THE COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

APPLICATION OF BELLSOUTH BSE, INC. FOR AUTHORITY TO PROVIDE LOCAL EXCHANGE SERVICE	)))	CASE NO. 97-417

O R D E R

INTRODUCTION

On October 1, 1997, BellSouth BSE, Inc. ("BSE") filed its application with the Kentucky Public Service Commission for approval to provide local exchange service in Kentucky. BSE is a wholly owned subsidiary of BellSouth BSE Holdings, Inc. which in turn is a wholly owned subsidiary of BellSouth Corporation ("BellSouth"). BellSouth Telecommunications, Inc. ("BST") is the largest incumbent local exchange carrier ("ILEC") in Kentucky and is also a wholly owned subsidiary of BellSouth. In connection with this application, BSE and BST have submitted their interconnection agreement for approval pursuant to 47 U.S.C. § 252(e).

AT&T Communications of the South Central States, Inc. ("AT&T"), the Southeastern Competitive Carriers Association ("SECCA"), MCI Telecommunications Corporation and MCImetro Access Transmission Services Inc. ("MCI"), and the Kentucky CATV Association, Inc., d/b/a Kentucky Cable Telecommunications Association ("KCTA") intervened. The Intervenors claim, among other things, that provision of local exchange service by BSE in BST territory would have anti-competitive effects, enabling BellSouth to avoid the legal restrictions imposed on BST as an ILEC. The Intervenors also claim that

BSE services, subsidized by BST by means of less than arm's-length transactions, would be priced below cost and would force legitimate competitors out of the market. On April 24, 1998, the Commission conducted a hearing on the matter, and subsequently BSE, AT&T, and SECCA and MCI jointly, submitted briefs.

CERTIFICATION REQUIREMENTS

BSE contends that its application meets the Commission's requirements for certification as a competitive local exchange carrier ("CLEC"). BSE asserts it has demonstrated to the Commission that it has the technical, managerial, and financial abilities to provide adequate service pursuant to KRS 278.020; it has submitted an interconnection agreement, 47 U.S.C. § 252; and it has submitted a local service tariff pursuant to KRS 278.160.[1]

The Intervenors herein contend that BSE lacks the financial resources to operate as a CLEC because it must depend upon the resources of its parent company. As BSE points out,[2] the Commission has certified other CLEC applicants that initially relied upon the resources of their parent companies. AT&T argues that BSE also lacks technical and managerial resources and depends upon the experience and expertise of employees of its affiliates.

---

[1] Post Hearing Brief of BellSouth BSE, Inc., filed May 26, 1998 ("BSE Brief"), at 1-2.

[2] BSE Brief at 2.

In Administrative Case No. 370,[3] pursuant to its authority under KRS 278.512 to exempt certain telecommunications carriers and products from statutory and regulatory requirements, the Commission determined that requiring CLECs to file applications to begin operations is no longer necessary to protect the public. CLECs, as such, possess neither market power nor own local exchange bottleneck facilities; moreover, there is no need for the Commission to monitor their financial stability to ensure their continued existence, since financial failure of a CLEC would not deprive customers of their carrier of last resort.[4] Accordingly, BSE is technically correct: its filings at the Commission are sufficient, pursuant to current regulatory requirements for CLECs, to enable it to begin operations in Kentucky. However, as the Intervenors point out, BSE is not merely a CLEC. It is an affiliate of BST, Kentucky's largest incumbent local exchange carrier, and the evidence demonstrates that its operations are intricately intertwined with those of this powerful affiliate. It is the alleged potential for anti-competitive behavior and distortion of the competitive local exchange market that are the problematic issues here.

Thus, while the dependence of BSE on its parent is not technically relevant to certification per se, the close relationship between BSE and BST does raise concerns regarding the operational separation of the entities and the resulting potential for gaining an unfair pricing advantage. If BSE acquires services at a discount from BST and those services are delivered in the same manner as if the transaction never occurred, then it

---

[3] Administrative Case No. 370, Exemptions for Providers of Local Exchange Service Other Than Incumbent Local Exchange Carriers, Order dated January 8, 1998 ("Administrative Case 370 Order").

[4] Administrative Case 370 Order, at 2.

appears that overhead expenses associated with providing service incurred by a typical CLEC may never be realized by BSE. The conceptual framework for the development of competition and the incentives to operate more efficiently and reduce costs could thereby be negated by a variant of price arbitrage.

INCONSISTENCY WITH THE PURPOSES OF THE TELECOMMUNICATIONS ACT OF 1996

The Intervenors argue that, if BSE provides service in BST territory, BST could subsidize BSE's prices, enabling BSE to provide BST services on a retail basis at rates that neither earn a profit nor cover BSE's costs. The resulting price squeeze would force other CLECs, which will need to make a profit to survive, out of the market. AT&T contends that Congress foresaw that an ILEC might attempt to be a CLEC as well as an ILEC and therefore enacted 47 U.S.C. § 251(h), which provides that, when a comparable carrier substantially replaces an ILEC in its market, the obligations placed on an ILEC by the Telecommunications Act of 1996, Pub. L. No. 104-104,110 Stat. 56 (1996) (the "Act") must apply.[5] MCI and SECCA state that, in fact, to consider BSE a CLEC in areas served by BST would be to "ignore the only reasonable definition of a CLEC -- a local exchange carrier that competes against the entrenched incumbent for customers."[6] BSE, the Intervenors contend, would not actually "compete" with the incumbent BST. MCI and SECCA point out that, in hearings on BSE certification in South Carolina, BSE witness

---

5 AT&T Brief at 11.

6 SECCA and MCI Brief at 1.

Robert C. Scheye stated outright that BSE does not "really want to compete with BST."[7] The Intervenors not only claim that there is no real distinction between BST and BSE; they also argue that the public will perceive no difference between BSE and BST. Both carry the name "BellSouth" and will use the BellSouth logo.

The real purpose of BSE's existence, the Intervenors claim, is to enable BellSouth to provide local exchange services absent the restrictions placed upon it by the Act as an ILEC in possession of bottleneck facilities. BSE will, for example, not be required to make retail services available for resale to CLECs at wholesale rates pursuant to Section 251(c)(3) and (4) of the Act.

BSE argues, among other things, that allegations regarding potential anti-competitive behavior on its part are only "conjecture,"[8] and that there are adequate remedies to deal with such activities if they occur.[9] BSE also contends it would be economically irrational to operate in a less than profitable manner.[10] The latter argument, however, does not take into account the ultimate benefit to BellSouth of eliminating competitors from the local market; and while it is true that anti-competitive behavior of the nature predicted by the Intervenors has not yet occurred, the Commission finds that the

---

[7] SECCA and MCI Brief at 3, citing Tr. 17, Before the South Carolina Public Service Commission, BellSouth BSE Application for a Certificate of Public Convenience and Necessity to Provide Local Exchange Telecommunications Services, Nov. 5, 1997, Docket No. 97-361-C.

[8] BSE Brief at 3.

[9] BSE Brief at 4.

[10] BSE Brief at 7, 8.

potential for such behavior would be greatly exacerbated by granting BSE the authority it seeks. Further, although remedies for violation of federal law do, of course, exist, this Commission does not routinely oversee the business activities of CLECs for the very reason that they do not possess the market power of an ILEC such as BellSouth.

CONCLUSIONS

The Commission regulates telecommunications services in the public interest. See, e.g., KRS 278.512(1)(c) ("[t]he public interest requires that the Public Service Commission . . . regulate and control the provision of telecommunications services to the public in a changing environment, giving due regard to the interests of consumers, the public, the providers of the telecommunications services, and the continued availability of good telecommunications service"). Public interest determinations "require consideration of all important consequences including anti-competitive effects." Denver & Rio Grande W.R.R. v. United States, 387 U.S. 485, 492 (1967). See also FCC v. RCA Communications, Inc., 346 U.S. 86, 94 (1953) ("There can be no doubt that competition is a relevant factor in weighing the public interest"). Section 252(e)(2)(A)(ii) of the Act provides that a state commission may reject an interconnection agreement on the ground that its implementation would not be "consistent with the public interest, convenience, and necessity."

The Commission finds that the public interest concerns raised by the Intervenors herein are grave ones justifying rejection of the BST/BSE interconnection agreement and denial, in part, of BSE's application to provide local exchange services in Kentucky.

IT IS THEREFORE ORDERED that:

1. BSE is granted the authority to provide intrastate telecommunications services as described in its application but only in areas outside the franchised service territory of BST.

2. The Interconnection agreement between BSE and BST is rejected.

3. BSE shall incorporate the restriction on its service area in its tariff.

Done at Frankfort, Kentucky, this 8th day of June, 1998.

PUBLIC SERVICE COMMISSION

Chairman

Vice Chairman

Commissioner

ATTEST:

Executive Director