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October 28, 2002

Dale Hardy Roberts  
Secretary of the Commission  
Missouri Public Service Commission  
P.O. Box 360  
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**FILED<sup>3</sup>**

**OCT 28 2002**

**Missouri Public  
Service Commission**

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

Dear Mr. Secretary:

Attached for filing with the Commission, please find the original and eight (8) copies of the reply brief of AT&T Communications of the Southwest.

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

Very truly yours,

  
Rebecca B. DeCook (TM)

Attachment

cc: All Parties of Record

**FILED<sup>3</sup>**

**BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION**

**OCT 28 2002**

**Missouri Public  
Service Commission**

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

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

**REPLY BRIEF OF AT&T COMMUNICATIONS  
OF THE SOUTHWEST, INC.**

Comes now AT&T Communications of the Southwest, Inc. ("AT&T") and submits its Reply Brief in the above-captioned matters.

**INTRODUCTION**

The Commission should reject Southwestern Bell Telephone Company's (SWBT's) proposed tariff sheets because the winback offers proposed therein are contrary to Missouri law because they are unreasonable and unjust, and will impede the development of competition in the local services market in Missouri. Nothing in SWBT's Initial Brief supports a different conclusion. The uncontroverted evidence shows that SWBT's tariffs would treat similarly situated customers who are making the same purchase decision as to whether or not to purchase service from SWBT unreasonably differently.

In addition, because of SWBT's dominant position in the local exchange market in Missouri, such a selectively targeted "competitive response" to the subset of customers that are being served by its competitors will harm the long-run prospects for local

competition and deny the full benefits of competition to the vast majority of local customers in Missouri.

## ARGUMENT

### **I. SWBT FAILS TO JUSTIFY WHY ITS PROPOSED WINBACK OFFERS ARE CONSISTENT WITH MISSOURI LAW.**

As AT&T stated in its Initial Brief, SWBT's proposed winback offers must be rejected because the offers provide like services to the target customers under the same or substantially same conditions as they are being offered to ineligible customers, but at a discounted price.

SWBT contends that its tariffs are lawful under Section 392.200 for a number of reasons. Because none of the reasons advanced by SWBT are supported by law, the evidence or simple logic, SWBT's arguments should be rejected.

First, SWBT claims that it is offering the winbacks to all similarly situated customers.<sup>1</sup> SWBT cites no Missouri case law to support this claim. In fact, SWBT's only support for this claim appears to be its definition of eligible customers in the proposed tariffs. The Missouri case law cited in AT&T's Initial Brief does not support SWBT's position. (AT&T's Brief, pp. 6-11). Under Section 392.200.2 and 3, customers must be treated in a nondiscriminatory fashion. These statutory sections require that customers cannot be charged differing rates for "like or contemporaneous service" that is offered under "the same or substantially the same circumstances or conditions." *See State ex rel. DePaul Hospital v. PSC*, 464 S.W.2d 737, 740 (Mo. App. 1970); *State ex rel. City of St Louis v. Public Service Commission*, 327 Mo. 318, 36 S.W.2d 937, 950; and *City of Grain Valley v. P.S.C.*, 778 S.w.2d 287 (Mo.App. 1989).

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<sup>1</sup> Southwestern Bell Telephone Company's Initial Brief, p. 14 (hereinafter cited as "Br., p. \_\_\_\_").

SWBT's arbitrary classification of customers, without presenting any evidentiary justification for why they are a unique class of customers or why they are not similarly situated with other new customers is unreasonable under Missouri law, particularly given SWBT's dominant position in the market. As AT&T explained in its Initial Brief, there is no factual difference in the conditions experienced by or services provided to the eligible customers versus the ineligible customers. (AT&T's Brief, pp. 8-9). In addition, SWBT has failed to demonstrate any cost basis for the proposed discounted rate. (*Id.*, pp. 12-13). Finally, the proposed tariff revisions would have a deleterious impact on the ongoing development of competition in Missouri. For all these reasons, the winback offers are contrary to Missouri law, are discriminatory and are unreasonable and unjust.

Second, SWBT claims that these tariffs are lawful, because the FCC has determined that winback offers are permissible under federal law and federal law is substantially the same as Missouri law. (Br., p. 23). SWBT's logic is flawed on numerous levels. In interpreting Missouri law, this Commission is not bound by federal interpretations under federal law. Even if it were, the paragraphs of the FCC Winback Order cited by SWBT are not applying the provisions of Section 202 (a), the comparable federal law provision, to a particular winback offer. Rather, the FCC was indicating that, as a general rule, it did not consider winback offers to be *per se* improper. However, the FCC indicated that ILEC winback offerings would be constrained by the FCC's tariff rules and non-discrimination requirements. (Winback Order, ¶ 71).

Indeed, in applying Section 202(a) in specific factual circumstances, the FCC has developed an analytical test that is remarkably similar to the analysis performed by Missouri courts under Section 392.200. As AT&T recounted in its Initial Brief, under

federal interpretations of Section 202(a), the standard for determining “likeness” is a functional equivalency test. As the Court stated in *American Broadcasting Companies, Inc., et al. v. FCC*, 663 F.2d 133, 138-39 (D.D.C. 1980):

Under this test as developed by the Commission, the inquiry centers on whether the services are “different in any material functional respect.” *American Trucking Associations, Inc. v. FCC*, 377 F.2d 121, 127 (D.C.Cir. 1966), *cert. denied*, 386 U.S. 943, 87 S.Ct. 973, 17 L.Ed.2d 874 (1987). The test looks to the nature of the services offered to determine likeness; the perspective of the customer faced with differing services is often considered a significant factor. *See American Telephone & Telegraph Co. (WATS)*, 70 F.C.C.2d 593, 609 & 614 (1978).

The Court went on to say:

By looking to the nature and character of the services in question, the test focuses the initial inquiry under section 202(a) on the similarity of the services. Considerations of cost differentials and competitive necessity are properly excluded and introduced only when determining whether the discrimination is unreasonable or unjust. *See Western Union International, Inc. v. FCC*, 568 F.2d 1012, 1019 n.15 (2d Cir. 1977), *cert denied*, 436 U.S. 944, 98 S.Ct. 2854, 56 L.Ed.2d 785 (1978).

*Id.*

Therefore, even under the FCC’s functional test, the FCC would compare the services offered to the customers eligible for the winback offer with the services offered to the customers that are not eligible for the winback promotion. That is precisely what Missouri courts assess. Here, there is no difference in the service being offered. The only difference is the rate being charged.

Even if SWBT could somehow demonstrate that the winback offers were not “like” services, the offers are not reasonable or just. SWBT has not established that there is a cost justification for the discounted rate it seeks approval of in the winback offers.

While SWBT claims that a difference in cost may be one means of differentiating customers, it states that it is not a requirement. (Br., p. 18). SWBT then asserts,

however, that such a cost difference does exist. (*Id.*, p. 19). SWBT claims that all eligible customers for SWBT's winback offers previously received service from SWBT and, therefore, SWBT will already have facilities in place to serve these customers, suggesting that these customers do not cause any conversion costs. (*Id.*). However, as AT&T pointed out in its Initial Brief, SWBT has admitted that there would be central office costs to convert these customers back to SWBT. (AT&T's Brief, p. 12). SWBT's assertion also ignores the fact that Mr. Hughes admitted that there would be other costs to convert those customers back to SWBT, such as field and central office work where the customer obtained service from a CLEC using unbundled loops. (*Id.*) Mr. Hughes also conceded that a customer that moves from one location to another where SWBT facilities already exist would be considered a "new" customer. (Tr. 316-17). However, such customers would not cause the facility costs that SWBT claims distinguishes "new" customers from the customer's eligible for this promotion. In addition, SWBT's analysis also ignores conversions from facilities-based CLECs. (*Id.*). Moreover, as AT&T addressed in its Initial Brief, new business customers that obtain service from the CLEC, but never had SWBT service, would be eligible for the "Win" offer described by SWBT. (Br., p. 7). For these customers, SWBT will likely have no existing facilities to provision service and it will incur precisely the same facility costs it claims it will incur for "new" customers. (AT&T's Brief, pp. 12-13). Thus, as Mr. Kohly testified, there are clearly circumstances where "the costs of reacquiring an eligible customer served by a competitor might actually be higher than the costs of initiating service with a new customer. (Ex. 10, Kohly Rebuttal, pp. 6-7). Since SWBT has presented no evidence to

support its claim that there is some cost justification for the differing rate and the evidence supports a contrary conclusion, SWBT's claim must be rejected.

Next, SWBT claims that SWBT's tariff sheets comply with Missouri law because the same or similar tariffs have been previously approved by the Commission. (Br. pp. 15-18). As AT&T explained in its Initial Brief, this argument is flawed for several reasons. First, the Missouri Commission has never "approved" any of the prior winback tariffs.

Second, the Commission has already considered and rejected this argument in Case Nos. TT-2002-108 and TT-2002-130, where it determined that the Commission is not bound to comply with its previous decisions. (Report and Order, p. 15).

Third, the Commission, more recently, has rejected a SWBT winback proposal. (Case Nos. TT-2002-108 and TT-2002-130).

Fourth, this Commission can only approve these tariffs if it finds them lawful and appropriate under Section 392.200. (Tr. 330).

In addition, SWBT makes a number of other irrelevant arguments. First, SWBT cites to the Commission's approval of an AT&T surcharge in Case No. TT-2002-129, claiming that if the Commission approved AT&T's charge there, it must approve SWBT's here. (Br., pp. 17-18). The case cited by SWBT is not in any way analogous here. AT&T was not attempting to create a separate class of service as SWBT is here. (Tr. 657-58). AT&T sought to assess a surcharge on all long distance customers, with three exceptions: 1) local customer of AT&T – who it is undisputed [and as Mr. Hughes agreed, "intuitive" (Tr. 350)] would not incur access charges on originating local calls (Tr. 624-25); 2) lifeline customers – who are treated as a separate class of customers by

law and by tariffs (Tr. 658); and 3) customers who do not generate long distance calls of more than \$1.00/month which Mr. Kohly explained was based upon a difference in cost. In TT-2002-129, the Commission concluded that AT&T's three exceptions were reasonable. SWBT's attempt to create a unique class of customers from existing CLEC customers is not.

Next, SWBT contends that winbacks offered in the long distance market demonstrate that SWBT's proposed winback offers here are proper. (Br., pp. 19-21). These long distance winback offers are irrelevant here for a variety of reasons. The offers cited by SWBT principally involve interstate long distance service. Thus, Missouri law simply doesn't apply. More importantly, however, the competitive overlay in the long distance market is markedly different from that in the local service market in Missouri. There is no competitor in the long distance market that has an 88% market share.

Third, SWBT claims that no CLEC has presented any evidence of competitive harm due to the existence of winback offers in Missouri. (Br., p. 32). However, SWBT, the party with the burden in this proceeding, has not presented any evidence from which it can be concluded that CLECs haven't been harmed. SWBT claims that, based upon the access line and line loss data it presented, that "competition has increased," "CLECs continue to compete effectively," and "competition is strong." (Br., pp. 32-35). The evidence SWBT has presented actually supports a different conclusion. While SWBT's numbers cannot be verified and, therefore, cannot be relied upon, comparing the SWBT numbers produced using the same minimal market share methodology shows that CLEC market share dropped from 15% last year to 12% this year. (Tr. 372). In addition, even

if there were some level of CLEC growth, SWBT has not demonstrated that the CLEC growth wouldn't have been greater, in the absence of SWBT's winback offers. As Mr. Kohly indicated, competition is not increasing at the pace one would expect (Tr. 654-55), leading to the conclusion that SWBT's winback may have slowed the growth of competition.

Finally, SWBT claims that if the Commission determines that SWBT's winback offers are unlawful then similar offers by other carriers must be deemed unlawful. (Br., p. 22). Of course, the Commission cannot reach such a conclusion in this proceeding, since the only tariffs noticed for consideration in this proceeding are SWBT's tariffs. Nor has SWBT established that any CLECs have winback offers in place for local service in Missouri. More substantively, AT&T disagrees with SWBT's conclusion for many reasons. As the Commission concluded in TT-2002-108 and TT-2002-130, the Commission must review promotional offers within the overlay of the Commission's general obligation to ensure the development and preservation of full and fair competition." (Report and Order, p. 11). Given SWBT's dominant position in the local service market and the harmful effect that SWBT's winback offers targeted at CLEC customers has on the development of competition, the Commission would have every justification for finding SWBT's tariffs unreasonable, while reaching a different conclusion on CLEC winback offers.

In sum, SWBT's proposed winback tariffs clearly constitute "rebates or special rates" for doing "a like and contemporaneous service...under the same or substantially the same circumstances and conditions" as defined in Section 392.200.2. Thus, under Section 392.200.2 the only way for SWBT's promotional tariffs to be lawfully approved

is for them to be deemed “otherwise consistent with the provisions of this chapter” and Section 392.200.3 plainly prohibits undue preferences to any “person or locality,” unless such person or locality can be “classified into such classes as are just and reasonable.” It is clear that SWBT’s attempted classification in this case is completely arbitrary and unreasonable. SWBT has provided no cost basis or cost study to support the price difference it proposes. SWBT has failed to provide any other rational justification for waiving connection fees only to SWBT’s alleged unique class. The only basis that SWBT could give for the rate differences was that it was a “business decision.” (Tr. 316). A “business decision” is not a reasonable basis or equitable justification for discriminatory pricing.

**B. The Proposed Winback Offers are Contrary to the Public Interest Because They Will Impede the Development of Competition.**

SWBT claims that its winback offers are in the public interest because they benefit consumers and competition. SWBT bases this conclusion on three principle arguments: 1) they offer lower prices; 2) they will increase a customer’s willingness to switch; and 3) they are a form of price competition that will promote competitive intensity. (Br., pp. 11-14).

While SWBT’s winback promotions may offer lower prices in the short term, they do so for only the limited subset of customers that are eligible for the promotions – current CLEC customers. As a result, the promotions do not bring the benefits of competition to all customers as mandated by Section 392.200.4(a). While these offers may benefit individual customers in the short term, SWBT’s offers are a threat to the long-term health of the competitive market for local phone service in Missouri.

The ultimate concern here for regulators should be that SWBT's proposed price discrimination means that the vast majority of consumers will never receive the benefits of competition through broader price reductions from the ILEC. Nor will the vast majority of consumers benefit from competitive choice because the effect of SWBT's promotions will be that CLECs will be unable to establish themselves in the initial markets they enter. As a consequence, new entrants will be unable to achieve economies of scale, which will keep new entrants' costs higher and reduce their ability to offer lower rates. As SWBT attacks the CLEC's initial customer base, the CLEC will lose the funding for its existing facility investment and future growth. The ultimate impact will be that CLECs will not have the financial means to expand into additional markets and may be unable to retain their existing investment in the markets they initially entered. (Ex. 10, Kohly Rebuttal, pp. 15-17).

In addition, if the incumbent is permitted to only target CLEC customers, the incumbent will never have an incentive to reduce rates to its existing customers or new customers. All of these consequences bear directly on the development of competition in Missouri and on whether all customers will benefit from competition.

On its second claim, SWBT presents no evidence that these offers increase a customer's willingness to switch. The fact that SWBT still has 85 to 88% market share and that CLEC market share has not increased significantly during the period these winback offers have been in place, belies this claim and suggests that there is no relationship between these offers and a customer's propensity to switch providers. In any event, given the larger concern regarding the impact these offers have on the ongoing development of competition, any purported benefit associated with inducing customers to

switch is outweighed by the impact these offers have on competition. If there are fewer or no competitors, what good is any inducement to switch?

As for SWBT's third claim that these offers will increase competitive intensity, SWBT appears to assume that competitive intensity will occur because CLECs will respond by matching or bettering SWBT's offer. However, as Mr. Kohly stated:

the competing CLECs will have to reduce rates for all customers in order to compete with SWBT as once that CLEC gains a customer, that customer is immediately eligible for SWBT's promotional rates. In essence, SWBT's proposed tariffs would permit SWBT to fund its targeted competitive response from revenues derived from other SWBT customers while its competitors have no such luxury. This unreasonably permits SWBT to preempt competitive entry.

(Ex. 10, Kohly Rebuttal, p. 14).

As Mr. Price indicated, no CLEC will have the desire or the ability to match SWBT's offers. (Ex. 8, Price Rebuttal, pp. 17-19).

In short, as Ms. Meisenheimer stated, "any short-term increase in competitive intensity must be weighed against the long-term successful emergence of an effectively competitive market." (Ex. 7, Meisenheimer Rebuttal, p. 9).

Indeed, by limiting the eligibility of a promotion to the narrow segment of CLEC customers, SWBT will be able to maintain high rates or even increase rates for the vast majority of other customers while limiting price reductions to only those customers that have sought competitive choice during these initial stages of competition. These targeted eligibility limitations make it much less costly for SWBT to engage in the limited price competition aimed exclusively at CLEC customers. (*Id.*, p. 14.) In truth, the broader base of customers in Missouri will not experience any "competitive intensity" as a result of SWBT's winback offers. SWBT's targeting of CLEC customers has limited any

“competitive intensity” to just that subset of customers. Thus, any real competitive benefit that would flow from SWBT’s competitive response is just theoretical.

Using an antitrust analysis, SWBT claims that its tariffs are not harmful to competition. (Br, pp. 24-31). As AT&T discussed in its Initial Brief, SWBT’s assertion misses the mark. This Commission’s competitive and public interest review is not in any way constrained by antitrust principles. Second, the principles and “learnings” that SWBT espouses have been applied under the very strict confines of federal antitrust law. The statutory mandates for stating an antitrust claim are much different and narrower than the controlling statutory and policy principles that govern this Commission’s assessment of the impact of these proposed tariffs on competition and the public interest.

As discussed extensively in AT&T’s Initial Brief, SWBT continues to possess significant market power, and has the ability and the incentive to utilize its market power in ways that are harmful to the competitive process and, over the long run, to Missouri telecommunications users. (AT&T’s Brief, pp. 6-11). SWBT still retains overwhelming control of the local market, with an 85 to 88% market share.

SWBT’s ability to limit the promotion only to customers that have left SWBT demonstrates SWBT’s market power. If the market for local telecommunications services were one characterized by effective competition, SWBT would not attempt to compete by limiting such a promotion to its “former” customers. Rather, it would be compelled to try to attract *any* new customer, regardless of whether the customer was a former customer of SWBT or some other carrier. That clearly is not occurring in Missouri yet.

This Commission is charged, *inter alia*, with construing Section 392 in a manner that “promotes diversity in the supply of telecommunications services and products throughout the state of Missouri” and “allows full and fair competition to function as a substitute for regulation when consistent with the protection of ratepayer and otherwise consistent with the public interest.” Section 392.185(3) and (6).

In addition, as established by the Legislature when it adopted SB 507, the intent of SB 507 is to:

bring the benefits of competition to **all** customers and to ensure that incumbent and alternative local telecommunications companies have the opportunity to price and market telecommunications service to **all** prospective customers in any geographic area in which they compete.

Section 392.200.4(2).

As part of its rationale in rejecting the winback provisions proposed by SWBT in Case Nos. TT-2002-108 and TT-2002-130, the Commission emphasized that it: “has a duty to regulate Missouri’s telecommunications industry in such a way as to promote the development of full and fair competition.”<sup>2</sup>

Competition remains vulnerable to interference by SWBT. As Mr. Kohly explained:

successful entry into the local exchange market requires a new entrant to achieve a sufficient amount of business to offset the significant capital investment required to offer local service. Whether the CLEC is using unbundled elements or its own facilities, CLECs entering the market must make large up-front investments before they can begin offering service. A new entrant's decision to enter and expand (and its corresponding ability to obtain financing through today’s capital markets) is, therefore, based on its expectation that it will be able to recover, within a reasonable time frame, its cost of these up-front investments, along with the on-going costs of providing services, plus a reasonable return on its investment. SWBT, the incumbent provider, has already sunk the large percentage of its costs

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<sup>2</sup> Report and Order, p. 14.

associated with its network (costs that were largely funded by ratepayers) and has a customer base that allows it to benefit from significant economies of scale, resulting in lower marginal costs for the incumbent.

Ex. 10, Kohly Rebuttal, p. 13.

The market for basic local services in Missouri is not yet fully, or effectively, competitive. SWBT remains the dominant provider with up to 88% of such local services. Competitive inroads have been slow because SWBT had 100% market share when the law first permitted competition. SWBT has other market advantages as well, such as economies of scope and scale, existing cash flow, and established customer relations and networks. In addition, SWBT retains such a disproportionate market share because it has been slow to open its network and systems to competitors - access that is critical to the development of competition.

Despite its market dominance and market advantages, SWBT seeks more. Because it does not yet face sufficient competition to discipline its pricing practices, it is not proposing broader based price decreases. Instead, it proposes the targeted discounts that are at issue here. Through these targeted discounts, SWBT seeks to regain the few customers lost to competitors. The impact of such pricing practices on competition cannot be ignored. Because competition hasn't developed sufficiently to discipline SWBT's pricing practices, it would be unreasonable to allow SWBT to price in a manner that would impede the competitive process in order to purportedly benefit only the few customers that have sought choice in their local service provider. The Commission needs to assure that competition can grow and not allow the market to lapse back into monopoly.

Finally, in its Initial Brief, SWBT fails to address the effect of its winback practices and procedures on competition. As this Commission has acknowledged, SWBT's practices and procedures could have relevance to the overall impact SWBT's winback offers have on competition. The sum and substance of SWBT's winback efforts, including the slamming inquiries, are invasive customer contacts that are designed to undermine the CLECs' ability to win and retain customers before the customer has even begun to experience the service the CLEC offers. These contacts are clearly designed to hinder customer choice, confuse customers, minimize the financial impacts of competition, and, ultimately, thwart competitive entry. Such practices clearly undermine the development of competition in Missouri and must be stopped until such time as appropriate constraints can be put in place by the Commission.

In sum, SWBT's proposed winback offers represent an attempt to exercise market power to the long-term detriment of the competitive process and of consumers. The Commission has already clearly articulated its recognition of, and agreement with, the need to prevent such exercises of market power by SWBT. The Commission should not change course now. The targeted discounts at issue are unreasonable and contrary to the public interest because they would impede the development of competition in the basic local market. Accordingly, the proposed tariffs should be rejected.

### **CONCLUSION**


SWBT's proposed winback offers are contrary to Missouri law, are unjust and unreasonable and are contrary to the public interest, given SWBT's continued dominance over the local service market. Its proposed tariffs contain discriminatory discounts that

would unreasonably impede CLECs' efforts to compete in that market. The proposed targeted discounts would target SWBT's competitive response on CLEC customer bases, rather than all customers, by offering competitive pricing only to CLEC customers.

Accordingly, the Commission should reject SWBT's proposed tariffs.

Respectfully submitted this 28th day of October, 2002.

**AT&T COMMUNICATIONS OF  
THE SOUTHWEST, INC.**

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CERTIFICATE OF SERVICE

Copies of this document were served on the following parties by electronic mail on this 28<sup>th</sup> day of October, 2002.

  
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