COMMONWEALTH OF KENTUCY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:	)	
	)	
INQUIRY INTO THE USE OF CONTRACT SERVICE ARRANGEMENTS BY TELECOMMUNICATIONS CARRIERS IN KENTUCKY	)))	Case No. 2002-00456 Filed: January 21, 2004

BELLSOUTH TELECOMMUNICATIONS, INC.'S POST-HEARING BRIEF

INTRODUCTION

BellSouth Telecommunications, Inc. ("BellSouth"), by counsel, hereby files its Post-Hearing Brief in accordance with the deadline set by the Commission at the hearing on October 23, 2003. On the basis of the evidence presented, the Commission should conclude that the current competitive environment makes the use of contract service arrangements ("CSAs") by telecommunications providers not only proper, but necessary, and that the use of CSAs fosters competition. Further, the Commission should adopt the CSA Standards jointly proposed by BellSouth, Alltel and Cincinnati Bell.

Procedural Background

By Order dated December 19, 2002, the Commission opened this docket to consider pricing practices with respect to contract service arrangements by telecommunications carriers. The Commission indicated that it wished to look at the relationship between pricing based on competition and the Kentucky statute dealing with similarly situated customers being provided the same price. In addition to other issues, the Commission also stated that it wished to amass a broad record in this proceeding and wished to determine whether competition should be a factor in

determining whether customers are similarly situated. The Commission's Order made all incumbent local exchange carriers ("ILECs") and those competitive local exchange carriers ("CLECs") that are active before the Commission parties to this proceeding.[1] The Commission noted that it expected full compliance from Kentucky's ILECs and from the larger CLECs who are active in Kentucky. However, the Commission allowed a carrier that did not wish to participate in the proceeding to file a statement so stating and include a full explanation of its reasons for not wishing to participate. The Commission further indicated that it would review those statements that were filed, and if necessary, enter Orders requiring information, if not full participation, from each carrier so filing. By the Commission's deadline, a number of smaller telecommunications carriers requested to be excused from participating in this proceeding.[2] In addition, AT&T and TCG Ohio stated that it filed full and complete copies of all CSAs entered into during the years 2001 to 2002 and provided information in an appendix; however, AT&T and TCG Ohio also stated that some of the CSAs in the appendix may not have been filed with the Commission. The ILECs in Kentucky provided complete responses, including ALLTEL, Cincinnati Bell, and BellSouth.

AT&T Long Distance stated in its filing on January 21, 2003, its assumption that the Commission did not intend to include long distance carriers. The Commission

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[1] The Commission also listed those parties on Appendix A and required those carriers named in Appendix A to respond to the data requests furnished in another Appendix and to comply with the procedural schedule established.

[2] Ballard Rural Telephone Cooperative Corporation, Inc., Brandenburg Telephone Company, Inc., Broadwing Telecommunications, Inc., Cincinnati Bell Long Distance, Gearheart Communications d/b/a Coalfield's Telephone Company, Duo County Telephone Cooperative Corporation, Inc., e-Tel, LLC, Foothills Rural Telephone Cooperative Corporation, Inc., Highland Telephone Cooperative, Inc., ICG Telecom Group, LecStar Telecom, Inc., Logan Telephone Cooperative, Inc., MCImetro Access Transmission Services, LLC and Intermedia Communications, Inc., North Central Telephone Cooperative, Inc., People's Rural Telephone Cooperative, South Central Rural Telephone Cooperative Corporation, Inc. and South Central Telcom, LLC, TDS Telecom Companies in Kentucky, Thacker-Grigsby Telephone Co., West Kentucky Rural Telephone Cooperative Corporation, Inc.

confirmed that long distance carriers and local providers were included in this proceeding, but modified the actual number of contracts to be filed to permit a random 10% sample for those carriers that had entered into more than 400 CSAs in the two-year period. *See,* Commission Order dated January 28, 2003. The purpose of the proceeding, the Commission noted, is to investigate all service arrangements provided by Kentucky carriers at other than tariff rates. *Id.* at 2. Nevertheless, AT&T, Sprint and Cinergy refused to provide the data requested by BellSouth. AT&T and Sprint objected to several of BellSouth's Data Requests, and Cinergy objected to responding to **all** of BellSouth's Data Requests.[3] Cinergy's explanation for its total refusal to respond to BellSouth's Data Requests was that Cinergy had "voluntarily participated" in this docket but that it "did not agree to be harassed by its competitors and forced to engage in a costly and time-consuming discovery process." Cinergy further stated that it wished to be released from participation in this docket if it had to respond to discovery requests from its competitors. However, Cinergy's response to the Commission's request indicates that it has entered into at least 400 CSAs, since it has opted to use the random sampling methodology. Response of Cinergy Communications Company to Commission Order Dated December 19, 2002, As Amended by Order Dated January 28, 2003, March 21, 2003, at Schedule A to Response No. 1. Cinergy also stated its opinion that the Commission's August 8, 2000 Order in Administrative Case 370 permits CLECs to no longer file CSAs.

As part of the informal workshop process undertaken pursuant to the Commission's July 8, 2003, Order, a Joint Proposal for CSA Standards was filed by

[3] The Commission's Order expressly allowed parties to submit data requests to other parties; BellSouth served only six data requests on the other parties to this proceeding.

BellSouth, Alltel and Cincinnati Bell on October 8, 2003 ("Joint Proposal"). AT&T subsequently filed a Response in opposition to this proposal. The Frankfort Plant Board filed an alternative proposal. Finally, seven CLECs filed Joint Comments on October 10, 2003 in which they argued that restrictions on the use of CSAs do not apply to CLECs.[4]

Pursuant to the Commission's procedural orders, a hearing was held on October 23, 2003. Eight witnesses filed testimony. Of these eight witnesses, seven testified on behalf of ILECs. The only other party to file testimony was the Frankfort Electric and Water Plant Board ("Frankfort Plant Board"). At the close of the hearing, Chairman Martin Heulsmann set the date for the Post Hearing Brief and outlined several issues he wished to be addressed in the briefs.

ARGUMENT

1. Contract Arrangements That Respond To Competition Are Reasonable And Permitted by Kentucky Law.

Kentucky law permits reasonable discrimination by carriers where there is a reasonable basis for making distinctions. The word "discrimination", in some contexts, has a pejorative connotation. As a result, it may seem incongruous to talk of "reasonable discrimination". This sense of incongruity is partly the result of the terms and concepts of discrimination often being associated with Title VII of the Civil Rights Act of 1994, 42 U.S.C. § 2000e, *et seq.* and similar statutes prohibiting certain types of discrimination based on race, gender, national origin or other impermissible, and often

[4] These CLECs, who referred to themselves collectively in their filing as "Joint Respondents," are Cinergy Communications Company, ICG Telecom Group, Intermedia Communications, Inc., NuVox Communications, Inc., MCI Telecommunications, MCImetro Access Transmission Services, LLC, and Time Warner Telecom.

immutable, characteristics. However, in its original meaning, "discrimination" referred to the ability to reasonably distinguish between different categories, as a consumer with "discriminating taste" is one who appreciates quality goods or services. It is this concept of "reasonable discrimination" which is more helpful in analyzing the types of varying contractual arrangements which are appropriately offered to purchasers of various telecommunications services without the contracts resulting in **unreasonable** discrimination.

Kentucky and federal law, with respect to common carriers, has never prohibited all discrimination, but only restricts unjust or unreasonable discrimination. For example, KRS 278.170(1) prohibits only "unreasonable preference or advantage", "unreasonable prejudice or disadvantage" or "unreasonable difference".[5] Section 202(a) of the Telecommunications Act of 1934 ("the Act"), as amended, prohibits a carrier from making any "unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services." *See* 47 U.S.C. § 202(a). Nor can a carrier "give any undue or unreasonable preference or advantage to any particular person, class of persons, or locality, or to subject any particular person, class of persons, or locality to any undue or unreasonable prejudice or disadvantage." *Id.* Thus, neither Kentucky nor federal law bars *all* rate discrimination, only "unjust and unreasonable discrimination."[6]

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[5] KRS 278.170(1) provides in pertinent part:

No utility shall, as to rates or service, give any unreasonable preference or advantage to any person or subject any person to any unreasonable prejudice or disadvantage, or establish or maintain any unreasonable difference between localities or between classes of service for doing a like and contemporaneous service under the same or substantially the same conditions. Similarly, in the federal arena, the Communications Act of 1934, which was modeled on the Interstate Commerce Act, was designed "to secure equality of rates as to all and to destroy favoritism, these last being accomplished by requiring the publication of tariffs and by prohibiting secret departures from such tariffs, and forbidding rebates, preferences and all other forms of undue discrimination".

[6] *See Connecticut Office of Consumer Counsel, et al. v. AT&T Communications, Memorandum Opinion and Order*, File No. E-88-061, 4 FCC Rcd 8130 (1989) at para. 12.

Or, as the United State Supreme Court recently expressed the rule: "the policy of nondiscriminatory rates is violated when similarly situated customers pay different rates for the same services". *AT&T v. Central Office Telephone, Inc.*, 524 U.S. 214, 233 (1998). Individual contracts that respond to individual differences in the circumstances of customers do not violate the principle of nondiscrimination nor do they treat similarly situated customers differently so long as they are made available to other customers willing and able to meet the contract's terms. *See, Competitive Telecom Assoc. v. FCC,* 998 F.2d 1058 (D.C. Cir. 1993).[7]

2. Reasonably Responding To Differences Is Not Unreasonable Discrimination.

More than half a century ago, Kentucky's then highest court upheld classifying users of a sewer district so that rates were substantially higher for those users outside the city limits than for those users within the city limits. *Louisville and Jefferson County Metropolitan Sewer District v. Joseph E. Seagram and Sons, Inc.*, 307 KY 413, 211 S.W.2d 122 (Ky. 1948). Citing as authoritative the text on the following public utilities, the Court stated:

> 'a distinction may be made between different customers or classes of customers on account of location, amount of consumption or such other material conditions which distinguish them from each other or from other classes.'

211 S.W. 2d at 126 quoting Pond, Public Utilities, Section 275, 288, 292.

A generation later, the Kentucky Court of Appeals again confirmed that a utility may establish reasonable classifications for service. *Marshall County v. South Central*

[7] Even a contract designed for a particular business customer is not impermissible so long as it is made available to all similarly situated customers who request it. *AT&T Corp. v. FCC,* 86 F.3d 242 (D.C. Cir. 1996).

Bell Tel. Co., 519 S.W.2d 616 (Ky. App. 1975). In *Marshall County*, subscribers of Marshall County and the City of Benton filed a complaint with the Kentucky Public Service Commission against South Central Bell Telephone Company, BellSouth's predecessor, seeking to require Bell to provide extended area service "at existing approved tariffs". 519 S.W.2d at 617. The Kentucky Court of Appeals, noting that the real basis of the complaint before the Commission was one of alleged discrimination, rejected the Commission's order directing Bell to provide service at the existing approved tariff, finding instead that the complainants had not proven that Bell's classification requiring toll charges was unreasonable. 519 S.W.2d at 619.

Fifteen years later, the Kentucky Court of Appeals again refused to find unreasonable discrimination by a utility for reasonable differences in rates. *National-Southwire v. Big Rivers Elec.*, 785 S.W.2d 503 (Ky. App. 1990). This time, the alleged discrimination was with respect to variable electric rates that were tied to the market price of aluminum. The Court upheld the variable or "discriminatory" rate system as reasonable, holding:

> Even if some discrimination actually exists, Kentucky law does not prohibit it per se. According to KRS 278.170(1), we only prohibit 'unreasonable prejudice or disadvantage' or an 'unreasonable difference'. KRS 278.030(3) allows reasonable classifications for service, patrons, and rates by considering the 'nature of the use, the quality used, the quantity used, the time when used . . . and any other reasonable consideration'.

785 S.W.2d at 514.

Thus, Kentucky courts have for many generations upheld the principle that differences in service rates are permissible, even where there is discrimination, so long as the distinctions that are made are reasonable. Of course, in the post World War II era, when *Louisville and Jefferson County Metropolitan Sewer District* was decided,

competition for telephone customers was unheard of. Even when *Marshall County v. South Central Bell Tel. Co.* decision was rendered and the baby-boomers were coming of age, competitive telephone service through multiple competitive local exchange providers, wireless service, and VoIP and satellite providers were still the stuff of science fiction. Now, in 2004, when the baby-boomer's children and grandchildren are coming of age, this Commission must consider what distinctions are reasonable and, therefore, permissible in light of the dynamic state of competition for telecommunications customers today.

3. CSAs Reasonably Respond to Changes In The Competitive Landscape.

Not only have extraordinary changes occurred in the competitive telecommunications market over the last several generations, but the concepts of discrimination relative to rates provided by carriers also have evolved. As the federal appellate court for the D.C. Circuit noted:

> Discrimination has never been a static concept, but instead has steadily evolved over the past century to reflect not only refinements in ratemaking methodology, but changes in the national economy as well.

Sea-Land Service, Inc. v. Interstate Commerce Comm., 738 F.2d 1311, 1319 (D.C. Cir. 1984). As the D.C. Circuit noted therein, even with respect to general common carrier duties of non-discrimination, "current law no longer considers contract rates to be per se violations" of that duty. 738 F.2d at 1316. The Court went on to explain:

> The core concern in the non-discrimination area has been to maintain equality of pricing for shipments subject to substantially similar costs and competitive conditions, while permitting carriers to introduce differential pricing where dissimilarities in those key variables exist. . . . In recent decades, for example, the Commission has approved non-contract discount rates on guaranteed annual volume shipments in various areas, on grounds of reduced costs and the need to meet intermodal competition. . . . Because shippers meeting these volume requirements are not

similarly situated with other shippers tendering lower volumes of traffic, no discrimination results from differential pricing in these circumstances.

738 F.2d at 1317 [citation omitted].

Both competition and technology are developing rapidly in the telecommunications market. With those developments, the concepts of what constitutes reasonable or unreasonable discrimination also are developing. For example, commercial mobile radio service providers ("CMRS"), though still subject to Title II of the Communications Act, 47 U.S.C. § 332(c)(1)(A), do not violate their Section 201 requirements (that charges, practices, classifications, and regulations be "just and reasonable") or Section 202 requirements (not to engage in unjust or unreasonable discrimination) by negotiating discounts with individual customers.[8] The U.S. Court of Appeals for the D.C. Circuit very recently rejected claims that negotiated "sales concessions" by Verizon Wireless were a violation of Verizon's common carriers duties of non-discrimination. *Orloff v. FCC*, 2003 U.S. App. LEXIS 26163 (12-23-2003). Even prior to passage of the 1996 Telecommunications Act, the FCC said:

> Success in the marketplace thus should be driven by technological innovation, service quality, competition-based pricing decisions and responsiveness to consumer needs – and not by strategies in the regulatory arena.

In re. implementation of Sections 3(n) and 332 of the Communications Act, regulatory treatment of mobile services. Second Report and Order, 9 FCC Rcd 1411, 1420 ("CMRS Second Report and Order").

The fact that competition exists in Kentucky in the local market for telephone service is, at this juncture, clear beyond any reasonable contradiction. On September

[8] The FCC has exempted CMRS providers from Section 203 tariff requirements.

18, 2002, the Federal Communications Commission approved BellSouth's application for inter-region interLATA services authority in Kentucky, and stated that "we find that barriers to competitive entry in the local exchange markets have been removed and the local exchange markets in each state today are open to competition." *In the Matter of Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc., And BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services in Alabama, Kentucky, Mississippi, North Carolina, and South Carolina*, WC Docket No. 02-150, *Memorandum Opinion and Order*, 17 FCC Rcd 17595 (2002) at para. 276. Further, at the time that BellSouth submitted its 271 case to this Commission, in March of 2002, CLECs had 7.3% of the total access lines in Kentucky. By April of 2003, the percentage of total access lines served by CLECs had grown to 13%, an increase of almost 100% in slightly more than a year (Ruscilli Direct, p. 3). As Mr. Ruscilli testified, "CLECs have acquired over 175,000 access lines in Kentucky, approximately 85,000 of which are business lines." (Ruscilli Direct, p. 4). Further, "it is the customers in the competitive business market that are the recipients of CSAs and are the most vulnerable to competitive offers." (*Id.*).

In reference to the small business market, BellSouth witness, Samuel Massey, provided testimony that BellSouth's overall share of local access lines has declined from 92.3% at the end of 1999, to 81.4% in February of 2003, a decline of 10.9%. (Massey Direct, p. 2-3).[9] BellSouth continues to lose between .1% and .3% additional market share <u>each and every month</u>. (*Id.*). Finally, BellSouth witness, Michael S. Hayden, testified, based on his personal experience in the Kentucky market, that the "number of

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[9] Mr. Massey's testimony was adopted by BellSouth witness, John Ruscilli.

competitors in the Kentucky telecommunications business market has grown exponentially" (Hayden Direct, p. 4). Further, "there are approximately 90 active Competitive Local Exchange Carriers ("CLECs") serving the telecommunications needs of Kentucky businesses and residences. (*Id.*)

4. CLECs And ILECs Should Play By The Same Rules.

Although a number of CLECs filed Comments to, in effect, request that they be given preferential treatment in the requirements that relate to CSAs, no one filed testimony that contained a substantive complaint about any ILECs' use of CSAs. BellSouth's witness, Jack Hullings, testified at length as to the process by which BellSouth develops and offers CSAs. No witness claimed that there is anything improper about any of BellSouth's practices. Further, no witness testified that CSAs are being misused in any way by BellSouth, or by any other ILEC. Given the fact that testimony was filed by one CLEC, and Comments were filed by a total of eight other CLECs that compete with ILECs to serve customers, one can be sure that if there were any facts to support a legitimate complaint, one of these parties would have filed testimony to place this evidence before the Commission. Instead, the evidence in this case supports only one conclusion, that there currently is no improper usage of CSAs by carriers.

Fairness requires that CSAs should continue to be available to ILECs and to CLECs on comparable terms. Because competition exists, the use of CSAs not only is appropriate, it is the only way to foster competition and to allow customers to reap the full benefits of competition. Despite the substantial inroads into the local market that CLECs have made in a very short time, the only CLEC witness that testified--Edward H.

Hancock, on behalf of the Frankfort Plant Board--contended that competition is not established in Kentucky at this time. The only actual information cited by Mr. Hancock, however, was a December 2002 FCC Report, that, according to his testimony, indicates that there is no competition to provide telephone service in 79% of the zip codes in the state of Kentucky. (Hancock Supplemental Testimony, p. 2). Mr. Hancock's testimony, however, really establishes the precise opposite of the point that he asserts. In other words, Mr. Hancock claims that there is no real competition in Kentucky, but cites to a report that purports to show that competitive alternatives currently exist in 21% of the state. Even if Mr. Hancock's numbers were accurate and up to date, a claim with which BellSouth strongly disagrees and which is contradicted by the voluminous information BellSouth has filed regarding the significant and increasingly competitive state of the Kentucky telecommunications market, wherever competition exists customers would be denied the full benefits of this competition if CSAs were not allowed or were restricted.

Further, Mr. Hancock's testimony on this issue appears to fundamentally miss the point of CSAs. As Mr. Ruscilli testified, "Mr. Hancock's assessment of the extent of competition in Kentucky is not important to the issues before the Commission in this proceeding, because CSAs are used only in competitive situations. If competition is as limited as Mr. Hancock believes, CSAs will only be used where there is competition. They are not relevant in other situations." (Ruscilli Rebuttal, pp. 3-4). In other words, although there is some disagreement among the parties as to how to determine when competition exists, all agree that the use of CSAs is appropriate only if there is competition. Thus, regardless of how many competitive alternatives exist or where, CSAs <u>should</u> be available to serve customers in the locations where competition <u>does</u>

exist.[10] Whether competition exists in 10%, 20%, 50% or 100% of the state, the real point is that CSAs should be available wherever there is competition to provide local service so that the benefits of this competition can be passed on to customers.

Moreover, there is no question that CSAs promote competition by allowing all carriers to compete to serve customers. As Mr. Ruscilli noted, the ILECs have the "responsibility to respond to all reasonable requests for service within their operating territory, while CLECs have no such responsibility." (Ruscilli Direct, p. 15). This means that ILECs, unlike CLECs, must provide service even in high cost areas, and even when a customer orders services that do not generate sufficient revenue to cover the cost of service. However, since the CLECs have no responsibility to serve less profitable customers, one can reasonably assume CLECs focus on the more profitable customers, i.e., business customers, in developing their business plans. As a result, significant development of competition to date has occurred in business service. If CSAs were not available, and incumbents were only able to offer service at tariffed rates, ILECs would be unable to compete and CLECs then would capture all of the more lucrative business market by offering services slightly below the tariffed rates of the incumbents. Competition, and ultimately end users, suffer when larger competitors are not permitted to vigorously compete. As the U.S. Court of Appeals recognized: "It is in the interest of competition to permit dominant firms to engage in vigorous competition, including price

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[10] Contrary to Mr. Hancock's testimony, however, BellSouth has submitted documentation that there are no less than **six active CLECs in EVERY wirecenter** in which BellSouth operates, and as many as **40** in **13 wirecenters**. Clearly, Mr. Hancock's references to the incomplete data in the FCC reports are not substantive support for his arguments. Letter from Joan Coleman to Thomas M. Dorman and Exhibit 5, *In the Matter of: The Review of BellSouth Telecommunications, Inc.'s, Price Regulation Plan,* Case No. 99-434, August 1, 2003, at 9.

competition". *Arthur S. Langenderfer, Inc. v. S.E. Johnson Co.*, 729 F.2d 1050, 1057 (6th Cir. 1984), *cert. denied* 469 U.S. 1036 (1984).

Mr. Ruscilli explained the necessity of CSAs in a competitive environment as follows:

> BellSouth needs . . . [CSAs] . . . because the rates contained in tariffs were developed based on average costs (statewide average total service long run incremental cost, or "TSLRIC") and average pricing. However, tariff rates often render BellSouth unable to compete in the highly competitive telecommunications market that exists in Kentucky. This occurs because CLECs typically do not offer average pricing in their CSAs. CLECs target customers that produce large revenues in lower cost areas and, as would be expected, CLECs have different cost structures from incumbent local exchange carriers ("ILECs").

(Ruscilli Direct, pp. 4-5).

Further, as Mr. Hullings explained in his testimony,

> If BellSouth did not have the flexibility to offer CSAs, BellSouth would not be able to compete effectively for most customers that had competitive options. Competitors would know this, and would be less inclined to offer prices to customers significantly below those published in BellSouth's general tariffs because competitors would be shielded from any meaningful competition from BellSouth. Consumers in Kentucky would be deprived of the robust competition (leading to lower prices and enhanced service) that would otherwise be available to them.

(Hullings Direct, pp. 9-10).

In other words, competition <u>should</u> function so that all service providers truly compete to provide service to customers by offering the best possible combination of service and price. If ILECs are not allowed to respond to competitive offers that slightly undercut tariffed rates by making even better offers, then customers will pay higher prices than they would if all carriers were allowed to compete fully.

5. <u>The ILECs Joint Proposal Should Be Adopted</u>.

All parties appear to agree, at least in concept, that CSAs should be allowed. The parties differ on three key issues: (1) to whom CSA restrictions should apply; (2) when CSAs should be allowed; and (3) the filing requirements for CSAs. The proposals of the ILECs on each of these points is set forth in the ILECs' Joint Proposal.

Under this Joint Proposal, "the standards apply to all telecommunications companies operating in Kentucky and therefore do not advantage or disadvantage one company or type of telecommunications provider over another." (Ruscilli Supplemental, p. 2). Further, as Mr. Ruscilli also explained, the Joint Proposal accomplishes the following:

> [T]he proposed standards define the circumstances under which a company may use CSAs in order to meet competition or to account for other unique circumstances. Further, the proposed standards streamline the CSA process and eliminate automatic filing requirements, yet retain the ability of the Commission or Staff to review copies of the signed contracts and supporting cost information upon request. Finally and importantly, the proposed standards preserve the privacy expectations of customers by redacting the customer name and address on any contract that is requested to be filed for the public record.

(*Id.*).

Mr. Ruscilli also testified that the Joint Proposal is consistent with the CSA standards that are increasingly being adopted throughout the states in BellSouth's region. "Clearly, the trend is toward reducing the administrative requirements for filing CSAs

and not toward making the filing requirements more burdensome." (Ruscilli Supplemental, p. 4).[11]

As stated above, the Joint Proposal would be applicable to all carriers. The Proposal also includes three controlling principles: 1) that companies may enter into contracts to meet competition or in other unique circumstances; 2) that there would be no filing requirements for the contracts or supporting information; and (3) the CSA information would, however, be available on request by the Commission or its Staff. In the event that the Commission or Staff requests the filing, the carrier would be allowed to redact customer names so that they would not appear in the public record.

Finally, the proposal lists five specific examples of when CSAs would be allowed. First, a CSA would be allowed when a customer either has a specific offer from a competitor or, because of the general knowledge of competition in the area, it is reasonable to believe that a customer has an offer from a competitor. Second, a CSA would be allowed when competitive offers have been made in an area or market segment via media or other form of communication. The third through fifth examples in the Proposal all represent situations in which a company would give customer discounts based on the volume of services ordered, the term of service, total volume of services purchased, or to encourage the customer to purchase integrated services packages or bundles.

[11] The Kentucky Commission's reduction of filing requirements for contract service arrangements for BellSouth, in the Order of September 28, 2001 in Case No. 2001-007 is in line with this general trend. The Commission's Order was issued in response to a Motion by BellSouth requesting that it be allowed to file a quarterly Summary Report of all Contract Service Arrangements (CSA), rather than filing each CSA with the Commission. This request was granted with the modification that the Summary Report would be filed on a monthly basis, within 10 days of the end of the respective month (Order, p. 3).

Although it filed no testimony in this proceeding, AT&T filed on October 16, 2003 a Response in opposition to the Joint Proposal. In its Response, AT&T criticized as "overbroad" the five examples of when CSAs could be offered. AT&T did not, however, propose any alternative criteria. Also, AT&T provided no specific responses to the criteria listed by the ILECs, or any specific reasons that it objects to this criteria. Thus, it is clear that AT&T disagrees with the Proposal, but AT&T has offered no specific basis for the disagreement (other than the general allegation of overbreadth) and has proposed no alternative.

The Frankfort Plant Board responded with its own version of the Joint Proposal.[12] The Frankfort Plant Board proposal provides that an incumbent would only be allowed to use CSAs to respond to a "written or verbal" offer from a competitive carrier, or in response to a formal Request For Proposal. Much of the opposition of the Board's witness, Mr. Hancock, to the Joint Proposal appears to be premised upon an extremely narrow, and somewhat unrealistic, definition of competition. Mr. Hancock stated "CSAs should only be offered in response to <u>actual</u> competitive situations, and not be offered in anticipation of a competitive situation." (Hancock Direct, p. 2) [Emphasis added.] Considering this contention in light of the counter proposal of the Frankfort Plant Board, it would appear that Mr. Hancock takes the view that actual competition does not exist unless a competitor of the ILEC has made a formal written or verbal offer.

On the contrary, a competitive situation exists whenever there is competition between two or more carriers to provide services to a customer, or group of customers, even if neither of the carriers has yet made a specific offer to a specific customer. Mr.

[12] However, in this case, the term "Joint Proposal" is something of a misnomer since the Frankfort Plant Board is the only party advocating these standards.

Ruscilli testified as to some of the many situations in which competition exists, but in which no written offer has yet been made. Specifically, Mr. Ruscilli testified that a customer may become aware of a competitor's service by "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, pp. 6-7). Obviously, in this situation, competition exists, even though the customer has not actually received a specific written or verbal offer.

When competition exists, all competitors should be allowed to compete without restrictions that favor one competitor over another. The restrictions proposed by the Frankfort Plant Board violate this fundamental principal. A requirement of a specific offer would prevent the ILEC from competing for customers' business. As Mr. Ruscilli stated, "once a customer receives a written offer, it is often too late to compete for the customer's business. Establishing such a parameter may simply foreclose the possibility that another carrier could compete for that business using a CSA." (Ruscilli Rebuttal, p. 7).

Further, it is obvious that the Frankfort Plant Board's proposed requirement would only work to prevent ILECs from competing for customers. Although the Board has retained in its alternative proposal the statement from the Joint Proposal that "the standards apply to ILECs, CLECs and IXCs," the Frankfort Plant Board has directly contradicted this general statement by making this requirement of a specific offer applicable only to incumbents. A CLEC, on the other hand, would be free to utilize precisely the same type of competitive pricing that would constitute a CSA, apparently

without any restriction whatsoever. This type of asymmetrical regulation would create an unfair advantage to CLECs to the detriment of both incumbents and end users.

The ILEC Joint Proposal proposes no filing of CSAs unless the Commission or Staff, either in response to a complaint or otherwise, requested CSA information. In response to this, AT&T filed Comments in which it advocated the requirement that CSAs filing contain specific customer information. AT&T's proposed filing requirement should be rejected because it creates serious problems. First, CLECs would be able to utilize the CSAs on file with the Commission as a sort of "shopping list." In other words, CLECs would be able to determine precisely the identity of the customers served by the ILECs' CSAs, as well as the terms and conditions and prices of those offerings. (Tr. 82). This information would obviously provide the CLEC with everything it needs to frame a competitive offer to the customer. In other words, this filing requirement would give the CLECs an unfair competitive advantage.

AT&T, of course, has taken the position that it files this information and that others should do so as well. However, the seven CLECs that refer to themselves as the Joint Respondents are adamant in their position that the CSA filing requirements do not (and should not) apply to CLECs in any way. And, as admitted in their responses, many CLECs are not filing CSAs today. Thus, any requirement to file customer specific information would (at least if these CLECs prevail) have a disproportionately negative effect on ILECs.

Moreover, as Mr. Ruscilli also testified (Tr. 82), it may prove more difficult to sign customers to CSAs if these customers know that doing so will result in information about their service being made public. Again, if this requirement applies only to ILECs,

as some CLECs advocate, this would be one more way in which this filing requirement would disadvantage ILECs.

AT&T claimed if CSAs are not filed with the Commission, the Commission will be unable to investigate matters that should be investigated, because these matters would be raised only by complaint, and "competitor[s] could rarely complain about an incumbent's CSA if the incumbent keeps the contract itself a secret." (AT&T Response, p. 2). Apparently, AT&T would have the Commission believe that it and other CLECs would not utilize the filing of customer specific information as a "shopping list" to target customers, but that they would comb through these filings to find particular CSA problems that should be brought to the Commission's attention via complaint. In fact, if AT&T or some other carrier were inclined to scrutinize incumbent's CSA offerings then they could obtain contracts for this purpose from the customers. Mr. Ruscilli testified that in the context of framing competitive offerings to customers, it is not uncommon for a carrier to ask a customer to disclose what they receive from another carrier. (Tr. 83). Clearly, CLECs have the means of determining the content of CSAs between ILECs and customers. However, if the information is obtained from the customer itself, then this obviously avoids a situation in which the customer information is publicly disclosed without that customer's consent. (*Id.*). Furthermore, customers have numerous sources of information, and do not need to rely on CSA filings at the Commission to determine competitive offers. A few of those sources are: RFPs, information on carriers' web sites, online reverse auctions, and, of course, direct contacts and negotiations with carriers. *See,* Hayden Supp. Dir., pp. 1-4.

The Frankfort Plant Board also advocated in its alternative proposal the filing of redacted copies of the CSA, in other words, the filing of the CSA, but not the customer-specific information. While BellSouth agrees that the CSA customer's name and address should not be made public, BellSouth does not agree that the CSA should be filed with the Commission. (Ruscilli Rebuttal Testimony, p. 9). As stated previously, the current standards require only the filing of a monthly summary report of all CSAs. Moreover, the trend throughout the various state Commissions in BellSouth's region is to have reduced CSA filing requirements.[13] As Mr. Ruscilli testified, in some states, BellSouth is not only <u>not</u> required to file individual CSAs, it is not even required to file periodic reports. Further, these significantly reduced requirements have been implemented without any negative impact to customers or other carriers. (Ruscilli Rebuttal, p. 9). There simply is no reason to return to the more burdensome filing process advocated by the Frankfort Plant Board.

Finally, any decisions that result from this proceeding should be applicable to all telecommunications carriers that operate in the state of Kentucky. As Mr. Ruscilli testified, "because all telecommunications markets are open to competition in Kentucky, it is not appropriate to establish a set of rules for ILECs and a separate set of rules for other carriers for retail operations." (Ruscilli Direct, p. 15). The CLECs that argue to the contrary have stated that this proceeding was instituted as a result of a prior case involving BellSouth. (*See* Comments of Joint Respondents, p. 7). However, when AT&T stated a similar belief to justify not turning over information to the Commission,

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[13] *See* BellSouth's Responses to the Commission's First Data Requests dated December 19, 2002, and January 28, 2003, Item 2, Attachment. *In re: Elimination of certain reporting requirements for incumbent local exchange telecommunications companies,* Docket No. 010634-TL, Before the Florida Public Service Commission, Order No. PSC-01-1588-PAA-TL, July 31, 2001, at 8.

the Commission clarified that "the purpose of this proceeding is to investigate all service arrangements provided by Kentucky carriers at other than tariffed rates." (January 28, 2002, Order, p. 2). Although there were a couple of allegations in the past against ILECs[14], no one has filed any facts, in testimony or otherwise in this proceeding, to advance allegations of this sort. As stated previously, there is absolutely no testimony submitted by any party, CLEC or otherwise, to suggest that ILECs are currently misusing CSAs or that, as a result, ILECs should be more restricted in their use of CSAs than CLECs.

Further, if ILECs' use of CSAs were to be restricted while such restrictions would not apply to CLECS, CLECs would be unfairly benefited to the detriment of ILECs. And, more importantly, end users would be harmed. Ultimately, competition benefits end users. To accomplish this goal, competition should be permitted so that all carriers can compete on an equal footing, and so win customers by providing the best service at the best price. Any approach that impedes the incumbents' ability to compete has a negative impact on competition and ultimately is contrary to the public interest.

6. Filed Rate Doctrine Is Not Inconsistent With CSAs To Respond to Competition.

The filed rate doctrine does not conflict with the allowance of CSAs to respond to competition.[15] As the U.S. Court of Appeals for the D.C. Circuit has held:

> . . . if the [individual service] package is made available to any customer who wants it upon the same terms, [**17] then there is no unlawful discrimination. *See, Sea-Land Service, Inc. v. ICC,* 238 U.S. App. D.C.

[14] Out of all the CSAs that BellSouth has filed over the last several years, a total of only two complaints regarding specific BellSouth CSAs have been filed, and both of those cases have been heard and resolved.

[15] Kentucky applies the filed rate doctrine. KRS 278.160. *Commonwealth ex. rel. Chandler v. Anthem Insurance Companies, Inc.*, 8 S.W.3d 48 (Ky. App. 1999) (filed rate doctrine bars civil damages); *see also, Southwestern Bell Telephone Co. v. Metro-Link Telecom, Inc.*, 919 S.W.2d 687 (Tex. App. 1996) (filed rate doctrine prevents claim of breach of contract and antitrust claims).

> 165, 738 F.2d 1311, 1317 (D.C. Cir. 1984) ("Although one normally regards contract relationships as highly individualized, contract rates can still be accommodated to the principle of nondiscrimination by requiring a carrier offering such rates to make them available to any [customer] willing and able to meet the [*1604] contract's terms"). But that is neither surprising nor contrary to the statutory scheme. Section 202(a) is designed to prevent a carrier from granting a discount to one (usually large) user that it would not grant were the same or a "like" service purchased by another (usually small) customer. By its nature, § 202(a) is not concerned with the price differentials between qualitatively different services or service packages. In other words, so far as "unreasonable discrimination" is concerned, an apple does not have to be priced the same as an orange.

The Competitive Telecommunications Assoc. v. F.C.C., 998 F.2d 1058, 1063-1064 (2d Cir. 1993).

There is ample authority and justification to allow CSAs as a competitive tool, and CSAs are authorized to respond to specific needs.[16] This Commission further has statutory authority, should it believe it necessary to so find that an exemption exists. *See* KRS 278.512. Competitive necessity has long been used by the FCC in weighing whether price differences may be justified when carriers seek to apply particular rates in particular situations or for particular customers or groups of customers.[17] The FCC has repeatedly ruled that carriers may respond to specific competitive threats with rates or offerings designed to meet those threats. Moreover, the competitive necessity doctrine has been widely applied in similar situations by other agencies to allow regulated

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[16] 807 KAR 5:011, Section 13.

[17] *See inter alia, American Telephone & Telegraph Co. Charges, Regulations, Classifications, and Practices for Voice Grade/Private Line Service (High Density—Low Density) Filed with Transmittal No. 11891,* Interim Decision and Memorandum Opinion and Order, Docket No. 19919, 55 F.C.C. 2d 224 (1975); and *in the matter of American Telephone and Telegraph Co., Revisions of Tariff FCC No. 260 private Line Services, Series 5000 (Telpak)*, Memorandum Opinion and Order, Docket No. 18128, 61 F.C.C. 2d 587 (1976).

companies to meet specific competitive threats with offerings targeted to win back or retain customers. In addition, promotional offerings have been endorsed as competitively desirable and even exempted from general costing rules.[18] Promotions that are commensurate with the threat that ILECs face from rival carriers are an example of offerings to targeted groups of customers that are justified under the competitive necessity doctrine.

Even outside the competitive world of telecommunications, where there is the opportunity for bypass, a reasonable basis has been found to charge different rates and that such different rates are not impermissibly discriminatory. See, for example, *Bryant v. Ark PSC,* 57 Ark. App., 73, 941 S.W.2d 452 (1997) (Court upheld "corridor rates" as not unreasonably discriminatory when the rates were designed to reflect the cost of servicing customers for whom bypass is economically and operationally feasible.); *Office of Utility Consumer Counselor v. Board of Directors for Utilities of Department of Public Utilities of the City of Indianapolis*, 678 N.E.2d 1127 (Ind. App. 1997) (Court upheld gas transportation agreement as not violating state statute that utility rates be nondiscriminatory; "bright-line" application of statute is untenable as there are reasonable differences for customers who have other alternatives for energy).

In essence, customers who have competitive alternatives are not similarly situated to customers who do not have the same competitive alternatives. Offering contract arrangements to respond to such competitive situations is consistent with the filed rate doctrine.

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[18] *See Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, Order and Notice of Proposed Rulemaking, 8 FCC Rcd at 3717 (1993).

7. ILECs Use Of Term Contracts And Termination Penalties Do Not Hinder Competition.

At the conclusion of the hearing, Chairman Heulsman also requested that the parties address in their Briefs the question of whether termination penalties in contracts and the length of contracts could be impediments to competition. BellSouth submits that neither termination penalties nor lengthy contracts are impediments to competition. Rather, termination penalties and term provisions are necessary features of contracts. These types of provisions commonly are utilized by both ILECs and CLECs.

Term contracts and termination penalties are common in both the telecommunications market and in the general business market.[19] Both contract provisions represent competitive tools used throughout the industry to provide pricing favorable to customers. When termination penalties and term provisions are part of a CSA, those features are not anticompetitive, but rather are part of a competitive response driven by the market. BellSouth believes that all providers should be allowed to use these tools in the CSA process to address competition and respond to customer needs.

Significant note needs to be made of the fact that CSAs entered into by BellSouth with an end user are available for resale at the resale discount. As testified during the hearing by both Mr. Hullings (Tr. 109-110) and Mr. Hayden (Tr. 153-154), when a customer agrees to a long term contract in exchange for a discount, a CLEC can subsequently persuade that customer to purchase service from the CLEC. The CLEC then can provide the service by the resale of the CSA in place. As Mr. Hullings

[19] For instance, it is not uncommon in most offices to lease a copier for a specified term and price which includes termination penalties.

and Mr. Hayden testified, where the CLEC is reselling the CSA, there is no termination liability under the CSA. (*Id.*). If a CLEC has signed a customer to a long term contract, ILECs would, of course, not have the same resale option. Thus, again, BellSouth emphasizes that there is nothing wrong with the use of longer contract terms and termination penalties, and no reason for the Commission to be concerned about these particular contract elements. However, if there were any reason for concern, in the case of BellSouth, those concerns are vitiated by the fact that BellSouth's CSAs are available for resale without any termination liability.

When entering into a CSA, customers have numerous choices of providers and types of contracts. The term of the contract is determined by customer requirements, competitive bids and/or market conditions. Customers have the ability through BellSouth's tariffs and letters of election to select the terms that best meet their needs. Customers can choose contract terms that vary from as short as month-to-month service to a service term that is several years in length. Customers generally receive the benefit of lower prices when they select longer contract terms, and many customers choose longer terms for this reason. In fact, such longer term contracts most often are the result of customers' requests for proposal specifying the length of the contract term they require bidders to offer, such as the Kentucky State Government RFP discussed by Mr. Hayden. *See* Tr. 165-166.

The termination penalties in BellSouth's CSAs are based on the terms in BellSouth's tariffs. These terms are modified at times, through the CSA process, based upon the requirements of the particular bid or competitive conditions, which are driven by the marketplace. Under a typical arrangement, the customer commits to purchase

service for an agreed upon period of time (whether month-to-month or several years), and the provider renders services at a price more favorable than would be otherwise available in consideration for the customer commitment to this longer term. This is a fair exchange that both parties enter into freely. When a customer commits to a longer contract in this manner, but then terminates the contract before its term has ended, termination liabilities are in place to recover for the discounted rate that was offered to the customer. Because the customer is given a larger discount in exchange for contracting for a longer term, it is only fair that the customer's discount should be adjusted if the customer later decides to purchase services for a shorter time period.

Moreover, in some instances, the use of termination liability may be necessary to prevent the sale of services below cost. For example, in some situations, the installation cost of equipment that is part of the service may result in a higher cost being incurred by the provider at the beginning of the contract term. The higher cost may be spread out over the agreed-upon length of the contract. In other words, the customer pays for what would otherwise be up-front costs over the agreed upon life of the contract. If the customer were to terminate the contract prematurely and there were no termination liabilities, in some cases, the up-front costs incurred on behalf of the customer would not be recovered. In other words, without termination liabilities, a customer potentially could receive service below the cost to the carrier to provide the service.

During the hearing, Mr. Hancock, on behalf of Frankfort Plant Board, indirectly addressed the question of contract length when he contended that CSAs could be misused to "lock up" customers by signing large business customers to long term CSAs.

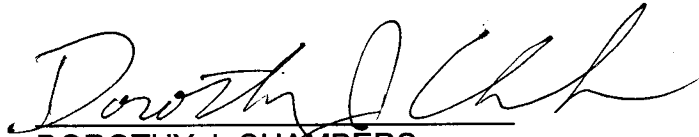
This contention, however, is at odds with what is actually taking place in the competitive market place. Specifically, as Mr. Ruscilli testified, even with the use of CSAs, "BellSouth is only successful in **25%** of the cases where it attempts to compete with a CSA offer." (Ruscilli Rebuttal, p. 5). [Emphasis added.] Thus, the notion that CSAs have somehow been utilized by the ILECs to lock out competitors is completely at odds with reality. Additionally, as previously mentioned, a CLEC can resell a BellSouth CSA without the end user incurring any early termination charges by BellSouth.

It is important to note that the use of longer contracts in exchange for discounted prices, and the inclusion of termination penalties, are standard in business, and, more specifically, are standard practices utilized by both ILECs and CLECs. Finally, as noted above, there cannot be any reasonable claim of competitive harm resulting from term contracts and termination liability where CLECs are permitted to resell those contracts at a discount and without the customer incurring liability. For the reasons stated above, BellSouth does not believe these practices are anticompetitive.

CONCLUSION

Pursuant to applicable law and based on the factual record, the Commission should conclude that CSAs promote competition and are beneficial to telecommunications end users. ILECs and CLECs should both be permitted to respond to competition with CSAs; administrative oversight of CSAs should be minimized through adoption of the Joint ILEC Proposal for CSAs.

Respectfully submitted this 21st day of January, 2004.



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