BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION

In the Matter of the Second Investigation Into the State of Competition in the Exchanges of Southwestern Bell Telephone, L.P., d/b/a SBC Missouri.	))))	TO-2005-0035

CLEC BRIEF

COME NOW MCImetro Access Transmission Services, LLC (including as successor by merger to Intermedia Communications, Inc.),[1] and MCI WorldCom Communications, Inc. (MCI), NuVox Communications of Missouri, Inc. (NuVox), XO Communications Services, Inc. (XO)(successor by merger to XO Missouri, Inc. and Allegiance Telecom),[2] Big River Telephone Company, LLC (Big River), and Socket Telecom, LLC (Socket),[3] and for their Brief state to the Commission:

Introduction

In this proceeding, SBC seeks release from price cap regulation for all its voice services in Missouri. Given the significance of the change requested by SBC, the Commission should proceed with caution. SBC has the burden of proof and persuasion.[4] Absent substantial evidence of effective competition, the Commission should deny SBC's request. There is no basis for SBC's self-serving assertion that the Commission should be predisposed to grant relief. (Tr. Aron p. 193). Quite the opposite, as discussed herein, the restraints on SBC are already very

[1] See Case No. TM-2005-0129.

[2] See Case No. LO-2005-0027.

[3] The Commission should ignore SBC's selective speculation as to the motivations of other CLECs that did not expend scarce resources on this case. When asked about the acquisition of AT&T by SBC, witness Unruh conveniently refused to speculate as to AT&T's motivations. (Tr. Unruh p. 345).

[4] Ex 49, Report and Order, Case No. TO-2001-467, p. 9.

limited and the Commission should be exceedingly reluctant to relinquish its last bit of control over SBC's ability to totally drive out as yet still emerging competition and harm the public.

Notwithstanding SBC's attempts to speak for the Missouri Legislature, the price cap statute does not express a preference for regulatory parity. Instead, the statute makes plain that price cap regulation applies only to incumbents and is not to be lifted absent a demonstration of effective competition for a specific service in a specific exchange. (Ex 32 Kohly Amended Rebuttal p. 3-4).

The statutes do not define "effective competition". Instead, Section 386.020(13) simply lists various factors that the Commission must consider when evaluating whether effective competition is present. Further, that section allows the Commission to consider any other relevant factor.

However, based on its prior experience with these issues under the price cap statute, the Commission has developed a definition for "effective competition." In its Report and Order in Case No. TO-2001-467, the Commission stated:

> When considered in the full context of Sections 392.245.5 and 386.020(13), "effective competition" as used in subsection 5 of the price cap statute refers to competition that is adequate to accomplish the purposes that were previously to have been accomplished by the cost floors and maximum prices and, to produce the intended or expected results, namely accomplishing the "purposes and policies of chapter 392, RSMo, including the reasonableness of rates, as set out in section 392.185," over a sustained period running up to five years into the future. As witnesses such as Dr. Aron testified, this means that "effective competition" is competition that exerts sustainable discipline on prices and moves them to the competitive level of true economic cost.

Hence, the Commission has recognized that "effective competition" means "competition that exerts sustainable discipline on prices", with "sustainable" meaning for a substantial period of time. (Ex 32 Kohly Amended Rebuttal p. 4-5). As indicated in the indented quotation above,

the Commission relied on testimony from Dr. Aron in the previous case on this point. She reaffirmed that testimony in this case. (Tr. Aron p. 75-76).

Witness Kohly discussed the Commission's definition of "effective competition" when examining the interrelated provisions of Sections 386.020(13)(c) and 392.185. He observed that the statutes require the Commission to consider whether the respective markets are "irreversibly competitive", for if competition is not irreversible or sustainable, "the competitive market cannot effectively replace price regulation and price deregulation will be premature." (Ex 32 Kohly Amended Rebuttal p. 23-24).

When the Commission examines the record, it can only conclude that SBC does not yet face effective competition for any additional services in any additional exchanges.

Issue 1. The Commission, pursuant to Section 392.245.5 RSMo. 2000, previously classified SBC Missouri's core business switched and business line-related services in the Kansas City and St. Louis exchanges as competitive in Case No. TO-2001-467. In which additional SBC Missouri exchanges, if any, does effective competition for those services exist, such that SBC Missouri's core business switched and line-related services should be classified as competitive?

SBC Missouri has not met its burden of proving the existence of effective competition for all core business services in any additional exchanges. Substantial barriers to entry protect SBC and limit the extent and level of competition regarding core business services. Substantial reductions in SBC's unbundling obligations will reduce wireline competition even further and intermodal competition does not contribute towards the level of competition regarding these services in any meaningful way. There is no basis on which to conclude that competition is or will be effective in any additional exchanges for core business services.

SBC chose to lump all business services together into one decision point. But it is clear from the record that there are distinct market segments, ranging from small businesses, to medium-size businesses, to large businesses.[5] The statute itself distinguishes between single line, or basic business service, and multiline or nonbasic business service.[6] In Case No. TO-2004-0207 the Commission concluded that there was a clear distinction between customers served by ten lines or less, versus a larger number of lines. (Ex. 32 Kohly Amended Rebuttal p. 11).

It is also clear from the record that competition to provide services to the largest of business customers does not mean that there is similar competition for the smallest of business customers. Indeed, SBC admits that there is no competition for the smallest of customers. (Ex 10 Stoia Direct p. 9; Tr. Stoia, p. 507-10).

With a single issue "business service" issue presented, the Commission can only protect the smallest of customers from premature price deregulation by taking a least common denominator approach. Accordingly, it should base its decision upon whether or not the least competitive market segment is subject to effective competition. (Ex 33 Kohly Surrebuttal p. 9; Tr. Kohly p. 1292, 1294).

NuVox and Socket are both facility-based CLECs using their own switches. NuVox serves small and medium-sized business customers in urban portions of SBC's Missouri service areas. It has a switch in St. Louis, Kansas City, and Springfield. Socket serves such customers in some rural portions of SBC's Missouri service areas. It has one switch, in St. Louis. Both

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[5] The FCC has recently noted the importance of disaggregating data into specific customer classes in order to properly assess market power. Order and Notice of Proposed Rulemaking, WC Docket No. 05-25, para. 103 (January 31, 2005).

[6] SBC witness Unruh conceded that only single line business service is subject to the basic service price cap and related price index adjustments, whereas SBC considers multiline service to be nonbasic service subject to 8% annual increases. (Tr. Unruh p. 518-19).

companies presented witnesses that discussed the absence of effective competition in these segments of the business service market. Ed Cadieux testified on behalf of NuVox, and Matt Kohly testified on behalf of Socket. (Ex 30 Cadieux Rebuttal p. 2-3, Ex 32 Kohly Amended Rebuttal p. 2-3; Tr. Kohly 1167).

One of the factors to be considered under Section 386.020(13) in the evaluation of whether competition is effective is the existence of barriers to entry. SBC witness Aron testified that this was the most important factor. (Ex 1 Aron Direct, p. 8; Tr. Aron p. 99, 103). In discussing barriers to entry in a recent proceeding regarding special access services, the FCC stated: "Markets where a price cap LEC owns or has access to important assets or resources that are not accessible to the potential entrant bestows an absolute advantage on the incumbent." Order and Notice of Rulemaking, FCC WC Docket No. 05-25 para. 107 (January 31, 2005).

NuVox witness Cadieux and Socket witness Kohly both explained that substantial entry barriers in the small and medium-size business customer market segments limit the extent and level of competition that SBC faces. They testified that their companies depend upon the availability of unbundled DS1 loops and DS1 loop and transport combinations known as EELs from SBC in order to use their own switching and related facilities to serve customers in these market segments in the respective areas of the state where they each compete. Mr. Cadieux explained that, as the FCC has recognized, the potential revenues from small and medium-sized business customers are not sufficient to support the costs of installing such facilities by a CLEC. In particular, he noted that the disparity between potential revenues and costs is greater when the customer is located in an end office where the CLEC does not have a collocation and unbundled transport (in the EEL combination), must be used to reach the customer. Mr. Kohly explained that the costs are even higher in rural areas, in part because the traffic must be brought out of the

rural area to the switch, and then back again for termination in the local calling scope. Even where unbundled facilities are available, the costs can be a barrier to entry. (Ex 30 Cadieux Rebuttal p. 2-14; Ex 32 Kohly Amended Rebuttal p. 27-28; Tr. Kohly 1178, 1314-15).

Most significantly, tremendous uncertainty surrounds the market for small and medium-sized business customers. The unbundled element combination of local switching and local loop known as UNE-P has been eliminated as a serving method by the FCC (at least in part at SBC's urging), so CLECs cannot compete for new customers using this arrangement and will have to cease use of this arrangement for existing customers within a year.[7] No one can be sure whether CLECs will be able to make alternative arrangements to compete for those smaller customers that have been served via UNE-P.[8] Many CLECs that have relied on UNE-P have indicated they intend to withdraw from the market. Mr. Cadieux testified that in his opinion it is likely that many such customers (now served by UNE-P) will revert back to SBC. Mr. Kohly agreed and quoted an industry analyst who projects that SBC will recapture 80% of such lines. Even SBC's

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[7] SBC wants to argue that because the FCC has found there is no impairment without access to unbundled local switching, ipso facto there is no impairment. (Ex 2, Aron Surrebuttal p. 66; Tr. Aron p. 115-17). Yet, as discussed below, when the FCC says that there is impairment without access to other unbundled elements, SBC says the FCC is wrong. The truth of the matter is that, regardless of what the FCC and courts say, the market will demonstrate whether or not there is impairment. Further, what is plain is that it is premature for anyone to try to reach a definitive conclusion as to what is going to happen in the market based on the latest round of dramatic changes in the availability of unbundled elements. What is certain is that current market share data cannot reasonably be viewed as indicative of future levels of competition.

[8] It remains to be seen whether CLECs as a whole and SBC can reach agreement on "market priced" alternatives to UNE-P. (Ex 33 Kohly Surrebuttal p. 2). SBC could not identify proposed terms and conditions at the hearing. (Tr. Unruh p. 527-29). Nor could it describe the terms and conditions of its agreement on the topic between it and Sage, other than an approximate price of $25 for a UNE-P-like service. (Tr. Unruh p. 529-30, 799-800). That agreement has not been filed with the Commission. (Tr. Unruh p. 532-33). Unless CLECs take SBC's terms, whatever they may be, they are out of luck. (Tr. Unruh p. 530-32). Given that Sage was totally dependent upon the UNE-P arrangement and faced business termination, it is far from clear that it was a truly voluntary agreement. It is not even clear that Sage seeks new customers under the new arrangement. (Tr. Unruh p. 536; Ex. 40).

Likewise, it remains to be seen whether the various contingencies that attend the limited CLEC offerings of unbundled switching in metropolitan areas get worked out, and to what degree such arrangements actually result in replacement of current UNE-P arrangements. (Tr. Unruh p. 544-48).

In any event, SBC has not provided any specific evidence regarding the ability of other carriers to supply enough capacity to respond to demand migrating from SBC's former UNE-P offerings.

financial projections indicate an expectation of at least short-term declines in competition due to the elimination of UNE-P. (Ex. 30 Cadieux Rebuttal p. 18-22; Ex 32 Kohly Amended Rebuttal p. 8-11, 25; Tr. Kohly p. 1309-11, 1336-37, 1347; Ex. 54; Tr. Unruh p. 524-25).

Regarding competitors like NuVox and Socket that have their own switch, but are nonetheless dependent upon higher capacity unbundled loops and transport in their efforts to serve customers more distant from their switches, there is also significant uncertainty regarding their ability to continue to serve such customers. The FCC's new rules eliminate the availability of higher capacity unbundled loops and transport in some areas, with an unclear impact on Missouri. But more importantly, SBC has made it clear that it intends to challenge the FCC's rules for not going far enough in eliminating such unbundling requirements. Moreover, SBC has made clear its position that unbundled elements are not available absent valid FCC rules. Presumably, for these reasons SBC has refused to include such facilities in its proposal for a successor agreement to the M2A interconnection agreement. Taken together, SBC's legal arguments create substantial uncertainty as to whether higher capacity loops and transport will continue to be available, despite the FCC's finding of CLEC impairment without access to such unbundled elements.[9]

Until these issues are resolved, no one can be certain as to the extent to which CLEC competition for business customers will continue outside the immediate locations of their switches.[10] Likewise, SBC's evidence of the location of CLEC switches and collocations does not demonstrate an ability to use those facilities to serve broad areas or different market

[9] The FCC indicated that it was only imposing unbundling obligations "in those situations where we find that carriers genuinely are impaired without access to particular network elements." Order on Remand, WC Docket No. 04-313, CC Docket No. 01-338, para. 2 (February 4, 2005)(TRRO).

[10] SBC agreed that virtually all CLEC switches are located in the metropolitan areas, whereas in contrast SBC has one of its approximately 200 switches located in each exchange. (Tr. Unruh p. 537-41).

segments. (Ex 30 Cadieux Rebuttal p. 18-22; Ex 32 Kohly Amended Rebuttal p. 15-16, 25, Tr. Kohly p. 1352-53; Tr. Unruh p. 806-07).

But even assuming that loops and transport remain generally available as unbundled elements, the elimination of unbundled local switching and with it the UNE-P combination means that smaller customers located outside the immediate area served by a CLEC switch will not have competitive options. Whether or not CLECs end up providing switching to each other, almost all the CLEC switches are located in the metropolitan areas. It is not cost-effective to serve smaller customers that are located distant from the switch. Again, the Commission has previously concluded that it is not economically feasible to serve customers with 10 or fewer lines by means of a DS1. At the DS0 level, the CLEC must either have an expensive collocation[11] or it must have access to not only loops and transport, but also multiplexing to combine voice grade loops with high capacity transport, as well as interconnection facilities. Such arrangements could cost nearly $700 for the first loop, and nearly an average of $50 per loop for a group of 24 loops. At the DS1 level, where the EEL combination is available and so a collocation is not required, the costs of the facilities prohibit service to smaller customers. But even at the DS1 level, where the combination is available and so a collocation is not required, the costs of the facilities prohibit service to smaller customers. The non-recurring cost would be over $600 and the monthly cost would also be over $600, just for the unbundled network elements and interconnection facilities.[12] (Tr. Kohly p. 1309-18, 1326-28, 1349-50; Late filed Ex. 53; Tr. Unruh p. 543-44, 808-10).

[11] Minimum of $30,000. (Tr. Kohly p. 1328).

[12] These costs are increasing as a result of Case No. TO-2005-0037.

Yet another cause for uncertainty for CLECs regarding necessary UNEs (among other things) is the imminent expiration of the M2A interconnection agreement, which is used by the vast majority of Missouri CLECs as the basis for interconnecting with SBC. (Tr. Unruh p. 522-24).

Mr. Cadieux also testified that the FCC has recognized that SBC's "first mover advantages" continue to pose a significant barrier to entry. These advantages include: preferential access to buildings and rights-of-way, higher risk of new entrant failure, incumbent sunk cost capacity, differences in operational experience, customer reluctance to change providers, and established brand name recognition. (Ex 30 Cadieux Rebuttal p. 10).

The lack of adequate capital also remains an economic barrier to CLEC market entry and expansion. (Ex 32 Kohly Amended Rebuttal p. 27-29). Dr. Aron agreed that capital spending in the telecommunications market has plummeted. (Ex 2 Aron Surrebuttal, p. 4; Tr. Aron p. 107).

Mr. Kohly identified other barriers to entry, including SBC's failure to provide terminating access revenues on traffic from the former PTCs to CLECs that serve customers with ported numbers and SBC's willingness to refuse to cooperate with CLECs regarding interconnection issues because of its continued market power. (Ex 32 Kohly Amended Rebuttal p. 28-31; Tr. Kohly 1199-1219, 1318-19, 1342-46, 1352).

With all these substantial barriers to entry, the Commission cannot find that SBC faces effective competition for any additional business services in any additional exchanges.

Section 386.020(13)(b) instructs the Commission to consider whether services offered by alternative providers are functionally equivalent to SBC's services. The CLEC witnesses testified that the only functionally equivalent services are those offered by CLECs.

NuVox witness Ed Cadieux testified that non-wireline technologies, or intermodal providers, like cable companies and wireless providers, are not significant participants in the market for small and medium-sized business customers in Missouri. He stated:

> NuVox's experience is that such competition in the market for small and medium size business customers in its Missouri cities – St. Louis, Kansas City and Springfield metro areas - is quite limited. Voice and broadband Internet access service via cable modem and coaxial cable plant continues to be primarily a residential service, since those services overlay the digital cable TV system. CMRS (cellular wireless) services are complimentary to, not substitutes for, traditional wireline voice and broadband services for small and medium size business customers – i.e., the customers NuVox calls on are not abandoning their wireline services in favor wireless cellular services, and only in limited situations has NuVox encountered fixed wireless arrangements as a competitor. In the vast majority of NuVox sales contacts with business customers, the competition is SBC or, to a more limited extent, another CLEC such as Birch, McLeod or MCI.

(Ex 30 Cadieux Rebuttal p. 17-18). (See also Tr. p. 1010-11). Mr. Cadieux also testified that the FCC has continued to find that intermodal providers are not full substitutes for wireline telephony. (Ex 30 Cadieux Rebuttal, p. 14-17).

Likewise, Socket witness Kohly testified that wireless services are not a substitute for landline services. Only a very small percentage of the residential market has demonstrated any willingness to abandon wireline service in favor of wireless services, and even for those few there is no clear evidence that they have made a lasting decision. SBC's purported market survey did not even cover business customers, was limited to urban area SBC residential wireline customers,[13] and was biased to select heavy cell phone users. The reality of the marketplace is

[13] SBC witness Shooshan admitted that the survey has no application to rural areas. (Ex 14 Shooshan Surrebuttal, p. 5).

that wireless is not a substitute for business wireline service.[14] (Ex 32 Kohly Amended Rebuttal p. 17-22; Tr. Kohly p. 1304-08, 1321-23, 1350; Tr. Shooshan p. 261-65).

SBC Chairman Whitacre says that wireless is not a substitute for wireline. Both the FCC and this Commission have also reached that conclusion in previous cases. (Ex 32 Kohly Amended Rebuttal p. 18-22).

Mr. Kohly also rebutted SBC's contention that VOIP serves as a substitute for wireline basic local business service. He explained that few businesses have the option of using a cable provider for the broadband connection that is a prerequisite to VOIP. He also testified to the fact that when SBC provides a DSL broadband connection, it requires the customer to maintain their regular voice services. He testified that the cost of the broadband connection, mandatory bundling with long distance, and lack of 911 access preclude VOIP from being a substitute for basic local service. In general, he described the uncertainties that attend the future of VOIP[15] and noted the lack of state-specific information from SBC regarding its use in Missouri.[16] It is an emerging product - even SBC's plans are not "fully baked". (Ex 32 Kohly Amended Rebuttal p. 22-23; Tr. Kohly p. 1320-21; Tr. Stoia, p. 501-02).

Thus, wireless and VOIP services are different services than wireline local voice service, and are not "functionally equivalent or substitutable at comparable rates, terms and conditions" as required under Section 386.020(13).

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[14] Isolated anecdotal evidence such as the story of Ford replacing the desk phones of some of its employees with wireless phones in Sprint territory is not proof that there will be substantial movement by businesses to replace wireline phones with wireless phones. Indeed, the action by Ford is described as "breaking new ground" and uncommon. (Ex. 37).

[15] A new uncertainty emerged during the hearing, when it was learned that AT&T (described by SBC as "one of the leading VOIP providers", Ex 10 Stoia Direct p. 5) was being acquired by SBC.

[16] Big River's VOIP seminar announcement does not demonstrate that VOIP has developed into a substitute for basic local business service. (Ex. 38).

It is certainly appropriate for the Commission to consider market share data as it evaluates the extent of competition under Section 386.020(13)(a).[17] But all parties warned the Commission that market share information can be misleading. (See, e.g. Ex 1 Aron Direct p. 59; Tr. Aron p. 102-03). Further, SBC witness Aron testified that trends are more important than a static measure of market share. (Ex 1, Aron Direct, p. 8; Tr. Aron p. 99). As indicated above, CLECs that are dependent upon UNE-P or other unbundled arrangements that have been eliminated or that face further legal challenges may not be able to continue to provide service. Most projections show such lines reverting to SBC. That is 41% of the lines that SBC says were served by CLECs in June 2004. Reversion of such lines to SBC would put the market back where it was in 2001. (Ex 32 Kohly Amended Rebuttal p. 10-11). Given such uncertainty, the Staff's approach of disregarding UNE-P competition is an appropriately conservative approach to the serious question of price deregulation. (Ex 33 Kohly Surrebuttal p. 1-2; Tr. Kohly 1190, 1319).

Additional uncertainty regarding the immediate future of CLEC competition was introduced by the announcement of SBC's intended acquisition of AT&T (and its market share) and similar information regarding MCI. According to SBC, AT&T was the single largest competitor in terms of advertising expenditures.[18] (Ex Fernandez Direct, p. 19; Tr. Fernandez p. 234). Clearly, the Commission needs to wait and see how such major transactions impact the level of competition in the various segments of the local business market.

[17] However, the Commission should not consider data that lumps together information from exchanges it has previously found to be subject to effective competition for certain services with the exchanges and services that are now at issue. (Ex Kohly Amended Rebuttal p. 11-12).

[18] The trends in advertising expenditures were also information as to trends in competition, as shown by Commissioner Gaw's questioning of SBC witness Fernandez in closed session. (Tr. Fernandez, p. 396-408).

All the barriers to entry discussed above and the related uncertainty as to the continuing ability of CLECs to serve customers in total makes it impossible to rely upon the June 2004 snapshot of the market that SBC presents in its testimony. At the very least the Commission needs to wait until the market has adjusted to all the changes in availability of unbundled elements, in order to see what the true level of competition is likely to be going forward. The Commission should not allow SBC to escape price cap regulation based on old market share data that cannot be considered as indicative of the likely level of ongoing competition. (Ex 30 Cadieux Rebuttal p. 23; Ex 32 Kohly Amended Rebuttal p. 26; Tr. Unruh p. 553-55).

Moreover, SBC's reliance on 911 data is questionable. In some instances CLECs may either under-report or over-report the number of lines that are actually in service.[19] (Ex 32 Kohly Amended Rebuttal p. 12-13; Ex 33 Kohly Surrebuttal p. 3-8; Tr. Cadieux p. 1006-07; Tr. Kohly p. 1156). The likelihood of inaccuracy is greatest for multiline business services. (Tr. Kohly p. 1290-91). CLEC witnesses were not able to see the data or audit its accuracy, even though SBC has thus far been allowed to violate the E911 rules and other purported assurances of confidentiality by making use of such data for competitive purposes. (Ex 32 Kohly Amended Rebuttal p. 6-7; Tr. Kohly 1289; Tr. Unruh p. 550-53). See 4 CSR 240-34.030(1)(B). Given these problems, the Staff's decision not to rely solely upon E911 data is certainly reasonable, although CLECs are not in a position to validate the seemingly low 9% breakpoint in the data. (Ex 33 Kohly Surrebuttal p. 9).

[19] SBC did not take its own line counts from the E911 database, so it is attempting to compare its actual retail line counts to inaccurate information regarding CLEC line counts. (Tr. Kohly p. 1288). Moreover, SBC witness Aron admitted that an unquantified amount of SBC's line losses are attributable to a downturn in the Missouri economy rather than to competition. (Tr. Aron p. 111-12). Staff counsel pointed out that population declines could also have an effect.

Resale is hardly worth discussion. SBC's data shows that it is virtually non-existent aside from prepaid providers. But in any event, it is not a true competitive alternative, because the resale competitor cannot differentiate its service from SBC's and because it cannot exert any price discipline. Nor is resale a legitimate temporary market entry strategy, because of the significant differences in product structure and operating systems between resale and facility-based activity. It is not even clear that there is an ability to price compete with SBC on a resale basis, given all the costs involved. (Ex 32 Kohly Amended Rebuttal p. 13-15, Ex 33 Kohly Surrebuttal p. 1; Tr. Kohly p. 1194, 1319-20). Whether resale will increase as a result of the elimination of UNE-P is a matter of pure conjecture. (Tr. Aron p. 111). Again, Staff's exclusion of resale data was appropriate.

The main flaw in Staff's analysis is that it did not break the business market down into pertinent segments. Specialized services to ISPs are treated the same as services to the largest of businesses, which are in turn treated the same as services to the smallest of businesses. As discussed above, the record shows that CLECs use different methods to serve, and offer different services to large and small businesses. The Commission found this to be the case in TO-2004-0207, when it differentiated between the mass market and the enterprise market based on whether the customer uses more than 10 DS0 lines at a particular location.

For example, Socket offers an inbound ISDN PRI service to ISPs and an integrated DS1 product to customers with combined voice and data needs. These are not services of use to, or even feasible to offer to, a small business that only needs a few voice lines. (Tr. Kohly 1159, 1292-94, 1350). Socket provides these different services in different exchanges. (Tr. Kohly (HC) 1180-81). But the evidence in the record does not break down the business access lines reported for each exchange into specific types of service in order to support a determination as to whether

small and large businesses both will have competitive choices in the exchanges at issue in the future, particularly with the demise of local switching and UNE-P and the uncertainty surrounding various other unbundled elements. Hence, the record is insufficient to support even the limited action that Staff recommends. (Ex 33 Kohly Surrebuttal p. 3, 6-10; Tr. Kohly 1156. 1294-97, 1303).

Prematurely releasing SBC from price cap regulation would be detrimental to customers and competitors. SBC would become able to target geographic areas and market segments facing limited competition for price increases to support decreases where competition is greater.[20] Even in areas and market segments with some degree of competition, SBC could implement general increases and then use winback promotions[21] and term commitments so that customers that are less inclined to change providers through inertia[22] would effectively fund discounts for customers that indicate a willingness to change. SBC's witnesses admitted such an intent, as they testified that they could not make "competitive" price decrease unless they could achieve revenue neutrality by raising other prices. (Tr. Unruh p. 793). Such predatory practices should be of particular concern at present, when economics force CLECs to focus on relatively narrow market segments. (Ex 32 Kohly Amended Rebuttal p. 3-4, 27; Tr. Kohly p. 1219-24, 1297, 1302, 1305-09, 1324-25, 1329-34).

[20] This is exactly the same type of predatory pricing that the FCC is working to guard against in the area of special access pricing. Order and Notice of Proposed Rulemaking, WC Docket No. 05-25, para. 51 (January 31, 2005).

[21] SBC's purported experts admitted that they did not consider the potential impacts of pricing discrimination through winback discounts. (Tr. Shooshan p. 268-70).

[22] There are also instances where the customer would be penalized for changing, such as having to change telephone numbers to avoid increases in optional MCA service prices. (Tr. Kohly p. 1349).

The Commission should not find any comfort in SBC's argument that price caps could be reinstated if the Commission finds that it has made a mistake. Any such proceeding would involve lengthy litigation and would provide relief too late. (Ex 32 Kohly Amended Rebuttal, p. 31; Tr. Unruh p. 339-40, 548). Nor should the Commission rely upon SBC's assurances that political pressures will prevent it from raising rates. Such a statement proves that the market is not competitive, because if SBC truly faced competitive pressures it would not be able to consider political ones. (Tr. Kohly 1221-22).

Nor does continued regulation over wholesale rates eliminate the need for retail price cap regulation. Absent effective competition, retail pricing would be uncontrolled regardless of wholesale pricing restrictions. (Ex 32 Kohly Amended Rebuttal p. 32). Moreover, switched access charges, while for wholesale services, would remain subject to price caps, and even as SBC increased retail rates after the lifting of caps, it would retain the subsidies from switched access services that have made lower retail rates possible. And those subsidies could then be used to support predatory pricing. Accordingly, the barrier posed by excessive access charges must ultimately be eliminated as a precondition to any further lifting of price cap regulation.[23] As discussed below, Section 392.246 provides an opportunity to address this problem. (Tr. Kohly p. 1350-51; Tr. Unruh p. 555-57).

[23] Switched access reform is an essential precondition to MCI's Real Deregulation initiative, which proposes a ubiquitous examination of all regulations applicable to all wireline carriers, not isolated pricing deregulation of the dominant incumbent. (Ex 35).

The Commission should not be distracted by SBC's complaints that it somehow cannot compete because of price caps. It still controls the market. It sets the prevailing prices. It can (and does) offer bundles of regulated and unregulated services just like CLECs. As discussed under issue 5 below, price cap regulation places very few restrictions upon SBC. While it is hard to believe how uncreative SBC purports to be regarding pricing techniques, it nonetheless has substantially more flexibility today than it is using. SBC witnesses claim it would be "amazing" if they could think like a CLEC, but what is truly amazing is how they can claim there is effective competition when their actions (and inaction) confirm that they actually recognize themselves to be a risk-adverse monopoly. (Tr. Kohly p. 1298-1301, 1348; Tr. Aron p. 102-03, 105-06; Tr. Fernandez p. 233-34; Tr. Moore p. 280-84; Tr. Unruh p. 549-50, 800).

SBC witness Aron agreed that lifting price cap regulation in the absence of effective competition would violate the statute and would not be in the public interest. (Tr. Aron p. 101-2). The obvious care that SBC took to make sure that none of its witnesses could testify to specific future pricing plans (even on a confidential basis) underscores that it feels no pressure from competitor pricing and instead wants relief from price caps purely for the sake of being free from regulation.[24] It does not expect to reduce prices on a targeted basis to meet competition and simply eat the lost revenues, but rather expects to achieve monopolistic revenue neutrality by raising other rates for services or areas that face even less (or no) competition. (Tr. Unruh p. 793).

[24] The SBC witnesses testified that no analysis has been done and no plans have been made, in terms of what SBC would do if it was released from price caps. (Tr. Stoia, p. 294, 498; Unruh p. 359, 701).

SBC wants to be perceived as fighting with one hand tied behind its back, notwithstanding its continued market dominance. (Tr. Unruh p. 619). But the record shows that SBC faces limited competition, and that there is tremendous uncertainty as to whether even that limited competition will remain. Competition is particularly weak at the smallest end of the spectrum of customers. Accordingly, the Commission should deny SBC's all-or-nothing request to have business services released from price cap regulation.

2. In which SBC Missouri exchanges, if any, does effective competition exist for SBC Missouri's Plexar services such that those services should be classified as competitive pursuant to Section 392.245.5 RSMo. 2000?

No position.

3. The Commission, pursuant to Section 392.245.5 RSMo. 2000, previously classified SBC Missouri's residential access line and residential line-related services in the Harvester and St. Charles exchanges as competitive in Case No. TO-2001-467. In which additional SBC Missouri exchanges, if any, does effective competition exist, such that SBC Missouri's residential access line and residential line-related services should be classified as competitive?

SBC Missouri has not met its burden of proving the existence of effective competition for all residential services in any additional exchanges. Substantial barriers to entry protect SBC and limit the extent and level of competition regarding residential services. Substantial reductions in SBC's unbundling obligations will reduce wireline competition even further and intermodal competition does not contribute towards the level of competition regarding these services in any meaningful way. There is no basis on which to conclude that competition is or will be effective in any additional exchanges for residential services.

The same problems attend the residential market, as discussed above regarding business services for smaller customers. The Commission should not mistake competition for secondary lines as competition for primary lines. (Tr. Kohly p. 1303-04).

SBC wants to be perceived as fighting with one hand tied behind its back, notwithstanding its continued market dominance. (Tr. Unruh p. 619). But the record shows that SBC faces limited competition, and that there is tremendous uncertainty as to whether even that limited competition will remain. Competition is particularly weak at the smallest end of the spectrum of customers. Accordingly, the Commission should deny SBC's all-or-nothing request to have residential services released from price cap regulation.

4. In which SBC Missouri exchanges, if any, does effective competition exist for SBC Missouri's directory assistance (DA) services such that those services should be classified as competitive pursuant to Section 392.245.5 RSMo. 2000?

CLECs agree with OPC that DA services should not be classified as being subject to effective competitive unless all residential and core business access line services have been so classified in an exchange.

5. What restrictions are placed upon SBC by the price cap statute?

CLECs seek to rebut the misinformation disseminated by SBC witnesses during the hearing regarding the few restrictions that are placed upon SBC by the price cap statute.

First, it is important to retain one's perspective. SBC was regulated as a monopoly prior to price cap regulation. Its total earnings were subject to PSC oversight and control. (Tr. Unruh, p. 586-87). Price cap regulation was a significant reduction in regulation of SBC, and fervently sought by SBC at the Legislature and before this Commission, notwithstanding SBC's current whining. Under price cap regulation, SBC's earnings are unlimited.

SBC sought price cap regulation for good reason, as it places very little restriction upon SBC. Under Section 392.245, initial maximum prices for existing services were set when SBC became subject to price cap regulation. While the maximum prices for SBC's basic local services and exchange access service have fluctuated over time (and will continue to do so) based on indexes tied to the economy, the maximum prices for all its other services have been (and will continue to be) subject to increase up to 8% per year (which percentage increase can be banked and used in subsequent years, see **INSERT CITATION**). Changes in maximum prices must be approved by the Commission within 45 days. Section 392.200.4(2)(c) also sets a long-run incremental cost floor for all services. SBC has been and remains free to change rates within the range set by the cost floor and the maximum price as many times as it wants. There is absolutely no basis for the assertion by various SBC witnesses that once a price is reduced within the range it cannot be increased back up to the maximum price.

Section 392.246 authorizes the Commission to increase SBC's maximum rates without regard to the procedures of Section 392.245, if the existing maximum rates are "insufficient to yield reasonable compensation for the service rendered." While SBC has not made any effort to use this statute to address its concerns about purportedly below-cost rates, it would appear that this statute would provide the means to reconcile the apparent conflict between the cost floor and the maximum rate for any below-cost services. It would also appear that the Commission could require elimination of what would become unnecessary subsidies from other services, such as exchange access service, in connection with such a proceeding to raise below-cost rates, thereby reducing the maximum rates for such services.

Section 392.245.11 also expressly authorizes SBC to introduce new services and set new prices for them. Notwithstanding the misinformed views of SBC's witnesses, the statute does

not prevent SBC from setting a maximum price for a new service above its perceived market price. SBC is free to propose a higher initial price to preserve the ability to move rates up and down. It can nonetheless charge its perceived market price from the outset by filing a lower promotional rate at the time of introduction. In other words, SBC could think like a CLEC if it wanted to, but instead continues to think like a monopoly by its own choice - because it is one.

SBC and CLECs must file tariffs with 30 day effective dates,[25] as required by Section 392.220.2 and 4 CSR 240-3.545(18), including for new services.[26] Every company has the right to seek expedited approval. The Commission has established in advance that promotional filings will be approved faster, requiring only 7 days notice for competitive services and 10 days notice for noncompetitive services. Any company can request even faster approval of a promotion.

As a price cap company, SBC must allow the Commission up to 30 days to approve price changes within the range (but again can seek expedited approval). In contrast, CLECs classified as competitive under Section 392.361 can file rate decreases (without any accompanying text change)[27] on seven days notice to the Commission, and rate increases upon ten days notice to customers. See Section 392.500; see also 4 CSR 240-33.040(4). Alternatively, rate bands can be pre-approved and then rate changes made within ten days. See Section 392.510. SBC would not be able to file rates under these statutes simply by obtaining release from the price cap statute, but rather would still need to obtain classification under Sections 392.361 and 392.370.[28]

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[25] Notice requirements under SBC's interconnection agreements are unrelated to this proceeding and irrelevant. (Tr. Unruh p. 330).

[26] Tariffs for new services may only be suspended for 60 days, unlike other tariffs which may be suspended for eleven months. Again, these provisions apply to both SBC and CLECs. See Sections 392.220 and 392.230.

[27] See 4 CSR 240-3.545(16).

[28] SBC appears to agree that these pricing statutes do not apply to services that have become subject to the price cap system, based on questions by their counsel and answers from their hired expert. (Tr. 199-200).

Like CLECs, SBC can accomplish price changes involving unregulated services (including as part of a bundle) without any delay or action by the Commission. Mr. Unruh acknowledged SBC takes advantage of this opportunity when questioned by Commissioner Gaw. (Tr. Unruh p. 703-04, 790).

6. What are the differences between competitive classification under Section 392.245 and under Sections 392.361 and 392.370?

CLECs seek to eliminate the confusion on this point that was apparent from some of the testimony and during the hearing in particular.

Section 392.245, the price cap statute, imposes a form of regulation over all services of an incumbent LEC. Once that regulation is imposed, Section 392.245.5 controls the process of changing the form of regulation.[29] Under Section 392.245, a particular service in a particular exchange can be released from price cap regulation if it is subject to effective competition under the criteria set forth in Section 386.020(13). That is the subject of the present proceeding. Thus, Section 392.245 solely concerns price regulation.

In contrast, Sections 392.361 and 392.370, which predate Section 392.245, set forth a separate mechanism by which the Commission can evaluate the degree of competition regarding a specific company and its services, can classify the company or some of its services as competitive or transitionally competitive across the state[30], and can reduce regulation by suspending or modifying certain statutes and regulations relating to subjects other than pricing. Additionally, greater pricing flexibility is available for services classified under these statutes as

[29] Additionally, as discussed above, an incumbent that is subject to price caps can seek relief under Section 392.246.

[30] The definitions of competitive and transitionally competitive set forth in Section 386.020 relate to classifications under Sections 392.361 and 392.370, not to the price cap statute.

competitive or transitionally competitive pursuant to Sections 392.500 and 392.510.[31] Under Section 392.370, other providers of the same service can also obtain similar classifications over time once the first provider's service has been classified.

In the course of litigation concerning SBC's first attempt to escape price cap regulation, the courts have thus far ruled that the two statutory systems are separate and distinct. Specifically, the courts have ruled that the Commission erred in relying upon prior classifications of SBC services under Sections 392.361 and 392.370 to release those services from subsequently imposed price cap regulation, when it was instead supposed to evaluate whether the services faced effective competition. Currently, a motion for transfer to the Missouri Supreme Court remains pending. (Tr. Unruh p. 803-04).

Thus, the two statutory systems work independent of one another. Prior classifications under Sections 392.361 and 392.370 do not supplant the required inquiry into effective competition under Section 392.245, and vice versa. Availability of regulatory flexibility depends upon the system.

Conclusion

As indicated above, SBC has not demonstrated that it faces effective competition for its business or residential local voice services in any additional exchanges. Moreover, SBC underscores its continuing market dominance by its heavy-handed tactics. It sees no need to present evidence regarding recognized market segments, even though it admits that there are substantial differences in levels of competition for larger versus smaller customers. It sees no need to be candid with the Commission regarding its pricing plans after price caps. Indeed,

[31] SBC appears to agree that these pricing statutes do not apply to services that have become subject to the price cap system, based on questions by their counsel and answers from their hired expert. (Tr. 199-200).

SBC's view is that any potential competition is effective competition, and only a perfect monopoly with no potential competitor faces no effective competition. (Tr. Unruh p. 358-59). Under such view, whether or not competition can impose price discipline in lieu of regulation is totally ignored. Of course, that is not what the statute says.

As the Commission has found and concluded before, effective competition means competition that will exert sustainable price discipline on SBC. In other words, effective competition is enough competition to make price regulation unnecessary for the foreseeable future. It is clear from the record that SBC does not face such competition. The Commission should not relinquish its limited control over SBC's pricing practices, for neither political pressure nor market forces will be able to protect consumers and competitors in the absence of Commission supervision of SBC's market conduct.

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Certificate of Service

A true and correct copy of the foregoing was served upon the parties identified on the attached service list on this 18th day of February, 2005, either by e-mail or by placing same in the U.S. Mail, postage paid.

/s/ Carl J. Lumley

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