COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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PUBLIC SERVICE COMMISSION

In the Matter of:

INQUIRY INTO THE USE OF CONTRACT SERVICE ARRANGMENTS BY TELECOMMUNICATOINS CARRIES IN KENTUCKY	)))	CASE NO. 2002-00456

MEMORANDUM

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May It Please the Public Service Commission:

Comes the Electric and Water Plant Board of the City of Frankfort, Kentucky (hereinafter FPB) and pursuant to the Public Service Commission's directive submits the following Memorandum for its consideration.

1. Termination Penalties and Length of CSAs Hurt Developing Competition.

BellSouth, on November 21, 2003, filed what it termed "Late Filed Hearing Exhibits" that addressed certain questions its witnesses were not prepared to answer during the hearing. Certain of those Exhibits related to contract termination penalties and contract length. According to Item No. 8 of these exhibits, the average term length of a special contract is 34 months. According to Item No. 10 of these Exhibits, all of the BellSouth contracts contain penalties for early termination. The specific penalties are not indicated. BellSouth states that "Normally, this termination liability applies as the tariff prescribes for the service that is provided for on the CSA." This raises a couple of significant competitive concerns that the Commission should consider and address at this time.

(a) The BellSouth Early Termination Penalties for Contracts are Excessive and Preclude Competitive Offers from Consideration.

A review of the BellSouth tariffs indicates that early termination penalties are severe and often effectively preclude any customer from early contract termination. For example, the BellSouth Kentucky Tariff applies the following early termination penalty for BellSouth Primary Rate ISDN service that would be a standard contract item for many medium/large businesses.

> *"A Termination Liability Charge is applicable if service is terminated prior to expiration of the contract. The applicable charge is dependent on the contract period subscribed to and will be equal to the number of months remaining in the contract times the monthly rate provided under the contract."*

(Source: BellSouth General Subscriber Service Tariff, Section A42.3.2, subparagraph A.2.)

The BellSouth tariff for its MegaLink Service (1.544 Mbps private line channel service) contains the same early termination penalty. This service would also be a common contract item for medium to large businesses. (Source: BellSouth Private Line Services Tariff, Section B7.1.2, subparagraph C)

The existence of such penalties represents a serious impediment to developing competition. In the BellSouth area now also served by the Frankfort Plant Board, BellSouth was actively soliciting business customers to long-term contracts prior to the time that FPB was operating as a CLEC. If a customer signed a thirty-six month contract with BellSouth a few months prior to the time they had a competitive choice, that customer is essentially locked away from competition for three years. The customer may have been unaware of potential competitive alternatives when they signed the contract. However, even though a competitive choice may now be available, the early termination penalties make it absolutely uneconomic for that customer to switch service to a competitor at this time. As

FPB witness Hancock stated under cross-examination "If CSAs are filed to preclude competition from developing in a particular marketplace, then that obviously does not advance competition. As a matter of fact, just the opposite occurs." (Transcript, page 207, lines 10-14)

(b) The Contract Language Should be Specific With Regard to Early Contract Termination Penalties.

Contracts that do not contain specific language regarding the early termination penalties that apply, but instead reference applicable tariff regulations, do a disservice to customers and should not be permitted. Most business customers are not familiar with utility tariffs and would likely not know how to find or interpret the myriad rules and regulations associated with such tariffs. As such, it is a reasonable assumption that many customers do not comprehend the severity of the early termination penalties contained in the tariffs referenced by their contract. Customers must have a clear understanding of the penalties they will incur for early contract termination. If the customer must pay for 36 months of service regardless of whether they use it or not, the contract should explicitly say so.

(c) Contrary to BellSouth Testimony and its Late Filed Exhibit, Early Termination Penalties Do Apply in Resale Situations.

Under direct examination from his attorney, BellSouth witness Hullings made the following assertion.

> *"If a CLEC approaches a BellSouth customer that has a CSA and that CSA is available to that competitor CLEC and under the same terms and conditions, that CLEC can have access, assume that contract at a discount and there is no termination liability that would apply."* (Transcript, page 108, line 23 to page 109, line 2).

The same witness provided further clarification of his understanding under cross-examination by the Commission Staff attorney.

Ms. Dougherty: *"It's your testimony that, if you have a CSA with a customer and a CLEC provider approaches that customer, then the CLEC provider can obtain that contract for the resale discount, avoided cost discount, and provide it without any termination penalties to the customer or to the carrier, or anything like that, and continue to provide that same contract?"*

Mr. Hullings: *"That is correct, at the CLEC's discretion."* (Transcript, page 123, lines 7 – 16)

Based on a review of our interconnection agreement with BellSouth and from information requested from BellSouth subsequent to the hearing, FPB asserts that the BellSouth witness misspoke with regard to the application of early termination penalties in a resale environment. FPB has been advised by its BellSouth representative for contract negotiation that in the case of a contract resale situation (referenced in the Interconnection Agreement as a "Special Assembly"), any termination liability penalties would apply. This situation is specifically addressed in the standard BellSouth interconnection agreement and states as follows.

"In the event FPB acquires an end user whose service is provided pursuant to a BellSouth Special Assembly, BellSouth shall make available to FPB that Special Assembly at the wholesale discount at FPB's option. FPB shall be responsible for all terms and conditions of such Special Assembly including but not limited to termination liability if applicable." (Source: April 2003 BellSouth/FPB Interconnection Agreement, Section 3.20)

It should also be noted that the BellSouth Late Filed Hearing Exhibit (Item 3) is worded to very gingerly avoid the reality of the situation without actually correcting what its witness testified. The BellSouth Exhibit response indicates that the "customer" would not incur termination charges but conveniently fails to mention that the CLEC would incur such charges if they assumed the contract.

Contrary to the implication of the BellSouth Exhibit response, what actually happens under a contract resale is that BellSouth shifts financial responsibility from the customer to its competitor. The CLEC would take on a huge financial gamble by taking over a customer contract. If a customer goes out of business, changes its technology platform, or presumably goes back to BellSouth prior to expiration of the contract, the CLEC is left with liability for the original contract penalties. Under all circumstances, if the contract is terminated prior to its original term length, BellSouth is fully compensated as if no competitive shift occurred.

The risk of excessive termination liability requirements would be compounded by the incredible administrative difficulties CLECs might expect in trying to manage anything out of the ordinary with BellSouth. There are no procedures established in the interconnection agreement for handling the special billing associated with this kind of arrangement. The financial burden and administrative problems are the reasons why only 6 contracts have been resold in Kentucky in the last three years and why none involve PRIs. (Source: BellSouth Late Filed Hearing Exhibits, Items 1 and 6).

At the conclusion of the hearing, Chairman Huelsman asked the parties to answer whether contract early termination penalties and lengths are harmful to competition. The answer to his question is: <u>Yes, they are</u>.
Lengthy contracts with prohibitively expensive termination penalties commit a customer to the almost-monopoly incumbent and preclude competitive alternatives from being considered for years to come. The 1996 Telecom Act is predicated on the assumption that competition is in the public interest. Regulatory requirements must support that concept. Competition has been slow to develop in Kentucky, and locking away medium to large businesses from competition is harmful to the public interest.

FPB recommends that the Commission Order in this docket address the above issues relative to contract length and early termination penalties.

1. Early contract termination penalties should allow a company to only recoup its actual cost for time and materials already expended in the provision of service for which payment has not yet been received at the time service is discontinued. Penalties in excess of the actual cost incurred by the company to discontinue service should not be allowed.
2. Oblique reference to rules and regulations as found in applicable tariffs does not provide adequate consumer knowledge. Actual termination penalties should be unequivocally specified in all carrier contracts for Kentucky consumers.

2. <u>BellSouth Does Not Restrict Use of Special Contracts .</u>

Based on the extensive and at times conflicting testimony of its numerous witnesses, it becomes obvious that BellSouth maintains little or no control over conditions under which special contracts are offered. While some BellSouth witnesses discuss guidelines to determine the existence of competition, other witnesses demonstrate that such guidelines are nothing more than paper formalities to placate potential legal or regulatory scrutiny.

For example, in its Late Filed Hearing Exhibits (Item 7), BellSouth produces a document from "BellSouth Legal" that purportedly "reminds" its sales personnel that CSAs are not authorized in the absence of a specific competitive threat. However, BellSouth witness Ruscilli, in disputing the need for a written offer to represent such a competitive threat, identifies some specific examples of what he considers to be adequate to identify a competitive threat. His standards include *"simply an advertised competitive offer via radio, television, or other media. It might be a small aircraft circling Churchill Downs trailing a banner that offers 20% off any BellSouth advertised offer."* (Ruscilli Rebuttal Testimony, page 6, lines 23-25)

The above-mentioned logic borders on the absurd. According to its own witness, the mere mention, observation, or hint of any competitive presence is evidently sufficient to satisfy BellSouth's specific competitive threat requirement and to generate a contract offer. Whether that competitive presence represents an actual market threat is apparently not considered. The fact that a cable company in Louisville now offers local telephone service over its cable lines does not mean that it is prepared to engineer complex trunking facilities for a multi-location business, regardless if it runs a generic radio advertisement or even hires a small plane to pull a banner. The mere existence of a competitor does not mean that competitor has the operational capability, billing support systems, or technical capacity to serve the unique requirements of a large business customer or would even attempt to do so. Under the competitive threat conditions as outlined by BellSouth witness Ruscilli, conceivably every business customer in Kentucky could be construed as qualifying for a special contract.

3. The FPB Industry Proposal For Contracts Should Be Adopted.

The Frankfort Plant Board Industry Proposal for Contracts represents an attempt to construct a reasonable approach that allows competitive responses to take place within the developing local telephone service market. Carriers that are soliciting new business from a customer may propose a contract to that customer. Conversely, carriers that currently provide service to the customer may respond to that actual competitive overture through the use of a contract. All carriers may respond to a formal Request for Proposal (RFP) for telecommunications services issued by a customer. What the FPB proposal prohibits is the current carrier using contracts in a preemptive maneuver to shut out competitors and preclude competition from developing in a market area.

The FPB proposal also allows carriers the option of maintaining contracts on their web-site with customer name and address redacted or providing the actual contract to the Commission. This would allow businesses in Kentucky the opportunity to review such contracts and determine if any would be appropriate for its operations. At the same time, customer confidentiality would be preserved. Customers would then have the ability to request in writing to have the same contract made available to them by the carrier. If the carrier determines that the customer is eligible for the contract under Commission guidelines, it would accommodate the request. If the carrier chooses not to provide the customer contracts on its web-site it must file the complete contract with the Commission, same as the requirement today.

The concept of maintaining copies of customer contracts on a carrier's web-site is not new. Certain telecommunications carriers that were previously regulated by the FCC currently maintain on their web-sites (with customer name and address redacted) copies of actual contracts that were recently negotiated for nationwide businesses. Telecommunications consultants and informed telecom managers regularly review such contracts to benchmark pricing trends and recent service level agreement modifications.

It is imperative that the Commission maintains regulatory oversight over contracts until such time as competition has sufficiently developed for the marketplace to regulate such activity. Kentucky is simply not there yet. The most recent FCC study on "Local Telephone Competition Status" continues to demonstrate that local telephone service competition in Kentucky lags behind the rest of the country. While some parties may complain about how and what information the FCC compiled, they cannot argue that the same criteria applied for all states and that Kentucky remains in position forty-seven out of fifty with regard to competitive penetration for local service. (Hancock Supplemental Testimony, Exhibit 1, FCC Report, Table 14)

CONCLUSION

If competition for local telephone service is going to develop in Kentucky, now is not the time for the Commission to deregulate the provision of contracts by almost-monopoly providers, as the BellSouth proposal would accomplish.

Respectfully submitted by the Electric & Water Plant Board of the City of Frankfort, Kentucky.

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CERTIFICATE OF SERVICE

It is hereby certified that a true and accurate copy of the foregoing was served on the individuals on the attached Service List by first-class mail, postage prepaid, on the 21st day of January, 2004.

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