REBUTTAL TESTIMONY OF STEVEN A. INKELLIS

ON BEHALF OF MCI

DOCKET NO. 960980-TP - 960847

September 30, 1996

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Steven A. Inkellis. My business address is MCI Communications Corporation, 1801 Pennsylvania Avenue, NW, Washington, DC 20006.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by MCI Communications Corporation as Vice President, Law and Public Policy. In that position, I am responsible for commercial affairs relating to MCI Telecommunications Corporation sales and marketing of telecommunications and related goods and services. In connection with MCI's entry into local telecommunications services, I have been asked to assist MCI Telecommunications Corporation and its affiliated local services company, MCI Metro Access Transmission Services, Inc., in their interconnection negotiations with incumbent local exchange telephone companies ("ILECs"). In particular, I have been acting as commercial counsel, together with other attorneys in MCI's Law and Public Policy group, in support of MCI's negotiations with various GTE telephone operating companies for interim and long term agreements for local exchange interconnection, resale and unbundled network elements. I have been responsible for preparing drafts of agreements, reviewing drafts under negotiation, supporting MCI's business negotiators responsible for the

interconnection arrangements MCI seeks, and from time to time personally engaging in the direct negotiations process.

Q. PLEASE SUMMARIZE YOUR BACKGROUND AND EXPERIENCE.

A. I have been employed in various commercial legal positions of increasing responsibility with MCI since May 1985, providing support for nearly every major business unit at MCI. For the last several years, I have been responsible for general legal support for MCI's major commercial operating units, MCI Mass Markets and MCI Business Markets. I supervise a staff of approximately 45 attorneys plus support staff, who are responsible for negotiating commercial arrangements with MCI's customers and vendors and for supporting MCI's marketing organizations in product development and promotion. In that capacity, I have been involved in development of MCI's local product initiatives, which has required me to become familiar with the provisions of the Telecommunications Act of 1996 promoting competition in the local exchange market and to become engaged in MCI's substantial efforts to integrate local exchange service into its existing product portfolio. Prior to that, I was an associate attorney with the law firm of Squire, Sanders & Dempsey from 1979-1985 with a varied commercial and public policy practice. I received a J.D. from George Washington University's National Law Center in 1979 and a B.A. from the University of Massachusetts at Amherst.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to explain why sound commercial practice and

public policy demonstrate that MCI's proposed provisions governing liability limits and indemnity should be adopted over GTE's proposed provisions in the arbitrated interconnection agreement between GTE and MCI. I am advised that this issue was identified in its current form after the deadline for filing direct testimony in this docket. My testimony generally responds to the portion of Mr. Langley's direct testimony filed in the AT&T arbitration proceeding (and incorporated by reference in this docket) in which he states that an ALEC should not be permitted to penalize GTE for not maintaining ALEC-imposed standards, and that liquidated damages should not be used as a penalty in an arbitrated agreement. (Langley Direct in Docket 960847-TP at pages 39-40)

Q. WHAT CONTRACTUAL PROVISIONS FOR LIABILITY AND INDEMNITY DOES MCI PROPOSE FOR INCLUSION IN THE ARBITRATED AGREEMENT BETWEEN MCI AND GTEFL?

A. The liability and indemnity provisions that MCI believes should be included in the arbitrated agreement are set forth below. These provisions have been the subject of negotiations between MCI and GTE. MCI also sought the assistance of the Commission staff to mediate this issue. Even with mediation, the parties have been unable to reach agreement. The highlighted portions show the language that GTE has been unwilling to agree to.

LIMITATION OF LIABILITY

Neither Party shall be liable to the other for any lost profits, or revenues or for any indirect, incidental, special or consequential damages arising out of or related to this

Agreement or the provision of service hereunder. Notwithstanding the foregoing, a Party's liability shall not be limited in the event of its willful or intentional misconduct, including gross negligence, ***its repeated breach of any one or more of its material obligations under this Agreement,*** or its acts or omissions causing bodily injury, death or damage to tangible property, ***or with respect to the Indemnifying Party's indemnification obligations under this Agreement.***

INDEMNITY

Each Party (the "Indemnifying Party") will indemnify and hold harmless the other Party ("Indemnified Party") from and against any loss, cost, claim, liability, damage, expense (including reasonable attorney's fees) to third parties, relating to or arising out of negligence or willful misconduct by the Indemnifying Party, its employees, agents, or contractors in the performance of this Agreement, ***or the failure of the Indemnifying Party to perform its obligations under this Agreement.*** In addition, the Indemnifying Party will, to the extent of its obligations to indemnify hereunder, defend any action or suit brought by a Third Party against the Indemnified Party.

It should be noted that this language is reciprocal, and each party has the same liability for its own intentional misconduct, gross negligence, or repeated breach of contract.

Q. WHAT IS THE MAIN AREA OF DISAGREEMENT BETWEEN MCI AND GTE?

A. The principal difference between the parties, in my opinion, is that GTE is unwilling to take responsibility for the natural consequences that would flow from its failure to provide interconnection services to MCI in accordance with the terms it will be required to provide in the arbitrated agreement. GTE attorneys, anticipating that GTE will fail to perform as required, are anxious to ensure that GTE will not suffer significant financial risk arising out of such failures. MCI is rightly concerned that substantial incentives exist for GTE employees to be negligent in providing effective interconnection services to MCI. MCI wishes to ensure that reasonable and appropriate incentives exist to cause GTE employees to effectively provide the services MCI requires. The difficulty for GTE employees is that the better they perform under the interconnection agreement, the better able MCI will be to compete with GTE in its monopoly local exchange market, GTE's crown jewel marketplace. To counter that, MCI needs to ensure that GTE employees will understand that failure to perform will cause GTE to incur the risk of substantial financial obligations. If MCI is successful in this arbitration, GTE attorneys will instruct their clients that there can be significant costs to GTE associated with repeated breaches of material interconnection obligations. I believe, based on my years of practice as commercial legal

counsel, that corporate employees faced with such choices will choose to perform their company's contractual obligations. If the goals of the Telecommunications Act of 1996 are to be achieved for the benefit of consumers, then there must be strong incentives for the ILECs to perform under the arbitrated agreements in accordance with their terms.

The principal natural consequence of GTE's failure to perform will be lost revenues and profits for MCI--that is, to the extent that MCI is unable to connect its network with GTE's, MCI will be unable to obtain and/or retain local services customers in GTE's former monopoly market. Thus, GTE will retain the customers, revenues and profits, and MCI will be left with no remedy other than to seek orders from this Commission enforcing the contract terms. The parties understand that it would be difficult for MCI to prove that GTE intentionally breached its agreement. Thus, MCI has asked that it have recourse to a lost revenues and profits damages claim in the event the GTE repeatedly breaches material provisions of the agreement. MCI believes that repeated breaches of material terms is tantamount to intentional or grossly negligent breach (which GTE accepts should cause it to lose any liability limitation protection). Moreover, GTE well understands that there is no other effective contractual remedy for MCI. The normal contract remedy for breach, cover damages, is simply unavailable where, as here, the only source of supply for interconnection to GTE's customers, network elements and resold ILEC service is GTE alone. MCI cannot cover. Thus, its only remedy is to seek its lost business revenues and profits, the clear and natural consequence of repeated breaches by GTE of its

material obligations. With respect to the indemnity provision, the parties disagree on whether GTE should be responsible to protect MCI against claims by its customers that result from GTE breach of the agreement. In the newly competitive and emerging market for local exchange services, customers will demand and get from their telecommunications suppliers the right to seek damages for failure to perform as promised. MCI will for some time to come be substantially reliant on GTE in order to provide local exchange service to its customers. If GTE is able to evade its responsibility to indemnify MCI against customer claims arising out of GTE's repeated failure to perform its material obligations, then MCI will be left with a significant coverage gap in a newly competitive marketplace. Overall, the effect of GTEFL's position is that it could repeatedly breach the agreement with impunity, unless the breaches resulted from GTE's intentional misconduct or gross negligence.

Q. HOW COULD MCI BE DAMAGED BY GTE'S BREACH OF ITS AGREEMENT?

A. If GTE does not perform its interconnection obligations, three things will happen, all of them bad for MCI but good for GTE. First, MCI will be unable to permit any of its local service customers to call or receive calls from GTE customers. Of course, as GTE currently has all or nearly all the local customers on its network, no rational consumer would sign up for MCI's service knowing that he or she could not call or receive calls from nearly anyone else in the local calling area. Second, MCI will be unable to effectively resell GTE's local service. Thus, the principal product MCI will require initially to enter the local consumer

services market will be unavailable. Third, MCI will be unable effectively to obtain and use unbundled network elements to combine to provide telecommunications services. The effect of any of those three will be that GTE will retain its existing customers and revenue and MCI will be unable to mount effective competition for GTE's monopoly customer base. In the meantime, GTE will continue to work to erode MCI's base of long distance customers by offering to them integrated local and long distance calling, service integration that customers have clearly indicated they desire. Without any of these three services provided in an effective manner, MCI will be unable to develop the critical mass of local services customers required to finance its own facilities build out. The natural result will be that GTE will remain the entrenched monopoly supplier.

For example, if GTE repeatedly fails to install interconnection circuits within contractually agreed time frames, or if the interconnection repeatedly fails to meet contractually agreed performance standards, the quality of service to MCI's customers will suffer. MCI may fail to meet scheduled due dates to transfer customers from GTE to MCI. Or if interconnection does not meet agreed quality standards, MCI's customers could experience an unsatisfactory level of call blocking. Either of these situations affect the public perception of MCI's service quality, even though the problems were caused by GTE's breach of its agreement. Moreover, GTE marketers can be expected to exploit these service deficiencies by advertising GTE reliability and quality attributes versus those of their new competitors. Of course, during any delay in transferring service from GTE to MCI, MCI will lose revenues and GTE will be unjustly enriched. And if MCI

develops a reputation for poor or spotty service quality, customers will elect to remain with GTE, or reconvert to GTE, again translating to lost profits for MCI and unjustified profits for GTE.

Q. WHAT IS THE EFFECT OF GTE'S POSITION?

A. The effect of GTE's proposed language would be to insulate GTE from financial responsibility for the consequences of breaching its agreement. GTE's attempt to limit liability in this way is totally unreasonable when you consider the nature of the relationship between GTE and MCI:

- MCI must interconnect with GTE in order for customers of the two companies to complete calls to each other. MCI has no alternative supplier for the needed interconnections and therefore no way to mitigate any damage caused by GTE's breaches.
- MCI for the first time will be competing in GTE's core business. Contrary to a typical commercial transaction in which a supplier (GTE) has an incentive to keep a large customer (MCI) happy, GTE has the incentive to see MCI fail, since every customer MCI captures represents a loss of market share to GTE. If GTE is not responsible for damages caused by a breach of its agreement, it is unlikely that GTE employees will be rewarded for making MCI's entry into the market run smoothly, or disciplined if that entry is delayed or frustrated. Put another way, no GTE employee is likely to receive a promotion for making MCI a stronger competitor in GTE's richest and best market.
- Because of the nature of interconnection, any problems will typically

degrade the quality of service to MCI's entire customer base.

Q. IF THE AGREEMENT WAS TOTALLY SILENT ON THE ISSUE OF LIABILITY, WOULD GTE BE RESPONSIBLE FOR LOST PROFITS AND OTHER CONSEQUENTIAL DAMAGES CAUSED BY A BREACH OF THE AGREEMENT?

A. Yes it would. Although I am not admitted to practice in Florida, I understand that the common law in Florida in consistent with that in most states, and that GTE would be responsible for any reasonably foreseeable consequential damages that result from a breach of contract. Given the nature of the agreement between MCI and GTE, lost profits are clearly a reasonably foreseeable result of a breach. MCI's proposed language affords protection to GTE that is above what it would have under general contract law, since there is no liability for consequential damages from a single breach, or from beach of minor contract provisions -- but only for damages from ***repeated breaches*** of its ***material obligations***.

Q. DON'T UTILITY TARIFFS TYPICALLY EXCLUDE LIABILITY FOR CONSEQUENTIAL DAMAGES?

A. Yes, they do, but for sound public policy reasons that do not apply here. Rate of return regulated monopolies have traditionally been permitted to limit their liability for their customers' consequential damages. First, it's often difficult for the utility to know what those damages might be and the damages may be substantially unrelated to the cost of the service. Thus, if a telephone company's banking customer is unable to place a trade, the customer might incur substantial

damages while the cost of the failed call might be pennies. Second, if the utility were held responsible for such damages, it would pass those costs on to its general body of ratepayers. In a regulated rate of return monopoly environment, the regulator would have been forced to permit this and there would be no competition to force the inefficient provider to limit its failures. Third, the tariff provisions are not designed to encourage new entrants to offer services that will unseat the incumbent from its monopoly supplier status. Instead, those tariffs apply to typical supplier-customer relationships, not to the particular type of supplier-competitor relationship that will exist under the MCI/GTE agreement. As I stated before, the incentives for GTE to fail to fully perform its obligations are much different here than in the usual case. Most importantly, if GTE fails to deliver as promised, MCI simply has no other supplier to turn to.

Q. IF MCI LIMITS LIABILITY TO ITS CUSTOMERS BY TARIFF, COULD GTE BE HELD RESPONSIBLE FOR AN MCI CUSTOMER'S LOST PROFITS IF IT BREACHED THE INTERCONNECTION AGREEMENT?

A. No. Let me start by noting that it is my understanding from local regulatory counsel that MCI will be required to file a price list for local service in Florida but will not be required to file a tariff. It is unclear to me exactly how limitations of liability will be established in this regulatory environment. I am hopeful, however, that GTE will not be in a better position to limit liability to its customers via tariffs than MCI will be able to as an ALEC operating without tariffs. In any event, under the proposed indemnity provision, GTE's responsibility for an MCI's customer's lost profits resulting from a GTE breach

would never exceed MCI's liability to that customer. And, of course, MCI will endeavor to limit its exposure for such losses to its customers in accordance with good telecommunications industry practice. However, if MCI sustained lost profits as a result of GTE's repeated breaches, GTE would be liable to MCI for those damages.

Q. HAS ANY OTHER LOCAL COMPANY AGREED TO MCI'S LANGUAGE ON LIABILITY AND INDEMNIFICATION?

A. Yes. Here in Florida, BellSouth has agreed to MCI's proposed provisions. In California, GTE itself has accepted this language first with MCI and with at least one other ALEC in agreements we've seen on file. Pacific Bell, too, has accepted this language. In each of these three cases where I have been personally involved in the negotiations the ILEC has accepted our rationale. I am at a loss to understand why GTE continues to oppose language that it accepted in California and that is clearly becoming industry standard for interconnection agreements.

Q. YOU STATED EARLIER THAT UNLESS GTE TAKES FINANCIAL RESPONSIBILITY FOR THE NATURAL CONSEQUENCES OF ITS ACTIONS, IT WILL NOT HAVE AN INCENTIVE TO FULLY PERFORM ITS OBLIGATIONS UNDER THE AGREEMENT. ISN'T THIS MORE OF A THEORETICAL CONCERN THAN A PRACTICAL ONE?

A. Absolutely not. In the early days of long distance competition, when the Bell System was both the supplier of access and the long distance competitor, the Bell

System used its monopoly power in a variety of ways to impede entry by MCI and other competitive carriers. See, United States v. AT&T, 524 F. Supp. 1336, 1352-1357 (D.D.C. 1981) and United States v. AT&T, 552 F. Supp. 131, 160-163 (D.D.C. 1982). In those early days of competition, AT&T disconnected MCI interconnections causing MCI grave harm in the marketplace. Similar problems existed in the GTE system as a result of its partnership with AT&T. See, United States v. GTE Corporation, 603 F. Supp. 730, 735 n. 23 (D.D.C. 1984). The same incentives exist in the local market today, as MCI and others begin to enter and compete with GTE in its core business.

Further, in the long distance access arena, I am advised that GTE has a poor track record of meeting service due dates. This could be an even greater problem in the local service arena unless GTE has the proper contractual incentives to perform up to its agreed standards.

Q. ARE YOU SUGGESTING THAT MCI'S PROPOSED CONTRACT LANGUAGE WOULD ELIMINATE THESE INCENTIVES.

A. Not entirely. But MCI's proposed contractual provisions -- which do nothing more than place financial responsibility on GTE for the consequences of actions that would at once harm MCI and benefit GTE -- can at least create a positive incentive for GTE to avoid repeated breaches of its contract.

Q. HOW SHOULD PUBLIC POLICY CONSIDERATIONS INFLUENCE THE COMMISSION'S DECISION ON THIS ISSUE?

A. Actions by the Florida Legislature and the U.S. Congress have established a public policy in favor of local competition. MCI's proposal advances competition by requiring GTE to take responsibility if it repeatedly breaches its contract to provide essential services to a new competitor. GTE's proposal, on the other hand, does nothing to promote competition. Instead it says that "so long as you can avoid being charged with intentional misconduct or gross negligence, you don't have to be very careful about how you meet your contractual obligations to your competitors." Adoption of GTE's proposal would affirmatively subvert the strong public policies favoring creation of competition in the local exchange marketplace.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.