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July 30, 1999

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

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

Dear Mr. Waddell:

I have enclosed an original and thirteen copies of Rebuttal Testimony of Consumer Advocate Division witness Stephen N. Brown, Economist in the above referenced matter. Copies are being furnished to counsel of record for interested parties.

Sincerely,

L. Vincent Williams
Consumer Advocate

c: Counsel of record

15999

Before the

TENNESSEE REGULATORY AUTHORITY

IN RE: PROCEEDING FOR THE PURPOSE OF ADDRESSING COMPETITIVE EFFECTS OF CONTRACT SERVICE ARRANGEMENTS FILED BY BELLSOUTH TELECOMMUNICATIONS, INC. IN TENNESSEE.
DOCKET NO. 98-00559

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REBUTTAL TESTIMONY
of
STEPHEN N. BROWN

****

July 30, 1999

15999

INTRODUCTION

Q. Please state your name.

A. Stephen N. Brown.

Q. Where do you work and what is your job title?

A. I am an economist in the Consumer Advocate Division, Office of the Attorney General.

Q. What are your responsibilities as Senior Economist?

A. I review utility filings and information relating to rates and rate changes and follow the economic conditions that affect the companies. I also assess and evaluate facts for the Consumer Advocate Division and other entities within the Office of the Attorney General.

Q. What experience do you have regarding utilities?

A. From 1986 to 1995 I was employed by the Iowa Utilities Board as Chief of the Bureau of Energy Efficiency, Auditing and Research, and Utility Specialist and State Liaison Officer to the U.S. Nuclear Regulatory Commission. From 1984 to 1986 I worked for Houston Lighting & Power as Supervisor of Rate Design. From 1982 to 1984 I worked for Arizona Electric Power Cooperative as a Rate Analyst. From 1979 to 1982 I worked for Tri-State Generation and Transmission Association as Power Requirements Supervisor and Rate Specialist. From 1979 through 1995 my work spanned many issues including cost of service studies, rate design issues, telecommunications issues and matters related to the disposal of nuclear waste.

Q. What is your educational background?

A. I have an M.S. in Regulatory Economics from the University of Wyoming, an M.A. and Ph.D. in International Relations with a specialty in International Economics from the University of Denver, and a B.A. from Colorado State University.

Q. Are you and have you been a member of any professional organizations, Dr. Brown?

A. Yes, I am a past member of the NARUC Staff Committee on Management Analysis, a past trustee of and a member of the Board for the Automatic Meter Reading Association, and a current member of the National Association of Business Economists.

Q. What were you asked to do with respect to this case?

A. I was asked to review the direct testimony of Mr. Frame from BellSouth and the specific contract service arrangements (CSAs) that are the subject of inquiry in this docket and to form an opinion on the company's overall position, expressed by Mr. Frame in his testimony, that the CSAs are not anti-competitive and not discriminatory.

Q. In your opinion, is the company's position correct, that its CSAs are not anti-competitive

and not discriminatory?

A. No. In my opinion the CSAs KY98-4958-00 and TN98-2766-00, and the others I saw are anti-competitive and discriminatory because they are meant solely to prevent a customer from transferring its telecommunications business to a competitor of the incumbent, even when such a transfer would be the economically rational thing to do. Thus, the CSAs are a barrier aimed at preempting competitors' entry into local telecommunications markets while imposing unjustified price discrimination on customers.

Q. Why does an incumbent in a local telecommunications market raise a barrier to entry?

A. The incumbent raises a barrier to protect its share of the market and yield as little of it as possible to competitors. This economic behavior on the part of market leading companies has been noted for over a century by economists, and the study of this behavior is a standard part of economics known as Industrial Organization.

Q. What is Industrial Organization?

A. It is the study of competitive processes and the effects of monopoly distortions in actual markets. The best article I refer to on this entire subject appears in the September 1984 issue of the *American Economic Review*, one of the oldest and one of the most prestigious economic journals in the country. The article's title is *Contestability vs. Competition* and its author is George Shepard. According to the author, "Real conditions are the ultimate guide in sifting the many concepts that theorists can invent."

Q. What does the author say about an incumbent company's efforts to retain market share?

A. He said two things that are apt for this docket. Regarding market share he said:

> "Market share appears to be the central element of market structure. It is closely associated with excess rates of return and it is the direct measure of competitive impacts on the firm. For leading firms, losses of market share (to large, small or new competitors) are the crucial threat."

Regarding the incumbent's offering of contracts, or CSAs as they are called in this docket, he said:

> "[one economic theorist] has suggested that entrants can offer long-term contracts as a plausible way to obtain total [market] entry before response [from the incumbent] can occur...this suggestion is too easy...the incumbent could set standing offers to beat all credible offers by entrants..."

Q. Is the incumbent in this case setting standing offers that beat the competitors offers?

A. Yes, as indicated by the company's success thus far in achieving its goal, spelled out in a company E-mail of 04/07/97, which is appended to this testimony as Exhibit CA-SNB Schedule - 1. The E-mail says the incumbent has targeted its "top 500" customers for special contracts.

Q. How many CSAs are currently on file with the Tennessee Regulatory Authority?

A. To my knowledge there are well in excess of 200 CSAs filed, thus we know that the incumbent has captured well over 40 percent of its top 500 customers.

Q. Do you know the status of the other 250 or so customers?

A. No. I do not know if more of them will sign with the incumbent. I do not know if they have signed contracts with competitors.

Q. Is the incumbent still engaged in efforts to bring the those other customers under a CSA?

A. Yes, as far as I know the incumbent has not ceased its efforts.

Q. Do you know why the incumbent has limited its efforts to the "top 500" customers?

A. No. I found nothing in Mr. Frame's testimony that explains the limited scope. Therefore, the limitation is discriminatory because two customers could be physically adjacent to each other, receive the same service, but one could receive a CSA and one could not, solely at the company's discretion.

Q. How much of BellSouth's business involves a CSA?

A. Mr. Frame's testimony at page 4 lines 4-14, suggests the business level is a *de minimus* issue, the CSA's representing over 10% of the company's business revenue and less than 1 percent of the business customers.

But the company's growing use of CSAs suggests that it is not a *de minimus* issue to the company. Indicators of the importance are Mr. Frame's silence on the company's profit margins from those customers and his silence on how their use of telecommunications services will grow.

Q. Does Mr. Frame explain how the company selects candidates for CSAs?

A. Yes he does, at page 4 lines 18-23 of his testimony he describes certain criteria the company uses. However, he does not explain how the criteria just so happens to focus on the company's "top 500" customers.

Q. How does the incumbent impose unjustified price discrimination on customers?

A. The incumbent imposes unjustified price discrimination on customers by pre-screening them, before the CSA is offered, to find out if the customer will acquiesce to the incumbent's offer, and then by discriminating between the different CSAs.

Q. **What evidence suggests that incumbent prescreens customers before offering them a CSA?**

A. Mr. Frame's testimony, at page 4 line 16 poses a question: "What criteria does BellSouth use to identify customers as candidates for a [CSA]?" Mr. Frame's response indicates that only those customers who have already signaled their readiness to accept the incumbent's CSA will actually be offered one.

Mr. Frame says "BellSouth follows three criteria" the third one being:

> "The customer is willing to sign a [CSA] with BellSouth and commit to the terms and conditions contained in the [CSA]."

The word "negotiate" is conspicuously absent from Mr. Frame's description. Therefore, item 3 contradicts Mr. Frame's assertions -- made at page 9 line 11, page 13 line 19, page 14 line 21, page 18 line 21, page 20 line 7 and page 21 line 12 -- that a CSA is the culmination of negotiations between equally strong bargainers. Mr. Frame's third criteria indicates that once the incumbent thinks its CSA offer will be accepted by the customer, the incumbent adopts a hardball "take-it-or-leave-it" stance towards the customer.

Q. Is there any other evidence indicating such a position by the incumbent?

A. Yes. A company E-mail of 10/02/97 is appended to this testimony as Exhibit CA-SNB Schedule 2 and shows the incumbent refusing to move from its original offer to the customer. The E-mail says in part: "Your request to offer...one year V&T Agreement with the option to renew at one year increments with increasing discounts is disapproved...When I **first provided** [emphasis added] the V&T Agreement the term was 3 years, [the customer] evidently desired a 1 year agreement...They should not expect to receive the savings of a 3 year agreement by signing a 1 year agreement and renewing it each year."

Q. Why can the incumbent successfully adopt a rigid position in CSA "negotiations" with the customer?

A. The incumbent is successful because it has economically structured its CSA as an economic tool that is subordinate to the economic tools in the tariff. The incumbent's CSA applies to services already under tariff and already being offered to the customer. The tariffs themselves include large termination fees that apply even if there were no CSA. To my knowledge the tariffs were crafted before the federal Telecommunications Act of 1996 became law and before the state of Tennessee passed its telecommunications legislation in 1995.

It is fair to say that both state and federal law established a public interest goal of promoting competition in local telecommunications markets. However, the incumbent's E-mail shown in Exhibit CA-SNB Schedule 3, which I will quote later in my testimony, suggest prevailing tariffs have not been adjusted to reflect the public interest goal.

Q. Is it the incumbent's position that any service offered under a CSA is a tariffed service?

A. Yes. BellSouth's response to the Consumer

Advocate's discovery request of July 3, 1999 indicates the company considers that all services are supplied through tariffs, and that the CSA is strictly for a price discount. The company was asked:

> "For each CSA and each service provided under the CSA admit or deny that the service is available at BellSouth's tariffs approved by the TRA under which BellSouth provides services to other ratepayers."

The company responded:

> "Admit with the following clarification. No services are provided or provisioned under the CSA. The services are provisioned under the tariffs for these services. The CSA provides discounts which apply to the services in the aggregate."

Q. Is it possible that a customer taking tariffed services under a CSA faces termination charges not only through the tariffs but through the CSA as well?

A. Yes and the incumbent is well aware of this fact.

For example, a company E-mail of 01/13/97 is appended to this testimony as Exhibit CA-SNB Schedule 3 and shows a conversation about a customer worried over being "double gigged" by the incumbent if the customer cancels all services from the incumbent:

> "I have done some calculations on the services that we currently have under contract...based on the termination penalties on these contracts, I share concern that they would be 'double gigged'... For example, if [the customer] enters into a 36 month MSA Agreement...but [if] they cancel ALL services through BellSouth at the conclusion of Year 1 their penalties would be..$938,000 contract termination penalties (ESSX,SMARTPath, PRI, ISDN,Synchronet)... $775,000 MSA cancellation penalty at the end of Year 1... $1,713,000 TOTAL TERMINATION PENALTY ... they do not feel we should have such hefty penalties."

The tariff penalty was $938,000 in this case, almost as large as the proposed penalty in the Master Service Agreement.

Q. In this particular case did the incumbent submit new tariffs or did it do something else to respond to the customer's worry about hefty penalties?

A. To my knowledge the incumbent did not submit a new tariff. The proposed solution was to reduce but not eliminate the penalty on the MSA [master service agreement]. The E-Mail says: "My contact tells me if we can get the MSA penalties more like the following we can continue negotiations...$266,000 Year 1 $134,000 Year 2."

Q. Do you know if the incumbent actually took that course?

A. No.

Q. Do you know if the incumbent made the same offer to any other customer?

A. No.

Q. Is it possible that the incumbent could trade-off termination amounts with discounts in a given CSA or have the discounts and termination fees vary across different CSAs?

A. Yes. But if the CSAs have varying amounts of termination penalties and discounts that are not derived from a common source or formula, then the CSAs are also discriminatory.

For example, the customer in the E-mail just quoted complained about "double gigging" and apparently got a price break in the CSA termination fee from the incumbent. However, the incumbent did not volunteer this information. Pity the customer who does not know enough to complain in the beginning.

Thus, Mr. Frame offers no proof, compelling or otherwise, that the customer is on equal footing with the incumbent when termination fees or the discounts are "negotiated."

For example, a company E-mail of 06/04/97 and shown as Exhibit CA-SNB Schedule 4 is a discussion of how the incumbent increased the termination charge by $100,000 in anticipation that the customer would want a reduction. The E-mails says "[the customer] wants the first year termination liability to be reduced $75K...This shouldn't be an issue since I added an additional $100K as a termination liability in the first year of the Supplemental agreement." Thus Mr. Frame's statement, at page 21 lines 11-12, that "These are large, sophisticated business customers and experienced negotiators" is unproven.

Q. Are there other ways could the incumbent successfully discriminate against customers?

A. One way is to keep the CSAs confidential.

Q. Isn't discrimination prevented by making the terms and conditions of the CSAs part of the public record, as Mr. Frame's says at page 23 lines 3-23 of his testimony?

A. No, despite his comments the CSA process is a 1-way information flow because the customer is still prevented from disclosing its particular CSA to another customer or the competitor. Unless all CSAs are the same, customers and competitors have to play a guessing game about which CSA applies to which customer. The incumbent, no one else, has all the information. This is not a level playing field for the customer or the competitor.

This 1-way information flow cripples competitive bidding for the customer's business during the CSA's term and hinders the public interest goal of developing competitive local telecommunications markets.

Also, that my testimony is filed under a protective order certainly indicates a constraint on information flow.

Q. **Isn't it true that the interconnection agreements between the incumbent and its competitors, as well as the permanent prices set for interconnection, give facilities-based competitors the opportunity to enter local telecommunications markets and compete?**

A. Yes, it is true that competitors have agreements that enable them to compete on a facilities basis in the residential and business markets and the legal entitlement to do so. But having the right to compete is quite different from finding customers who have not had a CSA deprive them of a level playing field to make to make plain, straight forward economic decisions.

Q. **How is the customer deprived of a level playing field to make to make plain, straight forward economic decisions about competitive offers?**

A. The customer is deprived of a level playing field by the incumbent's stated policy of applying two termination fees to any customer who transfers its business to a competitor. BellSouth intends to apply termination charges that are in the tariffs and that are in the CSAs. Contracts TN98-2766-00, paragraph IX section C and KY98-4958-00, paragraph IX section B, both say: "The application of termination charges shall not affect the application of termination charges pursuant to the tariff or any other request."

The incumbent's policy is to "double gig" the customer if it takes its business elsewhere.

Q. Do you know what the company's reason is for having termination fees in the CSA?

A. Although I saw nothing specific in Mr. Frame's testimony, Exhibit CA-SNB Schedule 5 is a document from the incumbent showing that it views termination charges as something "which is a deterrent to breaking volume and term contracts but is not punitive."

Q. Has the incumbent offered any explanation about its views on termination charges in the tariffs?

A. None that I know of.

Q. In your opinion, is incumbent's "double gig" policy a deterrent or a punishment of the customer?

A. It is a deterrent and a punishment because it has no apparent basis in either cost or harm done to the incumbent.

Q. Is it possible the CSA itself and the incumbent's policy of applying two termination fees is a means of more strongly binding the customer to the incumbent's tariffed services?

A. Yes, not only is it possible it's actually happening. The CSA's termination fee is a back-door way of increasing the tariff's termination fees because the most likely way a tariff termination fee takes effect is when a customer switches its business to a competitor.

Q. Is the incumbent's "double gig" policy anti-competitive?

A. Yes, it is anti-competitive in effect and in intent.

Q. How is the policy anti-competitive in effect?

A customer who stops doing business with the incumbent is exposed to two termination charges and will probably end up paying the incumbent far more for services actually received than if they had been taken on a month-to-month basis under the tariff. The additional cost is economic dead-weight borne by the customer or its new provider of services.

Taken together, the two termination charges are a powerful disincentive to any customer considering a change in telecommunications providers and a barrier to the development of competition in local telecommunication markets.

Q. What remedy do you propose to remove the barrier?

A. Both charges should be removed and replaced with one limited to the unrecovered facility cost for facilities that cannot be reused.

Q. How is the "double gig" policy anti-competitive in intent?

A. The anti-competitive intent of the "double gig" policy is crystal clear in paragraph X of CSAs TN98-2766-00 and KY98-4958-00. The customer's contractual liability for the termination is contingent upon the customer's behavior towards the incumbent's competitors rather than on the customer meeting its CSA obligations.

For example, paragraph X says "In the event of a business change as defined herein...with the result that [the customer] is unable to meet its Minimum Annual Revenue Base" then the incumbent and the customer "shall cooperate in efforts to develop a mutually agreeable alternative that will reduce [the customer's] liability." However, paragraph X says further: "This provision shall not apply to a change resulting from a decision by [the customer] to transfer portions of its traffic or projected growth to providers other than" the incumbent.

With this language the incumbent clearly signals its intent to prevent customers from switching their business to the incumbent's competitors. In any other event the incumbent is willing to accommodate customer.

Furthermore, paragraph X proves the point which I made at the outset of my rebuttal testimony--that a CSA aims at preempting competitors' entry into local telecommunications markets while imposing unjustified price discrimination on customers.

Q. Is it true that the incumbent's termination policies are no different than those of its competitors?

A. No, that is not true.

Q. Have you read the testimony of Bell South's witness, Mr. Frame, regarding this CSA and how its termination charge compares to competitor's

termination charges?

A. Yes, I have.

Q. Do you agree with him?

A. No, I do not agree with him because he has mischaracterized the comparison.

For example, at page 15 lines 7-10, Mr. Frame says: "based on the limited information available, BellSouth believes that the termination provisions of the two CSAs at issue are similar if not more lenient than comparable provisions offered by BellSouth's competitors."

His comparison is misleading in three ways.

First, the "leniency" he refers to is available to the customer provided it does not cozy up to a competitor, otherwise no mercy is granted. Thus what he calls leniency is an economic tool to punish the customer if it takes it business elsewhere.

Second, Mr. Frame's recitation of the competitor's termination charges contains no language where the competitor makes its termination charge contingent on the customer's behavior towards competitors. This sharply contrasts with BellSouth's language, as I explained earlier.

Third, Mr. Frame has not shown that competitors have termination fees beyond what the tariff states, unlike BellSouth's "double gig."

Q. Can you provide an example of how the "double

gig" policy would work?

A. Yes. Even with the rate assurance clause in CSA TN98-2766-00 the "double gig" can not be overcome. The details of paragraph XIII, the rate assurance clause, show why.

Section A requires the competitor's offer be at least 15 percent below the incumbent's discount, which is already just 90 percent of the tariff. Even if the customer is offered a price break of 10-14 percent below the incumbent's CSA rates, the incumbent ignores the customer and has no obligation to provide a counter offer.

The incumbent can retain the customer if the counter offer is more expensive than the competitor's offer. For example, Section C say: "In the event [the incumbent] elects to respond to the offering from the alternative carrier and offers [the customer] a service proposal with rates that are within ten percent(10%) of the alternative carrier's competitive offering, this Agreement shall continue in effect at the new customized rate and charges until the expiration of the V&T Agreement."

In terms of the tariff, the competitor's rate has to be:

Competing offer = .85 X .90 = 76.5% of tariff.

But the incumbent has right to counter offer up to 10 percent higher than the competitor:

Counter offer = 1.1*.765 = 84.2% of tariff.

The customer's potential savings, before termination fees are considered, equal the difference between the competitor's offer and the counter offer:

Savings = 84.2% - 76.5% = 7.7% of tariff.

Q. If the customer is rational, why would it sign a contract where competing offers must be 15 percent below the incumbent's price before the customer gets any benefit?

A. That condition results from a vast disparity in the bargaining power of the customer versus that of the incumbent, as I described earlier.

Q. Is it reasonable to assume that the incumbent's economic behavior is rational?

A. Yes.

Q. If the incumbent is rational, how does it does it persuade itself that a counter offer 10 percent higher than the competitor's rate is rational?

A. The incumbent must believe it has an economic "ace in the hole," one that influences the customer.

Q. Why would a rational customer agree to a counter offer 10 percent higher than the competitor's offer?

A. The customer must realize that the incumbent really has an economic "ace in the hole."

Q. What is the economic "ace in the hole" which influences the customer?

A. The economic "ace in the hole" is the termination provisions. Their cost is large enough to offset the savings accruing to the customer who switches its business to a competitor before the CSA's end date.

The CSA's termination clause by itself wipes out nearly all the economic savings accruing to the customer who switches its business to a competitor after the incumbent makes a counter offer. Additional termination charges from the tariff makes it prohibitive for customer to switch providers.

Consider the CSA's Appendix II, which shows the customer's minimum annual revenue base as $5.75 million in contract year one. Since the tariff rates are discounted by 10 percent and since the customer's savings are shown as $470,063, then the revenue from the discount eligible services must equal $4.7 million.

This figure provides a starting point to analyze the effect of the CSA's rate assurance language.

Since the revenues eligible for discount are equal to $4.7 million, the customer's potential savings are 7.7 percent of 4.7 million, or:

Savings=.077 * $4.7 million= $362,000

Q. Are these potential savings on an annual basis?

A. Yes, therefore the monthly figure would be approximately $30,000.

Q. How many months are in the this CSA?

A. There are 36 months.

Q. Do the savings include termination fees?

A. No.

Q. How would the customer know if the termination fees were less than the savings?

A. The customer would have to pick a month in which to terminate the contract and then compare the cumulative savings to the cumulative termination fees.

Exhibit CA-SNB Schedule 6 shows that it is literally impossible for this customer to transfer its business from the incumbent to a competitor during the CSA's term.

This is a perfect example of Shepard's observation, which I quoted at the beginning of my testimony: "the incumbent could set standing offers to beat all credible offers by entrants."

CONCLUSION

The development of price-on-price competition in Tennessee's local telecommunications market is obstructed by the incumbent's "double gig" policy, an anti-competitive practice if there ever was one. Not only does the incumbent "double gig"customers, it "gigs" each one differently and in an arbitrary manner derived from the so-called "negotiations" with the customer, without a hint of cost justification. However, my testimony is filled with examples, drawn from the incumbent's responses to my agency's data requests, where the incumbent outmaneuvers and outbargains its customers.

This concludes my testimony at this time.

BEFORE THE TENNESSEE REGULATORY AUTHORITY
AT NASHVILLE, TENNESSEE

IN RE: PROCEEDING FOR THE PURPOSE OF ADDRESSING COMPETITIVE EFFECTS OF CONTRACT SERVICE ARRANGEMENTS FILED BY BELLSOUTH TELECOMMUNICATIONS, INC. IN TENNESSEE.	)	DOCKET NO. 98-00559

AFFIDAVIT

I, Stephen N. Brown, Economist for the Consumer Advocate Division of the Attorney General's Office, hereby certify that the attached Rebuttal Testimony represents my opinion in the above referenced case and the opinion of the Consumer Advocate Division.

Stephen N. Brown

Sworn to and subscribed before me
this 30th day of July, 1999.

Teresa A. Harris
NOTARY PUBLIC

My commission expires on: Jan. 25, 2003

15999

Before the

TENNESSEE REGULATORY AUTHORITY

IN RE: PROCEEDING FOR THE PURPOSE OF ADDRESSING COMPETITIVE EFFECTS OF CONTRACT SERVICE ARRANGEMENTS FILED BY BELLSOUTH TELECOMMUNICATIONS, INC. IN TENNESSEE.
DOCKET NO. 98-00559

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EXHIBITS
of
STEPHEN N. BROWN

****

July 30, 1999

15999

Docket No. 98-00559
Exhibit CA-SNB____
Rebuttal Testimony____
Scnedule 1______
Page 1 of 1____

Jon Alexander
04/07/97 03:13 PM

To: Terry Stevens@BCI
cc: Kenneth Lewis@BCI, Paul Alsup@BCI, Randall Frame@BCI, David Poindexter@BCI, Sandra Wall@BCI
Subject: Re: Master Services Agreement for [redacted] - Memphis, TN

Thanks for your message. We'll have you an offer (V&T Agreement) that you can take to [redacted] that's as competitive as we can in order to retain and grow your business.

In the meantime, are there any CSA's? If so, for which services? Also, are these all the tiecodes?
regards,

Jon

To: Jon Alexander
cc: Kenneth Lewis, Paul Alsup, Randall Frame, David Poindexter, Sandra Wall
From: Terry Stevens
Date: 04/07/97 02:37:03 PM
Subject: Master Services Agreement for [redacted] - Memphis, TN

The Director of Networking of [redacted] informed Systems Designer, David Poindexter and me last Wednesday that unless BellSouth has a response to all the LOW prices he is seeing from MCI, Time-Warner, etc.., [redacted] is planning to take its business elsewhere.

I reminded him that [redacted] was on a list of our top 500 customers and last July I had approached him with the idea of a Master Services Agreement. At the time, I reminded him, I asked him to sign our nondisclosure form on our pricing. I reminded him that he refused to sign the form and thereby halted the process.

I told him I could not offer him the $100,000.00+ savings MCI had offered on his four Memphis metropolitan hospitals but could give him smaller but broader in scope discounts that could come close to the same neighborhood that MCI was playing in.

He stated that he did not want to leave BellSouth but had to take seriously these discounts from our competitors. I told him we would try our hardest to make is very difficult for him to leave BellSouth.

Jon, I had in mind a 7% to 8% V&T discount I have heard of others getting. If we can get the 8%, I feel we have a real good chance in keeping their business. He signed the nondisclosure form and told us we had one month to come back with a V&T agreement.

I am sending the Nondisclosure form and their CPNI letter via fax, but wanted to send you this memo now.

It is very important that we meet their deadline. Please work with us to win this one.

The TIE codes involved are in Tennessee and Mississippi and involve some other hospitals, clinics, home health agencies, etc. that they have recently acquired.

The TIE codes are: SC000207738 [redacted]
SC000207480 [redacted]
SC939987966 [redacted]

Jon Alexander
10/02/97 02:29 PM

To: Roger D Smith@BCI
cc: John Buchanan@BCI, John Ross@BCI, Mike Smith@BCI
Subject: [redacted]

Your request to offer [redacted] a one year Volume & Term Agreement with the option to renew at one year increments <u>with increasing discounts</u> is disapproved.

I recently e-mailed you 3-year and a 1-year Volume & Term Agreements. Both had aggressive and competitive savings for [redacted]. Should [redacted] want greater savings, the 3-year offer is recommended. Should [redacted] want a lesser term, the 1-year is recommended.

When I first provided the Volume & Term Agreement, the term was 3 years. [redacted] evidently desired a 1 year agreement, perhaps due to their purchasing policy. They should not expect to receive savings of a 3 year agreement by signing a 1 year agreement and renewing it each year over a two year period.

Thanks,

Jon

Timothy Norwood
01/13/97 10:43 AM

To: Jon Alexander
cc: Wanda Page, James Stringer
Subject: [redacted]

Jon:
Hope you are doing well so far in '97. I wanted to get back with you regarding our V&T (MSA) proposal to [redacted] As you and I have discussed, we recast most of their BellSouth services back in the third quarter of '96 for 36 or 49 months (depending on the service). The big obstacle preventing [redacted] rom signing the MSA today is the termination liability. They have stated that they intend to stay with BellSouth and have no intentions of canceling the contracts on the existing services (ESSX, SMARTPath, PRI ISDN, SynchroNet). There is a termination penalty associated with each BellSouth contract on these services. However, [redacted] eels that because of these termination penalties associated with each service, the termination penalty on the MSA should be lower.

still are lower

I have done some calculations on the services that we currently have under contract at [redacted] Based on the termination penalties on these contracts I share [redacted] concern that they would be "double gigged" in the highly unlikely event of an early termination on an MSA. For example, if [redacted] enters into a 36 month MSA agreement with an effective date of 2/01/97, but they cancel ALL service through BellSouth at the conclusion of Year 1 on 2/01/98, their termination penalties would be as follows:

$938,000	Contract termination penalties (ESSX, SMARTPath, PRI ISDN, SynchroNet)
$775,000	MSA cancellation penalty at end of Year 1
$1,713,000	TOTAL TERMINATION PENALTY

[redacted] understands that the individual contracts and the MSA agreement are two different issues, but they do not feel that we should have such hefty penalties. My contact tells me that if we can get the MSA penalties more like the following, we can continue with negotiations:

$266,000	Year 1
$134,000	Year 2

Please review this, and let me know what we can do to move ahead. I know that you are concerned with the MSA piece, but we have to look at the whole picture. We are also interested in more information on the Rate Assurance clause.

I look forward to hearing from you. Thanks!!
Tim

Docket No. 98-0055
Exhibit CA-SNB___
Rebuttal Testimony__
Schedule 3_____
Page 1 of 1____

Timothy Norwood
01/13/97 10:43 AM

To: Jon Alexander
cc: Wanda Page, James Stringer
Subject: [redacted]

Jon:
Hope you are doing well so far in '97. I wanted to get back with you regarding our V&T (MSA) proposal to [redacted] As you and I have discussed, we recast most of their BellSouth services back in the third quarter of '96 for 36 or 49 months (depending on the service). The big obstacle preventing [redacted] from signing the MSA today is the termination liability. They have stated that they intend to stay with BellSouth and have no intentions of canceling the contracts on the existing services (ESSX, SMARTPath, PRI ISDN, SynchroNet). There is a termination penalty associated with each BellSouth contract on these services. However, [redacted] feels that because of these termination penalties associated with each service, the termination penalty on the MSA should be lower.

I have done some calculations on the services that we currently have under contract at [redacted] Based on the termination penalties on these contracts I share [redacted] concern that they would be "double gigged" in the highly unlikely event of an early termination on an MSA. For example, if [redacted] enters into a 36 month MSA agreement with an effective date of 2/01/97, but they cancel ALL service through BellSouth at the conclusion of Year 1 on 2/01/98, their termination penalties would be as follows:

$938,000	Contract termination penalties (ESSX, SMARTPath, PRI ISDN, SynchroNet)
$775,000	MSA cancellation penalty at end of Year 1
$1,713,000	TOTAL TERMINATION PENALTY

[redacted] understands that the individual contracts and the MSA agreement are two different issues, but they do not feel that we should have such hefty penalties. My contact tells me that if we can get the MSA penalties more like the following, we can continue with negotiations:

$266,000	Year 1
$134,000	Year 2

Please review this, and let me know what we can do to move ahead. I know that you are concerned with the MSA piece, but we have to look at the whole picture. We are also interested in more information on the Rate Assurance clause.

I look forward to hearing from you. Thanks!!
Tim

Wanda Page
06/04/97 11:05 AM

To: Kenneth Lewis
cc: Timothy Norwood
Subject: [redacted] MSA

Well, we've worked long enough on this one!!! After my meeting with Bill Hurst yesterday, he met with Bob Young and [redacted] is ready to sign the MSA. There is just one minor issue that I have to discuss with Jon Alexander. [redacted] wants the first year termination liability to be reduced $75K ($325,000 to $250,000). This shouldn't be an issue since I added an additinal $!00K as a termination liability in the first year of the Supplemental agreement!. I am waiting to clear this change with Jon and plan to take the contracts down this afternoon for Bill's signature.

Bottom Line Statistics:

- 2 year with 3 year supplement
- $1.9 annual revenue commitment
- $9.5 over the 5 year contract

[redacted]

system is discontinued, termination charges apply in an amount based upon 40% of the initial and any subsequent minimum monthly charge amount(s) for the remainder of the initial and any subsequent service period(s)."

How are termination charges determined?
Termination Charges have become the standard for the industry and can be found throughout both Company and competing tariffs. These charges in a tariff environment are generally determined by a Product Team. Tariffs, both interstate and intrastate tariffs, are scrutinized by state regulatory commissions and open to comment and challenge before being approved or allowed to become effective.

Rationale for creating termination charges vary greatly.

- In some instances the charge is directed towards the recovery of non recurring installation, labor and/or some non recoverable portion of capital costs. This generally occurs when these costs are converted to a recurring cost and recovered in the monthly recurring contract rate charged for specific rate element or element(s) of the service. Example: The termination liability for CDS recovers the installation charge for early termination which was waived when the CSA contract was signed.
- In other cases the termination charge is established at a "market" level. That is, comparable to what is charged for a competing service or what is perceived as acceptable in the marketplace.
- Some termination charges are also based upon economic considerations such as revenue requirements or internally established product performance levels.
- The termination charges for Volume and Term contracts vary and like the discount level were established as a result of mutually agreed upon negotiations between the Company and the customer. Implementation and Tracking costs are covered by the contribution of the billed recurring revenue for existing services.

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Are these charges reasonable within a V&T context?
Yes. V&T Termination Charges are negotiated on a customer specific basis. The objective is to develop a termination liability charge which is a deterrent to breaking volume and term contracts but is not punitive. Volume and Term agreements were developed to create a win - win situation for the Company and the customer. This is the basis for making the termination liability amount and calculation methodology a negotiable item with the customer.

The specific application therefore varies greatly according to what the Company ... expectation or representation for the

Certificate of Service

I hereby certify that a true and correct copy of the foregoing Rebuttal Testimony of Stephen N. Brown was served on parties of record via U.S. Mail, postage prepaid, this 30th day of July, 1999.

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15999

How the CSA Termination Clause Eliminates Savings From The Rate Assurance Clause

Month in Contract Year	Contract Month	Termination Cost under Section A, Paragraph IX, Termination Liability	Termination Cost under Section B, Paragraph IX, Termination Liability	Termination Cost Pursuant to Tariff - Must be Calculated on a Tariff-by-Tariff Basis	CSA Termination Cost (Excludes Tariff termination Costs)	Potential Cumulative Savings From The Contract Month in Col. (2) Forward	Customer's Net Gain By Terminating CSA (Excludes Tariff termination Costs)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	1	0	0	0	0	0	0
2	2	0	0	0	0	0	0
3	3	0	0	0	0	0	0
4	4	0	0	0	0	0	0
5	5	0	0	0	0	0	0
6	6	350,000	2,350,000	unknown	2,700,000	900,000	-1,800,000
7	7	350,000	1,958,333	unknown	2,308,333	870,000	-1,438,333
8	8	350,000	1,566,667	unknown	1,916,667	840,000	-1,076,667
9	9	350,000	1,175,000	unknown	1,525,000	810,000	-715,000
10	10	350,000	783,333	unknown	1,133,333	780,000	-353,333
11	11	350,000	391,667	unknown	741,667	750,000	8,333
12	12	350,000	0	unknown	350,000	720,000	370,000
1	13	350,000	4,308,333	unknown	4,658,333	690,000	-3,968,333
2	14	350,000	3,916,667	unknown	4,266,667	660,000	-3,606,667
3	15	350,000	3,525,000	unknown	3,875,000	630,000	-3,245,000
4	16	350,000	3,133,333	unknown	3,483,333	600,000	-2,883,333
5	17	350,000	2,741,667	unknown	3,091,667	570,000	-2,521,667
6	18	350,000	2,350,000	unknown	2,700,000	540,000	-2,160,000
7	19	350,000	1,958,333	unknown	2,308,333	510,000	-1,798,333
8	20	350,000	1,566,667	unknown	1,916,667	480,000	-1,436,667
9	21	350,000	1,175,000	unknown	1,525,000	450,000	-1,075,000
10	22	350,000	783,333	unknown	1,133,333	420,000	-713,333
11	23	350,000	391,667	unknown	741,667	390,000	-351,667
12	24	350,000	0	unknown	350,000	360,000	10,000
1	25	0	4,308,333	unknown	4,308,333	330,000	-3,978,333
2	26	0	3,916,667	unknown	3,916,667	300,000	-3,616,667
3	27	0	3,525,000	unknown	3,525,000	270,000	-3,255,000
4	28	0	3,133,333	unknown	3,133,333	240,000	-2,893,333
5	29	0	2,741,667	unknown	2,741,667	210,000	-2,531,667
6	30	0	2,350,000	unknown	2,350,000	180,000	-2,170,000
7	31	0	1,958,333	unknown	1,958,333	150,000	-1,808,333
8	32	0	1,566,667	unknown	1,566,667	120,000	-1,446,667
9	33	0	1,175,000	unknown	1,175,000	90,000	-1,085,000
10	34	0	783,333	unknown	783,333	60,000	-723,333
11	35	0	391,667	unknown	391,667	30,000	-361,667
12	36	0	0	unknown	0	0	0