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OFFICE OF THE
EXECUTIVE SECRETARY

00-00523

June 26, 2000

K. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505

Re: IntraLATA Toll Settlements Contracts.

Dear Mr. Waddell

At the June 20, 2000 regularly scheduled TRA Conference, Director Greer requested that BellSouth notify the Authority of any future changes to the intraLATA toll settlements contracts between BellSouth and the Independent LECs.

I believe a little background regarding these contracts might be helpful. Historically in Tennessee, BellSouth and the Independent LECs have reached agreements for jointly provided telecommunication services on a negotiated basis. One of the most significant occasions in recent history was the intraLata toll agreement that was reached at divestiture in the 1984 timeframe. That agreement provided for a pooling of toll revenues among all telephone companies in Tennessee. All billed revenues were collected, remitted to the pool and each company, including BellSouth, drew out its access charges. Any residual revenues left over were divided in proportion to each company's access lines. BellSouth filed the toll tariff and the other companies concurred in that tariff through the intraLata Revenue Distribution Fund (RDF) agreement. Every non-Bell company in the state enjoyed an increase in revenues when that plan was established because the access charges were specifically priced for revenue neutrality and the residual money represented a "bonus" of sorts. Under this arrangement, each company (Independent LEC and Bell) served as the provider of intraLATA toll to its end users on a par basis and shared equally in the rewards and risks of the market.

Then in the 1992 timeframe the companies re-negotiated the RDF agreement. This was brought about by a series of toll rate reductions that BellSouth was required to make to deal with earnings issues and to prepare for the onset of toll competition. Because those toll rate reductions caused financial effects on the other companies, it was generally agreed to modify the RDF to eliminate the residual revenues feature of the agreement. This simply meant that future toll rate reductions filed by BellSouth would have no direct effect on the other companies' revenues and the market risks were assumed by BellSouth. The access charge rates were re-priced to produce revenue

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neutrality on the companies. In all other respects, the RDF agreement was left intact. Thus, the other telephone companies continued to concur in the BellSouth tariff and provide service to their customers as in the past. Operationally and administratively there was no change except for the method of calculating the non-Bell companies' toll compensation. Most companies have probably continued to identify themselves, not BellSouth, as the provider of the 1+ intraLATA toll service to its end users. The current agreement obligated no one to do otherwise, or, to use BellSouth branding or logo on the end user bill.

This revised arrangement was acceptable at that time because BellSouth's earnings were protected under rate of return regulation and little to no intraLATA toll competition existed. BellSouth and the Independent LECs understood that this arrangement was interim at best pending the onset of competition. Competition has now arrived and accordingly, so has the need to revise the toll compensation arrangement, as Inter-exchange Carriers are competing head to head with BellSouth. Already all companies operating in Tennessee have implemented a toll dialing parity plan.

Over the last several years BellSouth has discussed with a number of the Independent LECs in Tennessee the need to revise the intraLATA toll compensation arrangement. Last December, during a formal meeting to discuss settlements in general, BellSouth stated to those companies that were in attendance that the current agreement is disproportionately burdensome and that BellSouth is evaluating it's options. Two face-to-face meetings were held on May 11 and May 30, 2000 with a follow up conference call on June 22, 2000. As yet, little measurable progress has been made toward a new agreement. The next face-to-face meeting is scheduled for July 13, 2000. In the spirit of negotiation, BellSouth has made several modifications to its first proposal that included the establishment of interim steps to a final agreement as well as delaying the effective date of any new proposed contract.

What BellSouth has proposed during these meetings is a further change in the formula for compensation that more aligns with the competitive environment we are in since the establishment of competition in the intraLATA toll market as well as in the local market. BellSouth's proposal is to simply replace the Modified RDF with an access based compensation mechanism. Under the access based compensation mechanism, 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. The access based compensation mechanism is the one that is most widely used today in other states. Since it is important that all companies charge the same competitively neutral rate for the same use of their network by all companies/competitors, which is not the case today, BellSouth is proposing that each company use it's own access tariffs filed (current rates) in Tennessee for the intraLata toll traffic. Billing of toll charges to end users can continue under the BellSouth tariff as present. Or, each company can set its own toll prices as has already been done by Citizens in Tennessee. Or, still another possibility would be for the 1+ toll calls to be sent to the carrier that an end user has already selected for interLata calls.

As in the modified RDF, we would continue using the same basic process (Settlements) for handling the access based compensation payments. But, as pointed out above compensation would be based on each company's current intraLATA composite terminating access rate, which should be the same rate the Independent LECs charge all other carriers except BellSouth.

This concept has been implemented in several of the other states where BellSouth operates without any disruption of service to customers or disruption of the distribution of revenues to the telephone companies. The current contract contains provisions that allow either party to cancel the agreement with a 30-day notice. Depending on the outcome of our negotiations, BellSouth intends to move forward in Tennessee with a new contract in place no later than January 1, 2001.

As always, should you have any questions or comments, I can be reached at 214-6520.

Sincerely,

Charlie Howorth