



Public Service Commission

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DATE: June 6, 2002

TO: DIRECTOR, DIVISION OF THE COMMISSION
ADMINISTRATIVE SERVICES (BAYO)

FROM: DIVISION OF COMPETITIVE MARKETS & ENFORCEMENT (BARRETT, ^{msb} *AB*)
^{SAS} SIMMONS, CASEY, BULECZA-BANKS, GILCHRIST) ^{MSB} *AB*
OFFICE OF THE GENERAL COUNSEL (BANKS, DODSON) ^{FRB} *FRB*

RE: DOCKET NO. 020119-TP - PETITION FOR EXPEDITED REVIEW AND
CANCELLATION OF BELLSOUTH TELECOMMUNICATIONS, INC.'S KEY
CUSTOMER PROMOTIONAL TARIFFS AND FOR INVESTIGATION OF
BELLSOUTH'S PROMOTIONAL PRICING AND MARKETING PRACTICES,
BY FLORIDA DIGITAL NETWORK, INC.

AGENDA: 06/18/02 - REGULAR AGENDA - PROPOSED AGENCY ACTION -
INTERESTED PERSONS MAY PARTICIPATE

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: NONE

FILE NAME AND LOCATION: S:\PSC\CMP\WP\020119.RCM

CASE BACKGROUND

On January 15, 2002, BellSouth Telecommunications, Inc. (BellSouth) filed its 2002 Key Customer promotional tariff, Tariff No. T-020035, which became effective on January 31, 2002. On February 14, 2002, Florida Digital Network, Inc. (FDN) filed a Petition for Expedited Review and Cancellation of BellSouth Telecommunications, Inc.'s Key Customer Promotional Tariffs and For An Investigation of BellSouth Telecommunications, Inc.'s Promotional Pricing and Marketing Practices (Petition). On March 5, 2002, BellSouth filed its Response and Answer to FDN's Petition.

The promotional tariff at issue is currently effective and terminates on June 25, 2002. Based upon a history of BellSouth's past tariff filings, it is not uncommon for BellSouth to begin a

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new promotion upon, or near, the termination date of any given program. To illustrate, on May 10, 2002, BellSouth issued a notification to carriers of its intent to file a substantially similar tariff on June 11, 2002, to become effective on June 26, 2002 - the day after the promotional tariff at issue expires. Based on the notification, the (anticipated) discount levels and terms are slightly different, yet the qualifications and restrictions appear to be identical.

On March 13, 2002, the Commission issued Order No. PSC-02-0331-PCO-TP, to initiate an expedited discovery procedure in this docket because of the limited duration of this tariff. Additionally, the expedited discovery procedure was ordered because customers may continue to avail themselves of this tariff option while a determination as to its validity is pending - at least until the termination date.

Staff notes that on March 25, 2002, BellSouth filed a Motion for Reconsideration (Motion) of the Prehearing Officer's Order No. PSC-02-0331-PCO-TP, issued March 13, 2002. On April 2, 2002, FDN filed a Response to the Motion. The Motion asks for reconsideration of the discovery time frames required in the Order. In discussions between staff counsel and counsels for BellSouth and FDN, the concern regarding the discovery time frame has been reviewed on a going-forward basis. However, it is staff's understanding that should this matter be set for hearing, an Order Establishing Procedure would be issued with new discovery time frames. If, however, this docket is closed, there would be no need to address the Motion. In either case, the Motion would be rendered moot. Therefore, the Motion is not being addressed in this recommendation and will be addressed separately, if necessary.

This recommendation addresses the allegations raised by FDN with respect to the tariff filing and BellSouth's marketing practices, including, but not limited to "winbacks" and customer retention practices.

The Commission is vested with jurisdiction in this matter pursuant to Sections 364.01, 365.051, 364.08, and 364.285, Florida Statutes.

DISCUSSION OF ISSUES

ISSUE 1: Should BellSouth's 2002 Key Customer tariff filing (T-020035) be canceled?

RECOMMENDATION: No. BellSouth's 2002 Key Customer tariff filing (T-020035) should not be canceled. (**BARRETT, SIMMONS, GILCHRIST, BANKS**)

STAFF ANALYSIS: The argument set forth in this recommendation turns on the issue of whether staff can determine if BellSouth's 2002 Key Customer Program tariff filing meets certain criteria, including whether the rates for services purchased under it are compensatory. Staff believes that in order to be compensatory, a service offering or tariff must be priced at a rate equal to or greater than its incremental cost. After a general overview, staff will organize the arguments along the following topics:

- A) Is BellSouth's 2002 Key Customer Program tariff unduly discriminatory in concept?
- B) Are the rates for services purchased under BellSouth's 2002 Key Customer Program compensatory?
- C) Are the rates for BellSouth's 2002 Key Customer Program less than the wholesale cost for an ALEC?

General Overview

Commission records indicate that on January 15, 2002, BellSouth filed a tariff package entitled the 2002 Key Customer Program, with an effective date of January 31, 2002. The promotional tariff at issue is currently effective and terminates on June 25, 2002. The 2002 Key Customer promotional tariff replaces the 2001 Key Customer Program, though the 2001 Key Customer Program had not yet expired. (See T-020035) The specific discount terms in the two promotions are different, and staff notes that no petitions were filed in opposition to the 2001 Key Customer Program which was filed on June 11, 2001. Additionally, as stated in the Case Background, on May 10, 2002, BellSouth issued a notification to carriers of its intent to file a substantially similar tariff on June 11, 2002, to become effective on June 26, 2002 - the day after the promotional tariff at issue expires. Based on the notification, the (anticipated) discount levels and

terms are slightly different, yet the qualifications and restrictions appear to be identical.

The tariff package for the 2002 Key Customer Program set forth the offering, eligibility, and the restrictions of the offering, which are briefly summarized below.

2002 Key Customer Program Promotional Offering

- Percentage discount of 10 or 25% off of the customer's monthly total billed revenue¹, depending upon the length of contract signed. [The percentages are 10% for a 18 month contract, and 25% for a 36 month contract.]
- Percentage discount of 50 or 100% off of the monthly hunting service fees, depending upon the length of contract signed. [The percentages are 50% for a 18 month contract, and 100% for a 36 month contract.]
- A choice of Internet services consisting of certain waivers or monthly credits. [Specific offers vary by Internet product type.]

2002 Key Customer Program Eligibility

- Program is available to existing, new, or former BellSouth business customers that are served from selected wire centers, and who have monthly revenues in the range of \$75.00-\$3,000.00 per month.
- The promotion began on January 31, 2002, and ends on June 25, 2002.
- Subscriber must sign a 18 or 36 month agreement to receive the benefits of the program.

¹BellSouth monthly total billed revenue consists of total recurring, non-recurring, and usage charges subject to certain exclusions for nonregulated services, taxes, late payment charges, or access revenues.

2002 Key Customer Program Restrictions

- BellSouth customers with aggregate annual billings exceeding \$36,000 per state are not eligible to participate in this program.
- Customers with existing Volume and Term Agreement Contract Service Arrangements are not eligible to participate in this program.
- Customers with Analog Private Line Services are not eligible to participate in this program.
- In the event that the subscriber terminates the contract, the subscriber must pay BellSouth all cumulative discounts received to date.

Prior to the tariff's effective date, staff requested a meeting with BellSouth representatives to discuss some concerns about the initial filing, requesting BellSouth to specify the wire centers that were eligible and to supply cost data to support the tariff filing. On January 17, 2002, BellSouth representatives and staff met, and BellSouth subsequently substituted certain tariff pages. The tariff was processed administratively and became effective on January 31, 2002.

Although the effective date of BellSouth's 2002 Key Customer Program tariff was January 31, 2002, FDN petitioned the Commission on February 14, 2002 to

. . . enforce Sections 364.01(4)(a), (c), and (g), 364.051(6), 364.08, 364.09, 364.10, and 364.3381(3), Florida Statutes, and, specifically, to immediately review and cancel or, alternatively, suspend or postpone, the 2002 Key Customer tariff and any like tariffs filed by BellSouth Telecommunications, Inc. ("BellSouth") and to launch a comprehensive investigation of BellSouth's promotional pricing and marketing practices. (FDN Petition at p. 1)

FDN states the Commission has not reviewed the cost basis for the promotional discounts in BellSouth's 2002 Key Customer tariff filing. "The Commission is required to do so in support of a

finding of anticompetitive behavior and irreparable harm, or to suspend/postpone a tariff," according to FDN. (FDN Petition at ¶28) FDN alleges that it and other ALECs have suffered "and will continue to suffer irreparable competitive harm" if BellSouth's promotional tariff remains in effect. (FDN Petition at ¶18)

In addition, FDN claims that BellSouth's 2002 Key Customer Program tariff is aimed exclusively at existing and potential ALEC customers. (FDN Petition at ¶10) FDN believes that BellSouth's 2002 Key Customer Program tariff and other promotional tariffs are "unduly discriminatory on their face." (Id.) FDN alleges that the prices offered in the 2002 Key Customer Program ". . . are designed to, and have no purpose other than to, eliminate the competition." (FDN Petition at ¶26)

BellSouth counters that FDN's claims are unsubstantiated and states:

If the real-world facts bore any resemblance to these allegations, a dwindling number of ALECs in Florida would be serving a . . . steadily declining number of business access lines . . . [when, however,] just the opposite is happening. (BellSouth response to Petition at pp. 5-6)

BellSouth maintains that the 2002 Key Customer Program is "not limited to end users that are being served by ALECs or that are considering purchasing services from an ALEC. Instead, any business customer that . . . meets the . . . eligibility requirements may participate in the program." (Italics in original; BellSouth response to Petition at p. 7)

Additionally, BellSouth responds to FDN's allegation that the 2002 Key Customer Program results in rates that are lower than an ALEC reseller's wholesale cost as follows:

This allegation is utterly without merit because the 2002 Key Customer Program itself is available for resale. (BellSouth response to Petition at p. 7)

A) Is BellSouth's 2002 Key Customer Program tariff unduly discriminatory in concept?

FDN believes that BellSouth's 2002 Key Customer Program tariff "extends discounted rates to one segment of small business

customers who are indistinguishable from all other small business customers during the effective period of the lower rates," since BellSouth is only offering the promotion in those wire centers that have an ALEC presence, the so-called "hot wire centers." (FDN Petition at ¶9, 30) FDN asserts that business customers across all wire centers are similarly situated; having or lacking an ALEC presence should not be material, according to FDN, and BellSouth's 2002 Key Customer Program "does not treat them equally." (FDN Petition at ¶30) Additionally, FDN contends that BellSouth markets to soon-to-be-former customers using different means and methods than it employs for all other customers. (FDN Petition at ¶40) Staff notes that the marketing-related issues are addressed in Issue 2.

BellSouth states that it selected the "hot wire centers" on the basis of "heightened competitive activity in those wire centers." (BellSouth response to Petition at p. 7) BellSouth references Section 364.051(5) (a), Florida Statutes, which states in part:

364.051 Price regulation.--

. . . .

(5) NONBASIC SERVICES.--Price regulation of nonbasic services shall consist of the following:

. . . .

(a) . . . Nothing contained in this section shall prevent the local exchange telecommunications company from meeting offerings by any competitive provider of the same, or functionally equivalent, nonbasic services in a specific geographic market or to a specific customer by deaveraging the price of any nonbasic service, packaging nonbasic services together or with basic services, using volume discounts and term discounts, and offering individual contracts. However, the local exchange telecommunications company shall not engage in any anticompetitive act or practice, nor unreasonably discriminate among similarly situated customers.

. . . .

Staff believes that nothing in Section 364.051(5)(a), Florida Statutes, prohibits or restricts a LEC from targeting specific geographic markets and offering volume and term discounts. Therefore, staff believes that BellSouth's targeting is permissible under the provisions of this statute. As a result, staff is not swayed by FDN's contention that BellSouth's 2002 Key Customer Program tariff is unduly discriminatory based upon the argument that BellSouth only selectively offers the promotion in the so-called "hot wire centers."

In addition, FDN argues that BellSouth's 2002 Key Customer Program is discriminatory because it coincides with a separate tariff offering that increases the rates for all retail residential and business customers, including those not served by "hot wire centers." (FDN Petition at ¶12, 27) FDN asserts that such coincident action is anticompetitive behavior, and that "BellSouth, the dominant carrier in its Florida territory, has embarked on a course to selectively eliminate Florida's competing carriers through discriminatory offers and anticompetitive practices designed to lure away the competitors' current and potential customers." (FDN Petition at ¶19)

On January 11, 2002, BellSouth filed a tariff with the Commission to increase basic and nonbasic local exchange service rates in accord with Section 364.051, Florida Statutes. (See T-020030) The effective date of said tariff was February 16, 2002. Staff cites the relevant parts of Section 364.051, Florida Statutes:

(2) BASIC LOCAL TELECOMMUNICATIONS SERVICE.--Price regulation of basic local telecommunications service shall consist of the following:

(a) Effective January 1, 1996, the rates for basic local telecommunications service of each company subject to this section shall be capped at the rates in effect on July 1, 1995, and such rates shall not be increased prior to January 1, 2000. However, the basic local telecommunications service rates of a local exchange telecommunications company with more than 3 million basic local telecommunications service access lines in service on July 1,

1995, shall not be increased prior to January 1, 2001.

. . .

(3) In the event that it is determined that the level of competition justifies the elimination of price caps in an exchange served by a local exchange telecommunications company with less than 3 million basic local telecommunications service access lines in service, or at the end of 5 years for any local exchange telecommunications company, the local exchange telecommunications company may thereafter on 30 days' notice adjust its basic service prices once in any 12-month period in an amount not to exceed the change in inflation less 1 percent. Inflation shall be measured by the changes in the Gross Domestic Product Fixed 1987 Weights Price Index, or successor fixed weight price index, published in the Survey of Current Business or a publication, by the United States Department of Commerce. In the event any local exchange telecommunications company, after January 1, 2001, believes that the level of competition justifies the elimination of any form of price regulation, the company may petition the Legislature.

. . .

(5) NONBASIC SERVICES.--Price regulation of nonbasic services shall consist of the following:

(a) . . . a price increase for any nonbasic service category shall not exceed 6 percent within a 12-month period until there is another provider providing local telecommunications service in an exchange area at which time the price for any nonbasic service category may be increased in an amount not to exceed 20 percent within a 12-month period, and the rate shall be presumptively valid.

. . .

Staff reviewed the earlier tariff (T-020030) and determined that the rate increases were in compliance with the applicable statutes. Staff does not believe the two tariff filings conflict with the

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provisions of Section 364.051, Florida Statutes, and as such, we do not believe that FDN has demonstrated that the tariffs - alone or in combination - are unduly discriminatory in concept.

FDN also alleges that the termination liability provision in the 2002 Key Customer Program is discriminatory. The Petition states:

To take advantage of BellSouth's promotional pricing, subscribers must accept a "poison pill" condition that makes it extremely costly for them to later change carriers. Subscribers that sign up to receive promotional discounts, but leave BellSouth service before expiration of the contract term must reimburse BellSouth for **all** discounts received **and** pay any applicable termination charges. (Emphasis in original; FDN Petition ¶13)

Staff notes, however, that a termination liability is commonplace in many types of contracts, not just contracts signed in conjunction with a promotional offering.² Staff does not agree with FDN's characterization that a termination liability is "a poison pill," inasmuch as the customer is making a tradeoff -- lower rates in return for a commitment period. Staff believes that such tradeoffs are a common business practice, and this does not suggest that BellSouth's 2002 Key Customer Program tariff is unduly discriminatory.

B) Are the rates for services purchased under BellSouth's 2002 Key Customer Program compensatory?

In order for an offering to be compensatory, staff believes that it must be offered at a rate equal to or greater than its incremental cost. FDN argues that BellSouth's price inducements, up to and including free services in certain circumstances, are anticompetitive and violate certain Florida Statutes. (FDN Petition at ¶14, 23) In its Petition, FDN states

[T]he Commission has not reviewed the cost bases for the promotional discounts. The Commission is required to do so in support of a finding of anticompetitive behavior

²For example, termination liability provisions are very common in contracts for wireless services.

and irreparable harm, or to suspend/postpone a tariff. Pricing below profitability is not the applicable legal test. Rather, the Commission may act to halt (at least temporarily) any pricing/conduct that on its face is more anticompetitive than pro-competitive. In any case, one cannot say BellSouth's promotional prices are at a point above profitability or may be offered as a result of BellSouth's superior efficiency without questioning: (a) why BellSouth does not offer the promotional prices and free services to all of its customers, (b) how BellSouth can offer free and significantly discounted service without creating cross subsidies, (c) why BellSouth has increased rates to its other retail customers, and (d) why the tariff requires a subscriber to reimburse BellSouth if migrating before term's end. (FDN Petition at ¶28)

BellSouth contends that FDN's petition offers "no facts whatsoever" to infer that BellSouth is not in compliance with the applicable statutes. (BellSouth response to Petition at pp. 10-11) Furthermore, BellSouth states that the Commission staff explored these topics with Company representatives in a January 17, 2002, meeting in which BellSouth provided information to "demonstrate that its prices comply with Florida Statute Section 364.052 [sic] and, therefore, do not create cross subsidies." (Id.)

Staff notes that Section 364.08(2), Florida Statutes, addresses the statutory language regarding free service. Additionally, the sale of services at a below-cost rate is the topic of Section 364.051(5)(b) and (c). The pertinent portions of these statutes are as follows:

364.08 Unlawful to charge other than schedule rates or charges; free service and reduced rates prohibited.-

. . .

(2) A telecommunications company subject to this chapter may not, directly or indirectly, give any free or reduced service between points within this state. However, it is lawful for the commission to authorize employee concessions if in the public interest.

. . .

364.051 Price regulation.-

. . .

(5) NONBASIC SERVICES.--Price regulation of nonbasic services shall consist of the following:

. . .

(b) The commission shall have continuing regulatory oversight of nonbasic services for purposes of ensuring resolution of service complaints, preventing cross-subsidization of nonbasic services with revenues from basic services, and ensuring that all providers are treated fairly in the telecommunications market. The cost standard for determining cross-subsidization is whether the total revenue from a nonbasic service is less than the total long-run incremental cost of the service. Total long-run incremental cost means service-specific volume and nonvolume-sensitive costs.

(c) The price charged to a consumer for a nonbasic service shall cover the direct costs of providing the service and shall, to the extent a cost is not included in the direct cost, include as an imputed cost the price charged by the company to competitors for any monopoly component used by a competitor in the provision of its same or functionally equivalent service.

Staff notes that via discovery, certain cost data was obtained from BellSouth and evaluated. Specifically, a confidential cost analysis spreadsheet was produced along with various "typical customer" examples that supported BellSouth's price levels. (BellSouth's response to Staff Interrogatory No. 4) BellSouth asserts that the rates for services purchased under BellSouth's 2002 Key Customer Program are compensatory based upon "typical customer" configurations. (BellSouth's response to Staff Interrogatories Nos. 11, 14)

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In BellSouth's response to Staff Interrogatories Nos. 1-3 and Requests for Production of Documents Nos. 1-3, BellSouth submitted copies of the single-sheet enrollment forms for "actual" subscribers enrolled between January 31, 2002 and March 18, 2002. BellSouth did not identify the quantity of these forms, though staff estimates the number to be approximately 4,500. The enrollment forms, however, did not provide any sort of data about the quantities or types of individual services BellSouth was providing to these subscribers. Nonetheless, staff was able to determine that the percentage of contracts which are potentially non-compensatory is very low, based upon our analysis of other (confidential) information, related to the approximately 4,500 subscribers, that was provided.

In BellSouth's response to Staff Interrogatory No. 6, BellSouth states that it is not in violation of Section 364.08(2), Florida Statutes, by offering a 100% discount on line hunting service because this service is not a stand-alone offering and must be purchased with another service, and "the promotion as a whole covers cost." (See BellSouth's response to Staff Interrogatory No. 6). In response to Staff Interrogatory No. 14, BellSouth produced additional "typical configuration" examples for customers with services such as MegaLink®, ESSX®, MultiServ®, Centrex, and PBX which indicate that the discounted pricing in the 2002 Key Customer Program is compensatory. (See BellSouth's response to Staff Interrogatory No. 14)

Although BellSouth's examples of "typical customer" scenarios indicate that the rates for services purchased under BellSouth's 2002 Key Customer Program are compensatory, "actual" customer data was not evaluated. An argument could be made that an analysis of the rates and incremental costs associated with the services purchased by actual (as opposed to typical) customers might be necessary to conclusively determine if services purchased under BellSouth's 2002 Key Customer Program are compensatory. As previously stated, based on our analysis of BellSouth's responses to various staff discovery, we can determine that the percentage of contracts which are potentially non-compensatory is very small. By and large, and based upon the data BellSouth provided, staff believes the rates for services purchased under BellSouth's 2002 Key Customer Program are compensatory.

C) Are the rates for BellSouth's 2002 Key Customer Program less than the wholesale cost for an ALEC?

Under the maximum terms of this promotion, an eligible subscriber would be entitled to a 25% discount on the total billed revenue as set forth in the tariff. (See T-020035) FDN contends that such a substantial discount off of retail rates for a single group of small business customers calls into question the sufficiency of BellSouth's avoidable costs:

If BellSouth can make do with revenue from small business customers that is reduced by 25%, then perhaps BellSouth needs less revenue from its small business customers and/or BellSouth's wholesale rate to resellers should have a greater percentage reduction than the rate currently approved by the commission. (FDN Petition at ¶29)

BellSouth denies FDN's allegations and states that its post-discount rates after application of either the 10 or 25% factor are not below the ALEC's wholesale cost for resale or UNEs, citing examples with actual rates. (BellSouth response to Petition at pp. 8-10)

BellSouth also states that its 2002 Key Customer Program is available for resale, stating that any services resold would be subject to the current resale discount rate of 16.81%. (BellSouth response to Petition at ¶25) An ALEC reseller will always pay less to resell a promotion, according to BellSouth. (Id.) BellSouth also discusses the framework for an avoided cost calculation as provided in Section 252(d)(3) of the Act. BellSouth states that the Act

provides that the resale rate for a service is the retail rate for the service less the costs BellSouth avoids when it provides on a wholesale (as opposed to retail) basis . . . After these avoided costs are removed from the retail rate of the service, the resulting resale rate may include, among other things: (1) costs that are *not* avoided by providing the service on a wholesale basis; (2) contribution to overhead; and/or (3) any profit margin that was built into the retail rate. (Italics in original; BellSouth response to Petition at ¶29)

BellSouth states that FDN "simply does not support its claims of anticompetitive pricing." (BellSouth response to Petition at p. 10)

Staff observes that Section 252(d)(3) of the Act reads:

(3) WHOLESALE PRICES FOR TELECOMMUNICATIONS SERVICES.-

For purposes of Section 251(c)(4), a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.

Accordingly, the resulting wholesale rate may bear no resemblance to the incremental cost of providing the service at retail. Staff believes that BellSouth's ability to discount its retail rates and still cover incremental cost is not instructive in determining the reasonableness of the wholesale discount. Thus, staff does not believe FDN's assertions are on point. Staff does not believe the rates for BellSouth's 2002 Key Customer Program are less than the wholesale cost for an ALEC.

Though not directly related to any of the three preceding topics, staff had concerns about how BellSouth was (and is) adhering to the restrictions of Tariff No. T-020035, particularly in light of BellSouth's initial disclosure that it may have erroneously enrolled customers in its 2002 Key Customer Program. (BellSouth's April 22, 2002 Response to Staff's Interrogatory No. 11) After a thorough analysis, BellSouth reported that only eight (8) customers were erroneously enrolled through May 10, 2002. (BellSouth's May 16, 2002 Supplemental Response to Staff Interrogatory No. 11, BellSouth's May 20, 2002 Response to Staff Interrogatory No. 15) BellSouth attests that all eight (8) of these customers were BellSouth customers at the time their respective contracts were signed, and acknowledges that those enrollments were improper. BellSouth states that it is contacting these affected customers and offering them options for resolving the discrepancy. (BellSouth's May 16, 2002 Supplemental Response to Staff Interrogatory No. 11, BellSouth's May 20, 2002 Response to Staff Interrogatory No. 15) BellSouth traced the erroneous enrollments to specific salespersons, who have been counseled about the

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restrictions for the 2002 Key Customer Program. In addition, BellSouth orally re-emphasized that message to its entire sales force, and is developing a "written reiteration" on the topic. (BellSouth's May 16, 2002, Supplemental Response to Staff Interrogatory No. 11, BellSouth's May 20, 2002, Response to Staff Interrogatory No. 15) Staff intends to verify that BellSouth has (and is) applying its 2002 Key Customer Tariff correctly.

Conclusion

Based upon the preceding analysis and staff's review of the current data available, staff's recommendation is that BellSouth's 2002 Key Customer tariff filing (T-020035) should not be canceled. Our analysis considered FDN's allegations regarding whether BellSouth's 2002 Key Customer Program tariff was unduly discriminatory in concept, whether the rates for services purchased under the Program were compensatory, and whether BellSouth's post-discount rates were below an ALEC's wholesale cost. In each case, staff was not convinced by FDN's arguments that BellSouth's 2002 Key Customer Program tariff conflicted with applicable Florida Statutes.

ISSUE 2: Should any restrictions be placed on BellSouth marketing practices used for BellSouth's "win-back" promotions?

RECOMMENDATION: Yes, BellSouth should be prohibited from initiating any "win-back" activities to regain a customer for thirty days after the conversion to an Alternate Local Exchange Company (ALEC) is complete. The Commission should also prohibit BellSouth from including any marketing information in its final bill sent to customers who have switched providers, and prohibit BellSouth's wholesale division from sharing information with its retail division, such as informing the retail division when a customer is switching. (CASEY, BULECZA-BANKS)

STAFF ANALYSIS: Initiating a "win-back" program can be very advantageous for carriers. A study by Marketing Metrics found the average company has a 20 to 40 percent probability of successfully regaining a previous customer, and only a 5 to 20 percent probability of making a successful sale to a new prospect³.

Staff believes a "win-back" promotion is not in and of itself detrimental to competition. In fact, "win-back" promotions can be very beneficial to Florida consumers by giving them a choice of providers with varied services at competitive prices. The Federal Communications Commission (FCC) addressed "win-back" marketing in Order FCC 99-223, stating:

Win-back facilitates direct competition on price and other terms, for example, by encouraging carriers to "out bid" each other for a customer's business, enabling the customer to select the carrier that best suits the customer's needs. (¶ 68)

However, the manner in which a "win-back" promotion is marketed may result in anticompetitive behavior. The concept of "win-back" can be divided into two distinct types of marketing: marketing intended either to (1) regain a customer, or (2) retain a customer. Regaining a customer applies to the marketing situation where a customer has already switched to and is receiving service from another provider. Retention marketing, by contrast, refers to a carrier's attempts to persuade a customer to remain

³"Customer Winback - How to Recapture lost customers and keep them loyal", by Jill Griffin and Michael W. Lowenstein

with that carrier before the customer's service is switched to another provider.

"Win-back" Marketing to Regain a Customer

"Win-back" marketing programs by Incumbent Local Exchange Companies (ILECs) to regain a customer have been addressed by many state commissions. Attachment A of this recommendation contains a brief summary of other commissions' actions. Actions taken have ranged from a minimum action such as a mandatory waiting period before "win-back" marketing by the ILEC can commence, to a more stringent action such as outright rejection of "win-back" promotional tariffs to allow the ALECs to gain a foothold in the market.

The FCC has also addressed "win-back" marketing promotions. In Order FCC 99-223, released September 3, 1999, the FCC stated:

Some commenters argue that ILECs should be restricted from engaging in "win-back" campaigns, as a matter of policy, because of the ILECs' unique historic position as regulated monopolies. Several commenters are concerned that the vast stores of CPNI gathered by ILECs will chill potential local entrants and thwart competition in the local exchange. We believe that such action by an ILEC is a significant concern during the time subsequent to the customer's placement of an order to change carriers and prior to the change actually taking place. Therefore, we have addressed that situation at Part V.C.3, *infra*. However, once a customer is no longer obtaining service from the ILEC, the ILEC must compete with the new service provider to obtain the customer's business. We believe that such competition is in the best interest of the customer and see no reason to prohibit ILECs from taking part in this practice. (¶ 69) Because "win-back" campaigns can promote competition and result in lower prices to consumers, we will not condemn such practices absent a showing that they are truly predatory. (¶ 70)

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The FCC again addressed "win-back" campaigns in Order No. FCC 02-147⁴, released May 15, 2002. In answer to commenters remarks about BellSouth's marketing tactics, the FCC acknowledged state commission actions and stated:

We find that, in the absence of a formal complaint to us that BellSouth has failed to comply with section 222(b), the winback issue in this case has been appropriately handled at the state level, and that the actions undertaken by the state commissions and BellSouth should be sufficient to ensure it does not recur. The Georgia Commission issued an interim measure to prohibit BellSouth from engaging in any winback activities once a customer switches to another local telephone service provider. Since the Georgia Commission issued the interim measure, the Georgia Commission has opened a proceeding to investigate the allegations submitted to the state Commission, and determined that the staff of the Georgia Commission and the interested parties should develop a code of conduct for the industry. While there have been no formal complaints against BellSouth on this issue in Louisiana, the Louisiana Commission ordered BellSouth to abstain from any winback activities for seven days after a customer switches to another local telephone service provider, prohibited BellSouth's wholesale divisions from sharing information with its retail division, and prohibited the inclusion of marketing information in the final bill sent to a customer that has switched providers.

Staff continues to be concerned with how and when BellSouth "win-back" marketing to regain a customer begins in Florida. In Docket No. 960786A-TL⁵, BellSouth witness Cynthia K. Cox testified to BellSouth's "win-back" marketing. With respect to how BellSouth initiates "win-back" marketing, Ms. Cox's testimony described the process used by BellSouth to determine which customers to target for possible "win-back" opportunities.

⁴ In the Matter of Joint Application by BellSouth Corporation, BellSouth Telecommunications, Inc., And BellSouth Long Distance, Inc. for Provision of In-Region, InterLATA Services In Georgia and Louisiana.

⁵In the Matter of Consideration of BellSouth Telecommunications, Inc.'s Entry into InterLATA Services Pursuant to Section 271 of the Federal Communications Act of 1996.

What happens is there is a list that is generated at some point in time that will say here are customers that have disconnected, and we can determine whether they moved or whether they, you know, left the area, those kinds of things. So we will take those off, and all we can do is assume that the rest went to a competitor somewhere. We don't know which competitor and we didn't know for sure that is what happened. But that is how we use that to target customers. (Hearing transcript, Volume 3, Page 306, Lines 9-17)

Regarding the timing of "win-back" marketing to regain a customer, Interrogatory No. 5a of Staff's Second Set of Interrogatories in this docket asked BellSouth the following question:

When a customer initiates account activity which may lead to losing that customer to an ALEC, does BellSouth immediately contact that customer to attempt to retain the customer with a promotion? If not, at what point in time does BellSouth attempt to retain or win back this customer?

BellSouth answered "No, in Florida BellSouth waits three to seven weeks after a disconnect order completes before contacting a customer." On April 11, 2002, the Commission received a memo from BellSouth advising that BellSouth recently implemented a region wide minimum 10 calendar days waiting period for sales contacts made to any customer who has placed an order to disconnect his/her retail local service from BellSouth.

Staff believes ALECs who have obtained a new customer from an ILEC should be allowed a period of time to complete the customer conversion and institute a billing cycle before the ILEC's "win-back" activities to that former customer are initiated. Historically, customers have experienced billing errors when they have switched back to the ILEC during the conversion process. In that case, ALECs oftentimes are not aware that the customer has switched back to the ILEC during the conversion, and proceed to bill the customer. Billing errors by both the ALEC and ILEC can result when this happens. Staff also believes that the Commission should prohibit BellSouth from including any marketing information in its final bill sent to customers who have switched providers.

DATE: June 6, 2002

Although we applaud BellSouth for voluntarily implementing a waiting period after a disconnect order is complete, staff does not agree with the 10-day time period. As stated above, BellSouth previously waited three to seven weeks in Florida before initiating "win-back" efforts. Staff believes that a 30-day mandatory waiting period after the conversion to the ALEC is complete is a more appropriate waiting period before BellSouth is allowed to initiate "win-back" promotions to regain a customer.

This 30-day waiting period would allow a period of time for the ALEC to complete a full billing cycle with the new customer. There have been examples in the industry where win-back activities are started immediately after a customer is switched to an ILEC. If the ILEC is successful in winning the customer back immediately, the ALEC may submit its first month's bill to the customer not knowing that the customer already switched back to the ILEC during the initial billing cycle. The customer ends up receiving two bills, irritating the customer and causing negative feelings about the ALEC. The 30-day period would permit the ALEC to establish the customer's service and resolve any possible initial service impairments. The customer would also have the ability to experience the benefits of competition through service with a company other than an ILEC. Therefore, BellSouth should be prohibited from initiating any win-back activities for thirty days after the conversion to the ALEC is complete.

As can be seen in Attachment "A" of this recommendation, staff's recommended prohibition of BellSouth initiating any "win-back" activities for 30 days after the conversion to the ALEC is complete is consistent with actions of other regulatory agencies.

Although BellSouth may assert that this 30-day restriction is a hardship on them, staff believes it will aid in promoting competition in the State of Florida. Furthermore, since BellSouth previously waited three to seven weeks before initiating "win-back" promotions in Florida, staff doesn't believe this adjustment should have a significant impact on BellSouth operations. Section 364.01(4)(b), Florida Statutes, provides that the Commission shall exercise its exclusive jurisdiction in order to

[E]ncourage competition through flexible regulatory treatment among providers of telecommunications services in order to ensure the availability of the widest

possible range of consumer choice in the provision of all telecommunications services.

As for any fairness issue BellSouth may raise, staff emphasizes that although the 30-day restriction would not apply to ALECs who may have "win-back" promotions, Section 364.01(4)(d), Florida Statutes, provides that the Commission shall exercise its exclusive jurisdiction in order to:

Promote competition by encouraging new entrants into telecommunications markets and by allowing a transitional period in which new entrants are subject to a lesser level of regulatory oversight than local exchange telecommunications companies.

"Win-back" Marketing to Retain a Customer

As mentioned above, retention marketing refers to a carrier's attempts to persuade a customer to remain with that carrier before the customer's service is switched to another provider. Although the FCC has examined "win-back" retention marketing, staff believes this Commission should address it due to the complaints received from FDN and other carriers in Florida. In paragraph 16 of FDN's petition, FDN states:

The ALECs have experienced instances where BellSouth contacts customers about promotions when the customer has initiated account activity with BellSouth necessary to initiate a carrier change (e.g., changing or correcting a customer service record (CSR)), as well as at times suspiciously coincident to the CLEC's submitting a CSR request or local service request (LSR) to BellSouth.

The FCC has addressed retention marketing by ILECs in Order FCC 99-223, which states:

Several petitioners ask the Commission to reconsider Section 64.2005(b)(3) to permit use of CPNI for the retention of soon-to-be former customers without customer approval. On the other hand, other petitioners request that the Commission expressly prohibit ILECs from engaging in retention marketing. These petitioners claim that ILECs are using information derived solely from their status as providing carrier-to-carrier services to

their competitors in an anti-competitive manner. Petitioners argue that the use of another carrier's order, including a carrier or customer request to lift a PIC freeze, is clearly and separately forbidden by sections 222(b) and 201(b). (§ 75)

We conclude that section 222 does not allow carriers to use CPNI to retain soon-to-be former customers where the carrier gained notice of a customer's imminent cancellation of service through the provision of carrier-to-carrier service. We conclude that competition is harmed if any carrier uses carrier-to-carrier information, such as switch or PIC orders, to trigger retention marketing campaigns, and consequently prohibit such actions accordingly. Congress expressly protected carrier information in section 222(a) by creating a duty to protect the confidentiality of proprietary information of other carriers, including resellers. Section 222(b) restricts the use of such proprietary information and contains an outright prohibition against the use of such information for a carrier's own marketing efforts. As stated in the *CPNI Order*, Congress' goals of promoting competition and preserving customer privacy are furthered by protecting competitively-sensitive information of other carriers, including resellers and information service providers, from network providers that gain access to such information through their provision of wholesale services. (§ 76)

The FCC made it clear that there is no prohibition against an ILEC initiating retention marketing as long as the information regarding a customer switch is obtained through independent retail means. Order FCC 99-223 states:

We agree with SBC and Ameritech that section 222(b) is not violated if the carrier has independently learned from its retail operations that a customer is switching to another carrier; in that case, the carrier is free to use CPNI to persuade the customer to stay, consistent with the limitations set forth in the preceding section. We thus distinguish between the "wholesale" and the "retail" services of a carrier. If the information about a customer switch were to come through independent, retail means, then a carrier would be free to launch a

"retention" campaign under the implied consent conferred by section 222(c)(1). (§ 78)

However, the FCC went on to state that:

..[w]here a carrier exploits advance notice of a customer change by virtue of its status as the underlying network-facilities or service provider to market to that customer, it does so in violation of section 222(b). We concede that in the short term this prohibition falls squarely on the shoulders of the BOCs and other ILECs as a practical matter. As competition grows, and the number of facilities-based local exchange providers increases, other entities will be restricted from this practice as well. (§ 77)

Conclusion

In conclusion, staff recommends that BellSouth should be prohibited from initiating any "win-back" activities to regain a customer for thirty days after the conversion to an Alternate Local Exchange Company (ALEC) is complete. The Commission should also prohibit BellSouth from including any marketing information in its final bill sent to customers who have switched providers, and prohibit BellSouth's wholesale division from sharing information with its retail division, such as informing the retail division when a customer is switching.

ISSUE 3: Should this docket be closed?

RECOMMENDATION: If no person whose substantial interests are affected protests the Commission's PAA decision with 21-days of the issuance of the Order from this recommendation, the Order will become final upon issuance of a Consummating Order.

If, however, a timely protest of the Commission's PAA Order is filed, this matter should be set for hearing to address the issues in dispute. The issues set forth herein should be considered severable, and any issue not specifically protested should be deemed stipulated in accordance with Section 120.80(13)(b), Florida Statutes. The Docket should remain open pending the outcome of the hearing. Pending the resolution of the hearing process, staff believes that BellSouth should be precluded from filing any tariff that extends, mirrors, or builds upon the 2002 Key Customer Tariff provisions addressed in the proceeding until the Commission resolves the matters addressed at hearing. Staff notes that pending the outcome of the hearing there would be no need to address revenues collected under the tariff since the tariff will terminate prior to the anticipated close of the protest period.

(BANKS)

STAFF ANALYSIS: If no person whose substantial interests are affected protests the Commission's PAA decision with 21-days of the issuance of the Order from this recommendation, the Order will become final upon issuance of a Consummating Order.

If, however, a timely protest of the Commission's PAA Order is filed, this matter should be set for hearing to address the issues in dispute. The issues set forth herein should be considered severable, and any issue not specifically protested should be deemed stipulated in accordance with Section 120.80(13)(b), Florida Statutes. The Docket should remain open pending the outcome of the hearing. Pending the resolution of the hearing process, staff believes that BellSouth should be precluded from filing any tariff that extends, mirrors, or builds upon the 2002 Key Customer Tariff provisions addressed in the proceeding until the Commission resolves the matters addressed at hearing. Staff notes that pending the outcome of the hearing there would be no need to address revenues collected under the tariff since there are no potential overcharges.

Other Commissions' Actions on ILEC "Win-back" Activities

Alabama - Conducting an investigation of "win-back" promotions;

Georgia - By Interim Order, initiated a 7-day waiting period required after switch to an ALEC is complete before ILECs can commence "win-back" promotions. The industry is working on a marketing code of conduct (Docket No. 14232-U);

Illinois - Initiated a 17-day waiting period required after switch to an ALEC is complete before ILECs can commence "win-back" promotions (Docket No. 02-0160);

Indiana - A Petition for Suspension of Any and All Ameritech Indiana "Win-back" Promotions was filed April 19, 2002 by Midwest Telecom of America, Inc., Time Warner Telecom of Indiana, L.P., and Cinergy Communications Company (Cause 42218);

Kansas - On May 17, 2002, the Kansas Commission granted a staff Motion filed March 5, 2002 requesting that a docket be opened to consider whether local exchange companies should be allowed to offer "win-back" or retention promotions (Docket No. 02-GIMT-678-GIT);

Louisiana - Initiated a 7-day waiting period required after switch to an ALEC is complete before ILECs can commence "win-back" promotions, prohibited BellSouth's wholesale divisions from sharing information with its retail divisions, at any time, such as a notice that certain end users have requested to switch local service providers, and prohibited BellSouth from including any marketing information in its final bill sent to customers who have switched providers (Order No. U-22252-E);

Minnesota - The Public Utilities Commission has opened an investigation and asked for comments on how the 17.66% wholesale discount should be applied to Quest Corp.'s "win-back" tariff (Docket No. P421/CI-02-582);

Missouri - Rejected two Southwestern Bell "win-back" promotion tariffs stating the tariffs are "unjust and unreasonable". The Missouri Public Service Commission also stated in its Order issued December 18, 2001 that "Until the CLECs are in a strong enough position to effectively compete with Southwestern Bell, the use of save and "win-back" provisions by Southwestern Bell is anticompetitive." The Commission also stated that it believes that term agreements exceeding one year in length are an unacceptable threat to the health of competition. (Case Nos. TT-2002-108, and TT-2002-130);

Montana - On May 8, 2002, the Commission voted to file a complaint in district court regarding Qwest Corporation's WinBack promotional filing (Docket No. N2002.4.44);

North Carolina - Ordered BellSouth to abstain from any marketing activities directed to a customer for seven days after the customer switches to another local telephone company, prohibited BellSouth's wholesale divisions from sharing information concerning customer switches with its retail division, and ordered BellSouth not to include marketing information in the final bill sent to a customer who has switched providers (Docket No. P-55, Sub 1022).

Ohio - Initiated a 30-day waiting period required after switch to an ALEC is complete before ILECs can commence "win-back" promotions (Case No. 02-579-TP-CSS);

South Carolina - Initiated a 10-day waiting period required after switch to an ALEC is complete before ILECs can commence "win-back" promotions. Also prohibited BellSouth's wholesale divisions from sharing information with its retail division, and prohibited BellSouth from including any marketing information in its final bill sent to customers that have switched providers (Order Nos. 2002-1036, and 2002-2);

Tennessee - As a result of an investigation of BellSouth's "win-back" promotion, BellSouth was fined \$169,200 for its failure to tariff the Select Program, to charge customers the tariff rate, and to provide the Select Program for resale (Docket No. 01-00868); and,

Texas - The Public Utility Commission staff is developing a straw man rule which 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 (Project No. 24948).

Canada - The Canadian Radio-television and Telecommunications Commission (CRTC) first initiated win-back restrictions in an April 16, 1998 decision. In its letter decision, the CRTC stated:

... [A]n ILEC is not to attempt to win back a customer for a period of three months after that customer's service has been completely transferred to another local service provider, with one exception: ILECs should be allowed to win back customers who call to advise them that they intend to change local service provider.

On January 10, 2002, the CRTC revised the rule to read:

... an ILEC is not to attempt to win back a business customer with respect to primary exchange service, and in the case of a residential customer, with respect to primary exchange or any other service, for a period of three months after that customer's primary local exchange service has been completely transferred to another local service provider, with one exception: ILECs should be allowed to win back customers who call to advise them that they intend to change local service provider (Reference 8622-25-12/01).