BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

IN RE: **PETITION TO REQUIRE BELLSOUTH TELECOMMUNICATIONS, INC. TO APPEAR AND SHOW CAUSE THAT CERTAIN SECTIONS OF ITS GENERAL SUBSCRIBER SERVICES TARIFF AND PRIVATE LINE SERVICES TARIFF DO NOT VIOLATE CURRENT STATE AND FEDERAL LAW**	))))))))	**DOCKET NO. 00-00170**

PETITION TO REQUIRE BELLSOUTH TELECOMMUNICATIONS, INC. TO APPEAR AND SHOW CAUSE THAT CERTAIN SECTIONS OF ITS GENERAL SUBSCRIBER SERVICES TARIFF AND PRIVATE LINE SERVICES TARIFF DO NOT VIOLATE CURRENT STATE AND FEDERAL LAW, with (PROPOSED) ORDER TO SHOW CAUSE

On July 13, 1999, the Tennessee Regulatory Authority ("Authority" or "TRA") directed certain members of the TRA staff to investigate whether certain tariffs of BellSouth Telecommunications, Inc. ("BellSouth") presently conform to current public telecommunications policy as expressed by recent enactments of state and federal law. The specific purpose of such investigation was to determine whether the termination liability provisions in BellSouth's General Subscriber Services Tariff ("GSST") and Private Line Services Tariff ("PLST") are punitive in nature and have an anti-competitive effect on the local telecommunications market.[1]

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[1] At the regularly scheduled Authority Conference of July 13, 1999, the Directors of the Authority considered the Fourth Report and Recommendation of the Pre-Hearing Officer, issued July 8, 1999 in Docket No. 98-00559 -- *In Re: Proceeding for the Purpose of Addressing Competitive Effects of Contract Service Arrangements Filed by BellSouth Telecommunications, Inc. in Tennessee* (hereafter "CSA Docket"). After discussion and deliberations, a majority of the Directors approved and adopted this Report, which specifically included the Pre-Hearing Officer's recommendation to authorize and institute the instant investigation.

After conducting a preliminary investigation for the past seven months, the Staff Investigative Team ("Staff Team")[2] has determined that sufficient cause exists to justify the commencement of a show cause proceeding pursuant to Tenn. Code Ann. § 65-2-106.[3] The Staff Team respectfully requests the Authority to issue the (Proposed) Order to Show Cause, filed with this Petition as Attachment II, requiring BellSouth to appear before this Authority and show that certain sections of its General Subscriber Services Tariff and Private Line Services Tariff reflect sound telecommunications policy and do not violate current state and federal law.

State and Federal Law Promote the Development of Competition in Local Markets

The Introduction to the Federal Telecommunications Act of 1996 ("Federal Act") states that it is "[a]n Act [t]o promote competition and reduce regulation in order to secure lower prices and higher quality service for American telecommunications consumers . . . ."[4] Further, Section 253(a) of the Federal Act prohibits states from enforcing any law, regulation, or requirement that would have the effect of deterring competitive entry into the local telecommunications marketplace.[5]

Moreover, the Federal Communications Commission ("FCC") announced in its Local Competition Order that one of the principal telephony goals established by the Federal Act was

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2 The Staff Investigative Team consists of Gary Hotvedt, Chris Klein, Joe Shirley and Joe Werner.

3 This investigation addresses only the termination provisions found in BellSouth's tariffs. Should the Authority order BellSouth to amend or otherwise modify particular tariff sections, it may be appropriate to conduct additional investigations to consider whether other providers have similar provisions in their tariffs. However, if the dominant local provider in the state (BellSouth) is required to amend its tariffs, other such providers may make similar amendments in order to remain competitive, and additional investigations may not be necessary.

4 Public Law 104–104, 104th Congress, February 8, 1996.

5 Specifically, 47 U.S.C. § 253(a) provides: "IN GENERAL. – No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."

to open the local exchange and exchange access markets to competitive entry.[6] The FCC stated that "[c]ompetition in local exchange and exchange access markets is desirable, not only because of the social and economic benefits competition will bring to consumers of local services, but also because competition eventually will eliminate the ability of an incumbent local exchange carrier to use its control of bottleneck local facilities to impede free market competition."[7]

Prior to passage of the Federal Act by Congress, the Tennessee General Assembly proclaimed in 1995 that all telecommunications markets in this state are open to competition:

> Declaration of telecommunications services policy. The general assembly declares that the policy of this state is to foster the development of an efficient, technologically advanced, statewide system of telecommunications services by permitting competition in all telecommunications services markets, and by permitting alternative forms of regulation for telecommunications services and telecommunications services providers. To that end, the regulation of telecommunications services and telecommunications services providers shall protect the interests of consumers without unreasonable prejudice or disadvantage to any telecommunications services provider; universal service shall be maintained; and rates charged to residential customers for essential telecommunications services shall remain affordable.[8]

Pursuant to this mandate, the TRA has recognized and articulated its fundamental role in implementing a pro-competitive policy: "The mission of the Tennessee Regulatory Authority is to promote the public interest by balancing the interests of utility consumers and providers while facilitating the transition to a more competitive environment."[9] In light of the market-oriented features of the price regulation scheme set forth in Tenn. Code Ann. § 65-5-209,[10] the TRA is

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6 FCC 96-325, First Report and Order, August 8, 1996, ¶ 3.

7 *Id.*, ¶ 4.

8 Tenn. Code Ann. § 65-4-123.

9 Mission Statement of the Tennessee Regulatory Authority, 1997 Annual Report, Addendum C.

10 BellSouth is a price regulated incumbent local exchange carrier. By its Order entered on December 9, 1998 in Docket No. 95-02614, the Authority approved BellSouth's price regulation plan.

vested with the responsibility to guard against anti-competitive conduct on the part of incumbent local exchange carriers.[11] Furthermore, the TRA has a continuing duty to determine whether utility practices are just and reasonable.[12]

Background

The potential impact of termination provisions on competition in the local telecommunications market first came to the Authority's attention during the Authority's examination of BellSouth's repeated filings of Contract Service Arrangements (CSAs). After BellSouth filed over 170 CSAs for approval, the Authority opened the BellSouth generic CSA Docket[13] to study the possible effects of CSAs on competition. Through the generic docket as well as other individual CSA filings, the Authority ascertained that most CSAs contain termination provisions that reference and/or are controlled by the termination liability sections contained in the underlying BellSouth tariffs.[14] A majority of such sections were approved by the Tennessee Public Service Commission before 1996.

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11 Effective January 1, 1996, an incumbent local exchange telephone company shall adhere to a price floor for its competitive services subject to such determination as the authority shall make pursuant to § 65-5-207. The price floor shall equal the incumbent local exchange telephone company's tariffed rates for essential elements utilized by competing telecommunications service providers plus the total long-run incremental cost of the competitive elements of the service. When shown to be in the public interest, the authority shall exempt a service or group of services provided by an incumbent local exchange telephone company from the requirement of the price floor. **The authority shall, as appropriate, also adopt other rules or issue orders to prohibit cross-subsidization, preferences to competitive services or affiliated entities, predatory pricing, price squeezing, price discrimination, tying arrangements or other anti-competitive practices.** Tenn. Code Ann. § 65-5-208(c) (emphasis added).

12 No public utility shall adopt, maintain, or enforce any regulation, practice, or measurement which is unjust, unreasonable, unduly preferential or discriminatory, nor shall any public utility provide or maintain any service that is unsafe, improper, or inadequate, or withhold or refuse any service which can reasonably be demanded and furnished when ordered by the authority. Tenn. Code Ann. § 65-4-115.

13 Docket No. 98-00559, *In Re: Proceeding for the Purpose of Addressing Competitive Effects of Contract Service Arrangements Filed by BellSouth Telecommunications, Inc. in Tennessee.*

14 Specifically, the General Subscriber Services Tariff ("GSST") and Private Line Services Tariff ("PLST").

The Staff Team's examination of the GSST and PLST reveals that termination liability charges apply to numerous telecommunications services offered via extended service arrangements pursuant to these BellSouth tariffs. Such tariff term/extended service arrangements differ significantly from CSAs, because the terms and conditions of BellSouth's service to individual customers are not negotiated under these tariff term arrangements, whereas with CSAs, terms and conditions of service are specifically negotiated between BellSouth and the individual customer. With tariff term arrangements, BellSouth merely submits the proposed tariff to the Authority for approval, effectively making the Authority the surrogate for each and every customer when "negotiating" all extended service arrangements.

Therefore, relative to the reasonableness of any associated termination provisions triggered by the early termination of BellSouth's tariff term/extended service arrangement, the Authority's judgment stands in place of the individual customer's judgment. If the tariff term arrangement is approved by the Authority, BellSouth offers it *in toto* to the consuming public. A customer who then subscribes to the service under that tariff must accept all terms and conditions of service, including any previously approved termination provisions, without the ability to individually negotiate any such provisions or opine on their reasonableness.

In exchange for discounts on standard monthly rates, BellSouth customers who enter into CSAs and tariff term arrangements are obligated to commit to multi-year service periods. Generally, the longer the service commitment, the larger the discounts that subscribers receive. If the subscriber cancels the service prior to expiration of the agreed-upon service period, ordinarily the subscriber must pay a termination liability charge that is calculated pursuant to termination provisions contained in certain sections of the applicable service tariff. It is the most egregious of these tariff termination provisions that are at issue in this petition.

In his Second Report and Recommendation, approved by the Authority on April 6, 1999, the Pre-Hearing Officer recognized that, due to shifting policy considerations and the potential for unlawful penalties, it may be appropriate for the Authority to reexamine the scope and purpose of the termination provisions set forth in BellSouth's tariffs:

> Tennessee case law demonstrates that, while the courts permit the recovery of reasonable costs from the breaching party through termination or early cancellation provisions of contracts (such as CSAs), provisions allowing the recovery of amounts that are grossly disproportionate to actual costs may be deemed penalties by courts and thereby rendered unenforceable. Of course the issue of enforceability of a contract is an issue that exists between BellSouth and the CSA customer. Nevertheless, it may be appropriate for the Authority to consider, as part of its consideration of the entire CSA for approval, whether certain termination charges in a CSA constitute a penalty.
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> Where termination charges in a particular CSA are linked to the GSST and those termination charges display characteristics of being a penalty, it may be appropriate for the Authority [to] examine the termination provisions in the GSST. Most of the termination charges that exist in the GSST were originally considered and approved by the Tennessee Public Service Commission prior to the enactment of the Telecommunications Act of 1996. While such termination provisions may have been acceptable in a monopolistic market environment, the progression of that market toward competition and the General Assembly's pronouncement of the State's policy in Tenn. Code Ann. § 65-4-123 may require reexamination of the GSST or, at the very least, a reexamination of the termination charges that are set forth therein to determine their impact on competition.[15]

Three months later, the Pre-Hearing Officer opined that certain BellSouth tariff termination provisions could constitute a penalty to the customer and could have an adverse effect on the development of competition in the local telecommunications market:

> The Pre-Hearing Officer recognizes that termination charges are appropriate to recover costs as a result of the early cancellation or termination of service. It is reasonable, as well as just and equitable, for a company to recoup reasonable customer-specific costs linked to service termination or incurred in reliance upon the contract, such as recovery of special construction charges.
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> Nonetheless, the recovery of excessive termination charges is troublesome. First, recovery of an amount significantly more than actual costs incurred from the

15 Docket No. 98-00559, Second Report and Recommendation of Pre-Hearing Officer, March 23, 1999, p. 10.

termination of a service would not be reasonable under existing contract law and may be deemed a penalty. Further, where excessive termination charges recover significantly more than the remaining portion of customer-specific costs at the time of default the penalty to the customer becomes suggestive of anti-competitive conduct.

The Pre-Hearing Officer is of the opinion that BellSouth's tariff termination provisions which require the customer to pay either 90% or 100% of the remaining amount due under the tariff payment plan could have an adverse effect on competition in the local market and should be examined to determine whether such provisions are excessive in fact. Moreover, most of BellSouth's tariff termination provisions were approved before the onset of any meaningful competition in the local telecommunications market. At that time, a consumer may not have been as concerned about termination of service since there were no alternative providers of similar services. As the local telecommunications market attempts to move toward a competitive environment, the ability to terminate a service without burdensome and costly termination provisions will likely be a significant factor in the customer's decision to select an available competing service alternative.[16]

Accordingly, the Pre-Hearing Officer concluded that "[t]he Authority should open a separate docket for the purpose of initiating a show cause action addressing whether the termination liability provisions in the existing tariffs (GSST and PLST) of BellSouth are punitive in nature and have an anti-competitive impact on the local telecommunications market."[17] At the Authority Conference held July 13, 1999, the Authority authorized such an investigation.

Prior Actions of the Authority

The Authority has recognized for some time that excessive termination charges could have an adverse effect on the development of competition in the local telecommunications market, but it was within the context of CSA filings where BellSouth's tariff termination charges were first considered. However, a majority of the Directors have stated that individual CSA

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16 Docket No. 98-00559, Fourth Report and Recommendation of Pre-Hearing Officer, July 8, 1999, pp. 18-19.

17 *Id.*, p. 15.

filings are not the appropriate forum to take up this issue relative to the underlying tariffs.[18] Nevertheless, due to the concern that long-term contracts coupled with excessive termination charges could lead to anti-competitive situations, a majority of the Directors determined to mitigate some of the potential harm by requiring BellSouth to limit the terms of its CSAs to a maximum of three years.[19]

In August 1999, the Authority directly confronted the appropriateness of termination charges within the context of a tariff filing. In Docket No. 99-00406, BellSouth proposed its Toll Free Dialing ("TFD") service. In addition to subscribing to TFD on a monthly basis, the tariff also provided subscribers with discounts of 5%, 8%, or 11% off the monthly rates if the subscriber would commit to a tariff term plan of one, two, or three years, respectively. Additionally, BellSouth proposed the following termination provision for early cancellation of TFD service: "Upon cancellation of a term plan, the customer will be billed an amount equal to

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18 DIRECTOR GREER: While the cancellation charges may be considered by some to be somewhat anti-competitive, I'm not sure there's much we can do about it at this point since it's in the tariff with our – without reopening the case on a previously approved tariff, and I don't think that's what we're here for.

So based on what – the information I have, I think our – my position is that we should approve this CSA [Docket No. 98-00513], and then as we go through the CSA [generic] docket, we'll simply have to look at those tariffs that are already in existence. It's a pretty steep cancellation charge, but if it comes right out of the tariff, and I've had that confirmed, and I don't know that we've got a whole lot of alternative under the matter.

DIRECTOR KYLE: I vote with you.

Authority Conference Transcript, November 17, 1998, p. 49.

19 DIRECTOR GREER: Mr. Hicks, I have pretty consistently stated that I thought short-term CSAs did not give me a great deal of cause for concern or as much concern as those structured over a long period of time. I even specifically stated to you at one time that I would hope that BellSouth would have one-year contracts with one- or two-year renewal periods. But I think I have stated on more than one occasion that I thought CSAs for more than two or three years was too long. * * *

The issue is, as competition develops, I think that you [BellSouth] may be tying some of these customers up for a period longer than is reasonable under the competitive emerging market. And if someone is tied up for five years, it's highly unlikely that a competitor will have a real shot at that company. I'm not – that's why I continue to say I'm not overly concerned about a two-year and a three-year CSA. But when we start tying them up for 60 months, we get past what I would call an emerging competitive market. And that's my concern. * * *

Director Kyle, I'm going to second your motion [to approve eighteen CSAs]. But let me state again for the record I don't want to see any more five-year contracts coming in here. I will not vote for any more. So let me get that on the record. I will not vote for anymore that go past a 36-month term.

Further, let me reiterate that how I voted on these CSAs should not be interpreted as any position that I might take upon completion of the CSA docket.

Authority Conference Transcript, March 16, 1999, pp. 47-49, 55.

the discounted local calling area rate times the monthly usage commitment for the number of months remaining on the plan."[20] In other words, a 100% buy-out of the remaining service term would be required. The Authority voted unanimously to deny the TFD tariff as it was originally proposed solely because its termination provision was found to be harsh and punitive, and would constitute a penalty to customers.[21]

In the TFD Order, the Authority acknowledged its responsibility to guard the public interest by examining proposed tariff provisions to determine if they are just and reasonable. Rejecting BellSouth's TFD proposal, the Authority concluded that the "[r]ecovery of an amount not reasonably related to as well as significantly greater than a reasonable estimation of the costs incurred due to termination constitutes a penalty, is unjust, unreasonable and is unlawful in Tennessee."[22]

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20 Docket No. 99-00406, *BellSouth Tariff Filing for Toll Free Dialing Service*, filed June 8, 1999, revised June 22, 1999, Proposed Section A.19.5.21.B.4, Fourth Revised Page 11.

21 CHAIRMAN MALONE: This tariff contains – it references the type of service that I think is beneficial to the consumers in Tennessee and will help make the – it's in a competitive arena, and the more offerings in a competitive arena the better. So I like the service offering.

But on careful review of the entire offering and not just the benefits that are being offered by the service, I've concluded that the termination provisions are very different than the termination provisions that we've had – that have been at issue this past year before the Authority. This termination provision, unlike the others, doesn't raise questions about whether or not it might be illegal or approach harshness. This termination agreement is, in fact, under Tennessee contract law, illegal. This termination provision exacts a penalty that is too great for this agency to countenance. * * *

This tariff is illegal, and I would move that, for that basis, because the termination clause clearly, under state law, constitutes a penalty and makes the tariff unlawful, unreasonable, and unjust, that the tariff be denied.

DIRECTOR KYLE: I would vote also to deny this tariff because of harsh and punitive termination provisions for early termination of that service and also because Bell's response to our data request is clear that [the] termination charges far exceed the costs incurred by Bell and these charges would be deemed unreasonable under existing law. So I would vote no.

DIRECTOR GREER: I concur with the comments of my partners. And let me also reiterate what Chairman Malone said on the front end, that I, for the record, do favor such a service and I encourage BellSouth to refile this service with more reasonable charges, because I think it is a good service and I think it is a competitive service and one that the consumers would benefit from with more reasonable termination charges. So I make it unanimous.

Authority Conference Transcript, August 10, 1999, pp. 17-19.

22 *In re: BellSouth Telecommunications, Inc. Tariff Filing to Introduce Toll Free Dialing Service*, Docket No. 99-00406, Order issued December 10, 1999, p. 6.

Economic Analysis of Long-Term Contracts

The term tariff provisions at issue here are special cases of exclusive dealing or requirements contracts. These arrangements have been viewed as either competitively innocuous or beneficial, because it was thought that sellers could not induce buyers to accept contract terms that did not further the buyers' interests. The sellers would have to offer the buyers a better deal than they could get elsewhere – a lower price or better quality product – to entice them to constrain their ability to choose from whom to buy for a significant period of time. These enticements made the contracts pro-competitive and socially beneficial. One exception might occur when the enticements were "below cost" or otherwise predatory, but such predatory strategies were viewed as unprofitable for the seller and therefore, unlikely to be pursued.

Nevertheless, some situations arise in which a monopolist may profitably adopt exclusive contracts to prevent entry and to maintain its monopoly.[23] A monopolist may use contracts with excessive termination charges to force entrants to offer buyers significantly lower prices so as to entice such buyers to switch to the entrant and default on their contracts with the monopolist. Thereby, the monopolist indirectly extracts rents from entrants, as the entrants have to pay the discount *plus* all termination charges in order to capture the buyers' business. It is also possible for a monopolist to exclude entrants merely by signing all buyers to exclusive contracts without offering enticements. In this case, each individual buyer must believe that its decision to accept a contract alone will not significantly affect entry in the future, ignoring the behavior of other buyers. Consequently, all buyers accept contracts and future entry is deterred, to the buyers' detriment. Similarly, a dominant firm might profitably offer "predatory" contracts to some

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[23] Jonathan B. Baker, "Developments in Antitrust Economics," *Journal of Economic Issues*, Winter 1999, pp. 181-194.

buyers, if this slows both the rate of future entry and the accompanying erosion of the dominant firm's profits.[24]

In essence, the termination charge drives a wedge between the price charged by the incumbent and that offered by the entrant in order to win a buyer's business. For example, suppose the incumbent signs a customer to a 3-year contract at a price discount of 10% that requires the buyer to pay a "100% buy-out" termination charge, equal to the revenues that the incumbent would collect from the buyer over the remainder of the contract. An entrant wishing to win the customer must offer him a better deal. This means beating the 10% price discount offered by the incumbent *plus* an additional discount equal in value to the termination charge. If the buyer is considering terminating at the end of the first year and signing a 3-year contract with the entrant, then this additional discount amounts to at least 67% of the current contract price, an insurmountable burden.

Clearly, unless entrants are significantly more efficient than the incumbent, they will be unable to win customers who sign contracts with substantial termination charges. Such termination charges have the effect of slowing the competitive process, reducing the growth of entrants, and maintaining prices at higher levels for longer periods of time than would otherwise occur. Policies that allow such arrangements by tariff will be less effective at realizing the benefits of competition than those policies that limit termination charges under term arrangements.

Termination charges are only justified if they recover costs incurred by the incumbent to serve a specific customer that cannot be recovered by providing service to any other customer.

24 The dominant firm essentially shares current rents with its buyers in order to reduce and delay the rate of decline in those rents due to entry. Such contracts may not actually set any price below cost, but set a lower price than would occur in the absence of the entry threat. This is analogous to limit-pricing models of entry deterrence.

These costs *do not* stem from the incumbents' failure to sign up enough other customers to pay for its investment in general network facilities due to competition. This is the usual risk associated with general investments to serve competitive markets. These customer-specific costs refer to direct costs or investments incurred by the incumbent to serve a discrete customer that cannot be used or recovered through providing service to any other customer.[25] In these situations, the costs are truly stranded. Their recovery through termination charges is not only just and reasonable, but reflects the typical costs that would be recovered under contractual term relationships in competitive markets.[26]

The following characteristics of termination charges or term provisions suggest anti-competitive behavior:

1) termination charges are not specified or are vague;[27]

2) termination charges are excessive, recovering more than the remaining portion of customer-specific costs at the time of default;[28]

3) prices are below "cost" - the revenue collected over the term of the contract does not cover the accumulated operating expenses plus the cost of the initial customer-specific investment.

A related characteristic to consider is the length of the term at which anti-competitive concerns arise. The term length at which these contracting practices raise policy concerns is not obvious.

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25 For example: a fiber ring constructed on a customer's "campus" that cannot be used to serve a customer at any other location.

26 A hallmark of competitive markets is that prices reflect costs. The same can be said for termination charges. Otherwise, the seller can be squeezed by the buyer to extract an "appropriable rent."

27 A buyer's agreement to a contract with vague or unspecified termination charges implies that there is no intent to cancel the contract prior to the end of its term. This further suggests that a buyer does not expect to receive future offers from competitors that are sufficiently attractive to cause the buyer to default on the contract. In cases such as these, buyers do not care about the amount of any termination charges, as they never expect to pay. Under these circumstances, a monopolist/dominant firm may be able to deter or impose costs upon entrants by using contracts with termination charges.

28 This includes situations in which customer-specific costs are nonexistent as well as those in which customer-specific costs may exist, but are not specified in the contract.

Very short terms are unlikely to cause any significant harm, whereas long terms, given the necessary accompanying characteristics, substantially deter entry and cause significantly higher prices than would result in their absence.

Therefore, short term tariff provisions containing charges for termination of service that only recover the remaining customer-specific costs incurred by a utility in offering such service (provided that the service price is above cost in the traditional sense), are at worst innocuous.[29] Conversely, multi-year provisions containing vague, unspecified, or excessive termination charges are a barrier to competition. Such tariff provisions adopted under monopoly rate-of-return regulation may have been justified as an attempt to maintain a company's revenue stream as well as to forestall rate cases. In the transition to competition, however, such provisions will not serve a policy aimed at gaining the benefits of more competitive markets for consumers.

Analysis of Termination Provisions in BellSouth's Tariffs

The Staff Team maintains that "long-term" service commitments coupled with "excessive" termination charges have an adverse effect on the development of competition in the local exchange market. In this regard, the Authority must consider: (1) whether the termination provisions contained in certain sections of BellSouth's GSST and PLST apply to long-term service commitments; and (2) whether such termination provisions could reasonably be viewed as excessive.

First, the Staff Team's review and analysis of BellSouth's GSST and PLST reveals that many tariff term arrangements offered to the public *do* involve long-term service commitments. The tariff term arrangements identified in Attachment I provide for maximum service periods

[29] Tariff term provisions with appropriately specified prices and cost-based termination charges do not raise serious policy concerns regardless of length.

ranging from three to ten years. The Staff Team also ascertained that some of BellSouth's more competitive data services are provisioned through multi-year service agreements. For example, the Fast Packet Transport Services tariff, which includes services such as Frame Relay and ATM, offers term plans of up to five years in length, and the Primary Rate ISDN tariff offers a six-year term plan. Tariff term plans ranging from five to eight years are available for the data services offered through BellSouth's PLST.[30] These service periods extend well beyond the three-year criterion that a majority of the Directors have adopted during their examination of Contract Service Arrangements. Moreover, the Staff Team submits that regardless of duration, multi-year service commitments will be a barrier to competition if the customer's consideration of available competitive alternatives is outweighed by the customer's obligation caused by excessive termination provisions contained in binding tariff agreements.

Second, the Staff Team maintains that the thirty-two (32) termination provisions identified in Attachment I are excessive and unreasonable; nineteen (19) of these provisions require either a 90% or 100% buy-out of the remaining service commitment. Such provisions are facially harsh and punitive, when one considers that the amount of termination charges recouped by BellSouth would be grossly disproportionate to the benefits that subscribers receive. To illustrate this point, assume that a subscriber entered into a thirty-six month tariff term agreement in order to secure a 10% discount on the monthly rate. In this situation, the subscriber would be required to pay more to terminate the arrangement a mere four months early than the amount saved as a result of the previous 32 months' discounts.[31]

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30 MegaLink and SynchroNet services are provisioned through the Private Line Services Tariff.

31 Numerically, the calculations are as follows (percent discount multiplied by number of months): .10 * 32 = 3.20 in discounts received; .90 * 4 = 3.60 in termination charges at a 100% buy-out, or 3.60 * .90 = 3.24 in termination charges at a 90% buy-out.

Earlier terminations would result in even greater disparity between the discounts received and the termination charges due. If the subscriber in the above hypothetical decided to terminate the tariff term commitment at the end of the 20th month: under a 100% buy-out provision, she would owe 7.2 times more in termination charges than the discounts already received; under a 90% buy-out provision, she would owe almost 6.5 times more in termination charges than the discounts already received. Although these discounts are BellSouth's chief concession to term subscribers, the subscriber's subsequent payment of such exorbitant termination charges would place BellSouth in a much better position than if the subscriber simply satisfied the full term of the tariff arrangement. Such provisions severely penalize the subscriber for deciding to terminate a service in favor of a competitive alternative -- a result that is not appropriate for the development of a competitive marketplace.

Furthermore, the Staff Team has found no evidence that termination provisions in BellSouth's GSST and PLST are designed to recover remaining customer-specific costs of service. Available information suggests that BellSouth has made no attempt to even identify such costs. In denying BellSouth's first TFD tariff, the Authority found:

> BellSouth, however, has not provided cost data or any other evidence indicating that it will continue to incur costs or suffer other damage after a subscriber terminates a TFD Service term plan. Since TFD Service is provided over BellSouth's existing facilities and network, no additional investment will have to be made to serve a TFD subscriber. BellSouth will not incur any ongoing investment-related carrying costs or other foreseeable damages upon termination of service. As shown above, BellSouth seeks to recover amounts through termination charges that unreasonably exceed any anticipated costs or damages identified with terminating TFD Service.
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> In response to Authority data requests with respect to this tariff filing, BellSouth conceded that it had not performed a cost study or other financial analysis to justify potential damages incurred due to TFD Service subscribers terminating a term plan as opposed to month-to-month service. According to BellSouth "[t]he basis of the termination liability charge described in the proposed tariff is to

recover the remaining revenue the customer committed to pay the Company when it entered into the contract in exchange for receiving the discounted rates."[32]

While an incumbent local exchange carrier ("LEC") should be allowed to recover reasonable termination charges in certain instances, the utility's practice in this area should be balanced against the pro-competitive policies of the state and the nation. In weighing these competing interests, an incumbent LEC has a strong interest in recovering ongoing customer-specific carrying costs incurred on stranded customer-specific investments when the customer fails to maintain service.[33] Beyond that point, however, the state's interest in the development of competition in the local exchange market must prevail. Accordingly, the application of termination provisions should be limited to the recovery of remaining customer-specific costs incurred by the utility in offering the service.

That BellSouth does not impose termination charges for most services purchased under a month-to-month arrangement demonstrates that BellSouth does not continue to incur substantial investment-related carrying costs for services provided under a related term arrangement. The service that is provided to the subscriber is the same regardless of whether it is billed under a month-to-month arrangement or a term arrangement, and the Staff Team can discern no cost basis for imposing substantial termination liabilities in one instance and not the other.

Since the primary benefit of the term arrangement appears to be to reduce business risk by offering rate stability and discounts in exchange for a guaranteed revenue stream over a known period, the associated termination charges appear to be aimed at eliminating business risk as opposed to recovering costs. As competition in the local exchange market continues to

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32 *In re: BellSouth Telecommunications, Inc. Tariff Filing to Introduce Toll Free Dialing Service*, Docket No. 99-00406, Order issued December 10, 1999, pp. 5-6.

33 These costs might include items such as depreciation, maintenance, taxes, and cost of debt and equity.

develop, elimination of business risk is not sufficient justification for imposing termination charges that exceed costs. Termination charges limited to the recovery of customer-specific costs should be sufficient to protect BellSouth's interest, whereas excessive and unreasonable charges for terminating long-term tariff commitments impede the development of viable competition in the local exchange market -- a result which is in direct contravention of stated public policy.

Conclusion

Based on the foregoing, the Staff Team concludes that the tariff termination sections identified in Attachment I are excessive and unreasonable. Further, the application of these excessive termination provisions will obstruct and deter the development of competition in the local exchange market. Consequently, these referenced sections are clearly incompatible with the pro-competitive policies of both Congress and the Tennessee General Assembly.

The continued application of excessive tariff termination provisions is inconsistent with the Authority's recent TFD decision in Docket No. 99-00406. The majority of the termination provisions existing in BellSouth's GSST and PLST were approved by the Authority's predecessor agency, at a time when BellSouth was a rate-regulated monopoly. Many of these dated termination provisions are similar to the one originally proposed by BellSouth in its TFD filing which the Authority has now rejected. If the Authority were to apply the same rationale as it did when it examined the original TFD proposal in August 1999, the Authority would have to conclude that thirty-two (32) of BellSouth's existing tariff termination sections are as objectionable as the termination provision that was rejected in that docket.

The tariff sections listed in Attachment I are against public policy as enunciated by Congress, the Tennessee General Assembly, and the Authority itself. BellSouth can no longer justify the continued application of these dated and unreasonable tariff termination provisions in light of today's pro-competitive policy initiatives. Therefore, the Staff Team advocates the removal of the egregious provisions included within these sections from BellSouth's tariffs. Accordingly, the Staff Investigative Team respectfully requests that, pursuant to Tenn. Code Ann. § 65-2-106, the Authority issue an Order to Show Cause, requiring BellSouth to appear and show that certain sections of its General Subscriber Services Tariff and Private Line Services Tariff do not violate current state and federal law.

Respectfully submitted,

Chris Klein

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w/attachments

BellSouth Tariffed Termination Provisions

Tariff Section	Flat Cancel Charge	Repay Discounts To 12 Mos	100% Buyout	90% Buyout	60% Buyout	50% Buyout	40% Buyout	50% < 12 Mos; 20% > 12	Complex Calculation
GENERAL SUBSCRIBERS SERVICES TARIFF:									
A12.20.8.C – MultiServ – Cancellation Charges	$3,000/system<36 Mos; $2,000>36								
A12.21.8.B – MultiServ Plus – Cancellation Charges	$10,000/system<36 Mos; $7,500>36								
A19.5.21.B.4 - Toll Free Dialing Service		X							
A20.3.8.E.3 – WatsSaver			X						
A27.1.2.E – Shared Tenant Service			X 1/						
A29.1.2.C.5.b – Derived Data Channel Service (DDCS)			X						
A29.7.4.H – Administrative Management Service (AMS)				X					
A32.1.1.D.3 – Integration Plus Management Service (IPMS) (Includes IPMS, FlexServ & Network Usage Info. Service)				X					
A34.5.6.A.4 – CrisisLink – Charges			X						
A38.1.3.C – DADS Termination			X						
A40.10.2.B – Fast Packet Transport Services (Includes Frame Relay, NMLI, CDS, BBEL, ATM)				X					
A40.11.2.D – Video Conferencing Service				X	X				
A42.3.2.A – Primary Rate ISDN			X						
A110.1.5 – Centrex Service							X		
A112.26.6.G – ESSX Service – Vintage II									X 2/
A112.28.6.G – Digital ESSX Service – Vintage II									X 2/
A112.32.6.H – ESSX Service – Vintage I									X 2/
A112.34.6.G – Digital ESSX Service – Vintage I									X 2/
A113.39.4.E – Central Office Local Area Network Service			X						
A125.1.2.G – LightGate			X						
A131.2.2.A.8 – Area Communication Service (ACS)			X						
A134.3.7.A.8 – ZipCONNECT			X						

BellSouth Tariffed Termination Provisions

Tariff Section	Flat Cancel Charge	Repay Discounts To 12 Mos	100% Buyout	90% Buyout	60% Buyout	50% Buyout	40% Buyout	50% < 12 Mos; 20% > 12	Complex Calculation
PRIVATE LINE SERVICES TARIFF:									
B3.3.1.A.1–Commercial Quality Video (CQV)					X				
B7.1.2.C.5–MegaLink			X						
B7.2.2.H.1.c–SynchroNet			X						
B7.3.2.G–MegaLink Channel Service			X						
B7.4.2.G–LightGate						X			
B7.5.4.E–MegaLink ISDN			X						
B7.7.2.H.3–SMARTRing					X				
B7.8.3.E–SMARTPath								X	
B8.2.2.A.2–Customer Network Service Arrangement I			X (1,000 channel min.)						
B8.3.2.C–Customer Network Service Arrangement II			X (2,000 channel min.)						

1/ Tariff requires a 100% buyout plus a "penalty fee" for not providing six months notice of disconnection.

2/ Tariff requires the lesser of a 90% buyout or a non-recurring cancellation charge ranging from $2,000 to 10,000 depending on the number of customer ESSX lines in service.

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

IN RE:	)	
PETITION TO REQUIRE BELLSOUTH	)	
TELECOMMUNICATIONS, INC. TO APPEAR	)	
AND SHOW CAUSE THAT CERTAIN	)	**DOCKET NO.**
SECTIONS OF ITS GENERAL SUBSCRIBER	)	**00-00170**
SERVICES TARIFF AND PRIVATE LINE	)	
SERVICES TARIFF DO NOT VIOLATE	)	
CURRENT STATE AND FEDERAL LAW	)	

(PROPOSED) ORDER TO SHOW CAUSE

On July 13, 1999, the Tennessee Regulatory Authority ("Authority" or "TRA") authorized an investigation as to whether certain tariffs of BellSouth Telecommunications, Inc. ("BellSouth") presently conform to current public telecommunications policy, as well as state and federal law in light of recent enactments of such law. The purpose of this preliminary investigation was to consider whether the termination liability provisions in BellSouth's General Subscriber Services Tariff ("GSST") and Private Line Services Tariff ("PLST") are punitive in nature and have an anti-competitive effect on the local telecommunications market.[1]

[1] At the regularly scheduled Authority Conference of July 13, 1999, the Directors of the Authority considered the Fourth Report and Recommendation of the Pre-Hearing Officer, issued July 8, 1999 in Docket No. 98-00559 -- *In Re: Proceeding for the Purpose of Addressing Competitive Effects of Contract Service Arrangements Filed by BellSouth Telecommunications, Inc. in Tennessee* (hereafter "CSA Docket"). After discussion and deliberations, a majority of the Directors approved and adopted this Report, which specifically included the Pre-Hearing Officer's recommendation to institute the investigation which has precipitated this Order.

The results of such preliminary investigation are documented in the foregoing *PETITION TO REQUIRE BELLSOUTH TELECOMMUNICATIONS, INC. TO APPEAR AND SHOW CAUSE THAT CERTAIN SECTIONS OF ITS GENERAL SUBSCRIBER SERVICES TARIFF AND PRIVATE LINE SERVICES TARIFF DO NOT VIOLATE CURRENT STATE AND FEDERAL LAW*, which is hereby incorporated by reference as if set forth fully herein. After reviewing the foregoing Petition, [the reply of BellSouth and after considering the arguments tendered by the parties at the Authority Conference of ____________ __, 2000,] the Authority has determined that sufficient cause exists to justify and commence a show cause proceeding pursuant to Tenn. Code Ann. § 65-2-106.

IT IS THEREFORE ORDERED THAT:

1. BellSouth Telecommunications, Inc. appear before this Authority and show that the following sections of its GENERAL SUBSCRIBERS SERVICES TARIFF conform to public telecommunications policy, as expressed by recent enactments of state and federal law, and that such sections of this tariff do not otherwise violate current state and federal law:

a) A12.20.8.C - MultiServ - Cancellation Charges

b) A12.21.8.B - MultiServ Plus -Cancellation Charges

c) A19.5.21.B.4 - Toll Free Dialing Service

d) A20.3.8.E.3 -WatsSaver

e) A27.1.2.E - Shared Tenant Service

f) A29.1.2.C.5.b - Derived Data Channel Service (DDCS)

g) A29.7.4.H - Administrative Management Service (AMS)

h) A32.1.1.D.3 - Integration Plus Management Service (PMS)
(includes IPMS, FlexServ & Network Usage Information Service)

i) A34.5.6.A.4 - CrisisLink - Charges

j) A38.1.3.C - DADS Termination

k) A40.10.2.B - Fast Packet Transport Services
(includes Frame Relay, NMLI, CDS, BBEL, ATM)

l) A40.11.2.D - Video Conferencing Service

m) A42.3.2.A - Primary Rate ISDN

n) A110.1.5 - Centrex Service

o) A112.26.6.G - ESSX Service - Vintage II

p) A112.28.6.G - Digital ESSX Service - Vintage II

q) A112.32.6.H - ESSX Service - Vintage I

r) A112.34.6.G - Digital ESSX Service - Vintage I

s) A113.39.4.E - Central Office Local Area Network Service

t) A125.1.2.G - LightGate

u) A131.2.2.A.8 - Area Communication Service (ACS)

v) A134.3.7.A.8 - ZipCONNECT;

2. BellSouth Telecommunications, Inc. appear before this Authority and show that the following sections of its PRIVATE LINE SERVICES TARIFF conform to public telecommunications policy, as expressed by recent enactments of state and federal law, and that such sections of this tariff do not otherwise violate current state and federal law:

a) B3.3.1.A.1 - Commercial Quality Video (CQV)

b) B7.1.2.C.5 - MegaLink

c) B7.2.2.H.1.c - SynchroNet

d) B7.3.2.G - MegaLink Channel Service

e) B7.4.2.G - LightGate

f) B7.5.4.E - MegaLink ISDN

g) B7.7.2.H.3 - SMARTRing

h) B7.8.3.E - SMARTPath

i) B8.2.2.A.2 - Customer Network Service Arrangement I

j) B8.3.2.C - Customer Network Service Arrangement II; and

3. This proceeding be stayed for thirty (30) days to allow BellSouth Telecommunications, Inc. to voluntarily modify all tariff sections specified in 1 & 2, above, in a manner to satisfy any objections raised herein.

Melvin J. Malone, Chairman

H. Lynn Greer, Jr., Director

Sara Kyle, Director

ATTEST:

K. David Waddell, Executive Secretary

GRH: BST-TSC-ProposedSCOrder

CERTIFICATE OF SERVICE

I hereby certify that on this 6th day of March, 2000, a true and accurate copy of the foregoing was served by hand-delivery or U.S. Mail, first class postage prepaid, to Guy Hicks, Esq., BellSouth Telecommunications, Inc., 333 Commerce Street, Suite 2101, Nashville, TN 37201-3300.

Gary R. Hotvedt