LAW OFFICES

GULLETT, SANFORD, ROBINSON & MARTIN, PLLC

230 FOURTH AVENUE, NORTH, 3RD FLOOR
POST OFFICE BOX 198888
NASHVILLE, TENNESSEE 37219-8888

TELEPHONE (615) 244-4994
FACSIMILE (615) 256-6339

GARETH S. ADEN
LAWRENCE R. AHERN III
G. RHEA BUCY
GEORGE V. CRAWFORD, JR.
GEORGE V. CRAWFORD III
A. SCOTT DERRICK
THOMAS H. FORRESTER
MARCY S. HARDEE
M. TAYLOR HARRIS, JR.
DAN HASKELL
ANDRA J. HEDRICK
LINDA W. KNIGHT
JOEL M. LEEMAN
ALLEN D. LENTZ
JOSEPH MARTIN, JR.
JEFFREY MOBLEY

KATHRYN H. PENNINGTON
WM. ROBERT POPE, JR.
WAYNE L. ROBBINS, JR.
JACK W. ROBINSON, JR.
JACK W. ROBINSON, SR.
VALERIUS SANFORD
MARTY S. TURNER
WESLEY D. TURNER
PHILLIP P. WELTY

JOHN D. LENTZ
OF COUNSEL

B. B. GULLETT
1905-1992

November 9, 2000

VIA HAND DELIVERY

Mr. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37201

Re: *Generic Docket Addressing Rural Universal Service*
Docket No: 00-00523

Dear Mr. Waddell:

Enclosed are the original and thirteen copies of the Brief of AT&T Communications of the South Central States, Inc. as to Legal Issues with respect to the above-referenced matter. Copies are being served on counsel for all known parties.

Yours very truly,

Val Sanford

VS/ghc
Enclosures

cc: Counsel of record
James P. Lamoureux, Esq.
Garry Sharp

POSTED 11-13-00

148441.1

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

In Re: *Generic Docket Addressing Rural Universal Service*
Docket No: 00-00523

BRIEF OF AT&T COMMUNICATIONS OF THE SOUTH CENTRAL STATES, INC. AS TO LEGAL ISSUES

BACKGROUND

This case arises from the efforts of the rural local exchange carriers to find a source of revenue to replace the revenue lost because BellSouth has decided to replace its "toll settlement agreements" with an access based compensation system. In plain terms, a big customer has decided to do business in a different way so as to reduce its costs and the rural local exchange carriers want the TRA to step in and do something about it. Regardless of the merit (or lack thereof) of the rural carriers' concern about a decrease in revenues, a universal service fund is not the appropriate vehicle to address those concerns. To fully understand the issues in this case requires some familiarity with the purpose, origin and development of "toll settlement agreements."

Telephone service and telephone companies historically were organized on a territorial basis; see, e.g., T.C.A. §65-4-201(1993) and Peoples Tel. Co. v. Tennessee Public Service Commission, 216 Tenn. 608, 393 S.W.2d 285 (1965). Company A served customers in territory A and Company B served customers in territory B. There was no legal duty requiring Company A to interconnect its lines with those of Company B and thereby to allow customers of one company to call customers of the other company, even

if the territories overlapped; Home Tel. Co. v. Peoples Tel. & Tel. Co., 125 Tenn. 270, 141 S.W. 845 (1911).

These limitations were overcome largely through the insight of Theodore N. Vail, President of American Tel. & Tel. Co. and one of the great organizational geniuses in American business history, who recognized that the value of the telephone depended on the extent of the network it could reach. In 1910, he proposed the organization of what came to be the Bell System based on the concept that "the telephone system should be universal, interdependent and intercommunicating, affording opportunity for any subscriber of any exchange to communicate with any other subscriber of any other exchange; *1910 Annual Report American Tel. & Tel. Co.* On that basis, the national telephone network was organized, managed by AT&T, joining together not only the subscribers in the Bell System, but also the subscribers of the independent companies. This national network was not created by regulatory *fiat*, but rather was based on inter-company agreements providing for the division of revenues.

Regulation, however, required the separation of interstate and intrastate business. Thus, the federal regulatory authorities developed a system for the separation of interstate and intrastate costs and revenues. The Bell System coupled such separations with a system for the division of revenues within the Bell System and a settlement process for the independent companies. The development of this system is briefly traced in NARUC v. FCC, 737 F.2d 1095, 1104-1105 (D.C.Cir. 1994). The system of division of revenues and separations and settlements reflected the functioning of the national telephone network in the absence of competition. In the 1970s, however, technological developments and changes in regulatory philosophy brought competition to interstate long distance; see NARUC v. FCC, 737 F.2d 1095, 1105-1110.

The divestiture of the BOCs and the requirements of the MFJ in the AT&T Anti-trust case, United States v. American Tel. & Tel. Co., 552 F.Supp. 131 (D.D.C. 1982) ended the Bell System and required the replacement of the division of revenues and separation and settlement process for interLATA traffic. The TPSC then in December 1983 entered its first order imposing a system of access charges which respect to interLATA intrastate traffic: Docket Nos. U-83-7248, U-83-7262 and U-83-7275. As the TPSC explained in its Order entered March 4, 1985, In re Investigation Concerning Intrastate Access Charges, Docket No. U-83-7261 and related access charge tariff dockets, at page 8:

> Similarly, access charges in Tennessee are not now, and have never been, based on costs. Tr. 35. The purpose of the Commission Order of December 22, 1983, was to establish access charges at a level which would replace, in full, the revenues formerly received by the local exchange telephone companies from intrastate toll calls under the division of revenues and the separations and settlements process.

Competition had not come to the intraLATA toll market and the TPSC did not impose a system of access charges for such traffic. Instead, South Central Bell Telephone Company and the Independents reached an agreement for a pooling of toll revenues among all telephone companies in Tennessee. That system is described in the letter from Charles Howorth of BellSouth to David Waddell dated June 26, 2000, which appears in the record in this matter and will not be repeated here. Mr. Howorth also describes how that system was modified in 1992 to prepare for the onset of toll competition in the intraLATA markets. With the passage of Chapter 408 of the Public Acts of 1995, the Federal Telecommunications Act of 1996 and the development of competition in the intraLATA toll markets, BellSouth has, understandably, considered it to be necessary to

terminate the existing system of contractual arrangements and substitute in its stead a system of access charges, as described in Mr. Howorth's letter. That change in BellSouth's position has resulted in the institution of this proceeding and the necessity to address the three legal issues which are the subject of this brief.

1. DOES THE TRA HAVE JURISDICITON OVER THE TOLL SETTLEMENT AGREEMENTS BETWEEN BELLSOUTH AND THE RURAL LOCAL EXCHANGE CARRIERS?

Yes.

The fact that neither the TRA nor its predecessor the TPSC, saw fit to regulate such agreements does not mean that they had no jurisdiction to do so.

Prior to the adoption of Chapter 408 of the Public Acts of 1995, the TPSC had "practically plenary" jurisdiction over the rates and practices of all telephone companies (exclusive of the co-ops); T.C.A. §§65-4-104; 65-4-115; 65-4-117(1) and (3); and 65-5-201 (1993); and Tennessee Cable TV Association v. Tennessee Public Service Commission, 844 S.W.2d 151, 159 (Tenn. App. 1992). Thus, the TPSC had the jurisdiction to establish a system of access charges replacing the former contractual arrangements for interLATA traffic in 1983 and had the jurisdiction to adopt a similar system for intraLATA traffic which it chose not to exercise.

Chapter 408 did not change the TRA's jurisdiction or powers with respect to companies such as the rural local exchange carriers which remain under rate base rate of return regulation. Indeed, the rural local exchange carriers were specifically excluded from the competitive reach of that statute; T.C.A. §65-4-201(d) (2000 Supp.).

Incumbent local telephone companies under Chapter 408, however, could elect to adopt price regulation plans pursuant to what is now T.C.A. §65-5-209 (2000 Supp.), as BellSouth has done. The TRA's powers with respect to the rates of companies under price regulation plans are limited. Thus, the first key question here is whether the contractual system for intraLATA toll traffic existing between BellSouth and the independents in 1995 was within the scope of a price regulation plan as contemplated by T.C.A. §65-5-209 (2000 Supp.).

Subsection (a) of T.C.A. §65-5-209 provides that:

> Rates for telecommunications services are just and reasonable when they are determined to be affordable as set forth in this section. Using the procedures established in this section, the authority shall ensure that rates for all basic local exchange telephone services and non-basic services are affordable on the effective date of price regulation for each incumbent local exchange telephone company.

Subsection (c) provides in pertinent part:

> The authority shall enter an order within ninety (90) days of the application of an incumbent local exchange telephone company implementing a price regulation plan for such company. With the implementation of a price regulation plan, the rates existing on June 6, 1995, for all basic local exchange telephone services and non-basic services, as defined in § 65-5-208, are deemed affordable if the incumbent local exchange telephone company's earned rate of return on its most recent Tennessee Regulatory Authority 3.01 report as audited by the authority staff pursuant to subsection (j) is equal to or less than the company's current authorized fair rate of return existing at the time of the company's application. (Emphasis added).

"Current authorized fair rate of return" is defined in §65-4-101(g):

> "Current authorized fair rate of return" means:
>
> (1) For an incumbent local exchange telephone company operating pursuant to a regulatory reform plan ordered by the commission under TPSC rule 1220-4-2-.55, any return within the range contemplated by § 1220-4-2-.55 (1)(c)(1) or 1220-4-2-.55(d);
>
> (2) For any other incumbent local exchange telephone company, the rate of return on rate base most recently used by the commission in an order evaluating its rates.

Subsection (j) of §65-5-209 provides:

> For any incumbent local exchange telephone company electing price regulation under subsection (c), the authority shall conduct an audit to assure that the Tennessee Regulatory Authority 3.01 report accurately reflects, in all material respects, the incumbent local exchange telephone company's achieved results in accordance with generally accepted accounting principles as adopted in Part 32 of the uniform system of accounts, and the ratemaking adjustments to operating revenues, expenses and rate base used in the authority's most recent order applicable to the incumbent local exchange telephone company. Nothing herein is to be construed to diminish the audit powers of the authority. (Emphasis added).

Nothing in these provisions indicates an intent by the Legislature to include within the scope of a price regulation plan the agreements then in effect between BellSouth and the independents. The BellSouth Agreements did not establish "rates"; nor were they the subject of the TRA's "most recent order."

T.C.A. §65-4-124(a) (2000 Supp.) provides:

> All telecommunications services providers shall provide non-discriminatory interconnection to their public networks under reasonable terms and conditions; and all telecommunications services providers shall, to the extent that it is technically and financially feasible, be provided desired features,

> functions and services promptly, and on an unbundled and non-discriminatory basis from all other telecommunications services providers.

"Interconnection services" are defined in T.C.A. §65-4-101(f) (2000 Supp.):

> "Interconnection services" means telecommunications services, including intrastate switched access service, that allow a telecommunications service provider to interconnect with the networks of all other telecommunications service providers.

The arrangements between BellSouth and the rural local exchange carriers for intraLATA toll appear to come within the scope of "interconnection services" as so defined. Note Mr. Howorth's description of the proposed "access based compensation mechanism," i.e., "each company keeps its end users originating toll revenue and pays the other companies compensation for completing (serving as a terminating or intermediary function) the calls on the other companies' networks."

T.C.A. §65-4-124(a), however, applies to "terms and conditions" and not to rates. Indeed, rates were deliberately omitted from that provision, leaving issues as to interconnection rates to be determined pursuant to other provisions of the Code.

T.C.A. §65-5-209(g) (2000 Supp.) governs the powers of companies under price regulation plans with respect to rates for "interconnection services." As previously demonstrated, however, toll settlement agreements are not within the scope of price regulation plans. Note, moreover, that in that subsection, the right to complain is limited to "competing telecommunications service providers," which is a further indication that the Legislature did not intend to include the arrangements between BellSouth and the existing incumbent rural local exchange carriers under that provision.

In short, construing the various provisions of Chapter 408 as a whole, the Legislature did not intend to include the arrangements between BellSouth and the rural local exchange carriers within the scope of BellSouth's powers under a price regulation plan. Indeed, the purpose of Chapter 408 was to facilitate the policy adopted in T.C.A. §65-4-123 (2000 Supp.) favoring competition. The provisions of T.C.A. §65-4-201(d) (2000 Supp.) indicate a legislative intent to exclude the rural local exchange carriers from the competitive provisions of the statute unless such companies elected to become competitive.

Thus, T.C.A. §65-5-209 (2000 Supp.) does not include the arrangements between BellSouth and the rural local exchange carriers. Those arrangements remain subject to the general jurisdiction of the TRA as they were prior to the adoption of Chapter 408. In addition, the "terms and conditions" of those arrangements come within the TRA's jurisdiction over "interconnection" as provided in T.C.A. §65-4-124 (2000 Supp.). To the extent such arrangements affect the fixing of rates, the TRA's jurisdiction is based on T.C.A. §65-5-201 (2000 Supp.) and the other rate provisions of Title 65.

2. SHOULD THE WITHDRAWAL OF TOLL SETTLEMENT AGREEMENTS BETWEEN BELLSOUTH AND THE RURAL LOCAL EXCHANGE CARRIERS BE CONSIDERED IN THE RURAL UNIVERSAL SERVICE PROCEEDING? IF SO, HOW SHOULD THEY BE CONSIDERED?

As discussed below with respect to Issue 3, Tennessee law does not require or even contemplate a universal service proceeding with respect to incumbent rural local exchange carriers. The real issue raised by the rural carriers is whether the current settlement process is required in order for those carriers to earn their authorized rates of return. Consideration of the settlement agreements would, therefore, be more

appropriately addressed in proceedings addressing the rate of return and earnings of the affected carriers.

If there is to be a rural universal service proceeding, however, then the toll settlement agreements should be considered in such a proceeding, first, to determine if such agreements provide a subsidy that supports basic local exchange services for the incumbent rural carriers, and, if so, to determine to what extent and in what manner that subsidy should be made explicit in accordance with the factors stated in T.C.A. §65-5-207(b) and (c) (2000 Supp.).

The purpose and provisions of such toll settlement agreements are not matters of public record. Such agreements are not filed with the TRA; see Docket No. 97-01160. There is no basis without further investigation for finding that the payments from BellSouth to the rural local exchange carriers were intended as a subsidy for universal service, or were for some other purpose. Likewise, it is not clear, without further investigation, how the changes proposed by BellSouth actually affect each rural local exchange carrier, or how the various factors stated in the statute should be applied to the particular circumstances of each such carrier.

Thus, if the issues arising from the toll settlement agreements are to be considered in a rural local exchange carrier universal service proceeding, then a full opportunity for discovery of all relevant facts should be provided. However, AT&T respectfully contends that there is no statutory authority for any such proceeding.

3. **IS THE STATE UNIVERSAL SERVICE STATUTE, AS ENACTED, INTENDED TO APPLY TO RATE OF RETURN REGULATED RURAL COMPANIES, AS SUCH COMPANIES ARE DEFINED UNDER STATE LAW?**

No, unless such companies elect to become competitive.[1]

The first sentence of T.C.A. §65-5-207(a) (2000 Supp.) makes clear the proper answer to that question. It provides:

> Universal service, consisting of residential basic local exchange telephone service at affordable rates and carrier-of-last-resort obligations must be maintained after the local telecommunications markets are opened to competition. (Emphasis added).

The basis premise for the adoption of a statute dealing with universal service was that competition in local exchange markets would threaten universal service.[2] If there were no competition, then universal service could continue to be protected by the then-existing mechanisms. There would be no need for a new system.

Several of the factors stated in the statute are directly related to the presence of competition; e.g., "be fair to all telecommunications service providers"; "prevent the unwarranted subsidization of any telecommunications service providers' rates by consumers or by another telecommunications service provider"; "consider provision of universal service by incumbent local exchange telephone companies and by other

---

[1] The answer to this question also answers preliminary Issue No. 5, "[a]re any changes in state laws or TRA rules needed to implement a Rural Universal Service Fund?" A separate universal service fund for monopoly rural local exchange carriers could not be implemented without the enactment of new legislation authorizing that action.

[2] Federal universal service is likewise based on the directive that local telephone markets be opened to competition. Universal service is to be preserved in competitive markets not to guarantee economic success to providers but to assure customers of universal service; Alenco Communications, Inc. v. FCC, 201 F.3d 608 (5th Cir. 2000); and Texas Office of Public Utility Counsel v. FCC, 183 F.3d 393 (5th Cir. 1999).

telecommunications service providers"; "administer the universal service support mechanism in a competitively neutral manner"; when performing its duties under subdivisions (c) (5) and (6), "order no increase in the rates for any interconnection services"; and consider "intrastate access rates and the appropriateness of such rates as a significant source of universal service support."

Indeed, the basic concept of universal service as stated in T.C.A. §65-5-207(a) is tied to "basic local exchange telephone services," a term taken from T.C.A. §65-5-208(a) (2000 Supp.). The latter subsection begins by stating, "[s]ervices of incumbent local exchange telephone companies who apply for price regulation under §65-5-209 are classified as follows:" (Emphasis added). That subsection then defines "basic local exchange telephone services." Clearly, where the Legislature used the term in T.C.A. §65-5-207, it used it as defined in §65-5-208(a), i.e., as applicable to companies under price regulation. Thus, the basic terminology of §65-5-207 is taken from and relates to the statutes dealing with companies under price regulation plans.

Moreover, the language of the statute clearly indicates that there shall be one generic contested case and one alternative universal service mechanism. There is nothing in the statute which indicates that the Legislature contemplated, much less intended, that the TRA would have a separate universal service mechanism for rural local exchange carriers.

Taken together, the express language of §65-5-207 (2000 Supp.) carries out the basic purpose to provide a system of universal service where the "local telecommunications markets are opened to competition." The rural local exchange carriers deliberately chose to insist on their exclusion from competition, unless they voluntarily allowed it; T.C.A. §65-4-201(d). The universal service statute, as

demonstrated above, is premised on the presence of competition. The universal service statute does not provide for, or contemplate, the inclusion of a separate universal service fund or mechanism for rural local exchange carriers who have not elected to open their markets to competition and who remain under rate base rate of return regulation.

The rural local exchange carriers may have a problem arising from BellSouth's actions in terminating their existing agreements, but the answer to that problem is not to attempt to create a special universal service fund not authorized by statute. The TRA has ample power under its general jurisdiction to regulate the rates of the rural local exchange carriers and to regulate the terms, conditions and rates for their interconnection with BellSouth. Neither T.C.A. §65-5-207 (2000 Supp.) nor any other statute, however, gives the TRA the jurisdiction to conduct a special universal service proceeding for rural local exchange carriers, much less to establish a special universal service fund for their benefit, so long as the local telecommunications markets of such carriers are not opened to competition. If these rural local exchange carriers desire to participate in the TRA's universal service fund, then they must first open their markets to competition.

Respectfully submitted,

Val Sanford, #3316
GULLETT, SANFORD,
ROBINSON & MARTIN, PLLC
230 Fourth Avenue North, 3rd Floor
P.O. Box 198888
Nashville, TN 37219-8888
(615) 244-4994

James P. Lamoureux
AT&T
1200 Peachtree Street, N.E.
Atlanta, GA 30309
(404) 810-4196

Attorneys for AT&T Communications
of the South Central States, Inc.

CERTIFICATE OF SERVICE

I, Val Sanford, hereby certify that a copy of the foregoing Brief of AT&T Communications of the South Central States, Inc. as to Legal Issues has been served via United States First Class Mail, postage prepaid, to the following counsel of record, this 9th day of November, 2000.

Val Sanford

Guy Hicks
BellSouth Telecommunications, Inc.
333 Commerce Street, Suite 2101
Nashville, TN 37201-3300

Jon Hastings
Boult, Cummings, Conners & Berry, PLC
414 Union Street, Suite 1600
Nashville, TN 37219

Charles B. Welch, Jr.
Farris, Mathews, Brannan, Bobango &
Hellen PLC
618 Church Street, Suite 300
Nashville, TN 37219

David Espinoza
Millington Telephone Company
4880 Navy Road
Millington, TN 38053

Henry Walker
Boult, Cummings, Conners & Berry, PLC
414 Union Street, Suite 1600
Nashville, TN 37219

Richard Tettelbaum
Citizens Telecommunications
6905 Rockledge Drive, #600
Bethesda, MD 20817