IN THE SUPREME COURT OF FLORIDA

UNITED TELEPHONE LONG DISTANCE, INC., and UNITED TELEPHONE COMPANY OF FLORIDA,

Appellants,

vs.

FLORIDA PUBLIC SERVICE COMMISSION,

Appellee.

Case No. 72,988

ON APPEAL FROM THE FLORIDA PUBLIC SERVICE COMMISSION

REPLY BRIEF OF APPELLANTS

Julian Clarkson
Michael L. Rosen
HOLLAND & KNIGHT
Post Office Drawer 810
Suite 600, Barnett Bank Bldg.
Tallahassee, FL 32302
(904) 224-7000

and

Jerry M. Johns
UNITED TELEPHONE COMPANY
OF FLORIDA
Post Office Box 5000
Altamonte Springs, FL 32716-5000

Attorneys for Appellants

TABLE OF CONTENTS

	Page
Table of Citations	ii
Argument	1
I. The PSC's Imposition Of A Royalty Fee Is Based On Findings That Are Not Supported By Competent Substantial Evidence And That Are Legally Erroneous.	1
II. Imposition Of The Fee Is Not Authorized By Statute Because It Is Not In The Public Interest.	10
III. Imposition Of The Fee Is Confiscatory And Unconstitutional.	12
Conclusion	15
Certificate of Service	

TABLE OF CITATIONS

Cases	Page(s)
Board of Public Utility Comm'rs v. New York Telephone Co., 271 U.S. 23, 32 (1926)	1,6
Democratic Central Comm'n v. Washington Metropolitan Area Transit Comm'n., 485 F.2d 786, 806 (D.C. Cir. 1973)	3
General Development Utilities, Inc. v. Hawkins, 357 So.2d 408 (Fla. 1978)	passim
Gulf Power Co. v. Public Service Comm'n, 453 So.2d 799 (Fla. 1984)	passim
In Re Pacific Bell, Decision 87-12-067 (Cal. P.U.C. Dec. 22, 1987)	5
Re Southern California Edison Co., 90 P.U.R. 4th 45, 66 (Cal. P.U.C. 1988)	1,2,5

Florida Statutes

Section 364.14	11,13

ARGUMENT

I. The PSC's Imposition Of A Royalty Fee Is Based On Findings That Are Not Supported By Competent Substantial Evidence And That Are Legally Erroneous.

As its primary point on appeal, UTLD maintains that the PSC's imposition of a compensation fee for the benefit of UTF's ratepayers as a condition of certification is unfounded and should be set aside for two reasons. First, the compensation formula selected by the PSC is not supported by any competent substantial evidence of record as to the value of the alleged intangible benefits flowing to UTLD from UTF, or the impact of the fee on UTLD's ability to operate and compete in the long distance market. Second, the PSC's "belief that these [intangible] benefits were established and are being maintained by the monopoly company, UTF, at ratepayers' expense," is factually incorrect, because the evidence is undisputed that UTF's ratepayers do not own or pay for the use of the United name and logo, and that UTF's image advertising is funded entirely by the stockholders.

Moreover, UTLD maintains that the underlying basis for the PSC's ruling--that UTF's ratepayers are entitled to be compensated for UTLD's use of UTF's intangible assets--is legally erroneous. The United States Supreme Court has held that ratepayers do not acquire any interest in a company's property by paying for services, Board of Public Utility Comm'rs v. New York Telephone Co., 271 U.S. 23, 32 (1926); and the California Public Utilities Comm'n, in the only reported decision addressing this issue, has concluded that ratepayers do not contribute to and have no claim of right in a utility's name and reputation. Re

Southern California Edison Co., 90 P.U.R. 4th 45, 66 (Cal. P.U.C. 1988). No authority supports the theory that ratepayers have a right to compensation for use of a utility's goodwill.

The principal thrust of the arguments offered by the PSC and by Public Counsel in defense of the compensation fee is (a) that UTLD "will benefit substantially by using the name 'United' and otherwise being associated with" UTF; (b) that these intangible benefits--including the United name and reputation--"were substantially created by ratepayer revenues and are being maintained by those revenues," so that there is a "need for compensation" that will "remedy the perceived injustice"; and (c) that the compensation formula chosen by the PSC is "a reasonable alternative" that must be sustained under the authority of Gulf Power Co. v. Public Service Comm'n, 453 So.2d 799 (Fla. 1984), because it "is within the range of fees recommended by witnesses in the proceeding." In essence, the PSC and Public Counsel focus heavily on the evidence showing that UTLD will receive benefits from its association with UTF, and suggest that the compensation fee is justified because it would be unfair or "intolerable" to allow UTLD to receive such benefits without charge.

UTLD does not deny that it will benefit from the use of the United name and from its association with UTF. That fact alone, however, clearly does not warrant the PSC's conclusion that UTLD should be required to pay up to 17½% of its net income as a fee to compensate UTF's ratepayers. Indeed, nothing could be more unfair or unjust than to award such a windfall to UTF's ratepayers in light of the undisputed facts that those ratepayers

will bear no risk of any losses that UTLD may suffer, and will already benefit from the payments by which UTF is being fully compensated for all services and tangible assets provided to UTLD.

Stated another way, there is simply no rational basis for rewarding UTF's ratepayers with a reduction in local service charges based on earnings from a venture into the long distance market by UTF's stockholders, who must alone bear the risk of losses. The unrefuted testimony of UTLD's witnesses established 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. "[H]e who bears the financial burden of particular utility activity should also reap the benefit resulting therefrom." Democratic Central Comm'n v. Washington Metropolitan Area Transit Comm'n, 485 F.2d 786, 806 (D.C. Cir. 1973). In fact, the only evidence as to any effect on UTF's ratepayers was that they will benefit from the operation of UTLD, because UTLD's payments to UTF will replace revenues that would otherwise be lost by the phase-out of the use by AT&T of UTF's billing, collection, and operator services, and because UTLD will be sharing common costs that would otherwise be borne entirely by UTF's ratepayers.

Given the fact that UTF will be fully compensated for all services and tangible assets provided to UTLD, and that UTF's ratepayers stand to gain from this arrangement without any risk of loss, it is difficult to conceive of any reasonable basis for

requiring UTLD to pay additional compensation for the benefit of UTF's ratepayers. Without the operation of UTLD, UTF's ratepayers would pay the same rates for the same local telephone services; with the operation of UTLD, UTF's ratepayers will pay lower rates for the same local services without regard to the royalty, and will also enjoy the convenience of "one-stop shopping" for both local and long distance services. To grant them an additional reward in the form of a compensation fee from UTLD that will further reduce their local service rates--by artificially inflating UTF's return on its rate base--is nothing less than an unwarranted windfall at the expense of UTF's stockholders.

Despite the emphasis placed by the PSC and Public Counsel on the fact that UTLD will benefit from the use of the United name, logo, and reputation, the real issue here is not whether UTLD receives a benefit, but whether it should be required to compensate UTF's ratepayers for that benefit. That the PSC and Public Counsel are missing the point is illustrated by their reliance on the fact that United companies have formed long distance subsidiaries using the local exchange company name in other jurisdictions, and have experienced significant market penetration based on the United name and reputation. What they fail to mention, however, is the critical fact that in none of those other jurisdictions has the United long distance service subsidiary been required to pay a royalty or compensation fee to the parent local exchange company.

The reasons why no such royalties or compensation fees for intangible benefits have been imposed elsewhere are explained

in the two California Public Utilities Commission decisions discussed in the initial brief. In In re Pacific Bell, Decision 87-12-067 (Cal. P.U.C. Dec. 22, 1987), the California PUC denied the very recommendation on which the witnesses for the PSC and Public Counsel relied in this case, because it found "the notion of intangible benefits troubling." More recently, the California PUC considered and rejected the theory adopted by the PSC here that ratepayers are entitled to compensation for such intangible assets as the utility's name, reputation, and goodwill:

> 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 Co., 90 P.U.R. 4th 45, 66 (Cal. P.U.C. 1988) [A 22-24] (emphasis added).

Although the PSC suggests that the California PUC decisions are factually distinguishable,[1] no contrary authority is cited to support the notion that ratepayers have a compensable interest in the utility's intangible assets. Rather, the PSC and

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[1]The PSC's position here is the opposite of that taken by its witnesses below, who argued that the study prepared for the California Pacific Bell proceeding should be applicable to the present case.

Public Counsel rely on testimony of their witnesses to the effect that UTF's reputation "is determined by its quality of service, which service is paid for by local ratepayers," and that UTF's name recognition is attributable to "advertising for which ratepayers do pay that has the effect of enhancing the company's image by keeping its name before the public; e.g., logos on trucks. . . ." These contentions are meritless.

As pointed out in the initial brief, 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. The United States Supreme Court has stated:

> 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 Comm'rs v. New York Telephone Co., 271 U.S. 23, 32 (1926). It is significant that neither the PSC nor Public Counsel has addressed or even alluded to this authority. Certainly, no amount of testimony can alter an established principle of law.

Nor can the fact that UTF paints the company logo on its trucks--property owned by the stockholders--constitute a basis for concluding that ratepayers have somehow contributed to image advertising and thereby acquired a compensable interest in the company's name and reputation. It is undisputed that in Florida, as in California, the Commission does not allow goodwill to be included in a regulated utility's rate base; rather, image advertising is required by the PSC to be excluded from the

ratemaking process and to be borne entirely by the company's stockholders. In fact, of the $1,108,668 spent by UTF on image advertising in 1986, not one cent was contributed by or charged to the ratepayers.

Any notion that a utility's goodwill depends upon ratepayer contributions was refuted by the hypothetical posed by UTLD's witness below:

> [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.]

Neither law, nor logic, nor any competent substantial evidence of record supports the theory that ratepayer contributions through payment for services "establishes" or "maintains" the intangible assets of UTF for which the compensation fee would be assessed. Consequently, the PSC's order imposing the fee on UTLD cannot stand.

In any event, even assuming that some interest in the United name, logo, and reputation could properly be ascribed to UTF's ratepayers, the record is utterly devoid of any evidence to support the compensation formula adopted by the PSC. To determine a reasonable compensation fee, it is essential that there be some assessment of (a) the value of the intangible benefits to UTLD, (b) the proportionate share of that value (if any) that is attributable to the contributions of UTF's ratepayers, and (c) the impact of the proposed fee on UTLD's ability to compete in

the IXC market. In this case, however, no evidence was adduced as to any of those essential evaluations; rather, the PSC simply selected an arbitrary figure out of thin air.

The PSC and Public Counsel defend the formula adopted below on the basis that it falls within the range of proposed fees suggested by the various expert witnesses, and therefore is a "reasonable alternative" that must be sustained under this Court's decision in Gulf Power Co. v. Florida Public Service Comm'n, 453 So.2d 799 (Fla. 1984). Public Counsel asserts that "[f]actually Gulf is indistinguishable and must control the disposition of this case." Even a cursory review of the Gulf Power decision, however, reveals that it involved drastically different circumstances and that the principles applied there cannot be extended to this case.

At issue in Gulf Power was the question of how much fuel inventory Gulf Power should be allowed to include in its rate base. A simple question of value was at issue, all parties having apparently agreed that some level of fuel was needed. By contrast, in this case UTLD is not arguing in favor of a different royalty amount; it is arguing that no royalty is permissible, or to put it in terms of Gulf Power, fuel is not used. That is not equivalent to saying the value is $0 in a mathematical sense so that some value between $0 and a higher number appears to be a reasonable compromise.

Other grounds distinguish Gulf Power from this case. Gulf Power's witness had proposed a "60-day nameplate policy" adopted by the company's management, which would allow Gulf Power to include a fuel inventory of $64,801,764. The PSC staff, on

the other hand, had urged a reduction in allowable inventory based on a "90-day projected burn level," which would only amount to $46,812,917. The PSC found that neither proposal was supported by sufficient evidence to establish which policy ought to be adopted, and therefore it approved an inventory level halfway between the two proposals as being "within a zone of reasonableness." In affirming that result on appeal, this Court explained:

> Although the PSC rejected both Gulf's 60-day nameplate policy and the staff's 90-day projected burn level as necessarily proper, it was presented with sufficient evidence to enable it to choose a reasonable alternative.

453 So.2d at 805 (emphasis added).

Significantly, the Court in Gulf Power distinguished its decision in General Development Utilities, Inc. v. Hawkins, 357 So.2d 408 (Fla. 1978), where it had held that the PSC's selection of an equity/debt ratio was arbitrary and violative of due process:

> That case is distinguishable from the instant one in that we reached our conclusion because the PSC's decision was based on facts outside the record relating to other utilities generally. Here the PSC made a reasoned judgment based on competent substantial evidence within the record which related specifically to Gulf.

Id. (emphasis added). In General Development, this Court deemed improper the fact that the PSC, when confronted with two competing figures, "selected a ratio which nowhere appears in the record, apparently fabricating one for the company based on

information it has compiled for water companies generally." 357 So.2d at 409.

It is apparent from the foregoing analysis that the present case should not be controlled by Gulf Power, but rather should be governed by the same reasoning that warranted reversal of the PSC order in General Development. Here, as in General Development, the PSC selected an arbitrary compensation fee formula that was not based on any evidence of record relating to UTLD, but was fabricated from testimony and information concerning other telephone companies. Moreover, the various proposals presented by the witnesses who advocated a royalty below would have resulted in fees ranging from 50% to more than 13 times the total profit of the companies compared. This range of alternatives can hardly be characterized as reasonable; nor can the percentage selected by the PSC be regarded as reasonable without some evidence to substantiate its relation to UTLD's alleged benefits and anticipated earnings. Consequently, the compensation fee formula adopted below should not be approved under Gulf Power, but should be rejected as arbitrary on the authority of General Development.

II. Imposition Of The Fee Is Not Authorized By Statute Because It Is Not In The Public Interest.

In the initial brief, UTF and UTLD demonstrated that imposition of the compensation fee is not within the lawful authority of the PSC because (a) the only statutes that could be construed to confer such power on the PSC are those allowing certificates to be modified or subjected to different require-

ments "in the public interest"; and (b) although the PSC recited that it was in the public interest to require UTLD to pay compensation for the intangible benefits it derives from UTF, such fee actually serves no public interest but merely provides an unwarranted pecuniary windfall to UTF's ratepayers.

The PSC and Public Counsel argue that the compensation fee for the benefit of UTF's ratepayers is authorized because it will effectively reduce the local service rates paid by UTF's ratepayers, which "furthers the public interest in assuring universal service at affordable rates."[2] The problem with this theory is threefold.

First, it does not eliminate constitutional prohibitions against confiscation of property through failure to allow UTF to earn a fair rate of return. Second, it is unclear how a reduction of the rates paid by UTF's customers for local service promotes the <u>public's</u> interest. Third, even without the royalty, UTF's ratepayers will receive a benefit in the form of reduced local service costs--<u>costs that have already been determined by the PSC to be fair and reasonable</u>--by virtue of the fact that UTLD will pay full compensation to UTF for the services and tangible benefits provided. Thus, it is unclear why the <u>public</u>

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[2]Public Counsel's suggestion that the royalty may be assessed against UTLD based on the PSC's authority under section 364.14 to regulate rates and unjust or unreasonable practices of <u>local exchange companies</u> must be rejected because (a) it would extend the statutorily delegated powers beyond their proper scope, (b) there is no finding in the record to support the conclusion that UTLD's association with UTF results in unjust, unreasonable, or discriminatory rates for UTF's ratepayers, and (c) UTF's "practices" are not at issue in a UTLD certification proceeding.

interest requires that UTLD further subsidize UTF's ratepayers with a share of UTLD's profits, thereby reducing local service rates below the level needed to give UTF a reasonable return on its rate base--a result that is contrary to the public interest and prohibited by law.

The PSC and Public Counsel have failed to establish that the compensation fee is in the public interest. Accordingly, the imposition of that fee is unauthorized and must be set aside.

III. Imposition Of The Fee Is Confiscatory And Unconstitutional.

As the final point on appeal, UTLD maintains that the compensation fee is confiscatory and unconstitutional because (a) it constitutes a taking of property that belongs exclusively to UTF's stockholders for the benefit of UTF's ratepayers, without any public purpose justification; (b) it deprives UTF of the constitutionally protected right to earn a fair rate of return on its rate base by artificially inflating UTF's income and thereby distorting the ratemaking equation; (c) it is based on a formula that is inherently arbitrary in amount and that has no demonstrated relation to a permissible governmental objective; and (d) it violates UTLD's right to equal protection by imposing a burden to which similarly situated companies are not subjected.

At the outset, Public Counsel contends that the compensation fee will benefit UTF in the form of increased revenues, and therefore UTF has no standing to complain. The notion that imposition of a royalty will benefit UTF as opposed to UTF's

ratepayers is, however, clearly erroneous.[3] That the royalty will work an actual harm to UTF is illustrated by a simple hypothetical: In order to provide UTF with the opportunity to earn a fair rate of return (as guaranteed by the federal and Florida constitutions, and section 364.14, Florida Statutes), the Commission calculates UTF's investment, its expenses, and the required rate of return. Assume that the investment, expenses, and rate of return required to serve <u>UTF's</u> ratepayers demonstrate that UTF's rates to its customers should be set to produce $10 million annually. Also assume that the UTLD royalty generates $1 million to UTF (whether actually paid or imputed is immaterial). In setting UTF's rates to its customers, the Commission will offset the $10 million revenue requirement by the $1 million royalty, and thus will establish rates to collect only $9 million.

In plain terms--and this is the point that neither the PSC nor Public Counsel acknowledged--imposing a royalty fee allows the PSC to set rates below UTF's cost of serving its ratepayers. Stated another way, UTF will never be able to earn its authorized rate of return because its rates will be set to generate less revenues than are necessary to cover UTF's expenses and allow it a reasonable return on its investment.

Similarly, Public Counsel's exposition on the effects of consolidated accounting is not well taken. In the first place, there is no evidence in the record as to the effects of

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[3]Even the Commission rejects Public Counsel's argument on this point, recognizing that the fee will "return the value of those benefits to the ratepayers." (Commission Brief at 26.)

consolidated accounting. Moreover, Public Counsel knows full well that the PSC does not utilize consolidated financial accounting principles for ratemaking. To the contrary, the regulated operations of the company stand alone, and that is one reason why elaborate care is used to calculate a rate base rather than simply relying on published financial statements.

The PSC's and Public Counsel's response to UTLD's equal protection argument is that since UTLD is "unique," it can make no equal protection claims. This uniqueness cannot be ascribed to the fact that UTLD's parent is a local exchange telephone company, because there are now three long distance companies in Florida that are owned by local exchange carriers and that are not burdened by the royalty requirement.[4] Rather, the alleged uniqueness can only be predicated on the fact that UTF is a "major local exchange company." Such a classification is not recognized in the Florida Statutes, the Florida Administrative Code, or Florida decisional law and, therefore, is itself arbitrary and capricious. Moreover, no causal connection between UTF's size and the handicap that the royalty imposes on UTLD's ability to compete with the 90 other long distance carriers is

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[4]The PSC's statement that "UTLD is the only IXC in Florida which is associated with the area's local telephone company" (Commission Brief at 25) is in error, as is the statement that "no other IXC" is situated to gain market share by virtue of being associated with the area's local exchange company (Commission Brief at 26). Indeed, the PSC expressly acknowledged in its order below that "[o]f the over ninety certificated IXCs, only three are subsidiaries of local exchange companies (LECs)." [A 3.]

even suggested by Public Counsel or by the PSC; nor does either cite any authority for its position.

CONCLUSION

The PSC and Public Counsel have failed to demonstrate that there is any basis in the evidence, in the statutes, in the public interest, or in fundamental fairness to require that UTLD pay a portion of its profits over for the benefit of UTF's ratepayers, when those ratepayers have no stake or interest in the operations of UTLD. In addition, the PSC and Public Counsel have failed to refute the fact that the compensation formula is a totally arbitrary figure, unsupported by any evidence or findings relating to the value of the alleged intangible benefits to UTLD. Accordingly, that portion of the PSC's order imposing the compensation fee on UTLD should be set aside.

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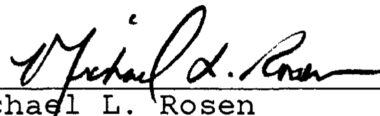
CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and accurate copy of the foregoing Reply Brief of Appellants has been furnished by U. S. Mail this 16th day of February, 1989, to: GREGORY J. KRASOVSKI, Esq., Florida Public Service Commission, 101 East Gaines Street, Tallahassee, FL 32399-0850; MICHAEL TYE, Esq., AT&T Communications Law Department, Suite 505, Barnett Bank Building, Tallahassee, FL 32301; RICHARD D. MELSON, Esq., Hopping, Boyd, Green & Sams, Post Office Box 6526, Tallahassee, FL 32302; JACK SHREVE, Esq., Office of Public Counsel, c/o Florida House of Representatives, The Capitol, Tallahassee, FL 32399-1300; JON P. FONS, Esq., Aurell, Fons, Radey & Hinkle, Post Office Box 11307, Tallahassee, FL 32302; PATRICK WIGGINS, Esq., Ranson & Wiggins, Post Office Drawer 1657, Tallahassee, FL 32302; BRUCE RENARD, Esq., Messer, Vickers, Caparello, French & Madsen, Post Office Box 1876, Tallahassee, FL 32302; and BARRETT G. JOHNSON, Esq., Johnson & Associates, Post Office Box 1308, Tallahassee, FL 32302.



Michael L. Rosen
Julian Clarkson
HOLLAND & KNIGHT
Post Office Drawer 810
Suite 600, Barnett Bank Bldg.
Tallahassee, FL 32302
(904) 224-7000

and

Jerry M. Johns
UNITED TELEPHONE COMPANY
OF FLORIDA
Post Office Box 5000
Altamonte Springs, FL 32716-5000

Attorneys for Appellants