



Rebecca B. DeCook
Senior Attorney

Room 1575
1875 Lawrence Street
Denver, CO 80202
303 298-6357

November 5, 2002

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65101

FILED³
NOV 05 2002

Missouri Public
Service Commission

Re: Case No. TT-2003-0043

Dear Judge Roberts:

Attached for filing with the Commission is the original and eight (8) copies of Proprietary Testimony and the original and eight (8) copies of Non-Proprietary Testimony for the above referenced case

I thank you in advance for your cooperation in bringing this to the attention of the Commission.

Very truly yours,

Rebecca B. DeCook

Attachment

cc: All Parties of Record

Exhibit No.
Issues: Spectra Tariffs
Witness: R. Matthew Kohly
Sponsoring Part: AT&T Communications of the
Southwest, Inc.
Type of Exhibit: Rebuttal Testimony
Case No.: TT-2002-0043

AT&T COMMUNICATIONS OF THE SOUTHWEST, INC.

REBUTTAL TESTIMONY

OF

R. MATTHEW KOHLY

CASE NO. TT-2003-0043

FILED³

NOV 05 2002

**Missouri Public
Service Commission**

November 5, 2002

Non-Proprietary

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Tariff of Spectra Communications)
Group, LLC, PSC MO. NO. 2, Facilities for Intrastate)
Access)

Case No. TT-2003-43

AFFIDAVIT OF R. MATTHEW KOHLY

STATE OF MISSOURI)

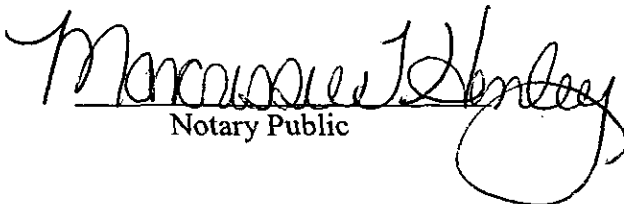
COUNTY OF COLE)

I, R. Matthew Kohly, of lawful age, being first duly sworn deposes and states:

1. My name is R. Matthew Kohly. I am the District Manager for AT&T Communications of the Southwest, Inc. in its Law and Government Affairs organization.
2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony.
3. I hereby swear and affirm that my answers contained in the attached document to the questions therein propounded are true and correct to the best of my knowledge and belief.

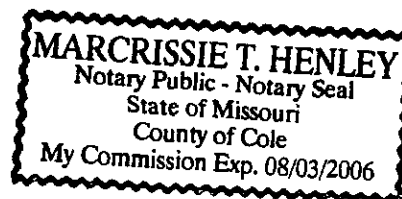

R. Matthew Kohly

Subscribed and sworn to this 5th Day of November, 2002


Notary Public

My Commission Expires:

8-3-2006



**BEFORE THE STATE OF MISSOURI
PUBLIC SERVICE COMMISSION
DOCKET TT-2003-0043**

1 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

2 A. My name is R. Matthew Kohly. My business address is 101 West McCarty Street,
3 Jefferson City, Missouri 65101.

4
5 **Q. BY WHOM ARE YOU EMPLOYED AND WHAT ARE YOUR
6 RESPONSIBILITIES?**

7 A. I am employed by AT&T Corporation in its Law and Government Affairs organization
8 as District Manager – Government Affairs. In this position I am responsible for the
9 development and implementation of AT&T's and its affiliates' regulatory policy and
10 activities in Missouri.

11
12 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

13 A. I have completed a Master of Science in Agricultural Economics from the University of
14 Missouri – Columbia, as well as a Bachelor of Science in Business Administration also
15 from the University of Missouri – Columbia.

16
17 **Q. WHAT IS YOUR PRIOR WORK EXPERIENCE?**

18 A. Prior to joining AT&T, I was employed by Sprint Communications Company, L.P. as a
19 Manager, State Regulatory Affairs. My responsibilities included the development of
20 Sprint's regulatory policy focusing on issues surrounding competitive market entry, such
21 as TELRIC costing of unbundled network elements, universal service, access charges,
22 and Section 271 proceedings.

Before that, I was employed at the Missouri Public Service Commission as a Regulatory Economist in the Telecommunications Department and, later, on the Commission's Advisory Staff. While in the Telecommunications Department, I assisted in developing Staff's position on issues related to costing, local interconnection and resale, universal service and tariff issues. While serving on the Advisory Staff, I advised the Commission on economic and competitive issues in the telecommunications industry and assisted in the preparation of orders and opinions. Also, while employed at the Commission, I participated on the Commission's Arbitration Advisory Staff assigned to mediation and arbitration proceedings filed pursuant to the 1996 Federal Telecommunications Act.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE STATE PUBLIC UTILITIES COMMISSIONS?

A. Yes. I have filed written testimony and/or testified before the Missouri Public Service Commission, Montana Public Service Commission, Oklahoma Corporation Commission and the Telecommunications Regulatory Board of Puerto Rico.

Q. CAN YOU DESCRIBE THE COMPANY YOU ARE REPRESENTING?

A. I am representing AT&T Communications of the Southwest, Inc ("AT&T"). AT&T operates as both an interexchange carrier throughout Missouri and as a local exchange carrier in portions of Missouri. AT&T purchases both originating and terminating access services in both the intrastate and interstate jurisdictions from Spectra Communications Group, L.L.C. ("Spectra").

Q. CAN YOU PLEASE DESCRIBE WHAT YOU KNOW ABOUT SPECTRA?

1 A. Yes. Spectra is a Delaware limited liability corporation authorized to do business in the
2 state of Missouri. Spectra purchased the exchanges that it now serves from GTE
3 Midwest, Inc.¹ That transaction was approved on April 14, 2000. To pay for that
4 purchase, Spectra borrowed the funds from CenturyTel, Inc. According to Spectra's
5 2001 Annual Report, CenturyTel, Inc. owns 75.65492% of Spectra and Spectra's balance
6 sheet lists a long-term debt obligation in the form of an advance from affiliates of
7 \$268,308,798. The latter appears to be an advance from CenturyTel. In 2001, Spectra
8 paid approximately \$22 million in interest to its affiliates. On March 28, 2001, Spectra
9 was granted permission to operate under the CenturyTel name.²

10
11 **Q. DOES BEING ORGANIZED AS AN L.L.C. HAVE ANY IMPACT ON THIS**
12 **PROCEEDING?**

13 A. Yes. Among other things, the owners of the L.L.C. are protected from liability in the
14 event the L.L.C. defaults on its financial obligations. Thus, if Spectra is unable to refund
15 any held deposits, the entity posting the deposit would have no recourse beyond Spectra
16 to recover those funds.

17
18 **Q. PLEASE DESCRIBE SPECTRA'S EXISTING TARIFFS AND THE PROPOSED**
19 **TARIFF REVISIONS THAT ARE AT ISSUE IN THIS PROCEEDING**

20 A. Under Spectra's existing tariffs, Spectra may collect a deposit from new access
21 customers that do not have established credit or from existing customers that have a
22 proven history of late payments. The amount of the deposit is limited to the estimated or

¹ Case No. TM-2000-182, *In the Matter of Joint Application of GTE Midwest Incorporated and Spectra Communications Group L.L.C. for authority to transfer part of GTE's franchise, facilities or system to Spectra; and authority for Spectra to borrow an amount not to exceed \$250,000,000.*

² Case No. TO-2001-437, *In the Matter of the Request of Spectra Communications Group, LLC, d/b/a CenturyTel, for recognition of the use of the fictitious name 'CenturyTel.'*

1 actual charges for two months of access service. Deposits will be refunded upon a
2 customer terminating service with Spectra or after the customer has established a one-
3 year prompt payment record.

4
5 Spectra's proposed tariff revisions alter those terms by permitting Spectra to also collect
6 a deposit from existing access customers whose credit rating drops below commercially
7 acceptable standards as defined by Spectra, regardless of past payment history. Deposits
8 collected under this additional provision will be refunded when the access customer's
9 credit rating returns to "commercially acceptable levels" and that customer has
10 established a one-year prompt payment record. This proposed tariff would also permit
11 Spectra to revise the amount of the deposit collected in the event a customer's gross
12 monthly billing increases beyond the amount originally used by Spectra to estimate the
13 amount of the deposit.

14
15 **Q. CAN YOU PLEASE STATE AT&T'S CONCERNS WITH SPECTRA'S**
16 **PROPOSED TARIFF REVISIONS?**

17 **A.** Spectra's proposed tariff revisions seek to modify the conditions under which Spectra
18 may require a deposit from its access customers. AT&T's overarching concern with the
19 proposed modification is that it would permit Spectra to require an existing access
20 customer to post a cash deposit based upon Spectra becoming aware of that access
21 customer's credit rating dropping below BBB (or equivalent rating) as reported by
22 Standard and Poor's or other nationally recognized rating agency.

23
24 ~~AT&T urges the Commission to reject the proposed tariff revisions in their entirety~~
25 because Spectra has not established that they are necessary, as demonstrated by the lack

1 of evidence or analysis set forth by Spectra to support them. Spectra has failed to prove
2 that the proposed revisions are needed to prevent significant harm. In addition, the
3 proposed revisions do not assess deposits on the companies that are most likely to default
4 on their access payments, they are unjust and unreasonable, they are anticompetitive and
5 discriminatory, and they are inconsistent with sound public policy. In addition, Spectra's
6 financial position and its management of its uncollectible risk should be considered in
7 determining whether it is really the access/telecommunications market or Spectra's own
8 financial structure and its business practices that is responsible for Spectra's situation.

9
10 In his direct testimony, Spectra's witness Arthur Martinez makes the statement that "[i]t
11 is contrary to the public interest to disadvantage those customers who pay in a timely
12 manner, only to advantage those customers, including long distance interexchange
13 carriers, that are chronically late in paying or have defaulted on their obligations."³ This
14 principal should guide the Commission as it considers the proposed tariff. Spectra's
15 proposed tariff revisions violate this principal because they would impose deposit
16 requirements on carrier's with a proven payment history, but not on carriers that have
17 defaulted on their obligations.

18
19 **Q. BEFORE ADDRESSING AT&T'S SPECIFIC CONCERNS, DO SPECTRA'S**
20 **PROPOSED TARIFF REVISIONS REPRESENT A SIGNIFICANT DEPARTURE**
21 **FROM THE CURRENT ACCESS DEPOSIT POLICY?**

22 A. Yes. The Commission should recognize that Spectra's proposed tariff revisions
23 represent a significant departure from the current deposit policy reflected in Spectra's
24 access tariff and, therefore, warrants very careful consideration and a heightened

³ Direct Testimony of Arthur P. Martinez, p. 3.

1 showing of necessity. If permitted, Spectra's proposed tariff revisions could result in
2 significant amounts of capital to be shifted from access customers to access providers.

3
4 These same or similar tariff revisions have been proposed by numerous ILECs at the
5 interstate level and will likely be mirrored by most ILECs in Missouri. It is entirely
6 possible that multiple deposit requirements could be demanded from IXCs across the
7 country at the same time. For example, because of their affiliate relationships, it seems
8 logical to believe that CenturyTel of Missouri and CenturyTel of Northwest Arkansas,
9 L.L.C. will also file similar tariffs if Spectra's proposed tariff is approved. In addition,
10 at the recent on-the-record presentation in Case No. TW-2003-0063, Counsel for
11 Southwestern Bell Telephone Company took the opportunity to urge the Commission
12 to permit increased deposits and announced that other LECs would be filing tariffs
13 similar to those filed by Spectra.⁴ The financial and administrative burden of such an
14 event would be enough to cause a strain on even a healthy company and could become
15 self-fulfilling prophecy that causes carriers to be forced into a bankruptcy that might
16 otherwise have been avoided. The financial and administrative consequences of
17 expanding the existing deposit policy would occur at a most inopportune time for
18 interexchange carriers and would only exacerbate the turmoil in the telecommunications
19 market.

20
21 Historically, Spectra has been limited to obtaining a security deposit from carriers that
22 have a history of late payments or missed payments or, at installation, have no payment
23 history at all (at least until a sufficient history of on-time payment has been established).
24 Under current tariffs, Spectra may request a security deposit from an established

⁴ Case No. TW-2003-0063, *In the Matter of an Investigation into the Effects of the Bankruptcy of*

1 customer only when there has been direct evidence that the carrier has been unable to
2 meet its financial obligations to Spectra itself. The result of this policy has been that the
3 group of carriers subject to Spectra's security deposit requirements has been very small.
4 This narrow scope of applicability strikes an appropriate balance between protecting
5 Spectra from foreseeable financial risk and limiting the ability of Spectra to impose
6 unfair standards that might have anticompetitive effects in the market.

7
8 Spectra's proposed security deposit requirements would fundamentally change the
9 current policy, however, and would significantly expand the number of carriers
10 potentially subject to the security deposit requirements. Spectra's proposed tariff
11 revision, if implemented, would turn current security deposit policy on its head by
12 imposing requirements based on factors unrelated to the financial relationship between
13 Spectra and its access customers. Under the proposed tariff revision, a security deposit
14 would no longer be imposed only on an IXC that had demonstrated its financial
15 unreliability as to Spectra; rather, a responsible IXC that had never missed a payment
16 and had never made a late payment to Spectra could be required to submit a security
17 deposit to Spectra based solely on an assessment of creditworthiness.

18
19 **Q. WHAT HAS THE FCC SAID ABOUT THIS DEPOSIT ISSUE IN THE PAST?**

20 A. In 1984, in response to LEC proposals that were strikingly similar to the revisions
21 proposed by Spectra, the Federal Communications Commission ("FCC") established its
22 original prescription of a narrow security deposit requirement.⁵ The FCC found "several
23 flaws" in the LECs' proposed tariff on security deposits, including the fact that it applied

Telecommunications Carriers in the State of Missouri, Transcript of October 9, 2000 proceeding, p. 44.

⁵ See *Investigation of Access and Divestiture Related Tariffs*, 97 F.C.C.2d 1082, 1168-70 (1984) ("1984 FCC Access Tariff Order").

1 so broadly that "only AT[&T]" - the recent affiliate of the BOCs - "will escape this
2 deposit requirement."⁶ Because the proposals applied so generally and could be
3 applied selectively to carriers chosen unilaterally by the LEC, the FCC found that the
4 LECs' proposed tariffs were "unreasonably onerous" in scope and had "anticompetitive
5 effects."⁷ Accordingly, the FCC determined that those proposed tariffs "*must* be
6 amended" and prescribed the more narrow language limiting security deposits to
7 carriers with a "proven history of late payments" or with "no established credit."⁸
8 Instead, the FCC struck an appropriate balance by allowing LECs to require security
9 deposits, but only for certain IXC with either poor payment histories or with no
10 established credit.

11
12 ILECs have repeatedly attempted in a variety of contexts to expand their ability to
13 demand significant security deposits from other carriers. In each instance, the FCC
14 has refused to allow these dominant LECs the broad discretion to determine whether
15 their captive IXC customers must provide a security deposit prior to purchasing access
16 services. In 1987, for example, BellSouth sought to revise its tariff to increase - by 50
17 percent - the deposit that affected IXCs were required to pay BellSouth.⁹ BellSouth
18 had claimed that such provisions were necessary because "some IXCs have filed for
19 bankruptcy while owing payments to BellSouth."¹⁰ The FCC, however, rejected the
20 proposed tariff revisions, noting that "BellSouth does not adequately identify the need"
21 for its proposed increase and "has not explained why other available measures have

⁶ *Id.* at 1169.

⁷ *Id.*

⁸ *Id.*

⁹ See *Annual 1987 Access Tariff Filing*, 2 FCC Rcd. 280, 317-18 (1987).

¹⁰ *Id.*

1 been unavailing to avoid the risks" of non-payment.¹¹ Further, the FCC again found
2 that the proposal to increase the security deposit was overbroad, and that any
3 advantages to be gained by BellSouth were "outweighed by the disadvantages to
4 *customers that may not pose a risk to BellSouth.*"¹²

5
6 In short, the FCC has, for nearly two decades, prescribed and enforced the specific
7 language that LECs must use in their tariffs when demanding a security deposit.
8 States have generally followed this prescription. The current Spectra tariffs contain
9 this longstanding, prescribed language that allows Spectra to collect security deposits
10 from customers with a poor payment history or with no established credit. These
11 provisions have protected LECs, including Spectra and its predecessors in both good
12 and bad economic times, and they are more than sufficient today. Spectra's tariff
13 revisions are at odds with this very persuasive body of federal precedent and the
14 underlying rationale.

15
16 **Q. IS THE FCC CURRENTLY CONSIDERING SIMILAR ISSUES?**

17 **A.** Yes. The Commission should be aware that the FCC is currently considering similar
18 interstate access tariff revisions filed by local exchange companies. The FCC has
19 recently indicated that it will require detailed quantifiable evidence from carriers trying
20 to impose more stringent security deposit requirements in interstate tariffs.¹³ Indeed,
21 with regard to the security deposit proposals filed by BellSouth and Iowa Telecom, the
22 Commission has issued an order in each proceeding announcing numerous issues for

¹¹ *Id.* at 318.

¹² *Id.* (emphasis added).

¹³ See, e.g., Order, DA 02-2318, pp. 5-7; Order, DA 02-2317, pp. 4-6.

1 investigation.¹⁴ Among those issues, the FCC called for BellSouth and Iowa Telecom to
2 each explain why it is not currently protected against the risk of uncollectibles and
3 directed BellSouth and Iowa Telecom to each submit a daunting list of data and analysis.
4 Should the Commission consider the issue of increased security deposits, its review will
5 only be aided and enhanced, in all respects, by the FCC's review.

6
7 The FCC is clearly requiring BellSouth and Iowa Telecom to make a comprehensive and
8 detailed showing of potential harm. It is also requiring these carriers to demonstrate with
9 hard evidence that there is a nexus between the potential financial harm and the current
10 security deposit requirements that would justify the requested tariff modifications. This
11 Commission should expect no less of a showing from Spectra here.

12
13 Imposing significantly different security deposit requirements at the state level will
14 create an undue burdens on carriers that provide services nation-wide. As a result, any
15 deposit implemented at the state level will have an effect on interstate switched access
16 and vice versa. For this reason, the Commission should reject the tariff revisions
17 proposed by Spectra until the FCC makes a decision at the interstate level and this
18 Commission has an opportunity to review and consider the findings and conclusions
19 reached by the FCC.

20
21 **Q. CAN YOU EXPLAIN THE NATURE OF ACCESS SERVICES AND HOW THAT**
22 **IS RELEVANT TO THIS CASE?**

23 **A.** Access services are monopoly services. Spectra's access services, as well as its local
24 services, are all non-competitive services. Even in the case of competitive companies,

¹⁴ *Id.*

1 this Commission has recognized that switched access represents a “locational monopoly”
2 where the access customer is a captive customer.¹⁵ Providers of monopoly services have
3 every incentive to exploit their monopoly status in the rates, terms and conditions they
4 establish for access service. In fact, as this Commission is well aware, the margins
5 Spectra and other Missouri LECs enjoy on access services are wildly excessive. Thus,
6 while Spectra is correct that access reform is needed, the Commission should focus on
7 reducing the LECs monopoly abuses in the rates they charge, not on increasing their
8 discretion and ability to obtain more revenues from captive customers. If an access
9 customer is required to post a deposit, the only choice that carrier has is to pay the
10 deposit, have its service terminated by Spectra altogether, or cease purchasing access
11 services in these exchanges as there are no alternative suppliers (thereby ceasing to
12 terminate calls to customers in these exchanges). Ironically, if Spectra’s proposed
13 tariffs caused access customers to exit the market, Spectra’s overall risk may actually
14 increase as its access customer base becomes more consolidated among fewer carriers.

15
16 Because Spectra retains this monopoly power, it retains the incentive and the ability to
17 impose unfair and discriminatory terms and conditions, such as this security deposit
18 proposal. It is this monopoly power that the FCC sought to check in the prescriptive
19 deposit limits it has maintained since 1984.

20
21 **Q. CAN YOU QUANTIFY HOW THE PROPOSED TARIFF REVISIONS MIGHT**
22 **IMPACT AT&T?**

23 **A. AT&T is currently rated a BBB by Standard & Poor’s. While AT&T may not be**
24 **impacted immediately by Spectra’s proposed tariffs, it is right at the bogie point for**

¹⁵ Case No. TO-99-596, *In the Matter of the Access Rates to be Charges by Competitive Local Exchange*

1 being assessed a deposit. AT&T is very concerned about the impact of the proposed
2 tariff revisions in the event AT&T's bond rating is lowered. If AT&T were required to
3 post a deposit under the proposed tariff revisions, AT&T would be required to give
4 Spectra over ** ____ ** for its intrastate access services, immediately upon a request
5 from Spectra. If other LECs in Missouri filed similar tariffs, AT&T could be required to
6 post a deposit over ** ____ ** for the intrastate access services it currently obtains from
7 those LECs. Such a deposit requirement would deprive AT&T of significant amounts of
8 capital – capital that could otherwise be used for new investment or the provision of new
9 technology or services -- at a time when that capital is scarce.

10
11 **I. SPECTRA HAS NOT ESTABLISHED A NEED FOR NEW DEPOSIT CRITERIA.**

12
13
14 **Q. HAS SPECTRA DEMONSTRATED THAT THERE IS A NEED FOR THE**
15 **ADDITIONAL DEPOSIT PROVISIONS?**

16
17 **A.** No. At a minimum, Spectra should be required to quantify its intrastate uncollectibles
18 and explain whether its existing rates adequately compensate Spectra for the risk of
19 uncollectibles. As Spectra seems to assert their existing rates do not provide adequate
20 compensation, Spectra should address why it believes those rates do not provide
21 adequate compensation. Spectra should also be required to demonstrate that any
22 increase in the level of uncollectibles is a long-term structural event affecting the
23 telecommunications market that necessitates changing the future policy for collecting
24 deposits from current access customers. In addition, Spectra should be required to
25 demonstrate that the existing longstanding deposit provisions do not adequately protect
26 Spectra. Spectra has made none of these showings.

1 **Q. HAS SPECTRA ADEQUATELY QUANTIFIED THE PAST AMOUNT OF**
2 **INTRASTATE UNCOLLECTIBLE ACCESS CHARGES INCURRED BY**
3 **SPECTRA?**

4 **A. No. Spectra has not demonstrated that it is experiencing a significant and sustained**
5 **increase in uncollectible expense. Spectra must do so before this Commission should**
6 **consider the radical and unsubstantiated shift in deposit policy that Spectra seeks. As the**
7 **sole basis for Spectra's request, Mr. Martinez asserts that the total pre-petition balance**
8 **owed to Spectra by all bankrupt carriers is approximately \$4.7 million.¹⁶ However, Mr.**
9 **Martinez does not state whether this amount is limited to intrastate access uncollectibles**
10 **or whether that amount includes uncollectibles associated with interstate access services**
11 **or other services in addition to intrastate access services. Mr. Martinez does not show**
12 **whether or how Spectra's uncollectible expense has grown over time or whether it is the**
13 **result of unique one-time events or normal business cycle fluctuations, rather than any**
14 **long-term trend that substantially increases the future risk of nonpayment. Additionally,**
15 **in bankruptcy situations, creditors have the opportunity to negotiate with the company**
16 **seeking bankruptcy protection and the bankruptcy court to recover some or all of the**
17 **amounts owed. Spectra's direct case has not addressed any of these issues. Thus, the**
18 **Commission has no evidence concerning the actual amount of uncollectible intrastate**
19 **access expense Spectra will actually incur.**

20
21 **Q. HAS SPECTRA DEMONSTRATED THAT ITS CURRENTS RATES DO NOT**
22 **ADEQUATELY COMPENSATE SPECTRA FOR THE RISK OF**
23 **UNCOLLECTIBLE ACCESS EXPENSES OR THAT SPECTRA'S ABILITY TO**

¹⁶ Martinez Direct, p. 8.

1 **PROVIDE SAFE AND ADEQUATE SERVICE IS IN JEOPARDY AS A RESULT**
2 **OF ITS UNCOLLECTIBLE SWITCHED ACCESS EXPENSE?**

3 A. No. Mr. Martinez asserts that "Spectra's ability to provide safe and adequate service is
4 highly dependent on its revenue stream" and "the potential for an increasing level of
5 uncollectibles from access service customers could only adversely affect the service it
6 provides and the rates of those customers who pay their statements in a timely fashion."¹⁷
7 However, these are simply unsupported statements. Mr. Martinez has not presented any
8 evidence regarding Spectra's overall earnings or rate of return that purports to
9 demonstrate that Spectra is not currently adequately compensated by its existing rates.
10 Mr. Martinez has also not presented any evidence that Spectra is not currently or is not
11 likely to earn a sufficient rate of return to be able to provide safe and adequate service.

12
13 It is my understanding that Spectra is currently regulated under rate of return regulation.
14 If Spectra's ability to provide safe and adequate service were at risk because of earnings
15 deficiencies, the prudent action for Spectra would be to request an earnings review to
16 seek rate increases. However, Spectra has taken the opposite path and notified the
17 Commission that it has elected price cap regulation.¹⁸ Under price cap regulation,
18 Spectra's rates will be set at the rates currently in effect on December 31, 2001,
19 (assuming Spectra's election is affirmed or granted this year). The fact that Spectra has
20 elected to "lock-in" its existing rates certainly implies that it is currently earning an
21 adequate return and there is no real risk to Spectra's ability to provide safe and adequate
22 service.

¹⁷ Martinez Direct, p. 3.

¹⁸ Case No. IO-2003-0132, *In the Matter of the Petition of Spectra Communications Group, LLC. d/b/a CenturyTel Regarding Price Cap Regulation under Section 392.245, RSMo 2000.*

1 **Q. IN ADDITION TO DEMONSTRATING AN OVERALL FINANCIAL NEED,**
2 **WHAT ELSE MUST SPECTRA DEMONSTRATE?**

3 A. Spectra must also demonstrate that any supposed financial weakness that affects its
4 ability to provide safe and adequate service is a direct result of losses due to
5 uncollectible access expense. Like all earnings issues, the Commission must consider
6 all relevant factors and not focus on a single rate or a single expense in isolation. That
7 cannot be done without a comprehensive review of all relevant factors; including but
8 certainly not limited to the current state of the overall economy, as well as Spectra's
9 capital structure.

10

11 **Q. HOW IS SPECTRA'S FINANCIAL STRUCTURE RELEVANT?**

12 A. At the time Spectra completed the acquisition of the former GTE exchanges, the Staff
13 expressed reservations about the level of debt used to finance the purchase. To alleviate
14 those concerns, Spectra agreed to several conditions. One of those conditions agreement
15 from Spectra "not seek to recover in rates an increased overall cost of capital nor an
16 increase to any component of cost of capital due to risk factors stemming from a low
17 common equity ratio or other capital risk issues. Potential capital structure risk
18 includes, but are not limited to, a high level of leverage in the capital structure and an
19 increased cost of debt due to a high level of leverage and/or an increased rate of return
20 on common equity due to a low common equity ratio."¹⁹ If Spectra is able to present
21 any evidence that its ability to provide safe and adequate service is in jeopardy, the
22 Commission must first determine whether that risk is a result of other issues, such as
23 Spectra's capital structure or even the health of the overall economy. If a company with

¹⁹ Case No. TM-2000-182, *In the Matter of Joint Application of GTE Midwest Incorporated and Spectra Communications Group LLC for authority to transfer part of GTE's franchise, facilities or system to Spectra; and authority for Spectra to borrow an amount not to exceed \$250,000,000*, Joint Recommendation, p. 4, January 26,

1 a stronger capital structure is able to withstand a temporary increase in uncollectibles
2 than Spectra because of more equity in the financial structure, Spectra has already
3 conceded the right to seek additional money through rates; which would include
4 increased deposits from existing customers.

5
6 **Q. DID AT&T ATTEMPT TO ANALYZE SPECTRA'S FINANCIAL POSITION TO**
7 **DETERMINE THE IMPACT OF UNCOLLECTIBLES ON SPECTRA'S**
8 **ABILITY TO PROVIDE SAFE AND ADEQUATE SERVICE?**

9 A. Yes. AT&T served data requests upon Spectra seeking copies of each Regulated Utility
10 Earnings Surveillance Report filed with the Missouri Public Service Commission Staff
11 since Spectra began providing basic local service in Missouri. The Staff of the Missouri
12 Public Service Commission can use these reports to monitor the earnings of local
13 exchange carriers to ensure they are able to meet their carrier of last resort obligations
14 and to determine if their earnings levels warrant an earnings investigation. In its
15 acquisition of the exchanges Spectra now serves, Spectra agreed to file earning
16 surveillance reports to alleviate Staff's concerns about Spectra's excessive reliance upon
17 debt to finance the transaction.²⁰ In its response to AT&T's data requests seeking those
18 reports, Spectra stated, "The Surveillance Reports previously provided to the
19 Commission by Spectra were found to contain errors. These reports are currently being
20 revised."²¹ As Spectra is apparently in the process of restating its financial reports,
21 Spectra has not provided these reports to AT&T as of the date of the filing of this
22 testimony. This information is critical in order to understand the status of Spectra's
23 current financial condition to determine if there is a true need for additional deposits.

2000.

²⁰ *Id.*

²¹ See Schedule RMK-1 – Spectra's Response to AT&T Data Request No. 2

1 This information should be produced by Spectra and reviewed by the parties and the
2 Commission as part of this proceeding.

3
4 **Q. HAS SPECTRA DEMONSTRATED THAT IT WILL INCUR THE SAME LEVEL**
5 **OF SWITCHED ACCESS UNCOLLECTIBLES IN THE FUTURE AS IT MAY**
6 **HAVE RECENTLY INCURRED?**

7 A. No. Spectra has not demonstrated that any recent increase in uncollectible revenues is a
8 long-term phenomena that warrants changing future policy. The basis used by Spectra to
9 justify the proposed tariffs is the past losses Spectra incurred as a result of the
10 bankruptcies of WorldCom and Global Crossing. These bankruptcies are events that
11 have already occurred and future deposits collected from other carriers will not change
12 that. Deposits were never intended to be revenue source to cover any past losses or to
13 pay current operating expense for the deposit collector. Deposits are designed to
14 mitigate future risk of default by specific customers. Before ongoing policy is changed,
15 Spectra should clearly demonstrate that future conditions warrant such a change. Spectra
16 has not made such a demonstration in its direct case.

17
18 Additionally, as Mr. Martinez admits, the proposed tariff language will not affect
19 WorldCom and Global Crossing as long as those carriers are under the jurisdiction of the
20 bankruptcy court.²² Not only will the losses Spectra has incurred not be recovered
21 through the proposed deposit provision, but the companies that caused these losses will
22 not even be impacted by the proposed deposit provisions as long as they are in
23 bankruptcy. This creates an outcome that even Mr. Martinez concludes is contrary to the
24 public interest as it "disadvantages those customers who pay in a timely manner, only to

²² Martinez Direct, p. 8.

1 advantage those customers, including long distance interexchange carriers, that are
2 chronically late in paying or have defaulted on their obligations.”²³

3
4 **Q. HAS SPECTRA DEMONSTRATED THAT THE EXISTING DEPOSIT**
5 **PROVISIONS DO NOT ADEQUATELY PROTECT SPECTRA?**

6 A. No. Spectra has not demonstrated that the current deposit requirements, if employed,
7 would not have adequately protected Spectra. Spectra has offered no explanation as to
8 why the current deposit requirements are not sufficient. It appears that Spectra, for its
9 own business reasons, chose not to invoke the current deposit measure to protect its
10 interests. If the current deposit measures had been invoked, Spectra could have
11 minimized its risk and limited the size of the uncollectibles it now claims it faces.

12
13 **Q. HAS SPECTRA DEMONSTRATED THAT THE NEW DEPOSIT REQUIREMENT**
14 **IS ANY MORE LIKELY TO PROTECT SPECTRA?**

15 A. Spectra has not demonstrated that circumstances have changed in a way that justify any
16 revisions at all to the longstanding tariff prescription on security deposits. Spectra’s
17 direct case on this fundamental issue is nonexistent. As Mr. Martinez concedes,
18 Spectra’s proposed revisions have been prompted by the WorldCom and Global Crossing
19 bankruptcies and the highly publicized accounting scandals that triggered these
20 bankruptcies.²⁴ Mr. Martinez suggests that these bankruptcies demonstrate the increased
21 risk that Spectra is exposed to and justify the imposition of additional security deposits
22 on IXCs.²⁵ Mr. Martinez’s assertion is flawed for numerous reasons.

23 Martinez Direct, p. 3.

24 Martinez Direct, pp. 4-5.

25 *Id.*

1 First, as discussed above, the proposed deposit provisions are not attempting to recover
2 deposits from the carriers that have caused the "increased risk." Rather, the deposit
3 provisions penalize those carriers that have never missed an access payment or been late
4 in making an access payment. The provisions are not targeted at the specific customers
5 that have caused the increase in risk.

6
7 Second, the WorldCom and Global Crossings bankruptcies remain open and Spectra
8 cannot determine the amounts it will recover from the bankrupt entities. Thus, the
9 purported uncollectibles that Spectra relies on to support its proposed revisions
10 significantly overstate its actual uncollectibles.

11
12 Third, as Mr. Martinez concedes, these bankruptcies have been linked to massive and
13 unprecedented instances of accounting improprieties. It would be improper to base
14 future policy that will affect all consumers on such aberrations that are both unlikely to
15 be repeated.

16
17 **Q. HAS SPECTRA DEMONSTRATED THAT ITS PROPOSED CREDIT**
18 **STANDARD IS A VALID PREDICTOR OF AN ACCESS CUSTOMER'S**
19 **PROPENSITY TO PAY ITS ACCESS BILLS?**

20 **A.** No. The additional deposit criteria that Spectra is proposing to apply to existing access
21 customers is based upon the access customers (or its parent company) having a bond
22 rating falling below a rating of BBB or equivalent rating.²⁶ Mr. Martinez has not
23 presented any evidence or analysis that demonstrates a company's secured debt rating is
24 a valid predictor of that company's willingness and ability to meet its short-term
25 operating expenses. Also, Mr. Martinez has not presented any studies or analysis that

1 demonstrates that a company with a bond rating of BBB or higher is more likely to meet
2 its short-term operating expenses than a company with a bond rating lower than BBB.

3
4 Through discovery requests, AT&T sought copies of all documents and communications
5 concerning Spectra's decision to base an existing customer's credit worthiness on a
6 credit rating of BBB or equivalent rating. AT&T also sought copies of documents and
7 communications prepared by or on behalf of Spectra that demonstrated or attempted to
8 demonstrate that an access customer's debt rating of BBB or equivalent rating is related
9 or correlated with that customer's ability or propensity to pay access bills. Spectra
10 responded to those two data requests with a single page answer that showed financial
11 rating information for Qwest Communications International.²⁷

12
13 Other than to look at Qwest's current bond ratings, Spectra has done no research,
14 conducted no studies, or performed any analysis to establish a link between long term
15 bond ratings and the propensity to pay access bills. It has presented no evidence that its
16 proposed tariffs will actually reduce the risk of uncollectibles caused by existing access
17 customers. Spectra proposed tariff revision appears to be directed solely at addressing a
18 concern it has regarding Qwest defaulting on access payments. This is insufficient
19 grounds to change the current deposit policy.

20
21 Assuming Spectra's response was complete, Spectra has not performed any analysis to
22 determine whether a customer's bond rating is a valid predictor of a current access
23 customer's propensity to pay its access bill. AT&T also sought similar information
24 regarding any analysis performed by CenturyTel, Inc. in the event that Spectra's majority

²⁶ Martinez Direct, p. 6.

owner or other affiliates made the decision to file the proposed tariffs or provide any supporting analysis to Spectra. Spectra objected to those requests on the grounds that CenturyTel is not a party to this case and does not seek to implement the deposit tariff that is the subject of this case, and that therefore, these data requests are not relevant to this proceeding.”²⁸

**Q. IN YOUR OPINION, DO CREDIT RATINGS MEASURE THE IXXCS
PROPENSITY TO PAY ITS MONTHLY ACCESS BILLS?**

A. No. The additional deposit criteria that Spectra is proposing to apply to existing access customers is based upon the access customers (or its parent company) having a bond rating falling below a rating of BBB.²⁹ Mr. Martinez justifies this measure on the grounds that “bond ratings provide the best measure of secured debt risk known to the modern financial markets.”³⁰ While this is debatable given the rating agencies recent performance, the relevant point is that access bills are not long term secured debt. Access payments represent short-term operating expenses. The credit ratings assess a company’s ability to meet its long-term debt obligations, rather than its current operating expenses. Mr. Martinez has not presented any studies or analysis that demonstrates that a company with a bond rating of BBB or higher is more likely to meet its short-term operating expenses than a company with a bond rating lower than BBB. In fact, according to Standard & Poor’s educational materials, a company with a rating of “B” is more vulnerable of nonpayment than a company with a rating of “BB,” but it currently has the capacity to meet its financial commitment on the obligations.³¹ As access

²⁷ See Schedule RMK-2 – Spectra’s Response to AT&T Data Requests Nos. 16 and 17.

²⁸ See Schedule RMK –3, Data Request Nos. 15 and 18, Letter stating objections dated 10/25/2001

²⁹ Martinez Direct, p. 6.

³⁰ Martinez Direct, p. 6.

³¹ Standard & Poor’s Long-Term Issue Credit Rating, <http://www2.standardandpoors.com> down loaded

1 obligations are short run operating costs, a rating of "B" implies that the company's
2 current situation is adequate to meet its access obligations. By way of example, an IXC
3 could have significant long term debt that might produce concerns regarding its ability in
4 the long term to pay off its investments, but at the same time be generating significant
5 revenues on its current operations that permit it to make payments on its current and mid-
6 term operating expenses.

7
8 Mr. Martinez has not presented any evidence or analysis that demonstrates a company's
9 secured debt rating is a valid predictor of that company's willingness and ability to meet
10 its short-term operating expenses. According to Moody's own information, only about
11 10 percent of the companies with below investment grade ratings default within 12
12 months.³² Even over the longer period of 15 years, companies with a rating of BB only
13 have an approximate 20 percent default rate.³³ Thus, long-term credit ratings are not
14 valid predictors of a company's ability to meet its short term operating expenses or to
15 default on its obligations in the near term.

16
17 While Mr. Martinez cites to the bankruptcies of Global Crossing and WorldCom as
18 reasons for needing expanded authority to require deposits from other existing access
19 customers, Mr. Martinez has not presented any evidence that the bond ratings prior to the
20 their bankruptcy filings would have predicted their likelihood of defaulting on access
21 payments. As Mr. Martinez notes, those bankruptcies were tainted with financial
22 misreporting, earnings restatements, and investor fraud. Bond rating agencies rely upon

10/29/2002.

³² http://www.moodys.com/cust/displaySummary.asp?busLineId=300000000063&document_id=2001400000389218

³³ Rating the Raters: Enron and the Credit Rating Agencies, Hearing Before the Senate Governmental Affairs Committee, 107th Cong., S. Hrg. 107-471 (March 20, 2002) at 64.

1 publicly reported information and were as unaware as other rating agencies, securities
2 analysts, and regulators and others when such misconduct was brought to light.

3
4 In fact, the objectivity and predictive value of credit rating agencies has come under
5 attack in the Enron scandal. Credit rating agencies have been soundly criticized for
6 failing to provide the investment community with advance warning as to the forthcoming
7 Enron crisis.³⁴ The fact is that the ratings issues by these credit agencies are simply the
8 opinions of one company and those opinions are not always based upon true facts. These
9 companies simply cannot provide the crystal ball that Spectra suggests.

10
11 The only conclusion that can be reached is that even if Spectra had the ability to require
12 deposits based upon bond ratings prior to those two bankruptcies, it is not likely the
13 proposed provisions would have provided any additional protection from non-payment
14 by WorldCom and Global Crossing. Mr. Martinez's direct testimony certainly does not
15 make such an assertion much less support that assertion through any type of analysis or
16 studies.

17
18 **II. SPECTRA'S TARIFF REVISIONS ARE UNJUST AND UNREASONABLE.**

19
20 **Q. PLEASE EXPLAIN WHY YOU BELIEVE SPECTRA'S TARIFF REVISIONS**
21 **ARE UNJUST AND UNREASONABLE.**

³⁴ *Rating the Raters: Enron and the Credit Rating Agencies*, Hearing Before the Senate Governmental Affairs Committee, 107th Cong., S. Hrg. 107-471 (March 20, 2002).

1 A. Spectra's proposed tariff language is not narrowly targeted to addressing the specific
2 changes in the level of risk; instead, it shifts the balance between the interests of Spectra
3 and its customers dramatically in the direction of Spectral.

4
5 First, the tariff language is not narrowly targeted only to specific customers that
6 are responsible for the alleged increase in risk. Indeed, the broad language proposed by
7 Spectra would apparently permit Spectra to request security deposits even from
8 customers that present a low risk to Spectra. For example, it is doubtful that customers
9 "whose gross monthly billing has increased beyond the amount initially used to estimate
10 a security deposit" necessarily present a greater risk than customers whose monthly
11 billing is unchanged or has declined. Similarly, it is not obvious that customers whose
12 "credit worthiness has fallen" present a greater risk than customers whose "credit
13 worthiness" has not changed but was low to begin with. And it is not obvious that a
14 decrease" in credit worthiness, no matter how slight, increases Spectra's risk by a
15 material amount.

16
17 Second, the size of the required deposit, i.e., two months' billing, in cash, is not
18 commensurate with the level of risk imposed by the groups targeted by the proposed
19 tariff language. While two months billing may have been an appropriate security deposit
20 for customers without established credit or a history of late billing, it is absurd to suggest
21 that two months' billing, in cash, is commensurate with the level of risk imposed by a
22 customer that does not have a history of late billing, has good credit worthiness, but still
23 falls within the scope of the new tariff language because its credit worthiness has fallen.

24
25 By targeting broad groups of customers, and by authorizing deposits far in excess

1 of the amount necessary to compensate Spectra for the risk associated with those
2 customers, the proposed tariff language would go far beyond simply reestablishing the
3 balance struck by prior Commission policy. Rather, the proposed tariff language would
4 emphatically shift that balance in the direction of CenturyTel's interests by virtually
5 eliminating Spectra's risk of nonpayment. But the Commission has no obligation to
6 eliminate Spectra's risk of nonpayment. After all, no non-ILEC has the ability to
7 eliminate its risk of nonpayment completely. Carriers operating in a competitive market
8 must balance their desire to reduce uncollectibles against the possibility that overly
9 stringent terms will cause customers to defect to other carriers.

10
11 **III. SPECTRA'S PROPOSED TARIFF REVISIONS ARE ANTICOMPETITIVE AND**
12 **DISCRIMINATORY.**

13
14 **Q. IF SPECTRA'S PROPOSED TARIFF IS APPROVED, WILL SPECTRA BE**
15 **ABLE TO USE THE NEW DEPOSIT PROVISIONS IN AN ANTICOMPETITIVE**
16 **MANNER TO DISCRIMINATE AGAINST ITS COMPETITORS?**

17 **A.** Absolutely. As the FCC recognized in 1984, the unfettered right to demand a security
18 deposit from IXC's is a powerful anticompetitive and discriminatory weapon.³⁵ By
19 requiring access customers to post cash deposits, Spectra will increase its access
20 customers cost of doing business. Mr. Martinez recognizes this, but casually dismisses
21 any concerns by assuming IXC's are already adequately compensated for any additional
22 cost caused by Spectra's tariff.³⁶ In fact, Mr. Martinez cavalierly suggests that IXC's can
23 simply pass through deposits as surcharges to its customers.³⁷ Those customers are

³⁵ 1984 Access Order, 97 F.C.C.2d 1168-70.

³⁶ Martinez Direct, pp. 8-9.

³⁷ Martinez Direct, p. 9.

1 already paying exorbitant access charges and a surcharge on top of that to account for the
2 high cost of access charged by companies such as Spectra. This is clearly not an
3 appropriate solution. Mr. Martinez also suggests that IXC's are adequately compensated
4 through reduced access charge of LECs.³⁸ Spectra has never reduced its access charges,
5 so it can find no support in this assertion either.

6
7 As Spectra's proposed credit measure has not been shown to be a valid predictor of the
8 propensity of a carrier to pay its access obligations, the proposed tariff would
9 unnecessarily and inappropriately increase IXC's whose bond rating drops below BBB
10 cost of doing business for no demonstrable reason. Access customer's cash tied up in
11 deposits is capital that cannot be used to build networks or develop other services.

12
13 AT&T competes in the interexchange market with Spectra and its affiliated IXC,
14 CenturyTel Long Distance. The inappropriate use of access deposits would certainly
15 have the anti-competitive affect of raising AT&T's cost of doing business, which would
16 improve the competitive position of Spectra and CenturyTel Long Distance relative to
17 AT&T.

18
19 Further, the language proposed by Spectra permits complete discretion for when Spectra
20 may require a deposit, creating the potential for unfettered discrimination. The proposed
21 tariff language explicitly gives Spectra full discretion to apply the greater security
22 deposits to some carriers that meet the conditions, but not to others. A requirement is
23 inherently discretionary to the extent that the entity is not obligated to impose such
24 requirement. Spectra's states that "[a] security deposit may be required."

³⁸ *Id.*

1
2 With regard to similarly discretionary language in Verizon's proposed tariff, the FCC
3 stated:

4 The terms 'may' and 'elects' give Verizon considerable
5 discretion to enforce these provisions. Without definitive
6 criteria in the tariff, what would prevent Verizon from collecting
7 a security deposit or advance payment from one customer and
8 nothing from another customer when both meet one of the
9 criteria for security deposits or advance payment?³⁹

10 Consequently, the FCC has called for Verizon to explain how its proposed tariff
11 provisions can be applied in a non-discriminatory manner.⁴⁰
12

13 In the event CenturyTel, Inc.'s credit rating drops below BBB, Spectra's proposed tariff
14 would allow it to choose whether or not to require a deposit from CenturyTel Long
15 Distance. To the extent CenturyTel Long Distance provides interexchange service
16 primarily as a reseller of wholesale long distance service, under Spectra's proposed
17 tariff, Spectra would also have the discretion to not require deposits from its underlying
18 wholesale providers; regardless of that carriers bond rating. This discretion could be
19 used to secure a better wholesale rate for its affiliated long distance carrier to unfairly
20 better its competitive position.
21

22 Spectra should also be required to explain how its proposed tariff revisions could be
23 applied in a non-discriminatory manner such that, for example, its IXC affiliates would
24 not be spared the security deposit requirements imposed on other IXCs having the same
25 level of commercially unacceptable credit.
26

³⁹ Order, DA 02-2522, p. 8.

⁴⁰ *Id.*

1 **Q. WOULD ELIMINATING THE SUBJECTIVENESS OF SPECTRA'S PROPOSED**
2 **TARIFF ALLEVIATE YOUR DISCRIMINATION CONCERNS?**

3 A. No, it would not. Transactions between affiliates are not the same as out-of-pocket
4 business expenses. In the instance where Spectra collects a deposit from an affiliate,
5 those funds still remain within the corporation. They are simply intercompany transfers
6 that do not represent a true operating expense. According to data request responses,
7 when Spectra receives a cash deposit from an access customer, Spectra puts that deposits
8 in CenturyTel's main bank account, creating a shell game where the cash flows directly
9 to CenturyTel.⁴¹ Thus, even if CenturyTel posted a deposit, it would not represent any
10 real operating expense for CenturyTel or its IXC affiliate. Where Spectra collects a
11 deposit from an unaffiliated interexchange carrier, that deposit represents a true out-of-
12 pocket operating expense for that company that flows directly to CenturyTel.

13

14 In addition, not all IXCs have credit ratings. Therefore, imposing a deposit on those
15 IXCs with credit ratings where IXCs without credit ratings are automatically excluded
16 from the deposit requirement is facially discriminatory.

17

18 **IV. SPECTRA'S FINANCIAL POSITION RAISES CONCERNS REGARDING THE**
19 **IMPOSITION OF THE PROPOSED DEPOSIT REQUIREMENT.**

20

21 **Q. IS SPECTRA ABLE TO GUARANTEE THAT SPECTRA WILL BE ABLE TO**
22 **MAINTAIN AND REFUND HELD DEPOSITS.**

23 A. I do not believe so. Neither Spectra's proposed tariff nor its direct case contain any
24 assurance that Spectra will be able to maintain and refund held deposits. This issue is

⁴¹ See RMK-4, Spectra's Response to AT&T Data Request No. 19

1 important because Spectra's proposed tariffs require cash deposits, which perversely
2 transfers the entire default risk from the access provider to the access customer. Before
3 the Commission requires any carrier to post a cash deposit held by Spectra (or
4 CenturyTel), the Commission needs to be able to guarantee those deposits will not be
5 lost in the event the deposit holder encounters financial difficulty.

6
7 **Q. DESPITE SPECTRA'S FAILURE TO ADDRESS THIS ISSUE IN ITS DIRECT**
8 **CASE, DID AT&T ATTEMPT TO REVIEW SPECTRA'S ABILITY TO**
9 **ADEQUATELY PROTECT HELD DEPOSITS?**

10 A. As described earlier, AT&T sought copies of Spectra's earnings surveillance reports that
11 it had agreed to file with the Commission. Spectra has not produced those reports
12 because it is in the process of restating the reports due to errors. In addition, AT&T also
13 sought copies of "all financial analysis or audits performed or reported by an
14 independent firm or regulatory agency of which Spectra is aware that analyzed, reviewed
15 or audited the financial condition of Spectra that was performed after September 3,
16 1999." Spectra responded that it was not aware of any such analysis or audits. In short,
17 there is nothing in Spectra's direct case that provides IXCs with any assurance of
18 Spectra's ability to properly maintain cash deposits. Nor has there been any analysis
19 performed by an independent party that Spectra is even aware that would support a
20 claim by Spectra that it is capable of safely maintaining cash deposits. As will be
21 discussed below, Spectra's administrative practice for handling deposits suggests that it
22 would be highly improper to allow Spectra collect a deposit from anyone.

23
24 **Q. WHAT DO YOU MEAN BY IMPROPER USE OF DEPOSITS?**

1 A. As stated earlier, the rationale behind collecting deposits is to mitigate future risk of
2 default using well-established and justifiable predictors of risk. It is AT&T's view that
3 entities that provide monopoly services should never be permitted to use the funds from
4 held deposits as general funds or to cover general operating expenses until the entity that
5 posted the deposit has been determined to have defaulted on its obligations. It is
6 inappropriate to permit a company to use deposits as a revenue source or as a means to
7 recover past losses or to meet its current or future operating expense.

8
9 **Q. HOW DOES SPECTRA HANDLE THE CASH THAT IS RECEIVED FROM**
10 **COLLECTED DEPOSITS?**

11 A. AT&T issued data requests requesting that Spectra identify how it plans or intends "to
12 use the funds collected through the deposits set forth in the proposed tariffs. In doing
13 so, please identify whether and how these funds will be invested, used, or maintained by
14 Spectra". Spectra responded by stating that, "Typically, Spectra puts deposits in
15 CenturyTel's main bank account and shows them as a liability on the balance sheet."⁴²
16 Pursuing similar information, AT&T also asked questions requesting that Spectra,
17 "identify whether any funds collected through the imposition of the deposits set forth in
18 the proposed tariffs will be used to pay Spectra's existing, current, or future Operating
19 Expenses, Operating Taxes, or Interest Expense." The reply provided by Spectra was,

20 No. Although the deposits go into the general funds when they are
21 received, cash is debited on the balance sheet and a corresponding credit
22 is made to a liability account for deposits. Spectra has a revolving
23 credit facility set up with a CenturyTel subsidiary that provides
24 operating fund for Spectra if needed. Because no accounts on the books
25 other than the cash account and a corresponding liability are affected
26 when a deposit is received, Spectra does not use deposits for operating
27 needs.⁴³

⁴² See Schedule RMK-4, Spectra's Response to AT&T Data Request No. 19.

⁴³ See Schedule RMK-5, Spectra's Response to AT&T Data Request Nos. 21 and 22.

1 As I interpret these two data requests together, when Spectra collects a deposit, that
2 deposit is placed into CenturyTel's main bank account. Should Spectra need funds for
3 operating expenses, it borrows that money from a CenturyTel subsidiary. Because
4 Spectra gives the deposit to another company and then borrows it back from an affiliate
5 of that company, Spectra contends that the deposit is not used to meet its current or
6 future operating expenses. However, the fact remains that the deposit is available for
7 CenturyTel, Inc. to use at its discretion and may, in fact, be flowed back to Spectra as
8 part of the fund transfer process it describes.

9
10 **Q. WHY DOES CENTURYTEL HOLD CASH DEPOSITS COLLECTED BY**
11 **SPECTRA?**

12 **A.** I really do not know the answer to that question and that is a major concern. In reality,
13 Spectra's proposed deposit collection seems nothing more than attempt to transfer cash
14 collected from its access customers to its creditor.

15
16 **Q. HAS SPECTRA PROVIDED ANY INFORMATION ABOUT CENTURYTEL'S**
17 **USE OF FUNDS FROM COLLECTED DEPOSITS?**

18 **A.** No. Spectra has objected to providing any information on CenturyTel's financial
19 position, use of any deposits collected or any safeguards that CenturyTel might have in-
20 place to protect held deposits, Spectra objected to those "on the grounds that these
21 requests ask for information regarding CenturyTel, Inc. who is not a party to this case
22 and does not seek to implement the deposit tariff that is the subject of this case." Yet,
23 CenturyTel is the entity that holds the deposit.⁴⁴

⁴⁴ See Schedule RMK -3 Data Request Nos. 15 and 18, Letter stating objections dated 10/25/2001 and Schedule RMK-6, Response to Data Request No. 27.

1

2 **Q. ASSUMING THE CASH COLLECTED FROM DEPOSITS WILL BE HELD BY**
3 **SPECTRA (RATHER THAN ITS CREDITOR), IS IT APPROPRIATE FOR**
4 **SPECTRA TO USE CASH RECEIVED THROUGH DEPOSITS TO MEET IS**
5 **CURRENT OPERATING EXPENSES?**

6 **A. No. The placement of cash deposits into any type of general cash account permits the**
7 **deposit holder to spend that money as it chooses. In the event the Commission permits**
8 **Spectra to collect any deposit from its access customers, those deposits must be**
9 **appropriately safeguarded and the deposit holder must be prevented from using those**
10 **funds for their own corporate purposes while they are held as deposits.**

11

12 **V. SPECTRA'S MANAGEMENT OF UNCOLLECTIBLE RISK RAISES**
13 **QUESTIONS AS TO THE APPROPRIATENESS OF THE PROPOSED DEPOSIT**
14 **REQUIREMENT.**

15

16 **Q. CAN YOU EXPLAIN HOW SPECTRA'S MANAGEMENT OF ITS**
17 **UNCOLLECTIBLE RISK IS RELEVANT TO THE TARIFF REVISIONS AT**
18 **ISSUE?**

19 **A. Yes. Before this Commission orders the imposition of a radically different deposit**
20 **policy on captive access customers, the Commission should assess whether Spectra**
21 **properly managed its uncollectible risk and sought to mitigate its risk through the use of**
22 **its current deposit policy. Clearly it did not. As a result, Spectra cannot possibly support**
23 **an argument that new measure are required when I t never attempted to employ the**
24 **current deposit measures.**

25

An analysis of Spectra's uncollectibles from late 2000 to the second quarter of 2002 reveals that those uncollectibles were trending upwards. [Based upon discovery responses provided by Spectra, its intrastate access uncollectibles were as follows:

2000	4th quarter	** \$	**
2001	1 st quarter	** \$	**
	2 nd quarter	** \$	**
	3 rd quarter	** \$	**
	4 th quarter	** \$	**
2002	1 st quarter	** \$	**
	2 nd quarter	** \$	⁴⁵ **]

Despite these growing uncollectibles, it does not appear that Spectra obtained any deposits from the defaulting IXCs, although it had the right to do so under its existing tariffs. It appears that Spectra took no action to mitigate the risk that it now uses as the justification for its proposed tariff revisions

As mentioned earlier, Spectra needs to maintain a capital structure that permits it to sustain revenue fluctuations and economic downturns.

An additional consideration is the related competitive ventures of Spectra and its affiliated owners such as CenturyTel, Inc. Spectra's majority owner and affiliate provides interexchange service in Spectra's franchise territory through CenturyTel Long Distance. In its annual report to shareholders, CenturyTel, Inc. boasts of the "unique competitive advantage" created by owning the local loop and having a direct relationship with customers. According to the annual report, this "unique competitive advantage" improves CenturyTel's ability to offer value-added competitive services such as long distance, Internet, and other data services.⁴⁶ As proof, CenturyTel boasts a 25.3% long

⁴⁵ Spectra's Response to AT&T Data Request No. 3.

⁴⁶ CenturyTel 2001 Annual Report, p. 5.

1 distance penetration rate among its local exchange service customers base. As Spectra
2 operates under the CenturyTel name, this advantage would also to Spectra's exchanges,
3 since CenturyTel, Inc. enjoys brand recognition and customer relationships with Spectra
4 d/b/a CenturyTel's local exchange customers. While this will benefit CenturyTel's
5 ability to sell ancillary services, this advantage, combined with certain business practices
6 and events, may also increase the risk of default for Spectra.

7
8 CenturyTel Inc.'s long distance affiliate operates primarily as a reseller of interexchange
9 service. This means that CenturyTel Long Distance's underlying wholesale provider is
10 Spectra's access customer. Thus, when CenturyTel uses its unique competitive
11 advantage created by owning the local exchange company to promote and sell its retail
12 interexchange services, it is also using that unique competitive advantage to indirectly
13 promotes the wholesale services of CenturyTel Long Distance's underlying wholesale
14 carrier. This increases the impact on and risk to Spectra in the event CenturyTel Long
15 Distance's underlying wholesale carrier defaults on its access bills owed to Spectra.

16
17 For example, assume the CenturyTel Long Distance resells the wholesale services of
18 Global Crossing. As CenturyTel Long Distance uses the unique competitive advantage
19 created by its relationship with Spectra to sell more minutes of retail toll services (either
20 through additional customers or additional minutes of use), it also increases the number
21 of access minutes that Spectra sells to Global Crossing, thereby increasing Spectra's
22 reliance on revenues from Global Crossing as Global Crossing's wholesale revenues
23 begin to account for a higher percentage of Spectra's access business. In the event
24 Global Crossing ceases to pay its access bills (as it apparently did), the impact on Spectra

1 is greater because of CenturyTel Long Distance's increased retail market share and the
2 increased access revenues generated through the use of Global Crossings.

3
4 Prior to their bankruptcy filings carriers such as WorldCom and Global Crossing were
5 increasingly offering lower prices through business deals that made no long-term
6 financial sense in an effort to show increased revenues at the expense of long run
7 sustainability. In the short run, such reduced wholesale prices benefited their wholesale
8 customers such Century Long Distance (and CenturyTel, Inc.) in this example. In the
9 longer term, this also increased Spectra's uncollectible expense and risk when the
10 wholesale providers chosen by CenturyTel, Inc. became insolvent. In short, if
11 CenturyTel and Spectra used the advantages associated with Spectra's ownership of the
12 local loop to increase their IXC market share and took advantage of those lower
13 wholesale rates or more favorable terms from unsustainable carriers and then got burned
14 when the carrier defaulted, they took a calculated business risk that should be a cost of
15 doing business. Other access customers should not have to pay for Spectra's and
16 CenturyTel poor business decisions.

17
18 Finally, the concern here really relates to the extensive reliance that Spectra and other
19 LEC have placed on access revenues. Like most LECs in Missouri, Spectra relies largely
20 upon access revenues to fund its regulated ILEC operations. Spectra should take steps to
21 diversify its revenues, thereby reducing its overall risk. Part of this can be
22 accomplished by rate rebalancing whereby more revenues are collected from non-access
23 services.

1 **Q. DO YOU HAVE CONCERNS WITH OTHER REVISIONS SPECTRA IS**
2 **PROPOSING IN THIS FILING?**

3 A. Yes. The last paragraph of Section A states that the deposit will be refunded or credited
4 to the IXC "when the customer has established commercially acceptable credit as
5 defined above and has established a one-year prompt payment record." This provision
6 appears to state that Spectra will keep the IXC's deposit for at least one year after the
7 IXC reestablishes commercially acceptable credit. This provision is patently
8 unreasonable. Spectra has established no basis for retaining an IXC's deposit for one
9 year - particularly in the case where the deposit requirement is imposed on an IXC that
10 has no history of missed or late payments.

11
12 **Q. CAN YOU PLEASE SUMMARIZE YOUR TESTIMONY?**

13 A. Yes. Spectra's proposed tariffs should be rejected. Spectra has presented no basis for
14 altering the careful balance that has been struck with the current deposit provisions to
15 protect Spectra from foreseeable financial risk while at the same time limiting the ability
16 of Spectra to impose unfair standards that might have anticompetitive effects in the
17 market. Spectra has failed to demonstrate any true future financial need that warrants the
18 radical change to the longstanding prescriptive deposit policy. Further, Spectra has not
19 demonstrated that the remedy it proposes would effectively mitigate any alleged future
20 risk; much less be equitable to its current access customers. In addition, the proposed
21 revisions do not obtain deposits from companies that are most likely to default on their
22 access payments, they are unjust and unreasonable, they are anticompetitive and
23 discriminatory, and they are inconsistent with sound public policy. Moreover, Spectra's
24 --financial structure and its own business decision appear to be an added, and potentially

Rebuttal Testimony of
R. Matthew Kohly

- 1 causal, factor for Spectra's situation. Access customers should not be required to pay
- 2 additional deposits to offset Spectra's poor business decisions.

SCHEDULES

2. Please provide a copy of each Regulated Utility Earnings Surveillance Report filed with the Missouri Public Service Commission Staff since Spectra began providing basic local service in Missouri.

Response:

The Surveillance Reports previously provided to the Commission by Spectra were found to contain errors. These reports are currently being revised. When these reports are re-submitted to the Commission, copies will be provided.

16. Please provide copies of all documents and communications in Spectra's possession or control concerning the decision to base an existing customer's credit worthiness on a credit rating of BBB or equivalent rating.

Response:

Subject to objection, see attached.

DR No. 16

<HELP> for explanation, <MENU> for similar functions.
Enter # <GO> for historical ratings.

PO65 Equity CRPR

Related Functions	Company Tree Ratings	CREDIT PROFILE
Quest Communications International		Page 1/1

MOODY'S

- | | | |
|--------------------------|------|----|
| 1) Issuer Rating | Caal | *- |
| 2) Senior Implied Issuer | WR | |
| 3) Senior Unsecured Debt | Caal | *- |

STANDARD & POOR'S

- | | |
|-----------------------------|---------|
| 4) Outlook | DEVELOP |
| 5) LT Foreign Issuer Credit | B- |
| 6) LT Local Issuer Credit | B- |
| 7) ST Foreign Issuer Credit | WR |
| 8) ST Local Issuer Credit | WR |

FITCH

- | | |
|---------------------------|------|
| 9) Outlook | NEG |
| 10) Senior Unsecured Debt | CCC+ |

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Hong Kong 852 2977 5000Brazil 5511 3048 4500
Japan 81 3 3201 8900Europe 44 20 7330 7500
U.S. 1 212 318 2000Germany 49 69 520410
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SCHEDULE RMK-2

17. To the extent not included in the response to DR 16, please provide copies of all documents and communications prepared by or on behalf of Spectra that demonstrate or attempt to demonstrate that an access customer's debt rating of BBB or equivalent rating is related or correlated with that customer's ability or propensity to pay access bills owed to Spectra.

Response:

See response to number 16.

DR 15. Please provide copies of all documents and communications in CenturyTel's possession or control concerning the decision to base an existing customer's credit worthiness on a credit rating of BBB or equivalent rating.

DR 18. To the extent not included in the response to DR 15, please provide copies of all documents and communications prepared by or on behalf of CenturyTel that demonstrate or attempt to demonstrate that an access customer's debt rating of BBB or equivalent rating is related or correlated with that customer's ability or propensity to pay access bills owed to Spectra.

LAW OFFICES

BRYDON, SWEARENGEN & ENGLAND
PROFESSIONAL CORPORATION

312 EAST CAPITOL AVENUE
P.O. BOX 466
JEFFERSON CITY, MISSOURI 65102-0466
TELEPHONE (873) 635-7166
FACSIMILE (873) 635-0427
E-MAIL: SMORGAN@BRYDONLAW.COM

DAVID V.G. BRYDON
JAMES C. SWEARENGEN
WILLIAM R. ENGLAND, III
JOHNNY K. RICHARDSON
GARY W. DUFFY
PAUL A. BOUDREAU
SONDRA B. MORGAN
CHARLES E. SMARR

DEAN L. COOPER
MARK G. ANDERSON
GREGORY C. MITCHELL
BRIAN T. MCCARTNEY
DIANA C. FARR
JANET E. WHEELER

OF COUNSEL
RICHARD T. CIOTONE

October 25, 2002

VIA FACSIMILE - (303) 298-6301

Rebecca B. DeCook
AT&T Communications of the Southwest, Inc.
1875 Lawrence Street
Denver, CO 80202

Re: Data Requests directed at Spectra Communications Group, LLC, MoPSC Case No. TT-2003-0043.

Dear Ms. DeCook:

In response to the Data Requests directed to Spectra Communications in the above-referenced case on October 15, 2002, attached please find responses to Data Request Nos. 1-3, 6, 10, 11, 16, 17, 19, 21, 22, 27 and 28. Responses to Data Requests Nos. 4, 5, 7, 8 and 9 will be provided on or before November 4. As to the remaining Data Requests, Spectra offers the following objections.

1. Spectra states a general objection to the "Instructions" to the Data Requests to the extent that they are inconsistent with Commission rules regarding discovery and, in particular, inconsistent with 4 CSR 240-2.090(2) regarding data requests.

2. Spectra objects to Data Requests Nos. 12, 13, 14, 15, 18, 20, 23, 24, and 25 (to the extent it relates to CenturyTel, Inc.) on the grounds that these requests ask for information regarding CenturyTel, Inc., who is not a party to this case and does not seek to implement the deposit tariff that is the subject of this case, and that therefore these data requests are not relevant to this proceeding.

3. Spectra objects to Data Request No. 27 to the extent the information requested is for CenturyTel, Inc. or any subsidiaries or affiliates of CenturyTel, Inc. other than Spectra for the

reasons stated in paragraph 2 above.

4. Spectra objects to Data Requests Nos. 16, 25 and 26 to the extent the production of any of the requested documents and materials involves privileged attorney/client communications. Spectra also objects to these Data Requests requesting production of "all documents and communications" as being overbroad, burdensome, not relevant and not likely to lead to the discovery of relevant information.

Sincerely,

BRYDON, SWEARENGEN & ENGLAND P.C.

By:



Sondra B. Morgan

SBM/szm

cc: Mr. Steve Weber

Mr. Arthur Martinez

19. Please identify how Spectra plans or intends to use the funds collected through the deposits set forth in the proposed tariffs. In doing so, please indicate whether and how these funds will be invested, used, or maintained by Spectra.

Response:

Typically, Spectra puts deposits in CenturyTel's main bank account and shows them as a liability on the balance sheet. Spectra would be willing to put deposits over a certain threshold (i.e. \$10,000) in a separate escrow account.

21. Please identify whether any funds collected through the imposition of the deposits set forth in the proposed tariffs will be used to pay Spectra's existing or current Operating Expenses, Operating Taxes, or Interest Expense.

Response:

No. Although the deposits go into the general funds when they are received, cash is debited on the balance sheet and a corresponding credit is made to a liability account for deposits. Spectra has a revolving credit facility set up with a CenturyTel subsidiary that provides operating funds for Spectra if needed. Because no accounts on the books other than the cash account and a corresponding liability are affected when a deposit is received, Spectra does not use deposits for operating needs.

22. Please identify whether any funds collected through the imposition of the deposits set forth in the proposed tariffs will be used to pay any of Spectra's future Operating Expenses, Operating Taxes, or Interest Expense.

Response:

No. Although the deposits go into the general funds when they are received, cash is debited on the balance sheet and a corresponding credit is made to a liability account for deposits. Spectra has a revolving credit facility set up with a CenturyTel subsidiary that provides operating funds for Spectra if needed. Because no accounts on the books other than the cash account and a corresponding liability are affected when a deposit is received, Spectra does not use deposits for operating needs.

27. In the event that CenturyTel's Inc.'s credit worthiness drops below standards defined in Spectra's proposed intrastate tariff, please identify any safeguards or measures that are currently in place or will be put in place to ensure that the deposits held by CenturyTel Inc. or any subsidiaries or affiliates are secure and can be refunded as necessary under the proposed tariffs. Please produce any communications or documents that support your response to this DR.

Response:

Subject to objection, see responses to numbers 19, 21 and 22.

CERTIFICATE OF SERVICE
(TT-200-0043)

I certify that nondisclosure agreements signed by Rebecca B. DeCook and Donald R. Finch on behalf of AT&T Communications of the Southwest, Inc. were served upon the following by depositing true copies in the U.S. Mail, postage prepaid, on November 5, 2002.

Rebecca B. DeCook _{TM}

Sondra Morgan
Brydon, Swearingen & England P.C.
12 East Capitol Avenue
P.O. Box 456
Jefferson City, MO 65102-0456

Stephen F. Morris
MCI Worldcom Communications Inc.
701 Brazos, Suite 600
Austin, TX 78701

Carl J. Lumley/Leland B. Curtis
Curtis, Oetting, Heinz, Garrett &
O'Keefe
130 S. Bemiston, Suite 200
St. Louis, MO 63105

Dana K. Joyce
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

John B. Coffman
Office of Public Counsel
P.O. Box 7800
Jefferson City, MO 65102