, is not a sufficient rationale for propping up an ailing
2 incumbent provider. More efficient, narrowly-targeted alternatives for
3 meeting any such needs exist, such as modifying the TAF so that TAF funds
4 that would otherwise be paid to ITCs to support their Lifeline services could
5 be used to provide vouchers or other direct subsidies to eligible customers in
6 order to help them pay for intermodal services.

7 **B. The Creation of a Fund Would Deter Competitive Entry**
8 **into ITC Service Areas**

9 Q. Aside from the fact that an explicit mechanism for providing financial
10 support to ITCs is unnecessary to ensure the continued existence of
11 universal service, what other conclusions can be drawn from the near-
12 ubiquitous existence of facilities-based competition in this State, as
13 demonstrated by the Staff and Verizon studies?

14 A. The studies show that robust competition is present in virtually all areas of
15 the State, except for a very small number of “white spot” areas. This
16 demonstrates the importance of adopting measures that will provide
17 incentives for competitive entry into the remaining white spots, and of
18 avoiding measures that will deter such entry. Subsidization of incumbent
19 providers through the creation of a new fund could further deter new entry
20 and may even lead existing competitors to exit the market. Accordingly,
21 the creation of a universal service fund would not only be unnecessary
22 but would actually be counterproductive, since it would hinder

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1 competition, which is the best guarantor of universal service, price and
2 service discipline, and innovation.

3 Q. Could the problem of deterring competition be addressed by providing
4 similar levels of funding to competitive providers in any area in which
5 funding is provided to an ITC?

6 A. No. Such a “solution” would create significant public policy concerns of its
7 own, as is illustrated by the widely-acknowledged problems experienced by
8 the federal High-Cost Fund (particularly the creation of subsidies that are
9 unnecessary to sustain universal service, and the resulting explosive growth
10 in fund size) as a result of the federal mandate to provide high-cost support to
11 competing and incumbent providers at equal levels.³⁷

12 **C. A Fund Would Create Inappropriate Incentives for ITCs**

13 Q. How would the creation of a fund affect the economic incentives of the
14 ITCs?

15 A. The availability of funding based simply on a showing of financial need by
16 an incumbent wireline provider would not solve the underlying problems
17 that led to that need. Rather, it would simply further delay resolution of

³⁷ See, e.g., 47 C.F.R. § 54.307; Federal Communications Commission, “Connecting America: The Broadband Plan” (March 2010) (“*National Broadband Plan*”), at 148 & nn.103-05 (labeling support of multiple competitive carriers for voice service in a particular area as “clearly inefficient”); *High-Cost Universal Service Support*, WC Docket No. 05-337, CC Docket No. 96-45, Order, 23 FCC Rcd 8834 (rel. May 1, 2008).

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1 the hard questions that incumbent companies need to confront — how, in
2 a competitive market, those carriers can become self-sustaining without
3 burdening competitors and their customers. The creation of a fund at this
4 point would provide little in the way of consumer benefits while creating a
5 class of permanently dependent providers — which is obviously not a
6 development that the Commission should encourage.

7 **D. A Fund Would Impose an Unfair Burden on Other**
8 **Service Providers and Their Customers**

9 Q. Are there other reasons why the Commission should not establish a fund?

10 A. Yes. Support for a fund would be an unfair and unreasonable burden to
11 impose upon the competitors that would be called upon to provide the
12 funding, particularly Verizon, and on the customers of those companies.

13 Q. Why?

14 A. Verizon suffers from its own formidable financial challenges in New York as a
15 result of many of the same factors that are affecting the ITCs: legacy
16 regulatory obligations, high fixed costs associated with the maintenance of a
17 legacy network, and competitive inroads on revenues. Four and a half years
18 ago, in the *Competition III Order*, the Commission concluded that “[m]any
19 consumers are taking advantage of [competitive] options and are reaping the
20 benefits of technology and competition; as a result, former monopoly

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1 providers are losing customers, lines, usage, and revenues.”³⁸ The
2 Commission in that Order also recognized “the availability of real competitive
3 alternatives and actual competitive gains that competitive carriers are
4 achieving. These market forces are constraining incumbent prices and
5 indeed are forcing incumbent prices down. This, in turn, reduces financial
6 margins on previously more profitable products”³⁹
7 These realities are reflected in Verizon’s financial metrics. For calendar year
8 2009 (the year of Verizon’s most recent Annual Report to the Commission):

- 9 • Verizon’s intrastate return on common equity was *negative*
10 142.96%.⁴⁰
- 11 • Its total-company net income was *negative* \$1.16 *billion*,⁴¹ and its
12 total-company net operating income was *negative* \$852.5 million.⁴²
- 13 • Its total-company cash flow from operating and investing activities
14 was *negative* \$1.02 billion.⁴³

³⁸ *Competition III Order* at 35.

³⁹ *Id.* at 54 (footnote omitted).

⁴⁰ See Annual Report of Verizon New York Inc. for the Year Ended December 31, 2009 to the State of New York Public Service Commission (“Report”), Schedule 10, Line 4(b). The corresponding total-company figure was *negative* 55.9%.

⁴¹ Report, Schedule 12, Line 48(c) minus Line 22(c). This figure excludes the income in Account 7355, “Equity in Earnings of Affiliated Companies,” a large part of which is income from Verizon’s *nationwide* long distance operations. (Those operations currently reside in a subsidiary of Verizon New York Inc.). Such income should not be included in an assessment of Verizon’s performance in this State.

⁴² *Id.*, Schedule 12, Line 16(c).

⁴³ *Id.*, Schedule 13, Line 18(b) + Line 40(b) – Line 13(b). This figure excludes dividends from subsidiaries and affiliates; see footnote 41. The predominant component of “investing activities” is additions to telephone plant.

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1 These figures are not short-term anomalies, but part of a consistent trend that
2 is documented in the following data from Verizon's annual reports to the
3 Commission for calendar years 2005 through 2009:⁴⁴

YEAR	Dollars in Millions			
	NET INCOME	NET OPER. INCOME	CASH FLOW	ROE
2005	- 474.5	- 360.1	-451.9	- 44.7%
2006	- 849.8	- 719.3	-924.5	- 73.6%
2007	- 942.1	- 927.9	-472.8	- 46.0%
2008	- 920.8	- 638.2	-1,000.6	- 48.7%
2009	- 1,155.1	- 852.5	-1,021.5	-143.0%

4 The picture is not nearly so grim for the companies that are now seeking
5 funding.⁴⁵ For 2009, the net income of the regulated New York
6 telecommunications industry as a whole — excluding Verizon — was
7 *positive* \$165.4 million, with total net operating income of *positive* \$127.5
8 million. The net income of Class B telecommunication companies⁴⁶ was
9 *positive* \$34.8 million and their net operating income was *positive* \$20.5
10 million. The ROE for the total industry excluding Verizon was *positive*

⁴⁴ All income and cash flow figures are total company numbers, and are given in \$ M. Net income excludes Account 7355 and cash flow excludes dividends from affiliates. Cash flow is for operating and investing activities combined. ROE is calculated on an intrastate basis.

⁴⁵ Data derived from <http://www.dps.state.ny.us/5yrbook/index5yr.htm>, files 2009tela-c.pdf and 2009teld-f.pdf. Values for some missing entries in these reports were requested from and provided by Staff.

⁴⁶ Class B telephone corporations are those with annual revenues less than \$100 million. 16 NYCRR § 661.1(a). The companies seeking draw-downs from a successor fund would presumably all fall within this group.

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1 7.7%, and the ROE for Class B telecommunications companies was
2 *positive* 5.8%.

3 This is not to say that some individual ITCs did not have negative values
4 for some key financial metrics in 2009. Nevertheless, it would clearly be
5 unjust and unreasonable to look to Verizon to subsidize other companies
6 whose financial metrics are no worse than — and in many cases
7 significantly better than⁴⁷ — Verizon's own, particularly in view of the facts
8 that:

- 9 • Verizon is not seeking such funding itself (but rather is seeking to
10 address its own financial challenges through cost reductions,
11 obtaining relief from outdated legacy regulatory obligations, and
12 the pursuit of new revenue opportunities);
- 13 • the company would under most contribution formulas be the
14 predominant contributor to a fund; and
- 15 • notwithstanding the financial challenges that it faces, Verizon is
16 aggressively investing in its infrastructure in the State.

17 Indeed, imposing such an obligation on Verizon would violate the
18 paramount federal and state policies against taking without just
19 compensation, as well as with the policies underlying § 97 of the Public
20 Service Law — which requires the Commission, in deciding whether a

⁴⁷ For example, of the four companies that currently draw from the Transition Fund or that have a funding application "in the pipeline" — Crown Point, Oneida County, Newport, and Germantown — three were cash-flow-positive in 2009. Only Crown Point had a reported ROE

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1 regulated telephone corporation should be required to reduce its rates, to
2 give “due regard, among other things, to a reasonable average return upon
3 the value of the property actually used in the public service.” Requiring a
4 company that already has a negative rate of return to subsidize other
5 companies cannot constitute “due regard . . . to a reasonable average
6 return” Certainly such due regard is no less appropriate when the
7 Commission is seeking to impose funding obligations on a regulated
8 company than when it is seeking to compel such a company to reduce its
9 rates. Even if imposing such obligations were lawful (and, as Verizon will
10 show in its briefs, it is not), it would be manifestly *unjust* and
11 *unreasonable*.

12 Q. Would this problem be adequately addressed if Verizon were permitted to
13 increase its existing rates — or to impose new end-user surcharges — in
14 order to recover the amount of its contributions?

15 A. No. Creating a surcharge would not solve the fundamental problems
16 resulting from the creation of a fund. In addition, such a surcharge would
17 not only harm consumers, but would also unfairly harm Verizon. Because
18 New York has an extraordinarily competitive telecommunications market,

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worse than Verizon’s; the other three companies had ROEs of negative 0.7%, negative 1.5%,
and negative 8.5%.

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1 Verizon may be unable to pass the contribution burden on to its own
2 customers, in which case it would bear additional revenue losses. Thus,
3 allowing Verizon to charge higher rates might merely convert a direct
4 financial burden (*i.e.*, a funding obligation) into an indirect one (*i.e.*,
5 further diminution of revenues due to competitive losses). For this
6 reason, there should be no mandate for any company to impose a
7 surcharge.

8 Although general rate relief measures (such as additional pricing
9 flexibility) may mitigate the financial impact of a funding obligation to
10 some extent, it cannot be assured to eliminate it totally. The precise
11 magnitude of the net impact would depend upon the amount of the
12 funding obligation that is imposed on Verizon, the nature of the rate relief
13 granted,⁴⁸ and other relevant factors. And, as Verizon will demonstrate in
14 its briefs, the Commission cannot impose a funding obligation on Verizon
15 absent rate relief or other measures that are *shown* to be adequate to
16 offset the adverse impact of the obligation on Verizon's already-negative
17 rate of return.

⁴⁸ An important factor is that Verizon *already* has broad pricing flexibility for virtually all non-basic retail residence services.

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1 Q. Should the imposition of such burdens on Verizon and other service
2 providers be a matter of concern to the Commission?

3 A. Yes. Impairing the financial ability of the funding companies to invest and
4 to serve their own customers would hardly advance the goal of universal
5 service. The FCC recognized this fact in an order that it issued earlier
6 this year, noting that “[s]everal courts” had determined that “over-
7 subsidizing universal service programs can actually undermine the
8 statutory principles set forth in [47 U.S.C. § 254(b)]” and concluding that
9 “a proper balancing inquiry must take into account our generally applicable
10 responsibility to be a prudent guardian of the public’s resources.”⁴⁹

11 As the FCC noted, courts have also weighed in on this issue. In upholding a
12 cap on high cost support for Competitive Eligible Telecommunications
13 Carriers, the United States Court of Appeals for the D.C. Circuit concluded
14 last year that the FCC must exercise fiscal responsibility with universal
15 service funding by “balanc[ing] the risks of excessive subsidization with the
16 principles set forth in § 254(b)” and “consider not only the possibility of
17 pricing some customers out of the market altogether, but the need to limit the

⁴⁹ *High-Cost Universal Service Support and Federal-State Joint Board on Universal Service*, WC Docket No. 05-337 and CC Docket No. 96-45, Order on Remand and Memorandum Opinion and Order, 25 FCC Rcd 4072 (rel. Apr. 16, 2010) (“*High-Cost Support Remand Order*”), ¶ 29.

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1 burden on customers who continue to maintain telephone service.”⁵⁰ The
2 court concluded that it was “entirely reasonable” for the FCC to “consider its
3 interest in avoiding excessive funding from consumers.”⁵¹ The D.C. Circuit
4 echoed the Fifth Circuit’s earlier findings in its *Alenco* decision.⁵²

5 **E. The Likely Implementation of Significant Structural**
6 **Changes in Federal Universal Service Support as a**
7 **Result of the National Broadband Plan Militates Against**
8 **the Creation of New State Support Mechanisms**

9 Q. How does the National Broadband Plan bear on the Commission’s
10 consideration of a fund?

11 A. Under Section 8.3 of the National Broadband Plan, the FCC proposes to
12 adopt a “comprehensive reform program” that will re-purpose the federal
13 High-Cost support program “from primarily supporting voice
14 communications to supporting a broadband platform that enables many

⁵⁰ See *Rural Cellular Ass’n v. FCC*, 588 F.3d 1095, 1102 (D.C. Cir. 2009) (“*Rural Cellular*”).

⁵¹ *Rural Cellular*, 588 F.3d at 1103.

⁵² See *Rural Cellular*, 588 F.3d at 1102. *Alenco* recognized that the FCC’s “broad discretion to provide sufficient universal service funding includes the decision to impose cost controls to avoid excessive expenditures that will detract from universal service.” See *Alenco Comms, Inc. v. FCC*, 201 F.3d 608, 620-21 (5th Cir. 2000). The *Alenco* court also noted that “excessive funding may itself violate” the Act by “detract[ing] from universal service by causing rates unnecessarily to rise, thereby pricing some consumers out of the market.” *Id.*, 201 F.3d at 620. The Tenth Circuit expressed similar concerns in its *Qwest II* decision, acknowledging that “excessive subsidization arguably may affect the affordability of telecommunications services, thus violating the principle in § 254(b)(1).” See *Qwest Comm’s Int’l Inc. v. FCC*, 398 F.3d 1222, 1234 (10th Cir. 2005).

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1 applications, including voice.”⁵³ Ultimately, the proposal is to “end all
2 financial support for networks that only provide ‘Plain Old Telephone
3 Service’ (POTS).”⁵⁴
4 Such a program would obviously have a profound effect on federal high-
5 cost funding and on the business plans of carriers that currently receive
6 such funding. In 2009, the NYSTA companies received \$27,829,264 in
7 total, federal USF support.⁵⁵ Changes to the federal fund in turn will have
8 an equally significant effect on the need for and structure of state high-
9 cost funds. As the FCC noted in the Plan, “Reform requires federal and
10 state coordination,” and the “FCC should seek input from state
11 commissions on how to harmonize federal and state efforts to promote
12 broadband availability.”⁵⁶
13 The recommendations of the National Broadband Plan will be the subject
14 of much discussion in the near future. The FCC has already begun to
15 initiate the multiple universal service reform proceedings contemplated by
16 the Plan. The Commission should be cautious about putting in place a

⁵³ *National Broadband Plan* at 141.

⁵⁴ *Id.* at 143.

⁵⁵ See Response to VZ-NYSTA-6, Exhibit VZ-I-06-01-01.

⁵⁶ *National Broadband Plan* at 143.

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1 new regulatory initiative that could fail to harmonize with — or indeed
2 could even impair — federal efforts and policies in this area.⁵⁷

3 **F. Summary**

4 Q. Please summarize your conclusions concerning the desirability of
5 creating a fund that would benefit financially troubled incumbent LECs.

6 A. The creation of a fund would promote unfair and unreasonable outcomes,
7 and would be inconsistent with the public interest. Accordingly, a fund
8 should not be created. Instead, to the extent it becomes necessary to
9 address the problems of financially-troubled ILECs (but only to that
10 extent), the Commission should utilize the other alternatives that are
11 discussed in Section IV.

12 Q. Should a fund nevertheless be created as a precautionary measure, in
13 case the Commission should conclude at some point in the future that the
14 need for funding outweighs the concerns outlined above?

⁵⁷ See *In re State Universal Service Fund*, Docket No. NOI-08-2, “Order Terminating Inquiry” (Iowa Utilities Bd Aug. 25, 2010), at 2 (determining that the “federal reforms [proposed in the National Broadband Plan] make it difficult at this time for the Board to move ahead with its inquiry into the SUSF. It is not yet clear how the ultimate changes to the USF and ICC will affect Iowa consumers. Without more information about how consumers will be affected, the Board cannot determine whether an Iowa USF is appropriate and what level of support would be necessary to maintain universal service at reasonable rates for Iowa consumers. Further, the extent to which Iowa will mirror federal reforms by directing universal service support to broadband instead of voice service is not yet known. For these reasons, the Board concludes that its present inquiry into a SUSF should be terminated.”).

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1 A. No. It is important to recognize that the creation of the fund would have
2 many of the adverse consequences discussed above even before any
3 determinations are made regarding the specific levels of funding that
4 should be paid to particular providers. The mere existence of a fund may
5 well hinder the expansion of competition in rural service areas, since it would
6 send a message to competitive providers that the incumbent providers may
7 be able to offer service on a subsidized basis.⁵⁸ By deterring the expansion
8 of competition, a fund would thus undermine the goal of universal service
9 rather than advance it. It would also send the wrong signals to the incumbent
10 providers themselves, who will be less likely to undertake major structural
11 changes in their business models — such as mergers and joint ventures
12 aimed at achieving economies of scope and scale — if they believe that there
13 is a significant chance that funding will be available to compensate them for
14 any revenue requirement shortfalls. A fund could also impose upon the
15 contributing companies a contingent obligation of uncertain magnitude, thus
16 exacerbating their own financial burdens, which, in at least some cases, are
17 more substantial than those faced by the potential fund recipients. Finally,

⁵⁸ See *Competition III Order* at 63 (“If rural rates more accurately reflect service costs, competitors may be able to extend their infrastructure and services to these areas. If nothing is done to adjust these subsidized rates, however, competition will be impeded and the benefits of intermodal services may be delayed or even denied in certain areas.”).

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1 creating a fund and keeping it in readiness would entail non-trivial transaction
2 costs that would have to be borne by the industry (and, ultimately, by its
3 customers).

4 **IV. AN ALTERNATIVE PROCESS FOR ADDRESSING ANY**
5 **DEMONSTRATED FINANCIAL PROBLEMS OF INCUMBENT**
6 **LECS**

7 Q. It has been suggested that financial support of troubled incumbent LECs is
8 necessary in order to preserve ITC functions essential to the maintenance of
9 universal service, such as the provision of retail service in any “white spot”
10 areas that might exist. Do you agree?

11 A No. The Commission should *not* assume that these concerns can be
12 addressed only by creating a fund and thereby inviting all of the harms
13 discussed in the previous section. Instead, the Commission should carefully
14 assess the existence, nature, and magnitude of the supposed problem, and
15 should address it in the most narrowly targeted and efficient manner possible.

16 Q. What framework would you propose for addressing such issues?

17 A. Verizon proposes a process that will ensure that before a financially-troubled
18 LEC seeks support from other companies (other than payments in
19 accordance with its approved tariffs for services that it actually renders), the
20 company itself will conduct a rigorous and disciplined review of alternatives
21 that will enable it to address its own financial problems while continuing to
22 provide all functions necessary to the maintenance of universal service within

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1 its existing service area — and will implement the most practicable,
2 reasonable, and efficacious of the alternatives that it identifies.

3 The first necessary step in such a review would be to determine the *minimum*
4 set of services and functions that the ITC would need to provide in order to
5 ensure the continued existence of universal service within the company's
6 service area, giving due recognition to the availability of competitive
7 alternatives.

8 Next, the company should review the measures it could take to achieve or
9 maintain financial health while assuring that the identified services and
10 functions will continue to be available. Such a review should be similar to the
11 type of review that might be conducted by a consultant or investment banker
12 advising a troubled company. All alternatives should be “on the table” for
13 purposes of such a review, including alternatives that would make
14 fundamental structural changes in the company's business model. Such
15 structural changes might include the following:

- 16 • the sale or spin-off of a portion of the company's business;
- 17 • the outsourcing of particular functions; or
- 18 • mergers, acquisitions, joint ventures, and other transactions that might
19 create economies of scope or scale.

20 We emphasize that because of jurisdictional limitations, the Commission
21 would not be able to compel the company to adopt all — or perhaps any — of
22 the alternatives identified in such a study. Clearly, however, it could decline

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1 to consider any funding proposal unless and until such a study is conducted
2 and the Commission determines that no practicable, reasonable alternative
3 to exogenous funding would be consistent with the continued existence of
4 universal service.

5 Q. How would the Commission determine whether the company's review was
6 adequate?

7 A. The filing company would be required to provide notice of its study to all
8 regulated telephone corporations in the State and to all intermodal providers
9 that indicate their interest in receiving such notice. All would have the ability
10 to review and comment on the study. Confidential information included in the
11 study could be protected through the issuance of a protective order or
12 through application of the Commission's existing FOIL regulations.
13 The study would be reviewed by Staff based on its own expertise and in light
14 of the comments of the parties. Staff would make a recommendation to the
15 Commission as to the adequacy of the study.

16 Q. What role would retail rate increases play in this type of proceeding?

17 A. The alternatives considered in such a study would have to include an
18 increase in the company's monthly retail basic service rate, as well as its
19 other retail rates, to the highest just and reasonable levels.

20 Q. How could such a rate ceiling be determined?

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- 1 A. Currently, in ITC rate cases in which funding is sought from the Transition
2 Fund, the Commission uses the Verizon basic local-service flat rate of
3 \$23/month as a “benchmark rate” for residential basic local service.
4 Funding is considered when a company cannot meet its revenue
5 requirement without increasing its basic local service rates above this
6 benchmark. As we show below, this benchmark is far lower than is
7 necessary to ensure just, reasonable, and affordable rates that will permit
8 the continued maintenance of universal service. (Moreover, some
9 companies have not yet increased their basic rates even to this
10 benchmark level.)⁵⁹
- 11 Q. Why is the \$23 benchmark conservative as a ceiling for ILEC basic
12 service rates?
- 13 A. The benchmark was originally set in the *Competition III Order*, primarily
14 based on a determination that such a rate would be reasonably cost-
15 based and consistent with market prices. The Commission did not make

⁵⁹ See Case 07-C-0349, Letter from Harter Secrest & Emery to Hon. Jaclyn A. Brilling (October 26, 2010) (enclosing tariff amendments proposing to increase Champlain Telephone Co.’s monthly residential basic local service rates to the range \$15.23 to \$16.32); *id.*, Letter from NYSTA to Hon. Jaclyn A. Brilling (October 26, 2010) (increase to \$17.99/month for Armstrong Telephone Co.); *id.*, Letter from NYSTA to Hon. Jaclyn A. Brilling (October 26, 2010) (increase to \$11.78/month for Cassadaga Telephone Corp.); *id.*, Letter from NYSTA to Hon. Jaclyn A. Brilling (October 26, 2010) (increase to range of \$13.65 - \$15.15/month for Ontario Telephone Co.). See also Response to VZ-NYSTA-8.

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1 any findings that higher rates would necessarily be unaffordable or would
2 compromise universal service.⁶⁰

3 Moreover, the \$23 rate represents a small portion of the median
4 household income in New York. When the EUCL and applicable fees,
5 taxes, and surcharges are taken into account, a \$23 monthly rate would
6 correspond to a monthly bill of about \$36-\$37, depending upon the area
7 of the State. According to Census Bureau data, the median household
8 income in New York for 2008-09 was \$50,243/year.⁶¹ The Department of
9 Housing and Urban Development projects 2010 nationwide median family
10 income of \$55,300 for non-metro areas, which roughly corresponds to the
11 areas served by smaller ILEC providers.⁶² Thus, it seems reasonably
12 conservative to use \$50,000/year, or \$4,167/month, as a reference
13 income level.

14 A monthly bill of \$36.50 represents less than 0.88 percent of this median
15 household income. Certainly there is no basis for any claim that such a
16 small percentage represents an absolute “affordability” ceiling. The FCC
17 has determined that average household expenditures for telephone

⁶⁰ See discussion in *Competition III Order* at 53-64. See also Response to CTANY-DPS-2, and orders cited therein.

⁶¹ See http://www.census.gov/hhes/www/income/data/incpovhlth/2009/statemhi2_09.xls.

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1 service (including the full range of wireless and wireline service) amount
2 to over 2% of total household expenditures, or about \$94/month as of
3 2008.⁶³ Clearly, reasonable increases in the amount allocated to basic
4 service within this overall household telecommunications budget will not
5 lead households to abandon their ability to communicate by telephone.
6 Indeed, since most households currently have some form of cellular
7 service, it is not surprising that households are becoming more likely to
8 decrease their overall telecommunications budget — if they feel a need to
9 do so — by “cutting the cord” and eliminating their wireline service
10 altogether, as the following discussions show:

11 [T]he truth is that despite the troubled economy, Americans are
12 still spending money on wireless and broadband services,
13 which is helping to keep phone companies much healthier than
14 other industries. That said, the industry is feeling the pinch.

(. . . continued)

⁶² See

http://www.novoco.com/low_income_housing/resource_files/income_limits/2010_medians.pdf.

⁶³ See Industry Analysis & Technology Division, Wireline Competition Bureau, FCC, “Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service” (2008), available at http://hraunfoss.fcc.gov/edocs_public/attachmatch/DOC-284934A1.pdf) (“*Reference Book*”), Table 2.1 (expenditures on telephone service for 2006 [most recent year reported] represent 2.67% of total household expenditures for rural households, 2.21% for urban households, and 2.25% for all households). See *also* Industry Analysis and Technology Division, Wireline Competition Bureau, “Trends in Telephone Service” (September 2010), available at http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db0930/DOC-301823A1.pdf), Table 3.1 (showing total household expenditures and telephone expenditures for 1981-2008).

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1 Specifically, phone companies are seeing a more rapid decline
2 in their traditional telephone businesses.⁶⁴

3 In a high-tech shift accelerated by the recession, the number of
4 U.S. households opting for only cell phones has for the first
5 time surpassed those that just have traditional landlines. It is
6 the freshest evidence of the growing appeal of wireless
7 phones.

8 Twenty percent of households had only cells during the last
9 half of 2008, according to a Centers for Disease Control and
10 Prevention survey released Wednesday. That was an
11 increase of nearly 3 percentage points over the first half of the
12 year, the largest six-month increase since the government
13 started gathering such data in 2003.

14 The 20 percent of homes with only cell phones compared to 17
15 percent with landlines but no cells.

16 That ratio has changed starkly in recent years: In the first six
17 months of 2003, just 3 percent of households were wireless
18 only, while 43 percent stuck to landlines.⁶⁵

19 Such a phenomenon does not indicate a failure of universal service, but
20 rather the growing tendency to connect to the network through alternative
21 intermodal services.

22 Q. Are there other ways to assess whether telephone rates will remain
23 affordable at levels above the current benchmark?

⁶⁴ Reardon, Marguerite, "Wireless Saving Phone Companies During Recession," CNET News, (Jan. 29, 2009), available at http://news.cnet.com/8301-1035_3-10151807-94.html.

⁶⁵ "One Way to Cope with Recession: More Cell Phone Users Dropping Their Landline," AARP Bulletin Today (May 6, 2009).

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1 A. Yes. Another approach to the affordability question might be based on
2 the FCC’s “reasonable comparability” test under § 254(b)(3) of the
3 Telecommunications Act.

4 Q. Please explain.

5 A. Section 254(b)(3) states that
6 [c]onsumers in all regions of the Nation, including low-income
7 consumers and those in rural, insular, and high cost areas,
8 should have access to telecommunications and information
9 services, including interexchange services and advanced
10 telecommunications and information services, that are
11 reasonably comparable to those services provided in urban
12 areas and that are available at rates that are reasonably
13 comparable to rates charged for similar services in urban
14 areas.
15 47 C.F.R. § 54.316(a) implements this provision of the Act by requiring states
16 annually to review the comparability of residential rates in rural
17 areas of the state served by non-rural incumbent local
18 exchange carriers to urban rates nationwide, and to certify to
19 the Commission and the Administrator as to whether the rates
20 are reasonable comparable, for purposes of section 254(b)(3)
21
22 Part (b) of the same Rule establishes a “safe harbor” test under which “a
23 state may presume that the residential rates in rural areas served by non-
24 rural incumbent local exchange carriers are reasonably comparable to urban

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1 rates nationwide if the rates are below” a benchmark equal to “the most
2 recent average urban rate plus two weighted standard deviations.”⁶⁶

3 The most recent computation of this benchmark rate sets it at 143% of the
4 average urban rate.⁶⁷ Applying this factor to Verizon’s \$23 per month
5 “benchmark” rate gives a comparable rural rate of \$32.89. While a
6 “comparability” standard is not necessarily the same as an “affordability”
7 standard, the principle behind the requirement in the Act was to ensure
8 that the benefits of competition in more densely populated areas would be
9 shared in less populated areas. Therefore, a reasonable rate in urban
10 areas provides a benchmark for what a reasonable rate is in more rural
11 areas.⁶⁸

12 Q. How would such analyses account for the needs of the poorest
13 customers?

14 A. Such customers’ needs will be adequately addressed by the continued
15 availability of Lifeline service, whether from the ILEC or through a
16 modification to the TAF that would permit direct Lifeline subsidies for

⁶⁶ See generally *High-Cost Support Remand Order*.

⁶⁷ *Reference Book*, Table 1.13.

⁶⁸ It should also be noted that the FCC intended to apply the factor to a broader range of rates, rather than just to a basic service rate. Nevertheless, the role of the factor as a fairness-based benchmark for comparing rural and urban rates is maintained whether it is used to compare a

(continued . . .)

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1 eligible customers, as proposed above. In addition, consideration for the
2 needs of the poorest customers must also include an accounting for any
3 added funding burdens placed on the contributing carriers' poor
4 customers. The facile identification of "poor customers" with "rural ITC
5 customers" is simply not valid. For example, the county in the State with
6 the lowest median household income is Bronx County, in which Verizon is
7 the sole incumbent LEC.

8 Q. Do you have any other recommendations concerning the use of reference
9 or benchmark rates for retail basic local service?

10 A. We have two additional recommendations. First, if any type of retail rate
11 ceiling is utilized, it should be adjusted periodically for inflation. Second,
12 a benchmark rate should not ignore the fact that many providers and
13 customers are migrating to service packages that include, but are not
14 limited to, basic local service (and that will obviously be priced somewhat
15 above the basic local service rate level). If some sort of reference rate
16 level is utilized, it should be flexible enough to be applicable to such
17 service bundles.

(. . . continued)

full "market basket" of urban rates to a comparable market basket of rural rates, or simply to compare basic urban rates to basic rural rates.

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1 Q. What role would regulatory relief play in the overall process of assessing a
2 troubled ITC's options?

3 A. If as a result of the assessment process described above, a company
4 proposes to withdraw from providing all or a portion of the regulated services
5 that it currently provides pursuant to its tariffs and the Commission's common
6 carriage regulations, then the Commission should limit the company's
7 obligations accordingly. For example, if demand has declined to the point
8 where it is not economic for a company to maintain facilities in the company's
9 current service area, then the company should be freed of any obligation it
10 may have under its existing tariffs to provide its own retail service in those
11 areas. Also, a company should be given the right to de-average its rates to
12 better reflect the cost characteristics of white spot areas, subject to the
13 constraint of maintaining just and reasonable rates that will permit the
14 continued existence of universal service in such areas. Aside from providing
15 additional support for the filing company, such measures will stimulate
16 competitive entry into areas currently classified as white spots.

17 **V. PRINCIPLES THAT SHOULD GOVERN THE OPERATION OF A**
18 **FUND, IF ONE IS CREATED**

19 Q. In the preceding sections of this testimony, you have argued against the
20 creation of a fund. Do you have any recommendations concerning the
21 design and operation of a fund, if the Commission concludes that it is both
22 lawful and desirable to create one?

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1 A. Yes. While Verizon does not believe that it would be either lawful or
2 desirable to create a fund, for the reasons set forth herein and in its briefs, if
3 the Commission does adopt a fund, Verizon makes the recommendations set
4 forth below. These recommendations are not in any way an admission of the
5 feasibility or lawfulness of a fund and are made solely in response to the
6 ALJ's direction.

7 **A. If a Fund Is Established, Eligibility for Funding and the**
8 **Amount of Funding Provided Should Be Determined by**
9 **Competitive Bidding**

10 Q. If a fund is established, how should the Commission determine which
11 company in any given area will be eligible to receive distributions from the
12 fund?

13 A. First of all, for the reasons described above, funding should be provided
14 to only one company per location. That company should be the one that
15 demonstrates that it is the most efficient provider of universal service in
16 that location — that is, the company that would be willing, for the least
17 amount of funding, to make its service available to any customers that do
18 not already have adequate access to the services of other providers.
19 It is quite possible that alternative providers would be able to provide
20 service in such areas for far less than it would cost to sustain the entire
21 current level of operations of an incumbent LEC. For example, wireless

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1 carriers might be able to add incremental coverage at a cost that is less
2 than maintaining an ILEC's network.

3 Q. Would the incumbent ITC nevertheless be eligible to be considered as a
4 potential fund recipient?

5 A. Yes, but only to the extent that it demonstrates that it is the most efficient
6 provider.

7 Q. How can the most efficient provider be identified?

8 A. There are many ways to identify the provider best able to serve an area
9 with the lowest subsidy. In the National Broadband Plan, the FCC
10 proposes to utilize some form of competitive bidding to select a single
11 subsidized high-cost provider in those areas where there would be no
12 provider without support.⁶⁹ If this Commission determines to move
13 forward with a fund — which it should not do — it makes the most sense
14 that the distribution mechanism be patterned after the process that the
15 FCC ultimately adopts. Moving ahead of or independent from the FCC
16 with a different process would be a poor use of resources and
17 inconsistent with the FCC's request in the National Broadband Plan for
18 coordinated action. The FCC has already taken steps to establish

⁶⁹ *National Broadband Plan* at 145.

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1 workable competitive bidding mechanisms for universal service,
2 consistent with the National Broadband Plan.⁷⁰

3 Q. How would this process work if the incumbent was the only provider
4 willing to provide ubiquitous adequate service within the service area?

5 A. In a competitive bidding context it is possible to impute results from an area
6 where there are multiple bids to areas with similar characteristics that lack
7 multiple bidders.

8 Q. What should be the scope of the geographic area for which such bidding is
9 conducted?

10 A. Bids should be solicited only for the services and areas identified as
11 necessary for the maintenance of universal service.

12 Q. Should there be any restrictions on a company's eligibility to submit a bid?

13 A. No. Any viable company that is authorized under law to provide service
14 should be permitted to bid.

⁷⁰ *Universal Service Reform — Mobility Fund*, WT Docket No. 10-208, Notice of Proposed Rulemaking (rel. Oct. 14, 2010) (laying out a detailed proposal for distribution of universal service funding to build wireless infrastructure in those few areas that still lack access to 3G wireless coverage).

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B. Strict Standards Should Limit the Amount of Funding That Will Be Provided If a Competitive Bidding Process Is Not Utilized

Q. If, despite the considerations discussed above, the Commission decides to create a fund, how should eligibility for such a fund be determined?

A. A number of rules should be established to ensure that the funding arrangement: (a) is strictly limited to the maintenance of such specific services in such specific areas as are found necessary to advance universal service; and (b) will minimize unfairness to other companies and their customers.

First, applicants should have the burden of justifying their request for funding, and their applications should be submitted to strict scrutiny in open proceedings in which funding contributors, among others, have a full opportunity to participate.

Second, in all aspects of the administration of the fund, the Commission should recognize the fundamental principle that funding should be provided only to the extent necessary to ensure the continuation of universal service.

Q. If a competitive bidding process is not utilized, how should the Commission determine the amount of funding that an entity would receive?

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1 A. The assumptions governing rate cases — and in particular the
2 assumption that a company is entitled to a level of revenue that will meet
3 its “revenue requirement” — should not apply in funding determinations.
4 Rather, the level of funding provided should be the minimum necessary to
5 ensure the continuity of universal service, given, among other things, the
6 availability of competitive alternatives. Moreover, this minimum should be
7 determined on the assumption that the company seeking funding has
8 raised or will raise its retail rates to the maximum just and reasonable
9 level (determined in accordance with the preceding discussion), and that
10 it has taken structural measures reasonably calculated to improve its
11 financial picture. Of course, under this framework there would be no
12 guarantee that the company would be able to recover its historical or
13 “embedded” costs.

14 Q. If the Commission determines that a company is entitled to pay-outs from
15 a fund, how long should the entitlement continue?

16 A. The Commission should establish an abbreviated annual process for
17 determining whether fund recipients continue to meet the standards for
18 funding. As we will discuss later in this testimony, any fund itself should
19 be subject to review in two years, and, additionally, all funding
20 determinations should sunset after three years, and a recipient company

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1 should be required to make a new, full showing to support its claim for
2 funding for the ensuing three-year period.

3 **C. If a Fund Is Established, VoIP Providers and Cellular**
4 **Providers May Not and Should Not Be Required to**
5 **Contribute to the Fund**

6 Q. If a fund is established, who should be required to contribute to the fund?

7 A. Only regulated service providers should be required to contribute to a
8 fund (as is the case with the TAF). In particular, CMRS providers and
9 VoIP providers (whether facilities-based or application-based) should be
10 exempt from any contribution obligation.

11 Q. Why?

12 A. Even if there were not legal barriers such as Publ. Serv. L. § 5(6) to
13 requiring intermodal providers to contribute to a fund (as Verizon will
14 show in its briefs), the Commission should decline to take such action as
15 a matter of State policy.

16 Q. Please explain.

17 A. There is no public policy rationale for requiring new, innovative services —
18 including wireless and VoIP — to help fund the chosen business models of
19 other telephone companies. And that is particularly the case where there has
20 been no demonstration that service would otherwise be unavailable or
21 unaffordable, that alternatives to traditional wireline service do not exist, or
22 that wireline carriers could not provide the service without such funds. The

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1 Commission should not burden new services and technologies (and the
2 customers that use them) with legacy regulatory obligations that have
3 outlived their usefulness, and with the associated costs of those obligations.
4 Indeed, these service and technology innovations are spurring competition in
5 the telecommunications marketplace, thereby providing an impetus for
6 reduced rates in the traditional wireline sector. Burdening such services and
7 customers with unnecessary new fees would simply punish their customers
8 for choosing to use competitive services, and could drive investment dollars
9 away from New York. Should the Commission choose to force wireless and
10 VoIP providers to contribute to a fund, the result will be higher rates, the
11 chilling of innovation, reduced investment, and fewer competitive options and
12 fewer benefits for consumers. For all these reasons, the Commission should
13 not hamper the continued growth of wireless and VoIP by imposing new fees
14 on customers of these services.

15 **D. If a Fund Is Established, Contributions Should Not Be**
16 **Required from Regulated Companies That Are Not**
17 **Themselves Earning a Reasonable Rate of Return**

18 Q. Should regulated companies that are themselves not earning a reasonable
19 rate of return be required to contribute to a fund?

20 A. No. As explained above, such a requirement would be inconsistent with
21 fundamental fairness, with the policies underlying the Public Service Law,
22 and with the federal and State constitutions.

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**E. If a Fund Is Established, the Contribution Obligation
Should Be Allocated Among Contributing Companies on
the Basis of Regulated Intrastate Revenues**

Q. On what basis should the total contribution allocation be allocated among regulated providers?

A. Unless and until the FCC adopts a system other than one based on interstate revenues to fund universal service, this Commission should not, on its own, attempt to re-invent the wheel. In addition to the complexity of creating an entirely new funding mechanism for any state universal service fund, the burden on fund contributors to administer dual state and federal contribution systems would be significant. Thus, we recommend the adoption of a system similar to that currently used for the TAF, in which contributions are based on regulated intrastate revenues. However, if the revenue-based TAF mechanism is used as a model for contributions to any fund that the Commission should create, we would recommend one easy-to-implement change in that mechanism. Currently, TAF contributions are assessed on the basis of intrastate revenues net of intercarrier payments such as switched access, UNE, and resale charges.⁷¹ The intercarrier payment offset should be eliminated, since it

⁷¹ Cases 94-C-0095 and 28425, "Opinion and Order Establishing Access Charges for New York Telephone Company and Instituting a Targeted Accessibility Fund" (Op. No. 98-10) (issued and effective June 2, 1998), at 39-40.

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1 has the inappropriate effect of penalizing the provision of facilities-based
2 service.

3 Q. Please explain.

4 A. Consider two carriers with identical services, rates, volumes, and
5 revenues. One is facilities-based, and therefore provides service by
6 investing in its own network. The second is non-facilities-based, and
7 instead of paying for its own network, makes wholesale payments to
8 another carrier for the use of that carrier's network. We may assume for
9 purposes of this hypothetical that the cost-based wholesale rates paid by
10 the non-facilities-based carrier are no higher than the internal costs
11 incurred by the facilities-based provider to maintain its network. Even
12 though the two carriers are similarly situated with respect to revenues and
13 costs, the non-facilities-based carrier would make much smaller TAF
14 contributions by virtue of the intercarrier offset. We describe this result as
15 inappropriate because it penalizes network investment, contrary to the
16 strong public policy of this State and country. Whether or not the
17 Commission is willing to eliminate the offset for purposes of the TAF itself,
18 this flawed mechanism certainly should not be carried over to a new fund.

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**F. If a Fund Is Established, Contributing Companies
Should Be Entitled to Recover the Amount of Their
Contributions Through End-User Surcharges**

Q. Should carriers who are required to contribute to the fund be permitted to recover their contributions through end-user surcharges?

A. Yes. Although as indicated above such surcharges could adversely affect a carrier's competitive position — and therefore contributing providers should not be *required* to impose a surcharge — such providers should at least have the discretion to decide for themselves whether such a mechanism could mitigate the contribution burden.

G. Other Issues

Q. If a fund is created, should it be subject to a sunset provision?

A. Yes. Any such fund that is created should be subject to Commission review after a period of no more than two years, and the Commission's initial order establishing the fund should make it clear that no carrier should assume or rely upon the continued existence of the fund beyond that point.

Q. Why should there be a sunset review after a fixed period?

A. *First*, a sunset review will minimize service-provider reliance on the fund, and will thus create an incentive for structural changes that will enable a provider to move towards financial self-sufficiency.

Second, technology, market structure, and regulation in the communications industry have changed rapidly in the last several years, and every indication

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1 is that such changes will accelerate in the future. As noted above, one
2 important factor in this regard is the National Broadband Plan, which will
3 undoubtedly have a profound effect on the need for and appropriateness of
4 state universal service funding mechanisms. A sunset period will ensure that
5 appropriate changes are made in the fund to reflect these external changes.

6 Q. Should a fund provide support for broadband services?

7 A. No. Broadband is a highly competitive service provided over multiple
8 technological platforms and special state funding mechanisms are not
9 needed to encourage its deployment. As the Commission observed in the
10 *Competition III Order*, “While we agree that broadband is an increasingly
11 valuable tool with a variety of social, political, and economic applications, we
12 remain convinced that competitive markets are the best tool to ensure
13 appropriate, widespread deployment.”⁷² In short, there is no evidence of a
14 market failure that requires regulatory intervention.

15 In any event, the National Broadband Plan recently issued by the FCC
16 contemplates some form of funding mechanism for broadband deployment in
17 unserved areas,⁷³ so it would be premature for state regulators to adopt new
18 funds that may be duplicative or even inconsistent with new federal initiatives.

⁷² *Competition III Order* at 76.

⁷³ See generally *National Broadband Plan* § 8.3.

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1 The Plan states that “[a] comprehensive reform program is required to shift
2 from primarily supporting voice communications to supporting a broadband
3 platform that enables many applications, including voice. This reform must
4 be staged over time to realign these systems to support broadband and
5 minimize regulatory uncertainty for investment.”⁷⁴

6 Even aside from funding that will potentially become available under the
7 National Broadband Plan, there are other sources of funding available to
8 subsidize broadband deployment. The American Recovery and
9 Reinvestment Act provides funding for two national broadband service
10 development and expansion programs: (1) the Rural Utilities Service
11 program, which provides loans and grants for broadband projects focused on
12 rural areas; and (2) the Broadband Technology Opportunities Program, a
13 broader broadband stimulus program to be administered by the NTIA that
14 targets unserved and underserved areas. Federal law thus provides a
15 comprehensive nationwide approach to stimulate investment in broadband
16 where such stimulation is needed.

17 Accordingly, there is no need for the Commission to use a fund to subsidize
18 an ITC’s broadband offerings, and indeed it would be counterproductive to do
19 so.

⁷⁴ *National Broadband Plan* at 141.

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1 Q. How should a fund be administered?

2 A. The administrative responsibility should be assigned through competitive
3 bidding. Obviously, only neutral parties — *i.e.*, ones with no financial interest
4 in contributing to or drawing from the fund — should be eligible to participate
5 in such competitive bidding.

6 Q. Should there be a cap on the fund?

7 A. Yes. If a fund is created, in order to avoid excessive harm to the contributing
8 companies, total fund payouts per year should be capped at the current size
9 of the Transition Fund.

10 **VI. SUMMARY AND CONCLUSIONS**

11 Q. Please summarize your testimony concerning the establishment of a fund for
12 the benefit of financially-troubled ITCs.

13 A. There is no need for such a fund. Competitive alternatives are present
14 throughout the State and obviate the need to provide financial support to
15 particular carriers who may not be the lowest cost providers in a particular
16 area. In fact, a fund would interfere with the competitive process and
17 would be a detriment to consumers and providers. It would also create
18 inappropriate incentives for funded companies. Providers like Verizon,
19 which themselves face severe financial challenges in this State, and who
20 would be the primary contributors to a fund, should not be required to
21 subsidize the business models of other carriers. For these reasons, the

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1 Commission should reject funding proposals and instead implement non-
2 fund solutions to the extent that some measures are deemed necessary to
3 ensure the maintenance of universal service in the ITC service areas.
4 If the Commission decides, nonetheless, to create a fund, it should be
5 targeted to the few, if any, remaining areas without competitive
6 alternatives, should adopt strict rules relating to eligibility and to the
7 amount of funding to be provided, should sunset after a fixed period of
8 time, should not burden new technologies, including wireless and VoIP,
9 and it should not subsidize broadband deployment.

* * *

10
11 Q. Does this conclude the Panel's initial testimony?

12 A. Yes.