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June 15, 1998

HAND DELIVERY

Ms. Blanca S. Bayo, Director
Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Betty Easley Conference Center, Room 110
Tallahassee, Florida 32399-0850

Re: Docket No. 971056-TX

Dear Ms. Bayo:

Enclosed herewith for filing in the above-referenced docket on behalf of Teleport Communications Group Inc./TCG South Florida ("TCG"), are the following documents:

1. Original and fifteen copies of TCG's Post-Hearing Brief; and

2. A disk in Word Perfect 6.0 containing a copy of the document.

Please acknowledge receipt of these documents by stamping the extra copy of this letter "filed" and returning the same to me.

Thank you for your assistance with this filing.

Sincerely,

John R. Ellis

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Application for certificate to provide alternative local exchange telecommunications service by BellSouth BSE, Inc.	)	Docket No. 971056-TX Filed: June 15, 1998

TELEPORT COMMUNICATIONS GROUP, INC./
TCG SOUTH FLORIDA'S POST-HEARING BRIEF

Teleport Communications Group, Inc. and its Florida affiliate, TCG South Florida (collectively "TCG") submit this post-hearing brief to the Florida Public Service Commission ("Commission") in Docket No. 971056-TX.

Issue 1: **In light of the provisions of the Telecommunications Act of 1996 and Chapter 364, Florida Statutes, should the Commission grant BellSouth BSE a certificate to provide alternative local exchange service pursuant to Sections 364.335 and 364.337, Florida Statutes, in the territory served by BellSouth Telecommunications, Inc. as the incumbent LEC?**

* No. Certification of BellSouth BSE to provide alternative local exchange service in the territory served by BellSouth Telecommunications as the incumbent LEC would not be in the public interest, as is required by Section 364.01, Florida Statutes, because it would not promote the development of fair and effective competition in markets for local exchange service . The 1996 Act and the 1995 amendments to Chapter 364 authorize new entrants into markets for local exchange service and impose obligations on incumbent LECs essential to the development of competition in those markets. Certification of BellSouth BSE would allow BellSouth Telecommunications to avoid its resale and unbundled network element obligations under the 1996 Act and would have significant anti-competitive effects.*

SUMMARY OF ARGUMENT

Markets for local exchange service are historic monopolies in which the incumbent local exchange carriers have enormous competitive advantages. The Telecommunications Act of 1996 ("Act") and the 1995 amendments to Chapter 364, Florida Statutes, are designed to promote competition in markets for local exchange service, in part by imposing certain obligations on incumbents for the benefit of new entrants into those markets. One such obligation is stated in Section 251(c)(4) of the 1996 Act: the duty to offer for resale at wholesale rates to new entrants, any telecommunications service that the incumbent provides at retail.

The proposal of BellSouth BSE, Inc. ("BSE") to operate as a new entrant in competition with its affiliate, BellSouth Telecommunications, Inc. ("BellSouth"), in Florida markets in which BellSouth is the incumbent is a legal fiction which fails to comply with the public interest standards of Section 364.01, Florida Statutes. The record in this proceeding demonstrates that BSE's proposal to provide "new and innovative services" is without substance, because with one exception - - provision of BellSouth's existing services outside BellSouth's nine-state territory - - every service which BSE proposes to provide already is being provided by BellSouth and its affiliates. BSE is requesting a certificate which would give it the combined benefit of the enormous competitive advantage of the BellSouth name in Florida markets for local exchange service and the wholesale discount for that service designed to promote new entrants into those markets. Further, BSE is requesting a certificate which would permit it to avoid BellSouth's resale obligation under Section 251(c)(4). If BSE is given that certificate, then the parent corporation of both BellSouth and BSE could use BSE to engage in selective discount pricing to prevent the loss of BellSouth's retail market

share to new entrants, without reducing BellSouth's wholesale price for any telecommunications service or its retail price to any other customers.

In concluding that the Act permits affiliates of incumbent local exchange carriers to offer local exchange service, the Federal Communications Commission ("FCC") in its First Report and Order in the Non-Accounting Safeguards proceeding, Docket No. 96-149, recognized that individual states may regulate such affiliates differently than other carriers.[1] The Commission should follow the lead of Commissions in Texas and Kentucky in not granting alternative or competitive local exchange carrier certification to affiliates of incumbents in markets served by those incumbents, and should not grant BSE a certificate to provide alternative local exchange service in the territory served by BellSouth as the incumbent. Alternatively, if the Commission grants BSE a certificate for Florida markets served by BellSouth as the incumbent, then the Commission should impose on BSE the resale and provision of unbundled network elements obligations of Section 251 (c) (3) and (4) of the Act.

ARGUMENT

The public policy that a competitive, free enterprise economic system can best achieve an efficient allocation of resources and a higher standard of living, is expressed in the preamble of the Telecommunications Act of 1996: "An Act to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."[2] Florida's 1995 revisions

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[1]Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 134, as amended, First Report and Order, FCC 96-489 (¶ 317).

[2]Pub. L. No. 104-104, 110 Stat. 56 (1996).

to Chapter 364, Florida Statutes, express the same public policy: "The Legislature finds that the competitive provision of telecommunications services, including local telecommunications service, is in the public interest and will provide customers with freedom of choice, encourage the introduction of new telecommunications services, encourage technological innovation, and encourage investment in telecommunications infrastructure."[3]

The introductory paragraph of the FCC's First Report and Order implementing the Act therefore declared that: "...we and the states remove the outdated barriers that protect monopolies from competition and affirmatively promote competition using tools forged by Congress."[4] And the United States Court of Appeals for the Eighth Circuit, in the introductory sentence of its opinion deciding challenges to the FCC's First Report and Order, found that: "[The Act] was designed, in part, to erode the monopolistic nature of the local telephone service industry by obligating the current providers of local phone service ... to facilitate the entry of competing companies into local telephone service markets across the county."[5]

Implementing this pro-competition public policy in markets for local exchange service means allowing new entrants into those markets; not for the sake of having more than one firm necessarily serve each market, but in order to allow market forces to substitute for regulation in acting as a check on monopoly pricing. The goal of the legislation is not new names and packages of services from

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[3]Section 364.01(3), Florida Statutes.

[4]Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, FCC 96-325, First Report and Order, ¶ 1.

[5]Iowa Utilities Board v. Federal Communications Commission, 120 F.3d 753 (8th Cir. 1997).

the same monopoly providers in their own territories; the goal is new entrants to compete against the monopoly providers.

The record in this proceeding reflects the following facts concerning the unlikelihood of BSE acting as a market rival of BellSouth. Both BSE and BellSouth are wholly owned subsidiaries of BellSouth Corporation (Tr. 36, 41,42). BSE's source of capital is BellSouth Corporation (Tr. 35). The shareholders to whom both BSE and BellSouth will be answerable are the shareholders of BellSouth Corporation (Tr. 36). BSE's budgeting process requires the approval of BellSouth Corporation's Chief Financial Officer, Mr. Ronald M. Dykes (Exhibit 4, at 53-54). BSE's sole director at the time of its incorporation and at the time of its Florida application is an executive officer of BellSouth Corporation, Mr. Earle Mauldin (Attachments to Florida application).[6] Approximately two-thirds of BSE's less than 20 employees are former employees of BellSouth companies (Tr. 42), including all five members of its senior management team (Florida application, Exhibit Q-16(B)). Concerning the trade name and logo of the monopoly provider against which the 1996 Act and the 1995 amendments to Chapter 364 seek to develop market rivals for the territory in question, BSE's witness at the hearing in this proceeding, Mr. Robert Scheye, testified as follows:

> ... I can assure you that we intend to use the BellSouth name, like all of the BellSouth affiliates do, and we would include the logo, as you describe it, the circle with the bell inside, just like BellSouth Cellular, BellSouth Publishing, BellSouth Entertainment, and eventually BellSouth Long Distance. (Tr. 36)

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[6]BSE's Florida Application is not listed as an exhibit in this proceeding, although presumably BSE has not withdrawn it.

When asked at his deposition in this proceeding if BSE would use the BellSouth logo in marketing services, Mr. Scheye answered "Yes. Essentially just like every other RBOC does or can." (Exhibit 4, at 20). In sum, there is no prospect whatsoever that BSE will act as a market rival of BellSouth to ensure that fair and effective competition is developed in Florida markets for local exchange service in which BellSouth is the incumbent LEC.[7]

BSE proposes to resell BellSouth's local service in BellSouth's serving territory (Tr. 182). However, BSE's proposal to provide new and innovative services to customers (Tr. 31, 34), different from and in addition to those that are available from the incumbent (Tr. 183), appears to be only an attempt to borrow the words used by the FCC in paragraph 315 of its Order No. 96-149 in the Non-Accounting Safeguards proceeding[8] (Tr. 29, 73, 181). In response to several questions by Commissioners concerning what services BSE proposes to provide that are new or innovative or different from the existing services provided by BellSouth or other affiliates of BellSouth (Tr. 51, 60, 61, 65), BSE's witness Mr. Scheye admitted that the only innovation BSE proposes to bring to the market is to package existing services -- and long distance, when a BellSouth entity is permitted to do so-- which BellSouth could do as well (Tr. 52, 59, 60, 64-65).

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[7]The subject of which companies BSE will or will not compete against is discussed in the documents filed with the Commission under the terms of the Protective Agreement between the parties and identified as vol. 5, pgs. 73, 80, and 190; vol. 7, pg. 3; and vol. 9, pgs. 51, 57.

[8] "We agree with the BOCs that the increased flexibility resulting from the ability to provide interLATA and local services from the same entity serves the public interest, because such flexibility will encourage Section 272 affiliates to provide innovative new services." Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 134, as amended, First Report and Order, FCC Rcd (¶ 315) (1996), pets. for recon. pending.

Rather than providing "new and innovative services," the record in this proceeding shows that there is only one "innovation" between what BSE proposes to do, and what BellSouth could do if it chose to: BSE proposes to avoid BellSouth's obligation under Section 251(c)(4) to offer local exchange service for resale at a wholesale discount to new entrants who seek to compete with BellSouth.

> **Q** The only two things that BellSouth BSE can do that BellSouth Telecommunications can not, before and after it's able to provide long distance services, is a) to provide outside the nine-state territory, and b) to sell local exchange service at a discount without being required to make that discount available to competitors?
>
> **A** Well, let me say I think that's a yes and no. If I sold the local exchange service - - and I believe Commissioner Clark's question was similar to that - - if I bought the local service at $18 but my price list price was $15, I would have to make it available to everyone at $15 and continuously lose money. So the part of it that is no, I don't plan to provide it at a discount in that fashion. I do believe, but I can't recall, the first part of your question, I think, was in the affirmative, though, was correct.
>
> **Q** First part being BellSouth Telecommunications can't go outside its nine-state territory?
>
> **A** Correct.
>
> **Q** The other is if BellSouth Telecommunications provides local exchange service, which, of course, it does, it has to provide that for resale at a discount, and BSE would not?
>
> **A** Correct. We do not have to provide it at a discount.
>
> **Q** Those are the only two differences between BellSouth Telecommunications and BellSouth BSE in terms of your marketing plan?
>
> **A** Again, not to bring it back, but the full integration of

the long distance eventually is also an aspect. (Tr. 79-80).[9]

TCG submits that giving an affiliate of BellSouth an ALEC certificate to accomplish this business purpose would not be in the public interest and would not provide for the development of fair and effective competition, within the meaning of Section 364.01(3), Florida Statutes.

The ALEC certificate which BSE seeks would permit Bell South Corporation to use BSE to effect a price squeeze for the purpose of preventing the loss of BellSouth's retail market share to new entrants. Two of the three conditions necessary to effect a price squeeze exist here, where BellSouth operates as the monopoly wholesale provider of local exchange services to new entrants and as the competitor of those new entrants at retail.

A price squeeze can occur where a firm: (1) operates at two levels of an industry and its customers at the first level are its competitors at the second level; (2) can set its price at the first level high enough, or its price at the second level low enough, so that its competitors cannot cover their costs and stay in business; and (3) has monopoly power at the first level. Town of Concord, Mass. v. Boston Edison Co., 915 F.2d 17, 18 (1st Cir. 1990). Here, BellSouth meets the first and third conditions: (1) pursuant to its Section 251(c)(4) resale obligation, BellSouth provides local exchange service at the first, wholesale level to new entrants as customers, and competes with those new entrant wholesale customers at the second, retail level, in the territory in which BellSouth is the

[9]BSE's proposal to provide a package of BellSouth's existing services outside BellSouth's nine-state territory could be accomplished by BellSouth, if BellSouth chose to compete with other ILECs (Tr. 51-52, 199).

incumbent LEC; and (3) BellSouth has monopoly power at the first, wholesale level as the sole provider of local exchange service for resale in that territory.

It is the critical and only difference between BellSouth and BSE that limits BellSouth's ability to effect a price squeeze: BellSouth's duty under Section 251(c)(4) to offer for resale at wholesale rates to new entrants, any telecommunications service that BellSouth provides at retail. The resale obligation operates to limit BellSouth's ability to effect a price squeeze against new entrants who purchase resale service. In the simplest example of the operation of this principle, if it is assumed that BellSouth offers a local exchange service to residential customers at a retail rate of $12.00 per month with a 20% wholesale discount,[10] BellSouth must offer that service for resale to new entrants at a wholesale rate of $9.60 per month, leaving a gross margin of $2.40 per residential customer within which a new entrant must cover its costs to stay in business. If BellSouth were to reduce its retail rate by ten percent, to $10.80, then its wholesale rate would be reduced to $8.64, still leaving a gross margin of $2.16. However, if BSE were to offer the same ten percent discounted rate of $10.80 to a selected market group of residential customers, the wholesale rate to new entrants would remain at $9.60 and the gross margin available to new entrants would be reduced in half, to $1.20, as to that market group of customers.

Thus if BSE is given the ALEC certificate it seeks, the mutual parent of BellSouth and BSE could engage in selective discount pricing to those customers groups or market segments which BellSouth perceives to be the most likely targets of competition by new entrants, in order to prevent

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[10]BellSouth's resale discounts in Florida of 21.83% for residential customers and 16.81% for business customers were first established in Order No. PSC-96-1579-FOF-TP, issued December 31, 1996 in Docket Nos. 960833-TP, 960846-TP, and 960916-TP, at p. 61.

the loss of BellSouth's retail market share. This would result in a market segment-by-market segment price squeeze against new entrants without reducing BellSouth's retail price across any customer class and without reducing BellSouth's wholesale price.

It is not necessary for BSE's exercise of BellSouth's monopoly power over wholesale local exchange service prices against new entrants, to be blatant in order for it to be successful in excluding competitors. "There are, however, a variety of more subtle ways in which a monopolist can exploit his power. For example ... 'limit pricing' whereby a monopolist may still make a profit but eliminate the threat or actual entry of a new competitor as the field suddenly looks less economically inviting." MCI Communications Corp. v. AT&T Co., 1982-83 Trade Cases, Par. 65-137, p. 71, 432 (7th Cir. 1983) (dissent of Wood, J.). BSE could sell local exchange service at a price which merely covers its costs, particularly if those costs do not reimburse BellSouth Corporation for advertising of the services BSE would package (Tr. 193-194) or for the use of the BellSouth brand name and logo (Tr. 41), in order to preclude competition from new entrants.[11] If the package of services was offered at a bundled price, determination of the price of the local exchange service would be required and would be complicated (Tr. 60, 66, 69-70, 153).

Section 364.337(1), Florida Statutes, does not require the Commission to give BSE the benefit of the doubt and wait to decide these issues in the context of claims of unfair competition in BSE's pricing of existing BellSouth services. There is no business purpose which BSE can accomplish that BellSouth cannot accomplish except the avoidance of BellSouth's resale obligation

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[11]Assistance to be provided by BellSouth Corporation to BSE is discussed in the documents filed with the Commission under the terms of the Protective Agreement between the parties and identified as vol. 1, pg. 409; vol. 5, pgs. 74, 101, 186; and vol. 10, pgs. 30, 76, 192, 193, 428.

under Section 251(c)(4) of the Act, and exercise of BellSouth's monopoly power over the wholesale price of local exchange service against new entrants in the emerging retail market for that service;[12] and BSE should not be certified to permit it to accomplish that anti-competitive business purpose.

In its June 8, 1998 Order rejecting BSE's application for certification as a competitive local exchange carrier in the franchised service territory of BellSouth in Kentucky, the Kentucky Public Service Commission stated that:

> the close relationship between BSE and BST does raise concerns regarding the operational separation of the entities and the resulting potential for gaining an unfair advantage. If BSE acquires services at a discount from BST and those services are delivered in the same manner as if the transaction never occurred, then it appears that overhead expenses associated with providing service incurred by a typical CLEC may never be realized by BSE. The conceptual framework for the development of competition and the incentives to operate more efficiency and reduce costs could thereby be negated by a variant of price arbitrage.

In the Matter of: Application of BellSouth BSE, Inc. for Authority to Provide Local Exchange Service, Case No. 97-417 before the Public Service Commission of the Commonwealth of Kentucky, at p. 3-4. The Kentucky Order quotes the testimony of BSE witness Robert C. Scheye "... that BSE does not 'really want to compete with BST." In rejecting BSE's contentions that the alleged potential for anti-competitive behavior was only conjecture, that there were adequate remedies in

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[12]Implications of BSE's certification on BellSouth's obligations under the Act are discussed in the documents filed with the Commission under the terms of the Protective Agreement between the parties and identified as vol. 9, pgs. 42, 43, 44.

place to deal with anti-competitive behavior if it occurred, and that it would be economically irrational for BSE to operate in a less than profitable manner,[13] the Kentucky Commission noted that:

> The latter argument, however, does not take into account the ultimate benefit to BellSouth of eliminating competitors from the local market; and while it is true that anti-competitive behavior of the nature predicted by the intervenors has not yet occurred, the Commission finds that the potential for such behavior would be greatly exacerbated by granting BSE the authority it seeks. Further, although remedies for violation of federal law do, of course, exist, this Commission does not routinely oversee the business activities of CLECs for the very reason that they do not possess the market power of an ILEC such as BellSouth.

Ibid., at p.5-6.

The Kentucky Commission thus concluded that its public interest determination required consideration of anti-competitive effects, citing Denver & Rio Grande W.R.R. v. United States, 387 U.S. 485, 492 (1967) and FCC v. RCA Communications, Inc., 346 U.S. 86, 94 (1953), and that these were grave public interest concerns which justified rejection of BSE's application to provide local exchange services in the territory served by BellSouth as the incumbent LEC.[14]

Section 364.335, Florida Statutes, sets forth requirements of each applicant for a certificate of necessity to provide telecommunications services, which necessarily includes applicants for certification as an alternative local exchange carrier. Section 364.335(3), Florida Statutes, provides that: "The commission may grant a certificate, in whole or in part or with modifications in the public interest...." The public interest considerations relevant to BSE's application include those stated in

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[13]This argument was advanced by Mr. Scheye at the hearing in this proceeding (Tr. 215, 216, 228).

[14]Similar applications by CLEC affiliates of incumbent LECs have been rejected or withdrawn in Texas, Michigan and California (Tr. 74, 169).

Section 364.01, Florida Statutes, and the Commission's consideration of BSE's application in this regard is not foreclosed by the terms of Section 364.337(1), Florida Statutes.

In Section 364.01, Florida Statutes, the Legislature found "... that the transition from the monopoly provision of local exchange service to the competitive provision thereof will require appropriate regulatory oversight to protect consumers and provide for the development of fair and effective competition...." The statute therefore authorizes the Commission to exercise its exclusive jurisdiction in order to: "Promote competition by encouraging new entrants into telecommunications markets and by allowing a transitional period in which new entrants are subject to a lesser level of regulatory oversight than local exchange telecommunications companies;" and to "Ensure that all providers of telecommunications services are treated fairly, by preventing anticompetitive behavior...." Section 364.01(4)(d) and (g), Florida Statutes. BSE is a new entrant in name only, and the form by which its parent BellSouth Corporation seeks to do business is the antithesis of the substance of the competition intended by the 1996 Act and the 1995 amendments to Chapter 364, Florida Statutes, to act as a substitute for regulation. Consequently, certification of BSE as an ALEC in the territory served by BellSouth as the incumbent LEC should be denied as not being in the public interest.

Issue 2: **In light of the provisions of the Telecommunications Act of 1996 and Chapter 364, Florida Statutes, if the Commission grants BellSouth BSE a certificate to provide alternative local exchange service in the territory served by BellSouth Telecommunications, Inc. as the incumbent LEC, what conditions or modifications, if any, should the Commission impose?**

*If the Commission grants BellSouth BSE a certificate to provide alternative local exchange service in the territory served by BellSouth Telecommunications as the incumbent LEC, then the

Commission should impose four conditions on the certificate: (1) the duty under Section 251(c)(4) to offer for resale at wholesale rates, the local service that BellSouth BSE provides at retail to its customers in that territory, including the provision of such service under Contract Service Arrangements; (2) the duty under Section 251(b)(3) to provide nondiscriminatory access to network elements on an unbundled basis; (3) the duty to provide information, in the form of monthly reports, regarding the service quality BSE receives from BellSouth; and (4) that BSE utilize the same OSS systems available to ALECs. Additionally, BellSouth Telecommunications performance of its duty under Section 252(c)(2)(c) of the Act, should be reported separately for BellSouth BSE.*

If the Commission approves BSE's application for an ALEC certificate for the territory served by BellSouth as the incumbent LEC, then the certificate should include modifications in the public interest under Section 364.335(d)(3) to limit the exercise of BellSouth's monopoly power over the wholesale price of local exchange service, for the reasons stated in the preceding argument.

Although its position is not fully developed in the record, BellSouth and its parent corporation may believe that packaging services to offer customers "one stop shopping" lowers marketing costs, raises customer loyalty, reduces churn levels, and increases overall usage in business and residential markets alike (Tr. 54, 60, 66). BellSouth and its parent corporation may anticipate using this marketing strategy when a BellSouth subsidiary is certificated to provide interexchange service, and may contend that the least profitable piece of the package is basic local service and consequently that only incumbents have a clear incentive to sell the entire package once they are permitted to do so. Of course, BellSouth is not currently prohibited from packaging its existing services, with or without BSE (Tr. 52).

However, if BSE is the vehicle by which BellSouth and its parent corporation choose to provide packaged services, that marketing strategy need not depend for its success on the ability to avoid BellSouth's resale obligation under Section 251(c)(4) for local exchange service.

BSE contends in this proceeding that its certification as an ALEC will help encourage the development of competition as a secondary benefit of BSE's use of BellSouth's operational support systems (Tr. 55-56, 141, 199-200). Although this would seem to suggest that BellSouth will develop its operational support systems when it can benefit itself despite its obligations under the Act, again this marketing strategy need not depend for its success on BSE's ability to avoid BellSouth's resale obligation under Section 251(c)(4). Similarly, BellSouth should be required to report separately as to BSE, concerning the service quality of the facilities and equipment provided under Section 252(c)(2)(c) of the Act.

BSE intends to enter into contract service arrangements with at least some of its potential customers, such as large customers in multiple states (Tr. 45-46). The certificate which BSE seeks also would permit BSE to avoid BellSouth's resale obligation under Section 251(c)(4) with respect to contract service arrangements (Tr. 48-49), and to avoid BellSouth's obligation to file contract service arrangements with the Commission (Tr. 119, 153). Consequently, if the Commission approves BSE's application for an ALEC certificate in BellSouth's territory, the modifications to the certificate should specify that BSE's resale obligation under Section 251(c)(4) extends to local exchange service provided by BSE, including contract service agreements, which BSE must file with the Commission.

BSE proposes to initially provide local exchange service by resale, and to move to provision of local exchange service with unbundled network elements when it becomes economical to do so

(Tr. 58). For the same reason that BSE should not be given a certificate which would permit it to avoid BellSouth's resale obligation under Section 251(c)(3), if the Commission grants BSE a certificate to provide local exchange service in the territory in which BellSouth is the incumbent LEC, then the certificate also should not permit BSE to avoid BellSouth's obligation under Section 251(c)(3) to provide nondiscriminatory access to network elements on an unbundled basis to any requesting telecommunications carrier.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the Teleport Communications Group Inc./TCG South Florida's Posthearing Brief was furnished by U. S. Mail to the following this 15th day of June, 1998:

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