Dulaney L. O'Roark III
Vice President & General Counsel, Southeast Region
Legal Department

verizon

5055 North Point Parkway
Alpharetta, Georgia 30022

Phone 678-259-1449
Fax 678-259-1589
de.oroark@verizon.com

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COMMISSION CLERK

July 24, 2008 – **VIA OVERNIGHT MAIL**

Ann Cole, Commission Clerk
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 070691-TP
Complaint and request for emergency relief against Verizon Florida LLC for anticompetitive behavior in violation of Sections 364.01(4), 364.3381, and 364.10, F.S., and for failure to facilitate transfer of customers' numbers to Bright House Networks Information Services (Florida), LLC and its affiliate, Bright House Networks, LLC

Docket No. 080036-TP
Complaint and request for emergency relief against Verizon Florida LLC for anticompetitive behavior in violation of Sections 364.01(4), 364.3381, and 364.10, F.S., and for failure to facilitate transfer of customers' numbers to Comcast Phone of Florida, LLC d/b/a Comcast Digital Phone

Dear Ms. Cole:

Enclosed for filing in the above-referenced matters are the originals and 15 copies of the Rebuttal Testimonies of Michelle Robinson and Jeffrey A. Eisenach on behalf of Verizon Florida LLC. Service has been made as indicated on the Certificate of Service. If there are any questions regarding this filing, please contact me at (678) 259-1449.

Eisenach's testimony - 06472-08
Robinson's testimony - 06473-08.

Sincerely,

Dulaney L. O'Roark III

Dulaney L. O'Roark III

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Enclosures

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that copies of the foregoing were sent via overnight mail(*) on July 24, 2008 and U. S. mail(**) on July 25, 2008 to:

Beth Salak(*)
Rick Mann(*)
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850
bsalak@psc.state.fl.us
rmann@psc.state.fl.us

Samuel F. Cullari, Counsel(**)
Comcast Cable
1500 Market Street
Philadelphia, PA 19102
samuel_cullari@comcast.com

Christopher McDonald(**)
Comcast Digital Phone
Director of State Government Affairs
300 West Pensacola Street
Tallahassee, FL 32301
christopher_mcdonald@cable.comcast.com

Charlene Poblete, Staff Counsel(*)
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850
cpoblete@psc.state.fl.us

Christopher W. Savage(**)
Davis Wright Tremaine, LLP
1919 Pennsylvania Avenue, NW, Suite 200
Washington, DC 20006
chrissavage@dwt.com

Beth Keating(**)
Akerman Senterfitt
106 East College Avenue, Suite 1200
Tallahassee, FL 32301
beth.keating@akerman.com

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In re: Complaint and request for emergency relief against Verizon Florida, LLC for anticompetitive behavior in violation of Sections 364.01(4), 364.3381, and 364.10, F.S., and for failure to facilitate transfer of customers' numbers to Bright House Networks Information Services (Florida), LLC, and its affiliate, Bright House Networks, LLC.	DOCKET NO. 070691-TP
In re: Complaint and request for emergency relief against Verizon Florida, L.L.C. for anticompetitive behavior in violation of Sections 364.01(4), 364.3381, and 364.10, F.S., and for failure to facilitate transfer of customers' numbers to Comcast Phone of Florida, L.L.C. d/b/a Comcast Digital Phone.	DOCKET NO. 080036-TP

REBUTTAL TESTIMONY OF JEFFREY A. EISENACH

On behalf of
Verizon Florida LLC

July 25, 2008

PUBLIC VERSION

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REBUTTAL TESTIMONY
OF
JEFFREY A. EISENACH, PH.D.

I. INTRODUCTION AND QUALIFICATIONS

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

A. My name is Jeffrey A. Eisenach. My business address is 1614 20th St. NW, Washington, DC 20009.

Q. Where, and in what capacity, are you employed?

A. I am Chairman of Criterion Economics, LLC.

Q. What is your educational background?

A. I earned a Ph.D. in economics from the University of Virginia and a B.A. in economics from Claremont McKenna College.

Q. What is your relevant experience for testifying in this matter?

A. I have more than 25 years of experience in economic analysis of legal and public policy issues, much of which has been focused on telecommunications and related markets. I have served in senior policy positions at the Federal Trade Commission and the White House Office of Management and Budget. I have also served on the faculties of Harvard University's Kennedy School of Government, Virginia Polytechnic Institute and State University and, currently, George Mason University School of Law; and, I served for 10 years as President of The Progress & Freedom Foundation, a non-partisan, non-profit think tank focused on issues affecting the high-tech sector of the economy. As President of the Foundation from 1993 until 2003, I led the Foundation's research into a wide range of issues, including an extensive program of studies on communications regulation. I have authored or co-authored numerous expert reports in litigation matters as well in regulatory proceedings before the Federal Communications Commission, the Federal Trade Commission, and other regulatory agencies, and testified before Congress on multiple occasions. I have also served as an expert witness before the District of Columbia Public Service Commission, the Maryland Public Service Commission and the Virginia State Corporation Commission, and in litigation in the Eastern District of Pennsylvania, where I testified on behalf of the U.S. Department of Justice. I have also testified before Congress on telecommunications issues on several occasions, and before the Department of Justice and Federal Trade Commission in their Joint Hearings on Single-Firm Conduct.

I am the author or co-author of eight books, including *The Digital Economy Fact Book, The Telecom Revolution: An American Opportunity*, and *America's Fiscal Future: Controlling the Federal Deficit in the 1990s*. In addition, I have edited or co-edited five books, including *Communications Deregulation and FCC Reform: What Comes Next?* and *Competition, Innovation and the Microsoft Monopoly: Antitrust in the Digital Marketplace*. My articles have appeared in scholarly journals as well as in such popular outlets as *Forbes, Investors Business Daily, The Wall Street Journal, The Washington Post*, and *The Washington Times*.

Among my previous affiliations, I have served as a scholar at the American Enterprise Institute, the Heritage Foundation and the Hudson Institute; as a consultant to the U.S. Sentencing Commission (on corporate sentencing guidelines); and as a member of both the Virginia Attorney General's Task Force on Identity Theft and the Virginia

Governor's Commission on E-Communities, a statewide effort to develop strategies for enhancing access to advanced communications infrastructures and the Internet for communities throughout the state. My consulting practice focuses heavily on the communications sector, and my clients include a wide range of firms. A copy of my curriculum vitae is attached as Exhibit JAE-1.

Q. Prior to your involvement in this matter, have you performed any previous analyses of the marketing practices at issue in this proceeding?

A. Yes. Earlier this year, I provided an Expert Declaration on Verizon's retention marketing practices to the Federal Communications Commission ("FCC") in its File No. EB-08-MD-002, *Bright House Networks et al v. Verizon California et al.* A copy of my Expert Declaration ("FCC Declaration") is attached as Exhibit JAE-2.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to address Issues 1, 3 and 4 in this case and specifically to provide my assessment of the Direct Testimony of Dr. Coleman D. Bazelon on behalf of Bright House Networks Information Services (Florida), LLC and its affiliate, Bright House Networks, LLC (together, "Bright House").[1]

Q. What materials have you reviewed in preparing your testimony?

A. In addition to Dr. Bazelon's testimony and the materials cited in my FCC Declaration, I have reviewed the Direct Testimony of Mr. Alan F. Ciamporcero (which is being adopted by Ms. Michelle Robinson), Ms. Bette J. Smith and Mr. Patrick J. Stevens, and the Rebuttal Testimony of Ms. Robinson, on behalf of Verizon (including attachments); the

[1] Throughout this testimony, and unless otherwise noted, my testimony concerning the claims made by Bright House also addresses the similar claims made by Comcast.

Direct Testimony of Mr. Timothy F. Frendberg on behalf of Bright House; the Direct Testimony of Ms. Beth Choroser on behalf of Comcast Phone of Florida, LLC; and, certain pleadings filed in this case, including the complaints filed by Bright House and Comcast. I have also reviewed and relied upon the materials cited in this testimony.

Q. Can you briefly summarize your conclusions?

A. Yes. First, Dr. Bazelon's testimony boils down to one simple proposition: Consumers will be better off if they are not aware of the choices available to them in the marketplace, and as a result pay higher prices (or receive inferior services) than if they had been fully informed. This proposition is economically indefensible and, in a word, wrong: Consumers are not better off being ignorant, and paying higher prices does not enhance their economic welfare.

Second, Dr. Bazelon's argument is based on the contention that Bright House is harmed when fully informed consumers choose Verizon's services over Bright House's competing services. No doubt this is true: Bright House would prefer to be able to capture Verizon's customers without having to offer them a better service, or lower prices, than Verizon. But the aim of competition law is to protect competition, not competitors: If Bright House cannot compete by offering consumers better products at lower prices, it is not a proper role for regulators, under the guise of competition law, to skew the market by placing a thumb on the competitive scales in Bright House's favor. *Indeed, if there is one central difference between Dr. Bazelon's analytical approach and my own, it is that Dr. Bazelon's analysis focuses on what is best for Bright House, while mine focuses on what is best for consumers.*

Third, Dr. Bazelon's dire predictions of Bright House's decline as a result of Verizon's practices are neither supported nor credible. Bright House has captured nearly 500,000 voice telephony customers in its Florida footprint in approximately three years; and, it remains the dominant cable TV and Internet provider in its service territories. There is no basis for Dr. Bazelon's contention that Verizon's customers need to be "protected" from lower prices in order to preserve Bright House as a vibrant competitor in the marketplace for voice services.

Fourth, there is no economic basis for Dr. Bazelon's argument that Verizon's practice of offering discounts to marginal customers (*i.e.*, those who are searching for lower prices) constitutes anticompetitive "price discrimination." To the contrary, the offering of discounts is commonplace throughout the economy, is practiced aggressively by the cable industry in its own customer retention efforts, and promotes competition by ensuring that the most efficient firm (the one willing to offer the best service at the lowest price), wins the customer's business.

Fifth, Dr. Bazelon's contention that Verizon's use of data obtained through the local number portability ("LNP") process is equivalent, as an economic matter, to "theft" is also incorrect, and Dr. Bazelon's attempt to support this contention by analogies to "shoplifting" or the stealing of one firm's productive assets by another are inapt. Thieves expend resources to commit their crimes, and having done so, they deprive the rightful owners of the ability to use the stolen goods. Verizon receives the data about a customer's intention to disconnect that accompanies an LNP order lawfully[2] and in the

[2] Verizon uses the customer request to disconnect Verizon retail service that Bright House sends with an LNP request to initiate its retention marketing process. Smith Direct at 2, Stevens Direct at 2-12.

normal course of business, and its use of the data does not deprive Bright House of the ability to use it as well.

Sixth, Dr. Bazelon's conclusions are based on multiple factual errors and misstatements, which I point out below. Most notably, Dr. Bazelon's contention that the discounts Verizon offers through its retention marketing program are not generally available is simply false. Because his conclusions are based on this and other factual errors and misstatements, the Commission should give no weight to Dr. Bazelon's testimony.

Seventh, and finally, for the reasons stated above, and others I discuss below, Dr. Bazelon's conclusion that Verizon's retention marketing program is anticompetitive is unfounded and incorrect. Moreover, while Dr. Bazelon does not directly testify that Verizon is obtaining an undue or unreasonable advantage by virtue of its retention marketing program, such a conclusion would also be unfounded and incorrect. To the contrary, the opposite is true: Verizon's retention marketing program helps to level the competitive playing field with Bright House and other cable companies, and in so doing promotes competition on the merits. Accordingly, economic welfare will be best served if the Commission takes no action to hinder or terminate Verizon's retention marketing program.

Q. How is the remainder of your testimony organized?

A. In Section II, I briefly summarize the analysis I conducted in my Expert Declaration before the FCC and explain that the FCC's order overturning its Enforcement Bureau's recommendation in File No. EB-08-MD-002 did not reject my findings.

In Section III, I address Dr. Bazelon's mischaracterizations of Verizon's retention marketing program, and explain why, from an economic perspective, it does not constitute "theft," "expropriation," "exploitation" or any of the other colorful terms used by Dr. Bazelon.

In Section IV, I explain why Verizon's retention marketing program, contrary to Dr. Bazelon's claims, does not constitute anticompetitive price discrimination, is not anticompetitive in any respect as that term should be construed by the Commission, and does not give Verizon an "undue or unreasonable advantage."

In Section V, I present a brief summary of my conclusions and my recommendation regarding the Commission's appropriate response to the complaints in this docket.

II. MY FCC DECLARATION DEMONSTRATES THAT VERIZON'S RETENTION MARKETING PROGRAM BENEFITS COMPETITION AND CONSUMERS

Q. Can you briefly summarize the analysis you conducted in your Declaration in FCC File No. EB-08-MD-002, *Bright House Networks et al v. Verizon California et al*?

A. Yes. My Declaration addressed the economic consequences of Verizon's retention marketing program. In my Declaration, I explain that consumer welfare is harmed when consumers, by virtue of having incomplete information about the choices available to them, pay higher prices or receive lower quality goods than would have been the case had they been fully informed. By the same token, competition is harmed because the firms offering the best products at the lowest prices are not fully rewarded for doing so. As I explain there, uninformed consumers create a form of market power for suppliers – in this case, Bright House and Comcast – which allows them to charge supra-competitive prices simply because consumers do not know of the available alternatives and thus do not respond to above-market prices by leaving for other suppliers.[3]

I also note that the welfare costs of "faulty" purchase decisions are especially high when there are sunk costs involved in switching providers, such as when a cable provider has to roll a truck to a new customer's home. In that case, the costs of implementing the faulty decision are incurred and cannot be recovered, even if the consumer later learns of a superior alternative and – in this case – switches back to Verizon.

My FCC Declaration also explains that Verizon's retention marketing program constitutes an efficient means of informing consumers about the available alternatives, because it targets consumers who are "in the market," and thus actively seeking such information. As a result, Verizon's retention marketing program reduces consumer search costs, makes it more likely that consumers will identify and purchase the product which best meets their needs at the lowest available price, and thus facilitates competition on the merits.

Q. What do you mean by the term "faulty" decision?

A. Simply put, if a consumer pays $X for a product when the identical product was available at the same terms of sale for $X - $1 (or, for that matter, $X - $0.01), simply because she was not aware that the product was available at the lower price, that consumer has made what I refer to as a "faulty" purchase decision. Similarly, if a consumer in a differentiated product market buys a particular product for the same amount she could have paid for another, when the other product has characteristics that would have better

[3] Eisenach Declaration at 4 (citing Carlton and Perloff at 452: "Firms can obtain market power from consumers' lack of knowledge about prices and quality. Limited information can lead to a monopolistic price in what would otherwise be a competitive market.")

satisfied that consumer's needs, then, again, this is a "faulty" purchase decision. There is nothing complicated or technical here: It's as simple as saying "the consumer overpaid." Moreover, the immediate consequences for consumer welfare are exactly what common sense would suggest: The consumer's welfare has been reduced by the amount of the overpayment.

Q. What do you mean by the term "sunk costs" of switching providers?

A. Again, there is nothing complicated here: When a cable company rolls a truck to a consumer's home (for example, to install a new MTA, or Multimedia Terminal Adaptor, the device that permits VoIP telephony over the cable infrastructure), the costs associated with that truck roll are unrecoverable, or "sunk." The same is true for the costs incurred by the consumer, such as staying home from work to wait for the cable truck. If those costs are incurred in the course of implementing an efficiency-enhancing switch, such as a consumer's decision to change from a more expensive or "inferior" (as perceived by the consumer) product from Verizon to a less expensive or "superior" product offered by Bright House, then they are presumptively efficient. If, on the other hand, they are incurred in the course of implementing a faulty purchase decision, they constitute a pure welfare loss.

Q. Did you conduct an empirical analysis of the economic welfare consequences of Verizon's retention marketing program?

A. Yes. I examined (a) the direct consumer savings generated by the program in the form of lower prices and superior services and (b) the welfare benefits of avoiding the sunk costs associated with switching consumers to services which, had they been fully informed, they would never have purchased in the first place. My empirical analysis showed that "the increase in economic welfare that is directly attributable to the retention marketing program (or, conversely, the economic welfare loss that would be associated with banning the program) ... over five years is between $75 million and $79 million."[4]

Q. The FCC found in favor of the complainants in File No. EB-08-MD-002. Does anything in the FCC's Memorandum, Opinion and Order in that case change the views you expressed in your FCC declaration?

A. No. The FCC specifically did not reject my findings, but rather indicated they would be more appropriately addressed in a different type of proceeding, such as a rulemaking or a forbearance petition.[5] Thus, nothing in the FCC's decision, or in the Enforcement Bureau decision that preceded it,[6] causes me to change any of the analysis or conclusions in my FCC declaration.[7]

Q. More broadly, since you filed your FCC declaration, have you become aware of any facts or analyses, including Dr. Bazelon's testimony, that cause you to change your opinion on the matters you addressed there?

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[4] Eisenach FCC Declaration at 1; figures are nationwide, and represent the discounted present value of the economic welfare gains generated over a five year period.

[5] *Federal Communications Commission, Memorandum Opinion and Order, Bright House Networks, LLC v. Verizon California, Inc.*, File No. EB-08-MD-002, FCC 08-159, ¶ 43 (rel. June 23, 2008)("FCC Order"). The FCC did note that, in its view, I "simply assumed, with no support, that material competition in the residential voice market would continue to exist" if Verizon's retention marketing program were allowed to continue. (FCC Order at n. 104). While it does not seem to me that anyone familiar with the facts could think such a demonstration necessary, I address this issue directly in Section IV below.

[6] *Federal Communications Commission Enforcement Bureau, Recommended Decision, Bright House Networks, LLC v. Verizon California, Inc.*, File No. EB-08-MD-002 (rel. April 11, 2008).

[7] Verizon is appealing the FCC's decision. See *Verizon California et al v. Federal Communications Commission, Petition for Review*, United States Court of Appeals for the District Of Columbia Circuit (June 27, 2008).). Earlier this month, the Court granted Verizon's *Petition* and, on its own motion, ordered expedited consideration, with briefing to be completed by September 22.

A. No. It remains my opinion that "Verizon's retention marketing program is pro-consumer and pro-competitive."[8]

III. DR. BAZELON MISCHARACTERIZES VERIZON'S RETENTION MARKETING PROGRAM

Q. Do you agree with Dr. Bazelon's characterization of Verizon's retention marketing program?

A. No. Dr. Bazelon mischaracterizes Verizon's retention marketing program in several important respects. First, his description of the program as offering discounts only to customers identified through the use of LNP data is factually incorrect. Second, both his characterization of the program as involving competition on product quality (as opposed to price) and the conclusions he attempts to draw on the basis of that characterization are at best misleading. Third, his characterizations of the program as constituting "theft" or "stealing," while colorful and provocative, are inaccurate as a factual matter and, as a matter of economic analysis, simply incorrect.

Q. How does Dr. Bazelon err in describing the availability of the discounts in Verizon's retention marketing program?

A. Dr. Bazelon testifies that "This is not a situation in which Verizon has a price plan available that consumers, with sufficient effort, can discover. To the contrary … the relevant price only exists for a customer that tries to switch carriers, and only at the moment of the switch. As a result, a customer who has not already tried to leave Verizon could not 'find' the special deal with any amount of searching, because Verizon does not *offer* that special deal to its overall customer base. In other words, *there is no amount of*

[8] Eisenach FCC Declaration at 20.

search that a Verizon customer could engage in to find the retention marketing price."[9] This is simply untrue. The discounts Verizon offers to customers who call Verizon's 800 number in response to its retention marketing solicitations are available to any Verizon customer who calls about disconnecting his or her Verizon service.[10]

Q. What is the significance of this error for Dr. Bazelon's conclusions?

A. Two of Dr. Bazelon's central conclusions, and much of his rhetoric, are based directly on this error.

First, Dr. Bazelon bases his attempt to rebut my finding that Verizon's retention marketing program lowers search costs for consumers, and is therefore economically efficient, largely on his mistaken belief that Verizon's offering is limited to consumers identified through the program. Specifically, he argues that my analysis, which cites Nobel Prize Winner George Stigler for the proposition that information costs reduce market efficiency, is irrelevant here, because it applies only in a situation where "there is 'price information' out in the market to be found."[11] Specifically, he asserts, "Stigler's analysis ...has nothing to do with the case at hand [because this] is not a situation in which Verizon has a price plan available that consumers, with sufficient effort, can discover...."[12] However, he concedes, if Verizon's offers were available to all

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[9] Bazelon Direct at 30. See also Bazelon Direct at 27 ("[W]ere it not for Bright House expending considerable resources to identify a particular pool of dissatisfied customers, the Verizon offering in question would not exist at all....[Verizon] is marketing an offering created specifically for this group of customers whose existence and membership is revealed – indeed, created – only through the efforts of Bright House.")

[10] Smith Direct at 4.

[11] Bazelon Direct at 29.

[12] Bazelon Direct at 30.

customers, and information about them could be found through searching, "The consumer will be better off if he knows that information."[13]

In fact, Verizon's discounts are not limited to its retention marketing program. Thus, Dr. Bazelon's reasoning, applied to the correct set of facts, directly supports my conclusion that Verizon's retention marketing program makes consumers "better off."

Second, Dr. Bazelon's error also forms the basis for his attempt to characterize Verizon's use of LNP data as "theft." Specifically, based on his mischaracterization of the program, he concludes that "Verizon wants to discriminate among its customers and offer the lower prices *only to the select group of customers that Bright House's efforts have identified.* Therefore Verizon's program only works if and to the extent that Verizon can use the fruits of Bright House's marketing efforts."[14] While Dr. Bazelon's analysis in this regard is incorrect at several levels, as I explain in depth below, it is important to note that the underlying factual premise upon which it is based – that Verizon's discounts are available only to customers identified by Bright House's marketing efforts – is simply not true.

Q. You say that Dr. Bazelon also mischaracterizes Verizon's retention marketing program with respect to product quality. What do you mean by this, and how does Dr. Bazelon's mischaracterization affect his conclusions?

A. Dr. Bazelon also attempts to discredit my analysis of search costs by noting that "Stigler's analysis … assumes that the goods in question (that is, the goods for which the consumer lacks information, such as the file cabinet in my earlier example) are differentiated only

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[13] Bazelon Direct at 29.
[14] Bazelon Direct at 29 (emphasis in original).

by price," and he quotes Dr. Stigler's article as stating that "'The search for knowledge on the quality of goods, *which has been studiously avoided in this paper*, is perhaps no more important but, certainly, analytically more difficult.'"[15]

While I can understand Dr. Bazelon's desire to discredit my reliance on such a universally accepted economic principle, his effort fails, for two reasons. First, Dr. Bazelon ignores the fact that Verizon's retention marketing program constitutes advertising about the *price and availability* of specific products, and has *little if anything to do* with product quality. Thus, while Dr. Stigler is correct in stating that "the search for knowledge on the quality of goods [is] analytically more difficult" than the analysis of price advertising, that is irrelevant here, as there simply is no "search for knowledge on the quality of goods" involved. Thus, Dr. Bazelon's attempt to discredit my analysis on this basis is – to borrow a phrase from his testimony – a red herring.

Moreover, and perhaps more importantly, the fact that Dr. Stigler did not address issues relating to product quality and differentiation does not mean the rest of the economics profession has been silent on the issue. To the contrary, to cite another study I referenced in my FCC Declaration, there is a virtually universal consensus that "Additional information induces sellers to compete for the patronage of informed consumers by offering better values – either lower prices *or higher qualities*."[16] Thus, even if one

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[15] Bazelon Direct at 30-31 (emphasis added by Dr. Bazelon).

[16] Howard Beales, Richard Craswell and Steven C. Salop, "The Efficient Regulation of Consumer Information," *Journal of Law and Economics* 24 (December 1981) 491-539, 503. (Emphasis added.) For an example of how Stigler's basic finding has been extended to differentiated product markets, and specifically to the effects of more efficient targeted marketing techniques, see Gene M. Grossman and Carl Shapiro, "Informative Advertising with Differentiated Products," *The Review of Economic Studies* 51;1. (January 1984), at 63-81, 77 ("We have constructed a model of purely informative advertising with heterogeneous goods. ... We have also studied the effects of changes in the advertising technology on equilibrium in product markets. ... *[W]e found that improved efficiency of advertising (e.g. a reduction in the cost per exposure) does indeed increase the competitiveness of the market (as measured by demand elasticities) and causes prices to fall.*") (Emphasis added)).

believed that Verizon's retention marketing program somehow involved product quality, it would not affect my analysis in any way.

Q. Dr. Bazelon equates Verizon's use of LNP data in its retention marketing program to "stealing," "theft" and "expropriation." What is your reaction to these characterizations?

A. While the use of such colorful rhetoric is no doubt designed to have a powerful persuasive impact, from an economic perspective Dr. Bazelon's characterizations are utterly unsupported and, as a result, highly misleading.

As a preliminary matter, Dr. Bazelon's characterizations cannot be statements of fact or conclusions of law. Neither he nor I are attorneys, but it seems apparent even to a layman that the question of whether Verizon has the *legal right* to use the customer disconnect and LNP request is the very question at issue in this proceeding, as well as in the litigation involving the FCC's ruling in File No. EB-08-MD-002. If it is ultimately determined that Verizon has the legal right to use that data for retention marketing, then as a factual matter its use of that data can hardly be characterized as "stealing." While it is convenient, from Dr. Bazelon's perspective, to assume his preferred result in this case, that assumption cannot properly form the basis for his analysis.

Thus, Dr. Bazelon's characterizations can only be relevant to the extent they are supported by analysis of the economic effects of Verizon's retention marketing program. However, Dr. Bazelon's attempt to equate the economic effects of the program to effects of "shoplifting" clothing from a department store or "a construction company in need of bulldozers that simply stole them from a competitor's work site"[17] is fatally flawed and fundamentally incorrect.

Q. Please explain why Dr. Bazelon's analysis is incorrect.

A. First, Dr. Bazelon makes a fundamental error when he acknowledges, but then fails to recognize the significance of, the distinction between information, which is a public good, and "bulldozers" and "clothes," which are not. Specifically, he states that "In the case of Verizon's retention marketing program, the asset is proprietary, competitively sensitive *information, rather than something tangible* like clothes or bulldozers. The information is, nonetheless, a valuable asset, whose expropriation by a competitor has *the same economic impact on society as stealing clothes or bulldozers.*"[18]

This statement is simply wrong, and for a very straightforward reason: When a construction company (to use Dr. Bazelon's analogy) steals a bulldozer from another construction company, the victim company is deprived of the further use of the bulldozer. This is because bulldozers do not have the characteristic of public goods known as being "non-rival" in consumption, *i.e.*, the characteristic that one person's use of the good does not diminish the ability of others to use the same good. Customer disconnect and LNP data, however, do have that characteristic: Verizon's use of the data does not in any way detract from Bright House's ability to continue using it. In terms of Dr. Bazelon's analogy, Verizon's use of the disconnect and LNP data is the economic equivalent of creating another bulldozer, and has the same effect on economic welfare: the amount of productive capital in the economy is increased. In slightly more technical economic

[17] Bazelon Direct at 4.
[18] Bazelon Direct at 4 (emphasis added).

terms, it is economically inefficient to exclude access to a public good (once provided),[19] since the use by one party does not diminish the ability of others to use it as well.

Second, Dr. Bazelon ignores another important distinction between bulldozers and clothes, on the one hand, and disconnect and LNP information on the other: When firms utilize bulldozers, or people wear clothes, the economic benefits of those goods are entirely private – that is, they accrue entirely to the firm or person consuming them. By contrast, when Verizon uses these data, it creates a positive externality for consumers, who are unambiguously better off as a result of Verizon's use of the data to inform them of its discounts – as demonstrated by the fact that many of them accept Verizon's offers.[20]

Put differently, Verizon's use of disconnect and LNP data to inform consumers of an offer they may find more attractive than the one proffered by Bright House facilitates competition on the merits by attenuating the *de facto* market power Bright House would otherwise enjoy as a result of consumer ignorance. As a matter of economics, the transfer of a bulldozer or a dress from one owner to another, whether by theft or otherwise, has no such salutary effect.

This analysis also helps to clarify another point upon which Dr. Bazelon places great weight, and which I discuss further below, which is that Verizon's use of the data diminishes the *value* of that data to Bright House. In one respect (and only one), Dr.

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[19] I discuss the effects of the retention market program on Bright House incentives to advertise in Section IV below. To preview my conclusion, Verizon's retention marketing program will not result in underinvestment in advertising by Bright House.

[20] See also Bazelon Direct at 3 ("Once Verizon has access to this information (the specific identities of the departing customers) it simply uses it for *its own* gain.") (emphasis added). The key missing point in this sentence is that Verizon only benefits to the extent consumers find its offerings superior to Bright House's – that is, *any benefit Verizon receives is as a direct result of increased consumer welfare.*

Bazelon is correct on this point. If the Commission awards Bright House the *exclusive* right to use the disconnect and LNP data at issue here, Bright House will acquire *de facto* market power over consumers who, had they been fully informed, would have chosen Verizon instead. Thus, Dr. Bazelon's claim amounts to saying that Bright House will be worse off to the extent it has less market power. While this is uncontroversial, it hardly creates an economic or public policy basis for granting the exclusivity Bright House desires.

Q. Do you have any other reactions to Dr. Bazelon's "stealing" metaphor?

A. Yes. Dr. Bazelon's assumption that Verizon's conduct constitutes "stealing," which cannot be justified as either a statement of fact or as a result of economic analysis, is absolutely central to his testimony. For example, he states that, "[I]f fewer customers came to Bright House because of Verizon's improved services or lower prices in the market, the overall economic effect would be positive. Here, however, the increase in customer acquisition cost and the decline in customers switching to Bright House's services arise because Verizon is *expropriating* Bright House's competitive intelligence."[21] But of course, the only reason Verizon's retention marketing program causes "fewer customers to come to Bright House" is *precisely because* the program makes them aware of Verizon's "lower prices in the market." Thus, Dr. Bazelon's testimony itself concedes that, but for his unjustified assumption that "Verizon is expropriating Bright House's competitive intelligence," the "overall economic effect" is positive.

[21] Bazelon Direct at 23 (emphasis added).

Q. Dr. Bazelon asserts that it would be more efficient for Verizon to develop this information on its own.[22] Do you agree?

A. No. First, it is not at all obvious how Verizon could develop the information at issue here, that is, information that specific customers are in the market shopping at a specific time.[23] Second, from an economic perspective, we come back again to the fact that information is a public good: Once the information has been created, the expenditure of additional resources to re-create it would be pure economic waste. Thus, even if Verizon could develop the same information, it would not be efficient for it to do so. Third, in the event that Verizon could not develop the information needed to engage in equally effective retention marketing, it might attempt to make up the difference by engaging in increased win-back marketing – *i.e.*, trying to get customers to return. But, as I explain more fully in my FCC Declaration, win-back marketing is no substitute for Verizon's retention marketing program, because the sunk costs of switching have already been incurred. Indeed, to the extent consumers do return to Verizon as a result of win-back marketing, there are actually two sets of sunk costs involved, the first when the customer makes the faulty choice to switch to Bright House (and thus, for example, takes a day off work for the installation), and the second when she has to take a second day off for the Verizon re-installation.

Q. Dr. Bazelon states that LNP activities are wholesale, not retail, activities. Do you agree?

[22] Bazelon Direct at 20.

[23] It is my understanding that Verizon could, in theory, develop this information by inconveniencing customers with a requirement that they can only disconnect their Verizon services by calling Verizon directly. Unlike Bright House, which does insist that customers contact it directly in order to terminate service, however, Verizon accepts disconnection instructions from Bright House, acting at the customer's direction, along with the LNP request. Ciamporcero Direct at 14-15; Stevens Direct at 4.

A. No. Dr. Bazelon states that, "broadly speaking, 'retail services are services provided directly to consumers, while 'wholesale' services are provided further up the value chain in order to permit a retail service to be offered."[24] While, again, neither Dr. Bazelon nor I are attorneys, from an economic perspective it is not true that all transactions that take place between firms are "wholesale," as Dr. Bazelon appears to be claiming. Rather, from an economic perspective, the defining characteristic of a "wholesale" product or service is that it is *intended for resale* by the buyer (*i.e.*, the retailer) to others. Thus, for example, when Bright House purchases accounting services to do its taxes, or legal services to appear before public service commissions, no one would characterize these services as "wholesale" simply because they are purchased by a firm rather than an individual. Nor, to use an analogy closer to home, is it a "wholesale" transaction if Bright House purchases a direct mail list of addresses to use in marketing customers. By contrast, when Verizon leases an unbundled loop to a CLEC, that transaction is properly characterized as "wholesale" because the services provided by the loop are then repackaged and sold *at retail* to consumers. Obviously, LNP and disconnect data are not resold to consumers, and are thus not "wholesale" as that term is typically used in economics.[25] Indeed, the information that the customer intends to disconnect from Verizon and the date on which that is scheduled to happen – which are the data that trigger the retention marketing effort – are classic *retail* data that Verizon must have to manage its *retail* relationship with its *retail* customer.

[24] Bazelon Direct at 17-18.

[25] Importantly, LNP obligations are not limited to carriers who provide services at wholesale. If Verizon provided no wholesale telecommunications services whatsoever, it would still be required to abide by the LNP rules. By the same token, the fact that Bright House has precisely the same LNP obligations as Verizon does not transform it into a wholesaler of any service.

IV. VERIZON'S RETENTION MARKETING PROGRAM IS NOT ANTICOMPETITIVE AND DOES NOT GIVE VERIZON AN UNDUE OR UNREASONABLE ADVANTAGE

Q. Dr. Bazelon testifies that Verizon's retention marketing program is anticompetitive. Can you summarize the basis upon which Dr. Bazelon reaches this conclusion?

A. Yes. Dr. Bazelon supports his conclusion on the basis of two arguments. First, he asserts that "Verizon's program is anticompetitive for the same reasons that it is anticompetitive for a firm to steal a rival firm's assets."[26] Second, he states that "Offering price breaks *only* to the consumers who have confirmed their willingness to switch to competitors undermines the essence of competition and is in no way pro-competitive."[27] I will refer to these as the "theft argument" and the "price discrimination argument."

Q. Do you agree with Dr. Bazelon's theft argument?

A. No. For the reasons I explained above, Verizon's retention marketing effort is not theft, either as a matter of fact or of law; and, Dr. Bazelon does not provide any support for the contention that the economic effects of the program are in any way similar to, let alone the same as, the economic effects of theft.

Q. But Dr. Bazelon also states that "Verizon's retention marketing program is anticompetitive because it uses information it has access to only because of local number porting to undermine the pro-competitive effects that such entrants as Bright House have on the local voice services market. The program expropriates

[26] Bazelon Direct at 2-3 ("In economic terms, it is exploitative for Verizon to base its retention marketing on competitive intelligence that Bright House, at considerable expense and effort, has developed and, but for the peculiarities of the number porting process, would not willingly reveal to Verizon.... Simply put, the exploitative nature of Verizon's retention marketing program makes it the economic equivalent of stealing. That is, Verizon's program is anticompetitive for the same reasons that it is anticompetitive for a firm to steal a rival firm's assets.") See also Bazelon Direct at 4 ([Verizon's retention marketing program] "degrades the value of Bright House's competitive asset.")

[27] Bazelon Direct at 22.

the fruits of Bright House's investments in recruiting customers, reducing the returns to Bright House's marketing efforts. This blunts Bright House's competitive impact on the local market, and, ultimately dulls the incentives for Bright House and other competitors to make those investments in the first place."[28] He also states that "Bright House today makes the effort to identify these customers only because the benefits – the net revenue from new Bright House customers – match or exceed the costs of doing so. This is the essence of rational economic decisionmaking and the essence of competition."[29] Isn't Dr. Bazelon correct that Verizon's retention marketing program harms competition by reducing Bright House's incentives to engage in marketing?

A. No. First, Dr. Bazelon is simply wrong that Verizon only has access to the information needed for retention marketing because of the LNP process. The essential information that triggers the retention marketing effort is the information that the customer intends to disconnect her Verizon service. Although that information is delivered with the LNP request if there is one, it does not depend on LNP and is logically separate.[30] Moreover, as I discussed above, the only portion of the value of the disconnect and LNP data to Bright House that is affected by Verizon's retention marketing program is the portion associated with the market power Bright House holds due to consumer ignorance. Put differently, in the absence of the retention marketing program, a portion of the incremental net revenue Bright House earns from its marketing activities would consist purely of *overpayments* from consumers who made faulty decisions out of ignorance.

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[28] Bazelon Direct at 12.
[29] Bazelon Direct at 19.
[30] Stevens Direct at 2-12.

There is no economic or public policy basis for providing Bright House with the incentive to engage in marketing that results in consumers overpaying for services. Indeed, the economics of this situation are no different from the economics of deceptive advertising. If, hypothetically, Bright House engaged in deceptive advertising which persuaded customers to choose its services over the services of other providers, when in fact competitors' services were superior, it would benefit from "incremental net revenues." But no one would argue that competition would be enhanced, consumers would be made better off, or economic welfare would be increased as a result.

Dr. Bazelon's argument amounts to a claim that whatever is good for Bright House is good for consumers, which is simply not the case. And, while Bright House's desire to possess market power may be, as Dr. Bazelon suggests, "the essence of rational decisionmaking" by Bright House, permitting it to have and exploit that power hardly constitutes "the essence of competition."

Q. Do you agree with Dr. Bazelon's price discrimination argument?

A. No. While Dr. Bazelon seems to at least partly understand why it is efficient for firms in declining cost industries to charge some customers more than others, he tries to single out Verizon's retention marketing program as a uniquely anticompetitive or inefficient example of this phenomenon. Contrary to Dr. Bazelon's claims, however, the price discrimination at issue here is no different from other forms of beneficial price discrimination found throughout the economy and, especially, in declining cost industries such as wireline communications.

Q. Can you elaborate?

A. Yes. First, Dr. Bazelon seems to comprehend the basic economics of declining cost industries, when he states that "In the case of a telecommunications provider such as Verizon, a large portion of total costs are fixed. Consequently, a typical consumer is charged a price significantly above the firm's incremental or marginal cost" while others are charged "a price that only covers the marginal costs of serving them."[31] As far as this goes, it is correct.

What Dr. Bazelon does not specifically say, presumably because it does not serve his purpose, is that such differentiated pricing is generally agreed to be economically efficient. As one authoritative article explains,

> many important industries involve technologies that exhibit increasing returns to scale, large fixed and sunk costs, and significant economies of scope. Two important examples of such industries are telecommunications services and information services. In each of these cases the relevant technologies involve high fixed costs, significant joint costs and low, or even zero, marginal costs. Setting prices equal to marginal cost will generally not recoup sufficient revenue to cover the fixed costs and the standard economic recommendation of 'price at marginal cost' is not economically viable. Some other mechanism for achieving efficient allocation of resources must be found.... *(i) efficient pricing in such environments will typically involve prices that differ across consumers and type of service; (ii) producers will want to engage in product and service differentiation in order for this differential pricing to be feasible; and, (iii) differential pricing will arise naturally as a result of profit seeking by firms. It follows that differential pricing can generally be expected to contribute to economic efficiency.*[32]

Thus, "price discrimination" and product differentiation are generally understood by economists to be economically efficient in industries such as telecommunications, and the price discounts that result are generally recognized to be a natural and welfare-increasing result of the competitive process.

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[31] Bazelon Direct at 14.

[32] Hal Varian, "Differential Pricing," *First Monday* 1;2 (August 1996) (available at http://www.uic.edu/htbin/cgiwrap/bin/ojs/index.php/fm/article/view/473/829).

However, Dr. Bazelon's analysis of Verizon's discounting reaches a radically different result. Specifically, he claims that "the win-back price [*i.e.*, Verizon's discounted price] is not the 'competitive price'" and, indeed, that "when Verizon offers a lower, 'competitive' price to select customers, Dr. Eisenach's reasoning [*i.e.*, that the discounted price *is* the competitive price] compels the conclusion that Verizon is charging its other existing customers prices above the competitive level."[33] In other words, Dr. Bazelon seems to be testifying – in apparent contradiction of his acknowledgement that differential pricing is commonplace in declining cost industries, and certainly in direct conflict with the overwhelming economic consensus – that there is only one "competitive price" in this market. Furthermore, he asserts, Verizon's discounts constitute *prima facie* evidence that "Verizon is over-charging ... its overall body of customers."[34] There simply is no basis in economics for this conclusion.[35]

Q. Does Dr. Bazelon explain how he believes Verizon's "price discrimination" harms competition or consumers?

A. I cannot find anywhere in his testimony where Dr. Bazelon explains his basis for believing Verizon's discounts, as such, are anticompetitive. Instead, I find several

[33] Dr. Bazelon attempts to buttress this claim by arguing that the discounted price is "simply the price Verizon is able to offer these select customers because it is using Bright House's proprietary information for free." (Bazelon Direct at 33.) However, as I explained above, Dr. Bazelon's factual basis for this statement is in error: Verizon does not limit its discounts to customers for which it receives LNP orders, but rather makes them available to any customer who threatens to switch.

[34] Bazelon Direct at 33. ("Put another way, if (a) the price Verizon offers the departing customers is 'the competitive price,' and (b) Verizon does not offer that 'competitive price - including recognition of the $100/$200 gift cards as effective price reductions - to its general body of customers, the inevitable conclusion is that *Verizon is over-charging (as compared to 'the competitive price') its overall body of customers.*")

[35] It is noteworthy that cable companies engage in precisely the same sorts of discounting practices as Verizon, including through the use of aggressive win-back programs. See Brian Santo, *Cable Show: Comcast To Try Win-at-Any-Cost Retention Program*, CedMagazine.com (May 20, 2008), *available at* http://www.cedmagazine.com/Cable-Show-Comcast-win-at-any-cost.aspx (Exhibit AFC-8 to Direct Testimony of Alan Ciamporcero). Like Verizon's discounts, such discounts are, as a general matter, beneficial to consumers.

statements where he simply characterizes the discounts as "price discrimination," as if price discrimination, in and of itself, should be assumed to be harmful. For example, he states at one point that

> Verizon's program is *a blatant display of price discrimination* that may be welfare increasing for those few customers that receive the deeply discounted prices but will not be directly beneficial to other Verizon customers, and will harm competition overall.[36]

While I infer from Dr. Bazelon's use of the word "blatant" that he believes the price discrimination at issue here to be harmful, and I see that he asserts that it will "harm competition overall," I cannot find in his testimony any explanation of the method by which he believes competition will be harmed. Similarly, Dr. Bazelon states, as a conclusion, that "Offering price breaks only to the consumers who have confirmed their willingness to switch to competitors undermines the essence of competition and is in no way procompetitive."[37] But, again, he never explains *how* or *why* he believes this to be the case.

Q. Can you infer from Dr. Bazelon's testimony what anticompetitive effect he might have in mind?

A. The only hint I can find is in Dr. Bazelon's claim that Verizon's retention marketing program "interferes with [Bright House's] pro-competitive activity because it decreases the incentive for entrants such as Bright House to invest to compete with Verizon. Due

[36] Bazelon Direct at 5. See also Bazelon Direct at 19 ("Q: *Other than allowing them to price discriminate, what is the harm in Verizon using the porting information?*")

[37] Bazelon Direct at 22.

to Verizon's behavior, for every dollar spent by a competitor to market to a potential customer, there is a lower probability of success and, consequently, a lower return."[38] To the extent Dr. Bazelon is referring in this statement to Verizon's discounts, and the resulting choices of consumers to purchase Verizon's services rather than Bright House's, he is correct that Bright House's marketing dollars yield a "lower probability of success and, consequently, a lower return." However, as I have explained above, the solution to this problem is not to attempt to stop consumers from being informed about Verizon's lower prices or better services, but to charge lower prices or offer better services itself – that is, to compete on the merits.

Q. Does Dr. Bazelon reach any conclusions about the ultimate effect of Verizon's retention marketing program on competition?

A. Yes. He states that, as a result of Verizon's retention marketing program, consumers "will all find themselves shopping in a less competitive marketplace in the future."[39]

Q. Does Dr. Bazelon provide any support for this conclusion?

A. No. The only claim Dr. Bazelon appears to make is that Verizon's retention marketing program, by reducing the effectiveness of Bright House's efforts to attract customers from Verizon, may cause it to advertise less and, ultimately, to win fewer of Verizon's customers. However, as I have explained above, allowing customers to be informed so that they choose between competing providers on the merits is pro-competitive, not anti-

[38] Bazelon Direct at 22.

[39] Bazelon Direct at 5. See also Bazelon Direct at 20 ("Customers, as well as society, will suffer from Verizon's anticompetitive activities as investments are driven down, competitors become less effective, and prices rise.")

competitive; it is hardly anti-competitive for Verizon to retain customers by offering a better product at lower prices.

Q. What is your opinion on the effect of Verizon's retention marketing program on Bright House's effectiveness as a competitor in the market for voice communications?

A. In my opinion, there is no probability whatsoever that the relative handful of "wins" Verizon may achieve through its retention marketing program will materially affect the ability of Bright House or other cable companies to compete effectively. To the contrary, cable companies are rapidly winning market share from telephone companies, while retaining their dominant positions in the markets for broadband and cable television. Nationally, cable companies serve 66 percent of the residential market for pay TV services, 54 percent of the residential market for broadband data services, and – despite the fact that their voice deployments are relatively new – already serve 18 percent of the market for residential wireline voice services.[40] Cable companies are also successfully expanding into the market for business voice services. Morgan Stanley, for example, recently concluded that "we believe it is reasonable to expect cable can achieve 20% market share of business telephony customers" and that "[t]he SME [small and medium enterprise] rollout is an opportunity to drive asset turns higher, as the product extensions

[40] Jeff Wlodarczak, "Equity Research: U.S. Q1'08 Video/Data/Phone Trends," *Wachovia Capital Markets LLC* (May 15, 2008) [hereafter *Wachovia Research Report*] at 8-9. By contrast, the report by Drs. William Taylor and Harold Ware submitted by Verizon in this proceeding demonstrates that telephone companies are rapidly losing lines to both wireline and wireless competitors. William E. Taylor and Harold Ware, *Intermodal Competition in Florida Telecommunications* (NERA, March 2008) (Exhibit AFC-1) (hereafter Taylor and Ware).

to this new customer set is not very capital intensive relative to the revenue opportunity."[41]

Bright House has been especially successful in winning new voice customers. Less than two years after launching its voice service offering in Florida, it proclaimed in May 2006 that it had already won 225,000 voice customers, suggesting a penetration rate of over 10 percent of homes passed.[42] Then, in January of this year, it announced the number had more than doubled, to "nearly 500,000" customers, suggesting a penetration rate of nearly 25 percent.[43] Thus, Bright House is achieving a net gain of well over 100,000 voice customers per year in its Florida service territories, translating into an increase in market share of more than five percentage points every 12 months. Other cable companies are achieving similarly rapid gains.[44]

Q. In this context, are you able to estimate the potential impact of Verizon's retention marketing program on Bright House's customer acquisition efforts?

A. Yes. Ms. Smith testified that in the three and a half months between January 1, 2008 and April 15, 2008, there were **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** in the Southeast region (Florida, North Carolina and South Carolina) who elected to stay with or switch back to Verizon in response to a retention marketing offer.[45] Extrapolating this figure to a full year indicates an annual rate of approximately **[BEGIN PROPRIETARY]** **[END PROPRIETARY]** accepting such offers each

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[41] Simon Flannery, "Cable & Telecom VoIP Success Driving Telco On-Net and Off-Net Video," Morgan Stanley (July 23, 2007), at 5-6.

[42] Bright House Networks, "More Than 225,000 Florida Families Switch to Bright House Networks Digital Phone," Press Release (May 1, 2006) (available at www.mybrighthouse.com/about_us/press_releases/default.aspx). See also Taylor and Ware at 27.

[43] "Bay Area Assists Verizon FiOS Boom" *St. Petersburg Times* (January 29, 2008.).

[44] Taylor and Ware at 22-31.

[45] Smith Direct at 5-6.

year. Of course, many of these customers are not in Bright House's service territory (or, for that matter, even in Florida). However, *even if* 100 percent of the customers in Verizon's Southeast region who accept Verizon's retention marketing offers would otherwise have switched to Bright House, the effect would be to slow the rate at which Bright House's is gaining net voice customers by **[BEGIN PROPRIETARY]** **[END PROPRIETARY]**.[46] In other words, Bright House will continue to experience six figure annual gains in voice customers, and its market share will continue to grow rapidly, with or without Verizon's retention marketing program. Moreover, to the extent that Verizon's retention marketing effort is taking a small bite out of Bright House's market share growth, it is only because, with more complete information, some customers are deciding that Verizon's offer gives them greater value than the Bright House offer they had initially accepted. That result is the essence of efficient competition.

With this in mind, it is clear that Dr. Bazelon's warnings that, as a result of Verizon's retention marketing program, Florida consumers "will all find themselves shopping in a less competitive marketplace in the future"[47] are worse than hyperbole. They are simply not true. Verizon's retention marketing program is having no material effect, and will not in the future have any material effect, on Bright House's viability as a wireline voice competitor. Casting all of the other arguments aside, this is reason enough for the Commission to find that the retention marketing program is not "anticompetitive."

Q. Does Dr. Bazelon offer an opinion on whether Verizon's retention marketing program gives Verizon an "undue or unreasonable advantage"?

[46] Based on Bright House's annual net voice customer growth of 100,000+ customers.

[47] Bazelon Direct at 5.

A. Not directly. While Dr. Bazelon states early in his testimony that he will "provide an economic perspective on whether that 'preference or advantage' is 'undue,'"[48] when he is asked directly, he responds that "I am not an attorney and cannot comment on whether the preferences/advantages given to the customers who receive the retention marketing offers are 'undue' in a legal sense. From an economic perspective, however, in the context of Verizon's retention marketing program, those preferences/advantages are clearly *anticompetitive*."[49]

Q. Do you have an opinion on whether Verizon's use of disconnect and LNP data gives it an undue or unreasonable advantage?

A. Yes, though of course my opinion is an economic, not a legal one. As an economic matter, an "undue or unreasonable advantage" can be thought of in terms a firm's ability to exercise unilateral market power. Thus, a policy or practice which facilitated the use of market power by (in this case) Verizon could be thought of as providing an "undue or unreasonable advantage."

Looked at in this way, Verizon's use of disconnect and LNP data does not give it an "undue or unreasonable advantage." Simply put, the effect of Verizon's retention marketing program is to allow it to offer consumers discounts, *i.e.*, lower prices. Bright House does not assert, and there is no evidence to suggest, that those discounts result in prices that are "below cost" by any standard that would cause them to be labeled "predatory."[50] Moreover, economists agree that unilateral conduct, especially conduct that results in lower prices, can only harm consumer welfare if there is a dangerous

[48] Bazelon Direct at 11.
[49] Bazelon Direct at 19.
[50] Bazelon Direct at 14.

probability that it will result in the preservation or creation of market power. As I have explained above, there is no probability whatsoever that Verizon's retention marketing program will materially affect the ability of Bright House or other cable companies to compete in the market for voice communications services.

In this context, it is also significant that Bright House and other cable companies have precisely the same rights and abilities to use LNP data to engage in retention marketing programs as does Verizon; indeed, in the related markets for broadband and cable television (*i.e.*, in the market for converged communications services, where the most heated competition is occurring), they have a substantial advantage, as customers must take the affirmative step of calling their cable company to disconnect these services rather than appointing Verizon their agent to do it for them. By contrast, when a customer chooses to leave Verizon to buy service from Bright House, she has the more efficient option of only calling one company, Bright House, because Verizon will accept a cancellation from Bright House, acting as the customer's agent.

Q. Does Dr. Bazelon assert any other negative effects of Verizon's retention marketing program?

A. Yes. He asserts that it will "create a strong incentive for competitors to avoid using the local number porting mechanism."[51]

Q. Do you agree with Dr. Bazelon's conclusions in this regard?

A. No. Here, as in his testimony generally, Dr. Bazelon gives little weight to the role of consumers in the marketplace. If consumers demand local number portability when switching wireline carriers, and it is clear that they do, providers seeking to win those

[51] Bazelon Direct at 6.

consumers' favor will provide it. Because the vast majority of consumers who switch landline carriers utilize local number portability, while Verizon's retention marketing program affects only a very small fraction of consumers, it is highly unlikely cable companies would forego the competitive advantage of offering LNP in order to prevent Verizon from retaining a relative handful of customers.[52]

V. CONCLUSION

Q. Based on the testimony you have given above, what do you conclude with respect to what action the Commission should take, if any, with respect to Verizon's retention marketing program?

A. Verizon's retention marketing program directly benefits consumers by providing information that allows them to choose the best offers available in the marketplace. As such, it is pro-competitive, not anticompetitive, and it does not provide Verizon with an undue or unreasonable advantage. Accordingly, the Commission should take no action to hinder or terminate Verizon's retention marketing program.

Q. Does that complete your testimony?

A. Yes.

[52] Conversely, if Bright House and other cable companies really were to stop offering number portability in order to prevent Verizon from engaging in retention marketing, it would be an indicator of precisely how highly those companies value consumer ignorance, *i.e.*, of the extent to which they believe, by keeping consumers in the dark about alternative options, they can charge higher prices. Such a decision would be a strong indicator of the extent of the cable companies' market power in the markets for cable TV and broadband and their ability to leverage that market power into the market for voice communications.

EXHIBIT JAE-1

July 2008

JEFFREY AUGUST EISENACH

Education

Ph.D. in Economics, University of Virginia, 1985
B.A. in Economics, Claremont McKenna College, 1979

Professional Experience

Chairman, Criterion Economics, LLC, June 2006-present
Chairman, The CapAnalysis Group, LLC, July 2005-May 2006
Executive Vice Chairman, The CapAnalysis Group, LLC, February 2003-July 2005
President, The Progress & Freedom Foundation, June 1993-January 2003
Executive Director, GOPAC, July 1991-May 1993
President, Washington Policy Group, Inc., March 1988-June 1991
Director of Research, Pete du Pont for President, Inc., September 1986-February 1988
Executive Assistant to the Director, Office of Management and Budget, 1985-1986
Special Advisor for Economic Policy and Operations, Office of the Chairman, Federal Trade Commission, 1984-1985
Economist, Bureau of Economics, Federal Trade Commission, 1983-1984
Special Assistant to James C. Miller III, Office of Management and Budget/Presidential Task Force on Regulatory Relief, 1981
Research Associate, American Enterprise Institute, 1979-1981
Consultant, Economic Impact Analysts, Inc., 1980
Research Assistant, Potomac International Corporation, 1978

Teaching Experience

Adjunct Professor, George Mason University School of Law, 2000-present (Courses Taught: The Law and Economics of the Digital Revolution; Seminar on Government Regulation)
Adjunct Lecturer, Harvard University, John F. Kennedy School of Government, 1995-1999 (Course Taught: The Role of Government in the 21st Century)
Adjunct Professor, George Mason University, 1989 (Course Taught: Principles of Economics)
Adjunct Professor, Virginia Polytechnic Institute and State University, 1985, 1988 (Courses Taught: Graduate Industrial Organization, Principles of Economics)
Instructor, University of Virginia, 1983-1984 (Courses Taught: Value Theory, Antitrust Policy)
Teaching Assistant, University of Virginia, 1982-1983 (Courses Taught: Graduate Microeconomics, Undergraduate Macroeconomics)

Awards, Activities and Concurrent Positions

Member, Board of Directors, PowerGrid Communications, 2008-present
Member, Board of Advisors, Washington Mutual Investors Fund, 2008-present
Member, Board of Advisors, Pew Project on the Internet and American Life, 2002-present
Member, Board of Directors, The Progress & Freedom Foundation, 1993-present
Member, Attorney General's Identity Theft Task Force, Virginia, 2002
Member of the Board of Directors, Privacilla.com, 2002-2003
Member, Executive Board of Advisors, George Mason University Tech Center, 2001-2004
Contributing Editor, *American Spectator*, 2001-2002
Member, Bush-Cheney Transition Advisory Committee on the FCC, 2001
Member, Governor's Task Force on E-Communities, State of Virginia, 2000-2001
Member, 2000-2001 Networked Economy Summit Advisory Committee, 1999-2001

Member, Board of Directors, Internet Education Foundation, 1998-2003
Member, Internet Caucus Advisory Committee, 1998-2003
Member, American Assembly Leadership Advisory Committee, 1996 -2002
Member, Commission on America's National Interests, 1995-2000
Adjunct Scholar, Hudson Institute, 1988-1991
Visiting Fellow, Heritage Foundation, 1988-1991
President's Fellowship, University of Virginia, 1981-1984
Earhart Foundation Fellowship, University of Virginia, 1981-1983
Member, Reagan-Bush Transition Team on the Federal Trade Commission, 1981
Henry Salvatori Award, Claremont Men's College, 1979
Frank W. Taussig Award, American Economic Association, 1978

Publications and Major Presentations

"A La Carte Regulation of Pay TV: Good Intentions vs. Bad Economics," (with A. Thierer) *Engage*, June 2008

"The Benefits and Costs of I-File," (with R. Litan and K. Caves) Criterion Economics, LLC, April 14, 2008

"Irrational Expectations: Can a Regulator Credibly Commit to Removing an Unbundling Obligation?" (with Hal J. Singer), *AEI-Brookings Joint Center Related Publication 07-28*, December 2007

"Due Diligence: Risk Factors in the Frontline Proposal," Criterion Economics, LLC, June 28, 2007

"The Effects of Providing Universal Service Subsidies to Wireless Carriers" (with K. Caves) Criterion Economics, LLC, June 13, 2007

"A New Takings Challenge to Access Regulation," *American Bar Association, Section on Antitrust Law, Communications Industry Committee Newsletter*, Spring 2007.

"Assessing the Costs of the Family and Medical Leave Act," Criterion Economics, LLC, February 16, 2007

"Improving Public Safety Communications: An Analysis of Alternative Approaches," (with P. Cramton, T. Dombrowsky, A. Ingraham, H. Singer) Criterion Economics, LLC, February 6, 2007

"Sell Globally, Sue Locally: The Growing Perils of Global 'Dominance,'" Antitrust Section, Ohio State Bar Association, October 27, 2006

"The Growing Global Perils of 'Dominance,'" Aspen Summit Conference, August 21, 2006

"Economic and Regulatory Implications of Unregulated Entry in the Canadian Mortgage Insurance Market," Criterion Economics, LLC, June 20, 2006

"Telecoms in Turmoil: What We Know and (Mostly) Don't Know About the Telecom Marketplace in 2006," National Regulatory Conference, May 11, 2006

"The FCC's Further Report on A La Carte Pricing of Cable Television," (with R. Ludwick) The CapAnalysis Group, LLC, Washington, DC, March 6, 2006

"Mandatory Unbundling in the U.S.: Lessons Learned the Hard Way," Telstra Corporation, November 25, 2005

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EXHIBIT JAE-2

PUBLIC VERSION

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of Bright House Networks, LLC, Comcast Corporation, and Time Warner Cable Inc., Complainants, v. Verizon California Inc., Verizon Delaware LLC, Verizon Florida, LLC, Contel of the South, Inc., Verizon South Inc., Verizon New England Inc., Verizon Maryland Inc., Verizon New Jersey Inc., Verizon New York Inc., Verizon Northwest Inc., Verizon North Inc., Verizon Pennsylvania Inc., GTE Southwest Incorporated d/b/a Verizon Southwest, Verizon Virginia Inc., Verizon Washington, D.C. Inc., Defendants.	File No. EB-08-MD-002

DECLARATION OF JEFFREY A. EISENACH

FEBRUARY 29, 2008

[NON-PROPRIETARY VERSION]

CRITERION ECONOMICS, L.L.C.

CONTENTS

I. Introduction

1. I have been asked by counsel for Verizon to analyze the economic welfare effects of the Verizon retention marketing program at issue in this proceeding. In this Declaration, I report the results of my analysis.

2. First, in Section II, I present my qualifications. In Section III, I explain the benefits to consumers and the economy of providing consumers with timely and accurate information about prices and product characteristics, and explain why the retention marketing program is uniquely effective in helping consumers make choices that best fulfill their needs. In Section IV, I estimate the increase in economic welfare that is directly attributable to the retention marketing program (or, conversely, the economic welfare loss that would be associated with banning the program). I estimate that the approximate discounted present value of the annual welfare gain from the retention marketing program is between $16 million and $17 million, and that the approximate discounted present value of the welfare gain over five years is between $75 million and $79 million.

II. Qualifications

3. My name is Jeffrey A. Eisenach. I am Chairman of Criterion Economics, an economic consulting firm based in Washington, D.C., and an Adjunct Professor at George Mason University Law School. I have more than 25 years experience performing economic analyses of competition, regulatory and public policy issues, and have served in senior policy positions at the U.S. Federal Trade Commission (FTC) and the White House Office of Management and Budget (OMB). I have also served on the faculties of Harvard University's Kennedy School of Government and Virginia Polytechnic Institute and State University. Prior to joining Criterion, I served as Chairman of CapAnalysis, the economic

consulting arm of Howrey LLC and, previously, as President of The Progress & Freedom Foundation.

4. I have authored or co-authored numerous expert reports in litigation matters as well as in regulatory proceedings before the Federal Communications Commission, the Federal Trade Commission, and other regulatory agencies, and testified before Congress on multiple occasions. I am the author or co-author of eight books, including *The Digital Economy Fact Book, The Telecom Revolution: An American Opportunity,* and *America's Fiscal Future: Controlling the Federal Deficit in the 1990s.* In addition, I have edited or co-edited five books, including *Communications Deregulation and FCC Reform: What Comes Next?* and *Competition, Innovation and the Microsoft Monopoly: Antitrust in the Digital Marketplace.* My articles have appeared in scholarly journals as well as in such popular outlets as *Forbes, Investors Business Daily, The Wall Street Journal, The Washington Post*, and *The Washington Times.*

5. Among my previous affiliations, I have served as a scholar at the American Enterprise Institute, the Heritage Foundation, and the Hudson Institute. I remain a member of the board of directors of The Progress & Freedom Foundation, and I also serve on the Advisory Board of the Pew Project on the Internet and American Life.

6. I hold a Ph.D. in economics from the University of Virginia and a B.A. in economics from Claremont McKenna College. My complete *curriculum vita* is provided as Exhibit A to this report.

III. VERIZON'S RETENTION MARKETING PROGRAM BENEFITS CONSUMERS AND COMPETITION

7. Imperfect information reduces economic efficiency, harms competition, and lowers consumer welfare. Retention marketing programs are an efficient mechanism for

providing consumers with timely information about product choices so that they can make utility-maximizing decisions. Verizon's retention marketing program provides consumers with timely and accurate information about Verizon's offerings. The proof of its value to consumers lies in the fact that, when fully informed about their choices, many consumers choose to accept Verizon's offer.

A. Retention Marketing Is an Economically Efficient Means of Providing Consumers with Information

8. It is a fundamental tenet of modern economics that markets function more efficiently when consumers are fully informed about the choices available to them in the marketplace.[1] As Nobel Laureate George Stigler noted in his seminal 1961 article, however, consumers seldom have full information.[2] The reason is that information is costly – costly to produce, costly to acquire, and costly to assimilate. As Stigler explained, "the cost of keeping currently informed about all articles which an individual purchases would be prohibitive." Moreover, "[t]he seller's problem is even greater: he may sell two thousand items,... and to advertise each on the occasion of a price change, and frequently enough to remind buyers of his price, would be impossibly expensive."[3]

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[1] *See*, e.g., Dennis W. Carlton and Jeffrey M. Perloff, *Modern Industrial Organization* (2005) at 440-441. The importance of information to economic efficiency is also well-recognized in the law. See, e.g., *Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council Inc.*, 425 US 748, 765 (1976) ("So long as we preserve a predominantly free enterprise economy, the allocation of our resources will be made through numerous private decisions. It is a matter of public interest that those decisions, in the aggregate, be intelligent and well informed. To this end, the free flow of commercial information is indispensable."); *Fair Packaging and Labeling Act*, 80 Stat. (1966) 15 U.S.C. §§1451-61. ("Informed consumers are essential to the fair and efficient functioning of a free market economy."); Federal Trade Commission, *Statement of Basis and Purpose, Labeling and Advertising of Home Insulation* 44 FR 50218, 50222 (1979) ("It is a basic tenet of our economic system that information in the hands of consumers facilitates rational purchase decisions; and, moreover, it is an absolute necessity for the efficient functioning of the economy.")

[2] George J. Stigler, "The Economics Of Information," *The Journal of Political Economy* 69;3 (June 1961) 213-225.

[3] *See* Stigler at 223.

9. At the most fundamental level, the effect of imperfect information is that consumers make "faulty" decisions: That is, they purchase products from sellers who charge more than the prices being charged for identical products by other sellers; or, if products are differentiated, they purchase products that do not fully meet their needs when a similar product, available for the same price, would provide them with greater satisfaction. Both consumers and competition are harmed as a result. Consumers' surplus is reduced by the difference between the price paid and the (lower) price that was available for the same product (or, by the difference in satisfaction the consumer receives from the "wrong" product and what she would have received had she purchased the "right" one). Competition is harmed because firms are not fully rewarded for charging the (lower) competitive price or making the more attractive product; and, as a result, all consumers end up paying more than they would in the presence of complete information.[4]

10. The costs to consumers (and the economy) of making faulty purchasing decisions also depend on the sunk (i.e., transaction-specific and non-recoverable) costs associated with such decisions. Sunk costs may be incurred by consumers, sellers or both. For example, if a consumer spends hours being fitted for a custom-made suit, when (given full information) an off-the-rack alternative would have better met his needs, he has incurred a cost that cannot be recovered; and, so has the seller, since the time spent by the tailor in fitting the suit is also unrecoverable. Both costs represent pure deadweight losses to the economy.

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[4] *See* Howard Beales, Richard Craswell and Steven C. Salop, "The Efficient Regulation of Consumer Information," *Journal of Law and Economics* 24 (December 1981) 491-539, 503. ("Additional information induces sellers to compete for the patronage of informed consumers by offering better values – either lower prices or higher qualities. This induced competition also benefits those uninformed consumers who purchase randomly.") (Hereafter, Beales, Craswell and Salop.); *see also* Carlton and Perloff at 452 ("Firms can obtain market power from consumers' lack of knowledge about prices and quality. Limited information can lead to a monopolistic price in what would otherwise be a competitive market.")

11. Firms have incentives to inform consumers of the prices and characteristics of the products they produce. However, as Stigler suggested, the costs of keeping all potential consumers constantly informed of all prices and all product qualities is prohibitive. Moreover, the value of information to consumers varies depending on their circumstances. Consumers who are "in the market" for a product are likely to place a higher value on information about prices and qualities of that product than consumers who are not currently planning on making a purchase.

12. Thus, firms seek to *target* their marketing efforts to consumers most likely to have an interest in purchasing a particular product at the time they receive the information.[5] In so doing, firms reduce both the costs of distributing and the costs of using relevant information: the firm saves by advertising only to the consumers most likely to put the information to use; and, the consumer saves by virtue of not having to sort through advertising content for which she has no immediate use.[6]

13. Retention marketing is a form of targeted advertising in which firms identify consumers who are "in the market" on the basis of information suggesting they are considering switching to some other provider.[7] Knowing this, the firm seeks to ensure that the potential "switcher" is fully informed about the benefits of the firm's products, and also that the

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[5] Pizza delivery services, for example, often advertise on television during sporting events, and wedding services advertise in the Spring. The Internet has vastly increased the ability of firms to undertake such "targeted marketing." Amazon.com, for example, maintains a record of books I have previously purchased there, and each time I visit the site (evidencing that I am "in the market" for books), it provides me with information on products in which, based on my prior purchases, I am most likely to have an interest.

[6] Empirical studies have found that consumers incur high "nuisance costs" from untargeted advertising (*See*, e.g., Kenneth C. Wilbur, *A Two-Sided, Empirical Model of Television Advertising and Viewing Markets*, Working Paper, University of Southern California (June 2007), *available at* http://ssrn.com/abstract=885465.). Economic models show that nuisance costs can result in levels of advertising that diverge from the welfare maximizing level (*See*, e.g., Simon P. Anderson and Stephen Coate, "Market Provision of Broadcasting: A Welfare Analysis," *Review of Economic Studies* 72 (2005) 947-972.)

[7] See, e.g., Jill Griffin and Michael W. Lowenstein, *Customer Winback: How to Recapture Lost Customers and Keep Them Loyal* (2001) at 30 (describing segmentation of customers in retention management programs).

consumer has the opportunity to take advantage of the firm's best offers. From the perspective of the firm, retention marketing is a substitute for customer acquisition: If it can provide a consumer with information which leads that consumer to remain a customer, it has avoided the costs associated with acquiring a new customer from scratch. From the perspective of a customer, retention marketing provides useful information at the very time the consumer is "in the market" and examining other sellers' offers.

14. Retention marketing is also uniquely valuable when there are sunk costs of switching providers. If a consumer, as a result of becoming more fully informed through a retention marketing program, chooses to remain with the current provider, the sunk costs of switching (which would otherwise pure deadweight losses) are avoided altogether. In this sense, retention marketing programs are unique: They inform consumers *before* the costs of switching are incurred.

15. Just as the benefits of consumer information are widely understood, so too are the costs of government restrictions on firms' abilities to convey truthful information about their products. Such restrictions have been shown to harm both consumers and competition, raising prices[8] and preventing firms from earning returns on their efforts to reduce costs or introduce better products.[9] Conversely, the removal of such restrictions benefits consumers and competition.[10]

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[8] *See* e.g., Carlton and Perloff at 482.

[9] *See* Beales, Craswell and Salop at 514-15. ("It is clear that bans on advertising impair competition by preventing firms with an advantage from conveying that fact that thereby expanding. *It should be equally clear that restrictions which prevent choice of the most efficient medium for conveying that information have the same effect.*") (Emphasis added.)

[10] *Id.* at 514. ("Perhaps the information remedy most compatible with the interests of individual sellers (if not their collective interest) is the removal of private or governmental restraints on the free flow of information. Such restrictions often tend to inhibit competition, with consequent efficiency losses.")

B. Verizon's Retention Marketing Program Unambiguously Benefits Consumers and Increases Economic Welfare

16. Verizon's retention marketing program offers consumers accurate information about their choices in the marketplace at a time when they are demonstrably "in the market" for voice, data and video services. It does so, typically, in two phases. First, customers who have indicated an intention to switch their voice service from Verizon to a competitor receive a letter and/or an automated telephone message from Verizon indicating Verizon's desire to retain their business and asking that they call a toll-free number to learn more about Verizon's product offerings. Second, upon calling, customers are offered discounts, either in the form of one-time "gift cards," or reduced monthly rates from Verizon's "rack" retail prices, or both.[11]

17. I obtained detailed information from Verizon on the discounts offered under the retention marketing program since its inception in mid-August 2007. As shown in Exhibit B, the discounts range from a minimum of [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] (for a [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] monthly discount with a six-month duration) to a maximum of [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] (for a two-year FiOS renewal package with monthly savings of [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]).[12] The average savings per customer, relative to Verizon's standard rates is [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY].[13]

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[11] See *Joint Declaration of Chris Creager, Bette Smith, Patrick Stevens, and Gary Sacra* at ¶¶43-58.

[12] The value reported here reflects the fact that (as I indicate below), I discount future savings at a rate of five percent after one year. In the absence of such discounting, the value of the savings would be simply [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY].

[13] As shown in Exhibit B, I calculated this average based on data provided by Verizon on the discounts received by customers who accepted retention marketing program offers between August 15, 2007 and December 31, 2007. *See* VZ-TWC_RM-09-00000023. For one-time savings offers (e.g., an American Express Gift Card), I recorded the actual amount of the discount. For recurring monthly discounts, I obtained from Verizon the duration of the discount (in months) and calculated the total savings accordingly. For customers who received recurring

18. The retention marketing program's high response rates indicate that consumers find the information provided by Verizon to be valuable, because a large proportion of them act on that information. Whereas a response rate of two percent is considered highly successful for direct mail marketing campaigns,[14] approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] of customers who receive Verizon's direct mail piece call the toll-free number, and approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] of those customers choose to purchase Verizon's discounted offerings.[15]

19. Consumers who choose to accept Verizon's offer are unambiguously better off than they would have been in the absence of the retention marketing program. That is, they choose to remain with Verizon because, based on the information provided through the retention marketing program, they find Verizon's services to be superior in price, quality, or some combination of price and quality, to the services offered by the competitor.

20. The welfare gains from the retention marketing program do not, however, end with the savings consumers gain in terms of lower prices or superior services. Two other forms of welfare gains must also be taken into account.

21. First, consumers benefit by virtue of savings in "sunk" costs they would otherwise have incurred had they chosen to switch to a Verizon competitor when in fact the Verizon offer (had it been known to them) was superior. In particular, most if not all switches between wireline telephone and wireline cable service require a cable service representative to

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discounts extending for more than 12 months, I discounted savings beyond the 12th month using a discount rate of five percent, in order to get the present discounted value of their savings. I then computed the aggregate savings for all consumers, and divided the total number by the number of consumers who accepted retention marketing program offers during this period. Note that there are more discounts [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] than customers receiving them [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY], reflecting the fact that some customers received multiple discounts.

[14] *See*, e.g., Direct Marketing Association, "DMA Releases 5th Annual 'Response Rate Trends Report'" (October 13, 2007) (available at http://www.the-dma.org/cgi/disppressrelease?article=1008).

[15] *See* VZ-TWC_RM-11-00003429.

visit the consumers' home – and require the consumer to be present when the visit occurs. In choosing to remain with Verizon, consumers avoid the time cost associated with staying home from work or refraining from other activities. The consumer welfare savings from the retention marketing program include these avoided, sunk costs.

22. Second, cable companies also incur a one-time, sunk cost associated with initiating service for a new customer, which includes consumer premises equipment, labor and other customer-specific provisioning costs. When such costs are incurred to achieve a *misallocation* of economic resources, they constitute pure deadweight losses, which must be taken into account in measuring the economic benefits of the retention marketing program or, conversely, the economic harm that would result from banning it.[16]

23. As noted above, retention marketing – that is, providing information to consumers after they are known to be "in the market" but *before* they have actually switched – is unique in its ability to the avoid sunk costs of switching. No alternative (e.g., "win-back" marketing aimed at consumers *after* they switch) can achieve this objective.

24. In Section IV below, I estimate the economic benefits to consumers and the economy associated with the retention marketing program, and find them to be substantial.

25. The retention marketing program also benefits competition. In differentiated product markets such as this one, firms compete by seeking to offer individually-tailored combinations of prices and services that are most-preferred by as many consumers as possible.

[16] Of course, there is nothing generically "inefficient" or economically wasteful about the existence of sunk costs incurred in switching from one provider to another, regardless of whether those costs are borne by consumers or by sellers. Assuming full information, these costs are incurred to move *from a less efficient choice to a more efficient one*, and are only incurred if the overall welfare gains exceed the costs. In the instance described here, the switching costs are incurred in the process of moving *from a more efficient choice to a less efficient one*. Thus, for example, when a cable company rolls a truck to switch a consumer from a more-preferred choice (given full information) to a less-preferred one, the cost of that truck roll is a deadweight loss. If, on the other hand, Verizon has to roll a truck to provide new services to a customer who – having been fully informed – prefers Verizon's services, that cost is part and parcel of an efficiency-enhancing transaction.

Their reward, when they are successful, is that they win the customer's business. Depriving firms of the ability to *inform* consumers of their best offers would remove their incentives to make those offers in the first instance. In short, to forbid firms from informing customers of their best offers is to deprive them of the incentive to compete.

26. Looked at from the other direction, the competitive price facing Verizon's competitors – the price they must meet or beat to win a customer away from Verizon – is Verizon's best offer. To prohibit Verizon from making that offer is, by definition, to *allow its competitors to charge prices above the competitive price*, while still winning customers. It may seem "unfair" to Verizon's competitors that they should actually have to make a better offer in order to win customers, but that requirement is precisely what is meant by "competition." And, from the perspective of consumers, it is the very essence of "fairness."

IV. THE ECONOMIC HARM FROM BANNING THE RETENTION MARKETING PROGRAM WOULD BE SIGNIFICANT

27. I requested from Verizon information on the number of consumers who have participated in the retention marketing program since its inception in mid-August 2007, as well as the nature of the offers made to consumers who elected to remain with Verizon as a result of the program. I also gathered information on the "sunk" costs associated with switching from Verizon to a cable competitor, including both the time costs incurred by consumers and the one-time "setup" costs incurred by cable companies. Based on this information, I estimated the gains to consumers and to overall economic welfare of the retention marketing program. Specifically, I estimated (a) increase in consumer surplus associated with consumers' choice of a preferred package of services and the avoided sunk costs of switching carriers, and (b) the increase in overall economic welfare associated with avoided sunk costs incurred by cable operators. My calculations are summarized in Exhibits B and C.

28. To summarize, I found that the five-year discounted present value of the welfare gains associated with Verizon's retention marketing program is between approximately $75 million and $79 million. Of this, approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] consists of direct gains to consumers, and the remainder consists of welfare gains to the economy overall.

A. The Retention Marketing Program Directly Increases Consumer Welfare

29. Consumers benefit directly from the retention marketing program in two ways. First, they benefit because, having become fully informed about their product choices, they choose a package they prefer to the one they would have chosen in the absence of complete information. Second, they benefit by avoiding the sunk costs associated with switching to the competitor's (less preferred) offering.

30. To estimate the consumer welfare benefits associated with the retention marketing program, it is necessary to calculate (a) the number of customers who, based on the information provided through the retention marketing program, choose Verizon's offer over the competitor's, (b) the value those consumers place on Verizon's offer relative to the competitor's, and (c) the avoided sunk costs of switching carriers. I estimated these values on both an annual basis and over a five-year period.

31. As shown in Exhibit C, approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] consumers accepted RMP discount offers from August 15, 2007 through January 31, 2008, an average of [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] per month. Throughout the analysis that follows, I estimate that

the RMP program will continue at this level,[17] i.e., that [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] consumers will accept RMP discount offers each month throughout the periods for which I provide estimates.[18]

32. The benefit to consumers who choose retention marketing program discount offers consists of (a) the difference between their valuations of the Verizon retention marketing program offer, on the one hand, and the less preferred competitor's offer, on the other hand, and (b) the avoided sunk costs of switching.

33. Based on Bureau of Labor Statistics data showing that average hourly earnings were $17.75 in January 2008[19] (representing the opportunity cost per hour of time), and on an average "wait time" for a cable visit of four hours,[20] I estimate consumers' avoided sunk costs of switching to be $71.00 per consumer. Assuming approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] consumers accept retention marketing program offers each month (approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] per year)], the resulting annual consumer benefit is approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] per year. Note that these savings represent a pure welfare gain, as they are the avoided costs of implementing *welfare-reducing* choices made by consumers based on incomplete information. Furthermore,

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[17] While there may be reasons for believing the rate of customers attempting to shift from Verizon to cable telephony will increase over the next few years, I assumed conservatively that it will remain unchanged. *See also* Bernstein Research, *U.S. Telecom: Wireline Limbo - How Low Can You Go?* (February 7, 2008) at 24 ("[T]he historical rate of decline is a reasonable basis for future attrition….").

[18] As shown at VZ-TWC_RM-11-00003429, the retention marketing program also results in "win backs," i.e., customers who return to Verizon even after the initial cancellation order has been executed. Though these consumers also benefit from the retention marketing program, for simplicity, I do not include these benefits in my analysis.

[19] See Bureau of Labor Statistics, *Average Hourly Earnings of Production and Nonsupervisory Workers* (Table B-4) (available at http://www.bls.gov/webapps/legacy/cesbtab4.htm).

[20] Cable franchise agreements typically specify four-hour "appointment windows" for service appointments. See e.g., http://www.nyc.gov/html/doitt/html/faq/faq.shtml#13, http://www.ci.austin.tx.us/telecom/acvexa.htm, and http://www.state.vt.us/psb/orders/2005/files/7044sqrp.pdf.

these savings are achievable *only* through the retention marketing program. Alternatives, such as after-the-fact win-back programs, may cause consumers to switch back, but the sunk costs of making the ill-informed switch in the first place have already been incurred.[21]

34. Estimating the difference between the valuations consumers place on Verizon's retention marketing program offer and competitors' offer is slightly more complex: Although we have extensive information about Verizon's retention marketing program offers, we cannot directly observe competitors' offers.[22] However, it is straightforward to establish upper and lower bounds on the difference in valuations and, based on these, to establish reasonable estimates.

35. The upper bound on the incremental value consumers place on Verizon's retention marketing program offer is established by the fact that a consumer who initially chose to switch to a competitor did so because she found the competitor's offer at least marginally superior to her *existing Verizon package*, again taking into account (a) the difference between her valuations of the *Verizon standard rate* and the competitor's offer, and (b) the avoided costs of switching carriers.

36. For clarity in exposition, I label the consumer's valuation of her existing Verizon package V_I, and her valuation of the competitor's offer C_I. In order to even consider switching from Verizon, it must be the case that the consumer's valuation of the competitor's offer exceeded the consumer's valuation of the existing Verizon package by the cost of the "wait

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[21] Indeed, in cases where consumers, having made an ill-informed decision to switch, decide after the fact to switch back, they may incur further sunk costs associated with returning to their original provider. Given that the initial decision was based on incomplete information, *both* sets of switching costs constitute economic waste. While it would be appropriate to count "switchback" costs as an additional benefit of the retention marketing program, I did not attempt to estimate the magnitude of these costs.

[22] Even if competitors' offers were observable, the fact that communications services are highly differentiated (e.g., cable modem service is not identical to either FiOS or DSL service) would mean that we could not directly compare offerings and would still need to infer consumers' valuations.

time" for cable telephony installation. That is, a consumer who initially accepted the competitor's offer found that offer, standing alone, to be worth at least \$71 more than her existing Verizon package. Mathematically, this condition can be expressed as follows:

$$C_I - V_I \geq \$71$$

37. For the marginal consumer who is indifferent between the cable offer and the existing Verizon package, the expression above will hold with equality. That is, $C_I - V_I = \$71$. The maximum possible benefit to consumers of accepting the retention marketing program offer is therefore the *full value of the retention marketing program discount relative to Verizon's standard rate*, less the \$71 time cost of switching. Thus, the *upper bound on the consumer's incremental welfare improvement from accepting Verizon's average retention marketing program discount of approximately* [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY].

38. Of course, for many consumers, the valuation of the cable offer will exceed the valuation of their existing Verizon package by more than \$71. (That is, $C_I - V_I > \$71$.) These consumers will accept the retention marketing program offer only if by doing so they increase their utility. This will occur whenever the full value of the retention marketing program discount, less the difference between the cable valuation and the valuation of the existing Verizon package, is greater than zero. In other words, consumers will accept a retention marketing program discount whenever:

[BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]

$$- (C_I - V_I) \geq \$0$$

For the marginal consumer who is indifferent between accepting the cable offer and accepting the retention marketing program discount, the expression above will hold with equality. That is,

[BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]
$$- (C_I - V_I) = \$0$$

Therefore, the lower bound to the consumer's incremental welfare improvement as a result of a retention marketing program discount of [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] is $0.01.

39. To summarize, no consumer who accepts Verizon's average retention marketing program discount benefits by more than [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY], no consumer benefits by less than $0.01, and most consumers presumably benefit by an amount somewhere in between. The average value received depends on how consumers who accept Verizon's retention marketing program offer are distributed between the two extremes.

40. A conservative approach is to assume that the distribution of consumers is symmetric, and that the typical consumer falls at the mean of this distribution. i.e., to take the simple arithmetic average of [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] and $0.01. Using this approach, I estimate that the incremental welfare gain to the typical consumer who accepts Verizon's retention marketing program offer is [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY].

41. This estimate is conservative because it fails to take into account selection bias in the distribution of consumers who accept retention marketing program offers. That is, consumers who believe, *ex ante*, that Verizon's retention marketing program offer will be superior to the competitor's offer by a significant amount are likely over-represented in the

group of consumers who, *ex post*, accept the retention marketing program offer, while consumers who believe, *ex ante* that Verizon's retention marketing program offer would be inferior or only marginally superior are likely to be under-represented. Simply put, the fact that a consumer bothers to call the toll free number in the first place tells us that this consumer is unlikely to place an incremental valuation on Verizon's offer close to $0.01 (the lower bound), and is disproportionately likely to belong to the population of consumers whose incremental valuation is relatively close to [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] (the upper bound). In statistical terms, the distribution of consumers is likely to exhibit *negative skewness*, meaning that the mean is likely to lie above the simple average of its upper and lower bounds, as shown in Figure One below.

42. To account for this selection bias, I also calculated the incremental valuation of the retention marketing program on the assumption that, rather than falling midway between the upper and lower bounds of the incremental value distribution, the typical consumer who accepted the retention marketing program offer fell in the 75th percentile of the distribution. That is, the incremental value they placed on the retention marketing program offer was [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] * 0.75, or [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]. Thus, I estimate that the typical consumer's incremental valuation of the Verizon retention marketing program offer relative to the competitor's offer, standing alone, is at least [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] and at most [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY].[23]

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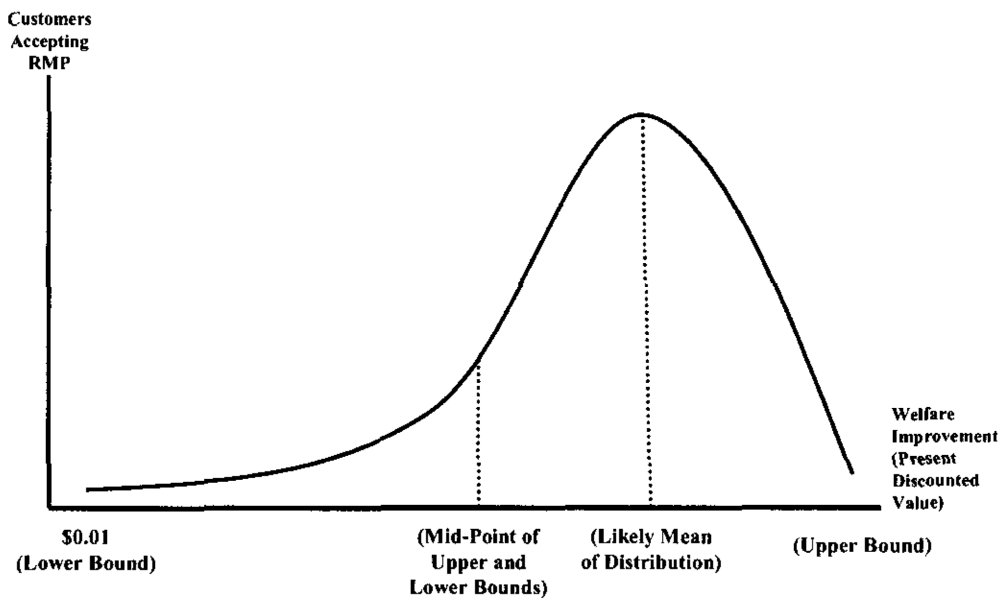
[23] Recall that, for offers that extent over more than 12 months, these values represent the present discounted value of the offer, discounted at a five percent discount rate.

Figure One:
Distribution of Savings for Customers Accepting Retention Marketing Program Offers



43. As noted above, based on historical data, I estimate that approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] consumers will accept retention marketing program offers during any given 12 month period. The approximate annual welfare gains to consumers resulting from the higher valuations they place on Verizon's retention marketing program offer relative to competitors' offers is thus between [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] and [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY].

44. The total annual welfare gains to consumers from Verizon's retention marketing program are the sum of the incremental valuation they place on the retention marketing program

offer plus the avoided time costs of switching carriers. Adding the annual avoided time costs of switching carriers (approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] to the figures above yields approximate total annual welfare gains from the program of between [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] This is the harm consumers would suffer directly in the 12 months immediately following a decision by the FCC to ban the retention marketing program.

B. The Retention Marketing Program Avoids Additional Deadweight Losses Associated with Switching Carriers

45. As discussed above, competitors also incur non-recoverable sunk costs in switching consumers from Verizon's services to their own, and these costs also represent pure deadweight loss, as they are incurred to facilitate a switch which, in and of itself, reduces overall economic welfare.

46. I consulted analyst reports on the incremental costs incurred by cable companies to establish VoIP telephone service for each new consumer, and found that cost to be estimated at $255 per incremental customer.[24]

47. Multiplying this figure by the total number of uneconomic switches avoided by the retention marketing program each year (approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]) yields additional annual economic welfare gains from the retention marketing program of approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]. This is the additional amount of economic harm that would result from an FCC decision to ban the retention marketing program during the 12 months

[24] See InStat, *The Worldwide Market for Cable Telephony Services* (April 2007) at Table 5. Note that this figure is the most conservative I could have chosen, as it reflects the incremental cost of premise-powered (as opposed to network-powered) service using VoIP (as opposed to circuit-switched) technology. The incremental cost of network-powered VoIP service is $280 per subscriber; the incremental cost of circuit-switched cable telephony is $345. (See *id.* at Tables 4 and 6.)

immediately following the decision. Again, these costs cannot be avoided by alternatives such as win-back programs, which take effect only after the ill-informed, welfare-reducing switch has occurred.

C. The Total Economic Welfare Cost of Banning the Retention Marketing Program Are Substantial

48. Adding the consumer welfare gains from the retention marketing program (approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]) to the additional welfare gains calculated immediately above (approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]) yields an estimated total annual welfare gain from the retention marketing program of between approximately $16 million and $17 million. However, these figures represent only the welfare loss that would occur during the first 12 months following an FCC ban of the program. The total impact on economic welfare of such a decision is the present discounted value of the economic welfare loss over the life of the program.

49. While I am aware of no plans on Verizon's part to terminate (or alter in any way) the program at any time in the future, I calculated the total welfare loss on the conservative assumption that the program would run for five years. To do so, I assumed that the program would continue to operate at the current rate, and that it would continue to offer the current range of discounts. Thus, over five years, I assumed that approximately [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] consumers would benefit from retention marketing program discounts, and that the other economic benefits of the program (in both time costs and avoided sunk costs incurred by cable companies) would continue at current rates. Based on these assumptions, and discounting benefits in the "out" years at a five percent discount rate, I estimate that the discounted present value of the economic welfare losses from

banning the retention marketing program would be between approximately $74 million and $79 million.

Table One:
Welfare Costs of Banning the Retention Marketing Program

	Annual Cost	Five-Year Cost[25]
Incremental Value of Retention Marketing Program Offers to Consumers	[BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]	[BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]
Consumer Avoided Sunk Costs	[BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]	[BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]
Direct Consumer Benefits (Subtotal)	[BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]	[BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]
Carrier Avoided Sunk Costs	[BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]	[BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY]
TOTAL	**$16 million - $17 million**	**$75 million - $79 million**

V. CONCLUSION

50. Verizon's retention marketing program is pro-consumer and pro-competitive. It provides consumers timely and accurate information, which they use to make welfare-increasing decisions. The value of the consumer information provided through the program is demonstrated by the high rates at which consumers participate. As a result of their participation, consumers are able to choose services which they find, *prima facie*, to be superior to the ones they would otherwise have purchased, and the difference is substantial – between [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] over five years.

[25] Figures do not add to totals due to rounding. See Exhibit C for un-rounded figures.

Taking into account the costs consumers would otherwise incur switching carriers, the direct consumer benefits total between [BEGIN HIGHLY PROPRIETARY] [END HIGHLY PROPRIETARY] All told, the retention marketing program increases economic welfare by between $75 million and $79 million over five years. Furthermore, the vast majority of these gains are unique to the retention marketing program, and cannot be achieved through increased "win-back" advertising or other means.

51. The welfare gains associated with the retention marketing program are a direct result of consumer sovereignty – fully informed consumers making utility maximizing choices among competing providers of comparable services. As such, they represent the essence of *gains from competition:* They are precisely the benefits Congress anticipated when it passed the 1996 Telecommunications Act, and which the Commission has struggled so hard to achieve through its implementation of the Act. To ban the retention marketing program on the grounds that it *harms* competition, as complainants suggest, would be Orwellian indeed.

Exhibit A

February 2008

JEFFREY AUGUST EISENACH

Education
Ph.D. in Economics, University of Virginia, 1985
B.A. in Economics, Claremont McKenna College, 1979

Professional Experience
Chairman, Criterion Economics, LLC, June 2006-present
Chairman, The CapAnalysis Group, LLC, July 2005-May 2006
Executive Vice Chairman, The CapAnalysis Group, LLC, February 2003-July 2005
President, The Progress & Freedom Foundation, June 1993-January 2003
Executive Director, GOPAC, July 1991-May 1993
President, Washington Policy Group, Inc., March 1988-June 1991
Director of Research, Pete du Pont for President, Inc., September 1986-February 1988
Executive Assistant to the Director, Office of Management and Budget, 1985-1986
Special Advisor for Economic Policy and Operations, Office of the Chairman, Federal Trade Commission, 1984-1985
Economist, Bureau of Economics, Federal Trade Commission, 1983-1984
Special Assistant to James C. Miller III, Office of Management and Budget/Presidential Task Force on Regulatory Relief, 1981
Research Associate, American Enterprise Institute, 1979-1981
Consultant, Economic Impact Analysts, Inc., 1980
Research Assistant, Potomac International Corporation, 1978

Teaching Experience
Adjunct Professor, George Mason University School of Law, 2000-present (Courses Taught: The Law and Economics of the Digital Revolution; Seminar on Government Regulation)
Adjunct Lecturer, Harvard University, John F. Kennedy School of Government, 1995-1999 (Course Taught: The Role of Government in the 21st Century)
Adjunct Professor, George Mason University, 1989 (Course Taught: Principles of Economics)
Adjunct Professor, Virginia Polytechnic Institute and State University, 1985, 1988 (Courses Taught: Graduate Industrial Organization, Principles of Economics)
Instructor, University of Virginia, 1983-1984 (Courses Taught: Value Theory, Antitrust Policy)
Teaching Assistant, University of Virginia, 1982-1983 (Courses Taught: Graduate Microeconomics, Undergraduate Macroeconomics)

Awards, Activities and Concurrent Positions
Member, Board of Advisors, Washington Mutual Investors Fund, 2008-present
Member, Board of Advisors, Pew Project on the Internet and American Life, 2002-present
Member, Board of Directors, The Progress & Freedom Foundation, 1993-present
Member, Attorney General's Identity Theft Task Force, Virginia, 2002
Member of the Board of Directors, Privacilla.com, 2002-2003
Member, Executive Board of Advisors, George Mason University Tech Center, 2001-2004
Contributing Editor, *American Spectator*, 2001-2002
Member, Bush-Cheney Transition Advisory Committee on the FCC, 2001
Member, Governor's Task Force on E-Communities, State of Virginia, 2000-2001
Member, 2000-2001 Networked Economy Summit Advisory Committee, 1999-2001
Member, Board of Directors, Internet Education Foundation, 1998-2003
Member, Internet Caucus Advisory Committee, 1998-2003

Member, American Assembly Leadership Advisory Committee, 1996 -2002
Member, Commission on America's National Interests, 1995-2000
Adjunct Scholar, Hudson Institute, 1988-1991
Visiting Fellow, Heritage Foundation, 1988-1991
President's Fellowship, University of Virginia, 1981-1984
Earhart Foundation Fellowship, University of Virginia, 1981-1983
Member, Reagan-Bush Transition Team on the Federal Trade Commission, 1981
Henry Salvatori Award, Claremont Men's College, 1979
Frank W. Taussig Award, American Economic Association, 1978

Publications and Major Presentations

"Irrational Expectations: Can a Regulator Credibly Commit to Removing an Unbundling Obligation?" (with Hal J. Singer), AEI-Brookings Joint Center Related Publication 07-28. December 2007

"Due Diligence: Risk Factors in the Frontline Proposal," Criterion Economics, LLC, June 28, 2007

"The Effects of Providing Universal Service Subsidies to Wireless Carriers" (with K. Caves) Criterion Economics, LLC, June 13, 2007

"A New Takings Challenge to Access Regulation," *American Bar Association, Section on Antitrust Law, Communications Industry Committee Newsletter,* Spring 2007.

"Assessing the Costs of the Family and Medical Leave Act," Criterion Economics, LLC, February 16, 2007

"Improving Public Safety Communications: An Analysis of Alternative Approaches," (with P. Cramton, T. Dombrowsky, A. Ingraham, H. Singer) Criterion Economics, LLC, February 6, 2007

"Sell Globally, Sue Locally: The Growing Perils of Global 'Dominance,'" Antitrust Section, Ohio State Bar Association, October 27, 2006

"The Growing Global Perils of 'Dominance,'" Aspen Summit Conference, August 21, 2006

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Exhibit B Redacted

Exhibit C Redacted