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July 26, 2002

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

FILED

JUL 26 2002

Missouri Public
Service Commission

Re: Case No. TT-2002-472 and TT-2002-473

Dear Judge Roberts:

Attached for filing with the Commission is the original and eight (8) copies of AT&T Communications of the Southwest, Inc.'s Rebuttal Testimony of R. Matthew Kohly in the above referenced docket.

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.:
Issue: Tariff Issues – Other Tariff
Issues
Witness: R. Matthew Kohly
Sponsoring Party: AT&T Communications of
the Southwest, Inc
Type of Exhibit: Rebuttal Testimony
Case Nos.: TT-2002-472 & TT-2002-473

AT&T COMMUNICATIONS OF THE SOUTHWEST, INC.,

REBUTTAL TESTIMONY

OF

R. MATTHEW KOHLY

CONSOLIDATED CASE NOS. TT-2002-472 & TT-2002-473

**Jefferson City, MO
July 26, 2002**

FILED
JUL 26 2002
Missouri Public
Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of Southwestern Bell Telephone)
Company's Tariff Filing to Initiate Residential) Case No. TT-2002-472
Customer Winback Promotion) Tariff No. 200200831

In the Matter Southwestern Bell Telephone)
Company's Tariff Filing to Extend Business) Case No. TT-2002-473
Customer Winback Promotions) Tariff No. 200200828

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:

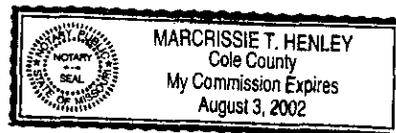
- 1. My name is R. Matthew Kohly. I am the District Manager for AT&T Communications of the Southwest, Inc. in its Law and Government Affairs organization.
2. Attached hereto and made a part hereof for all purposes is my Rebuttal Testimony.
3. I hereby swear and affirm that my answers contained in the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

[Signature]
R. Matthew Kohly

Subscribed and sworn to this 26th Day of July, 2002

[Signature]
Notary Public

My Commission Expires: 8-3-2002



**BEFORE THE STATE OF MISSOURI
PUBLIC SERVICE COMMISSION
DOCKET TT-2002-472 & TT-2002-473**

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

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

10 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

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

14 **Q. WHAT IS YOUR PRIOR WORK EXPERIENCE?**

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

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

11 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY?**

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

15 **Q. CAN YOU DESCRIBE THE COMPANIES YOU ARE REPRESENTING?**

16 **A.** I am representing AT&T Communications of the Southwest, Inc. AT&T
17 Communications of the Southwest, Inc. operates as both an interexchange carrier
18 throughout Missouri and as a local exchange carrier in portions of Missouri.

19 **Q. CAN YOU BRIEFLY DESCRIBE SWBT'S PROPOSED TARIFFS AT**
20 **ISSUE IN THIS PROCEEDING?**

21 **A.** SWBT is proposing several tariffs that waive the non-recurring service installation
22 charge for eligible potential customers¹ SWBT is proposing one tariff that applies to

¹ The term "potential customer" is used because these tariffs waive non-recurring installation charges

1 potential residential customers and the remaining tariffs apply to potential business
2 customers. All proposed tariffs contain eligibility requirements that the customer must
3 meet in order to receive the promotional waiver. To be eligible the customer must:

- 4 • have been a previous SWBT local customer
 - 5 • have purchased local exchange service from a competitive local exchange
6 company (CLEC);
 - 7 • not have had service disconnected for non-payment; and
 - 8 • must not have any past due bills for regulated service owed to SWBT.
- 9

10 **Q. CAN YOU PLEASE OUTLINE AT&T'S CONCERNS WITH THE**
11 **PROPOSED TARIFFS AND SWBT'S USE OF WINBACK TARIFFS IN**
12 **GENERAL?**

13 **A.** The winback offers proposed by SWBT are unreasonably discriminatory,
14 and are anti-competitive. The terms and conditions of SWBT's proposed tariffs limit
15 the availability of the promotional waivers to specific customers, affording those
16 customers with undue and unreasonable preference, which is contrary to Section
17 392.200.3 RSMo. 2000. The tariffs create the situation where similarly situated
18 potential customers who are making the same purchase decision (whether or not to
19 purchase service from SWBT) are unreasonably treated differently. In addition, the
20 tariffs offer lower priced service to specific customers, while similarly situated
21 customers are not given the same price break because they are not CLEC customers or
22 they do not meet the requirements set forth above, in violation of Section 392.200
23 RSMo. 2000.2.

designed to attract residences and businesses to become customers of SWBT.

1 From a competitive standpoint, these offers contained in these tariffs allow SWBT
2 to selectively target its “competitive response” to only the subset of customers that are
3 being served by competitors or that are considering switching to a competitor. This
4 ability to engage in targeted response will harm the long run prospects for local
5 competition and deny the benefits of competition to the vast majority of local customers
6 in Missouri.

7 While SWBT’s proposed tariffs should be rejected on their own merit, the
8 Commission should also be cognizant of the totality of SWBT’s winback and retention
9 efforts. In addition to engaging in narrowly targeted price reductions, SWBT is also
10 engaging in other efforts that promote the risks of switching to an alternate local provider.
11 SWBT is also contacting former customers who have switched to a CLEC alleging they
12 may have been slammed by their new provider. These marketing efforts are not designed
13 to promote value, customer benefit, or choice. Rather, these efforts are designed to
14 hinder customer choice, confuse customers, minimize the financial impacts of
15 competition, and, ultimately, thwart competitive entry. In addition to rejecting the
16 proposed tariffs, the Commission must address these actions and set forth an enforceable
17 code of conduct or other rules that prohibit these abuses and proscribe the scope of proper
18 winback/retention activity.

19 **Q. DESCRIBE YOUR FIRST CONCERN REGARDING THE SWBT**
20 **PROPOSED TARIFFS**

21 **A.**Section 392.200.3 prohibits telecommunications companies from subjecting any
22 customer to undue or reasonable advantages or disadvantages. The Commission’s Order
23 in Case No. TT-2002-108/TT-2002-130 stated that this statute has generally been

1 interpreted to “forbid discrimination in charges for doing a like or contemporaneous
2 service with respect to communication by telephone under the same or substantially the
3 same circumstances and conditions.”² In other words, discrimination between similarly
4 situated customers is unlawful. That is precisely what the SWBT tariffs do.

5 **Q. WITH REGARD TO YOUR SECOND CONCERN, WHAT IS PRICE
6 DISCRIMINATION?**

7 **A.** Price discrimination is just a difference in price; price discrimination is obvious
8 on its face: a seller charges different prices to different buyers³. SWBT’s proposed tariffs
9 clearly constitute price discrimination as only certain potential customers will receive a
10 waiver of non-recurring installation charges and therefore different buyers pay different
11 prices.

12 **Q. IS PRICE DISCRIMINATION UNLAWFUL?**

13 **A.** No. Not all price discrimination is necessarily unlawful. However, unreasonable
14 price discrimination is unlawful. Section 392.200 RSMo. 2000 generally prohibits
15 unreasonable price discrimination. Section 392.200.2 RSMo. prohibits rate
16 discrimination for “doing a like and contemporaneous service ... under the same or
17 substantially the same circumstances and conditions.” Thus, Missouri law appears to
18 prohibit the pricing tactic SWBT proposes in these two tariffs.

19 **Q. WHAT FACTORS HAVE REGULATORS PREVIOUSLY RECOGNIZED
20 AS JUSTIFICATION FOR REASONABLE PRICE DISCRIMINATION?**

² Case No. TT-2002-227, Report & Order, Case, No. TT-2002-108, *In the Matter of Southwestern Bell Telephone Company's Tariff Filing to Initiate a Business MCA Promotion*, Case No. TT-2002-130, *In the Matter of Southwestern Bell Telephone Company's Proposed Revisions to PSC Mo. No. 35 General Exchange Tariff Regarding CompleteLink, Report and Order*, citing State ex rel. DePaul Hospital v. PSC, 464 S.W.2d 737, 738 (Mo. App.1970)

³ Kintner, E. *An Antitrust Primer*, 64 (1964).

1 **A.** Historically, regulators have permitted price differences between residential and
2 business customers because residential customers are generally considered not similarly-
3 situated to business customers. The ability to charge residential and business customers
4 different rates was created by tariff restrictions, which prohibit business customers from
5 purchasing residential services. With respect to basic local service, the Commission has
6 historically allowed price differences based upon a customer's perceived "value of
7 service". This is the reason that customers in smaller exchanges typically pay less than
8 customers in larger exchanges for basic local service. In this context, smaller and larger
9 refer to the calling scope in a particular exchange. Another basis for different prices that
10 has historically been recognized as an appropriate justification for different rates has been
11 differences in the cost of providing the service. An example of this would be volume
12 discounts that telecommunications providers have historically offered.

13 **Q.** **IS THERE IS A COST DIFFERENCE HERE THAT WOULD JUSTIFY**
14 **WAIVING THE CONNECTION CHARGES FOR CUSTOMERS THAT MEET**
15 **THE THREE CRITERIA ABOVE?**

16 **A.** I do not believe so. Neither Mr. Hughes nor Mr. Regan's direct testimony asserts
17 any cost differences between serving a customer eligible for this promotion and a
18 customer ineligible for this promotion.

19 From a theoretical standpoint, it does not seem reasonable that the service
20 connection charges for serving an eligible customer would necessarily be lower than the
21 costs of serving a customer classified by SWBT as ineligible for the promotion. In fact,
22 there are many instances where the costs of re-acquiring an eligible customer served by a
23 competitor might actually be higher than the costs of initiating service with a new

1 customer in an existing location that is ineligible for the promotional waiver. For
2 example, if an eligible customer who was served by a facilities-based CLEC decided to
3 return to SWBT, SWBT would most likely have to dispatch a technician to the customer
4 premises to physically place that customer back on the SWBT network. Most likely, that
5 is more costly than provisioning service to an existing SWBT customer who has moved
6 to a new location where SWBT already has facilities. Under SWBT's proposed tariffs,
7 the potential customer with higher costs would be eligible for the non-recurring charge
8 waiver while the existing SWBT customer with lower costs would not be eligible. As a
9 result, I do not believe different costs justify the tariff limitations.

10 **Q. WHAT JUSTIFICATION DOES SWBT PROVIDE FOR THE**
11 **LIMITATIONS CONTAINED IN ITS PROPOSED TARIFF?**

12 **A.** SWBT's justification for the proposed tariffs is essentially that customers
13 returning to SWBT, "do not understand or generally accept the idea of paying
14 nonrecurring fees" and "are disappointed to learn that there is a non-recurring charge to
15 re-establish service with SWBT. This is often times different than their experience when
16 they switched to the CLEC for local service, because CLECs frequently waive non-
17 recurring charges for establishing service." (Regan Direct, p. 8).

18 **Q. DOES THIS JUSTIFY THE ELIGIBILITY LIMITATIONS IN SWBT'S**
19 **PROPOSED TARIFFS APPROPRIATE?**

20 **A.** No. I believe the restrictions contained in SWBT's proposed tariffs deny the
21 promotional waiver of non-recurring charges to all similarly-situated customers. As a
22 result, the proposed tariffs are unlawful and must be rejected under Section 392.200
23 RSMo. 2000.

1 There is no dispute that the services covered by the promotions are the same for,
2 both eligible and ineligible customers (i.e. both customers are seeking like and
3 contemporaneous service). Also both eligible and ineligible customers are located in
4 SWBT's ILEC territory, are not presently served by SWBT, and are making the same
5 purchase decision (i.e. whether or not to purchase service from SWBT). In short, the
6 ineligible customers are similarly situated with the eligible customer in terms of the
7 nature and terms of service the customers seek from SWBT. There is no reasonable basis
8 for differentiation created by the eligibility limitations in the proposed tariffs.

9 While SWBT describes the local exchange market as competitive, SWBT fails to
10 recognize that, in a competitive market, it is the customer who determines whether or not
11 he or she is similarly situated to a particular customer segment and makes his or her
12 purchase decision based upon his or her own preferences. Instead of customers
13 determining whether or not to avail themselves of SWBT's promotional rate based upon
14 their own preferences, SWBT's proposed terms and conditions prohibit some customers
15 that opportunity. While espousing its view of how free markets operate, SWBT often
16 complains about its competitors seeking protectionism. In this case, it is SWBT that is
17 seeking protectionism by asking the regulators to insulate SWBT from rate reductions
18 and competition.

19 **Q. DOES SWBT ADDRESS THE ISSUE OF SIMILARLY SITUATED IN ITS**
20 **DIRECT TESTIMONY?**

21 **A.** Mr. Hughes and Mr. Regan both make the statement that the customers eligible
22 for this promotion are similarly situated. However, that statement does not address the
23 true issue before the Commission; which is whether or not the customers SWBT has

1 deemed eligible are similarly situated to other customers SWBT has deemed ineligible.
2 SWBT has not attempted to address this issue.

3 **Q. HAS THE COMMISSION PREVIOUSLY RULED THAT SIMILAR**
4 **TARGETED DISCOUNTS OFFERED BY SWBT ARE ANTICOMPETITIVE**
5 **AND REJECTED SIMILAR TARIFFS?**

6 **A.** Yes. In Case No. TT-2002-108/TT-2002-130, the Commission made a factual
7 finding that Southwestern Bell's save and winback provisions are harmful to competition.
8 Specifically, the Commission found that,

9 Southwestern Bell's save and winback provisions would have
10 much the same impact on the health of competition in the local
11 service market as would term agreements. But, in addition to the
12 anticompetitive effects resulting from the use of term agreements
13 by a dominant ILEC, save and winback provisions can cause
14 further damage to the emerging competitive market. Such
15 provisions are targeted directly at the customer base of the CLECs.
16 If Southwestern Bell takes back many of those customers with save
17 and winback provisions, and then locks them up with long-term
18 contracts, CLECs might be left without a customer base to which
19 they can market. Edward J. Cadieux, witness for NuVox
20 Communications of Missouri, Inc., one of the CLECs currently
21 attempting to compete against Southwestern Bell, testified that the
22 combination of term discounts and save and winback provisions
23 might freeze competition at its currently inadequate level. If the
24 CLECs are frozen out of the competitive market, they would then
25 be forced to abandon their attempt to compete in Missouri, leaving
26 only Southwestern Bell as a viable local service provider. Until the
27 CLECs are in a strong enough position to effectively compete with
28 Southwestern Bell, the use of save and winback provisions by
29 Southwestern Bell is anticompetitive.
30

31 These findings and rationale are directly applicable to SWBT's proposed tariffs,
32 and support the same result here. SWBT's proposed tariffs are anti-competitive and must
33 be rejected.

1 **Q. SWBT ALSO ATTEMPTS TO JUSTIFY ITS PROPOSED TARIFFS ON**
2 **THE GROUNDS THAT THIS COMMISSION HAS PREVIOUSLY APPROVED**
3 **SIMILAR OFFERINGS. DO YOU HAVE A RESPONSE?**

4 **A.** This same argument was previously rejected by the Commission in Case No. TT-
5 2002-108/TT-2002-130 and in Case No. TT-2002-227. In Case No.; TT-2002-108/TT-
6 2002-130, the Commission specifically found that;

7 the Commission is not bound to comply with its previous
8 decisions. As an administrative agency the Commission is not
9 bound by *stare decisis*, and the failure of the Commission to
10 explain why it is not taking the same position in one case that it
11 took in a previous case is not a basis for overturning the
12 Commission's action.
13

14 Also, just as the Commission may have approved similar offerings, the
15 Commission has also rejected similar offerings so there is no clear precedent either way.

16 **Q. ARE THERE OTHER STATUTORY PROVISIONS THAT APPLY TO**
17 **THESE PROPOSED TARIFFS?**

18 **A.** Possibly. Beyond merely citing to Section 392.200.2 or 392.300.3, SWBT's
19 testimony never directly addresses the prohibitions contained in those sections other than
20 to say the Commission has previously approved similar offerings. SWBT's Witness Mr.
21 Hughes also references Section 392.200.4(2). Section 392.200.4 generally sets forth a
22 process for a company to define a telecommunications service as a different service based
23 upon some type of market segmentation. By defining a promotion or special rate as a
24 different service, SWBT apparently hopes to circumvent the discrimination prohibitions
25 set forth in Section 392.200.2 and 392.200.3. While not stating it directly, I interpret Mr.
26 Hughes' reference to this section as a recognition that the proposed tariffs are inconsistent

1 with Section 392.200.2 and Section 392.200.3 and as an improper attempt to define these
2 promotional offers as a new service to avoid those prohibitions.

3 **DOES MR. HUGHES PROVIDE A COMPLETE CITATION OF SECTION**
4 **392.200.4(2)?**

5 No. Mr. Hughes omits the word "all" from two places of this section. That sentence of
6 the statute actually states;

7 [I]t is the intent of this act* to bring the benefits of competition to
8 **all** customers and to ensure that incumbent and alternative local
9 telecommunications companies have the opportunity to price and
10 market telecommunications service to **all** prospective customers in
11 any geographic area in which they compete."

12
13 **WHAT IS REQUIRED BEFORE A COMPANY CAN SEGMENT THE**
14 **MARKET BY CLASSIFYING A SERVICE AS A DIFFERENT SERVICE?**

15
16 In order to define a service as a different service based upon market segmentation,
17 the company must meet the following requirements as set forth in Section
18 392.200.4(2)(b)

19 For services proposed in a geographic area smaller than an
20 exchange or other market segmentation within which or to whom
21 such telecommunications service is proposed to be offered, a local
22 exchange telecommunications company may petition the
23 commission to define and establish a local exchange
24 telecommunications service or exchange access service as a
25 different local exchange telecommunications service or exchange
26 access service. The commission shall approve such a proposal if it
27 finds, based upon clear and convincing evidence, that such service
28 in a smaller geographic area or such other market segmentation is
29 in the public interest and is reasonably necessary to promote
30 competition and the purposes of this chapter. Upon approval of
31 such a smaller geographic area or such other market segmentation
32 for a different service for one local exchange telecommunications
33 company, all other local exchange telecommunications companies
34 certified to provide service in that exchange may file a tariff to use
35 such smaller geographic area or such other market segmentation to
36 provide that service [emphasis added].

1 Based upon this statute, the Commission can only approve SWBT's proposed
2 attempt to differentiate these two tariff offerings as new products, based upon a finding,
3 using a clear and convincing evidence standard, that such market segmentation is in the
4 public interest and necessary to promote competition and the purposes of this chapter.
5 The purposes of this chapter are set forth in Section 392.185 RSMo. 2000. Two that are
6 directly applicable to these proposed tariffs are 392.185.3 - promote diversity in the
7 supply of telecommunications services and products throughout the state of Missouri;
8 392.185.6 - allow full and fair competition to function as a substitute for regulation when
9 consistent with the protection of ratepayers and otherwise consistent with the public
10 interest.

11 **Q. DO SWBT'S PROPOSED TARIFFS MEET THOSE REQUIREMENTS?**

12 **A.** No. SWBT's proposed tariffs are not consistent with the purposes of this act as
13 stated in Section 392.200.4 RSMo. 2000. First, SWBT's promotional rates are not
14 available to all customers of SWBT or all potential customers in the geographic area in
15 which SWBT offers service. These tariffs are also not consistent with the purposes set
16 forth in Section 392.185. SWBT's anti-competitive tariffs certainly do not further that
17 purpose.

18 While it may be argued that SWBT's proposed tariffs offer one short-run benefit
19 of competition (i.e. a waiver of a non-recurring charge), it does so only to a subset of
20 what SWBT believes are the most desirable customers that are served presently by a
21 CLEC and have a payment history SWBT deems suitable. These proposed tariffs do not
22 bring any short-term benefit to all potential customers. Far outweighing any limited short
23 run benefits, approval of SWBT's proposed tariffs will harm competition for several

1 reasons. Having recently rejected SWBT's targeted discounts on the grounds that "the
2 use of save and winback provisions by Southwestern Bell is anticompetitive", there is
3 certainly no basis to conclude by clear and convincing evidence that such offers now
4 promote competition.

5 **Q. PLEASE DESCRIBE THE ANTI-COMPETITIVE IMPACT OF THE**
6 **PROPOSED TARIFFS?**

7 **A.** Successful entry into the local exchange market requires a new entrant to achieve
8 a sufficient amount of business to achieve significant economies of scale. Even with the
9 availability of UNEs, CLECs entering the market must make large up-front investments
10 before they can begin offering service. For facilities-based CLECs, the upfront
11 investment is obviously much greater. A new entrant's decision to enter and expand (and
12 its corresponding ability to obtain financing through today's capital markets) is, therefore,
13 based on its expectation that it will be able to recover, within a reasonable time frame, its
14 cost of these up-front investments, along with the on-going costs of providing services,
15 plus a reasonable return on its investment. SWBT, the incumbent provider, has already
16 sunk its costs and has a customer base that allows it to benefit from significant economies
17 of scale, resulting in lower marginal costs for the incumbent. As the incumbent, SWBT
18 has the long-term incentive to deprive entrants of the opportunity to achieve significant
19 economies of scale to keep its rivals cost higher than its own.

20 Obviously, competing vigorously by reducing rates to all customers is one way to
21 accomplish such a goal. As long as that did not raise predation concerns, that would be
22 viewed as part of the competitive process. However, reducing rates to all customers is
23 not what SWBT is attempting to do. By limiting the eligibility of a promotion to the

1 narrow segment of CLEC customers, SWBT will still be able to maintain high rates or
2 even increase rates for the vast majority of other customers while limiting price
3 reductions to only those customers that have sought competitive choice during these
4 initial stages of competition. These targeted eligibility limitations make it much less
5 costly for SWBT to engage in limited price competition aimed exclusively at CLEC
6 customers (with suitable payment history). Meanwhile, the competing CLECs will have
7 to reduce rates for all customers in order to compete with SWBT as once that CLEC gains
8 a customer, that customer is immediately eligible for SWBT's promotional rates. In
9 essence, SWBT's proposed tariffs would permit SWBT to fund its targeted competitive
10 response from revenues derived from other SWBT customers while its competitors have
11 no such luxury. This unreasonably permits SWBT to preempt competitive entry.

12 This was the same reason the FCC rejected a proposal made by SWBT to permit
13 targeting of dedicated access facilities that SWBT provided in competition with
14 competitive access providers ("CAPs")⁴. In rejecting that proposal, the FCC found that
15 SWBT's proposal

16 may permit SWBT unreasonably to deter or foreclose competitive entry
17 into the markets in which it has a monopoly. As formulated, [SWBT's
18 proposal] allows SWBT a virtually unlimited opportunity to preempt new
19 market entrants in its territory by reducing rates to individual customers to
20 which it believes new entrants may make offers, without making those
21 rates available to similarly situated customers elsewhere⁵.

22
23 Because of the potential for SWBT to use targeted discounts to deter entry and to
24 drive new entrants from the market, the FCC rejected SWBT's proposal. I would

⁴ CAPs have been providing inter and intrastate dedicated services since the 1980s in competition with SWBT.

⁵ CC Docket No. 97-158, Transmittal No. 2633, *In the Matter of Southwestern Bell Telephone Company, Tariff F.C.C. No. 73*, ORDER CONCLUDING INVESTIGATION AND DENYING APPLICATION FOR REVIEW, Nov. 14, 1997

1 also add by finding the tariff was not available to all similarly situated customers
2 seeking service from SWBT, the FCC found that an individual customer likely to
3 receive a competitive offer is similarly situated to a individual customer not likely
4 to receive a competitive offer.

5 In rejecting SWBT's same proposed tariff described above, the FCC also
6 addressed the harmful reputation impacts such targeted discounts would have on
7 competitive entry through the entirety of SWBT's service region. According to the
8 FCC's decision,

9 If the incumbent is able to develop a reputation of aggressively
10 competing via targeted bids with recent entrants by doing so in a
11 handful of markets, it may be able to dissuade potential entrants
12 from entering any of its other markets. Thus, the incumbent may
13 protect its monopoly position in all of its markets by aggressively
14 competing in markets where entry initially occurs.⁶

15
16
17 The ability to stall or foreclose entry through targeted pricing is especially true in
18 the local telecommunications market where much of the CLEC's investment becomes
19 sunk in a particular geographic area upon entry. Facility investments are not easily
20 moved to other markets or sold in secondary markets at prices high enough to recover the
21 initial investment and will thus be stranded if the new entrant is ultimately forced to exit.⁷
22 Knowing this, new entrants will be unlikely to enter the market or make further
23 expansions if they believe that the incumbent will reduce prices to a level that makes

⁶ CC Docket No. 97-158, Transmittal No. 2633, *In the Matter of Southwestern Bell Telephone Company, Tariff F.C.C. No. 73*, ORDER CONCLUDING INVESTIGATION AND DENYING APPLICATION FOR REVIEW, Nov. 14, 1997 citing Ordoover, Janusz, A. and Garth Saloner "Predation, Monopolization, and Antitrust" in *Handbook of Industrial Organization*, Schmalensee, Richard & Robert D. Willig, eds., Vol. 1, 1989 Elsevier Science Publishers B.V., pp. 550-556.

⁷ From a sellers or investors perspective, bankruptcy court is not a desirable secondary market. Just recently, E-spire announced in bankruptcy proceedings that it was going to sell certain assets for \$68 million. E-spire originally invested 1.6 billion in these assets.

1 competition unsustainable. Similarly, entrants that have yet to realize such economies
2 may be forced to withdraw from the market or curtail expansion plans if SWBT is able to
3 re-capture a large portion of the market through targeted responses to CLEC customers.
4 As noted above, successful price discrimination created by SWBT's proposed targeted
5 discounts allows SWBT to limit the pool of customers taking advantage of the promotion
6 thus limiting the financial impact of its competitive response. This makes it much less
7 costly and thus much more likely for the incumbent to engage in these targeted activities
8 designed to thwart entry.

9 **Q. DOES THE FACT THAT SWBT'S PROPOSED WINBACK**
10 **PROMOTIONS IN THIS CASE DO NOT DIRECTLY REQUIRE A TERM**
11 **COMMITMENT CHANGE THE ANTI-COMPETITIVE IMPACT?**

12 **A.** Even without term plans, targeted pricing still has the same anti-competitive
13 impact as it allows SWBT to limit competitive losses while engaging in very targeted
14 price competition with the entire CLEC customer base while simultaneously ignoring its
15 existing customer base or other potential customers. Each time a CLEC obtains a
16 customer, that CLEC incurs facilities, installation, and promotional expenses. If the
17 CLEC relies upon unbundled network elements to provision service, those expenses are
18 paid to SWBT in the form of non-recurring UNE rates. As SWBT's targeted discounts
19 which are aimed at CLEC customer bases create more customer churn for the CLEC than
20 would have occurred if SWBT were required to engage in system-wide pricing to all
21 customers, these targeted winback discounts increase CLEC costs and often generate
22 revenue for SWBT.

1 **Q. THAT SOUNDS LIKE YOU ARE SUGGESTING THE COMMISSION**
2 **“PROTECT” NEW ENTRANTS IS THAT TRUE?**

3 **A.** No. I am suggesting that CLECs be allowed the opportunity to compete fairly.
4 As new entrants, CLECs must offer the same rates to all similarly situated customers in
5 the area where it competes in order to attract customers. Just as CLECs must do that
6 because the market necessitates it, SWBT should similarly be required to do so.

7 **Q. WHAT WILL BE THE LONG TERM IMPACTS ON COMPETITION IF**
8 **SWBT IS PERMITTED TO ENGAGE IN TARGETED WINBACK PRICING?**

9 **A.** The ultimate concern for regulators should be that SWBT's proposed price
10 discrimination means the vast majority of consumers never receive the benefits of
11 competition through broader price reductions from the ILEC nor does that same vast
12 majority of consumers benefit from competitive choice because the CLECs do not obtain
13 a footing in their initial markets that allows further expansion. It also keeps new entrants
14 from achieving economies of scale, which will keep new entrants costs higher and reduce
15 their ability to offer lower rates.

16 If the incumbent is able to only target former customers that it deems desirable,
17 what incentive does the incumbent have to reduce rates to its existing customers or new
18 customers that will, by default, choose service from SWBT? The answer is very little to
19 none. Should all consumers benefit from rate reductions or should only those customers
20 who have switched to a CLEC and have suitable credit history receive a non-recurring
21 charge waiver just to return to SWBT to pay increasing monthly rates along with the vast
22 majority of other customers that did not switch to a CLEC?

1 **Q. WHAT IS YOUR RESPONSE TO SWBT'S CLAIMS THAT THE LOCAL**
2 **COMPETITION IS FLOURISHING?**

3 **A.** One only needs to look at the state of the industry to realize local competition is
4 not flourishing. As FCC Chairman Powell said, "There were problems in the telecom
5 sector that were continuing to present stresses, and there was no sector who needed less to
6 be kicked in the gut than the telecom sector at this moment in time." Clearly, the state of
7 the industry does not support SWBT's claims that CLECs continue to compete
8 effectively.

9 SWBT's witnesses Mr. Hughes and Mr. Regan do present general data purporting
10 to show the number of access lines that it believes CLECs won over almost a two-year
11 period. Mr. Hughes' estimates rely upon ill-gotten wholesale and E-911 data while
12 SWBT's witness Mr. Regan also presents general data purporting to show the number of
13 access lines lost by SWBT based upon retail data. None of the data presented is specific
14 to the products covered by the promotions. None of the data even separately presents
15 retail and business information. Therefore, no conclusions can be drawn from this data.
16

17 **Q. DO SWBT'S LIMITATIONS IN ITS PROPOSED TARIFFS SUPPORT**
18 **THE ASSERTIONS THAT THE LOCAL MARKET IS COMPETITIVE?**

19 **A.** They do not. If the local market were truly competitive, SWBT would be waiving
20 the non-recurring installation charges for all new customers and not just former customers
21 served by CLECs. SWBT's recurring rates for the products being promoted also do not
22 support the notion that the local market is competitive. In May, SWBT increased the

1 monthly recurring rates for SuperTrunk service by 8%⁸. Basically, SWBT is proposing
2 to reduce the service connection charge for some customers while increasing the monthly
3 rates for all customers.

4
5 **Q. DOES SWBT HAVE THE PRICING FLEXIBILITY TO RESPOND TO**
6 **COMPETITION WITHOUT APPROVAL OF THESE PROPOSED TARIFFS?**

7 **A.** Certainly. Under “Price Cap” regulation SWBT can reduce rates to meet
8 competition as long as it does not price the service below long run incremental costs. For
9 SWBT’s services classified as competitive, SWBT has the ability to increase or decrease
10 those rates in response to competition. If SWBT were to make similar promotions
11 available to all potential customers, SWBT could certainly do so.

12 **OTHER WINBACK ISSUES**

13 **Q. AT THE BEGINNING OF YOUR TESTIMONY, YOU REFERENCE THE**
14 **TOTALITY OF SWBT’S RETENTION AND WINBACK EFFORTS. CAN YOU**
15 **PLEASE DESCRIBE WHAT YOU MEANT BY THAT?**

16 **A.** Yes. The Commission needs to recognize that SWBT’s proposed winback offer
17 tariffs are not being proposed in a vacuum. While SWBT’s testimony references
18 promoting value and customer choice, that is not the campaign SWBT is using to retain,
19 and win back customers.

20 Through advertising, SWBT promotes the risk of switching to a CLEC with ads
21 comparing switching to a CLEC to sticking a fork in a toaster or licking a light post in the

⁸ SWBT increased the monthly rates for SuperTrunk Port for month-to-month and one year term plan customers. The obvious goal of such a strategy is create the financial incentive for customers to enter into longer term commitments to avoid rate increases.

1 winter. These ads attempt to scare Missouri customers into not choosir,g a CLEC. Even
2 at the install level, SWBT promotes the fear of switching to a CLEC. An AT&T
3 employee recently had DSL service installed in her home from SWBT's DSL affiliate.
4 During that install, the SBC technician made numerous derogatory comments about the
5 unreliability of Covad Communications, Inc.'s DSL service. AT&T has had similar
6 experiences in other states where the installers inform customers that AT&T's local
7 service is less reliable and inferior to SWBT's service; even when AT&T is using UNE-P
8 to serve the customer.

9 In addition, SWBT is sending letters to those customers that have switched to
10 another service provider, stating:

11 We understand that your telephone account has been disconnected from
12 SBC Southwestern Bell Telephone Company. As employees who value
13 your business, we want to be sure that this information is correct. If you
14 did not intend to cancel your service with SBC Southwestern Bell, please
15 contact us, toll free, at 1-888-483-9340 and we will update our records
16 immediately and re-establish your service.
17

18 The letter goes on to encourage customers that intentionally switched providers to return
19 to SBC for all calling needs including local service, DSL, Prodigy Dial-Up, SWBT or
20 SBC long distance. The customers that intentionally switched from SWBT are given the
21 same number to call as those who fear they may have been slammed. The letter is signed
22 by the Director Consumer Winback – SBC Southwestern Bell. In lieu of a letter, a
23 similar message may also be sent to customers that have switch local service provider via
24 an automated call.

25 If the customers follows the instructions and calls the number in the message, they are
26 connected to a salesperson who is unable to tell whether the customer has been slammed,

1 but tries to convince the customer to come back to Southwestern Bell. A recent article
2 in the Wichita Eagle notes, "Southwestern Bell acknowledged that the company has no
3 idea whether a customer has been slammed when the warning call goes out. The
4 company also acknowledged that the salespeople at the contact number, by law, do not
5 have access to the information needed to tell customers if they have been slammed."⁹
6 SWBT's letter is misleading and is obviously intended to confuse the customer into
7 contacting SWBT under the guise of a purported concern about slamming, so that SWBT
8 can convince the customer through scare tactics into returning to SWBT. SWBT's letter
9 is completely inappropriate. In addition, AT&T is concerned that SWBT is relying upon
10 wholesale disconnect information to identify and target these customers with winback
11 offers. Use of wholesale data is impermissible under the confidentiality provisions of the
12 M2A and other ICAs. Even if the Commission rejects the proposed tariffs, these
13 additional concerns warrant further review by the Commission. As the Commission is
14 charged with enforcing the relevant statutes and ensuring continued compliance with the
15 Section 271 obligations, the Commission should investigate these practices. Within
16 SWBT's traditional five state region, Texas and Kansas have initiated similar
17 investigations and rulemakings

18

19 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

20 **A.** Yes.

⁹ Dion Lefler, "Does Bell's Message Got To Far", Wichita Eagle 17 June 2002.