Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island;	)	WC Docket No. 08-24
	)	
Petition of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in Cox's Service Territory in the Virginia Beach Metropolitan Statistical Area	)	WC Docket No. 08-49
	)	

SUPPLEMENTAL DECLARATION OF DR. MICHAEL D. PELCOVITS

I have been asked by Cavalier Telephone Corporation ("Cavalier") to respond to a number of points made by Verizon in an *Ex Parte* filing made on May 1, 2009 in regard to the issue of wireless substitution. This declaration will address three arguments that Verizon made in its partial response to the analysis that I presented in my original declaration.[1] First, I examine the recent NERA "study," which Verizon claims provides evidence on the cross price elasticity between wireless and wireline services. Second, I address Verizon's attempt to respond to the evidence about number portability that I presented in my original declaration. Third, I discuss Verizon's total failure to address the issue of market segmentation.

[1] Declaration of Dr. Michael D. Pelcovits, WC Docket Nos. 08-24, 08-49 (Apr. 21, 2009).

1. Verizon makes much of the point that the "CLECs ignore one recent study that is directly contrary to their claims."[2] This is a report by Dr. William Taylor and Dr. Harold Ware, released in December 2008. I was aware of this report at the time that I filed my original declaration, but judged it to be a brief opinion piece, and not a "study." Since Verizon had not introduced this into the record in this proceeding, I did not think they intended to rely on it as "evidence." In my experience, it would be out of the realm of possibility for a major consulting firm to produce an expert report on such a complex subject as the substitutability of wireline and wireless that was only seven pages long and contained no modeling, statistical analysis, or hypothesis testing. The study provides a cursory analysis of rate packages offered by wireless and wireline carriers. The only "hard" data point contained in the "study" that Verizon points to is that the NERA report "calculated the 'cross-price elasticity' between wireless and wireline [services], which is found to be 'about 1.4.'"[3] Verizon also claims that none of the studies cited by the CLECs "except for the Taylor/Ware study, actually measure the price-cross elasticity between wireless and wireline."[4]

Estimation of cross-price elasticity, however, is serious business and requires that proper mathematical and statistical tools be applied to a comprehensive data set. The NERA report does none of this. It simply calculates the ratio of changes in the demand for wireline to the change in the relative price of wireless and wireline service.[5]

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[2] Letter from Rashann Duvall, Verizon to Marlene Dortch, FCC, WC Docket Nos. 08-24, 08-49, at 18 (May 1, 2009) ("Verizon Ex Parte").
[3] *Id.*
[4] *Id.*
[5] The authors of the report claim that they measure the reduction in wireline demand "associated with gains in wireless-only households." William E. Taylor & Harold Ware, *The Effectiveness of Mobile Wireless Service as a Competitive Constraint on Landline Pricing: Was the DOJ Wrong?* 5 (Dec. 11, 2008), attach. B, Verizon Ex Parte ("Taylor and Ware"). This is a back-of-the-envelope attempt to cope with a complex

According to the authors, this ‘implies” a cross-price elasticity of about 1.4. I disagree. Rather, the “estimate” of a cross-price elasticity of 1.4 is just an algebraic exercise that *assumes* that the vast majority of the reduction in wireline demand over a six year period was due to changes in wireless prices. The reason this generates such a high cross-price elasticity is that it fails to account properly for the effect of *all other factors*, such as the vast improvement in wireless quality, the change in household composition, and the impact of the Internet. A properly constructed and specified econometric analysis could yield an entirely different result bearing little relationship to the 1.4 ratio used by NERA.

Dr. Taylor and Dr. Ware acknowledge that their approach is deficient. “We would have preferred to estimate price elasticity from the coefficients of a demand function that controls for other factors such as changes in taste and income.”[6] The authors are certainly aware of the right way to estimate cross price elasticity. Further, Verizon could provide the data to analyze the issue properly. The fact that Verizon has not provided such a study, but rather attempts to shift the burden of proof to the CLECs, should speak for itself.

2. In my original declaration I presented data on number porting to disprove Verizon’s hypothesis that increases in the price of wireline service would be unprofitable because many *current* wireline customers would cut the cord. Verizon does not dispute the data, but argues that “if anything, they prove the opposite.”[7] It interprets the evidence to mean that when households with both wireline and wireless service decide to cut the cord they do not port their wireline number, because it would entail getting rid of their

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econometric problem, and would never suffice in the type of work presented to one of the antitrust agencies.

[6] Taylor and Ware, at 5.

[7] Verizon Ex Parte at 22.

existing wireless number. This ignores the reality of the market. As the CDC data demonstrates, there are major demographic groups that have done relatively little cord-cutting. For example, only 9.9% of homeowners have cut the cord, and only 3.3% of senior citizens have cut the cord. I have no reason to believe (nor has Verizon provided any proof) that Verizon's hypothesis has any bearing on the customers belonging to these demographic groups. Quite the opposite is true. Most homeowners and senior citizens that have maintained the same wireline number for many years would be unlikely to cut the cord on this phone, unless they ported the number to a new wireless phone. The evidence on number porting indicates that these customers have not responded to lower wireless prices by cutting the cord on their primary household telephone. Since the population of wireline customers is shifting increasingly to these type of customers (as others have cut the cord), Verizon will face even less constraint in the future on its pricing of wireline service.

3. Verizon also fails to remedy the central flaw in its case, in general, and in its reliance on the CDC data, specifically. Verizon has failed to explain how the low level of cord-cutting among some large demographic groups is consistent with the simple theory that wireless prices do constrain and will constrain wireline prices. The importance of such factors as age, home ownership status, and geographic region, persists even in the CDC update released this week.[8] For example, cord cutting by homeowners has reached only 9.9% as of the second-half of 2008. This is a 10% increase from the previous survey in the first half of 2009. Even if cord cutting continues to grow at that same rate, however, it would take almost four more years for cord cutting to reach even 20% in that

[8] Stephen J. Blumberg & Julian V. Luke, National Center for Health Statistics, *Wireless substitution: Early release of estimates from the National Health Interview Survey, July-December 2008*, (May 6, 2009).

demographic group. It is not possible to conclude, based on the CDC data or any other evidence presented by Verizon, that wireless will constrain Verizon's ability to raise prices for large blocks of customers that continue to rely to a very large degree on wireline service.

Although the recently-released CDC data has received significant attention in the press, and will no doubt be touted by Verizon as further proof of wireless substitution, there is no new evidence pertinent to the question of market definition and market power. The CDC report is not a competition analysis, but rather a presentation of survey results. The first sentence in the conclusion to the latest report sums up the key finding: "The potential for bias due to undercoverage remains a real and growing threat to surveys conducted only on landline telephones."[9] In other words, the mix of respondents to a telephone survey must be adjusted to account for the different demographics of the wireline and wireless-only population. This does not prove that wireless and wireline services belong in the same product market. Indeed, the CDC's warning of a "potential for bias due to undercoverage" captures the point that I have made – that substitution depends on a lot of factors other than price. The importance of these factors cannot be weighed without a comprehensive statistical analysis, which Verizon has not provided.

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Verizon has introduced no new evidence that would support its claim that wireless service is an effective competitive constraint on wireline service. The only "new" evidence is a brief report by Taylor and Ware, which contains none of the empirical analysis that would be necessary to meet the standards of the antitrust agencies. Verizon has also failed to explain how the persistent variation in the "cut-the-cord" penetration

[9] *Id.*,at 4.

across demographic groups reported by the CDC surveys is consistent with its hypothesis that the relative prices of wireless and wireline services is the key factor determining the level of wireless substitution. For these reasons, I recommend that the Commission treat wireless and wireline voice and data services as belonging to separate antitrust markets.

I declare under penalty of perjury that the foregoing is true and correct. Executed this 8th day of May, 2009, at Washington, D.C.

Michael D. Pelcovits

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