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June 15, 2007

Ms. Elizabeth O'Donnell
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

RE: Dialog Telecommunications, Inc. v. BellSouth Telecommunications Inc. Case No. 2005-00095

Dear Ms. O'Donnell:

Enclosed please find an original and ten copies of Dialog Telecommunications, Inc.'s Supplemental Comments in response to Commission's Order of May 31, 2007.

Please indicate receipt of this filing by your office by placing a file stamp on the extra copy and returning to me via our runner.

Very truly yours,

STOLL KEENON OGDEN PLLC

Douglas F. Brent

DFB:jms
Enc.

cc: Mary Keyer, BellSouth
Cheryl Winn, BellSouth

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

DIALOG TELECOMMUNICATIONS, INC.	)	
	)	
v.	)	**CASE NO.**
	)	**2005-00095**
BELLSOUTH TELECOMMUNICATIONS, INC.	)	

DIALOG'S SUPPLEMENTAL COMMENTS

Dialog Telecommunications, Inc. ("Dialog"), for its supplemental comments in response to the Commission's May 31, 2007 Order, states as follows:

INTRODUCTION AND BACKGROUND

On February 8, 2007, the Commission entered its Order in this case (the "Final Order") granting summary judgment to Dialog on the narrow jurisdictional issue presented – whether, as a matter of law, resale of service is the tantamount to the sale of network elements (also referred to herein as "UNEs")-- and finding as follows:

> Dialog specifically requests that the Commission articulate the difference between network elements provided pursuant to 47 U.S.C. § 251(c)(3) and resale provided pursuant to 47 U.S.C. § 251(c)(4). Such an interpretation is squarely within this Commission's jurisdiction.

[Final Order, at 5].

The object of Dialog's Complaint was, of course, to put an end to BellSouth's (now AT&T Kentucky's) obdurate refusal to cease attempting to collect an unlawful

"tax"on UNEs.[1] Dialog also needed – given the difficulty in finding a forum to vindicate its rights – a Commission conclusion that, pursuant to applicable utility law and the parties' Interconnection Agreement, Dialog's good faith dispute of the alleged "tax" prevented BellSouth from cutting off its access to UNEs while the dispute is pending.

However, Dialog did not ask the Commission to adjudicate tax issues, carefully steering clear of those matters within the jurisdiction of the Department of Revenue. Indeed, the Commission specifically noted in its Order that "Dialog is not asking the Commission to adjudicate this sales tax claim." [Final Order Granting Summary Judgment, at 2]. The Commission did, however, order BellSouth to "seek a tax refund, as described herein, which may benefit Dialog ***and the Kentucky operations of all CLECs.***" [Final Order at 6 (emphasis added)].

BellSouth did not challenge that aspect of the Commission's Order requiring it to file a refund application for all taxes it had paid (and collected from its competitors) on network elements. Instead, BellSouth attempted to derail the effect of the Summary Judgment by asking the Commission to order Dialog to pay any amounts for taxes on network elements that Dialog had withheld. Dialog responded to this red herring on March 16, explaining that whether or not Dialog had paid the disputed sales tax was irrelevant to the purely legal question that had been before the Commission. However, the Commission later issued an Order holding that Dialog should pay all alleged "taxes"

[1]Since 2001, Dialog has disputed the applicability of a service tax to network elements. The odyssey it has undertaken to attempt to end this unlawful tax has led from the ILEC, which stonewalled, to the court, which essentially refused to rule, to the Department of Revenue, which has denied standing, to a two-year proceeding before this Commission, then to court, and now back to the Commission. During these ***six years*** during which Dialog has sought a ruling on a clear question of law, the ILEC providing UNEs to Dialog has continued its course of harassing, and reducing the cash flow of, its competitors by continuing to charge the alleged "tax" while refusing to seek a Department of Revenue ruling no one else can request and issuing periodic cut-off threats to Dialog. Meanwhile, residential CLECs continue to exit the Kentucky market and BellSouth slowly recaptures its former customers.

billed to it, based upon its finding that "AT&T Kentucky [formerly BellSouth] ***cannot legitimately seek a refund*** for amounts it has not received." [Order dated March 23, 2007 ("Rehearing Order")(emphasis added)]. On April 12, 2007, Dialog sought reconsideration of that Order. Four days later Dialog appealed the same Order to the Franklin Circuit Court to preserve its rights under KRS 278.410(1). The Commission responded by asking the Court to remand the matter to the Commission, explaining that the Commission did not have a reasonable and adequate opportunity to address the arguments Dialog made in its April 12, 2007 Motion for Reconsideration. Judge Wingate granted the Motion to Remand, and this matter is again properly before the Commission. To the extent necessary to preserve its rights, Dialog incorporates herein its Motion for Reconsideration and its May 1, 2007 Reply to BellSouth's Response and Motion to Strike.

Remand from the Circuit Court provides the reasonable and adequate opportunity the Commission needs to reconsider its prior conclusions in light of the legal analysis provided herein and in Dialog's April 12 Motion for Reconsideration. The Commission should correct its earlier error and vacate its Rehearing Order.

ARGUMENT

I. AT&T KENTUCKY MOST CERTAINLY *CAN*, UNDER APPLICABLE TAX LAW, CONTEST THE TAXATION OF UNES AS SERVICE WITHOUT PAYING THE "TAX," AND THERE WILL BE NO LIEN ON ITS ASSETS DURING THE PENDENCY OF SUCH CONTEST.

At pages 2 and 3 of its Rehearing Order, the Commission held that, "based on this provision of the interconnection agreement [Section 11.4.4], in order for AT&T Kentucky to pursue an application for a refund of the sales tax which Dialog believes has

been improperly collected, Dialog must pay to AT&T Kentucky the tax in question." At page 3 of the Rehearing Order, the Commission asserted that "Dialog has failed to pay AT&T Kentucky the sales tax on UNEs, as required under the interconnection agreement." This is clear error.

As Dialog explained in its April 12 Motion and in its May 1 Reply, the Commission's Rehearing Order not only contradicts its previous (and correct) conclusion that an end to AT&T Kentucky's collection of this "tax" benefits all CLECs (some of whom no doubt *have* paid all alleged "taxes" to date, and whose rights under law should not be limited by Dialog's payment or lack thereof); it is based upon fundamental errors of tax law – an area outside the Commission's jurisdiction, and one into which it was not requested to enter. As is explained further below, and in the attached Revised Affidavit of Steven L. Lenarz, former Commissioner of the Department of Tax Compliance at the Kentucky Revenue Cabinet, even the Commission's interpretation of the parties' interconnection agreement, at Section 11.4.4, in which it suggested that BellSouth would be unable to file for a refund unless Dialog first paid these unlawful "taxes" is based upon erroneous conclusions of tax law. The Commission may have failed to recognize that Kentucky law permits BellSouth to challenge the tax *without* paying it first. *See* KRS 131.110; *Revenue Cabinet v. Castleton, Inc.* 826 S.W. 2d 334 (Ky.App. 1992). Thus, Dialog's payment history was irrelevant, and BellSouth's March 5, 2007 Motion for Reconsideration should have been denied.

BellSouth moved to strike a prior affidavit of Mr. Lenarz, claiming it did "not address the core ruling made by the Commission in its *Recon Order* – that is, Dialog has a contractual obligation to pay the amounts it has withheld from AT&T Kentucky."

BellSouth Response and Motion to Strike at 6. (italics in original). BellSouth's motion to strike is now moot. However, Mr. Lenarz has reviewed Section 11.4 of the interconnection agreement, including the language in Section 11.4.4 that was the heart of BellSouth's March 5, 2007 Motion for Reconsideration, and he has determined that the interconnection agreement does not require Dialog to pay the tax in question.

Section 11.4.4, quoted in the Commission's Rehearing Order, at 2, provides as follows:

> ***In the event that*** all or any portion of an amount sought to be collected must be paid ***in order to contest the imposition of any such tax*** or fee, ***or to avoid the existence of a lien on the assets of the providing Party during the pendency of such contest,*** the purchasing Party shall be responsible for such payment and shall be entitled to the benefit of any refund or recovery.

(Emphasis added.)

Thus, there are two conditions that would trigger a payment obligation on the part of Dialog. Neither exists. The alleged tax ***need not be paid "in order to contest the imposition"*** of the tax. Nor is it necessary to pay the alleged tax in advance of a "contest" of the tax to ***"avoid the existence of a lien on the assets of the providing Party during the pendency of such contest."*** As the Lenarz Revised Affidavit explains, at ¶ ¶7 and 8, BellSouth is the "taxpayer" and can, pursuant to KRS 131.110, contest the tax without first paying it. The Lenarz Revised Affidavit also explains, at ¶ 8, that no lien can be placed on the assets of AT&T Kentucky until the tax is "due," and that, while the contest is pending, no tax is yet "due." Finally, the Lenarz Revised Affidavit also explains, at ¶ 9, that under the Interconnection Agreement Dialog does not have to pay the disputed charges to BellSouth in order for BellSouth to seek a refund of taxes it paid on network elements.

Thus, pursuant to well-established tax law, neither of the conditions precedent to Dialog's obligation to pay the disputed tax exists. The Commission's finding to the contrary was clear and palpable error.

II. AT&T KENTUCKY MOST CERTAINLY *CAN*, UNDER APPLICABLE TAX LAW, SEEK A REFUND OF ALL AMOUNTS IT HAS REMITTED TO THE REVENUE CABINET, WHETHER OR NOT DIALOG HAS FIRST REMITTED ANY AMOUNT TO AT&T KENTUCKY.

The PSC held, in its Rehearing Order at 3, that "AT&T Kentucky cannot legitimately seek a refund for amounts it has not received." This conclusion is error.

As the Lenarz Revised Affidavit, at ¶ 6, explains, the retailer, AT&T Kentucky, certainly is permitted to seek a refund for taxes it has paid, regardless of whether it collected those taxes from the purchaser. It bears repeating that, as the retailer, AT&T Kentucky is the "taxpayer" for purposes of reporting to the Department of Revenue. The Department of Revenue has absolutely no relationship with Dialog under these circumstances. It is concerned neither with Dialog's payments to AT&T Kentucky nor with Dialog's objections to paying the tax. The Department of Revenue has refused to hear any of Dialog's objections. That, combined with BellSouth's refusal to assist Dialog despite Judge Crittenden's February 2004 order,[2] is why Dialog is before this Commission in the first place.

It is AT&T Kentucky that has a relationship with the Department of Revenue with respect to the communications "service" tax it has charged to CLECs who purchased UNEs from it. Dialog is without actual knowledge of whether AT&T Kentucky has remitted all of this "tax" to the Department of Revenue, but states categorically that, if it

[2] Complaint, Exhibit 2.

has, it may seek a refund of those taxes. If it has not, it can contest the imposition of those taxes whether or not they have been paid, without any worries that a lien will be placed on its assets. *See* Lenarz Revised Affidavit.

The PSC did not need to reach this issue in any event. It is outside the Commission's jurisdiction to rule on the procedure that AT&T Kentucky would follow to obtain a refund from the Department of Revenue. Moreover, Dialog does not demand, and has not demanded, that AT&T Kentucky (or BellSouth before it) file a refund claim with the Revenue Cabinet.[3] Dialog's interest is in ending AT&T Kentucky's unlawful billing practices to it, and the accompanying, ever-present threat that AT&T Kentucky will cease to provide network elements to Dialog during its efforts to vindicate its rights in this matter. Whether or not AT&T Kentucky files an administrative refund claim for money it remitted to the Department of Revenue due to legal error is not of direct concern to Dialog.

Dialog does, however, note that the Commission in its Final Order recognized the industry-wide significance of BellSouth's billing practice challenged by Dialog, and ordered BellSouth to seek a tax refund that could benefit every CLEC providing service in Kentucky. It is difficult to understand why, in its Rehearing Order, the Commission withdrew an industry-wide benefit based upon the payment history of a single CLEC. After all, if BellSouth and the Kentucky Department of Revenue have erred, the vast majority of the amounts to be refunded will go to carriers other than Dialog.

It is equally difficult to understand why the Commission would cast doubt on Dialog's right under Commission precedent to continue to obtain UNEs from AT&T

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[3] Letters of Douglas F. Brent to Elizabeth O'Donnell dated July 18, 2005, at 3, n. 2 and May 5, 2006, at 3.

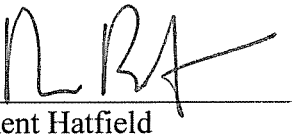
Kentucky during its good faith dispute of these unpaid, alleged "taxes," or why the Commission would further enable AT&T Kentucky to profit from its six-year pattern and practice of undermining its competitors by charging a disputed "tax" and refusing to take action that *only it can take* to cease collection of this charge. Dialog should not be punished for AT&T Kentucky's recalcitrance, and AT&T Kentucky should not be rewarded for it. Moreover, neither rewards nor punishments prescribed by this Commission should be based on interpretations of tax law.

CONCLUSION

The Rehearing Order is based upon errors of tax law, an area outside the Commission's jurisdiction and expertise. Accordingly, Dialog respectfully requests the Commission to vacate its Rehearing Order.

Respectfully Submitted,

DIALOG TELECOMMUNICATIONS, INC.

By: 

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CERTIFICATE OF SERVICE

It is hereby certified that this 15th day of June, 2007 I have served the within Response on the following by deposit in the U. S. Mail, first class.

Counsel for Dialog Telecommunications

Mary Keyer
Cheryl Winn
BellSouth Telecommunications
P. O. Box 32410
601 West Chestnut Street, Room 407
Louisville, KY. 40232

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

DIALOG TELECOMMUNICATIONS, INC.	)	
	)	
	)	**CASE NO.**
	)	**2005-00095**
v.	)	

BELLSOUTH TELECOMMUNICATIONS, INC.

REVISED AFFIDAVIT OF STEVEN L. LENARZ

1. My name is Steven L. Lenarz. I am 52 years old, and I am entirely competent and authorized to make this affidavit.

2. I am a Kentucky lawyer, am duly licensed, and have been in good standing with the Kentucky Bar Association since 1983. No ethics complaints have been filed against me.

3, I also am a Kentucky certified public accountant, and duly licensed, and have been in good standing with the Kentucky Board of Accountancy since 1979. No complaints have been filed against me.

4. My entire career has been spent studying and applying the Kentucky tax law, including for the Kentucky Revenue Cabinet of which I was Commissioner from 1992 to 2000. From 1977 to 1988, I held various tax-related positions including Senior Tax Manager at Ernst and Whinney, a big eight CPA firm. From 1988 to 1992, I was the Partner in Charge of Tax for a 50 person, three office CPA firm. From 1992 to 2000, I served as Commissioner of the Department of Tax Compliance at the Kentucky Revenue Cabinet. From 2000 to early 2005, I was the designated subject matter expert on Kentucky tax issues for PricewaterhouseCoopers. For the remainder of 2005, I practiced in the State and Federal Tax Practice Group for the Louisville office of the law firm of Stoll Keenon Ogden PLLC. I now practice in the Louisville office of the law firm of Hurt Crosbie & May, PLLC. My practice is limited solely to Kentucky tax matters.

5. I have been asked by Petitioner's counsel to explain the procedure by which a retailer (the "taxpayer") seeks a refund of sales taxes paid; whether sales tax must be paid in advance of a contest of such sales taxes; and when a lien arises with respect to unpaid sales taxes.

6. Kentucky law imposes the sales tax on the retailer (KRS 139.200) and requires the retailer, in turn, to collect the tax from its customer (KRS 139.210(1)). That the retailer is liable for sales tax regardless of whether the tax is in fact collected from the customer was conclusively established in *ITT Fluid Prods. Corp. v. Crane Co.*, 793 S.W.2d 844 (Ky.App. 1990). For the same reason, a retailer may seek a refund of overpaid sales tax from the Kentucky Department of Revenue, regardless of whether that tax previously had been collected from the customer. (KRS 139.770 and 134.580). If the retailer previously collected the tax from the customer, the retailer must refund to the customer any amounts refunded by the KDOR. (KRS 139.770(3)).

7. Kentucky law provides that taxpayers may challenge the imposition of a sales tax or other state tax either before paying the tax (under KRS 131.110) or after having paid the tax by seeking a refund (under KRS 134.580). The separate existence of each avenue to challenge the imposition of tax was conclusively established in *Revenue Cabinet v. Castleton, Inc.*, 826 S.W.2d 334 (Ky.App. 1992).

8. A retailer making potentially taxable sales in Kentucky may contest the imposition of sales tax on those sales without first having collected the tax from the customers or having paid the tax to the KDOR. If the KDOR later audits and assesses tax on those sales, the retailer may protest the assessment and obtain administrative review within the KDOR pursuant to KRS 131.110(1) and (2). If the retailer receives an adverse final ruling from the KDOR on its administrative protest, the retailer may appeal to the Kentucky Board of Tax Appeals (KRS 131.110(3)) and then on to the Courts. A lien against the retailer for unpaid sales tax does not arise until the tax becomes due and the retailer is liable to pay it. KRS 134.420(2). Tax is not due, the retailer is not liable to pay it and the KDOR cannot file a lien and seek to collect unpaid sales tax until the administrative and judicial process is resolved, and then only if it is resolved in the KDOR's favor. This was conclusively established in *Revenue Cabinet v. Hall*, 941 S.W.2d 481 (Ky. App. 1997).

9. I have reviewed Section 11.4.4 of the interconnection agreement between Dialog Telecommunications, Inc. ("Dialog") and BellSouth Telecommunications, Inc. ("BellSouth") in effect as of the date Dialog filed its complaint. Dialog does not have a contractual obligation under Section 11.4.4. to pay sales tax on charges for unbundled network elements (the amounts it has withheld from BellSouth) because Dialog does not have to pay sales tax to BellSouth in order for BellSouth either (i) to contest the imposition of sales tax on those charges or (ii) to avoid the existence of a lien on Bellsouth's assets during the pendency of such contest.

Steven L. Lenarz

STATE OF KENTUCKY)
) SS:
COUNTY OF JEFFERSON)

Subscribed and sworn to before me by Steven L. Lenarz, this 13th day of June, 2007.

My Commission expires: 03/23/08

Linda W Huggins
NOTARY PUBLIC