BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs and For an Investigation Of BellSouth's Promotional Pricing And Marketing Practices by Florida Digital Network, Inc.	Docket No. 020119-TP
In Re: Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs by the Florida Competitive Carrier's Association	Docket No. 020578-TP

DIRECT TESTIMONY OF
MICHAEL P. GALLAGHER

FILED ON BEHALF OF

FLORIDA DIGITAL NETWORK, INC.

DOCUMENT NUMBER-DATE
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1 **Q. Please state your name and address.**

2 A. My name is Michael P. Gallagher. My business address is 390 North

3 Orange Avenue, Suite 2000, Orlando, Florida, 32801.

4 **Q. Who do you work for?**

5 A. I am Chief Executive Officer of Florida Digital Network, Inc. ("FDN").

6 **Q. What are your responsibilities as CEO of FDN?**

7 A. As CEO of FDN, I am ultimately responsible to the shareholders for all

8 aspects of FDN's operations and performance. On a management level,

9 FDN's President & Chief Operating Officer, Chief Financial Officer and

10 General Counsel report directly to me; FDN's Engineering & Operations,

11 Customer Service, and Sales Vice Presidents report to the President & COO,

12 who is also in charge of FDN's Marketing and IS functions. I am involved in

13 the day-to-day business dealings of the company and the decision-making on

14 everything from marketing and sales strategies, product development,

15 network architecture and deployment, financing, human resources, customer

16 care, regulatory changes, etc.

17 **Q. Please describe your education and your work experience in the**

18 **telecommunications sector.**

19 A. I received a B.S. Degree in Mathematics with a minor in Physics from

20 Rollins College.

21 Prior to co-founding FDN in 1998, I served as Regional Vice

22 President for Brooks Fiber Communications where I had overall

23 responsibility for operations, engineering, finance and sales in the State of

1 Texas. Brooks Fiber Communications merged into WorldCom on January
2 31, 1998. Prior to holding the VP position at Brooks, I was president of
3 Metro Access Networks (MAN), a second-generation CLEC in Texas
4 founded in 1993. At MAN, I developed all business strategies, designed
5 network architecture, secured contracts with the company's original customer
6 base, and had overall responsibility for operations and performance. MAN
7 merged into Brooks Fiber in March 1997. Prior to MAN, I worked for
8 Intermedia Communications and Williams Telecommunications Group
9 (WilTel) as sales representative securing contracts with large commercial
10 customers.

11 **Q. Have you previously testified in a regulatory proceeding before a**
12 **state utility commission, the FCC or a hearing officer?**

13 A. Yes. I have testified before this Commission in Docket No. 010098-TP
14 (FDN's Arbitration case with BellSouth) and in Docket No. 990649A-TP (the
15 120-day portion of BellSouth's UNE cost case).

16 **Q. What is the purpose of your testimony in this proceeding?**

17 A. I will address FDN's concerns with BellSouth discount price programs
18 generally and BellSouth's Key Customer programs in particular.

19 **Q. Please briefly describe FDN's operations.**

20 A. FDN is a facilities-based Florida CLEC. FDN is also an IXC, a data
21 services provider (both dial-up and dedicated), and, through an affiliate, FDN

1 offers ISP and other Internet services. FDN was founded in 1998 with the
2 mission of offering packaged services (local, long distance and Internet) to
3 small- and medium-sized businesses. FDN launched operations in Orlando in
4 April 1999 and expanded to Fort Lauderdale in May 1999 and to Jacksonville
5 in June 1999. A second round of expansion in West Palm Beach, Miami and
6 the Tampa Bay area was completed in the first quarter of 2000.

7 FDN owns and operates Class 5 Nortel DMS-500 central office
8 switches in Orlando, Tampa, Jacksonville, and Ft. Lauderdale. FDN's
9 switches are connected by fiber optic cable owned or leased by FDN to
10 nearby incumbent local exchange carrier (or "ILEC") tandem switches. FDN
11 leases collocation cages or has virtual collocation space in over 100 ILEC
12 wire centers. Remote switching equipment is installed at these collocation
13 sites and from these sites FDN accesses ILEC UNE loops. Connectivity from
14 the collocation sites to the central ILEC tandem switch is via T-1 circuits
15 leased from the ILEC. FDN relies upon its rights under the federal
16 Telecommunications Act of 1996 (the "Act") to obtain "last mile" access to
17 Florida consumers through the purchase of unbundled network elements
18 (UNEs) from ILECs such as BellSouth.

19 FDN uses BellSouth's TAG gateway for electronic ordering. Using
20 systems and software FDN developed on its own, FDN accesses BellSouth
21 customer service records ("CSRs") electronically, and FDN transmits
22 virtually all of its local service requests ("LSRs") to Bell electronically. The
23 vast majority of FDN's LSRs to BellSouth are for 2 wire voice grade UNE

1 loops. Based on information from BellSouth, FDN believes that FDN is the
2 largest procurer of UNE voice-grade loops in BellSouth territory in Florida.
3 At the time this testimony is filed, FDN does not utilize either the resale or
4 UNE-P service delivery methods in BellSouth territory.
5 **Q. Several issues in this proceeding ask what criteria, if any, should be**
6 **established to determine if a BellSouth promotional tariff offering is**
7 **unfair, anticompetitive or discriminatory. What factors do you think the**
8 **Commission should consider?**
9 A. First, I think the Commission cannot lose sight of the dominant market
10 power that BellSouth currently has in Florida. In other words, the
11 Commission cannot ignore the fact that BellSouth still effectively enjoys
12 monopoly status in its incumbent territory. Though the exact percentage of
13 ALEC market share in BellSouth territory was the subject of significant
14 debate in BellSouth's 271 case (Docket No. 960786-TP) and the Commission
15 did not make any specific findings as to ALEC market share, I do not believe
16 anyone can seriously dispute that BellSouth is by far the dominant provider
17 for voice services in its incumbent territory and has commanding market
18 share. Nor do I think it can be disputed that BellSouth has substantial market
19 power by virtue of its market share and its position in the market.
20 As a general proposition, the Commission should never permit a
21 dominant market provider like BellSouth to use its market power to dictate
22 market products or prices to the detriment of competitors and consumers,
23 particularly when competition is still in a vulnerable infancy, as is the case

1 here in Florida. When competition for IXC services commenced on a broad
2 scale, the FCC recognized the harm that could result from letting the
3 dominant market provider, AT&T, dictate price to its lesser competitors. For
4 example, AT&T was subject to penalties when it offered special off-tariff
5 pricing only to customers receiving a competitive offer. The FCC recognized
6 that the pricing strategies of a dominant market provider may stifle
7 competition at the root level. When AT&T lost enough market share in the
8 IXC market such that AT&T was no longer a dominant carrier, AT&T was
9 permitted greater pricing flexibility. By this time an emerging and healthy
10 competitive industry was in place and customers enjoyed lower prices and
11 competitive choices.
12 Further, it is important that the Commission understand that this is an
13 extremely geographic issue. Based on its collocation footprint assumes that it
14 can serve about 60% of the states' business lines via UNE loop facilities.
15 BellSouth is leveraging the geographic weakness in FDN's and other
16 competitors' network topologies by lowering prices only in the "islands" of
17 competition, while raising or maintaining monopoly type rates elsewhere.
18 Competitors do not have the option of resale or UNE-P in these other areas
19 due to the viability and pricing inversion issues I discuss later in this
20 testimony.
21 ALECS like FDN compete with BellSouth largely on the basis of
22 price. FDN, for example, generally offers business service rates that are 20%
23 lower than BellSouth's, and a lower price to the customer is one of the

1 primary selling points that attract small and medium sized business to FDN's
2 service. In a healthy competitive environment, competitors should be able to
3 respond to one another's prices. However, for the telecommunications
4 market in BellSouth's incumbent territory in Florida, ALECs could not
5 survive were they to adjust prices to levels lower than BellSouth's Key
6 Customer rates. ALECs do not have market power in BellSouth territory,
7 and an ALECs' ability to counter a BellSouth price discount is extremely
8 limited if not impossible (depending on the level of those discounts),
9 particularly under present circumstances.
10 With regard to BellSouth's market power, the Commission must also
11 understand the impact of a small ALEC's losing customers versus
12 BellSouth's losing customers. If BellSouth loses a 100 line customer, that
13 loss does not have a meaningful impact on BellSouth because that customer
14 represents an extremely small portion of its total business and, assuming the
15 departing customer ports from BellSouth to an ALEC, BellSouth is likely to
16 gain revenue from wholesale services the ALEC requires to serve that
17 customer. By contrast, when a small ALEC loses a 100-line customer, it has
18 a tremendous impact on the ALEC's bottom line. One customer can
19 represent a significant portion of the ALEC's business. Once the customer is
20 lost, retail revenue from that customer is lost and that revenue is not replaced
21 with any wholesale revenue.
22 From a business model approach, there are other practical matters the
23 Commission must put into perspective. An ALEC like FDN must pay

1 BellSouth an installation fee of well over 3 times the monthly charge just to
2 move the customer from BellSouth to ALEC services. Plus the ALEC must
3 incur its own customer acquisition costs. The ALEC must then pay a
4 continuing monthly fee to BellSouth to provide services over BellSouth
5 facilities. Upon completing a customer conversion, an ALEC has reduced the
6 consumer's telecommunication costs and increased BellSouth wholesale
7 revenues. However, if after the ALEC acquires a customer, BellSouth via the
8 2002 Key Customer Program descends upon the customer and offers a steep
9 40% discount from BellSouth's original rates, BellSouth may entice the
10 customer to rejoin BellSouth. If BellSouth is successful, the ALEC has now
11 lost a customer for which costs have been incurred (costs largely not
12 recovered), causing significant financial harm to the ALEC. But the pain and
13 irony continue in that BellSouth will bill the ALEC a fee equal to 1.5 times
14 the monthly charge to disconnect the customer's service even though the
15 ALEC submitted no order for and played no part in the disconnection.
16 ALECs provide a beneficial service to Florida's consumers by
17 reducing the rates the consumers had been paying to BellSouth, and the
18 ALECs enhance BellSouth operations via nonrecurring charges and
19 continued monthly wholesale charges in the place of BellSouth's retail
20 customer charges. And yet, for this service, ALECs have been made prey to
21 BellSouth "promotions" whereby the ALEC is left without revenue or a
22 customer, and instead is left with a bill from BellSouth and significant
23 unrecovered costs.

1 So, at an ALEC specific level, the impact of BellSouth's discounts
2 can be extremely harmful when an ALEC loses existing customers.
3 Moreover, on a big-picture level, if the Commission permits BellSouth's
4 price discounts to continue unimpeded, BellSouth can use its monopoly status
5 to peg ALEC market share at whatever level it desires, when it desires, in the
6 geography it desires, and retain indefinitely its dominant status.
7 Investors are being asked to put capital at risk in competitive
8 telecommunications ventures in Florida knowing that BellSouth, with its
9 monopoly market power, can offer discounted prices at or below its smaller
10 competitors' prices and push the competitors out of the market entirely and/or
11 cause the competitor's growth to stagnate. Investors in the competitive
12 carrier space do not commit capital to resellers, but in facilities-based
13 competitors, and these investors key on growth potential. Growth potential is
14 clearly jeopardized by the promotional prices and conduct of BellSouth.
15 Further, the capital markets will be indifferent toward a small
16 telecommunications competitor which has experienced growth in the past
17 when continued growth is subjected to the unabated promotions of a
18 dominant carrier like BellSouth, when growth is not what it otherwise would
19 have been but for such promotions and if the growth has come at the expense
20 of other providers that have failed. Without real growth potential, there is no
21 doubt that capital markets will not look favorably on investment in Florida's
22 competitive telecommunications sector. BellSouth's promotions pose a
23 chilling effect on ALEC investment.

1 Additionally, without strong competitors, there will be no effective
2 competition in Florida, and Florida's consumers will never receive the
3 promised benefits of competition. A dominant provider like BellSouth will
4 be able to increase prices as soon as the competition is disabled, and the fact
5 that BellSouth has already increased prices to its captive customers
6 foreshadows what can happen for the rest. Further, it would be inherently
7 unfair and anticompetitive were BellSouth to use higher prices from captive
8 customers to cover the cost of lower prices to customers subject to
9 competition.
10 It is not FDN's position that ALECs should be forever insulated from
11 an ILEC price response. Rather, it is FDN's position that the public interest
12 demands that ALECs at least be protected from the anticompetitive conduct
13 of a provider with BellSouth's market power.
14 **Q. Aside from BellSouth's market power, what other factors should**
15 **be considered?**
16 A. The Commission must also evaluate the amount of the BellSouth
17 discounts, the availability of the discounts and the manner in which the
18 discounts are offered.
19 The maximum discounts BellSouth has offered under its Key
20 Customer tariffs, for example, amount to 40% off a normal BellSouth bill.
21 Under a Key Customer tariff, BellSouth has offered a 25% discount off total
22 billed revenue (including basic local service), plus a 100% additional
23 discount off hunting (or rotary) service, which is a $10.00 per line feature that

1 nearly every multi-line business requires. ALECs simply cannot beat
2 discounts like this without placing their futures in peril.
3 To me, it is very telling that at a conference in Miami on September
4 10, 2002, Mr. Ronald Dykes, BellSouth's CFO, claimed that Bellsouth wins
5 back two out of every three customers it loses. At rates no viable competitor
6 can beat, his assertion seems understandable. BellSouth's proprietary
7 response to FDN Interrogatory No. 15 confirms that few customer lines in the
8 Key Customer programs have left for competitors.
9 Attached hereto as Exhibit _____ (MPG-1) are spreadsheets that
10 illustrate several points I would like to make relative to the price - cost issues
11 involved in this matter. For this exhibit, FDN selected five sample customer
12 location scenarios, Miami, West Palm Beach, Port St. Lucie, Orlando and
13 Tamarac for a hypothetical customer with three business lines and hunting on
14 all three lines – fairly typical for a small business. The exhibit compares the
15 retail prices under a standard Bell tariff arrangement, a BellSouth's Key
16 Customer deal (the current June 2002 tariff), and a standard FDN offering.
17 As the exhibit shows, BellSouth's Key Customer scenario offers the customer
18 a lower monthly recurring bill in each of the five cases than the FDN
19 standard offering. On paper only, FDN may be able to beat the BellSouth
20 Key Customer price (excluding consideration for any early termination or
21 other liabilities) if FDN offered Key Customer programs through resale, but
22 resale is not a viable option and does not justify BellSouth's practices as I
23 address later in this testimony.

1 The wholesale cost information shown on this same exhibit
2 demonstrates a few other points. For purposes of illustration, I suggest that
3 the Commission's approved UNE-P rates can be used as a surrogate for a
4 portion of a facilities-based ALEC's overall network cost or, alternatively,
5 one can look at it simply from the perspective of an ALEC that uses UNE-P
6 as its means of delivering service. Since the market will demand that ALECs
7 compete with BellSouth on price such that, in the case of Key Customer
8 rates, an ALEC must offer rates at least, if not more than, 16.81% off the Key
9 Customer rates (with 16.81% representing the resale discount). Accordingly,
10 if an ALEC attempts to price at 16.81% below the Key Customer level, in the
11 case of the three line Miami location customer, that discount would generate
12 ALEC revenue of $73.77 to cover costs of $72.66. (Note that per the
13 Commission's recent decision, the CO at issue was switched from a UNE
14 Zone 1 to a Zone 2). In this and in the other examples, it should be
15 understood that the cost shown is just a portion of the ALEC's total cost; it
16 does not include other costs like ALEC overhead, cost of sales, recovery of
17 BellSouth's nonrecurring charges, etc. For the three line West Palm Beach
18 customer, pricing 16.81% below the Key Customer rate would produce the
19 same results. For the three line Port St. Lucie customer, pricing 16.81%
20 below the Key Customer price would generate revenue of $65.79 to cover
21 costs of $101.97. (This wire center was recently shifted from a Zone 2 UNE
22 to Zone 3.) In the cases of the Orlando and Tamarac customers, where
23 currently the lowest BellSouth retail and UNE rates are available, pricing

1 below the Key Customer price would generate revenue of $73.77 to cover
2 costs of $59.13, or a margin of just under 20% -- not much better than the
3 resale margin and not enough to cover an ALEC's cost and not enough to
4 encourage new investment in ALECs. Thus, it is not just a question of the
5 margins being too thin to promote facilities based competition, but in many
6 cases there will be no margin at all.
7 Stressing the geography issue again, I note that while BellSouth's
8 discounts are placing downward pressure on rates, the Commission's UNE
9 rate structure places an upward pressure on costs. By recent Commission
10 decisions (including Order No. PSC-02-1311-FOF-TP, issued September 27,
11 2002), there are very limited UNE Zone 1 access lines and Central Offices
12 ("COs") and the vast majority of BellSouth's access lines and COs are in
13 UNE Zones 2 and 3. Exhibit No. ____ (MPG-2) is a map illustrating the
14 limited geography covered by Zone 1 COs. Zone 2 and 3 UNEs cost
15 significantly more than UNEs in Zone 1, and that fact alone serves as a
16 deterrent to ALECs contemplating geographic expansions into Zones 2 and 3.
17 However, BellSouth's promotions in Zone 2 rate centers, for example, serve
18 as an even greater deterrent.
19 Should an ALEC attempt to meet or beat the Key Customer prices
20 where those prices are available, the ALEC's overall margins would mortally
21 suffer. Significantly, there are over 120 Hot Wire Centers per the June 2002
22 Key Customer tariff, but there are only 38 UNE Zone 1 wire centers where
23 lower UNE rates are available to the ALECs. Less than one-third of all of the

1 Hot Wire Centers are UNE Zone 1 wire centers, and only one Zone 1 wire
2 center is not a Hot Wire Center. The UNE rate structure severely limits the
3 ALECs' ability to have a price response to BellSouth's 40% discounts, let
4 alone invest in Zone 2. FDN would again, as it did in the 120-day portion of
5 Docket No. 990649A, encourage the Commission to change the UNE rate
6 structure such that there are more Zone 1 wire centers, and I suggest that the
7 Commission's doing so becomes even more critical if the Commission does
8 not restrict BellSouth's discounts.
9 I think the Commission must also look to how BellSouth has
10 structured its promotional program eligibility and how BellSouth has
11 marketed those programs. In my opinion, because BellSouth has not made its
12 discounts available to all customers in the business class, the discounts are, if
13 not discriminatory, at least anticompetitive in the manner in which they are
14 set up and marketed. If BellSouth wants to offer steep discounts and free
15 hunting to customers, it should offer those discounts and free hunting to
16 **every** customer in the business class in Florida, not just to those customers
17 who are or may be ALEC customers. Also, BellSouth should alert all eligible
18 customers of those offers in the same way so that BellSouth does not in
19 practice manipulate the eligibility criteria.
20 The promotional programs BellSouth has offered, like the Key
21 Customer programs, are at least ostensibly designed to differentiate eligibility
22 on the basis of a competitive presence in the customer's serving wire center.
23 Thus, the programs target current ALEC customers and prospective ALEC

1 customers. A customer in the business class not served by a Hot Wire Center
2 pays a higher rate for both basic and nonbasic services than the same
3 customer in the same business class who is served by a Hot Wire Center. I
4 believe this, in itself, is discriminatory, anticompetitive, or both, but more so
5 when considered in the context of the other factors present in this case (such
6 as Bell's market power and the level of the discounts). Not only do Florida's
7 ALECs suffer from losing existing customers to BellSouth's discounts, but
8 the discounts are available only to customers who could leave BellSouth for
9 an ALEC, which negatively impacts the total pool of future customers to
10 whom the ALECs can sell.

11 Further, even if the eligibility terms were not discriminatory or
12 anticompetitive, nothing FDN has seen from BellSouth's discovery responses
13 or elsewhere convinces FDN that BellSouth uses the same means, methods
14 and materials to offer the Key Customer program to **ALL** eligible customers.
15 Instead, BellSouth focuses its marketing efforts on ALEC eligible customers,
16 not on BellSouth's own eligible customers. If BellSouth has a lower tariffed
17 rate available, BellSouth should be required to truly "offer" the lower rate to
18 anyone eligible, not just to those who have already shopped around.
19 BellSouth is acting in the manner of a retail store that has a sale on a product
20 but does not give you the sale price unless you affirmatively ask for the sale
21 price. The Commission should not sanction this, and I believe that any
22 disparate marketing of BellSouth promotions is discriminatory,
23 anticompetitive or both, in effect.

1 **Q. Do you have a specific recommendation as to how the**
2 **Commission should incorporate the factors you've just addressed?**
3 A. Yes. Subject to adjustment for future changes in UNE cost structure,
4 FDN maintains that the Commission should issue an order or rule whereby
5 until such time as BellSouth no longer has market power and ALECs have
6 achieved meaningful market share in BellSouth territory -- and the
7 Commission may want to consider 40% ALEC market share as a reasonable
8 and simple measure reflecting a shift in market power -- BellSouth should be
9 barred from offering direct or indirect discounts of more than 10% off total
10 billed basic and nonbasic telecommunications services, including hunting and
11 all features. Further, any discounts available must be offered to all customers
12 in the same class. This should at least diminish the anticompetitive effects of
13 BellSouth's promotional discounts.
14 **Q. Do you have an opinion as to the termination liability provisions**
15 **and the program and contract durations of BellSouth promotional**
16 **tariffs?**
17 A. I think there should be established criteria for evaluating these aspects of
18 BellSouth promotions, but the Commission must first focus on the criteria I
19 have already mentioned: market share, price/cost, and class-wide eligibility.
20 In principle, I think more lenient criteria can be applied to evaluate the
21 anticompetitive or discriminatory impacts stemming from termination
22 liability or from program or contract duration if the key criteria are as I have
23 proposed.

1 While termination liability provisions such as those in BellSouth's
2 Key Customer tariffs (T-020035 and T-020595) may be acceptable for a
3 company without dominant market power, when a company has BellSouth's
4 monopolistic market power, such termination liability provisions represent an
5 unacceptable anticompetitive practice. These termination liability provisions
6 "lock-up" customers in the coffers of the dominant provider and deter
7 customers from freely migrating even if they find a better provider. As I
8 mentioned earlier, while BellSouth is the dominant player and individual
9 ALECs hold insignificant market share, ALECs have much more to lose if a
10 customer ports out than does BellSouth. BellSouth's intent to lock up as
11 much of the market as possible for itself is illustrated in BellSouth's response
12 to FDN's Interrogatory No. 30. There, BellSouth said any wire centers that
13 were not "30% penetrated by contracts" were not removed from the January
14 2002 Key Customer list of Hot Wire Centers when the June 2002 list was
15 filed.
16 The penalty a customer must pay to leave BellSouth's January Key
17 Customer program increases over time since that penalty consists of the
18 aggregate rebates the customer has received from BellSouth. The penalty a
19 customer must pay to leave the June Key Customer program is a flat fee per
20 month remaining on the contract, so that penalty is higher if the customer
21 wishes to leave earlier in the term. For both tariffs, the customer also has to
22 repay waived connection charges. But, whether early or late in the Key
23 Customer contract term, once a customer is lured away from an ALEC back

1 to BellSouth, the customer has a substantial financial disincentive from
2 leaving BellSouth again, and, as noted above, very few have.
3 ALECs cannot realistically attempt to regain customers lost to a
4 BellSouth Key Customer program. ALECs cannot beat the Key Customer
5 rates and remain viable, and an ALEC that lost a customer to a BellSouth
6 Key Customer program still has unrecovered costs from when BellSouth took
7 the customer, so any ALEC efforts to try to regain the lost customer would
8 involve significant and redundant costs ALECs would be remiss in spending.
9 It is interesting to note that in the case of the January 2002 Key
10 Customer termination liability scheme, when BellSouth increases its rates,
11 the amount of the customer's termination liability increases because the
12 discounts the customer has to repay at termination are based on a percentage
13 of the total bill. This scheme could actually incent BellSouth to raise prices,
14 and the customers would have more to lose if they wanted to leave early.
15 My general view of program or contract duration issues is similar in
16 that if a BellSouth promotion meets the market-focused recommendation I
17 made above, for instance, no more than a 10% discount, the program
18 discounts could be available until BellSouth is no longer dominant.
19 However, BellSouth's practice of rolling over recent promotional programs
20 and the prospect of its rolling over related customer contracts compounds the
21 detrimental effects on competition that the promotions cause in the first
22 place.

1 **Q. Do you recommend any specific restrictions for the termination**
2 **liability provisions of BellSouth promotions?**
3 A. To remove the anticompetitive obstacles posed by the sorts of
4 termination liability provisions in BellSouth's Key Customer programs, I
5 recommend that where a customer leaves a BellSouth promotion early to port
6 to a carrier serving the customer through UNEs, the customer's termination
7 liability should not exceed BellSouth's retail line installation rates. Aside
8 from competitive concerns, this also recognizes the benefit that BellSouth
9 would receive on the wholesale side from the nonrecurring and recurring
10 charges paid by the new carrier.
11 **Q. Do you recommend any specific restrictions for the duration of**
12 **promotions eligibility and associated contracts?**
13 A. In the absence of the limits I recommended on the promotions
14 themselves, I believe that the duration of the discounts should be no greater
15 than 60 – 120 days, depending on the level of the discount. At the current
16 levels offered in the Key Customer programs, I would say no more than 90
17 days should be permitted. BellSouth should not be permitted to provide the
18 discounts again thereafter for another year. This would serve to mitigate the
19 anticompetitive impacts I have mentioned above. I also think the
20 Commission has to recognize that the anticompetitive effects and inequities
21 of the programs will be exacerbated over time and difficult to adjust
22 midstream. If competition levels stagnate or, worse yet, decrease, it could be
23 problematic for the Commission to alter the terms and conditions of discounts

1 after the fact. Further, the eligibility distinctions can be troublesome enough
2 for customers that do not qualify, but if contract rollovers were permitted
3 without limitation, a customer with a Key Customer discount, for example,
4 could move in year 2 of his contract to a non-Hot Wire Center, among a host
5 of ineligible customers, yet could still keep his discount through contract
6 rollovers for an unreasonable period.
7 **Q. Do you think that BellSouth's January 2002 Key Customer tariff**
8 **and its June 2002 Key Customer tariffs are unfair, anticompetitive, or**
9 **discriminatory?**
10 A. Yes, I do, for all the reasons stated in this testimony and for the
11 reasons set forth in FDN's petition initiating Docket No. 020119.
12 Additionally, neither of those BellSouth tariffs meets the criteria I have
13 suggested above.
14 **Q. Do you have an opinion on how the Commission should evaluate**
15 **whether the billing conditions of a BellSouth promotion or the**
16 **geographic targeting of a promotion are unfair, anticompetitive or**
17 **discriminatory?**
18 A. As I stated earlier, I think that the way BellSouth has structured its
19 promotions is discriminatory, anticompetitive or both. The Key Customer
20 promotions, for example, which discount basic and nonbasic services, have
21 not been available to all customers in the business class, and BellSouth has
22 not offered the discounts to all eligible customers using the same means,
23 methods and materials. This notwithstanding, I believe that BellSouth should

1 not be permitted to manipulate availability so as to run afoul of some other
2 basic principles of fairness. I believe that any permitted discounts must be
3 narrowly designed to meet competitors' offerings in specific geographies.
4 Thus, for example, if the Commission permits BellSouth to offer a discount
5 of nonbasic services in a geographic area (such as an area served by Hot Wire
6 Center) to meet the specific offering of a competitor, the Commission should
7 not permit the BellSouth discount to apply to different locations of the same
8 business entity regardless of geography (such as areas outside Hot Wire
9 Center locations) unless competitors can also make the same multi-location
10 offer. Even so, other businesses located outside the Hot Wire Centers will
11 claim discrimination.

12 **Q. Do you think the Commission should apply any criteria it**
13 **establishes in this case to BellSouth affiliates?**

14 A. To the extent that an affiliate offer discounts, rebates or awards of any
15 kind that apply to basic or nonbasic telecommunications services, yes.

16 **Q. Under what terms and conditions should BellSouth promotional**
17 **offerings be available for ALEC resale?**

18 A. The terms and conditions should be consistent with the FCC's
19 established rules and regulations. One of the FCC's requirements is that the
20 terms and conditions for resale be reasonable.

21 I want to briefly address a few matters with respect to terms for
22 reselling BellSouth's promotions. First, in a discovery response (FDN
23 Interrogatory No. 25), BellSouth stated that, at present, the bills it will send to

1 ALECs reselling existing Key Customer promotions will not reflect the Key
2 Customer discounts; but rather, the ALECs will have to calculate those
3 discounts on their own and then apply to BellSouth for credits. I do not think
4 that a system of mandatory and recurring credit requests is a reasonable way
5 of billing a customer, and such a scheme would be unduly burdensome on the
6 ALECs. If BellSouth anticipated ALECs' reselling these promotions, I
7 would think that it would already have the systems in place to properly bill
8 ALECs for reselling the promotions.
9 Also, in discovery responses (e.g. FDN Interrogatory No. 24),
10 BellSouth indicates that if a customer to whom an ALEC resells a BellSouth
11 promotion leaves the ALEC service before the end of a promotion contact
12 term, BellSouth will charge the ALEC (not the end user) the entire
13 termination liability. I believe that if the termination liability is unfair,
14 anticompetitive or discriminatory to begin with, it would be even more so
15 when resold such that the ALEC was responsible for those charges. Further,
16 at least in cases where the departing customer goes back to BellSouth, I
17 believe it is unreasonable to require the ALEC to pay BellSouth the
18 termination liability and then for BellSouth to get the customer too. The
19 Commission must question how resale conditions work relative to the
20 nonrecurring charges (at the outset and at termination) in any case.
21 **Q. What do you believe is the impact of the resale of BellSouth**
22 **promotions?**

1 A. Putting it bluntly, as long as the Commission permits BellSouth to
2 continue providing discounts like the Key Customer programs, ALECs have
3 a choice of becoming nonviable by trying to beat BellSouth's promotional
4 prices or becoming nonviable by reselling those discounts. The resale
5 "option" is not a vehicle for ALECs to mitigate the effects of BellSouth's
6 anticompetitive practices; rather, like the promotions themselves, it is a plan
7 for dissembling facilities-based competition.
8 Any opportunity ALECs have to resell BellSouth promotional prices
9 is an empty consolation. Resale does not serve to avoid the harm ALECs
10 suffer from BellSouth promotions, nor does it remedy BellSouth's conduct.
11 The resale business has been for sometime now widely considered a non-
12 viable, unfinanciable venture, and many ALECs like FDN do not generally
13 resell services because of resale's inadequate margins -- margins that do not
14 change when reselling a promotion. Even BellSouth admits that no Florida
15 ALEC has resold to a customer with a BellSouth Key Customer contract
16 (FDN Interrogatory No. 28). If resale terms and conditions were reasonable
17 and resale were a viable competitive option, one must ask why this would be
18 the case.
19 BellSouth has advocated that the Commission and the FCC promote
20 facilities-based competition. Judging from an early October 2002 speech
21 given by FCC Chairman Powell, the FCC seems to agree with BellSouth's
22 sentiments for encouraging facilities-based competition. Chairman Powell
23 said:

1 Economic recovery means building business that can expand
2 employment opportunities for our Nation's citizens.
3
4 It means bringing real competitive choice to consumers and
5 enhancing consumer welfare through differentiated products and
6 services and differentiated pricing packages.
7
8 It means, in short, investment in facilities. For only through
9 facilities-based competition can an entity offer true product and
10 pricing differentiation for consumers.
11
12 Only through facilities-based competition will corporate spending on
13 equipment thrive.
14
15 Only through facilities-based competition can a competitor lessen its
16 dependency on an intransigent incumbent, who if committed to
17 frustrate entry has a thousand ways to do so in small, imperceptible
18 ways.
19
20 Only through facilities-based competition can an entity bypass the
21 incumbent completely and force the incumbent to innovate to offset
22 lost wholesale revenues.
23

1 Only through facilities-based competition can our Nation attain
2 greater network redundancies for security purposes and national
3 emergencies.
4
5 Further, in an October 17, 2002, letter to Florida' congressional
6 delegation and FCC Chairman Powell, this Commission stated:
7
8 In the long term, facilities-based competition is the best way to
9 provide maximum benefit to consumers. However, we recognize and
10 we hope others recognize that in order to spur long term investment
11 and commitment it is necessary to provide a stable, reasonably
12 predictable legal and regulatory framework under which investors and
13 service providers can operate with confidence.
14
15 Resale of ILEC promotional rates by ALECs will naturally promote
16 erosion of facilities-based competition. As demand for resold promotional
17 prices grows, demand for facilities-based services declines. Facilities-based
18 ALECs cannot beat BellSouth's Key Customer discounts and remain viable,
19 and ALECs and their investors should not then be given the signal to abandon
20 existing facilities capacity and/or abandon possible facilities expansions just
21 to compete with BellSouth as a reseller. This is totally at odds with the
22 public interest (the facilities-based competition BellSouth itself has espoused)
23 and totally at odds with Chairman Powell's and this Commission's stated

1 intentions. Besides, neither fairness nor common sense could require a
2 competitor to change its business model to a nonviable one (resale) just to
3 evade anticompetitive conduct. The resale "option" is nothing more than
4 another way of BellSouth's forcing its will on the market, and the
5 Commission must reject BellSouth's promotions as anticompetitive and
6 against the public interest.

7 **Q. What marketing restrictions should be placed on BellSouth**
8 **relative to promotions?**

9 A. There should be adequate assurances in place so that BellSouth abides
10 by existing CPNI and wholesale information restrictions. For example, no
11 BellSouth retail employee or agent should have any access to wholesale
12 information, such as an ALECs request for CSR information of submission
13 and status of local service orders ("LSRs"). Further, the Commission should
14 forbid BellSouth from using in-bound customer calls as a vehicle for
15 retention efforts when the customer requests account activity predicate to a
16 carrier change, including the following activities: steps necessary to
17 reconfigure BellSouth's tied xDSL services and (until there is a suitable
18 vehicle for ALECs to address pending service orders) steps for clearing
19 pending service orders or problems with CSRs.

20 The customer has no choice but to go to BellSouth to initiate these
21 identified types of account activities, and there is no accepted vehicle for
22 ALECs to carry out such activities for the customer. For example, only the
23 customer can have xDSL service moved off the billed-to number ("BTN"

1 also know as the main or lead number) to another working number on the
2 account. BellSouth's wholesale unit considers such matters a basis for
3 clarifying or delaying LSRs submitted by ALECs. While a clarification to
4 the LSR on the wholesale side may be understandable, BellSouth's rules or
5 procedures should not be set up so ALECs basically have to deliver a porting
6 customer right to the doorstep of BellSouth's retail side for a possible
7 retention/winback sale. BellSouth's tying xDSL to voice service is
8 anticompetitive to begin with, so requiring the customer to be subjected to a
9 BellSouth retention/winback sale when the customer must go to BellSouth to
10 minimize any xDSL port-related service problems is just as unfair and
11 anticompetitive. The rationale relative to pending service orders is much the
12 same. The ALEC should not be required to deliver a porting customer to
13 BellSouth's retail group to clear a pending service order only to have the
14 customer subjected to a retention/winback sale.
15 Additionally, I note that where an ALEC is voluntarily or
16 involuntarily exiting a market, BellSouth should not be able to take
17 advantage of its unique position as the underlying carrier to offer discounts to
18 customers facing disconnection before the customers could have enough
19 opportunity to fully evaluate other carrier options. A customer of a departing
20 ALEC may be "under the gun" of disconnection or may be placed in the
21 service of BellSouth by default as of a date certain if the customer does not
22 select another carrier. The customer may be notified of such by BellSouth or
23 by the departing carrier. In cases where BellSouth notifies the customers of a

1 disconnection date or where BellSouth is listed as the default carrier on a
2 notice, BellSouth has an inherent marketing advantage because the customers
3 will likely turn to BellSouth for assistance. In cases where the exiting carrier
4 notifies the customer of its departure and BellSouth is not a default carrier,
5 BellSouth still has an inherent marketing advantage in that it already has
6 subscriber information for all customers in an area that disconnected from
7 BellSouth and can target market its discounts that way. ALECs who wish to
8 compete for the business of the customers of the departing ALEC do not have
9 either of these advantages. Therefore, if the Commission permits BellSouth
10 to continue to offer Key Customer type discounts, the Commission should
11 level the competitive playing field by directing BellSouth not to offer such
12 discounts to customers of a departing ALEC until 30 days after the date that
13 those customers are subject to disconnection or rolling over to BellSouth as a
14 default carrier. This should permit the customers to evaluate offerings of
15 other ALECs interested in their business.
16 **Q. Are you aware of what some other state Commissions have done**
17 **relative to ILEC promotions, retention and winback programs?**
18 A. FDN made a public records request to the PSC staff asking for
19 information that the staff had gathered regarding other state commissions'
20 activities on the subject of promotions, retention and winbacks. One
21 commission that has addressed the substance of promotional discounts was
22 the Missouri PSC. Relying principally on the market power rationale I
23 suggest above, the Missouri PSC suspended Southwestern Bell's winback

1 tariffs. A copy of the Missouri PSC's December 21, 2201, suspension order
2 is attached hereto as Exhibit ___ (MPG-3). Although the order speaks for
3 itself, I note that the Missouri PSC reasoned that although ALECs had
4 captured 22% of the business market and that the market was open to
5 competition for 271 purposes, that 22% market share was divided among 66
6 ALECs and Southwestern Bell still was the dominant provider and the
7 promotions would endanger competition. The Missouri PSC acknowledged
8 that customers benefited temporarily from the lower winback rates, but
9 determined it had the duty to look beyond this and to protect the viability of
10 the overall market.
11 Similarly, the Texas PUC approved its staff's recommendation to
12 move forward with rulemaking on winback/retention promotions largely on
13 the rationale that ILECs continue to possess significant market power and can
14 use winback/retention programs to keep competition sufficiently weak so that
15 ILEC prices can be maintained or raised without significant consequence.
16 An excerpt of the public record materials FDN obtained from staff regarding
17 the Texas PUC's decision is attached hereto and marked Exhibit ___ (MPG-
18 4).
19 **Q. Does that conclude your direct testimony?**
20 A. Yes.
21
22

CERTIFICATE OF SERVICE

I hereby certify that a copy of the prefiled direct testimony of Michael P. Gallagher was sent by e-mail and regular mail to the persons listed below, and that the prefiled exhibits of Mr. Gallagher were sent by regular mail to the persons listed below, other than those marked with an (*) who have been sent a copy via overnight mail, this 22d day of October, 2002.

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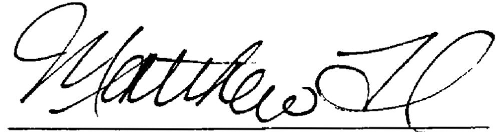

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs and For an Investigation Of BellSouth's Promotional Pricing And Marketing Practices by Florida Digital Network, Inc.	}	Docket No. 020119-TP
In Re: Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs by the Florida Competitive Carrier's Association	}	Docket No. 020578-TP

EXHIBIT MPG-1

FILED WITH THE DIRECT TESTIMONY OF MICHAEL P. GALLAGHER

FILED ON BEHALF OF

FLORIDA DIGITAL NETWORK, INC.

Retail
ALLAPATTAH - MIAMFLAL (RG12) - ZONE 1

BellSouth Tariff-Customer

Business lines x 3 lines	$110.85				
Hunting x 3 lines	$30.00				
Total MRC:	**$140.85**	Per line:	**$46.95**	Termination Liability*	$0.00
				Total:	$0.00
Total NRC:	**$80.00**				

FDN Tariff-Customer**

Business lines x 3 lines	$88.68				
Hunting x 3 lines	$22.50				
Total MRC:	**$111.18**	Per line:	**$37.06**	Termination Liability*	$10.00
				Total:	$180.00
Total NRC:	**$150.00**				

BellSouth Key Customer***

Business lines x 3 lines	$88.68				
Hunting x 3 lines	$0.00				
Total MRC:	**$88.68**	Per line:	**$29.56**	Termination Liability*	$25.00
				Total:	$450.00
Total NRC:	**$0.00**				

*Customer terminates agreement after 30 months. Assumes BellSouth charges $25.00 per line/per month remaining on the contract.

**Customer signs a 36 month commitment with Florida Digital Network.

***Customer signs a 36 month commitment with BellSouth.

Wholesale

ALLAPATTAH - MIAMFLAL (RG12) - ZONE 1

FDN Resale-Standard

Business lines x 3 lines	$92.22		
Hunting x 3 lines	$24.96		
Total MRC:	**$117.17**	Per line:	**$39.06**

FDN Resale-Key Customer*

Business lines x 3 lines	$73.77		
Hunting x 3 lines	$0.00		
Total MRC:	**$73.77**	Per line:	**$24.59**

FDN UNE-P-Zone 1**

Business lines x 3 lines	$56.13		
Hunting x 3 lines	$6.51		
Total MRC:	**$62.64**	Per line:	**$20.88**

*Customer signs a 36 month commitment, FDN is liable for termination liability to BellSouth.

**SL1 Loop. Assumes 380 minutes of outbound local calls on the BellSouth network and 190 minutes of outbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

**SL1 Loop. Assumes 305 minutes of inbound local calls on the BellSouth network and 152 minutes of inbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

ALLAPATTAH - MIAMFLAL (RG12) - ZONE 2

FDN UNE-P-Zone 2***

Business lines x 3 lines	$66.15		
Hunting x 3 lines	$6.51		
Total MRC:	**$72.66**	Per line:	**$24.22**

***PSC proposed SL1 Loop. Assumes 380 minutes of outbound local calls on the BellSouth network and 190 minutes of outbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calc

***PSC proposed SL1 Loop. Assumes 305 minutes of inbound local calls on the BellSouth network and 152 minutes of inbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calcula

Retail
HAVERHILL - WPBHFLHH (RG 9) - ZONE 2

BellSouth Tariff-Customer

Business lines x 3 lines	$110.85				
Hunting x 3 lines	$30.00				
Total MRC:	**$140.85**	Per line:	**$46.95**	Termination Liability*	$0.00
				Total:	$0.00
Total NRC:	**$80.00**				

FDN Tariff-Customer**

Business lines x 3 lines	$88.68				
Hunting x 3 lines	$22.50				
Total MRC:	**$111.18**	Per line:	**$37.06**	Termination Liability*	$10.00
				Total:	$180.00
Total NRC:	**$150.00**				

BellSouth Key Customer***

Business lines x 3 lines	$88.68				
Hunting x 3 lines	$0.00				
Total MRC:	**$88.68**	Per line:	**$29.56**	Termination Liability*	$25.00
				Total:	$450.00
Total NRC:	**$0.00**				

*Customer terminates agreement after 30 months
**Customer signs a 36 month commitment with Florida Digital Network
***Customer signs a 36 month commitment with BellSouth.

Wholesale

HAVERHILL - WPBHFLHH (RG 9) - ZONE 2

FDN Resale-Standard

Business lines x 3 lines	$92.22		
Hunting x 3 lines	$24.96		
Total MRC:	**$117.17**	Per line:	**$39.06**

FDN Resale-Key Customer*

Business lines x 3 lines	$73.77		
Hunting x 3 lines	$0.00		
Total MRC:	**$73.77**	Per line:	**$24.59**

FDN UNE-P-Zone 2**

Business lines x 3 lines	$68.64		
Hunting x 3 lines	$6.51		
Total MRC:	**$75.15**	Per line:	**$25.05**

*Customer signs a 36 month commitment, FDN is liable for termination liability to BellSouth.

**SL1 Loop. Assumes 380 minutes of outbound local calls on the BellSouth network and 190 minutes of outbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

**SL1 Loop. Assumes 305 minutes of inbound local calls on the BellSouth network and 152 minutes of inbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

HAVERHILL - WPBHFLHH (RG 9) - ZONE 2

FDN UNE-P-Zone 2***

Business lines x 3 lines	$66.15		
Hunting x 3 lines	$6.51		
Total MRC:	**$72.66**	Per line:	**$24.22**

***PSC proposed SL1 Loop. Assumes 380 minutes of outbound local calls on the BellSouth network and 190 minutes of outbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculat

***PSC proposed SL1 Loop. Assumes 305 minutes of inbound local calls on the BellSouth network and 152 minutes of inbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

Retail
PORT ST. LUCIE MAIN - PTSLFLMA (RG6) - ZONE 2

BellSouth Tariff-Customer

Business lines x 3 lines	$98.85				
Hunting x 3 lines	$30.00				
Total MRC:	**$128.85**	Per line:	**$42.95**	Termination Liability*	$0.00
				Total:	$0.00
Total NRC:	**$80.00**				

FDN Tariff-Customer**

Business lines x 3 lines	$79.08				
Hunting x 3 lines	$22.50				
Total MRC:	**$101.58**	Per line:	**$33.86**	Termination Liability*	$10.00
				Total:	$180.00
Total NRC:	**$150.00**				

BellSouth Key Customer***

Business lines x 3 lines	$79.08				
Hunting x 3 lines	$0.00				
Total MRC:	**$79.08**	Per line:	**$26.36**	Termination Liability*	$25.00
				Total:	$450.00
Total NRC:	**$0.00**				

*Customer terminates agreement after 30 months

**Customer signs a 36 month commitment with Florida Digital Network

****Customer signs a 36 month commitment with BellSouth*

Wholesale

PORT ST. LUCIE MAIN - PTSLFLMA (RG6) - ZONE 2

FDN Resale-Standard

Business lines x 3 lines	$82.23		
Hunting x 3 lines	$24.96		
Total MRC:	**$107.19**	Per line:	**$35.73**

FDN Resale-Key Customer*

Business lines x 3 lines	$65.79		
Hunting x 3 lines	$0.00		
Total MRC:	**$65.79**	Per line:	**$21.93**

FDN UNE-P-Zone 2**

Business lines x 3 lines	$68.64		
Hunting x 3 lines	$6.51		
Total MRC:	**$75.15**	Per line:	**$25.05**

*Customer signs a 36 month commitment, FDN is liable for termination liability to BellSouth.

**SL1 Loop. Assumes 380 minutes of outbound local calls on the BellSouth network and 190 minutes of outbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

**SL1 Loop. Assumes 305 minutes of inbound local calls on the BellSouth network and 152 minutes of inbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

PORT ST. LUCIE MAIN - PTSLFLMA (RG6) - ZONE 3

FDN UNE-P-Zone 3***

Business lines x 3 lines	$101.46		
Hunting x 3 lines	$6.51		
Total MRC:	**$107.97**	Per line:	**$35.99**

***PSC proposed SL1 Loop. Assumes 380 minutes of outbound local calls on the BellSouth network and 190 minutes of outbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being c

***PSC proposed SL1 Loop. Assumes 305 minutes of inbound local calls on the BellSouth network and 152 minutes of inbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calc

Retail
MAGNOLIA - ORLDFLMA (RG11) - ZONE 1

BellSouth Tariff-Customer

Business lines x 3 lines	$110.85				
Hunting x 3 lines	$30.00				
Total MRC:	**$140.85**	Per line:	**$46.95**	Termination Liability*	$0.00
				Total:	$0.00
Total NRC:	**$80.00**				

FDN Tariff-Customer**

Business lines x 3 lines	$88.68				
Hunting x 3 lines	$22.50				
Total MRC:	**$111.18**	Per line:	**$37.06**	Termination Liability*	$10.00
				Total:	$180.00
Total NRC:	**$150.00**				

BellSouth Key Customer***

Business lines x 3 lines	$88.68				
Hunting x 3 lines	$0.00				
Total MRC:	**$88.68**	Per line:	**$29.56**	Termination Liability*	$25.00
				Total:	$450.00
Total NRC:	**$0.00**				

*Customer terminates agreement after 30 months. Assumes BellSouth charges $25.00 per line/per month remaining on the contract.

**Customer signs a 36 month commitment with Florida Digital Network.

***Customer signs a 36 month commitment with BellSouth.

Wholesale

MAGNOLIA - ORLDFLMA (RG11) - ZONE 1

FDN Resale-Standard

Business lines x 3 lines	$92.22		
Hunting x 3 lines	$24.96		
Total MRC:	**$117.17**	Per line:	**$39.06**

FDN Resale-Key Customer*

Business lines x 3 lines	$73.77		
Hunting x 3 lines	$0.00		
Total MRC:	**$73.77**	Per line:	**$24.59**

FDN UNE-P-Zone 1**

Business lines x 3 lines	$56.13		
Hunting x 3 lines	$6.51		
Total MRC:	**$62.64**	Per line:	**$20.88**

*Customer signs a 36 month commitment, FDN is liable for termination liability to BellSouth.

**SL1 Loop. Assumes 380 minutes of outbound local calls on the BellSouth network and 190 minutes of outbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

**SL1 Loop. Assumes 305 minutes of inbound local calls on the BellSouth network and 152 minutes of inbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

MAGNOLIA - ORLDFLMA (RG11) - ZONE 1

FDN UNE-P-Zone 1**

Business lines x 3 lines	$52.62		
Hunting x 3 lines	$6.51		
Total MRC:	**$59.13**	Per line:	**$19.71**

***PSC proposed SL1 Loop. Assumes 380 minutes of outbound local calls on the BellSouth network and 190 minutes of outbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calcula

***PSC proposed SL1 Loop. Assumes 305 minutes of inbound local calls on the BellSouth network and 152 minutes of inbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculatec

Retail
TAMARAC - PMBHFLTA (RG12) - ZONE 2

BellSouth Tariff-Customer

Business lines x 3 lines	$110.85				
Hunting x 3 lines	$30.00				
Total MRC:	**$140.85**	Per line:	**$46.95**	Termination Liability*	$0.00
				Total:	$0.00
Total NRC:	**$80.00**				

FDN Tariff-Customer**

Business lines x 3 lines	$88.68				
Hunting x 3 lines	$22.50				
Total MRC:	**$111.18**	Per line:	**$37.06**	Termination Liability*	$10.00
				Total:	$180.00
Total NRC:	**$150.00**				

BellSouth Key Customer***

Business lines x 3 lines	$88.68				
Hunting x 3 lines	$0.00				
Total MRC:	**$88.68**	Per line:	**$29.56**	Termination Liability*	$25.00
				Total:	$450.00
Total NRC:	**$80.00**				

*Customer terminates agreement after 30 months. Assumes BellSouth charges $25.00 per line/per month remaining on the contract.

**Customer signs a 36 month commitment with Florida Digital Network.

***Customer signs a 36 month commitment with BellSouth.

Wholesale

TAMARAC - PMBHFLTA (RG12) - ZONE 2

FDN Resale-Standard

Business lines x 3 lines	$92.22		
Hunting x 3 lines	$24.96		
Total MRC:	**$117.17**	Per line:	**$39.06**

FDN Resale-Key Customer*

Business lines x 3 lines	$73.77		
Hunting x 3 lines	$0.00		
Total MRC:	**$73.77**	Per line:	**$24.59**

FDN UNE-P-Zone 2**

Business lines x 3 lines	$68.64		
Hunting x 3 lines	$6.51		
Total MRC:	**$75.15**	Per line:	**$25.05**

*Customer signs a 36 month commitment, FDN is liable for termination liability to BellSouth.

**SL1 Loop. Assumes 380 minutes of outbound local calls on the BellSouth network and 190 minutes of outbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

**SL1 Loop. Assumes 305 minutes of inbound local calls on the BellSouth network and 152 minutes of inbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculated.

TAMARAC - PMBHFLTA (RG12) - ZONE 1

FDN UNE-P-Zone 1***

Business lines x 3 lines	$52.62		
Hunting x 3 lines	$6.51		
Total MRC:	**$59.13**	Per line:	**$19.71**

***PSC proposed SL1 Loop. Assumes 380 minutes of outbound local calls on the BellSouth network and 190 minutes of outbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calcula

***PSC proposed SL1 Loop. Assumes 305 minutes of inbound local calls on the BellSouth network and 152 minutes of inbound local calls via multiple networks. ADUF/ODUF/CABS charges are not being calculate

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

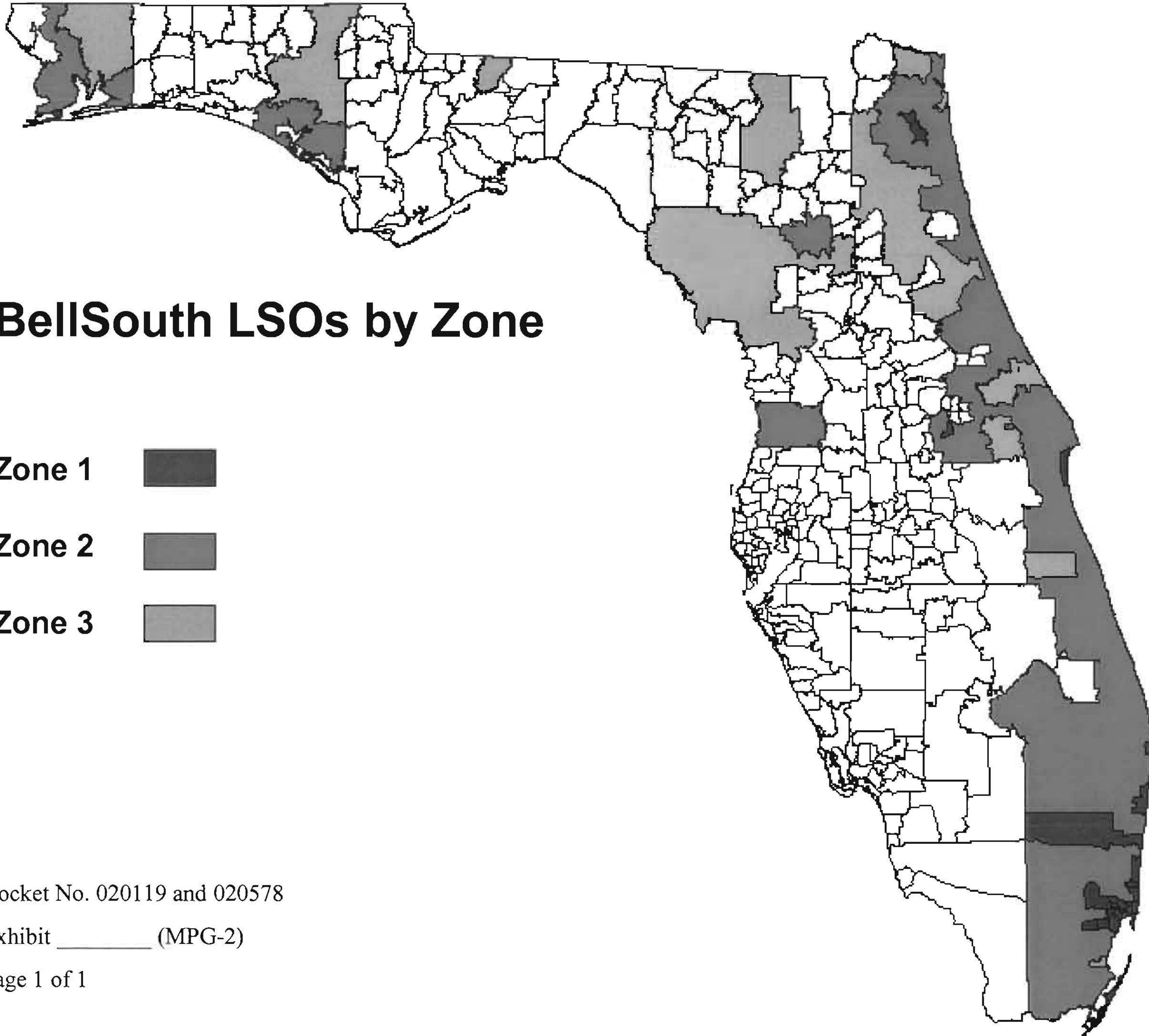
In Re: Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs and For an Investigation Of BellSouth's Promotional Pricing And Marketing Practices by Florida Digital Network, Inc.	}	Docket No. 020119-TP
In Re: Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs by the Florida Competitive Carrier's Association	}	Docket No. 020578-TP

EXHIBIT MPG-2

FILED WITH THE DIRECT TESTIMONY OF MICHAEL P. GALLAGHER

FILED ON BEHALF OF

FLORIDA DIGITAL NETWORK, INC.



Docket No. 020119 and 020578

Exhibit ________ (MPG-2)

Page 1 of 1

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs and For an Investigation Of BellSouth's Promotional Pricing And Marketing Practices by Florida Digital Network, Inc.	}	Docket No. 020119-TP
In Re: Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs by the Florida Competitive Carrier's Association	}	Docket No. 020578-TP

EXHIBIT MPG-3

FILED WITH THE DIRECT TESTIMONY OF MICHAEL P. GALLAGHER

FILED ON BEHALF OF

FLORIDA DIGITAL NETWORK, INC.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Southwestern Bell Telephone Company's Tariff Filing to Initiate a Business MCA Promotion	)))	**Case No. TT-2002-108** Tariff No. 200200051
In the Matter of Southwestern Bell Telephone Company's Proposed Revisions to PSC Mo. No. 35 (General Exchange Tariff) Regarding CompleteLink	)))	**Case No. TT-2002-130** Tariff No. 200200151

REPORT AND ORDER

Issue Date: December 18, 2001

Effective Date: December 28, 2001

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Southwestern Bell Telephone Company's Tariff Filing to Initiate a Business MCA Promotion	)))	**Case No. TT-2002-108** Tariff No. 200200051
In the Matter of Southwestern Bell Telephone Company's Proposed Revisions to PSC Mo. No. 35 (General Exchange Tariff) Regarding CompleteLink	)))	**Case No. TT-2002-130** Tariff No. 200200151

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For: The Staff of the Missouri Public Service Commission.

REGULATORY LAW JUDGE: **Morris L. Woodruff**

REPORT AND ORDER

SUMMARY

Southwestern Bell Telephone Company has submitted a tariff that would implement a discount for its Business MCA service based on the customer's execution of a one-, three- or five-year term agreement. In a separate tariff, Southwestern Bell would establish a CompleteLink service offer that would grant discounts to customers who agreed to term and volume commitments. The Commission suspended both tariffs and now finds that the proposed tariffs would harm competition in the local exchange services market. For that reason, Southwestern Bell's tariffs are rejected.

FINDINGS OF FACT

The Missouri Public Service Commission, having considered all of the competent and substantial evidence upon the whole record, makes the following findings of fact. The Commission in making this decision has considered the positions and arguments of all of the parties. Failure to specifically address a piece of evidence, position or argument of any party does not indicate that the Commission has failed to consider relevant evidence, but indicates rather that the omitted material was not dispositive of this decision.

Procedural History

On August 21, 2001, acting on its own motion, the Commission issued an order in Case Number TT-2002-108 that suspended a tariff filed by Southwestern Bell Telephone Company. Southwestern Bell's tariff would implement a promotion that would discount optional Metropolitan Calling Area (MCA) service rates pursuant to term contracts signed by business customers. In its order suspending Southwestern Bell's tariff, the Commission expressed its concern that the proposal to offer rate discounts in long-term contracts might adversely affect competition. So that it would have sufficient time to study the effect of the proposed tariff, the Commission suspended Southwestern Bell's tariff for a period of 120 days, from August 22 to December 20. On December 13, the Commission issued an order further suspending the tariff until December 31, so that this Report and Order could be given a ten-day effective date.

In its order suspending Southwestern Bell's tariff, the Commission directed its records department to send notice of the tariff suspension to all telecommunications companies certificated to do business in Missouri. The Commission also directed that any proper person or entity desiring to intervene should submit an application to intervene no later than September 10. The Commission received timely applications to intervene from Choctaw

Telephone Company and MoKan Dial, Inc., NuVox Communications of Missouri, Inc., and AT&T Communications of the Southwest, Inc. On September 19, the Commission issued an order granting each of those applications to intervene.

On September 4, NuVox Communications of Missouri, Inc. filed a motion asking the Commission to suspend or reject a tariff filed by Southwestern Bell. NuVox's motion was assigned case number TT-2002-130. The tariff that NuVox asked the Commission to suspend or reject would modify Southwestern Bell's general exchange tariff to introduce what Southwestern Bell calls CompleteLink service.

Southwestern Bell, AT&T, and Staff filed responses to NuVox motion to suspend on September 12. Southwestern Bell opposed the motion to suspend. AT&T and Staff supported the proposed suspension and both filed motions asking the Commission to consolidate case numbers TT-2002-108 and TT-2002-130, as the issues regarding the two tariffs are similar.

On September 20, the Commission issued an order that suspended Southwestern Bell's CompleteLink tariff until January 22, 2002. In the same order, the Commission directed its records department to provide notice of the tariff suspension to all telecommunications companies certificated to do business in Missouri and directed any proper person or entity wishing to intervene to file an application to intervene no later than October 10.

On September 28, the Commission issued an order that consolidated case numbers TT-2002-108 and TT-2002-130. In the same order, the Commission adopted a procedural schedule for the consolidated cases. All parties in either case were made parties in the consolidated case. Subsequently, on October 25, IP Communications Corporation, which had timely applied for intervention in TT-2002-130, was made a party to the consolidated case.

The parties submitted prefiled direct, rebuttal and surrebuttal testimony and the consolidated case proceeded to hearing on November 5 and November 7. Southwestern Bell, Staff, Public

Counsel, and AT&T and NuVox filed initial briefs and proposed findings of fact and conclusions of law on November 21.[1] The same parties filed reply briefs on November 28.

The Two Tariffs

The Commission has suspended two tariffs filed by Southwestern Bell. Under the first tariff, referred to as the Business MCA Promotion,[2] business customers are eligible to receive a discount on each of the optional MCA services that they subscribe to in return for a one-, three-, or five-year term commitment for their local access line and optional MCA services. The tariff provides that customers will receive an eighteen percent discount on a one-year contract, a twenty-two percent discount on a three-year contract, or a twenty-five percent discount on a five-year contract. Southwestern Bell's Business MCA promotion is available to all business customers in the optional MCA areas.

If a Southwestern Bell business customer signs a term commitment under the Business MCA promotion and then disconnects any portion of its contracted service prior to the expiration of the term commitment, that customer will be required to pay an early termination fee. The tariff provides that the early termination fee will be fifty percent of the monthly rate for the service that was disconnected, multiplied by the number of months remaining on the contract.

Southwestern Bell's Business MCA promotion is optional. No customer will be required to enter in to a term commitment. A business customer may choose to purchase MCA service at a standard month-to-month retail price with no term commitment, no term discount, and no risk of imposition of an early termination fee.

The second suspended tariff is referred to as the CompleteLink service offer. CompleteLink is an optional term and volume discount plan by which a business customer receives discounts on the multiple services that a customer purchases from Southwestern Bell. For example, a customer might receive a discount on its local access, local usage, toll usage, toll-free usage and various vertical features that it might purchase, such as call waiting, call forwarding, and other custom calling features. The CompleteLink plan does not require the

customer to purchase any set number of products or services.

Under the CompleteLink plan, a business customer would receive monthly discounts on the products and services it purchases from Southwestern Bell, based on the customer's Minimum Annual Revenue Commitment, referred to as the Customer's MARC. The customer's MARC is the sum total of the customer's annual billed charges, before any discount is applied, for regulated services provided by Southwestern Bell in its five state region, consisting of Missouri, Arkansas, Kansas, Oklahoma, and Texas. The business customer may subscribe to CompleteLink by agreeing to a one-, three-, or five-year service agreement.

The CompleteLink customer that chooses a longer length of service agreement will receive a greater percentage discount. For example, if a customer has a MARC of $12,000 and signs a one-year service agreement, the customer would receive a 6.5 percent discount. If that same customer signs a five-year service agreement, the customer would receive a 9 percent discount. Similarly, a customer with a higher MARC will receive a greater percentage discount. For example, a customer with a $12,000 MARC and a one-year service agreement would receive a 6.5 percent discount, but a customer with a $150,000 MARC and a one-year service agreement would receive a 10 percent discount.

CompleteLink customers who fail to meet their MARC will be billed the difference between their MARC and the annual revenue billed. Customers terminating a CompleteLink service agreement prior to the expiration of the service agreement would be subject to an early termination fee equal to 50 percent of the MARC multiplied by the number of years, or portions of a year, remaining in the customer's service agreement. For example, if a customer has a MARC of $7,000 and agrees to a three-year service agreement, but cancels after two years, the termination charge would be $3,500. The CompleteLink tariff does contain a provision that allows a customer to cancel the agreement within 90 days of execution without incurring an early termination fee.

CompleteLink is available to all business customers, but business customers who have received a written competitive offer, and are considering taking that offer, but decide to stay with Southwestern Bell, will receive an additional four percent discount. That provision is

referred to as a "save" or "retention" provision. A business customer who has left Southwestern Bell and is returning to Southwestern Bell by committing to a CompleteLink agreement will receive an additional eight percent discount. That provision of the tariff is referred to as a "winback" provision.

Competitive Position of Southwestern Bell

Southwestern Bell is an incumbent local exchange carrier (ILEC) as that term is defined in Section 251(h) of the Telecommunications Act of 1996. [3] That means that before the passage of the Telecommunications Act of 1996, Southwestern Bell was a regulated monopoly provider of local exchange service within its exchanges. In other words, before the advent of competition, all local service customers within Southwestern Bell's exchanges were customers of Southwestern Bell.

The Telecommunications Act of 1996 permitted the creation of competitive local exchange carriers (CLECs). CLECs are telecommunications carriers that have decided to go into the exchange of an ILEC to compete to provide local telephone services. Currently there are 66 CLECs competing with Southwestern Bell in its Missouri exchanges. At least one CLEC is operating, and serving customers in each of Southwestern Bell's 160 Missouri exchanges. Furthermore, at least 22 percent of the business market in Southwestern Bell's exchanges is controlled by a CLEC.

Southwestern Bell suggests that the current level of competition in its exchanges justifies its attempts to maintain, or increase its market share using term agreements, and retain and winback provisions, as promotional tools. However, Southwestern Bell is still in a position to dominate its CLEC rivals. While the CLECs collectively may control 22 percent of the business market in Southwestern Bell's exchanges, that 22 percent is spread out among 66 different CLECs. No CLEC has the resources to attempt to duplicate Southwestern Bell's telecommunications network. As a result, CLEC competitors must rely on their ability to utilize

all or a portion of Southwestern Bell's network in order to provide services to their own customers.

Walt Cecil, a regulatory economist for the Staff of the Commission, testified that because of its powerful position in the local telephone market, Southwestern Bell "is in a position to threaten competitors' market shares and continued existence, while the competitors are not yet in a position to threaten SWBT's (Southwestern Bell's) existence in its own exchanges."[4] Mr. Cecil goes on to testify that "SWBT is different than its competitors and therefore should be subject to more stringent regulatory oversights until those differences become less substantial."[5] The Commission agrees with Mr. Cecil's statement. If effective competition in the local telecommunications market is to survive and prosper in Southwestern Bell's exchanges, Southwestern Bell must be subject to heightened regulatory oversight.

Effect of Term Agreements on Competition

Both the Business MCA Promotion and the CompleteLink tariff provide that customers who want to obtain discounted rates must agree to remain as customers of Southwestern Bell for periods of one, three, or five years. The requirement that the customer remain with Southwestern Bell throughout the length of the term agreement is enforced by the requirement that a customer leaving Southwestern Bell before the expiration of its term agreement pay a substantial early termination fee.

There is nothing inherently improper about the imposition of an early termination fee. As Southwestern Bell points out, many tariffs of its competitors - tariffs that have been approved by the Commission - contain similar early termination fees. Similarly, there is no indication that the amount of the fee that would be imposed by Southwestern Bell is unusual or excessive. Again, the early termination fees charged by some of Southwestern Bell's competitors may be higher than those that Southwestern Bell plans to impose. Nevertheless, there can be no doubt that the early termination fees would achieve their desired goal of

providing a strong incentive for a business customer not to switch its service to a competing provider during the term of the service agreement. Any CLEC attempting to persuade a customer to leave Southwestern Bell while subject to a term agreement would not only have to offer a better rate but would also have to find a way to convince the customer to pay a large upfront penalty for leaving Southwestern Bell.

In addressing the possible impact of long-term service agreements, Walt Cecil, witness for the Staff, stated that:

> [i]n general, multi-year contracts artificially reduce the pool of potential CLEC customers and forestall the intended effects of the Act. By reducing the pool of potential customers, CLEC growth plans and investment recovery, essentially the opportunities to grow and to successfully compete are constrained.[6]

Cecil then went on to say that "Long term contracts offer lower prices and are more attractive to end-users. If end-users choose these lower priced, long-term relationships, the competitive environment in the long run is at risk of collapsing."[7] The Commission agrees with and accepts the expert opinion of Mr. Cecil.

Effect of Save and Winback Provisions

In addition to its provisions for term agreements, Southwestern Bell's CompleteLink tariff contains provisions that would give an additional four percent discount to customers who turn down a service offer from a CLEC to stay with Southwestern Bell. Furthermore, the tariff would reward customers who return to Southwestern Bell after having purchased services from a CLEC by giving them an additional eight percent discount. These tariff terms are referred to as "save" and "winback" provisions.

Southwestern Bell's save and winback provisions would have much the same impact on the health of competition in the local service market as would term agreements. But, in addition to the anticompetitive effects resulting from the use of term agreements by a dominant ILEC, save and

winback provisions can cause further damage to the emerging competitive market. Such provisions are targeted directly at the customer base of the CLECs. If Southwestern Bell takes back many of those customers with save and winback provisions, and then locks them up with long-term contracts, CLECs might be left without a customer base to which they can market. Edward J. Cadieux, witness for NuVox Communications of Missouri, Inc., one of the CLECs currently attempting to compete against Southwestern Bell, testified that the combination of term discounts and save and winback provisions might freeze competition at its currently inadequate level. If the CLECs are frozen out of the competitive market, they would then be forced to abandon their attempt to compete in Missouri, leaving only Southwestern Bell as a viable local service provider. Until the CLECs are in a strong enough position to effectively compete with Southwestern Bell, the use of save and winback provisions by Southwestern Bell is anticompetitive.

CONCLUSIONS OF LAW

The Missouri Public Service Commission has reached the following conclusions of law.

Southwestern Bell is a "Telecommunications Company" as that term is defined in Section 386.020(51), RSMo 2000, and is subject to the jurisdiction of the Commission pursuant to Section 386.250(2), RSMo 2000.

Section 392.230.3, RSMo 2000, grants the Commission the authority to determine, after hearing, the propriety of any rate, rental, charge, regulation, or practice filed with the Commission by any telecommunications company. That same section authorizes the Commission to suspend the operation of such rate, rental, charge, regulation, or practice for a period of 120 days, plus an additional six months if the hearing regarding such suspension cannot be concluded within 120 days.

In 1996 the Missouri General Assembly passed legislation aimed at promoting competition in Missouri's telecommunications industry. Section 392.185, RSMo 2000, which establishes the purpose of that legislation, states that:

The provisions of this chapter shall be construed to: (3) Promote diversity in the supply of telecommunications services and products throughout the state of Missouri; (6) Allow full and fair competition to function as a substitute for regulation when consistent with the protection of ratepayers and otherwise consistent with the public interest."

Therefore, the Public Service Commission has a duty to regulate Missouri's telecommunications industry in such a way as to promote the development of full and fair competition.

Section 392.200.2, RSMo 2000, provides in pertinent part as follows:

No telecommunications company shall directly or indirectly or by a special rate, rebate, drawback or other device or method charge, demand, collect or receive from any person or corporation a greater or less compensation for any service rendered or to be rendered with respect to telecommunications or in connection therewith, except as authorized in this chapter, than it charges, demands, collects, or receives from any other person or corporation for doing a like and contemporaneous service with respect to telecommunications under the same or substantially the same circumstances and conditions. *Promotional programs for telecommunications services may be offered by telecommunications companies for periods of time so long as the offer is otherwise consistent with the provisions of this chapter and approved by the commission.* ... (emphasis added)

This statute means that the Commission has an obligation to review promotional offers made by telecommunications companies to ensure that those offers are consistent with the provisions of statute, including the obligation to ensure the development and preservation of full and fair competition.

Section 392.200.3, RSMo 2000, provides as follows:

No telecommunications company shall make or give any undue or unreasonable preference or advantage to any person, corporation or locality, or subject any particular person, corporation or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever except that telecommunications messages may be classified into such classes as are just and reasonable, and different rates may be charged for the different classes of messages.

This statute has been interpreted to "forbid discrimination in charges for doing a like or contemporaneous service with respect to communication by telephone under the same or substantially the same circumstances and conditions."[8] Rate differences are permitted only

if there is any "reasonable and fair difference in condition which equitably and logically justifies a different rate." [9]

The Commission has previously found, as a matter of fact, that Southwestern Bell's proposed promotional tariffs will be detrimental to the health and development of competition in Missouri's local exchange market. Those tariffs are therefore unjust and unreasonable. In keeping with the Commission's obligation under Section 393.200, RSMo 2000, the Commission must reject Southwestern Bell's tariffs.

Decision

After applying the facts as it has found them to its conclusions of law, the Commission has reached the following decisions regarding the issues identified by the parties.

1. Should the Missouri Public Service Commission approve Southwestern Bell Telephone Company's Business Metropolitan Calling Area Service Promotion, which would discount Optional Metropolitan Call Area service rates pursuant to term contracts signed by business customers?

2. Should the Missouri Public Service Commission approve Southwestern Bell Telephone Company's CompleteLink Tariff, which contains term commitments and retention and winback provisions?

Southwestern Bell argues that its tariffs should not be rejected for six reasons. The Commission is not persuaded by any of Southwestern Bell's arguments. Southwestern Bell's first argument is that its Business MCA promotion and CompleteLink service offers are optional. In other words, no business customer will be obliged to sign up for these offers. The optional nature of Southwestern Bell's promotional offers would be relevant only if the Commission were concerned about the fairness of these offers as they impact individual customers. The Commission does not doubt that these offers could be of short-term benefit to

individual business customers. Certainly, business customers are sophisticated enough to do the necessary cost-benefit analysis to determine whether they will benefit from the proposed promotions. The Commission's concern is not with protecting the individual business customer. Rather, it is concerned about protecting the viability of the overall market for local exchange telecommunications services.

Indeed the problem may be that these promotions will be such a good deal for individual business customers that Southwestern Bell will be able to claim, and lock up for an extended period, so many customers that its competitors will be weakened, or even driven out of the market entirely. If that happens, competition will have failed and business customers will ultimately lose the benefits of competition.

Southwestern Bell's second argument is that its Business MCA promotion and CompleteLink service offer benefit customers through increased options and lower prices. Again, while the offers will benefit individual customers, at least in the short term, the Commission has found that Southwestern Bell's offers are a threat to the long-term health of the competitive market for local phone service. Ultimately, if the market fails, customers will be left with no choice except Southwestern Bell.

Third, Southwestern Bell argues that its Business MCA promotion and CompleteLink service offers are being made in response to the demands of its customers. Southwestern Bell asserts that its customers want: (a) to receive telecommunications services at lower prices; (b) service offerings that recognize the full volume of services that they are purchasing from SWBT; (c) term commitments that allow them to project the costs of their telecommunications needs; and (d) to purchase Southwestern Bell's CompleteLink service offer, which is available in the four other SBC Southwestern Bell states and the five SBC Ameritech states. The Commission does not doubt that there will be customer demand for the promotional offers that Southwestern Bell would like to make available. All businesses are interested in their bottom line, not necessarily with the health of competition. But the Commission has a duty to look beyond the bottom line. The Commission is obligated to protect the viability of the competitive market in order to protect Missouri's telecommunications customers from the threat of

monopoly power in a future without viable competition in the local telecommunications market.

Southwestern Bell's fourth argument is that it is offering its Business MCA promotion and CompleteLink service offer in response to the competitive market and that its proposed offerings will increase rather than harm competition. Southwestern Bell argues that this Commission and the Federal Communications Commission have recently found that Southwestern Bell has opened its local market in Missouri to competition when they approved Southwestern Bell's application to provide interLATA long distance service in Missouri. Southwestern Bell also points to the fact that ever larger numbers of CLECs are offering competitive services in its exchanges, testimony indicated that approximately 22 percent of the business market is now controlled by CLECs.

While this Commission and the FCC have found that Southwestern Bell satisfied the fourteen-point checklist found in Section 271 of the Telecommunication Act of 1996,[10] that finding only indicates that the local telecommunications market in Missouri is open to competition. It does not mean that the competitive market is mature enough to withstand the pressures that would be placed on it by the promotions proposed by Southwestern Bell. Unless the Commission acts to protect competition, the local exchange market may be open to competition but have no surviving competitors.

Southwestern Bell's fifth argument is that its Business MCA promotion and CompleteLink service offer are consistent with previous decisions of this Commission. Southwestern Bell presented evidence at the hearing of seventeen tariffs offering term discounts by seven of Southwestern Bell's competitors, fourteen tariffs offering volume discounts by eight of Southwestern Bell's competitors, and seventeen tariffs from ten of Southwestern Bell's competitors that contain save or winback provisions. Southwestern Bell also points out that the Commission has previously approved term, volume, save, or winback provisions in other

tariffs that it has submitted.

Southwestern Bell is correct when it contends that the Commission has previously approved, or allowed to go into effect, tariffs that contain provisions similar, or nearly identical to the provisions that it is rejecting in this order. However, the Commission is not bound to comply with its previous decisions. As an administrative agency the Commission is not bound by *stare decisis,*[11] and the failure of the Commission to explain why it is not taking the same position in one case that it took in a previous case is not a basis for overturning the Commission's action. [12] Furthermore, only these two tariffs are currently before the Commission. In finding that these two particular tariffs will harm competition, the Commission is not attempting to establish a rule with application beyond the facts of these cases. If other tariffs are brought to the attention of the Commission, the Commission will deal with those tariffs on their own merits. Similarly, the Commission will examine on their own merits tariffs submitted by CLECs that may contain term or volume discounts, or save or winback provisions.

The Commission makes no binding decision in this report and order beyond its rejection of the two tariffs currently before it. However, the Commission is currently considering another tariff filed by Southwestern Bell, as well as tariffs filed by various CLECs that also contain term agreements. While it does not wish to prejudge those cases, for the guidance of the telecommunications industry, the Commission will set forth its views regarding term agreements. The Commission believes that term agreements exceeding one year in length are an unacceptable threat to the health of competition. Term agreements that do not exceed one year in length may be acceptable.

Finally, Southwestern Bell argues that there is no statutory authority that would allow the Commission to reject its tariffs, or to treat its tariffs differently than those of its competitors. In

its conclusions of law the Commission has found to the contrary. The Commission believes that sound public policy requires that it take the steps necessary to preserve the existence of the competitive market for local exchange telecommunications services.

Based on the evidence, the arguments of the parties, the Commission's Findings of Fact and its Conclusions of Law, the Commission determines that Southwestern Bell's tariff to add a Business MCA promotion and its tariff to introduce its CompleteLink service offer are unjust and unreasonable and should be rejected.

IT IS THEREFORE ORDERED:

1. That the proposed tariff sheet submitted on July 20, 2001, by Southwestern Bell Telephone Company, and assigned Tariff No. 200200051, is rejected. The tariff sheet rejected is:

P.S.C. Mo. – No. 24
Local Exchange Tariff
Original Sheet 1.0302

2. That the proposed tariff sheets submitted on August 23, 2001, by Southwestern Bell Telephone Company, and assigned Tariff No. 200200151, are rejected. The tariff sheets rejected are:

P.S.C. Mo. – No. 35

General Exchange Tariff
Section 54
Original Sheet 1 through Original Sheet 5

3. That this Report and Order shall become effective on December 28, 2001.

BY THE COMMISSION

Dale Hardy Roberts

Secretary/Chief Regulatory Law Judge

(S E A L)

Simmons, Ch., and Lumpe, C., concur;
Gaw, C., concurs, with concurring opinion attached;
Murray, C., dissents, with dissenting opinion attached;
certify compliance with the provisions of
Section 536.080, RSMo 2000.
Forbis, C., not participating.

Dated at Jefferson City, Missouri,
on this 18th day of December, 2001.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Southwestern Bell Telephone Company's Tariff Filing to Initiate a Business MCA Promotion	)))	Case No. TT-2002-108
In the Matter of Southwestern Bell Telephone Company's Proposed Revisions to PSC Mo. No. 35 (General Exchange Tariff) Regarding CompleteLink	)))	Case No. TT-2002-130

CONCURRING OPINION OF COMMISSIONER STEVE GAW

I join in the decision of the majority but write separately to state that I agree that save and winback provisions, when used in conjunction with term agreements exceeding one year in length, are a threat to competition. However, I express no opinion today as to whether save and winback provisions, when not associated with term agreements exceeding one year, should be allowed.

Respectfully submitted,

Steve Gaw, Commissioner

Dated at Jefferson City, Missouri,
on this 18th day of December, 2001.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Southwestern Bell Telephone Company's Tariff Filing to Initiate a Business MCA Promotion	)))	Case No. TT-2002-108 Tariff No. 200200051
In the Matter of Southwestern Bell Telephone Company's Proposed Revisions to PSC Mo. No. 35 (General Exchange Tariff) Regarding CompleteLink	)))	Case No. TT-2002-130 Tariff No. 200200151

DISSENTING OPINION OF COMMISSIONER CONNIE MURRAY

I respectfully disagree with the majority's decision. The Commission has rejected two tariffs filed by Southwestern Bell Telephone Company that would offer reduced rates and other benefits to customers. The Commission indicates that it has taken this step because it fears that the tariffs will threaten competition in the basic local service market.

Without question, Southwestern Bell wants to offer these promotions so that it can improve its position in the competitive basic local service market. That is what competitor's do in a competitive market. It is equally understandable that Southwestern Bell's competitors, including those that appeared in this case, would like to prevent Southwestern Bell from improving its competitive position, while at the same time improving their own position. Again, that is what competitors do in a competitive market. There is, however, no sufficient evidence in the record for the Commission to conclude that it must step into the competitive market to

protect certain competitors by rejecting Southwestern Bell's promotional tariffs.

The types of promotions that Southwestern Bell is attempting to offer are not new. The evidence established numerous instances in which the Commission has approved term agreements, "save" provisions, and "winback" provisions as well as early-termination-fee provisions that are substantially similar to the provisions in the tariffs at issue. Those provisions have been offered by Southwestern Bell, as well as by its competitors. Yet there was no evidence presented that would indicate that these provisions have harmed the state of competition. Instead, the evidence indicates that the market continues to become more competitive.

The number of competitive local exchange carriers competing in that portion of the local market served by Southwestern Bell has increased from 47 in June of 2000, to 66 at the time of the hearing. CLEC's serve customers in every one of Southwestern Bell's exchanges and serve a minimum of 22 percent of the lucrative business market. Far from being stifled, competition in the basic local service market has continued to grow, and there is no reason to believe that the promotions proposed by Southwestern Bell will stifle competition in the future.

When competition was introduced to the basic local service market in 1996 there was an expectation that competition would provide an incentive for incumbent local exchange carriers, such as Southwestern Bell, to improve the service they offer their customers by offering more options and lower prices. Missourians have seen the fruits of that competition through promotional offers such as those that Southwestern Bell has been offering in the state and would like to continue to make available to its customers.

The proposed offers would be available for resale to CLECs at the resale discount. The result would be continued growth of competition with customers of both ILECs and CLECs having more options and lower prices. Furthermore, facilities-based CLECs have been free to offer similar services. If Southwestern Bell's proposed tariff were approved there would be an incentive for CLECs to respond in kind. Competing services are one of the benefits of a

competitive environment which would flow from the Commission's approval of Southwestern Bell's Business MCA promotion and Complete Link service offer.

The majority states that the use of the proposed tariffs by Southwestern Bell would be detrimental to the health and development of competition in Missouri's local exchange market. Yet, there are no findings of fact from the record that support that conclusion. In fact, there is no explanation of why those tariffs "are . . . unjust and unreasonable" in today's market which admittedly is more competitive than the market that existed when similar tariffs were previously found to be just and reasonable. Today's decision unnecessarily denies Missouri consumers many of the benefits of competition.

I respectfully dissent.

Respectfully submitted,

Connie Murray, Commissioner

Dated at Jefferson City, Missouri
on this 18th day of December, 2001

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[1] At their request, Choctaw Telephone Company and MoKan Dial, Inc. were excused from participation in the hearing and have not filed briefs.
[2] MCA is an acronym for Metropolitan Calling Area. The MCA service is available in several of Missouri's larger cities and permits a customer to make discounted calls across exchange boundaries within the metropolitan area.
[3] 47 U.S.C. 251(h).
[4] Cecil Rebuttal, exhibit 6, at 3
[5] Cecil Rebuttal, exhibit 6, at 3
[6] Cecil Rebuttal, exhibit 6, at 5.
[7] Cecil Rebuttal, exhibit 6, at 6.
[8] *State ex rel. DePaul Hospital v. PSC* , 464 S.W.2d 737, 738 (Mo. App. 1970)
[9] *Id*. at 740
[10] 47 U.S.C. 271(c)(2)(B)
[11] *State ex rel. GTE North v. PSC* 835 S.W.2d 356 (Mo. App. W.D. 1992)
[12] id.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs and For an Investigation Of BellSouth's Promotional Pricing And Marketing Practices by Florida Digital Network, Inc.	}	Docket No. 020119-TP
In Re: Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs by the Florida Competitive Carrier's Association	}	Docket No. 020578-TP

EXHIBIT MPG-4

FILED WITH THE DIRECT TESTIMONY OF MICHAEL P. GALLAGHER

FILED ON BEHALF OF

FLORIDA DIGITAL NETWORK, INC.

Rulemaking to Amend R. § 26.226 to Address Winback/Retetion Offers by Chapter 58 Electing Companies

Project #25784

List of Questions

1. As to (c) (2) (B), might the appropriate time period be 7, 10, 15, 60 or some other number of days? Please provide a rationale for such time period.
2. As to (c) (2) (C), might the appropriate discount level instead be 10% or some other level? Please provide a rationale for such level of discount. And might the appropriate time period instead be 30, 90, or some other number of days? Please provide a rationale for such time period.
3. Is (c) (2) (D) administratively practical and enforceable? If not, please propose alternative language that places any appropriate restrictions on retention offers.

Last Updated: 05/06/02

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§26.226. Requirements Applicable to Pricing Flexibility for Chapter 58 Electing Companies.

(a) **Application.** This section applies to any electing company as the term is defined in the Public Utility Regulatory Act (PURA) §58.002. Other sections applicable to an electing company, include, but are not limited to §26.211 of this title (relating to Rate-Setting for Services Subject to Significant Competitive Challenges), §26.224 of this title (relating to Requirements Applicable to Basic Network Services for Chapter 58 Electing Companies), §26.225 of this title (relating to Requirements Applicable to Nonbasic Services for Chapter 58 Electing Companies) and §26.227 of this title (relating to Procedures Applicable to Nonbasic Services and Pricing Flexibility for Basic and Nonbasic Services for Chapter 58 Electing Companies).

(b) **Purpose.** The purpose of this section is to establish requirements for Chapter 58 electing incumbent local exchange companies (ILECs) to exercise pricing flexibility.

(c) **Pricing flexibility.** An electing ILEC shall exercise pricing flexibility in accordance with this section and §26.227 of this title.

(1) Pricing flexibility includes:

(A) customer specific contracts,

(B) packaging of services;

(C) volume, term, and discount pricing;

(D) zone density pricing, with a zone to be defined as an exchange, and

(E) other promotional pricing.

(2) A discount or other form of pricing flexibility for a basic or nonbasic service may not be preferential, prejudicial, discriminatory, predatory or anticompetitive.

(A) A discount or other form of pricing flexibility for a basic or nonbasic service, including packaging of regulated and unregulated services, is presumed not to be discriminatory if it is made available on a system wide basis.

(B) A discount or other form of pricing flexibility for a basic or nonbasic service, including packaging of regulated and unregulated services, is presumed to be anti-competitive if the eligibility of such discount is limited to a former customer and the discount is offered to a former customer within 30 days after that customer switches to and is receiving service from a CLEC.

(C) A discount or other form of pricing flexibility, including packaging of regulated and unregulated services, where eligibility of such discount is limited to a former customer, is presumed to be anti-competitive if such discount or pricing flexibility consists of a discount for more than 25% of the recurring charges exceeding 60 days.

(D) A discount or other form of pricing flexibility, including packaging of regulated and unregulated services, is presumed to be anti-competitive if the eligibility for such discount is only for a customer who is

(i) considering changing some or all of their services to a competitor of the electing ILEC or an affiliate of the electing ILEC; and/or

(ii) has been contacted by a competitor of the electing ILEC or by an affiliate of the electing ILEC.

(3) This section does not prohibit a volume discount or other discount based on a reasonable business purpose.

(4) Notwithstanding PURA §58.052(b) or PURA, Chapter 60, Subchapter F, an electing company may exercise pricing flexibility for basic network services, including the packaging of basic network services with any other regulated or unregulated service or any service of an affiliate.

(5) An electing company may flexibly price a package that includes a basic network service in any manner provided by paragraph (1) of this subsection.

(6) An electing company may use pricing flexibility for a basic or nonbasic service.

(d) **Pricing standards.** An electing company exercising pricing flexibility shall price its offerings pursuant to this subsection.

(1) The electing ILEC shall set the price of a package of services containing basic network services and nonbasic services at any level at or above the lesser of.
   (A) the sum of the long run incremental costs of any basic network services and nonbasic services contained in the package; or
   (B) the sum of tariffed prices of any basic network services contained in the package and the long run incremental costs of nonbasic services contained in the package.

(2) A price that is set at or above the long run incremental cost of a service is presumed not to be a predatory price.

(3) The price of a package that combines regulated products or services with unregulated products or services shall, in addition to the requirements of paragraph (1) of this subsection, recover the cost to the electing company of acquiring and providing the unregulated products or services In this section, unregulated products or services are products or services provided by an entity that is unaffiliated with the electing company.

(4) The price of a package that combines regulated products or services with the products or services of an affiliate shall, in addition to the requirements of paragraph (1) of this subsection, recover the cost to the electing company of acquiring and providing the affiliate products or services, which shall be greater than or equal to the cost to the affiliate of acquiring and/or providing the products or services. The cost to the electing company of acquiring or providing the affiliate's products or services shall be valued in a manner consistent with FCC requirements and with paragraph (5) of this subsection. A group of products or services that are jointly marketed by an electing company in conjunction with one or more of its affiliates shall be priced in a manner consistent with FCC requirements, if any, and with paragraph (5) of this subsection.

(5) Consistent with PURA §52.051(1)(C), an electing company shall not use revenues from regulated monopoly services to subsidize services subject to competition.

(c) **Requirements for customer-specific contracts.** Consistent with PURA §58.003, an electing ILEC may enter into customer-specific contracts for certain basic network services and certain nonbasic services as provided in this subsection. Additionally, for services listed in PURA §52.057(a), an electing ILEC may enter into customer-specific contracts pursuant to §26.211 of this title only if such customer-specific contracts are not inconsistent with the requirements of PURA, Chapter 58.

(1) An electing company serving fewer than five million access lines may offer customer-specific contracts in accordance with this subsection.
   (A) An electing company serving fewer than five million access lines shall not offer customer-specific contracts until it notifies the commission of the company's binding commitment to make the following infrastructure improvements consistent with PURA §58.003(b):
      (i) install Common Channel Signaling 7 capability in each central office; and
      (ii) connect all of the company's serving central offices to their respective local access and transport area (LATA) tandem central offices with optical fiber or equivalent facilities.
   (B) The commitments described by subparagraph (A) of this paragraph do not apply to exchanges of the company sold or transferred before, or for which contracts for sale or transfer are pending on, September 1, 2001. In the case of exchanges for which contracts for sale or transfer are pending as of March 1, 2001, where the purchaser withdrew or defaulted before September 1, 2001, the company shall have one year from the date of withdrawal or default to comply with the commitments.

(2) An electing company serving more than five million access lines may offer customer specific contracts in accordance with this subsection.
   (A) Unless the other party to the contract is a federal, state, or local governmental entity, an electing company serving more than five million access lines may not offer in an exchange a service, or an appropriate subset of a service, listed in PURA §58.051(a)(1) – (4) or §58.151(1) – (4) in a manner that results in a customer-specific contract until the earlier of:
      (i) September 1, 2003; or

(ii) the date on which the commission finds that at least 40% of the total access lines for that service or appropriate subset of that service in that exchange are served by competitive alternative providers that are not affiliated with the electing company.

(B) Pursuant to subparagraph (A)(ii) of this paragraph, the commission may find that the following subsets of services are served by an alternative provider that is not affiliated with an ILEC serving more than five million access lines:

(i) flat residential rate local exchange telephone service;
(ii) residential primary directory listings;
(iii) residential tone dialing service;
(iv) lifeline and tel-assistance service;
(v) service connection for basic residential services;
(vi) flat business rate local exchange telephone service;
(vii) business primary directory listings;
(viii) business tone dialing service;
(ix) service connection for all business services;
(x) direct inward dialing for basic business services; and
(xi) receipt of a directory.

(3) This subsection does not preclude an electing company from offering a customer-specific contract to the extent allowed by PURA as of August 31, 1999.

(4) An electing company may not implement a customer-specific contracting program in such a way as to circumvent prohibitions contained in Chapter 58 and subsection (c)(2) of this section.

Bob Casey

From: Stewart, Roger [roger.stewart@puc.state.tx.us]
Sent: Friday, April 19, 2002 7:06 PM
To: 'bcasey@psc.state.fl.us'
Subject: TX PUC Proj 24948 winback investigation - TX PUC ok'd staff propo sal to initiate rulemaking

Hi Bob,
Just a brief update: In an "open meeting" yesterday (Thurs Apr 18), the TX Commissioners gave Staff an informal go-ahead to proceed with a winback rulemaking: to be Project 25784.
(Another note: looks as if the TX rulemaking may focus on discount pricing - such as: no discounts on recurring charges > X% or for more than Y months, no discounts at all in the first 7 or 10 or 30 days, etc. -- rather than on winback activities - such as: no winback marketing efforts within X days after switch, etc.)
Have a good weekend! (Hope you already are by the time of this message!)
Roger

Roger Stewart
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512-936-7296
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TR's State NewsWire.........with TRINSIGHT® -- April 15, 2002

STATE REGULATION WATCH
TEXAS -- Staff concludes 'win-back' restrictions are necessary
INDIANA -- URC sets hearings on Ameritech structural-separation plan
ARIZONA -- ACC to hold public meetings on Qwest LD bid
WASHINGTON -- UTC to examine Qwest's provisioning parity
OREGON -- AG files 'slamming,' prepaid service settlements
COLORADO -- Page recommends adopting 'N11' rules
ILLINOIS -- Court: filed-rate doctrine bars lawsuit
NEW YORK -- Court dismisses '976' complaint against Verizon

STATE LEGISLATION
CALIFORNIA -- Committee to mull sharing bill
CALIFORNIA -- Bill adds 'junk faxers' to 'no-call' list

BUSINESS ACTIVITY
ARIZONA -- Report examines Internet voting

PEOPLE ON THE MOVE
CALIFORNIA -- Gov. Davis appoints Superior Court judges

TEXAS -- Staff concludes 'win-back' restrictions are necessary

The Public Utility Commission staff plans to develop a "straw man" rule restricting price-cap-regulated incumbent local exchange carriers' "win-back" and retention promotions. Win-back programs attempt to persuade customers who have switched their local service to a CLEC (competitive local exchange carrier) to return to the incumbent.

The straw man rule could (1) prohibit incumbents from offering win-back promotions for the first 30 days after a customer converts local service to a competitor, (2) restrict the terms and discounts in incumbents' win-back promotions, and (3) restrict incumbents' retention offers, the staff said.

Some win-back and retention promotions "can have anti-competitive impacts," the staff said. The commission should "limit such impacts" until price-cap regulated incumbents "are no longer dominant carriers," the staff said.

The staff said that incumbents' rates for "many vertical features are above super-competitive levels," which is evidence that price-cap-regulated incumbents "continue to possess significant market power."

Last year, a group of competitors asked the PUC to ban price-cap-regulated incumbents' win-back tariffs. (9/7/01 a.m.) The commission denied the competitors' request but held a workshop to investigate the effect of incumbents' win-back and retention activities on competition to decide whether any rule changes were necessary. (Project 24597)

INDIANA -- URC sets hearings on Ameritech structural-separation plan

The Utility Regulatory Commission has scheduled April 15-16 hearings on a proposal to separate SBC Ameritech-Indiana's retail and wholesale operations.

Last year, the Association of Communications Enterprises, AT&T Corp., the Competitive Telecommunications Association, and McLeodUSA Telecommunications Services, Inc., asked the commission to divide Ameritech's operations. (5/11/01 a.m.) AT&T told *TR* that structural separation was necessary to "jump start" competition in the residential local services market. SBC Ameritech controls more than 98% of residential and small business lines and more than 95% of all lines, AT&T said.

ARIZONA -- ACC to hold public meetings on Qwest LD bid

The Corporation Commission is planning to hold public comments sessions on Qwest Corp.'s bid to enter the in-region interLATA (local access and transport area) services market under section 271 of the federal Telecommunications Act of 1996, an ACC staff member told *TR*. The comment sessions will likely take place in May in the state's major population centers, the staff member added.

WASHINGTON -- UTC to examine Qwest's provisioning parity

OPEN MEETING COVER SHEET

MEETING DATE: April 18, 2002

DATE DELIVERED: April 12, 2002

AGENDA ITEM NO. : 24

CAPTION: Project No. 24948 – Investigation of Winback/Retention Offers by Chapter 58 Electing Companies

ACTION REQUESTED: Discussion and Possible Action on Staff Recommendation

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Public Utility Commission of Texas

Memorandum

TO:	Commissioner Brett A. Perlman Commissioner Rebecca Klein
FROM:	Bih-Jau (BJ) Sheu – Telecommunications Division Randy Klaus – Telecommunications Division Tina Ghabel – Policy Development Division Roger Stewart – Legal Division
DATE:	April 12, 2002
RE:	Agenda Item No. 24, Project No. 24948 – Investigation of Winback/Retention Offers by Chapter 58 Electing Companies

Summary

Staff proposes that the Commission conclude this investigation with a finding that certain winback/retention promotions by Chapter 58 electing companies can have anti-competitive impacts. Staff thus recommends amending SUBST. R. 26.226 to limit such impacts until such time that Chapter 58 ILECs are no longer dominant carriers. Staff's analysis leading to that recommendation is found below. Attached to this memorandum please find a procedural history and a summary of parties' positions (Attachment A).

Staff Recommendation

Staff again recommends against a blanket prohibition of winback and retention offerings, consistent with Staff's response to the rulemaking petition in Project No. 24597. Such a restriction would undoubtedly deprive customers of one of the intended benefits of competition. Insulating CLECs from that form of price competition would deny customers of price reductions that might otherwise occur when competitors woo each other's customers. Nevertheless, Staff agrees with CLEC commenters that winback/retention offers can be used to selectively target marginally competitive market segments to the detriment of competition, especially in the early stages. The market reality that prices of many vertical features are above super-competitive levels today is

evidence that Chapter 58 ILECs continue to possess significant market power. Staff further recognizes that dominant carriers are able to use narrowly-tailored winback/retention promotions to keep competition sufficiently weak so that prices generally can be maintained or raised above the competitive level without losing so many sales so rapidly that the price increase proves unprofitable and must be rescinded.

Staff also notes that PURA permits Chapter 58 companies pricing flexibility with the following caveat – such pricing flexibility may not be preferential, prejudicial, discriminatory, predatory, or anticompetitive. PURA § 51.004(a). Given current market conditions and the State of Texas policy to "(1) promote diversity of telecommunications providers" and "(2) encourage a fully competitive telecommunications marketplace" (PURA § 51.001; *see also* § 58.001(5)), Staff believes that the intermediate and long-term benefits of encouraging and maintaining market viability and provider choice for customers in general can outweigh certain short-term benefits to certain individual customers. Staff therefore recommends that the Commission direct Staff to initiate a rulemaking amending SUBST. R. 26.226 regarding certain types of promotions until such time that Chapter 58 ILECs are no longer dominant carriers.

Staff envisions that a "straw man" rule language would impose certain time and term/discount restrictions on winback and retention promotions. The "straw man" rule language could include:

- A time restriction on winback promotions (e.g. a Chapter 58 ILEC must wait 30 days after a former customer has switched to a competitor to offer such promotions.)
- A limit on discounts and terms provided in winback promotions.
- Restrictions placed on retention offers.

As mentioned above, provided in attachment A are a procedural history and a summary of parties' positions drawn from the oral and written comments before, at, and after the workshop.

Attachment A

Procedural History

On September 4, 2001, Southwest Competitive Telephone Association, IP Communications Corporation, XO Texas, Inc., Association of Communications Enterprises, Competitive Telecommunications Association, Sage Telecom, Inc., Z-Tel Communications, Inc, and Birch Telecom Of Texas, LLP (Petitioners) filed a petition (assigned to Project No. 24597) to amend P.U.C. SUBST. R. 26.226. Petitioners sought to amend SUBST. R. 26.226 relating to Requirements Applicable to Pricing Flexibility for Chapter 58 Electing Companies by incorporating a blanket prohibition of winback and retention programs to curtail what they believed to be anticompetitive and discriminatory behavior.

On October 12, 2001, Southwestern Bell Telephone Company (SWBT) and Verizon Southwest (Verizon) filed comments opposing that petition. Time Warner Telecom of Texas, L.P., Ionex communications, Inc., KMC Telecom, Inc. and Talk America, Inc. filed comments supporting the petition.

On November 8, 2001, the Commission denied the petition in Project No. 24597 but directed Staff to hold a workshop to further investigate the issues raised by the Petition. In response to Staff questions issued in this project, a number of carriers and trade associations filed comments on November 30, 2001. Staff held a workshop on December 12, 2001. Parties filed post-workshop comments on January 18, 2002. In light of "new" comments from SWBT, Staff invited reply comments, which were filed on March 15, 2002.

Summary of Parties' Positions:

(Note: Comments regarding the alleged misuse of customer proprietary network information (CPNI) are omitted intentionally, because Project No. 22490 dealt specifically with that issue and resulted in Subst. R. 26.122(c)(3) regarding the use of CPNI in a retention or winback context)

CLEC commenters:

CLEC commenters contended that marketing practices by incumbent local exchange carriers (ILECs) directing special "winback" and "retention" promotions and practices constitute price discrimination. CLEC commenters opined that ILECs as former monopolists intend to squelch developing competition and withhold the benefits of competition from all but a few customers. CLEC commenters stated that ILECs are able to maintain high rates for a certain group of customers while limiting price reductions to only those customers that have sought competitive choice due to the ILEC's market dominance.

According to CLEC commenters, the foundations for this investigation are the competitive protections in PURA and the continued market dominance of ILECs in Texas. CLEC commenters stated that pricing flexibility is prohibited for Chapter 58 companies if the promotion is preferential, prejudicial, discriminatory, predatory, or anticompetitive, and that the Commission has repeated those restrictions in Subst. Rule 26.226. Furthermore, CLEC commenters urged the Commission to look at the reality of the market today and to recognize the substantial market share and market power enjoyed by the ILECs.

CLEC commenters defined winback and retention offers as ILEC offerings that contain favorable price or contractual terms to a CLEC's customer previously served by the ILEC in order to induce the customer to return to the ILEC. Such inducements are however, not offered to other similarly situated ILEC customers. CLEC commenters claimed that all special pricing promotions as part of winback/retention activities that meet the definition above are anticompetitive and/or discriminatory when offered by an entity with market power.

CLEC commenters emphasized that the Legislature, recognizing that competition remains in the early stages in Texas, tempered the availability of pricing flexibility with a requirement that such pricing flexibility not be exercised in a manner that is preferential, prejudicial, discriminatory, predatory, or anticompetitive.

CLEC commenters stated that, although the magnitude of the problem of winback/retention activities is hard to gauge, ILECs are able to deter entry by

demonstrating their ability to "chill" aggressive entry and expansion through a multitude of promotions to winback or retain their customers. Thus, unchecked anticompetitive behavior will have a chilling affect on the development of competition, even though the number of Texas relevant winback/retention offers may currently be low.

CLEC commenters contended that winback/retention promotions by ILECs with substantial market power are a form of "price discrimination" and will lead to concentration/preservation of market power, especially when offered only to CLEC customers and/or prospective CLEC customers. CLEC commenters averred that restricting offers only to CLEC consumers discriminated against those consumers who have not received service from a CLEC. Furthermore, it is such discrimination that constitutes the exact nature of the anticompetitive affect of the winback/retention promotions. By targeting CLEC customers, ILECs increase their existing market power while at the same time using existing market power to continue to obtain the higher and likely super-competitive rates from the remaining and overwhelming majority of consumers. CLEC commenters urged the Commission to prohibit such market power-driven winback/retention promotions, and to create an environment that will allow market development to discipline prices and force down monopoly rates that the winback/retention offers seek to perpetuate.

CLEC commenters argued that retention offers discriminate between existing customers with competitive choice and existing customers without competitive choices because competition generally develops in pockets, either in market segments or geographic areas. The anticompetitive winback/retention promotions by ILEC may stifle the CLECs' opportunities to expand to new segments and locations, thus delaying the development of competitive choice to new customer locations and classes. As a result, the price discipline that competition would otherwise provide has little chance to materialize. This is especially true of local exchange telephone services, where customer concentration drastically reduces the cost of deploying central office facilities and facilities over the last mile.

CLEC commenters disagreed that restricting winback eligibility to former customers is for a reasonable business purpose. CLEC commenters stated that the

industry is in transition and that former monopolists' use of market power to perpetuate the benefits of that power must be deemed illegitimate and discriminatory.

CLEC commenters opined that for the theory of "functionally availability" to exist, consumers would require perfect information, perfect service conversions, and negligible transaction costs. Moreover, for a winback/retention offer to be "functionally available" to all customers, there must be competitive choice effectively available to every customer of an ILEC. Otherwise, the issue of "functional availability" remains a hypothetical discussion.

CLEC commenters stated that "meeting competition" is not a term of economics but of rhetoric. The economic outcome of a winback/retention promotion is determined by the effect of market power on developing markets and the use of that market power to keep the benefits of competition from developing in a manner that would exist in the absence of market power. Moreover, ILECs have other venues to "meet competition" that are permissible and without resorting to practices that take advantage of their market power. For example, ILECs can offer system wide price reductions on those services that they deem to be under competitive pressure, provided that those reductions do not drop prices below the threshold of predatory pricing. CLEC commenters urged the Commission to encourage broad-based rate reductions and bring the benefits of competition to all customers.

CLEC commenters stated their belief that it is permissible to ban or limit winback/retention offers made by dominant carriers while not likewise banning or limiting such offers made by non-dominant carriers. CLEC commenters stated that the Commission is obligated pursuant to PURA § 58.152 to disallow any attempt to exercise pricing flexibility by dominant carriers that is preferential, prejudicial, discriminatory, predatory, or anticompetitive. Not only did PURA impose no similar statutory requirement for CLECs, but also, because CLECs have no market power, CLECs as "price takers" cannot manipulate the market to obtain inflated rates. The sole benefit for CLECs when initiating a winback offer is to regain the customer. However, with a dominant ILEC, there exists the secondary benefit of distorting the market by obtaining monopoly profits from its broader customer base. It is exactly this secondary benefit that causes the dominant ILEC's promotion to be anticompetitive and discriminatory.

CLEC commenters claimed that no forums other than a rule clarification/modification are available for addressing the oversight of potential market power abuse in the winback/retention activities. CLEC commenters stated that filing a complaint on a case-by-case basis in the tariff review process is extremely limited in the scope of each case and burdensome for an individual competitor to justify. CLEC commenters sought further definition within the Commission's rules to specifically define the anticompetitiveness of such promotional activity. CLEC commenters believe there is no other forum with a similar breadth of application and administrative efficiency to allow competitors to bring this issue before the commission.

CLEC commenters posited that there is no lesser remedy other than a ban of winback/retention promotions that will remove or mitigate the discriminatory or anticompetitive aspects of such offers. No time restriction or price restriction will prevent ILECs from utilizing market power to thwart the development of competition with one hand while perpetuating continued super-competitive rates with the other.

Filing separately from other CLECs, VarTec asserted that the commission should prohibit ILEC winback offers from the time the CLEC places the conversion order up to at least the first 30 days after the customer converts to a competitive provider. VarTec opined that this window of time will allow the competitive provider a more reasonable time to establish the consumer's service and resolve any initial service impairments. Furthermore, this extra time will allow the consumer a more meaningful opportunity to experience having service with a company other than the ILEC, giving them the ability to know the benefits of competition first-hand.

Finally, CLEC commenters suggested that a HHI (Herfindahl-Hirschman Index) of 1000 is evidence of lack of market power. However, said the CLEC commenters, the current HHI is in excess of 8,000, and the threshold HHI for a determination that winback/retention promotional activities are no longer anticompetitive should be 1,000, 2,500, or somewhere in between, but such a determination is not immediately relevant.

Chapter 58 ILECs:

SWBT countered that retention/winback programs are pro-competitive and pro-consumer so long as they are not predatory. SWBT argued that discounts specifically targeting certain customer groups are not unlawfully discriminatory, because those discounts have a "reasonable business purpose" – "meeting competition." SWBT said that CLEC commenters' requested relief would insulate CLECs from normal competitive pressures and would deny CLEC customers the benefits of competition. SWBT contended that the Commission should either disregard the retention/winback offers in other states, because those programs are neither offered in Texas nor governed by Texas law, or the Commission could observe that such offers are being demonstrated throughout the country as a reasoned response to competition. SWBT further stated that competition is significant, and that the Commission should disregard CLEC commenters' inflammatory allegations that local competition is in a fledgling state and that retention/winback offers are an abuse of market power.

SWBT defined a winback offer as "a promotional offer or discount that is available to former customers who voluntarily terminated their service and subscribed to another service provider." [1] SWBT also defined retention offer as "a promotional offer or discount that is available to existing customers who have an offer from another company available to them and are considering switching their service to another company."

SWBT argued that winback/retention activities can be anticompetitive only if they involve predatory pricing. SWBT also contended that winback/retention activities are not unlawfully discriminatory if they (a) do not draw "status-based distinctions among classes of protected entities that are arbitrary with respect to the policies that PURA is meant to advance," (b) are a direct response to competition, or (c) provide discounts that are "functionally available to all similarly situated customers."

SWBT averred that there is no "problem" with winback/retention activities now or in the foreseeable future. According to SWBT, winback and retention programs are fundamental tools for obtaining and retaining customers in a competitive market.

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[1] Project 24948, Comments of SWBT in Response to Questions Posed by the Commission's Staff, p.1. November 30, 2001

Moreover, winback and retention activities result in price decreases and service value increases, consistent with the objectives of a competitive market. Customers would be denied the benefit of a competitive market–reduced price if any carrier is barred from making rationally responsive offers such as winback and retention offers.

SWBT claimed that if it is prohibited from making competitive winback or retention offers, then customers considering using or are already using an alternative provider will wrongly view SWBT's unresponsiveness as an indication that SWBT is not interested in providing service to them and/or is unable to viably compete for their business. Eliminating a service provider's ability to offer such competitive options would be contrary to customer expectations about how a competitive market works and harm the competitive market's ability to function as it should.

SWBT maintained that winback/retention promotions do not lead to "concentration of market power." Rather, having to respond to the offer of another competitor is substantial evidence that "market power" does not exist. Furthermore, the existence of winback/retention promotions shows that no provider controls the market price in a way that permits monopoly profits and there is no capacity constrain in the marketplace.

SWBT averred that winback offers do not discriminate between new-but-not former customers and new-but-former customers. The former group lacks experience and a past relationship with SWBT and may not have any experience with CLECs in Texas. In contract, the latter group has had experience with both SWBT and at least one CLEC in Texas. Furthermore, to the extent that this different treatment can be characterized as "discrimination" because SWBT can only "win back" a former customer, then such "discrimination" is reasonable in view of the differences in customers' experiences and relationships with SWBT.

SWBT argued that retention is not discriminatory between existing customers with competitive choice and existing customers without competitive choices because all customers have competitive choice in Texas due to the proliferation of CLECs, satellite providers, wireless providers, and Internet telephony, and with ubiquitous CLEC market coverage available via SWBT's unbundled network element platform.

SWBT claimed that restricting winback eligibility to former customers is legitimate and not discriminatory because it is for a reasonable business purpose. Customers that have switched to another carrier demonstrate a relative lack of brand loyalty and tend to care more about price than about other product attributes such as particular brand names or quality characteristics. It is therefore a common business practice to appeal to their preferences by attempting to attract them via price offers. Other customers tend to care more about other service attributes, and it is a common and reasonable business practice to appeal to different customers on the basis of their different revealed preferences.

SWBT contended that under the federal Robinson-Patman Act, promotional incentives are not discriminatory if they are "functionally available" to all similarly situated customers. SWBT's winback/retention promotions are functionally available to all customers and not unlawfully discriminatory.

SWBT posited that meeting competition is a reasonable business purpose regardless of whether the offeror is a dominant carrier or allegedly has "market power."

SWBT argued that consumers would be left with fewer choices and competition would be inhibited if limitations were placed on dominant carriers only. SWBT claimed that straight-jacketing the allegedly "dominant" carrier might artificially increase CLEC profits and diminish CLECs' incentives to price their services competitively, to the detriment of competition and consumers.

SWBT asserted that no forum is necessary to address winback/retention promotions. Rather, the Commission should be concerned abut "regulatory process abuse" by which one or more competitors tries to convince a regulator to unfairly and unlawfully shackle another competitor, solely for the purpose of minimizing the level of competition to the detriment of consumers and competition. SWBT argued that ILEC winback/retention should not be prohibited or limited; therefore there is no need to consider a trigger for review or termination of any prohibitions or limitation.

SWBT's hired economist Dr. Aron claimed that the appropriate basis to evaluate a winback/retention offer is by its anticipated effects on consumer welfare and economic efficiency. According to her, the remedy sought by CLEC commenters would create a price umbrella to protect the inefficient competitors from price competition to the

detriment of consumers. Dr. Aron also stated that market power is a red herring because it is relevant only in evaluating whether a producer or cartel of producers can increase and maintain its prices above a competitive level without losing so many customers as to make the behavior unprofitable. Dr. Aron further stated that SWBT is not pricing predatorily and does not undercut its rivals' prices. Dr. Aron concluded that there is no public benefit – in the long run or the short run – gained from limiting winback/retention offers.

Additionally, Verizon claimed a rule amendment to prohibit winback/retention would violate the federal Telecom Act of 1996 requirement that consumer safeguards be competitively neutral. Verizon posits that the Texas Legislature has already addressed consumer safeguards in PURA Chapter 60. Verizon also argued that market share is not synonymous with market power and ILECs do not posses market power. Verizon stated that market power is defined as the ability to increase and sustain prices significantly above competitive levels without losing so many customers that the increase in price is unprofitable. Verizon contended that ILEC price reductions through winback and retention offers constitute evidence that ILECs do not possess market power.