BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

October 4, 2000

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

ORDER REJECTING PROPOSED SETTLEMENT AGREEMENT AND DISMISSING SHOW CAUSE PETITION

This matter came before the Tennessee Regulatory Authority ("Authority") at a regularly scheduled Authority Conference held on July 11, 2000 for approval of a *Proposed Settlement Agreement* filed by and entered into between BellSouth Telecommunications, Inc. ("BellSouth") and the Tennessee Regulatory Authority Staff Investigative Team ("Staff Investigative Team") in connection with the Staff Investigative Team's *Petition to Require BellSouth Telecommunications, Inc. to Appear and Show Cause that Certain Sections of its General Subscriber Services Tariff* ("GSST") *and Private Line Services Tariff* ("PLST") *Do Not Violate Current State and Federal Law* ("Show Cause Petition").

Procedural History

At a regularly scheduled Authority Conference held on July 13, 1999, the Authority considered the Fourth Report and Recommendation of the Pre-Hearing Officer in Docket No. 98-00559.[1] During the deliberations, the Directors discussed the following recommendations put forth by the Pre-Hearing Officer in the Fourth Report and Recommendation: 1) that the Authority open a rulemaking docket to examine the use of CSAs on an industry-wide basis; 2) that the list of issues developed in Docket No. 98-00559 be considered in the context of the two consolidated contested case CSA dockets (Nos. 99-00210 and 99-00244); and 3) that the Authority open a separate docket for the purpose of investigating grounds for commencing a show cause proceeding addressing whether the termination liability provisions in BellSouth's existing general tariffs (GSST and PLST) are punitive in nature and have an anti-competitive impact on the local telecommunications market.[2]

During the July 13, 1999 Authority Conference, the Directors unanimously approved the first two recommendations. A majority of the Directors[3] voted to approve the third recommendation.[4]

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[1] Docket No. 98-00559 was opened by the Authority on August 12, 1998 for the purpose of addressing the competitive effects of contract service arrangements ("CSAs") filed by BellSouth in Tennessee. A number of parties intervened in that docket, including BellSouth, NEXTLINK, SECCA and the Consumer Advocate. After the completion of discovery between the parties, the filing of briefs and the conduct of several pre-hearing conferences, the Pre-Hearing Officer issued his Fourth Report and Recommendation on July 8, 1999.

[2] *See Proceeding for the Purpose of Addressing Competitive Effects of Contract Service Arrangements Filed by BellSouth Telecommunications, Inc. in Tennessee*, Docket No. 98-00559 (July 8, 2000) (Fourth Report and Recommendation of the Pre-Hearing Officer).

[3] Director Greer did not vote to approve the third recommendation because he was of the opinion that a show cause action would be redundant to the initiation of a rulemaking proceeding.

[4] A hearing was held on August 17 and 18, 1999 in the contested case dockets 99-00210 and 99-00244, and the Authority rendered its decision in those dockets, unanimously approving the CSAs in question, on September 2, 1999. On July 11, 2000, the Authority officially opened Docket No. 00-00702 for the purpose of promulgating rules for the provisioning of tariff term plans and special contracts. The proposed rules were published for comment in the September, 2000 Administrative Register.

Pursuant to the Authority's July 13, 1999 decision, the Staff Investigative Team was established and initiated its investigation of BellSouth's GSST and PLST tariffs.[5] The Staff Investigative Team determined that there was sufficient cause to justify the commencement of a show cause proceeding pursuant to Tenn. Code Ann. § 65-2-106. On March 6, 2000, the Staff Investigative Team filed in this docket and served on BellSouth its Show Cause Petition. In advance of filing a response to the Show Cause Petition, representatives of BellSouth contacted the Staff Investigative Team and entered into a series of meetings to address the concerns raised in the Show Cause Petition. During the course of these meetings, the Staff Investigative Team and BellSouth negotiated an agreement. On May 9, 2000, the Staff Investigative Team and BellSouth filed the Proposed Settlement Agreement for consideration by the Authority. The Proposed Settlement Agreement's stated intent was to resolve expeditiously the concerns raised in the Show Cause Petition and apply the proposed resolution of those concerns to incumbent local exchange companies as well as competing telecommunications services providers.

On June 13, 2000, the Consumer Advocate Division ("Consumer Advocate") filed a *Petition to Intervene, Object to the Proposed Settlement and to Consolidate with Docket 99-00246*. On June 14, 2000, NEXTLINK, Tennessee Inc. ("NEXTLINK") and the Southeastern Competitive Carriers Association ("SECCA") filed a joint letter of comments. Later that day, NEXTLINK and SECCA each filed a *Petition to Intervene*. On June 19, 2000, BellSouth responded to the comments and petitions to intervene by filing a *Memorandum in Opposition to*

[5] The Staff Investigative Team consisted of Joe Werner and Joe Shirley of the Telecommunications Division, Chris Klein of the Economic Analysis Division and Gary Hotvedt of the Legal Division. These persons were designated parties in interest and did not serve in an advisory capacity to the Directors or other Authority members on matters involving contract service arrangements.

NEXTLINK's "Petition to Intervene;" SECCA'S "Petition to Intervene;" and the CAD's "Petition to Intervene, Object to the Proposed Settlement Agreement and to Consolidate with Docket 99-00246." The Staff Investigative Team filed a "*Collective Response*" to all of these filings on June 27, 2000.

During the July 11, 2000 Authority Conference, the Directors heard arguments from the Staff Investigative Team, BellSouth, NEXTLINK, SECCA, and the Consumer Advocate. After considering the filings and the arguments of the parties, the Authority voted to deny the *Proposed Settlement Agreement* and subsequently voted to dismiss the Show Cause Petition.

Findings and Conclusions

During the July 11, 2000 Conference, the Authority found that the terms of the *Proposed Settlement Agreement* ultimately affected the rights and liabilities of competing local exchange carriers who were not a part of the settlement negotiations between the Staff Investigative Team and BellSouth. Having determined that all affected parties had not been extended the opportunity to participate in the negotiations leading up to the *Proposed Settlement Agreement*, the Authority concluded that the *Proposed Settlement Agreement* would not be enforceable as to those parties. In addition, the Authority concluded that an approval of the *Proposed Settlement Agreement* could be interpreted as the adoption of a rule of general applicability relating to termination provisions in the context of an adjudicatory proceeding, i.e. the show cause proceeding, which would not be the proper proceeding within which to establish such a rule.[6]

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[6] Under *Tennessee Cable Television Assoc. v. Tennessee Pub. Serv. Comm'n*, 844 S.W.2d 151, 160-61 (Tenn. App. 1992*), perm. app. denied* (Tenn. 1992), an agency should use a rulemaking proceeding if the determination:

> (1) is intended to have wide coverage encompassing a large segment of the regulated or general public, rather than an individual or a narrow select group; (2) is intended to be applied generally and uniformly to all similarly situated persons; (3) is designed to operate only in future cases, that is, prospectively; (4) prescribes a legal standard or directive

Having determined not to approve the *Proposed Settlement Agreement*, a majority of the Authority voted to dismiss the Show Cause Petition. Without making any determination as to the validity of the show cause petition, the majority found that there was no efficiency or positive benefit to continuing with a show cause proceeding as to BellSouth while, at the same time, the Authority would be engaged in a rulemaking proceeding addressing the use of CSAs on an industry-wide basis.[7] Moreover, the majority found that proceeding with the show cause action would likely delay the rulemaking proceeding which is intended to address a broader range of issues surrounding CSAs and specifically, issues related to termination provisions in CSAs for the telecommunications industry as a whole.[8]

IT IS THEREFORE ORDERED THAT:

1. The *Proposed Settlement Agreement* entered into by and between the Tennessee Regulatory Authority Staff Investigative Team and BellSouth Telecommunications, Inc. is rejected.

> that is not otherwise expressly provided by or clearly and obviously inferable from the enabling statutory authorization; (5) reflects an administrative policy that (i) was not previously expressed in any official and explicit agency determination, adjudication or rule, or (ii) constitutes a material and significant change from a clear, past agency position on the identical subject matter; and (6) reflects a decision on administrative regulatory policy in the nature of the interpretation of law or general policy. Citing, *Metromedia, Inc. v. Director, Div. of Taxation*, 97 N.J. 313, 47 A.2d 742, 751 (1984).

Because the adoption of the *Proposed Settlement Agreement* would necessarily involve the criteria for a rulemaking proceeding, the Authority concluded that such a determination should not be made in this show cause proceeding.

[7] *Transcript of Proceedings* of July 11, 2000 Authority Conference, p. 84 (July 11, 2000).

[8] Director Malone did not vote with the majority. Director Malone stated that he had not been provided any information which would cause him to question the previously recognized need and approved action by the Authority to examine the initiation of a show cause proceeding. Director Malone concluded that the best approach would be to proceed with the entry of a show cause order against BellSouth, commencing the show cause proceeding, and then advance with the rulemaking proceeding.

2. The *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* is dismissed.

3. Having dismissed the *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*, the Consumer Advocate Division's *Petition to Intervene, Object to the Proposed Settlement and to Consolidate with Docket 99-00246*, NEXTLINK, Tennessee Inc.'s *Petition to Intervene*, and the Southeastern Competitive Carriers Association's *Petition to Intervene* have been rendered moot.

4. Any party aggrieved by the Authority's decision in this matter may file a Petition for Reconsideration within fifteen (15) days of the entry of this Order.

Sara Kyle, Chairman

H. Lynn Greer, Jr., Director

Melvin J. Malone, Director*

ATTEST:

K. David Waddell, Executive Secretary

* Director Malone concurs in part and dissents in part.

BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

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

OPINION OF DIRECTOR MALONE
CONCURRING IN PART AND DISSENTING IN PART

As stated in the Order, I concur with my colleagues in rejecting the Proposed Settlement Agreement as presented. For the reasons set forth below, however, I disagree with the decision to summarily dismiss the Show Cause Petition.

My opinions concerning both BellSouth's long term contract service arrangements ("CSAs") that contain severe terminations provisions and BellSouth's tariffs that contain similarly severe provisions are well documented in various Tennessee Regulatory Authority ("TRA") dockets. *See, e.g., In Re: BellSouth Telecommunications, Inc. Tariff Filing to Offer Contract Service Arrangement (TN 9801665-00)*, TRA Docket No. 98-00612 (August 1999) (Malone, M., dissenting) ("Having acknowledged that the local telecommunications market in Tennessee is 'in an embryonic stage' and that the Tennessee General Assembly is 'acutely concerned' about promoting competition within Tennessee, the Tennessee Regulatory Authority should not be deterred from carefully

scrutinizing CSAs[.]"). Notwithstanding the foregoing, however, a brief overview here is essential.

Since mid-1998, the TRA has expended countless hours and extensive resources in reviewing the appropriateness, from a public policy standpoint, of permitting BellSouth to continue the practice of entering into long term CSAs with severe termination provisions. For my part, I have long advocated, as I am fully persuaded that the public interest demands, a comprehensive review of said practice, particularly in light of Tennessee's policy to foster the development of competition in the local telephony market and Congress's policy of the same.

To be sure, I have not previously, and do not here, oppose BellSouth entering into CSAs per se. What I have cautioned against, however, is permitting, *without careful scrutiny*, BellSouth to execute hundreds of long term CSAs that contain harsh termination provisions. The rationale supporting the call for such a review is simple. The Authority's charge in this regard is to ensure that CSAs do not, intentionally or unintentionally, have the effect of creating a barrier to entry into the local telephony market in Tennessee by thwarting or prohibiting customers' ability to select alternative providers. *See, e.g., Order Granting in Part and Denying in Part Application for Certificate of Public Convenience and Necessity*, TRA Docket No. 97-07505 (Dec. 1998) ("[A]nti-competitive behavior, whether intentional or not, and whether slight or aggressive, can cause irreparable harm to Tennessee's emerging competitive process.").

It is a matter of public record that as of June 30, 2000, BellSouth had approximately 92 % of the total access lines and approximately 77% of the business access lines in its traditional Tennessee territory. Suffice it to say that the main potential

consequence of permitting the traditional incumbent, BellSouth, to "lock-in" hundreds of its business customers under long term contracts with irrefragably hefty termination provisions is a local telephony market devoid of robust competitive development.[1] In such scenarios, in order to select a competing provider that may offer a better price or better service, or both, the customer would be forced to pay BellSouth a substantial sum to exit its contract with BellSouth.

There is no doubt that *some* "locked-in" customers realize immediate benefits under CSAs. These "benefits" are, nonetheless, deceptive when measured against the agency's ultimate responsibility to protect the public interest in both the short *and* long terms. One may contend that the agency has protected the public interest in the "short term" by approving CSAs that grant discounted rates to some customers. This short term approach, however, albeit well intentioned, is not enough. In instances where CSAs exhibit the unfortunate effect of creating barriers to entry by tying up customers in long term CSAs so that new entrants are unable to extend offers or bid for these customers, competition, as envisioned by both the Tennessee General Assembly and the United States Congress, would have failed.[2]

The opportunity for Tennesseans to exercise competitive choice in the local telephony market may be lost – sacrificed under the pretext of competition in the guise of

[1] It is likewise noteworthy that a policy that allows the levying of severe termination provisions in long term contracts necessarily embraces the allowance of contractual disincentives that prohibit individual businesses from pursuing least cost service offerings; and, arguably, dissuades competitors from rapidly deploying innovative price realignment packages and from speedily introducing current competitive service offerings. Despite the often referenced and apparently persuasive argument that CSAs provide immediate discounts, It is my opinion that, in the long run, a policy that perpetuates the inability of ratepayers to pursue least cost alternatives creates the unsavory and *anti-competitive* effect of constructively *increasing* rates to given businesses that may wish to exit these contracts and, as alluded to above, potentially thwarts new technology innovation and deployment by competing carriers. This is not, I dare say, what the General Assembly envisioned.

immediate short term discounted rates. If unrestrained competitive choice for local telecommunications services does not materialize, then all Tennesseans, including those few customers who benefited in the "short term" from discounted rates, will be again subjected to a non-competitive pricing environment.

After many months of considering this and other ancillary issues, I have concluded that, at present, it is not in the public interest to continue, without any modifications whatsoever, the agency's policy of approving hundreds of long term BellSouth CSAs containing termination provisions that trigger substantial financial consequences in the event a customer elects a competing provider.[3]

My position has consistently remained that the agency should reject BellSouth CSAs containing harsh termination provisions. This position has been consistently rejected. Consequently, I have, after compromising, but still largely unsuccessful in gaining competitively redeeming modifications, agreed to the approval of certain CSAs. Such compromise, on my part, was predicated solely upon actions of the agency that strongly communicated that all of BellSouth's harsh termination provisions, wherever contained, would be modified in a timely manner. One such action was the Hearing Officer's recommendation to open a docket for the purpose of initiating an investigation to determine whether BellSouth's termination provisions "are punitive in nature and have an anti-competitive impact on the local telecommunications market" in the *Fourth Report and Recommendation of Pre-Hearing Officer*, TRA Docket No. 98-00559, pp. 18-19 (July 8, 1999), which was approved and adopted by the agency on July 13, 1999.

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[2] *See cf.* E. ALLAN FARNSWORTH, CONTRACTS § 5.3 (1982) ("Courts view a promise in the light of its potential as well as its actual effects, taking account of the protection of the promisee's legitimate interests, the hardship to the promisor, and any injury to the public.").

Regrettably, the action taken today (July 11, 2000) rejecting the formidable, although preliminary, investigative report by the TRA Staff Investigative Team, will close this most important matter, resulting in a less than optimal outcome toward the realization of a Tennessee with unrestrained competitive choice.[4] Not surprisingly, the agency seeks refuge for such action in an unsupported, and, in fact, unsupportable conclusion that there is "no efficiency or positive benefit" to continuing with a show cause proceeding against BellSouth in the midst of a rulemaking aimed at addressing CSAs on an industry-wide basis. While this reasoning may sound compelling to the unversed or unfamiliar ear, it is clearly not sustainable when evaluated in total and in context of this agency's more than two-year review of BellSouth's CSAs. While I may applaud, and fundamentally do not oppose, the efforts of the agency to establish a rule targeted to industry-wide CSAs, the most immediate concern plaguing this agency and threatening the development of a competitive market is the urgent and direct need for modification of BellSouth's harsh termination provisions, wherever contained. This is the sole reason that dialogue on this issue began and why it continues today.

Notwithstanding the soft rationale provided for the action taken today, the agency did not embark upon the show cause proceeding in a vacuum. It must not be lost that the

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[3] Optimistically, I remain hopeful that a competitive market may yet emerge in spite of the agency's approach to date. In my opinion, however, the potential, as concerning hundreds of BellSouth CSAs, for anti-competitive effects is so great, so likely, as to warrant a materially different approach.

[4] The Report of TRA Staff Investigative Team is attached hereto as **Exhibit 1**. Said Team concluded that "sufficient cause exists to justify the commencement of a show cause proceeding pursuant to Tenn. Code Ann. § 65-2-106." *Exhibit 1* at 2. The Team maintained that "'long-term' service commitments coupled with 'excessive' termination charges have an adverse effect on the development of competition in the local exchange market." *Id.* at 13. Pursuit of the Hearing Officer's recommendation represented the most expedient, and substantively inclusive, manner in which to cure harsh termination provisions with respect to BellSouth, consistent with the original intent of TRA Docket No. 98-00559. As the Telecommunications Act of 1996 recognizes, ILECs are positioned much differently in the local market than are CLECs, and as such are subject to different requirements and treatment in order to advance a competitive environment. Continuing the Show Cause would have recognized at the state level what Congress already has at the national level.

Generic CSA Docket, TRA Docket No. 98-00559, from which the Show Cause Petition originated, was opened due to an agency concern surrounding the submission of hundreds of CSAs by BellSouth. At the direction and oversight of the Directors, the Hearing Officer expended much time, effort, and study in determining, after considering all relevant factors, the most efficient, both from a timeliness and substantive perspective, manner in which to proceed in TRA Docket No. 98-00559. "After considering the original purpose of this docket [98-00559] and after reviewing the discovery and the issues for determination," the Hearing Officer recommended, without equivocation, that the agency reaffirm its prior decision to initiate a rulemaking addressing CSAs on an industry-wide basis ***and*** initiate a show cause action addressing BellSouth's termination provisions. *Fourth Report and Recommendation of Pre-Hearing Officer*, TRA Docket No. 98-00559 (July 8, 1999). As noted earlier, this recommendation was approved and adopted by the agency.

A careful review of the record in TRA Docket No. 98-00559 will unambiguously demonstrate that the Hearing Officer did not consider the rulemaking and the Show Cause Petition mutually exclusive. To the contrary, the Hearing Officer, as did the agency prior to today, recognized that each course, by design, was intended to reach different parties, address different issues, and resolve different public policy concerns. According to both the Hearing Officer and the Tennessee Regulatory Authority, both proceedings were necessary.[5]

[5]In fact, it is interesting to note that given the extent and depth of the information gathered and the issues formulated in TRA Docket No. 98-00559, coupled with the investigative report issued by TRA Staff Investigative Team in this docket (TRA Docket No. 00-00170), the agency could have, if warranted after providing BellSouth the opportunity to respond to the Show Cause Petition, established an expedited procedural schedule.

Consequently, to cavalierly opine that "no efficiency or positive benefit" is to be derived from proceeding with the Show Cause Petition is, at best, disingenuous. This is particularly so given that the agency previously determined that both the rulemaking ***and*** the show cause were necessary. In sum, the agency summarily reversed itself and materially changed course without a reasonable, and thereby supportable, explanation.

As we await the completion of a rulemaking, which necessarily faces a daunting challenge in addressing each of the issues for which the show cause proceeding was originally initiated, BellSouth continues to submit long term CSAs with hefty termination provisions. In my opinion, to continue to acquiesce, absent a complete and open investigation, in the application of buyout schemes adopted during and in support of a rate base/rate of return environment is, to say the least, imprudent. As is well known, the need to provide BellSouth with the opportunity to earn an authorized rate of return by guaranteeing its revenue streams via the allowance of severe termination provisions passed with the effectiveness of BellSouth's price regulation plan. Given the initial action of the agency to open an investigation coupled with the thorough preliminary results submitted by TRA Staff Investigative Team, I am of the opinion that it is well past time to abandon our current rate of return ideology in this context and to immediately conform BellSouth's termination provisions to today's environment and to BellSouth's election to operate under price regulation. [6]

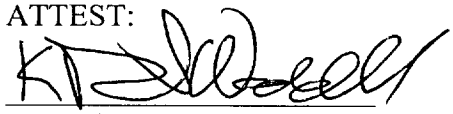
[6] As noted earlier, it is the policy of the State of Tennessee to foster the development of an efficient, technologically advanced, statewide system of telecommunications services by: (1) permitting competition in all telecommunications services markets; and (2) permitting alternative forms of regulation for telecommunications services and telecommunications services providers. BellSouth fought long and hard to participate in the second prong of the foregoing means and is currently operating under price regulation, an alternative form of regulation. It stands to reason that the agency should stand guard to ensure that both means established by the General Assembly are used to reach the intended end.

For the foregoing reasons, I respectfully concur in part and dissent in part.

Respectfully submitted,

DIRECTOR MELVIN J. MALONE

ATTEST:



Executive Secretary

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	)	

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.
>
> 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.

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[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,

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w/attachments