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May 23, 2002

Secretary of the Commission
200 Madison Street, Suite 100
P.O. Box 360
Jefferson City, Missouri 65102-0360

Re: Case No.: TT-2002-227, et al.

Dear Secretary of the Commission:

Enclosed please find for filing with your office an original and nine (9) copies of the Initial Brief NuVox Communications of Missouri, Inc., MCI WorldCom Communications, Inc., Brooks Fiber Communications of Missouri, Inc., MCI metro Access Transmission Services, LLC, TCG St. Louis and TCG Kansas City. Upon your receipt, please file stamp the extra copy received and return to the undersigned in the enclosed, self-address, stamped envelope. If you have any questions; please contact me.

Very truly yours,

A handwritten signature in black ink that reads "Carl J. Lumley" with a stylized flourish at the end.

Carl J. Lumley

CJL:dn
Enclosures
cc. Parties of Record (W/Enclosure)

BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION

In the Matter of Southwestern Bell Telephone Company's Proposed Revisions to PSC Mo. No. 26, Long Distance Message Telecommunications Service Tariff.	)	Case No. TT-2002-227 Tariff No. 200200300
In the Matter of MCImetro Access Transmission Services, LLC's Local NationwideOne Promotion.	)	Case No. TT-2002-235 Tariff No. 200200338
In the Matter of NuVox Communications of Missouri, Inc.'s "Free Month" Promotion for New Customers.	)	Case No. TT-2002-274 Tariff No. 200200364
In the Matter of American Communication Services of Kansas City, Inc.'s Tariff Filing to Introduce New Product Packages for Basic Local Service Business Customers.	)	Case No. TT-2002-294 Tariff No. 200200364
In the Matter of MCImetro Access Transmission Services, LLC's Proposed Revisions to its Local Exchange Service Tariff, MO P.S.C. Tariff No. 1.	)	Case No. TT-2002-304 Tariff No. 200200395
In the Matter of MCI WorldCom Communications, Inc.'s Proposed Revisions to its MO P.S.C. Tariff No. 4.	)	Case No. TT-2002-305 Tariff No. 200200394
In the Matter of Brooks Fiber Communications of Missouri, Inc.'s Proposed Revision to its P.S.C. Tariff No. 2, General Exchange Services.	)	Case No. TT-2002-306 Tariff No. 200200396
In the Matter of TCG St. Louis' Proposed Revisions to its P.S.C. Tariff No. 2, Local Exchange Services.	)	Case No. TT-2002-308 Tariff No. 200200515
In the Matter of TCG Kansas City's Proposed Revisions to its P.S.C. Tariff No. 1 Local Exchange Services.	)	Case No. TT-2002-209 Tariff No. 200200516
In the Matter of Talk America, Inc.'s Proposed Revisions to its P.S.C. Mo. Tariff No. 3.	)	Case No. TT-2002-343 Tariff No. 200200476

INITIAL BRIEF OF
NUVOX COMMUNICATIONS OF MISSOURI, INC., MCI WORLD COM
COMMUNICATIONS, INC., BROOKS FIBER COMMUNICATIONS OF MISSOURI,
INC., MCImetro ACCESS TRANSMISSION SERVICES, LLC, TCG ST. LOUIS AND
TCG KANSAS CITY

COME NOW NuVox Communications of Missouri, Inc. ("NuVox"), MCI WorldCom Communications, Inc. ("MCI WorldCom"), Brooks Fiber Communications, Inc. ("Brooks"), MCImetro Access Transmission Services, LLC ("MCImetro" and, with MCI WorldCom and Brooks, collectively "WorldCom"), TCG St. Louis and TCG Kansas City (collectively "TCG") and for their Initial Brief state to the Commission:

Introduction

The Commission should approve all of the CLEC long-term discount tariffs at issue in this case. The CLEC and Staff witnesses thoroughly explained how tariffs such as the ones at issue are essential to CLECs continued efforts to succeed in the Missouri basic local business market. Moreover, all of the parties provided testimony that the CLECs lack market power and cannot impede the development of competition by means of such tariffs. There is absolutely no evidence that would support a rejection of the CLECs' tariffs.

On the other hand, the Commission should reject Southwestern Bell Telephone Company's (SWBT's) proposed CompleteLink-Basic tariff, for the same reasons that it just rejected SWBT's long-term discount promotional tariffs in Case No. TT-2002-108. SWBT's latest proposed promotion of long-term commitment discounts is unreasonable and unlawful, given the resulting adverse impact of such pricing practices by SWBT on competition for basic local business telecommunications services. SWBT seeks to stall, or even reverse, the growth of

competition for basic business services by promoting targeted long-term discounts meant to bind customers into contracts that would eliminate them as potential customers of competitors.

SWBT still controls as much as 75% of the basic local business service market and of course 100% of its ubiquitous network. CLECs still struggle to overcome SWBT's natural advantages as the historic monopoly provider. They have their own problems in the competitive market as well.

Yet in addition to its inherent advantages, SWBT wants to preclude competition for lucrative business customers by means of long-term contracts. In short, SWBT seeks to increase the natural inertia of its large customer base, in order to preserve its status quo market dominance.

The Commission should not allow SWBT to impede competition in this way. Rather, the Commission should encourage SWBT to examine its pricing practices in a more general fashion, without the use of unreasonably large or lengthy term contract discounts. Accordingly, the Commission should reject SWBT's unreasonable and unlawful CompleteLink-Basic tariff.

The Commission should not be distracted from the facts and law by SWBT's simplistic plea for "equal treatment". First and foremost, the Commission must recognize that it cannot reject the CLECs' tariffs simply because it rejects SWBT's tariff. There is no evidence the CLECs' tariffs will do anything but promote more stable competition and they must be approved. Secondly, the Commission should continue to recognize the clear, unmistakable and significant differences between SWBT as the incumbent and CLECs as new entrants that not only justify, but also demand, different regulatory treatment of SWBT. The evidence continues to demonstrate the substantial problems posed by use of long-term commitments by SWBT, just as it did in Case No. TT-2002-108 and the Commission should again reject SWBT's proposed tariff.

The Commission should not dilute its efforts to foster competition by accepting the new and unfounded exchange-by-exchange compromise proposed by Staff, because SWBT's use of long-term discounts for basic local service will remain unreasonable and unlawful until it ceases to dominate the market and is classified as a fully competitive company.

Upon completion of this proceeding, the Commission should commence a rulemaking to codify restrictions against incumbent LECs using long-term discounts and other anti-competitive targeted pricing practices such as winback and retention discounts. Any such pending ILEC tariffs should simply be rejected based on the decisions in Case No. TT-2002-108 and this case, under a moratorium pending the rulemaking. Tariff-specific proceedings are too costly and inefficient. Furthermore, a rulemaking will be able to deal with existing incumbent tariffs as well as future incumbent tariffs.

Jurisdiction

The Commission has jurisdiction in this matter pursuant to its general jurisdiction over telecommunications companies providing telecommunications service within the State of Missouri under Section 386.250 RSMo¹ and its specific jurisdiction over rates proposed by telecommunications companies for their services, as provided in Sections 392.200 and 392.230.3.

Standard of Review

This case involves questions concerning the reasonableness of proposed promotions and resultant differences in rates for identical services based on customers meeting specific discount qualifications. Under Section 392.200.2 and .3, such rate discrimination can only be permitted if found to be reasonable under the circumstances and otherwise consistent with the provisions of Chapter 392. See State ex rel. DePaul Hospital v. PSC, 464 S.W.2d 737 (Mo. App. 1970). Further, under Section 392.200.4(2)(B), such market segmentation can only be approved if there is clear and convincing evidence that it is in the public interest and reasonably necessary to promote competition and the purpose of Chapter 392 (which are stated in Section 392.185).

Parties

Staff of the Missouri Public Service Commission and Office of Public Counsel are parties to these proceedings, as are the following companies:

SWBT is an incumbent local exchange company (ILEC) that is an authorized provider of basic local and other telecommunications services in its service area within the State of Missouri under authority granted and tariffs approved by the Commission. See SWBT Pleadings.

NuVox, MCI WorldCom, Brooks, MCImetro, TCG St. Louis, TCG Kansas City, and American Communications Services of Kansas City, Inc. ("ACS" also known as "e.spire") are competitive local exchange companies (CLECs) that are authorized providers of basic local and other telecommunications services in Missouri, including in SWBT's service areas, under certificates granted and tariffs approved by the Commission. See CLEC Pleadings.

Qwest Communications Corporation ("Qwest") is also an authorized provider of basic local telecommunications service in Missouri under certificates granted and tariffs approved by the Commission. See Qwest Application to Intervene.

Procedural History

On October 19, 2001, SWBT filed a tariff sheet seeking to renew an expiring promotion for its CompleteLink Basic Service that would provide business customers with a discounted postalized intraLATA toll service rate in exchange for term commitments for basic local service that could exceed one year under an existing term discount tariff. It was assigned Tariff No. 200200300. SWBT's proposed promotion would have run for twelve months from November 19, 2001 through November 18, 2002. The tariff bore an effective date of November 19, 2001. See Order Suspending Tariff, Case No. TT-2002-227 (November 15, 2001).

On November 15, 2001, the Commission ordered that the tariff be suspended as permitted by Section 392.230.3 to December 20, 2001, or until otherwise ordered by the Commission. The Commission indicated that it wanted to be in a position to treat SWBT's tariff filing consistently with an anticipated decision regarding other SWBT tariffs under consideration in consolidated Case No. TT-2002-108. *Id.*

¹ Except as otherwise noted, all statutory references herein are to the Revised Statutes of Missouri (RSMo.).

On November 1, 2001, MCImetro filed a tariff sheet seeking to provide new promotional rates for new basic local business customers that choose to make term commitments for basic local service that could exceed one year under an existing term discount tariff. It was assigned Tariff No. 200200338. New customers would have had to make the term commitment during the promotional period, from December 1, 2001 to February 28, 2002. The tariff bore an effective date of December 1, 2001. See Order Suspending Tariff, Case No. TT-2002-235 (November 29, 2001).

On November 29, 2001, the Commission ordered that the MCImetro tariff be suspended as permitted by Section 392.230.3 to December 20, 2001, or until otherwise ordered by the Commission. The Commission indicated that it wanted to be in a position to treat MCImetro's tariff filing consistently with the anticipated decision in consolidated Case No. TT-2002-108. Id.

On December 6, 2001, Nuvox filed a tariff sheet seeking to introduce a "free month" promotion for basic local business customers that choose to make new term commitments for basic local service that could exceed one year. It was assigned Tariff No. 200200453. The tariff bore an effective date of December 13, 2001. See Order Suspending Tariff, Case No. TT-2002-274 (December 11, 2001).

On December 11, 2001, the Commission ordered that NuVox tariff be suspended as permitted by Section 392.230.3 to December 20, 2001, or until otherwise ordered by the Commission. The Commission indicated that it wanted to be in a position to treat NuVox's tariff filing consistently with the anticipated decision in consolidated Case No. TT-2002-108. Id.

On November 9, 2001, ACS filed tariff sheets with term commitments that could exceed one year. The tariffs were assigned Tariff No. 200200364. The tariffs initially bore an effective date of December 9, 2001, but the company extended that date to December 28, 2001. See Order

Suspending Tariff, Directing Notice and Scheduling a Prehearing Conference, Case No. TT-2002-294 (December 27, 2001).

On November 19, 2001, MCImetro, MCI WorldCom and Brooks each filed tariff sheets seeking to extend certain promotions that included term discounts for basic local service with term commitments that could exceed one year. The tariffs were assigned Tariff Nos. 200200395, 200200394, and 200200396, respectively. The tariffs bore an effective date of January 7, 2002. See Orders Suspending Tariff, Directing Notice and Scheduling a Prehearing Conference Case Nos. TT-2002-304, TT-2002-305, TT-2002-306 (January 3, 2002).

On December 21, 2001, TCG St. Louis and TCG Kansas City each filed tariff sheets seeking to implement certain promotions that included term discounts for basic local service with term commitments that could in some (but not all) instances exceed one year. The tariffs were assigned Tariff Nos. 200200515 and 200200516, respectively. The tariffs bore an effective date of January 1, 2002. See Orders Suspending Tariff, Directing Notice and Scheduling a Prehearing Conference, Case Nos. TT-2002-308, TT-2002-309 (December 31, 2001).

Upon determining that SWBT's tariffs at issue in consolidated Case No. TT-2002-108 would "adversely affect competition", the Commission extended the suspension of the tariffs at issue herein filed by SWBT, MCImetro (first set) and NuVox to dates in March and April, 2002 "to allow the Commission an opportunity to determine whether [they] will also have an adverse effect on competition". Further, the Commission caused notice of the proceedings to be sent to all telecommunications companies certificated to do business in the State of Missouri. See Orders Further Suspending Tariff, Granting Intervention Directing Notice and Scheduling a Prehearing Conference, Case No. TT-2002-227, Case No. TT-2002-235, Case No. TT-2002-274 (December 18, 2001).

The Commission also suspended the tariffs filed by MCImetro (second set), MCI WorldCom, Brooks, ACS, TCG St. Louis, and TCG Kansas City to dates in April and May, 2002 as permitted by Section 392.230.3 so that the Commission could further consider its concern "that the use of term discounts in the basic local service market may be a detriment to the development of a robust competitive market". Again, the Commission caused notice of the proceedings to be sent to all telecommunications companies certificated to do business in the State of Missouri. See Orders Suspending Tariff, Directing Notice and Scheduling a Prehearing Conference Case No. TT-2002-294 (December 27, 2001), Case No. TT-2002-308, Case No. TT-2002-309 (December 31, 2001), Case No. TT-2002-304, TT-2002-305, TT-2002-306 (January 3, 2002).

By order of the Commission, prehearing conferences were held in each of the foregoing cases, and pursuant thereto and on behalf of the parties Staff proposed a procedural schedule for the cases on January 16, 2002. Staff also filed a motion to consolidate the cases on January 29, 2002, which all the parties supported. See Order Granting Motion to Consolidate and Adopting Procedural Schedule (February 20, 2002).

On January 30, 2002 the Commission ordered consolidation of the foregoing cases. *Id.* The Commission extended the suspension of all of the tariffs to July 3, 2002. See Order Further Suspending Tariffs (February 5, 2002).

The Commission granted intervention to Qwest. See Order Granting Application for Intervention. Case No. TT-2002-235 (January 14, 2002).

^z On February 20, 2002, the Commission consolidated Case No. TT-2002-343, regarding a tariff submitted by Talk America, Inc., with this proceeding. However, Talk America subsequently withdrew its proposed tariff. On March 29, 2002 the Commission severed Case No. TT-2002-343 from this proceeding.

The Commission established a procedural schedule and adopted a protective order. See Order Granting Motion to Consolidate and Adopting Procedural Schedule (January 30, 2002); Order Establishing Protective Order (February 13, 2002).

Pursuant to the procedural schedule, the parties submitted pre-filed direct, rebuttal and surrebuttal testimony, as well as a list of issues and statements of position •hereon.

The Commission held hearings on April 17-18, 2002.

Late-filed Exhibit 23 was admitted into evidence post-hearing. See Order Admitting-Post-Hearing Exhibit into Evidence. (May 10, 2002).

Witnesses

SWBT presented witnesses Steven W. Getz, Craig A. Unruh and Debra J. Aron. Mr. Getz is employed by SBC Operations, [Inc. as](#) Director, Business Competitive Packaging, and has responsibilities for SWBT in Missouri. (Ex. 4 NP, Getz Direct, p. 1). Mr. Unruh is employed by SWBT as Executive Director- Regulatory for Missouri. (Ex. 7, Unruh Direct, p. 1). Dr. Aron is an economist hired as a expert witness by SWBT. (Ex 1 NP, Aron Direct, p. 1).

WorldCom presented witness Stephen F. Morris. Mr. Morris is a Senior Attorney in WorldCom's Law and Public Policy organization, whose responsibilities include Missouri. (Ex 11, Morris Direct, p. 1).

NuVox presented witness Edward J. Cadieux. Mr. Cadieux is Vice-President, Regulatory and Public Affairs - Midwest Region, for NuVox's parent corporation. (Ex. 10 NP, Cadieux Direct, p. 1).

TCG presented witness R. Matthew Kohly. Mr. Kohly is Regulatory Manager - Government Affairs and an economist for TCG's affiliate AT&T Communications of the Southwest, [Inc. in](#) Missouri. (Ex. 13, Kohly Direct, p. 1).

ACS presented witness David M. Kaufman, its Director of Regulatory Affairs. (Ex 17 Kaufman Direct, p. 1).

Staff presented the testimony of witness Walt Cecil. Mr. Cecil is a Regulatory Economist ¹¹ with the Staff. (Ex. 18, Cecil Rebuttal, p. 1).

Public Counsel and Qwest did not present witnesses.

Summary of Testimony and Statement of Facts

NuVox is a facilities-based CLEC that provides basic local service to small and medium-sized business customers in St. Louis, Kansas City and Springfield. (Ex. 10 Cadieux Direct, p. 1, 7, Tr. 169).

NuVox's proposed tariff contains a promotion pursuant to which new customers who signed new service contracts (covering local, long distance, Internet and two additional services) between December 13, 2001 and March 1, 2002 would have received a free month of service (in the form of a credit) for each year of the term of the contract, for terms between one and three years in length. The proposed tariff did not alter the terms and conditions of regulated and unregulated services, including existing provisions regarding term contracts, but rather only sought to introduce a promotional rate discount of 8.5% in order to stimulate new customers to choose NuVox as their provider during the limited promotional period of three and one-half months. (Ex. 10, Cadieux Direct, p. 2-3, 8, Schedule EJC-2, Tr. 200).

NuVox witness Cadieux indicated that such promotions are necessary for NuVox to get the attention of potential customers and overcome lack of name recognition. (Ex. 10, Cadieux Direct, p. 8-9, Tr. 200).

Mr. Cadieux explained that NuVox's proposed promotional tariff would not and could not adversely affect competition in Missouri. He stated: "NuVox does not possess market power in the local exchange market and, therefore, does not have the ability to impede competition." He elaborated on this point, stating:

NuVox is a new entrant into the local exchange market, having commenced operations in St. Louis in June 1999. While it is a "facilities-based" provider as that term is used in the industry, the amount of network facilities it owns is

dwarfed by the size of SWBT's network. In each of its city service areas in Missouri (St. Louis, Kansas City and Springfield), NuVox has a single digital switch plus a number of collocations which are areas within SWBT central offices that NuVox rents from SWBT in order to be able to gain access to unbundled network elements leased from SWBT and to interconnect with SWBT's network, all pursuant to NuVox's interconnection agreement with SWBT that is on file with the Commission. NuVox must lease all of the loop facilities connecting its customers to its collocations, and all of the transport facilities connecting its collocations to its switch. NuVox obtains all of its loop facilities and a substantial portion of its transport facilities from SWBT. SWBT is the sole available source of loop facilities for NuVox in Missouri. Thus, NuVox does not control "bottleneck facilities" like SWBT does.

Mr. Cadieux testified that NuVox does not have market power because unlike SWBT, it does not control "bottleneck facilities" that other carriers depend upon and cannot interfere with competitors by impairing the quality or availability of such facilities or overcharging for them.³ He also testified that NuVox does not have market power because its market share is too small. (Ex. 10 Cadieux Direct p, 5-8, Tr. 188).

Mr. Cadieux noted that regulators have confirmed that NuVox lacks market power. In Missouri, NuVox is classified as a competitive carrier. Likewise, NuVox is treated as a non-dominant carrier by the FCC and the other states in which it provides service. (Ex. 10, Cadieux Direct, p. 7).

Specifically, addressing term discounts, Mr. Cadieux testified that NuVox cannot impede the development of competition by entering into three-year service agreements with its customers. He explained that NuVox's lack of market power, and in particular its small market share as a new entrant, would make it impossible for NuVox to impede competition by using long-term discounts. He stated:

³ While agreeing that SWBT's market power and control over "bottleneck facilities" is constrained somewhat by regulation, Mr. Cadieux explained that regulation is not an adequate constraint because of the delays involved. He stated: "And right now time is really of the essence for competitive carriers in this environment". (Tr. 185). He also indicated that limited resources impact CLEC access to regulatory remedies. (Tr. 186). He confirmed that after-the-fact remedies would not help. (Tr. 218-20).

As a new entrant into the local exchange market, NuVox has a very limited market share and it does not have the ability to "lock up" the customer base and impede the development of competition.

At bottom, use of long-term discounts by NuVox does not negatively impact the overall development of competition. (Ex. 10, Cadieux Direct, p. 8-9, Tr. 177).

On the other hand, Mr. Cadieux made it clear that NuVox needs to be able to use long-term discounts in order to succeed as a new entrant into the basic local market. Such discounts afford customers lower rates, which is one way of distinguishing NuVox's offerings from SWBT's incumbent offerings. He stated that adding and retaining new customers is essential to NuVox's ability to succeed. In this regard, term commitments provide "greater assurance of sustainable revenue flows". Mr. Cadieux testified that stable revenues are "particularly critical to new entrants in the local exchange market."⁵ (Ex. 10, Cadieux Direct, p. 8-9, Tr. 172-73, 218).

Mr. Cadieux's opinions were confirmed by the fact that the "overwhelming majority" of NuVox's customers have signed term contracts. (Tr. 169, 193(HC)). Further, the majority have signed at least two-year commitments. (Tr. 174, 194(HC)). In fact, NuVox's existing tariffs require a minimum of a one-year commitment from any customer whom will be served by NuVox facilities. Customers who do not wish to make term contracts would be served through UNE-P facilities leased from SWBT, but NuVox does not have any such customers because such an offering is not attractive in comparison to incumbent offerings. (Tr. 172-73).⁵ Accordingly, NuVox re-filed its proposed promotional tariff, restricting the discount to one-year commitments, in order to be able to do something pending resolution of this case. (Tr. 191).

While acknowledging that SWBT also benefits from stable revenues, Mr. Cadieux explained that CLECs need for stability is greater because of the financial pressures they face as new entrants. (Tr. 1891).

Mr. Cadieux also clarified that 1-2% of its lines are provided by UNE-P, involving situations where the customer's main location is served by NuVox facilities, but its small additional locations are beyond the reach of NuVox facilities. (Tr. 173-74).

Mr. Cadieux concluded by stating that "NuVox's proposed tariff will further the development of competition, not impede it." (Ex. 10 Cadieux Direct, p. 8-9).

In contrast, because of SWBT's continuing market power, Mr. Cadieux testified that SWBT should have to overcome a presumption and establish that any offer involving a term contract in excess of one year would not unreasonably impede competition, based on an analysis of all relevant factors (such as length of term, size of discount, type of service). (Tr. 210). He opposed allowing SWBT carte blanche to lock-up its incumbent customer base with long-term contracts during this critical period. (Tr. 219).

Mr. Cadieux testified that his concerns about SWBT's ability to impede competition by using multi-year arrangements with its incumbent customer base are not mitigated by the legal ability of competitors to assume and resell SWBT arrangements. In particular, for a company like NuVox that does not engage in resale as part of its business plan, Mr. Cadieux explained that it was not feasible or economic to develop all of the necessary systems in order to incorporate such isolated resale opportunities into the business. Moreover, in general, Mr. Cadieux stated that resale is not feasible because of the restrictive margins and the inability to differentiate products. (Tr. 211-14).

Through the use of term commitments and other business promotions, NuVox has been successful in retaining its small number of customers and reducing its access line losses. (Tr. 176, 180, 196-97). As a result (of course in combination with other factors, including territorial expansion and mergers), NuVox has been able to grow revenues and lines in service, and attract additional equity financing. But it is still under pressure and striving towards positive EBITDA ⁶ (and thereafter towards positive cash flow, and then positive earnings for shareholders) and must still attract additional equity financing in the near future in a difficult capital market in order to

fund near-future operations. Mr. Cadieux explained that these financial conditions make this a critical time for NuVox and all CLECs, and a critical time for regulators to prevent SWBT from impeding competition including by precluding its use of long-term commitments. (Tr. 179-82, 198, 208, 214-18).

Mr. Cadieux emphasized that the market is evolving and that the Commission should continue to monitor it. He stated that the Commission should remain proactive at least until there is "vigorous and sustainable competition." He testified that the key signpost will be when SWBT's prices move in general (not merely in targeted instances) to the level of competitors' rates. Until competition is sufficient to place such pressures on SWBT, Mr. Cadieux stated SWBT will be able to obstruct competitive efforts at "a very central juncture" by means of targeted discounts that are underwritten by its generally higher incumbent rate levels. (Tr. 220-22).

The three WorldCom subsidiaries are all classified as competitive companies and are authorized to provide basic local service in Missouri. They provide service to business customers in Springfield, Kansas City and St. Louis. (Ex. 11, Morris Direct, p. 1).

All three of the WorldCom companies submitted proposed tariffs to introduce the Local NationwideOne promotional offering. New or existing business customers who would choose to subscribe or renew a term plan of at least one year for a new T-1 ⁷ under existing tariffs between December 1, 2001 and February 28, 2002 (and otherwise meet eligibility requirements) would have been eligible for discounted rates. MCImetro also submitted proposed tariffs setting forth a number of promotional offers for new or existing business customers who would choose to

⁶ Earnings Before Interest, Taxes, Depreciation, and Amortization. (Tr. 208).

⁷ A "T-1" is a digital transmission link with a total signaling speed of 1,544 Mbps, also known as DS-1. It can generally be divided into 24 voice-grade channels or be used unchanneled, or a combination of the two. (Tr. 317). See also Newton's Telecom Dictionary.

subscribe to at least a one-year term commitment between January and March 2002 (and otherwise meet eligibility requirements) such as: waiver of local service install charges; credits for certain recurring digital trunk charges; credits for certain non-recurring equipment and facility costs; and discounted recurring charges. MCImetro's tariff included a "satisfaction guarantee" provision that would allow customers to cancel their term commitment during the first 90 days for any reason without penalty. (Ex. 11, Morris Direct, p. 1-5 and Attachments A-D, Tr. p. 245).

WorldCom witness Morris testified that CLECs like the WorldCom companies cannot "dominate or control any significant percentage of the local exchange market in Missouri to the detriment of other providers as a result of the term commitments contained in their promotional tariffs." He stated: "CLECs cannot dominate the local telephone market in Missouri and cannot by signing up customers to term commitments undermine or impede competition in that market." (Ex. 11 Morris Direct, p. 5).

Mr. Morris explained that use of long-term commitments by CLECs would promote competition, not hinder it. He testified that CLECs need to be able to offer potential customers incentives, such as term commitments, in order to persuade them to change local providers. He stated: "Without incentives, many local exchange customers would be content to stay with their existing local carrier, thus keeping local competition at a standstill." He testified to the frequency of use of term contracts by WorldCom in camera, but indicated publicly that it is a high percentage because it is essential to CLEC competition. (Ex. 11 Morris Direct, p. 6; Tr. 238-41 (HC), 253-55).

In contrast, Mr. Morris indicated that the Commission should not allow SWBT to attempt to hold on to its near-monopoly market share by means of long-term commitment programs that

are targeted responses to the limited inroads being made by CLECs. He explained that SWBT is a competitor "that is different in degree as well as being different in kind from any other carrier operating in Missouri." It retains a near-monopoly market share stemming from its historic monopoly. It has "an ubiquitous network that touches virtually every customer or potential customer in its service territory." It has an established "brand identification" as a local provider. It has "financial resources that rival every other carrier in the United States with the possible exception of Verizon." Such differences in resources remain a significant obstacle to competition in the capital-intensive local market. CLEC market capitalization has declined substantially over the past year, while RBOCs such as SBC have experienced an increase. Mr. Morris testified that the identity of the offeror of the proposed long-term contract tariff, SWBT versus CLEC, should currently be determinative. He stated: "SWBT should remain subject to a different standard of reasonableness." (Ex. 11, Morris Direct, p. 5-6; Ex. 12, Morris Rebuttal, p. 2-4, Tr. 224-25, 233, 249-53).

The fact that SWBT must allow CLECs to resell its service at a discount under federal law, as well as in certain limited instances currently allows CLECs to assume existing term contracts with customers without a discount, does not mitigate SWBT's market power or otherwise make use of long-term contracts by SWBT appropriate. SBC representatives themselves describe resale as "sham competition.". There simply is insufficient opportunity for a facility-based CLEC to earn a profit through resale (and no opportunity at all when no discount is available). (Ex. 12, Momm Rebuttal, p. 2).

The TCG companies are competitive facilities-based basic local service providers that serve business customers in Kansas City and St. Louis. (Ex 13 Kohly Direct p. 1).

The TCG companies submitted proposed tariffs under which new customers or existing business customers purchasing new services could (1) receive a waiver of one month of Monthly Recurring Charges if they order designated DS 1 services between January 1, 2002 and December 31, 2002 and commit to generate \$500 in combined Local, IntraLATA, and Monthly Recurring Charges over a 12-month period; and (2) receive a \$1000 Vendor Equipment and Services credit for designated DS1 services when they commit to a three-year term plan for Local, IntraLATA, and Monthly Recurring Charges. (Ex 13 Kohly Direct p. 3, Schedule RMK-1).

TCG witness Kohly testified that the Commission should not be concerned about the use of long-term commitments by CLECs like the TCG companies, but that it should continue to limit the use of such arrangements by SWBT as it did in Case No. TT-2002-108. He indicated that SWBT's dominant market position continues to require heightened regulatory scrutiny. In contrast, he noted that there was a consensus among the witnesses that CLECs lack the market power necessary to hinder competition. He stated that SWBT continues to benefit from the inertia of customers that it has served since it was a legal monopoly. In contrast, he explained that CLECs must persuade customers to make a "positive choice to switch providers." (Ex 13 Kohly Direct p. 4-6, Ex 14 Kohly Rebuttal p. 3).

Mr. Kohly advised that economists recognize that economic entities have a strong tendency to remain at the status quo, even if a change would be in their best interest. He stated that this behavior is labeled "status quo bias". (Ex 13 Kohly Direct p. 6-7).

Mr. Kohly identified various factors that cause customers to forego changing local telecommunications service providers due to status quo bias, such as fear of the unknown, fear of service problems (including those caused by the incumbent), concern over the viability of the potential new provider, and up-front switching costs. He stated that out-of-pocket switching

costs are particularly problematic, because customers resist spending money in the present to save money in the future for a variety of reasons. He noted the Commission has recognized the problems that high up-front costs pose for CLECs, citing the decision in Case No. TO-2001-439. (Ex 13 Kohly Direct p. 6-7).

Mr. Kohly provided evidence that status quo bias was deterring the development of basic local competition in Missouri. He noted that other CLEC witnesses also provided such evidence. (Ex 13 Kohly Direct p. 8-10; Ex 14 Kohly Rebuttal p 4).

Mr. Kohly explained that CLECs need to be able to use long-term commitments in order to overcome status quo bias, and other barriers to entry, and in particular to be able to reduce switching costs. He testified that "CLECs must make a compelling offer to attract customers." Specifically, he described how CLECs must be able to reduce or waive switching costs up-front, but then have to have the opportunity to recover such costs over time. Continuing on, he testified that term commitments provide the necessary assurance that all costs will be recovered over a continuing business relationship. Such assurance is also essential to a CLEC that is deploying new facilities and systems to serve customers, because it cannot recover all the costs of deployment up-front. (Ex 13 Kohly Direct p. 11-12; Ex 14 Kohly Rebuttal p. 2-3, 20-21; Ex 15 Kohly Surrebuttal p. 8-9, Tr. 297).

Thus, Mr. Kohly showed that CLECs must attract new customers to survive, must be able to reduce switching costs to attract new customers, and must be able to employ long-term arrangements to be able to reduce switching costs without sustaining long-term financial losses. He added that such matters are particularly critical at this unmistakable time of financial crisis for CLECs. He noted the Commission has already recognized the fact that financial constraints

are hindering CLEC market entry and development, citing the decision in Case No. TO-2001-467. (Ex 13 Kohly Direct p 12).

Mr. Kohly concluded that the tariffs proposed by TCG will promote competition. He demonstrated that these tariffs are designed to attract new customers by reducing switching costs to overcome status quo bias. He showed that long-term commitments are a necessary component of such offers. He explained that such commitments are particularly important for the DS1 offerings involved in the TCG tariffs, which require deployment of facilities. He provided highly confidential testimony about the frequency of TCG use of long-term commitments with such facility-based offerings, driving home the point. He indicated that the tariffs should accordingly be approved. (Ex 13 Kohly Direct p. 14; Ex 14 Kohly Rebuttal p 4-5; Tr 312-13(HC), 317-18).

Turning to SWBT's proposed tariff, Mr. Kohly testified that the Commission should reject the tariff for the same reasons that it recently rejected SWBT's term discount tariffs in Case No. TT-2002-108. He indicated that the market conditions were the same, and that SWBT did not present any new information that should cause the Commission to change its mind after only a few months about the problems that attend SWBT's use of long-term discounts. He explained that SWBT retains the advantages of its monopoly origins, including its embedded customer base and related status quo bias, disparate access to capital, economies of scale, and control of the bottleneck network. (Ex 14 Kohly Rebuttal p. 5-6; Ex 15 Kohly Surrebuttal p. 17-18).

Mr. Kohly explained that SWBT's proposed tariff seeks to deter competition by using SWBT's market power and locking existing customers into long-term arrangements (with early termination fees) that increase switching costs. He observed that SWBT was likely tying up the very customers that would otherwise be most willing to switch providers and make similar

commitments with a new entrant. He noted that the tariff does not focus on attracting new customers by reducing or waiving non-recurring charges or other switching costs, but rather focuses on reducing recurring rates for a non-local SWBT service that is not even available to customers who change local providers. He pointed out that SBC itself had expressed concerns about efforts by Microsoft to impose switching costs. (Ex 13 Kohly Direct p. 13, Ex 14 Kohly Rebuttal p 6-8, 18-19, Ex 15 Kohly Surrebuttal p 19-20, Tr 321).

He testified that SWBT has far less need for term commitments than CLECs, because SWBT does not need to overcome status quo bias and does not need to reduce switching costs to retain its embedded customer base. Indeed, SWBT typically has fewer up-front costs and investments to recover because it is operating from an existing ubiquitous network that was largely built during its legalized monopoly. It has substantial profits to fund ongoing operations and investments. It can and does increase rates to prompt customers to avoid the increase through term discounts. Even when it loses a customer, it still usually recovers network costs from the competitor. (Ex 14 Kohly Rebuttal p 19-24).

Mr. Kohly refuted arguments that SWBT was not trying to tie-up its existing customer base. He observed that resale and contract assumption "opportunities" do not mitigate the exclusivity of SWBT's term arrangements with customers, because as a practical matter CLECs cannot make a profit and cannot recover their own investments. He also observed that the theoretical potential for some customers to use multiple local providers does not mitigate the practical exclusivity of SWBT's term arrangements for most customers. (Ex 14 Kohly Rebuttal p. 8-11, Ex 15 Kohly Surrebuttal p. 11-12).

Mr. Kohly also refuted arguments that customers would not make long-term commitments with SWBT if they believed better deals were available from others. He noted the

established criticism of the Chicago doctrine espoused by Dr. Aron, regarding its general failure to focus on how people really behave. People really will oftentimes accept immediate benefits notwithstanding long-term costs. Mr. Kohly cited research involving retail power markets. Again, status quo bias plays a role as well. (Ex 14 Kohly Rebuttal p 12-13, Ex 15 Kohly Surrebuttal p 9-10, 15-16).

Likewise, Mr. Kohly observed that individual customers are not going to consider the impact of their isolated decisions on the development of competition. He noted the Commission already reached that conclusion in Case No. TT-2002-108. (Ex 14 Kohly Rebuttal p. 13-14, Ex 15 Kohly Surrebuttal p. 15-16).

Mr. Kohly opposed Staffs proposed compromise under which SWBT would be allowed to use long-term contracts for basic local service in exchanges where the Commission has determined it faces effective competition. He explained that until SWBT as a company as a whole is classified as competitive, it should remain subject to heightened scrutiny including the current restriction against use of long-term contracts. He noted that the Commission established this restriction at the same time, based on the same market conditions, that it made its decision that S WBT faces effective competition for basic local service in certain exchanges. He observed that the Commission should be particularly concerned about targeted efforts by SWBT to deter competition in these exchanges because of the Commission's reliance on competition to discipline SWBT's overall pricing practices. Mr. Kohly further testified that Staffs proposal would enable SWBT to fund basic local long-term discounts in such exchanges with revenues from other exchanges and services. He also noted that the particular tariff in question would result in unlawful deaveraging of toll rates and a de facto term plan on non-competitive SWBT switched access services under Staffs proposal. (Ex 15 Kohly Surrebuttal p. 2-8, 19-20).

Finally, Mr. Kohly indicated that other states are investigating concerns about the use of term contracts by incumbents. He also confirmed that switching costs such as are created by long-term contracts by incumbents have been recognized as a barrier to entry in a variety of court and regulatory proceedings. (Ex 14 Kohly Rebuttal p. 30, Ex 15 Kohly Surrebuttal p. 13-14).

ACS is a competitive CLEC that offers basic local service in SWBT's service area in Missouri. (Ex. 17, Kaufman Direct, p. 2-3).

ACS submitted its proposed "VIP" package of services, which extends discounts to customers committing to two and three-year arrangements. (Ex. 17, Kaufman Direct, p. 4).

ACS witness David Kaufman explained that CLECs are different from SWBT, because SWBT was a monopoly until 1996 and still retains de facto monopoly control over its local exchange markets through its overwhelming market share and control over essential network facilities. It also retains a significant advantage in terms of market recognition as a local provider. (Ex. 17 Kaufman Direct, p. 3, 6-8).

Mr. Kaufman testified that CLECs have made significant up-front investments and are not yet generating positive cash flow. He indicated his company had to go through reorganization in bankruptcy. He testified that it was essential for CLECs to develop a stable revenue stream, and that long-term contracts make that possible. (Ex. 17, Kaufman Direct, p. 5-6).

He stated that CLECs continue to have difficulty persuading former monopoly customers of SWBT to switch carriers. He opposed allowing SWBT to further impede competition by tying customers into long-term arrangements. (Ex. 17, Kaufman Direct, p. 6-8).

Staff witness Cecil agreed with the CLEC witnesses that the Commission can and should regulate SWBT in a different manner than CLECs regarding discounts tied to long-term

contracts. (Ex. 18, Cecil Rebuttal, p. 3-5, 8-11). Mr. Cecil testified that problems plague the CLECs that have sought to enter the basic local market in Missouri. He demonstrated the continuing reluctance of customers to switch providers from SWBT to a CLEC. He concluded that "CLECs face competitive pressures that are not borne by SWBT." He noted that individual CLECs have very small market shares compared to SWBT and are not yet in position to survive. (Ex. 18, Cecil Rebuttal, p. 5-7, 12, Tr. 325-26, 345-47, 358-59, 396-97).

Mr. Cecil testified that the Staff recommends approval of all the CLEC tariffs at issue in this case. He stated: "Staff supports the proposals because each one increased the number and diversity of service available to the public and did not impede the development of the competitive environment." He testified that approval of the CLEC tariffs would "foster a successful competitive environment." He indicated CLECs need to be able to offer multi-year discounted arrangements to establish stable, predictable cash flow and attract capital. (Ex. 18, Cecil Rebuttal, p. 11; Tr. 392-93).

On the other hand, Mr. Cecil indicated that use of discounts involving term contracts in excess of one year by SWBT would impede the development of competition in the Missouri local market. According to Mr. Cecil, such long-term contracts, when used by SWBT, reduce the pool of customers available to new competitors and are likely to force competitors to exit the market. He indicated that such restraints upon SWBT are a natural part of the process of introducing competition to the market, which requires SWBT to lose market share. Hence, Staff opposes SWBT's proposed tariff because it would promote an existing long-term discount regime. (Ex. 18, Cecil Rebuttal, p. 8-10, 13; Tr. 362-65).

Staff witness Cecil agreed with the CLEC witnesses that resale and assumption opportunities do not mitigate SWBT's market power, but rather confer the powerful monopoly characteristics of "the price maker". (Ex. 18 Cecil Rebuttal, p. 7).

However, Mr. Cecil indicated that Staff had changed its position since the proceedings last Fall in Case No. TT-2002-108 and would now be willing to allow SWBT to use long-term contracts in exchanges in which the Commission has found it faces effective competition for basic local service. He confirmed that Staff previously opposed all use of long-term contracts by SWBT for basic local service, and that there has been no change in market conditions between the time that Staff presented such complete opposition and the hearing in this case. He offered no explanation or justification for this change in position and did not reconcile it with the rationale behind Staff's continuing general opposition to use of long-term discounts by SWBT. (Ex. 18, Cecil Rebuttal, p. 12; Tr. 326-27).

SWBT witness Steven Getz testified in support of SWBT's proposed CompleteLink - Basic tariff. SWBT's proposed tariff would renew a promotion that had already run for one year, under which business customers who sign a term-commitment arrangement that could exceed one year would receive a postalized (i.e. not time of day or distance-sensitive) discounted intraLATA toll rate in addition to the other discounts afforded by the term plan. The term plan would include an early termination fee. He confirmed that SWBT only offers intraLATA toll to its own local customers. (Ex. 4, Getz Direct, p. 3-6, 15; Ex. 6, Getz Surrebuttal, p. 8; Tr. p. 92, 110-11).

Mr. Getz testified that a large majority of SWBT's business customers do not choose to subscribe to term commitment plans. (Ex. 4, Getz Direct, p. 10; Ex. 6, Getz Surrebuttal, p. 6).

He also discussed how often customers who do choose to subscribe to such plans limit their commitment to one year. (Tr. 97 (HC)).

He testified that SWBT began using term discount programs for basic local service just before passage of the federal act that enabled local competition in 1996. (Ex. 4, Getz Direct, p. 8-10; Tr. 83-85). He described SWBT's filings as a "direct response to competitors' initiatives." (Ex. 4, Getz Direct, p. 11). He confirmed that SWBT's plan does not affect non-recurring charges, but rather only recurring charges. (Ex. 6, Getz Surrebuttal, p. 3-4).

He testified that SWBT has been losing market share to CLECs. (Ex. 4., Getz Direct, p. 12). However, he acknowledged that the rate of loss was changing. (Tr. 99 (HC)).

He acknowledged that "access to capital is a fundamental and continuing requirement of the telecommunications market." (Ex. 6, Getz Surrebuttal, p. 1).

Mr. Getz testified that SWBT does not inform competitors when SWBT's customer term commitments are going to expire. (Tr. 88).

SWBT witness Unruh testified regarding the amount of basic local competition. Relying upon various sources, including confidential 911 data⁸, he concluded that over 60 CLECs collectively have obtained a basic local business market share of 25% to 32%. (Staffs Late Filed Exhibit 23 indicates that the lower figure is more accurate, and even Staffs figures appear inflated when compared to the specific numbers reported by the CLECs in this case, Tr. 193-94, 238-41, 313-14 (HC)). He provided information that there is at least one CLEC in each of SWBTs 160 exchanges. He testified that SWBT retains 68% to 75% of the market (again, Exhibit 23 reflects the higher number to be more accurate), with a total of 787,497 business

⁸ In addition to its other market advantages, SWBT has also been able to monitor its market position and otherwise improperly use confidential 911 data in efforts to promote its retail offerings before the Commission. (Ex. 12, Morris Rebuttal, p. 1; Ex 14, Kohly Rebuttal p. 25-28; Ex 15, Kohly Surrebuttal p. 18-19). CLECs are not able to determine their market share or otherwise access this data. (Ex. 10, Cadieux, Direct, p. 7).

access lines. He confirmed that the Commission should "ensure that markets are open, thus, leading to a competitive environment." (Ex. 7, Unruh Direct, p. 7-11; Tr. p. 146, 163).

He testified that CLECs can purchase SWBT's retail discount plans at a wholesale discount and then resell those plans. He also testified that CLECs can assume existing SWBT term contracts with specific customers, but without any wholesale discount, under certain interconnection agreements. (Ex. 7, Unruh Direct, p. 13-14).

Mr. Unruh indicated that SWBT has no objection to CLEC term discount plans, so long as SWBT is permitted to offer such plans as well. (Ex. 7, Unruh Direct, p. 14).

Mr. Unruh testified that SWBT's term discounts are targeted and that SWBT continues to use its generally higher business service rates to subsidize other lower rates. (Ex. 7, Unruh Direct, p. 18-19; Ex. 9 Unruh Surrebuttal p. 17).

He indicated he did not know whether SWBT's existing term discount plans had slowed the growth of CLEC market share. (Tr. 122-23).

He acknowledged that SBC companies run ads that disparage CLECs and portray switching to CLEC service as being foolish and dangerous. (Tr. 125-26).

SWBT witness Dr. Debra Aron testified to the general benefits of long-term contracts. Dr. Aron testified that companies particularly need term commitments when they must make up-front investments to commence service. However, she acknowledged that such contracts could be used for anti-competitive reasons under certain circumstances. She stated that a dominant incumbent could exclude new entrants by making long-term contracts with customers. However, she opined that such exclusion could only result if the contract covered all of the customer's business and the customer expected the new entrants to set prices above cost. She further opined that she did not believe such conditions exist in the Missouri local market. On the other hand,

she acknowledged that some models indicate that incumbents can use such arrangements to deter entry. (Ex. 1, Aron Direct, p. 4-8, 18; Ex. 2, Aron Rebuttal, p. 12).

Dr. Aron indicated that the early termination fees that are typically included in long-term contracts create a switching cost that a customer must bear to terminate the contract early to switch to another provider. She indicated the existence of such switching costs is sometimes referred to as "lock-in". (Ex. 1, Aron Direct, p. 7).

Dr. Aron testified that the current provider will seek ways to prolong or renew long-term commitments when they approach expiration, while competitors will try to identify customers whose switching costs are at a minimum and are most receptive to change. She also acknowledged that entrants could reduce switching costs by using long-term contracts themselves. (Ex. 1, Aron Direct, p. 14, Ex. 2, Aron Rebuttal, p. 12).

Dr. Aron confirmed that a "status quo bias" effect has been observed in some experimental settings. She described such bias as anomalous, "contrary to the standard economic theory under which an individual's choices should be internally consistent." She opined that businesses "may not" exhibit status quo bias. (Ex. 2, Aron Rebuttal, p. 7-9).

On the other hand, she confirmed that market inertia exists, stating that new entrants must "provide additional value to attract customers". The entrants must "offer what the customer perceives is a better product, a lower price, better service, or some combination of these to win customers". Dr. Aron testified that the incumbent's strong brand name could form a barrier to entry, as can concerns about the financial viability of the entrant. She stated that such issues could cause a customer to select a higher-price provider. (Ex. 2, Aron Rebuttal, p. 10-11, 19; Ex. 3, Aron Surrebuttal, p. 25).

She testified that CLECS "face sufficient competition from each other and SWBT that they are unlikely to have substantial market power." She agreed that there has been no allocation of the local market, but rather only a transition from an incumbent with virtually all of the market to the present conditions. She agreed that SWBT is subject to extraordinary regulation in order to create an environment that permits effective competition. She testified that successful competitive entry causes harm to the incumbent, but benefits consumers. (Ex. 1, Aron Direct, p. 13, 27; Ex. 2, Aron Rebuttal, p. 18, Tr. 48).

In its December 2001 Report and Order in Case No. TT-2002-108 (See Exhibit 16), the Commission made the following findings of fact regarding SWBT and its proposed term discount tariffs:

- SWBT is an incumbent local exchange carrier (ILEC) as that term is defined in Section 251(h) of the Telecommunications Act of 1996. That means that before the passage of the Telecommunications Act of 1996, SWBT was a regulated monopoly provider of local exchange service within its exchanges. In other words, before the advent of competition, all local service customers within SWBT's exchanges were customers of SWBT. (Ex. 16, p. 9).

- The Telecommunications Act of 1996 permitted the creation of competitive local exchange carriers (CLECs). CLECs are telecommunications carriers that have decided to go into the exchange of an ILEC to compete to provide local telephone service. Currently there are 66 CLECs competing with SWBT in its Missouri exchanges. At least one CLEC is operating and serving customers in each of SWBT's 160 Missouri exchanges. Furthermore, at least 22 percent of the business market in SWBT's exchanges is controlled by a CLEC. (Id.).

- SWBT is still in a position to dominate its CLEC rivals. While the CLECs collectively may control 22 percent of the business market in SWBT's exchanges, that 22 percent is spread

out among 66 different CLECs. No CLEC has the resources to attempt to duplicate SWBT's telecommunications network. As a result, CLEC competitors must rely on their ability to utilize all or a portion of SWBT's network in order to provide services to their own customers. (Ex. 16, p. 9-10).

- Because of its powerful position in the local telephone market, SWBT is in a position to threaten competitors' market share and continued existence, while the competitors are not yet in a position to threaten SWBT's existence in its own exchanges. (Ex. 16, p. 10).

- SWBT is different than its competitors and therefore should be subject to more stringent regulatory oversight until those differences become less substantial. (Id.).

- If effective competition in the local telecommunications market is to survive and prosper in SWBT's exchanges, SWBT must be subject to heightened regulatory oversight. (Id.).

- Any CLEC attempting to persuade a customer to leave SWBT while subject to a term agreement would not only have to offer a better rate but would also have to find a way to convince the customer to pay a large up-front penalty for leaving SWBT. (Ex. 16, p. 11).

- In general, [SWBT's] multi-year contracts artificially reduce the pool of potential CLEC customers and forestall the intended effects of the Act. By reducing the pool of potential customers, CLEC growth plans and investment recovery, essentially the opportunities to grow and to successfully compete are constrained. (Id.).

- If end users choose these [SWBT] lower priced, long-term relationships, the competitive environment in the long run is at risk of collapsing. (Ex. 16, p. 11-12).

As shown in the foregoing summary of testimony, the record herein (not surprisingly) shows that there have been no significant changes in the few months that elapsed between the close of the record in Case No. TT-2002-108 and the hearing in this case. Thus, all of the

Commission's findings of fact regarding SWBT and the anti-competitive nature of its use of long-term discount tariffs for basic local business service are still accurate. Further, the record reflects that SWBT plays upon the inertia and status quo bias of its embedded customer base and seeks to increase that inertia and bias by creating unnecessary switching costs in the form of long-term contracts with early termination fees for customers that are otherwise likely to consider changing providers. (Ex. 13, Kohly Direct, p. 13; Ex. 14, Kohly Rebuttal, p. 6-8, 18-19; Ex. 15, Kohly Surrebuttal, p. 19-20, Tr. 321).

The resale "opportunities" cited by SWBT do not mitigate concerns about the negative impact that the proposed CompleteLink promotion of long-term commitment discounts would have upon the continued development of local exchange competition. As Mr. Cadieux, Mr. Morris, and Mr. Kohly each explained, resale does not provide a basis for sustainable, effective local exchange competition because it does not permit a CLEC to control costs and engage in service and technology innovation, and because of the inadequate margins inherent with resale. Resale is simply an early market entry strategy and an ancillary provisioning method. Resale does not constitute a viable long-term mode of sustainable, effective local competition. (Ex. 12, Morris Rebuttal, p. 2; Ex. 14, Kohly Rebuttal, p. 8-11, Tr. 211-14).

The Commission did not have any CLEC tariffs before it in Case No. TT-2002-108. Accordingly, it made no findings of fact regarding such tariffs. However, the record reflects that its recent findings about CLECs remain accurate: they are still dependent upon SWBT and its network, they are not in a position to threaten SWBT, they are different from SWBT and should be regulated differently, they have to overcome customer inertia and convince SWBT's embedded customers to change providers. (Ex 16, p. 9-12).

The record in this case demonstrates that use of long-term (i.e. more than one year in duration) discount arrangements are essential to the ability of CLECs' to successfully compete. Moreover, the point is undisputed, as all parties and witnesses support the use of long-term discounts by CLECs. The only opposition comes from SWBT, and that opposition is based solely upon a contingent argument for equal regulatory treatment and not upon any purported substantive problem with the CLEC tariffs.

CLECs must be able to attract the attention of customers and overcome their inertia and status quo bias. CLECs must be able to recover the investment in new facilities deployed to serve new customers, as they have no existing ubiquitous network. CLECs must not only grow revenues, but also they must secure and stabilize them. CLECs have been relying heavily on long-term arrangements and must be able to continue to do so at this critical point in time, when the viability of competition hangs in the balance. It is undisputed that they have no market power and further it is undisputed that their use of long-term discounts will promote competition, not impede it.

Argument

As the Commission concluded in its Report and Order in Case No. TT-2002-108, Section 392.230.3 authorizes the Commission to determine, after hearing, the propriety of tariffs filed with the Commission by telecommunications companies. Further, as the Commission concluded, Section 392.185 makes it the Commission's responsibility to regulate Missouri's telecommunications industry in such a way as to promote the development of full and fair competition. (Ex. 16, p. 13-14).

Section 392.200.2 provides in pertinent part as follows:

No telecommunications company shall directly or indirectly or by any special rate, rebate, drawback or other device or method charge, demand, collect or receive from any person or corporation a greater or less compensation for any service rendered or to be rendered with respect to telecommunications or in connection therewith, except as authorized in this chapter, than it charges, demands, collects or receives from any other person or corporation for doing a like and contemporaneous service with respect to telecommunications under the same or substantially the same circumstances and conditions. Promotional programs for telecommunications services may be offered by telecommunications companies for periods of time so long as the offer is otherwise consistent with the provisions of this chapter and approved by the commission.

This statute requires the Commission to review differential pricing and promotional offers made by telecommunications companies to ensure that such offers are consistent with the law, including the Commission's duty to ensure the development of full and fair competition. (Ex. 16, p. 14).

Section 392.200.3 provides as follows:

No telecommunications company shall make or give any undue or unreasonable preference or advantage to any person, corporation or locality, or subject any particular person, corporation or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever except that telecommunications messages may be classified into such classes as are just and reasonable, and different rates may be charged for the different classes of messages.

These statutes prohibit undue or unreasonable rate preferences. Rate discrimination (i.e. application of different rates) is prohibited in situations where the carrier is performing "a like and contemporaneous service with respect to telecommunications under the same or substantially the same circumstances and conditions." Section 392.200.2.

Regarding rate differences, the test is whether there is any "reasonable and fair difference in conditions which equitably and logically justifies a different rate." State ex rel. DePaul Hospital v. PSC, 464 S.W.2d 737, 740 (Mo. App. 1970).

Section 392.200.4(2)(b) provides as follows:

For services proposed in a geographic area smaller than an exchange or other market segmentation within which or to whom such telecommunications service is proposed to be offered, a local exchange telecommunications company may petition the commission to define and establish a local exchange telecommunications service or exchange access service as a different local exchange telecommunications service or exchange access service. The commission shall approve such a proposal if it finds, based upon clear and convincing evidence, that such services in a smaller geographic area or such other market segmentation is in the public interest and is reasonably necessary to promote competition and the purposes of this chapter. Upon approval of such a smaller geographic area or such other market segmentation for a different service for one local exchange telecommunications company, all other local exchange telecommunications companies certified to provide service in that exchange may file a tariff to use such smaller geographic area or such other market segmentation to provide that service.

Based upon this statute, the Commission can only approve proposed non-geographic market segmentation if it finds (based on clear and convincing evidence) that such market segmentation is in the public interest and is reasonably necessary to promote competition and the purposes of Chapter 392.⁹

SWBT's proposed promotion of long-term discounts constitutes price discrimination. Customers would be obtaining exactly the same services under the same circumstances. In the words of the statute, SWBT would be providing "a like and contemporaneous service with respect to telecommunications under the same or substantially the same circumstances or conditions." Section 392.200.2.

Discounts are inherently simply a different price for the same service. The service is the same, whether purchased for a month, a year, or five years. Hence, the issue is not whether the discounts are discriminatory, but rather whether such promotions and price discrimination are reasonable and therefore lawful.

The Commission cannot analyze the reasonableness of SWBT's proposed tariff in a theoretical vacuum, but rather must consider the actual market conditions in Missouri in which

SWBT's tariff would take effect. Further, the Commission needs to consider the overall impact of SWBT's tariff, and not merely the purported perceptions of individual customers.

The market for basic local business services is not yet fully competitive. SWBT remains the dominant provider. It still provides about 75% of such services. (Ex. 7, Unruh Direct, p. 7-11; Ex. 23).

SWBT retains such a disproportionate market share in part simply because it had 100% well past 1996 when the law first permitted competition and has other accompanying advantages such as name recognition, existing cash flow, and established customer relations and networks. (Ex. 16).

The testimony of the CLEC and Staff witnesses shows that CLECs have many hurdles to overcome to break through customer inertia and persuade customers to switch local service from the historic monopoly provider, including customer concerns (unique to local service) about the changeover process itself and the viability of competitors.

SWBT also retains such a disproportionate market share because, at least according to this Commission and the FCC, it has only recently adequately opened up its network and systems to competitors. Such open access is absolutely essential to competition, because SWBT has the only ubiquitous network and will retain such unique status for the foreseeable future. But as the Commission held in Case No. TT-2002-108, "It does not mean that the competitive market is mature enough to withstand the pressures that would be placed on it by the promotions proposed by Southwestern Bell." (Ex. 16, p. 17-18).

All the foregoing factors intertwine, leaving SWBT with a distinct ability to retain a substantial market share. As the Commission has already held: "Unless the Commission acts to

⁹ See Section 392.185 for a statement of purposes.

protect competition, the local exchange market may be open to competition but have no surviving competitors." (Id.).

SWBT still seeks additional advantages. Through the promotion of long-term discounts that is now at issue, SWBT seeks to deter competition by binding customers to contracts that would in all practical respects preclude them from taking competitive offers in the future.

The impact of such pricing practices on competition cannot be ignored. CLECs have struggled since 1996 to compete and have collectively gained only a 25% market share for basic local business service. If SWBT's proposed tariff were to be approved, instead of continued competition for all customers, more of SWBT's existing customers would be taken out of play through long-term commitment discounts. In short, rather than having a legitimate opportunity to grow, competition would in all likelihood contract. There are already signs it is slowing.

As long as competition remains in its early stages, it would be unreasonable to allow SWBT to price in a manner meant to impede the competitive process. The Commission needs to assure that competition can survive and grow and not allow the market to lapse back into monopoly. SWBT's witnesses acknowledged this responsibility of the Commission. While these witnesses would have the Commission wait until harm actually occurs, the Commission must instead follow the applicable statutes by anticipating and preventing unreasonable, harmful practices.

SWBT's promotion of long-term discounts is unreasonable because it would impede the development of competition in the basic local business market. Hence, the proposed tariffs are unlawful under Section 392.200.2 and .3. The Commission reached exactly this conclusion in its Report and Order in Case No. TT-2002-108, stating:

The Commission has previously found, as a matter of fact, that Southwestern Bell's proposed promotional tariffs would be detrimental to the health and development of

competition in Missouri's local exchange market. Those tariffs are therefore unjust and unreasonable. In keeping with the Commission's obligation under Section 392.200 RSMo 2000, the Commission must reject Southwestern Bell's tariffs.

(Ex. 16, p.15).

Likewise, the proposed tariffs are unlawful under Section 392.200.4(2)(B), because for the foregoing reasons the resulting non-geographic market segmentation would not be in the public interest and would not be reasonably necessary to promote competition and the purposes of Chapter 392 (such as allowing competition to develop to the point that it can replace regulation).

That is not to say that SWBT must be totally precluded from offering term discounts. As the Commission concluded in Case No. TT-2002-108, it is unlikely that use of one-year term discounts by SWBT would impair the development of competition. (Ex. 16, p. 19).

The adverse impact of these tariffs would not be mitigated by any resale opportunities, because as stated herein above, resale does not provide a basis for sustainable, effective competition.

Regarding the CLECs' proposed tariffs, the record demonstrates that there is no basis for concluding that use of long-term discounts by CLECs is in any unreasonable or would in any way impair the competitive process. No party opposes the tariffs on substantive grounds. The record unequivocally demonstrates that use of such discounts by CLECs is essential and will promote the competitive process. Hence, notwithstanding the Commission's advisory statements in its Report and Order in Case No. TT-2002-108 regarding CLEC tariffs, now that it has a record before it regarding such tariffs it should approve them (or for those tariffs that have gone stale because the **proposed promotional period has passed, indicate that the** CLECs can refile such tariffs with new promotional periods).

Much of the "evidence" offered by SWBT concerned its argument that it is somehow entitled to be treated exactly the same as its competitors. This agreement cannot provide a basis for rejecting the CLECs tariffs, when the record unequivocally supports approval. Moreover, the record is clear that SWBT is substantially different from its competitors. It is the only formerly lawful monopoly provider. It is the only provider that does not have to compete against the formerly lawful monopoly provider. It is the only provider with a dominant market position. It is beyond dispute that SWBT is in fact regulated differently than its competitors, both under federal and state law. The Commission already made this determination in Case No. TT-2002-108, indicating that it agreed with Staff witness Cecil's testimony that "SWBT is different than its competitors and therefore should be subject to more stringent regulatory oversights until those differences become less substantial." (Ex. 16, p. 10).

Further, the Commission held: "If effective competition in the local telecommunications market is to survive and prosper in Southwestern Bell's exchanges, Southwestern Bell must be subject to heightened regulatory oversight." (Id.) Staffs new "compromise" proposal to allow SWBT to use long-term discounts in exchanges where the Commission has found there is effective competition, which it did not propose in Case No. TT-2002-108 and which is directly contrary to the rest of Staffs substantive testimony, is inconsistent with the Commission's decision in TT-2002-108. The Commission has already concluded that it needs to restrict SWBT's use of long-term discounts in order to preserve effective competition. SWBT is still a non-competitive company. Its basic local service remain tied to its non-competitive switched access services. Staffs proposal would dilute the heightened scrutiny and oversight which it otherwise endorses down to a meaningless trace. Hence, the Commission should reject Staffs proposed compromise.

The time has come for the Commission to reject all pending incumbent long-term discount tariffs, establish a moratorium on such incumbent tariffs, and develop a rule restating such incumbent tariffs (existing and future). These tariff-specific proceedings are too costing and inefficient.

Conclusion

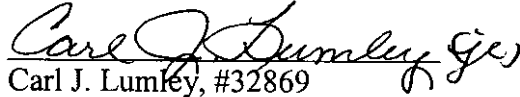
The Commission's decision in Case No. TT-2002-108 about the adverse impact of use of long-term discounts by SWBT was right on the mark. SWBT continues to dominate the basic local business market. Its proposed tariff would promote long-term discounts that unreasonably impede CLEC efforts to compete in that market. These long-term discounts bind SWBT customers into long-term contracts that take them off the market.

CLECs do not seek an allocation of SWBT's market share. They simply want to be able to compete. SWBT's proposed CompleteLink-Basic tariff would promote unreasonable and unlawful long-term discounts that would significantly impede competition for all customers. Accordingly, the Commission should reject SWBT's proposed tariff. It should also develop a rule restricting the use of long-term discounts by incumbents.

On the other hand, CLECs need to use long-term discounts in order to survive and compete. The record provides no basis for any action other than approval of the CLEC tariffs.

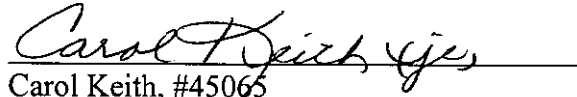
Respectfully submitted,

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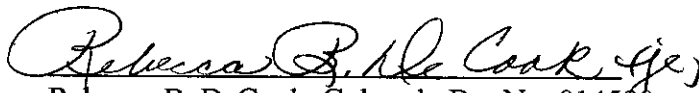
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Certificate of Service

A true and correct copy of the foregoing was served upon the parties identified on the attached service list on this 23rd day of May, 2002, by e-mail and by placing same in the U.S. Mail, postage paid.

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