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May 5, 2006

Ms. Beth O'Donnell  
Executive Director  
Public Service Commission  
211 Sower Boulevard  
P.O. Box 615  
Frankfort, Kentucky 40602

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COMMISSION

**Re: Case No. 2005-00095 -- Dialog Telecommunications, Inc. v. BellSouth  
Reply to BellSouth's Response to Dialog's Cross Motion for Summary  
Judgment on Count II**

Dear Ms. O'Donnell:

This is in reply to BellSouth's response to Dialog's Cross Motion for Summary Judgment, in which BellSouth claims Dialog "has no interest in resolving any tax issue" and is engaged in "scheme to evade taxes." These statements are clearly nonsense. But resort to fallacy has pervaded BellSouth's advocacy in the matter. Finding no good way to get around the clear legal distinctions between § 251(c)(3) network elements and § 251(c)(4) telecommunications services, and unable to explain away BellSouth's own statutory construction arguments before the FCC which contradict its position here<sup>1</sup>, BellSouth instead attacks Dialog's motivation for bringing this dispute to the one state agency with authority over intercarrier disputes.

The Commission need only review the background of this dispute, outlined in paragraphs 15 – 20 of Dialog's amended complaint, to understand that Dialog acted with ample good faith in bringing this complaint to the Commission only after BellSouth brushed off Franklin Circuit Judge Roger Crittenden's February 2004 order that Dialog request BellSouth to seek a refund of taxes BellSouth had presumably paid on network elements. As explained in the amended complaint, BellSouth refused to seek a refund, using the flimsy excuse that Dialog had not paid the disputed amounts to BellSouth. Coerced into paying those amounts, Dialog filed a complaint with the Commission more than a year ago.<sup>2</sup> Three months ago Dialog filed a cross motion for

<sup>1</sup> See pp. 8-9 and Exhibit 2 to Dialog's Cross Motion for Summary Judgment.

<sup>2</sup> Dialog's formal complaint was filed in March 2005 and was amended in July 2005 after staff brought the parties together for an informal conference.

summary judgment and advised the Commission it waives its right to a hearing on Count II of the complaint, which concerns BellSouth's erroneous demand for "sales tax" on non-taxable network elements.

During this time and while waiting for the Commission to decide the narrow question of law raised in Count II of Dialog's complaint, Dialog in good faith continued to honor BellSouth's erroneous invoices for "sales tax" on network elements. In addition, *as it always has*, Dialog has continued to pay Kentucky sales taxes on its sales of communications services to its thousands of Kentucky customers. In other words, Dialog has been doubly burdened with "tax" obligations while awaiting action on the complaint.

Now, more than a year later, not only has BellSouth taken no further action to correct its mistake, BellSouth now claims that by filing its complaint at the Commission Dialog is making a "blatant" attempt to "contradict and undermine" a sister administrative agency's "prior tax ruling." BellSouth Reply, p. 5. Dialog is doing no such thing. As explained in the cross motion for summary judgment, the question before the Commission is one of utility law. The Commission has authority to rule on the complaint.

Worse still, in its attempt to buffalo the Commission BellSouth has now conflated a Department of Revenue ("DOR") staff letter to Dialog's former counsel into a "ruling." It could not possibly be. As Dialog explained in its complaint, the DOR has taken the position that Dialog lacks standing to even ask for a ruling. *See* Dialog amended complaint at par. 17. The DOR contends, in fact, that the staff letter is not subject to judicial review. BellSouth is aware of this. The only "scheme" playing out here it is BellSouth's ploy to confound the Commission into making no decision at all.

The relief requested by Dialog in Count II of its complaint is simple – Dialog asks that the Commission determine that, as a matter of law, "network elements" are distinct from "service." The Commission need only review the Telecommunications Act and its prior orders<sup>3</sup> to make such a determination. All of these things are outlined in Dialog's motion and in the handouts provided during the informal conference. Dialog has not asked the Commission to usurp the authority of any other state agency in Kentucky, and BellSouth is wrong to suggest otherwise. The Commission should disregard BellSouth's advice to carelessly accept as determinative an incomplete, inaccurate view of federal telecommunications law offered informally nearly three years ago by a tax policy staff member at the Department of Revenue. That cannot possibly be the right approach here.

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<sup>3</sup> *E.g.*, Case No. 96-482, *In the matter of Interconnection Agreement Negotiations between AT&T Communications of the South Central States and BellSouth Telecommunications, Inc.* (February 6, 1997), p. 22 (rejecting BellSouth's argument that a purchase of elements to "create a service" pursuant to Section 251(c)(3) must be priced at the rate for "purchase of service for resale" under Section 251(c)(4)).

BellSouth's offer to file a refund request "on behalf of Dialog" is as insincere as its claim that Dialog "dropped its refund request [to BellSouth]." BellSouth Reply, p. 3. BellSouth distorts the discussion which took place at the informal conference called by the Commission staff. During that conference, in response to questions from Mr. Tipton and Ms Winn about what Dialog wanted from BellSouth, Dialog made clear that any decision to seek a refund was BellSouth's alone. Undersigned counsel then wrote to the Commission on July 18, 2005, addressing that very issue by explaining that any refund application would necessarily be on behalf of BellSouth, the taxpayer, not Dialog. Dialog then amended its complaint to address any lingering confusion. Obviously, Dialog has not amended its complaint to "drop" a refund request from *BellSouth*. But it is BellSouth that must make the refund request from the *DOR*, and the request must be made on BellSouth's behalf.

BellSouth's refusal to proceed with a refund request on its own is easily explained. BellSouth has no incentive at all to correct the DOR's misunderstanding of the difference between UNEs and services. An honest effort to correct that misconception could lead to a determination that BellSouth should not have collected sales tax on UNEs. If such determination were to trigger a refund, BellSouth would be obliged to return the money to all CLECs which leased UNEs, not just to Dialog. BellSouth has no interest in assisting its competitors in this way. BellSouth would prefer to keep this issue forever trapped in the vacuum it helped create when it filed a half-hearted "sale for resale" exemption request with the DOR in March, 2003<sup>4</sup> which blurred the distinction between network elements and telecommunications services. Having contributed to DOR's confusion, BellSouth benefits by preserving the status quo.

Dialog is not asking the Commission to comment on, let alone undermine, informal opinions from another agency. At the same time, the fact that an informal opinion exists at all is no reason for the Commission not to act on Dialog's complaint now. While the final determination of the applicability of sales tax to network elements will not be made by this Commission, the Commission is certainly qualified to consider the definitions in the Kentucky tax statutes, the language in the Telecom Act, and the conduct of the parties in this case and to determine if there is a valid outstanding dispute about these charges. On this the record is quite clear.

The Commission's reaffirmation that access to network elements under §251(c)(3) is not the same thing as "resale" under § 251(c)(4) would provide the foundation for BellSouth to file a refund claim at the DOR, *if that is what BellSouth chooses to do*. All Dialog asks is that the Commission make such a determination now and rule that Dialog has raised a *bona fide* billing dispute.

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<sup>4</sup> In a July 1, 2005 letter to the Commission BellSouth claimed to have filed that request "on behalf" of an unnamed BellSouth customer.

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The burden resulting from BellSouth's billing error has forced Dialog to pay over to BellSouth hundreds of thousands of dollars which would otherwise have been used in support of Dialog's voice and broadband network facilities build-out in rural Western Kentucky. Further delay only helps BellSouth as the prospect of rural competition continues to dim. Dialog respectfully requests that the Commission promptly rule on Dialog's Cross Motion for Summary Judgment, granting all the relief requested therein and, with respect to Count II, in the amended complaint.

If you have questions, please do not hesitate to contact me.

Sincerely yours,

A handwritten signature in black ink, appearing to read 'D. Brent', with a long horizontal flourish extending to the right.

Douglas F. Brent

Cc: Ms. Cheryl Winn