STATE OF NEW HAMPSHIRE
BEFORE THE
PUBLIC UTILITIES COMMISSION

Comcast Phone of New Hampshire, LLC	)	
Request for Authority to Provide	)	Docket No. DT 08-013
Local Telecommunications Services	)	

DIRECT TESTIMONY OF MICHAEL D. PELCOVITS

ON BEHALF OF

COMCAST PHONE OF NEW HAMPSHIRE, LLC

September 9, 2008

I. INTRODUCTION AND SUMMARY

Q. Please state your name, occupation, and business address.

A. My name is Michael D. Pelcovits. I am a principal with the economic consulting firm of Microeconomic Consulting and Research Associates (MiCRA). My business address is 1155 Connecticut Avenue, N.W. Suite 900, Washington, D.C. 20036.

Q. Would you please summarize your experience and educational qualifications?

A. I received my Ph.D. in Economics from the Massachusetts Institute of Technology in 1976. Since serving on the economics faculty of the University of Maryland and as a Senior Economist at the Civil Aeronautics Board, I have spent my entire career specializing in the economics of regulation and competition in the telecommunications industry.

From 1979 to 1981, I was a Senior Economist at the Federal Communications Commission, Office of Plans and Policy. From 1981 to 1988, I was a founding member and principal of the consulting firm Cornell, Pelcovits and Brenner. In 1988 I joined MCI Communications Corporation and remained with the Company following its merger with WorldCom, until 2002. I held positions of increased responsibility at MCI, and was appointed Vice President and Chief Economist of the corporation. In this position I was responsible for the

economic analyses of policy and regulatory matters provided and presented by the Corporation before federal, state, foreign, and international government agencies, legislative bodies and courts.

Q. What are your professional responsibilities at MiCRA?

A. I joined MiCRA in October 2002, immediately after leaving MCI, and am one of six principals of the firm. MiCRA is an economic consulting firm based in Washington, DC. The firm was founded in 1991 by a group of economists who served in senior positions at the Antitrust Division of the U.S. Department of Justice. MiCRA provides economic analysis, expert testimony, and economic research to clients in a wide range of antitrust, regulatory, and other legal and public policy settings. Since joining MiCRA, I have testified before several state regulatory commissions on telecommunications policy and ratemaking issues. These testimonies have focused on the importance of establishing the proper foundation to facilitate competition in telecommunications markets. I have also filed several declarations before the Federal Communications Commission on a wide range of common carrier, wireless, and international telecommunications policy issues. I have consulted and provided testimony on telecommunications, intellectual property and competition matters before several other Courts and administrative bodies, including: Federal District Court; U.S. Copyright Royalty Judges; and London Court of International Arbitration.

Q. Have you testified previously before the New Hampshire Public Utilities Commission?

A. Yes. I testified on behalf of the New England Cable & Telecommunications Association, Inc. and Comcast Phone of New Hampshire, LLC on the petition of Verizon and FairPoint to transfer assets in Docket No. DT 07-111.

Q. What is the purpose of this testimony?

A. My testimony addresses whether a grant of franchise to Comcast Phone of New Hampshire, LLC ("Comcast Phone") in the service territories of the three affiliated incumbent local exchange carriers is for the public good. I conclude that such a grant is in the public good because it brings the recognized benefits of competition to additional areas of New Hampshire.

Q. What authority does Comcast Phone seek in its application before the Hew Hampshire PUC?

A. I understand that Comcast Phone has filed for authority to provide local exchange telecommunications services pursuant to RSA 374:22 in the service territories of Kearsarge Telephone Company (KCT), Merrimack County Telephone Company (MCT) and Wilton Telephone Company (WTC). All of these companies are subsidiaries of TDS Telecom, which is owned by Telephone and Data Systems Inc. In these service territories, Comcast Phone proposes to

offer the same services as in areas now served by FairPoint Communications. There, it now offers a single-line, resold business Local Service. Comcast Phone will also be offering high-speed T1 voice and data service to primary and secondary schools, municipal libraries and other "e-rate" eligible institutions in both the FairPoint and TDS service areas. These are the retail telecommunications services that Comcast Phone relies on as a basis for seeking certification in New Hampshire. In addition, although it does not rely on this service in its application for certification as a retail service in New Hampshire, Comcast Phone also provides its affiliate, Comcast IP Phone II, LLC ("Comcast IP"), with two-way interconnection with the public switched telephone network for the exchange of voice traffic, access to and administration of numbering resources, local number portability, operator services, access to the 911 network, and directory listing and directory assistance services. This wholesale "Local Interconnection Service" is made available via the service guide posted on Comcast's website. The wholesale telecommunications services provided by Comcast Phone enable Comcast IP to serve New Hampshire residential customers with Comcast Digital Voice service, an interconnected voice over Internet protocol ("VoIP") service.

Q. What is the standard that governs Comcast Phone's application?

A. My understanding is that in general the Commission has the authority to authorize public utility service when it finds that the grant of authority is consistent with the public good. More specifically, as explicated in RSA 374:22-

g, in determining the public good with respect to the grant of authority a competing telecommunications provider in a service territory already served by a telephone utility,

> " the commission shall consider the interests of competition with other factors including, but not limited to fairness; economic efficiency; universal service; carrier of last resort obligations; the incumbent utility's opportunity to realize a reasonable return on its investment; and the recovery from competitive providers of expenses incurred by the incumbent utility to benefit competitive providers, taking into account the proportionate benefit or savings, if any, derived by the incumbent as a result of incurring such expenses."

I further understand that this provision now applies to competition in all areas of the state, regardless of the size of the local exchange.

Q. How do you propose to address the issue of public good in your testimony?

A. First, I will address the benefits from removing entry barriers to competition in telecommunications markets. Competition is the bedrock of our economic system and is presumed to serve the public good, absent some serious market failure. Competition in telecommunications is incorporated into public policy New Hampshire. Second, I will discuss the effect of competition on the incumbent local exchange company and whether Comcast Phone's application should trigger concern about universal service, carrier of last resort obligations, and the incumbent utility's opportunity to realize a reasonable return on its investment. Third, I will discuss the mechanism by which the incumbent utility will recover the expenses of providing service to Comcast Phone.

Q. How does competition serve the public good?

A. Competition is essential to the proper functioning of free markets. A free market system solves the complex economic problems of determining what goods and services should be produced, by which firms they should be produced, and how they should be produced. In the absence of functioning free markets, there would be no way for the U.S. economy to solve these problems short of government ownership or control of the means of production.

Competition is the engine that drives the free market. It compels firms to produce the goods that consumers demand and to produce them as efficiently as possible. If an individual firm does not operate efficiently, or it attempts to overprice its output, competition will compel that firm to change its production process and its prices, or it will be forced to exit the market.

Competition will also encourage firms to innovate and create new services and new technology that can better serve the market. This long-term benefit from competition is particularly important in the telecommunications market.

The New Hampshire regulatory environment explicitly recognizes these benefits of competition as a matter of policy. In adopting the standard for competitive telecommunications entry quoted above, the New Hampshire Legislature declared in 1995 N.H. Laws 147:1 that "Competitive markets generally encourage greater efficiency, lower prices, and more consumer choice. It is the policy of the state of New Hampshire to encourage competition for all

telecommunications services, including local exchange services, which will promote lower prices, better service, and broader consumer choice for the residents of New Hampshire." In its Order No. 24,887 scheduling this hearing, the Public Utilities Commission stated that "current CLEC registration rules provide for an appropriate balance between the interests of incumbent telecommunications providers and those of competitive entrants." These legislative and regulatory policies favoring rapid competitive entry embody the economic principles that are so vital to the proper functioning of markets.

Q. What role has competition played in telecommunications markets?

A. Competition has largely replaced the old market structure of regulated monopoly phone companies serving different franchise areas and markets. After decades of questioning the wisdom of competitive entry, policymakers at the Federal and State level have largely embraced the competitive model for virtually all telecommunications markets. Competitive telecommunications markets have brought enormous benefits to market in terms of greater efficiency, lower prices, and dramatic technological innovations.

Q. How has competition for residential and small business customers evolved in local voice service markets?

A. Following the enactment of The Telecommunications Act of 1996, several companies, including large long distance carriers, began to offer voice service in local residential markets using the unbundled network element platform

("UNEP"). The UNEP-based services were very popular and reached over 17 million subscriber lines at the height of their success.[1] This mode of entry into local voice markets, however, was closed off after adverse rulings by the Courts and the FCC.[2]

Over the last few years, the cable companies have taken over the leading competitive role in local voice markets. The cable companies have invested over $100 billion in the past ten years on their infrastructure,[3] which is now capable of providing high-speed Internet (and in most cases IP-voice service) to over 117.7 million housing units in the United States.[4] Presently, the cable companies provide voice service to over 15 million customers.[5]

Q. How will the grant of Comcast's application increase competition in the relevant New Hampshire markets?

A. Despite the general policy in New Hampshire of opening telecommunications markets to competition, to date the telephone market in the MTC, KTC, and WTC service areas has retained many of the elements of the old model of regulated monopoly telephone companies, with the incumbents facing limited competition from wireline voice providers. Competition in local voice

[1] Federal Communications Commission, *Local Telephone Competition: Status as of June 30, 2007*, March 2008, Table 4.
[2] Federal Communications Commission, *Order on Remand,* WCC Docket No. 04-314, December 15, 2004
[3] National Cable & Telecommunications Association, http://www.ncta.com/Statistic/Statistic/InfrastructureExpenditures.aspx (date visited, September 3, 2008)
[4] National Cable & Telecommunications Association, http://www.ncta.com/Statistic/Statistic/CableBroadbandAvailability.aspx, (date visited, September 3, 2008).
[5] *Id.*

markets has been slow to develop in these areas because of regulatory and other barriers to entry. The repeal by SB 386 signed into law July 7, 2008 of potential statutory barriers in RSA 374:22-f now applies the same sound policies in the MTC, KTC, and WTC service areas as in the rest of New Hampshire.

In turn, grant of Comcast Phone's application will extend the competitive model to these additional areas of New Hampshire. Comcast Phone is seeking CLEC certification for these service areas based on the offer of business local service and schools and libraries network service as retail telecommunications services. The entry of a highly-qualified and experienced carrier into the local market to serve small businesses and schools and libraries is a very positive development. The grant of Comcast Phone's application not only would introduce competition for businesses and schools and libraries but also would enable competition in additional markets, since once authorized as a CLEC, Comcast Phone could introduce other forms of local exchange service, exchange access, or interexchange services. From an economic standpoint, if the authorization of Comcast Phone's application for CLEC certification reduces entry barriers affecting Comcast IP's participation in the market, then it will contribute to the public good.

Q. Could you elaborate and the potential benefits from cable-voice competition?

A. Yes. I recently conducted a study estimating consumer benefits from cable voice competition, and found the potential benefits to be in excess of $100

billion over a five year period.[6] The continuing success of cable voice competition in the marketplace and the vigorous price and service competition are evidence that the predictions found in the study are very likely to be realized. These benefits can accrue to consumers in any market, including the New Hampshire territories served by KCT, MCT and WTC.

Another major development in the residential market is the popularity of service bundles, especially the "triple play" of voice, data, and video service. Comcast offers a triple play service in most of its operating territory nationwide, including in other franchise areas in New Hampshire. Insofar as granting the instant application ultimately would facilitate Comcast's ability to offer the triple play in the service territories of KCT, MCT, and WTC through Comcast IP, it will enable competition for bundles with the three TDS Companies, which apparently offer the triple play already to their customers.[7]

TDS has emphasized the importance of the triple play to their own business plan, which lists "aggressively market Triple Play service bundles to new and existing customers" as one of the five TDS Telecom Objectives for 2008.[8] This continues the strategy that TDS pursued in 2007, during which it "aggressively marketed its Triple Play bundles of voice, high-speed data, and DISH Network™ television services to gain new revenue-generating units, to

[6] MiCRA, "Consumer Benefits from Cable-Telco Competition," November 2007. http://www.micradc.com/news/publications/pdfs/Updated_MiCRA_Report_FINAL.pdf

[7] http://www.tdstelecom.com/Residential/NH

[8] Telephone and Data Systems, Inc., "Notice of Meeting and Proxy Statement for 2008 Annual Meeting of Shareholders and 2007 Annual Report," April 15, 2008, at v.

retain existing customers by reducing churn, and to make its service offerings more attractive to customers who might otherwise choose services from cable companies."[9] While it is beneficial to the public good to encourage TDS to offer new and innovative bundles of service, these benefits will be limited unless competition from other players, such as Comcast, is also permitted.

Q. What is the likely impact of competition in local telecommunications markets on an incumbent?

A. Competition presents a challenge to the firm or firms already in a market. An inefficient incumbent has much to fear from competition, because it will be unable to maintain a price level that allows it recover its excessive level of costs. Similarly, even an efficient incumbent that sets its prices in excess of economic costs will lose its ability to earn monopoly profits once competition takes hold. While harmful to the interests of the individual firm in either of these cases, competition will benefit consumers, by driving down prices to economic costs.

On the other hand, an efficient, well-managed market incumbent should be able to respond to competitors and still recover a reasonable return on past and future investment. Competitors cannot, and will not, price below their own long-run costs and therefore they will not drive prices below the costs of an equally or more efficient incumbent.

[9] *Id.* at iv.

Q. How will Comcast Phone's entry into the market affect the TDS companies' ability to continue to offer universal service and serve as the carrier of last resort in their service territories?

A. There is no reason to believe that the TDS Companies cannot continue to serve basic local telephone customers and serve as the carrier of last resort, upon Comcast Phone's entry into the market. The TDS Companies' corporate parent, Telephone and Data Systems, Inc., announced it was ranked on the Fortune 500 list this year.[10] The TDS Companies have already acknowledged their ability to serve as the provider of last resort and to preserve universal access to affordable basic service even in the presence of what it characterizes as "competitive wireline, wireless or broadband service available to a majority of the retail customers in each of the exchanges" served by Merrimack County, Kearsarge, Wilton, and Hollis Telephone Companies. Further, as recognized in the testimony of Mr. Michael Reed, Manager of State Government Affairs at TDS, "what is even more important is that significant competition exists at this very moment, and will increase tomorrow."[11] Clearly, the TDS Companies have already had to come to grips with the advent of competition and do not foresee a problem in meeting their historic provider of last resort responsibilities.

[10] Press Release, "TDS Climbs Fortune 500," http://www.tdstelecom.com/absolutenews/templates/news_template.asp?articleid=522&zoneid=5%20 (April 29, 2008)

[11] Kearsarge Telephone Company, Wilton Telephone Company, Inc., Hollis Telephone Company, Inc. and Merrimack County Telephone Company Petition for an Alternate Form of Regulation, DT 07-027, Direct Testimony of Michael C. Reed, at 10 (filed March 1, 2007).

Moreover, the three TDS Companies will continue to receive Federal high costs support to offset the embedded cost of their local switching and common line plant. In 2007, the three companies received $2.4 million in Federal high-cost support.[12] The composition of the high-cost support payments made in the last five years to these companies is shown in the table below.

Amounts in US $

Keasarge Telephone Company

ID # 120045	2002	2003	2004	2005	2006	2007
Interstate Common Line Support Trued-up Payments by Study Area	48,263	144,404	233,150	393,590	413,436	366,522
Local Switching Support Trued-up Payments by Study Area	568,432	560,844	536,626	561,924	380,124	639,096
Total High-Cost Support Payments by Study Area	994,233	1,153,084	958,710	1,100,450	793,560	1,005,618

Merrimack County Telephone Company

ID # 120047	2002	2003	2004	2005	2006	2007
Interstate Common Line Support Trued-up Payments by Study Area	142,701	0	3,392	280,172	181,524	359,820
Local Switching Support Trued-up Payments by Study Area	943,765	563,172	662,704	699,312	437,556	585,024
Total High-Cost Support Payments by Study Area	1,605,400	976,440	921,054	977,708	619,080	944,844

Wilton Telephone Company - New Hampshire

ID # 120050	2002	2003	2004	2005	2006	2007
Interstate Common Line Support Trued-up Payments by Study Area	22,033	67,085	70,414	97,188	79,044	126,966
Local Switching Support Trued-up Payments by Study Area	330,193	262,692	256,418	251,652	121,764	298,176
Total High-Cost Support Payments by Study Area	352,226	329,777	326,832	348,840	233,112	457,446

Sources:
FCC, Universal Service Monitoring Report, CC Docket No. 98-202, 2007, Tables 3.27, 3.29, 3.30

[12] FCC, *Universal Service Monitoring Report*, CC Docket No. 98-202, 2007, Table 3.30, at 3-134.

Q. How will the incumbent local exchange companies recover the expenses incurred to serve a new entrant, such as Comcast Phone?

A. The expenses incurred by the incumbents to serve Comcast Phone can be expected to be limited to the costs of providing interconnection. Interconnection consists of the physical exchange of traffic from one carrier to another. According to the provisions of the 1996 Telecommunications Act, the incumbents must terminate calls to their own customers that originate on a competitor's network. The cost of terminating this traffic consists of the incremental cost of interoffice transport and local switch terminating usage. The TDS Companies are entitled under the Act to recover the forward looking economic costs of transport and termination that they provide to the interconnecting CLEC.[13] Similarly, the competitive carrier is entitled to recover its own costs of terminating traffic originating on the TDS Companies' network. The cost-based interconnection fees must be set by a negotiated agreement among the parties. If the parties fail to reach agreement, the Commission must arbitrate to set these rates. In addition to compensation for traffic exchange, any carrier that provides facilities to another carrier to enable direct interconnection – comparable to the ILEC special access facilities – would be able to charge for use of those facilities.

Q. What precedent is there for an agreement on the terms and conditions of interconnection?

[13] 47 CFR §51.505

A. Comcast Phone of Vermont and the TDS Telecom companies in Vermont evidently have reached an interconnection agreement, which was approved by the Public Service Board of the State of Vermont on August 20, 2008. This agreement can serve as a template for an agreement between Comcast Phone and the TDS Telecom Companies in New Hampshire, and is already doing so in the negotiations currently underway between the companies.[14]

Q. Are there any other issues that you would recommend the Commission should consider in this case?

A. No. In my opinion, the authorization of a fully qualified telecommunications company into a new market should be a routine matter. The laws of New Hampshire allow for competition and indeed competition has already come to many of the markets served by the TDS Companies. There is no reason to delay any longer the entry of a new and vigorous competition into these markets.

Q. Does this conclude your testimony?

A. Yes.

[14] One option that is being considered in these negotiations is to use a "bill and keep" regime for interconnection. This regime provides many benefits to the market and is allowed under FCC rules.