IN THE SUPREME COURT OF FLORIDA

UNITED TELEPHONE LONG DISTANCE, INC., and UNITED TELEPHONE COMPANY OF FLORIDA, Appellants,	
vs.	Case No. 72,988
FLORIDA PUBLIC SERVICE COMMISSION, Appellee.	

ON APPEAL FROM THE FLORIDA PUBLIC SERVICE COMMISSION

INITIAL BRIEF OF APPELLANTS

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INTRODUCTION

This is an appeal from Order No. 18939 of the Public Service Commission [A 1-12], granting the application of UNITED TELEPHONE LONG DISTANCE, INC. ("UTLD") for a Certificate of Public Convenience and Necessity to provide long distance telephone service as an interexchange carrier ("IXC"), subject to certain conditions. UTLD is a wholly-owned subsidiary of UNITED TELEPHONE COMPANY OF FLORIDA ("UTF"), a local exchange telephone company certificated and regulated by the Public Service Commission. UTLD and UTF have invoked the jurisdiction conferred upon this Court by article V, section 3(b)(2) of the Florida Constitution, and sections 350.128(1) and 364.381, Florida Statutes (1987), to seek review of that portion of the order requiring UTLD to pay UTF a compensatory fee in the nature of a royalty for "intangible benefits."

Pursuant to Florida Rule of Appellate Procedure 9.220, this brief is accompanied by an Appendix, which includes a copy of the order to be reviewed. References to the Appendix are signified as [A ___]. References to other portions of the record are signified as [R ___], except that references to the transcript of the hearing conducted on September 23-24, 1987, are signified as [T ___].

STATEMENT OF THE CASE AND FACTS

On March 18, 1987, UTLD filed an application with the Public Service Commission ("PSC") pursuant to section 364.335(1), Florida Statutes (1987), seeking a certificate of public convenience and necessity to operate as an interexchange (long distance telephone) carrier ("IXC") for traffic originating in the service area of its parent, UTF [R 1-62]. UTF is a local exchange telephone company certificated by the PSC to provide telecommunications services to all or parts of 24 Florida counties [R 23]. UTF formed UTLD as a wholly-owned subsidiary corporation on March 16, 1987 [R 6,19] to provide an alternative long distance company to UTF's customers, to enable those customers to deal with one location for complete telephone services, and to replace revenues that will be lost as AT&T phases out the use of UTF's billing and collection services and operator services [T 14-15,47,225].

By its application, UTLD sought specific authority to operate as a reseller of interLATA MTS and WATS service to customers in UTF's service area by delivering the traffic through the facilities of another IXC, U.S. Sprint, and charging the same rates as AT&T [A 3; R 22; T 16]. It was proposed that UTLD would pay UTF the same access charges as AT&T, and would contract with UTF to receive certain services from UTF under the same terms and conditions as other IXCs, including billing and collection services, operator services, telemarketing services, direct mail services, trouble reporting service, and certain other administrative services [A 3; R 22; T 16-19,27]. Under the proposal, UTLD would be charged directly by UTF at the same rate as other IXCs for services entirely attributable to UTLD, and the costs of services or assets shared by UTF with UTLD would be allocated pursuant to non-regulated accounting procedures ("NAP") previously approved by the PSC [R 24; T 310-15,329,343-50,389-91].

Although the PSC had previously certificated more than 90 other IXCs--including three that are also subsidiaries of local exchange companies--without substantial controversy, UTLD's application was deemed significant for several reasons [R 400-01]. The fact that UTF is a subsidiary of United Telecommunications, Inc. ("UTI"), and that another subsidiary of UTI is a fifty percent owner of U.S. Sprint, raised questions about the interrelationship of the companies [R 400]. In addition, UTLD's close affiliation with UTF, a major local exchange company, presented novel issues concerning corporate structure and cost allocations [R 401]. Consequently, the PSC set the matter for hearing on its own motion, and a number of competing IXCs, as well as Public Counsel, intervened to oppose UTLD's application.[1] [R 63-90,101,104,188-89,203,400].

After an issue identification meeting on June 18, 1987 and a Prehearing Conference on August 26, 1987, a Prehearing Order was issued on September 14, 1987, identifying fourteen distinct issues and summarizing the positions of the parties [R

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[1]The intervenors below, other than Public Counsel, were AT&T Communications of the Southern States, Inc.; Florida Association of Concerned Telephone Companies; MCI Telecommunications Corporation; Microtel, Inc.; Metromedia Long Distance, Inc.; and Teltec Saving Communications Company.

217-47]. One of the issues, which was included over the objection of UTLD and UTF, posed the question of whether UTLD should be required to pay UTF not only for services and tangible benefits, but also an additional compensation fee in the nature of a royalty for the use of the United Telephone name, logo, and goodwill, and for other intangible benefits allegedly received by UTLD from its association with UTF, such as access to financing and a skilled work force.

Framed as Issue 3, the royalty question was stated as follows:

> Should UTLD compensate UTF and its ratepayers for services and tangible and intangible benefits (including, but not limited to, use of UTF's name, logo, goodwill, information, personnel, facilities and financial resources), if any, UTLD receives from its association with UTF and its ratepayers? If so, should this compensation be accomplished by:
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> a. Accounting for UTLD's revenues and expenses above the line; or
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> b. Sharing of UTLD's profits; or
>
> c. Some form of compensating payment(s) by UTLD to UTF? [R 228.]

The royalty issue was raised by Public Counsel, who had adopted the idea from a similar proposal made by the counterpart consumer representative office in a pending California PSC proceeding involving Pacific Bell [T 526,534-39].

The position of UTLD and UTF on the royalty issue, as set forth in their Prehearing Statement [R 170-87] and summarized in the Prehearing Order [R 228-29], was that UTF should properly be compensated for the tangible benefits it provides to UTLD, but that no royalty should be imposed for so-called intangible benefits. UTLD and UTF urged that UTF and its ratepayers would be fully compensated for the benefits provided to UTLD by UTLD's payment of (a) premium access charges, which include a contribution to the cost of local service; (b) fees for services provided by UTF to UTLD under contractual arrangements, which revenues reduce the need for local rate increases; and (c) an assigned portion of the common costs of assets and services shared by UTF with UTLD, through PSC-approved NAP allocations. UTLD and UTF further maintained that UTLD should not be required to compensate UTF and its ratepayers for use of the United Telephone name, logo, and goodwill, because the United name and logo are not owned by UTF, but are registered service marks of UTF's parent, United Telecommunications, Inc., and because UTF's goodwill or reputation is not something that UTF's ratepayers have furnished, but rather expenditures for goodwill (such as image advertising) are required to be borne by UTF's stockholders. Finally, UTLD and UTF asserted that it would be unreasonable to allow UTF's ratepayers to share in UTLD's profits when only UTF's stockholders are bearing the risks of losses.

Public Counsel, joined by the PSC staff and several of the intervenors, took the position that UTLD should be required to pay a compensation fee or royalty to UTF for intangible benefits, because failure to compensate UTF for those benefits "gives UTLD a free competitive advantage and deprives UTF of compensation for a benefit it provided." [R 230.] Asserting that the value of the United Telephone name, logo, reputation, and heritage "was generated as a by-product of the provision of local telephone service," Public Counsel contended that UTF and its ratepayers "should be compensated for the opportunity cost of not being able to market these things of value to others who might use them." [R 230.] Public Counsel recommended a "cost compensation fee of five percent (5%) of UTLD's total company gross revenues based on the study conducted by the California PSC staff" (actually the Public Staff Division, which is the counterpart of the Public Counsel in Florida [R 539]). [R 231.]

The matter proceeded to a public hearing before the PSC on September 23-24, 1987 [A 1; T 1-691], at which both the propriety of a royalty and the proposed formulae to be applied were the subject of extensive testimony. In support of their position that UTF and its ratepayers would be fully compensated by UTLD's payments for tangible services, and that the imposition of an additional royalty fee for intangible benefits would be improper, UTLD and UTF offered the testimony of two witnesses, Bruce H. Reynolds, the Vice-President of Operations for UTF [T 11], and Richard D. McCrae, the Vice-President of Finance for UTF [T 308].

Reynolds offered several reasons why the proposed royalty would be improper. With respect to UTLD's use of the United Telephone name and logo, he testified that because the name and logo are the property of UTF's parent, United Telecommunications, Inc.,[2] and because neither UTF itself nor its ratepayers have ever paid for the use of that name and logo, it would be wrong to make UTLD pay UTF and its ratepayers for something they never paid for and do not own [T 24,32-33]. He further testified that "goodwill" is not something provided by customers, but is created by the performance of the company that possesses it [T 25]. Moreover, since the PSC requires the expense of goodwill or image advertising to be borne entirely by a utility's stockholders and excluded from ratemaking, the ratepayers are not entitled to be compensated for that intangible asset [T 25,33,98,200-01].

Reynolds also pointed out that UTF's assets belong to its investors, not its ratepayers, and that it is UTF's investors who bear the risk of UTLD's success or failure; thus, any earnings of UTLD should belong to UTF's investors and should not be confiscated for the benefit of UTF's ratepayers [T 22-23]. According to Reynolds, UTF ratepayers will in fact benefit financially from UTLD's payments to UTF for contractual services, which will replace revenues lost due to the phase-out of the use by AT&T of UTF's billing and collection services and operator services [T 15], and UTLD's sharing of costs, which would otherwise be borne entirely by UTF's ratepayers [T 35]. Reynolds refuted the notion that UTLD would enjoy a financial advantage, explaining that UTLD will pay UTF the same access charges as

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[2] It was noted that UTI has previously prosecuted litigation to protect its property right in the United name against unauthorized use [T 219-22,239].

AT&T, and will receive contractual services from UTF under the same terms and conditions as other IXCs [T 27,101-02,111-12].

Reynolds also testified that some of the costs contemplated by the royalty payment are already included in the recovery mechanisms for the NAP allocations, and thus may be duplicated costs if a royalty is imposed [T 234]. He recounted that while UTI subsidiaries had obtained authority to operate as IXCs in North Carolina, South Carolina, and Tennessee, no royalty fee was imposed in any of those other states [T 236-37].

McRae's testimony focused on the financial aspects of the relationship between UTF and UTLD. He explained that UTF's funding of UTLD was "no different than the funding of any subsidiary by a parent with the risk of loss borne by the stockholders of the parent and not by the ratepayers," and that it would have no impact on UTF's ratepayers because any investment in UTLD is excluded from UTF's regulated rate base [T 318-19]. He also confirmed that UTF's ratepayers will benefit because a portion of UTF's fixed costs will be charged to UTLD [T 314-15,322], and because the earnings from UTLD could actually lower UTF's cost of capital [T 409-10]. Finally, he reaffirmed that any work done for UTLD will be charged at the same rate as UTF charges other IXCs [T 346-47].

The principal witnesses testifying in support of the royalty fee were Billy D. Smith, a Utility Analyst with the Office of Public Counsel, and Daryl Nall, an Economic Analyst on the PSC staff. Smith took the position that a royalty fee was justified because the free use of the United Telephone name, reputation, and heritage by UTLD, and UTLD's access to UTF's resources, constituted "a competitive advantage to UTLD." [T 521.] While admitting that UTF ratepayers do not own these intangible assets [T 525], and that UTF itself does not own the "United Telephone" name [T 532], Smith opined that UTF ratepayers "have a beneficial interest in the value of these assets" because they "paid for the valuable exposure the United Telephone name and logo has received" through the local service charges [T 525]. He also stated that he was "concerned that potential customers are being misled through the use of the United Telephone name . . . into paying extra for a non-existent benefit." [T 527-28.]

Smith recommended that a "cost compensation fee" of 5% of UTLD's gross revenues be imposed to compensate UTF and its ratepayers for the "opportunity cost" of UTLD's use of UTF's name, reputation, heritage, and other tangible and intangible assets [T 526]. He based this proposal on a report given to him by his lawyer, which was prepared by the Public Staff Division of the California PSC [T 526], the counterpart of the Office of Public Counsel in Florida [T 539].

Smith admitted, however, that he had not participated in or seen the work papers on which that report was based; that the California PSC had not yet ruled on the proposal; that he had never personally performed or directed a study of royalty payments; and that he did not verify the facts contained in the report [T 534-41]. He also conceded that the California materials involved royalty payments for services that were also included in the NAP allocations for UTLD [T 547-48], and dealt with a franchise relationship that did not exist between UTF and UTLD [T 541-42]. At the conclusion of his testimony, the PSC sustained UTLD's objection and ruled that the California study would not be admitted into evidence [T 567-72].

In her testimony on behalf of the PSC staff, Nall rejected the recommendation of a 5% royalty as a "somewhat arbitrary" figure that "would appear to be confiscatory and . . . could even produce a loss." [T 585-86.] She agreed, however, that a compensatory fee was appropriate because of a marketing advantage to UTLD based on name recognition [T 580-81]. Based on her analysis of the experience of AT&T in 1986 [T 583], she proposed two alternative "sharing mechanisms" to compensate UTF and its ratepayers: either 8% of the difference between total revenue and access charges, or a minimum of 2% of UTLD's gross revenues plus 50% of UTLD's profit up to a maximum of 5% of gross revenues [T 592,596].

On cross-examination, however, Nall admitted that the 8% profit-sharing formula was something she "invented . . . because it seemed like it was an objective easy to audit" figure, and that the "8% could be too high or too low." [T 602-03,620-21,626]. She also conceded that application of her formula would consume about half of the net operating income of AT&T, and that she had no facts to suggest it would not consume at least that much of UTLD's earnings [T 599-600,604,615]; in her opinion, requiring UTLD to pay half its profits to UTF "would be a good amount." [T 630.] Regarding the alternative formula, she admitted that a 2% minimum royalty could result in negative revenue [T 634].

Nall, who had conceded on deposition that she was not an expert on royalties [T - Exhibit 80E], also admitted on cross-examination that she had not analyzed how her alternative compensation mechanisms relate to the dollar benefit that UTLD will receive from UTF [T 597]. Indeed, she did not request any information on UTLD's projected operating income in an effort to determine the impact of her formulae [T 616]. Nall conceded that to place a value on the benefit to UTLD, she would "have to think about that and . . . do more of a study." She admitted using the California Public Staff study as "additional information," but did not verify any facts in that study [T 624-25]. Once again at the conclusion of her testimony, an effort to move the admission of the California study into evidence was rejected by the PSC [T 640-42].

The royalty fee was also supported by three witnesses who appeared on behalf of intervenor IXCs that are competitors of UTLD. Brian Sulmonetti of Microtel stated that UTLD's use of UTF's name will "disadvantage interexchange competitors" [T 420-21]; during his questioning, however, Commissioner Beard stated that "trying to figure out what goodwill costs" is a "problem," and Sulmonetti admitted that he was "not an expert" and "wouldn't venture to even guess." [T 453.] Mark Neptune of Teltec testified that customer confusion could occur if UTLD uses the United Telephone name and logo [T 460]; he admitted, however, that goodwill is not included in rate base accounting [T 493-94], and that the threat of potential loss of market due to name recognition can be offset by advertising [T 511-13]. He also confirmed that application of the proposed fee of 5% of gross revenues in 1986 would have amounted to more than 13 times Teltec's entire net income before taxes [T 486-87]. Donald Evans of MCI likewise acknowledged that a 5% royalty payment would have represented 75-80% of MCI's net income in 1984, 2½ times MCI's net income in 1985, and 3½ times MCI's net income in 1986 [T 277-78].

Significantly, both Sulmonetti and Neptune testified that they considered structural separation of UTF and UTLD a preferable means of offsetting the alleged competitive advantage than denying UTLD the use of the United Telephone name and logo [T 451-52,498-99]. This prompted Commissioners Beard and Wilson to express surprise that two witnesses for the competing IXCs did not consider name recognition to be the most important factor in the anticipated competitive advantage [T 500-01]. Commissioner Beard also suggested that United's name recognition will impact more on AT&T than on other IXCs, which have lower rates [T 503-05].

Following the submission of posthearing briefs [R 259-367], and a PSC staff analysis recommending a royalty fee of 4% of the difference of revenues minus access charges [A 14], the PSC on March 2, 1988 entered Order No. 18939 granting UTLD a certificate of authority to provide IXC service [A 1-12]. As a condition of approving the application, however, the PSC ordered that UTLD "be required to compensate UTF for the intangible benefits it receives because of its association with UTF." [A 2.] While acknowledging that "[t]he majority of the potential benefits and detriments presented by both sides are based on speculation," and that UTLD's existence would be "to the benefit of [UTF's] ratepayers" [A 5], the PSC determined that "UTLD directly benefits from UTF's established name and reputation," and concluded that "[i]t is therefore appropriate to require UTLD to pay to UTF a compensatory fee. . . ." [A 6.]

In setting the royalty, the PSC rejected the recommendations of Smith, Nall, and the PSC staff, and adopted a different formula, stating:

> We find it is in the public interest to require UTLD to compensate UTF for the many intangible benefits it receives, including, but not limited to the following: the use of the United name; the use of the United logo; reliance on the United reputation; immediate access to financing; and the ability to capitalize, through contractual arrangements, on a trained, skilled workforce.
>
> UTLD's relationship to UTF avoids all the start-up costs a fledgling competitor faces when it enters the long distance market. UTF is essentially a one-stop-shopping center for all of UTLD's technical, personnel, administrative, informational and financial needs. We find it unfair to allow UTLD to rely on these benefits without compensating UTF.
>
> Accordingly, the compensatory fee reflects our belief that these benefits were established and are being maintained by the monopoly company, UTF, at ratepayers' expense. The actual fee to be collected shall equal 2.8% of the difference between net revenues (gross revenues minus uncollectibles) and originating and terminating access charges. However, in no event shall the fee exceed, on an after tax basis, 17.5% of

UTLD's net operating income to be computed without the fee.

[A 10.] The order concluded with a Finding of Fact that UTLD "shall compensate [UTF] for use of the United name, logo and reputation, pursuant to the terms of this order." [A 11.]

UTLD and UTF filed a Motion For Reconsideration [R 411-31]. On July 27, 1988, the PSC entered an Order Disposing of Motion For Reconsideration, which modified Order No. 18939 in certain respects not directly affecting the royalty fee [R 466-68]. UTLD and UTF then filed a timely Notice of Administrative Appeal to seek review of Order No. 18939 insofar as it "require[s] UTLD to pay compensation in the nature of a royalty fee to UTF for intangible benefits." [R 469.]

SUMMARY OF THE ARGUMENT

That portion of the PSC's order requiring UTLD to pay a royalty to UTF and its ratepayers should be quashed. Ironically, the California proposal that served as the basis for the royalty recommendation in this case was ultimately not accepted by the California Public Utilities Commission. More recently, in denying another royalty proposal, the California Commission flatly rejected the theory adopted by the PSC below that ratepayers have a compensable interest in the name and reputation of a utility. The same rationale and result should obtain here for three reasons.

First, the order imposing the royalty requirement is not supported by competent substantial evidence. The record is devoid of any evidentiary basis to substantiate or explain the royalty valuation formula adopted by the PSC, which differed from the recommendations of Public Counsel and the PSC staff. Since there was no showing that the formula selected bears any reasonable relationship to the value of the benefits allegedly flowing to UTLD, the royalty is inherently arbitrary. In addition, the PSC's underlying "belief" that UTF's ratepayers established, maintained, and are entitled to be compensated for UTF's intangible assets is not only unsupported by the evidence, but is contrary to the undisputed facts that the United Telephone name and logo are the property of UTF's parent, that the PSC itself requires image enhancement advertising to be paid entirely by UTF's stockholders, and that a utility's goodwill is not attributable to funds received from ratepayers for services.

Second, the imposition of a royalty requirement is unauthorized by statute. The PSC has the power to prescribe such a condition of certification only if it is in the public interest.

In this case, the PSC did not offer any specific reasons to explain why it was in the public interest to make UTLD share its profits with UTF's customers. In fact, the royalty fee does not serve any interest of the public, such as inhibiting anti-competitive practices or eliminating customer confusion over names. Rather, the royalty simply provides an undeserved pecuniary benefit to UTF's customers.

Finally, the royalty fee is constitutionally impermissible because it is confiscatory and violative of due process and equal protection. By compensating UTF's ratepayers for the value of intangible assets that are paid for and owned by UTF's stockholders, and by falsely distorting the ratemaking equation so as to deny UTF a fair return on its investment, the royalty is confiscatory and constitutes a taking of private property. The royalty also violates the due process clause because the fee is inherently arbitrary and bears no reasonable relation to a permissible state objective. Finally, the royalty requirement denies equal protection by forcing UTLD to bear an unreasonable burden not imposed on similarly situated IXCs.

ARGUMENT

I. The PSC's Imposition Of A Royalty Fee Is Not Supported By Competent Substantial Evidence

In light of the fact that the royalty fee proposal in this case had its genesis in a recommendation by the Public Staff Division of the California PSC in a Pacific Bell proceeding, which was relied upon in whole or in part by the witnesses for both Public Counsel and the PSC staff below, it is significant at the outset to note that the California PSC ultimately declined to accept the 5% royalty proposal in that proceeding. In re Pacific Bell, Decision 87-12-067 (Cal. P.U.C. Dec. 22, 1987).[3] The California Commission there stated that it was "not persuaded that DRA's [Division of Ratepayer Advocates] recommendation for a 5 percent across-the-board royalty should be adopted," that it preferred "to rely upon tangible measures to value and compensate for tangible flows of resources or other benefits from utility to affiliate which have an identifiable effect on ratepayers," and that it found "the notion of intangible benefits troubling." [A 20.]

Of greater significance here is a more recent decision of the California PSC in which it flatly rejected the conclusion, adopted by the Florida PSC in this case, that a utility's ratepayers have any proprietary interest in or right to compensation for the utility's name, reputation, and goodwill:

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[3]Relevant excerpts of the unreported California PSC order are included at A 15-21.

> The name and reputation of a utility is not an asset to which ratepayers have a claim. Indeed, the Commission has never included good will in the rate base of a utility for ratemaking purposes. It follows that ratepayers have never had to pay through rates a return on the value of good will. Ratepayers have paid nothing for the enhancement of the utility's name and reputation. Those have been built by the management of the utility if they are of any value. Also, those things which build up the name and reputation of a utility such as institutional advertising and charitable contributions have not been included in the cost of service for ratemaking.

Re Southern California Edison Company, 90 P.U.R. 4th 45, 66 (Cal. P.U.C. 1988) [A 22-24] (emphasis added).

In that case, the Commission rejected the Division of Ratepayer Advocates' recommended royalty payment of 5% of gross revenues, because "DRA has not shown that a royalty payment of 5% . . . bears a relationship to any costs or benefits from the affiliates' association with the utility," and because the DRA witness "was unable to put a value on the [intangible] 'benefits.'" Id. The Commission also found that the DRA witness' "use of the relationship between franchisors and franchisees as an analogy of the relationship between Edison and its affiliates to justify his 5% recommendation . . . is flawed because the underlying comparison is improper." Id.

The Southern California Edison case is particularly instructive here because it demonstrates that the factual basis for the PSC's decision on the royalty fee issue is fatally deficient in two respects. First, and most obviously, the record is utterly devoid of any evidentiary predicate for the royalty fee valuation formula adopted below. Second, the undisputed facts refute the PSC's "belief" that the intangible benefits for which the royalty is to be imposed "were established and are being maintained by the monopoly company, UTF, at ratepayers' expense." Under settled principles, an absence of competent substantial evidence to support the PSC's findings requires reversal of the order. E.g., Duval Utility Co. v. Florida Public Service Commission, 380 So.2d 1028, 1031 (Fla. 1980); State v. Hawkins, 364 So.2d 723, 727-28 (Fla. 1978).

As indicated in the Southern California Edison case, the determination of whether a particular compensation fee can properly be charged for intangible benefits must depend on an assessment of the relationship of the proposed royalty to the value of the benefits for which it is to be paid. Such a comparison in this case necessarily requires a finding as to the value of the alleged intangible benefits to UTLD and the impact of the proposed royalty fee on UTLD's viability as an IXC. Absent such findings, any royalty fee is inherently and completely arbitrary--a figure simply "plucked out of thin air."

A review of the record reveals that there was absolutely no evidence presented, nor any finding made, either as to the value of the alleged intangible benefits to UTLD, or as to the impact of any royalty fee on UTLD's ability to operate and compete in the long distance market. As a consequence, there is no factual foundation whatsoever to support a conclusion that the royalty fee figure selected by the PSC--2.8% of the difference between revenues and access charges, but not exceeding 17.5% of net income after taxes--bears any reasonable relationship to the costs or benefits arising from UTLD's association with UTF.

Indeed, although the record reflects five different royalty fee recommendations from four different sources--one by Smith for Public Counsel, two by Nall, one by the PSC staff, and the one ultimately fashioned by the PSC in its final order--not one of the proponents even attempted to relate the recommended royalty fee formula to the value of the benefits for which UTLD was to pay UTF. Given the absence of these essential findings, or of any reliable evidentiary foundation that would have supported such findings,[4] it is manifest that the royalty imposed by the PSC is an arbitrary fee unsupported by any competent substantial evidence, and thus cannot be sustained. E.g., Blocker's Transfer & Storage Co. v. Yarborough, 277 So.2d 9, 12 (Fla. 1973).

Aside from the fact that the record is devoid of any factual basis for the PSC's formula as a valuation of the intangible benefits allegedly flowing to UTLD, the imposition of a royalty fee must be reversed because it is premised on the PSC's equally unfounded "belief" that UTF's ratepayers established, maintained, and are entitled to be compensated for the utility's intangible assets. Any conclusion that UTF's ratepayers have a

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[4]The only assessments attempted below involved measuring the potential impact that some of the royalty fee formulas proposed by the witnesses would have had on some of the existing IXCs during various years; notably, these comparisons yielded results showing that the royalty fees would have consumed amounts ranging from one-half to more than ten times the respective IXCs' profits.

proprietary interest in the United Telephone name, logo, reputation, and heritage not only lacks an adequate factual foundation, but flies directly in the face of the undisputed evidence, and must therefore be rejected. An agency order resting on a conclusion that conflicts with unrebutted testimony must be set aside as one not supported by competent substantial evidence. State v. Hawkins, 364 So.2d at 727-28; Wade Bradford Grove Service, Inc. v. Bowen Bros., Inc., 382 So.2d 719, 720 (Fla. 1st DCA 1980).

At the hearing below, UTLD and UTF presented Reynolds' unrebutted testimony that the United Telephone name and logo do not belong to UTF or its ratepayers, but are the registered property of UTF's parent, UTI. In addition, his testimony was uncontradicted that neither UTF nor its ratepayers for their part are paying or have ever paid for use of the United Telephone name and logo. Thus, insofar as the order below rests on the conclusion that UTF and its ratepayers have some rights in the United Telephone name and logo that entitles them to compensation for the use thereof by UTLD, the order is not supported by competent substantial evidence.

With respect to the finding that UTF and its ratepayers should be paid for UTLD's "reliance on the United reputation," the record reflects no factual basis for attributing UTF's reputation or image to the contributions of the ratepayers. Significantly, it was undisputed that the only identifiable direct expenditure made by UTF to enhance its reputation, image advertising, is required by the PSC to be excluded from the ratemaking process and to be borne entirely by UTF's stockholders. The evidence showed that, in fact, UTF spent $1,018,668 on image advertising in 1986, and that none of that expense was contributed by the ratepayers.

As for other elements of goodwill, testimony presented by Reynolds on behalf of UTLD and UTF established that goodwill, in terms of reputation, is earned by the company's performance, and like other assets is the sole property of its stockholders. Characterizing the idea that ratepayers contribute to and should receive a monetary return on a utility's goodwill as "not even rational," Reynolds offered the following hypothetical to illustrate the point:

> [T]wo ratepayers may pay identical rates to two utilities, one of which provides excellent, reliable service and the other of which provides terrible service. No reasonable person would suggest that both companies earned equal amounts of goodwill in terms of reputation, yet the ratepayers' contribution would have been equal in both cases. [T 25-26.]

Because the evidence clearly established that a utility's goodwill is not the product of customer contributions, there is no basis for the PSC's conclusion that UTF's ratepayers have acquired an interest in the value of UTF's reputation for which they should be compensated by UTLD.

Advocates of the royalty fee argued that UTF's ratepayers have a "beneficial interest" in UTF's goodwill on the theory that it is a by-product of the provision of local telephone service, for which the ratepayers are charged. Such suggestions, however, do not satisfy the competent substantial evidence standards established by this Court, but are merely "conclusory statements," which "do not provide sufficient support for the findings necessary to underpin the commission's action." Duval Utility Co. v. Florida Public Service Commission, 380 So.2d at 1031. There was no evidence offered to establish a factual link between ratepayer contributions and the quality of UTF's service.

In any event, it is settled as a matter of law that ratepayers do not acquire an interest in a utility's property by paying for the services they receive. As the United States Supreme Court has observed:

> Customers pay for service, not for the property used to render it. . . . By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company.

Board of Public Utility Commissioners v. New York Telephone Co., 271 U.S. 23, 32 (1926). Absent some factual basis to warrant a finding that intangible property should be treated differently than tangible assets in this regard, the PSC's conclusion that UTF's ratepayers should be compensated for the value of the company's intangible assets is without any evidentiary or legal foundation, and must therefore be rejected.

The foregoing analysis demonstrates that the PSC erred in ruling that payment of a royalty fee by UTLD was justified in this case to compensate UTF's ratepayers for the value or "opportunity cost" of UTF's name, logo, reputation, and other intangible benefits.[5] Here, as in the Southern California Edison case, the record does not contain competent substantial evidence to support either the arbitrary royalty fee formula adopted by the PSC or the underlying conclusion that UTF and its ratepayers are entitled to such compensation from UTLD. Accordingly, that portion of the order imposing the royalty fee should be quashed.

[5] It is important to note that UTF is being fully compensated by UTLD for all services and tangible assets provided by UTF. Indeed, the evidence established and the PSC recognized that monies received by UTF from UTLD, through access charges, contractual payments, and NAP allocations, would benefit UTF's ratepayers by reducing the cost of regulated telephone service.

II. The PSC's Imposition Of A Royalty Fee Is Not Authorized By Statute Because It Is Not In The Public Interest

The PSC cited no statutory authority for the imposition of the royalty fee below, and in fact there is no statute specifically empowering the PSC to impose a royalty fee in this context. Such authority, if any, can only be derived from section 364.335(4), Florida Statutes (1987), which provides that the PSC "may grant a certificate, in whole or in part <u>or with modifications in the public interest</u>," or from section 364.337(1)(a), which provides that "the commission, <u>if it finds that such action is consistent with the public interest</u>, may . . . [p]rescribe different requirements for the company than are otherwise prescribed for telephone companies." (Emphasis added.)

The plain import of these provisions is that the PSC has authority to modify an application for a certificate by prescribing special requirements only if the conditions imposed are in the public interest. As recognized by this Court, the limitation created by the legislature ensures that the PSC does not exercise unbridled discretion in the certification of telephone companies. See <u>AT&T Communications of the Southern States, Inc. v. Marks</u>, 515 So.2d 741, 743-44 (Fla. 1987); <u>U.S. Sprint Communications Co. v. Marks</u>, 509 So.2d 1107, 1110 (Fla. 1987); <u>Microtel, Inc. v. Florida Public Service Commission</u>, 464 So.2d 1189, 1191 (Fla. 1985).

In ordering the imposition of the royalty fee below, the PSC recited that "it is in the public interest to require

UTLD to compensate UTF for the many intangible benefits it receives." The PSC did not offer any specific reasons to explain why the royalty requirement would be in the public interest, however, other than the bare conclusory statement that it would be "unfair to allow UTLD to rely on these benefits without compensating UTF." It is readily apparent that, in fact, the imposition of a royalty fee does not serve any interest of the <u>public</u>, but simply provides an unwarranted pecuniary benefit to UTF's ratepayers.

In its order, the PSC recognized that the certification of UTLD would benefit both the public and UTF's ratepayers in several ways. On the other hand, the PSC also identified a number of perceived problems that could result if UTLD's application were granted without modification. With only two exceptions, however, the problems posed involved potential disadvantages to UTLD's competing IXCs or potential detriments to UTF's ratepayers.

The only perceived threats to the <u>public</u> interest were the opportunity to "introduce certain anti-competitive practices into the IXC market" and the possibility, based on the use of the United name, that "[c]ustomers will be confused as to who is actually providing their long distance service." Because the payment of a royalty by UTLD to UTF would do nothing to inhibit anti-competitive practices or to reduce customer confusion, there is no public interest justification supporting the PSC's exercise of statutory authority to impose that special requirement. Absent such statutory authority, of course, it is clear that the

PSC has no power to order the payment of a royalty, and therefore that portion of the order entered below must be quashed. See, e.g., United Telephone Co. v. Public Service Commission, 496 So.2d 116, 118 (Fla. 1986); City of Cape Coral v. G.A.C. Utilities, Inc., 281 So.2d 493, 495-96 (Fla. 1973) (PSC has only those powers conferred by statute, and any reasonable doubt as to the existence of a particular power must be resolved against the exercise thereof).

III. The PSC's Imposition Of A Royalty Fee Is Confiscatory And Contravenes The Due Process And Equal Protection Clauses Of The Florida And Federal Constitutions.

This Court has established that, in reviewing orders of the PSC, it "will not affirm a decision of the Commission if it is arbitrary and unsupported by substantial competent evidence, or in violation of a statute or a constitutionally guaranteed right." Shevin v. Yarborough, 274 So.2d 505, 509 (Fla. 1973). The arguments in points I and II above demonstrate that the PSC's decision to impose a royalty fee against UTLD in this case is unsupported by competent substantial evidence and exceeds the PSC's statutory authority. Even if the Court concludes that those grounds are not sufficient to warrant reversal, however, the royalty fee must nonetheless be set aside because it is confiscatory and violates the due process and equal protection clauses of the Florida and federal constitutions.[6]

The constitutional provision that no person may be deprived of property without due process of law prohibits the confiscation of private property, except for a public purpose and upon payment of just compensation. See, e.g., Keating v. State, 173 So.2d 673, 677 (Fla. 1965); Holland v. Fort Pierce Financing & Construction Co., 157 Fla. 649, 27 So.2d 76, 83 (1946). In this case, the PSC's order is confiscatory in at least two respects. First, to the extent that the royalty provides compensation to UTF's ratepayers for the value of UTF's reputation or

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[6] Art. I, §9 and art. X, §6(a), Fla. Const.; amend. V and amend. XIV, U.S. Const.

goodwill, it constitutes a taking of property that belongs exclusively to UTF's stockholders.

Even assuming that some elements of goodwill could properly be attributed in part to ratepayer contributions, it is undisputed that UTF's expenditures for image advertising--which amounted to more than one million dollars in 1986--are required by the PSC to be borne entirely by UTF's stockholders. Because the PSC prohibits UTF from recovering any of that image advertising cost from ratepayers, they cannot be deemed to have any ownership interest in the property created by those expenditures. Thus, the imposition of a royalty that compensates the ratepayers for the value of UTF's image is nothing less than an impermissible confiscation of property owned by UTF's stockholders.

A less obvious but equally objectionable confiscatory effect of the royalty fee requirement is that it will, as a practical matter, impair UTF's opportunity to earn a fair rate of return on the capital it has invested to provide regulated services. As this Court has recognized, "[a] regulated public utility is entitled to an opportunity to earn a fair or reasonable rate of return on its invested capital . . . for the benefit of the utility's investors," United Telephone Co. v. Mann, 403 So.2d 962, 966 (Fla. 1981), and "[f]ailure to allow the utility the opportunity to earn a fair rate of return would violate the rights to due process, to just compensation for taking of property and the right to possess and protect property." Gulf Power Co. v. Bevis, 289 So.2d 401, 403 n.1 (Fla. 1974). The United

States Supreme Court has likewise held that denial of a reasonable return is "unjust, unreasonable, and confiscatory, and . . . deprives the public utility company of its property in violation of the 14th Amendment." Bluefield Water Works & Improvement Co. v. Public Service Commission, 262 U.S. 679, 690 (1923).

The confiscatory effect of the royalty in this regard follows from a distortion of the ratemaking equation. Ordinarily, a company's revenue requirement, which is based on its level of investment (or rate base) and its required rate of return, should equal the company's revenues from existing regulated service rates. However, inclusion of the royalty payments in UTF's "above-the-line" revenues, without a corresponding increment in the rate base for the value of goodwill and other intangible assets for which the royalty is received, will distort the equation by imputing to UTF revenues that are not actually being earned from regulated services.

With revenues thus being falsely inflated by the royalty payments, it will appear that UTF's regulated revenue exceeds its revenue requirements, even though in actuality UTF may not be receiving sufficient revenues from regulated services to produce a fair return on the investment made to provide those services. The result is that the royalty could prevent UTF from ever earning a fair return on its investment. Thus, by ordering the payment of royalty fees to UTF, the PSC will in effect confiscate profits from UTLD to deprive UTF of the fair rate of return to which it is constitutionally entitled.[7]

In addition to proscribing the confiscation of private property, the due process clauses of the state and federal constitutions operate to prohibit state officials from taking action that affects property rights in a manner that is arbitrary, or that is not reasonably related to a permissible government objective. See, e.g., Prune Yard Shopping Center v. Robins, 447 U.S. 74, 85 (1980); Johns v. May, 402 So.2d 1166, 1169 (Fla. 1981). Measured by these standards, the royalty imposed by the PSC must be deemed violative of due process on both grounds.

The most patent defect in the royalty requirement is that the amount of the fee to be assessed is inherently arbitrary. As previously discussed, there is not one shred of evidence in the record to substantiate the PSC's determination that 2.8% of the difference between net revenues and access charges is appropriate compensation for the intangible benefits allegedly provided by UTF to UTLD. From all that appears in the testimony and in the order, the PSC could just as easily have selected another formula, or simply ordered that all UTLD revenues be paid over to UTF, and neither the parties nor this Court would have any basis for determining the derivation of the formula or the propriety of the order. Such arbitrary and capricious

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[7]The right of a telephone company to "a reasonable rate of return upon its rate base" is also recognized by statute in Florida. §364.035(1), Fla. Stat. (1987).

decisionmaking by the PSC clearly cannot withstand constitutional scrutiny.

Furthermore, there is no factual foundation to support a finding that the royalty imposed is reasonably related to a permissible government objective. In the first place, prior analysis has demonstrated that the ostensible purposes for requiring UTLD to compensate UTF bear no relation to the public interest, but serve only to benefit UTF's ratepayers and UTLD's competitors. The only stated goals that can be fairly regarded as permissible government objectives are to protect against anti-competitive practices and to prevent customer confusion; yet it is unclear to what extent, if any, the imposition of a royalty fee is reasonably related to either of those objectives. In any event, there is absolutely no evidence from which it can be determined whether the amount of the royalty fee is sufficient or excessive for purposes of accomplishing any of the PSC's avowed goals.

Finally, the constitutional guaranty of equal protection forbids unjust discrimination by requiring that the states and their agencies afford the same rights and impose the same burdens on similarly situated persons. See, e.g., Plyler v. Doe, 457 U.S. 202, 216 (1982); Davis v. Florida Power Co., 64 Fla. 246, 60 So. 759, 766 (1913). While more than 90 other IXCs have been granted certificates of authority in Florida, including three that are also subsidiaries of local exchange companies, only UTLD has been subjected to the requirement that it must share its profits with its parent and the parent's customers.

That burden places UTLD at a serious disadvantage as compared to its similarly situated competitors, and thus constitutes an unjust discrimination that denies UTLD equal protection. Accordingly, the royalty requirement must be reversed.

CONCLUSION

The foregoing analysis confirms that the imposition of a royalty fee on UTLD as a condition of certification was improper and unauthorized. Neither the compensation formula selected by the PSC nor the underlying conclusion that any royalty was appropriate and necessary is supported by competent substantial evidence. In addition, the PSC's attempt to require payment of a royalty is statutorily unauthorized and constitutionally impermissible. Accordingly, that portion of the order entered below imposing a royalty fee as a condition of certification for UTLD should be quashed.

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