IN THE SUPREME COURT OF FLORIDA

UNITED TELEPHONE COMPANY
OF FLORIDA,

Appellant,

v.

CASE NO. 66,673

JOHN R. MARKS, III, et al.

Appellee.

(CONSOLIDATED CASES)

GENERAL TELEPHONE COMPANY
OF FLORIDA,

Appellant,

v.

CASE NO. 66,633

JOHN R. MARKS, III, et al.

Appellee.

****

On Appeal From The Florida Public Service Commission

REPLY BRIEF OF APPELLANT UNITED TELEPHONE COMPANY OF FLORIDA

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SUMMARY OF ARGUMENT

The Commission and Southern Bell assert that the Commission orders permitting Southern Bell to earn a higher rate of return on access charges and toll service than United and other telephone companies is necessary to carry out the F.C.C.'s plans for deregulating CPE. The Commission and Southern Bell also assert that the Commission has the statutory authority under Sections 364.055 and 364.14, Fla. Stat. (1983) to issue the orders under review and that the orders do not constitute retroactive ratemaking because this is not a rate proceeding.

The F.C.C.'s actions to deregulate CPE do not justify the orders under review. The 60 month phase out of CPE costs ordered by the F.C.C. was not affected by divestiture nor is the $9.7 million at issue herein connected in any way with the costs which are to be recovered over 60 months by Southern Bell, United, General and all other telephone companies. Neither the Commission or Southern Bell have demonstrated that the action under review is a necessary or proper measure to carry out divestiture or the deregulation of CPE. To the contrary, the Commission orders elevate the interests of Southern Bell above those of all other telephone companies by erroneously implying that only Southern Bell has been financially affected by the transfer of CPE.

Appellees' reliance upon Sections 364.055 and 364.14, Fla. Stat. (1983) is misplaced. United entered into settlement agreements with Southern Bell for access charges and intraterritory toll service at the Commission's direction. Those agreements provide that Southern Bell and United shall receive the same rate of return on access charges and toll. The Commission orders under review direct Southern Bell to collect a higher rate of return than United by regulating the division of toll and access charge revenues. The only Commission authority over division of such revenues is found not in Sections 364.055 or 364.14, but rather in

Section 364.07, a provision both the Commission and Southern Bell concede does not authorize the Commission's action.

With respect to retroactive ratemaking, the Commission asserts that the prohibition against it does not apply to this situation because this is not a ratemaking proceeding. The Commission has thus met itself on the circuitous path of its own arguments: asserting on the one hand that the Commission conducted this proceeding under Sections 364.055 and .14, which are both ratemaking statutes, and asserting on the other hand that the orders cannot involve retroactive ratemaking because this is not a ratemaking proceeding. As a matter of law, the instant proceeding is analogous to that examined by the Court in Southern Bell v. Florida Public Service Commission, 453 So.2d 780 (Fla. 1984), which involved a prohibition of retroactivity for Commission ordered settlement changes.

ARGUMENT

POINT I. THE COMMISSION ORDERS UNDER REVIEW HEREIN CANNOT BE JUSTIFIED AS BEING REQUIRED FOR THE DEREGULATION OF CPE.

The substance of the Commission's response is that the Commission acted to avoid a "drastic customer impact" resulting from divestiture and to avoid "enriching" companies like United and General at Southern Bell's expense. (Commission Brief at 6) These reasons are offered apparently to explain the Commission's motivation in regulating the division of toll and access charge revenues by ordering Southern Bell to earn a higher rate of return on those services.

The Commission has made no effort to identify what "drastic customer impact" it contemplates. Southern Bell has three million customers in Florida. (R 62) The $9.7 million at issue herein equates to 27 cents per customer monthly. Even that may be an overstatement given Southern Bell's "agressive cost controls and revenue stimulation measures" which would certainly tend to reduce the ratepayers burden

going forward. (R 354) It is insufficient for the Commission to brandish phrases which direly hint of drastic customer impacts without addressing what those impacts are. United's right to have Commission orders reviewed by the court are diminished to the extent that the Commission can assert conceptual generalities and ignore specifics. Commission orders must contain concise findings of the fact and conclusions of law. Occidental Chemical Co. v. Mayo, 351 So.2d 336 (Fla. 1977). What drastic impact, other than the one experienced by United and other telehone companies, has the Commission redressed? The Commission had three opportunities (in the two orders under review and in its answer brief) to explain its position and has refused in each event to do so in a manner that permits judicial review. United offers that the Court has no alternative but to reject such unsupported rationales.

With respect to the Commission's intent to avoid the enrichment of United, General and other telephone companies, who has been enriched? Southern Bell who has been authorized to earn a greater rate of return on toll service and access charges has been enriched. Southern Bell, who alone of all telephone companies in Florida has been authorized to recover expenses for a service it no longer provides (CPE), has been enriched. Conversely, United has been deprived of its bargained for right to receive the same rate of return on toll service and access charges as Southern Bell.

The implication that Southern Bell's circumstances are such as to require special surcharges against the pools is not well-founded. The Commission orders ignore all facts of record which do not bolster its conclusion. For example, the Commission totally disregards the fact that United's sale of CPE to its customers has "enriched" all parties to the toll and access charge pools. United has sold approximately one-half of its CPE, but has received no special consideration from the Commission which would allow it to surcharge the pools for expenses associated with the CPE which has been sold to customers. Nor would United expect the

Commission's special consideration. It is a natural consequence of pooling that cost savings of one participant are shared by all participants. (Tr. 609) In fact, because of Southern Bell's size relative to other telephone companies, if United saves $1 of expense, Southern Bell gets 50¢ of the benefit. The Commission's action in this proceeding ensures that the benefits of such cost savings flow only in Southern Bell's direction.

If, as is claimed, Southern Bell continues to incur expenses which were allocated to CPE even though it no longer provides CPE, it is obvious that those expenses must be associated with a service that Southern Bell did not divest. (Tr. 610) Rather than undertake an inquiry as to what service those expenses should be allocated to, the Commission simply ordered that Southern Bell continue to collect them as if they were CPE related expenses. The Commission apparently believed that this was necessary to fulfill a commitment that the ratepayer would not have to pay any of the costs of divestiture. (A. 9) But, if Southern Bell divested all of its CPE and continued to incur expenses of $9.7 million, those expenses cannot have been caused by divestiture of CPE or divestuture of any other asset or service. In short, if the expenses in question existed before divestiture and if after divestiture they still are being incurred by Southern Bell, then they cannot be a "cost of divestiture" even under the Commission's interpretation. If the expenses exist, they are incurred by Southern Bell to provide some regulated service and should be recovered from the recipients of those services.

The Commission's suggestion that it is righting a great wrong by keeping Southern Bell whole is not supported by the circumstances of this case. The so-called price of Southern Bell's divestiture has been lifted from Southern Bell's shoulders and distributed among the other telephone companies. As United's witness in this proceeding testified:

> If we are the winners, I have real compassion for the losers. As a result of the settlement

> between the Department of Justice and AT&T to resolve the antitrust action brought against AT&T, the entire telephone industry has undergone great change. United employees have spent literally thousands of hours adapting United for the post-divestiture environment. This activity continues even today. Yet much of this activity is nonproductive in the sense that it doesn't improve service or reduce costs. It is undertaken solely in repsonse to a consent decree in which the LECs had no part to play.
>
> To characterize United and other LECs as the winners in divestiture is not accurate and, in fact, is rather ironic since the Bell operating companies, a part of AT&T, who agreed to the terms of the modified final judgment, are depicted as the losers.

The Commission and Southern Bell place great emphasis on the actions of the F.C.C. and the Florida Public Service Commission providing for a phase out of CPE costs from toll settlements. Southern Bell correctly notes that CPE costs are gradually being reduced over a 60 month period.

Southern Bell argues that if United can recover CPE expenses over this transition period, Southern Bell should be able to as well. The 60 month phase out is not at issue: Southern Bell's ability to continue to recover CPE costs over the 60 month period is not affected by divestiture. Costs were identified at the beginning of the phase out and the amount thereof was "frozen" at that time. The balance of frozen CPE is being recovered by Southern Bell, United, General and all other telephone companies alike over the 60 month period. Recovery of frozen CPE was not a divestiture issue and is not associated with the $9.7 million subject to review in this proceeding. United does not now and never has objected to Southern Bell's continued recovery of frozen CPE over the F.C.C.'s prescribed transition period and considers implications to the contrary to be a red herring.

Aside from the frozen CPE costs that Southern Bell is recovering without objection from United or any other party, the Commission orders complained of allow

Southern Bell to recover indirect CPE expenses such as certain commercial (business office) costs. It is these indirect expenses upon which this appeal has been taken. Southern Bell and the Commission assert that since these indirect expenses continue to be recovered by companies like United, Southern Bell should be allowed to continue to recover them.

Southern Bell and the Commission overlook the fact that United and General have these CPE expenses because they have CPE assets; while Southern Bell cannot have CPE expenses because it has no CPE. To carry Southern Bell's argument one step further, United and General should continue to recover expenses on the CPE they sold to customers. United has sold approximately half of its CPE to customers as a result of which actual commercial expenses have decreased as has United's recovery of same from the pools. Southern Bell disposed of all of its CPE to a single "customer", AT&T, but has convinced the Commission to allow it to continue to recover so-called CPE expenses by a special surcharge from the pools revenues.

Over the course of the last several years, United, General and other telephone companies have actively solicited the sale of their CPE investment to the customers who were using the CPE. Each sale of CPE by United, and the other companies, reduced the CPE expenses which those companies recovered from the pools and thereby improved the pools' rate of return. For every $1 by which the pools' rate of return rose, Southern Bell earned an additional 50¢. Given the millions of dollars of CPE investment sold by United and other telephone companies, Southern Bell benefited prior to divestiture by enjoying a higher rate of return. This benefit to Southern Bell was not reduced artificially by the imposition of special surcharges for the benefit of United or any other telephone company. The end result is a situation where the rate of return was built up by United's efforts to sell CPE with the resulting benefits shared by all companies, including Southern Bell. Similarly, General sold CPE and built up the pools' return with the resulting benefits shared

by all companies. But, by Commission order, when Southern Bell disposed of its CPE and built up the pools' return, no one benefited but Southern Bell. The obvious inequity of such a situation is what this appeal is designed to redress.

In sum, on this point:

1. There is no identifiable "drastic customer impact" at stake in this proceeding.

2. United and General have not been "enriched" by divestiture; but, on the contrary, been deprived of a bargained-for equality with Southern Bell in order to allow Southern Bell to continue to recover expenses for a service it no longer provides.

3. Southern Bell's ability to recover frozen CPE costs is not at issue in this proceeding.

4. The pool has benefited over time from the sale of CPE by United and other telephone companies and the resulting reduction of CPE related expenses to be recovered. The greatest part of this benefit has already accrued to Southern Bell because no other telephone company has been given the right to surcharge the pools.

5. The benefits of each telephone company's sale of CPE has been shared among all the participants to the pools except for Southern Bell's sale of CPE, the benefits from which have been entirely taken by Southern Bell.

POINT II. THE COMMISSION HAS NO STATUTORY AUTHORITY TO REFORM CONTRACTS BETWEEN SOUTHERN BELL AND UNITED.

The initial briefs of both United and General argue that except for the limited authority granted to the Commission in Section 364.07, Fla. Stat. (1983), the Commission has no authority to regulate the division of toll revenues among telephone companies. United and General placed strong emphasis on this court's holding in Florida Telephone Corporation v. Mayo, 350 So.2d 775 (Fla. 1977). The Commission and Southern Bell concede that the Commission orders complained of do not

involve Section 364.07, Fla. Stat. Commission brief at 9; Southern Bell brief at 10, footnote 3. Interestingly, neither the Commission nor Southern Bell make the least effort to address the Florida Telephone case; in fact, this case which United believes to constitute controlling law is not even cited in the answer briefs! In the Florida Telephone case the court was faced with a question of whether the Commission had any authority to order how settlement revenues should be divided among the telephone companies. The court held:

> ". . . the Commission has no statutory authority to regulate the contractual division of long distance toll revenues between telephone companies." Id, at 778. (Emphasis added)

Yet it is irrefutable that the Commission orders under review have redistributed those revenues between the telephone companies by giving Southern Bell an additional $9.7 million and taking a like amount from United, General and the other Florida telephone companies.

United's argument in the initial brief that the Florida Telephone case is controlling law in the absence of a Section 364.07 proceeding has been ignored by both the Commission and Southern Bell. They rely instead upon Sections 364.055 and 364.14. Commission brief at 9 and 10; Southern Bell brief at 8.

In support of that argument, the Commission refers to provision in Section 364.14 which provides that the Commission may

> ...readjust practices of telephone companies if it determines that such practices would lead to unjust, unreasonable, unjustly discriminatory or unduly preferential effects. PSC Brief at 8.

Southern Bell asserts that neither General nor United challenge the Commission's authority under Sections 364.055 and 364.14 to hold hearings and enter appropriate orders on the effects of divestiture. Southern Bell brief at 8. It is not United's burden to speculate that the Commission would claim reliance upon a

particular statute. At no time in proceedings before the Commission, including in the orders under review, did the Commission state or infer that the Commission is proceeding under Section 364.14, Florida Statutes.

The Commission's belated reliance upon Section 364.14 is misplaced. At issue in this proceeding is not a "practice" of a telephone company. United was ordered by the Commission to pool access charges and toll revenues with Southern Bell. The contracts providing for that pooling state that Southern Bell and United will share the same rate of return. Without explaining what a "practice" is or how it affects the instant proceeding, the Commission has introduced a theory of law on appeal that it never even considered during proceedings before the Commission despite ample opportunity to do so. See discussion in Tr. 7-10 of March 20 hearing.

The language in Section 364.14 upon which the Commission and Southern Bell ground their arguments has been in the statutes for many years. The most recent bound volume of Florida Statutes Annotated was published in 1968 and contains the very language relied upon by Southern Bell and the Commission. It must be presumed that the court was knowledgeable of this provision when it considered the issues in the Florida Telephone case in 1977 and concluded that there is no statutory authority to support the Commission on this point. Id, at 778.

The Commission misapprehends United's argument to be that United asserts the primacy of its settlement contracts over the Commission's statutory authority. That is not what United is arguing at all. United's argument is that the Commission has no statutory authority to regulate the division of toll revenues among telephone companies, except the limited authority in Section 364.07, which the Commission has disavowed.

Section 364.055, Fla. Stat. (1983) which the Commission and Southern Bell also cite as giving the Commission authority to regulate the distribution of toll revenues is so clearly inapposite that United will leave it to the court's review

without further argument beyond noting that whereas Section 364.07 is the legislature's response to Florida Telephone Corporation v. Mayo, supra, Section 364.055 is the legislative response to a series of cases beginning with City of Miami v. Florida Public Service Commission, 208 So.2d 249 (Fla. 1968) and culminating in United Telephone Company of Florida v. Mann, 403 So.2d 962 (Fla. 1981).

POINT III. THE COMMISSION'S ORDERS UNDER REVIEW CONSTITUTE UNLAWFUL RETROACTIVE RATEMAKING

Southern Bell concedes that the Commission may not retroactively adjust the distribution of telephone company toll revenues, but argues that the Commission orders under review dealt with expenses and not revenues. Southern Bell brief at 16. This astounding assertion is simply not correct.

Under the authority of Order No. 14047, Southern Bell as the pool's administrator, distributed $9.7 million of revenues to itself and deprived United and the other telephone companies of a like amount. United did not bring this action to resist Southern Bell from incurring expenses; they can spend themselves into insolvency if they wish. It is revenues which are at issue in this case: revenues that lawfully belong to United, but are being held by Southern Bell. Southern Bell's statement of the case and the facts repeatedly characterize the issue as being related to "revenues". Southern Bell brief at 1-6. See also the Commission order under review herein:

* * * *

> It is further
>
> Ordered that Southern Bell Telephone & Telegraph Company is authorized to recover $9.7 million in interim relief as set forth in the body of this Order and shall inform this Commission of the mechanism it shall use to do so. It is further

* * * *

> Ordered that the revenues obtained by Southern Bell Telephone & Telegraph Company pursuant to this Order shall be collected on an interim basis ..... A. 6 (Emphasis added).

In the case of Southern Bell Telephone & Telegraph Co., v. Florida Public Service Commission, 453 So.2d 780 (Fla. 1984) the Court noted that it was faced with a question of whether

> "...the Commission's authority includes the power to order a change in the course of dealing followed by two telephone companies pursuant to their contractual arrangement." At 781.

In that context, the Court held that the Commission may not retroactively adjust the distribution of revenues among companies. The issue therein was whether five or seven day studies should be used as a basis for distributing toll revenues. The studies in question determine how expenses and investments shall be allocated to toll service. Thus, the holding in the Southern Bell case is analogous to the proceeding at bar: the recovery of a greater level of expense translates directly into a question of revenue recovery. Southern Bell's argument that the instant proceeding can be distinguished from the 1984 Southern Bell case on the basis of expenses versus revenues is incorrect. In this proceeding and in the Southern Bell case, a Commission ordered change in the method of allocating expenses to the pools resulted in a change in the division of revenues. In order to arrest the change in revenues, it is necessary to undo the action which affected expenses.

Southern Bell and the Commission both rely upon Citizens of Florida v. Florida Public Service Commission, 415 So.2d 1268 (Fla. 1982) as being applicable herein. Decided two years prior to the 1984 Southern Bell case, supra, the 1982 Citizens case is not controlling, and in any event, can be distinguished. At issue in the Citizens case was the question of whether a mid year change in depreciation expense could be made retroactive to the beginning of the year. The Court held that that

did not constitute retroactive ratemaking. The fact that distinguishes the depreciation expense in the Citizens case from the CPE expense in this proeeding is that the former was an actual expense while the latter is not. Southern Bell cannot continue to have CPE expense if it has no CPE. This is borne out by the fact that upon divestiture of CPE, Southern Bell's CPE expenses went to zero, and in turn prompted the Commission to allow continued collection of hypothetical expenses. Incidentially, United did not oppose Southern Bell's recovery of additional depreciation in the Citizens case because the company believed the recovery of actual expenses is legitimate notwithstanding the fact that United's rate of return decreased as a consequence of Southern Bell's additional expense. Moreover, United and Southern Bell would have continued to earn the same, albeit lower, rate of return after Southern Bell recovered the additional depreciation expense.

As stated in United's initial brief (at 11), United's settlement contracts specifically recognize the right of each party to recover its actual expenses (A. 36 Subsection I.A.1) The right to earn the same rate of return is in a different subsection and is not compromised by changes in the level of expenses recovered by each party. (A.36 Subsection I.A.2)

Finally, on this point, the Commission asserts that in this proceeding the Commission was not "ratemaking in the traditional sense". The court made clear in Southern Bell Telephone & Telegraph v. Florida Public Service Commission, supra, that the proscription against retroactive ratemaking applies to Commission attempts to direct how toll revenues should be distributed. Moreover, the Commission, at great length in Point II of its argument, asserted that Sections 364.055 and 364.14, Fla. Stat. (1983) control this case. Both of those statutes are used for "ratemaking in the traditional sense"; in fact, 364.055 is nothing but a ratemaking provision while 364.14 has been used for many years by the Commission as the statute under which telephone rate cases initiated by the Commission or a third party are

prosecuted. Any proceeding under Section 364.14(2) would come within the requirement that

> "....the Commission shall determine that just, reasonable, proper, adequate and efficient rules, regulations, practices, equipment, facilities, and service to be thereafter installed, observed, and used and shall fix same by order or rule as hereinafter provided." (Emhpasis added)

The Commission and Southern Bell have both crafted arguments defending retroactive ratemaking from which an observer could conclude that nothing happened to United's revenues or Southern Bell's revenues in this proceeding: Appellees were just trying to keep the status quo. Neither cares to acknowledge or concede to the Court that based on a Commission order issued on April 9, 1984, Southern Bell took revenues from United and other telephone companies which were associated with the period January 1 - April 9, 1984. United has calculated those revenues to be $2.7 million. United's initial brief at 18. As a corollary, neither appellee will concede that, absent a Commission order authorizing this taking, it could not have been accomplished. The fundamental fact of retroactive ratemaking in this case is: On April 9, 1984, Southern Bell received the Commission's authority to take $2.7 million of revenues for the period January 1 - April 9, 1984; on the prior day, April 8, that right did not exist.

CONCLUSION

Neither the Commission or Southern Bell has addressed the fundamental issues in this case.

- the intentional abrogation of settlement agreements by Southern Bell at the Commission's direction.

- the complete absence of Commission authority to regulate the distribution of toll revenues in clear violation of Section 364.07 Fla. Stat. (1983), and Florida Telephone Corporation vs. Florida Public Service Commission, supra.

- the flagrant disregard of the Court's proscription of retroactive ratemaking in City of Miami v. Florida Public Service Commission, supra, and Southern Bell Telephone & Telegraph v. Florida Public Service Commission, supra.

United earnestly requests the Court to quash Orders No. 13179 and 14047 insofar as they direct Southern Bell to withdraw $9.7 million annually from the access charges and intraterritory toll pools. United also asks the Court to direct the Commission to order the refund of all such moneys collected under those orders, plus interest, to United and the other telephone companies from which they were unlawfully withheld.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the foregoing Reply Brief of Appellant, United Telephone Company of Florida, has been served by United States Mail on all parties listed below on this 8th day of July, 1985:

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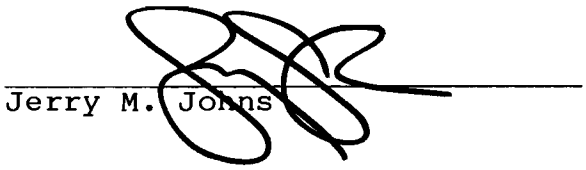

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