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June 16, 1999

Mrs. Blanca S. Bayó
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Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: 980253-TX ("Fresh Look") Docket

Dear Ms. Bayó:

Enclosed is an original and fifteen copies of BellSouth Telecommunications, Inc.'s Brief of Law and the Evidence, which we ask that you file in the captioned docket.

A copy of this letter is enclosed. Please mark it to indicate that the original was filed and return the copy to me. Copies have been served to the parties shown on the attached Certificate of Service.

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Sincerely,

Michael P. Goggin

Michael P. Goggin

Enclosures

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Proposed Rules 25-4.300, F.A.C.,) Docket No. 980253-TX
Scope and Definitions; 25-4.301, F.A.C.,)
Applicability of Fresh Look; and 25-4.302,)
F.A.C., Termination of LEC Contracts.)
_______________________________________) June 16, 1999

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STATEMENT OF THE CASE

On February 17, 1998, Time Warner AxS of Florida, L.P. ("Time Warner"), filed a Petition to Initiate Rulemaking. In its petition, Time Warner requested that the Florida Public Service Commission (the "Commission") adopt what it described as a "Fresh Look" rule, under which a customer of an Incumbent Local Exchange Carriers ("ILEC") who had agreed to a long term, discounted contract would have an opportunity to abrogate that contract without incurring the termination liability to which it had agreed, in order to contract with an Alternative Local Exchange Carrier ("ALEC"). The Commission granted the Petition, and a Notice of Rule Development was published in the Florida Administrative Weekly on April 10, 1998. A workshop was held on April 22, 1998. Interested persons were afforded an opportunity to file comments and testimony.

Based on information received from carriers in response to staff data requests, the proposed rules were revised. On March 4, 1999, the staff recommended that the rules, as revised, be adopted by the Commission. At its Agenda Conference on March 19, 1999, the Commission set the rulemaking for hearing. On March 24, 1999, the Commission issued a Notice of Rulemaking, which included further revisions to the proposed rules.

Interested parties filed comments and testimony. A hearing on the proposed rules was held before the Commission on May 12, 1999.

STATEMENT OF BASIC POSITION

The Commission is considering whether to adopt rules implementing a so-called "Fresh Look" requirement. The proposed rules would allow parties that have entered into otherwise valid and binding contracts with BellSouth, despite the availability of competitive alternatives, to abrogate those contracts without incurring the full termination liability to which those parties agreed. Such termination provisions form a central underpinning of the prices agreed to by the parties to the contracts.

For the reasons set forth herein, the proposed rules should be rejected and this docket closed. The purported justification for the proposed rules is that certain customers of BellSouth and other ILECs entered into long term contracts with the ILECs at a time when these customers had no competitive alternatives, and that these contracts constitute a barrier to market entry for ALECs who subsequently have begun to compete with the ILECs. Despite three opportunities to submit testimony and comments and a hearing before the Commission, none of the rules' proponents has provided evidence to demonstrate that these purported justifications exist. Indeed, the record in this matter tends to show the opposite is true. Accordingly, the adoption of the proposed rules is unjustified. Moreover, even if it could be shown that the proposed rules would benefit competition, the Commission does not have the statutory authority to take this action. In addition, the rules proposed, even if the Commission had the statutory authority to adopt them, would be constitutionally infirm. For all of these reasons, the proposed rules should be rejected.

STATEMENT OF POSITION ON THE ISSUES

Issue 1: Should the Commission propose new Rules 25-4.300, F.A.C., Scope and Definitions; 25-4.301, F.A.C., Applicability of Fresh Look; and 25-4.302, F.A.C., Termination of LEC Contracts?

**Position: No. The Commission lacks the statutory authority to authorize the abrogation of the contracts at issue, such rule would violate the contracts and takings clauses of the United States and Florida Constitutions, and there is no evidence that the adoption of the proposed rules is justified or would benefit competition.

A. The Proposed Rules Are Unjustified.

Even if the Commission had the authority to adopt the proposed "Fresh Look" rules, they are unjustified. The rules' proponents suggest that these rules are justified because the contracts at issue were entered into at a time when no competitive alternatives to ILEC services was available. See, e.g. The Florida Competitive Carriers Association's Responsive Comments on Proposed Fresh Look Rule ("FCCA") at 1; and Responsive Comments of KMC Telecom Inc. ("KMC") at 16. Moreover, they contend that these agreements constitute barriers to their entry into the market. See, e.g. Comments of AT&T Communications of the Southern States, Inc. on the Proposed Fresh Look Rule ("AT&T") at 1; FCCA at 1. Neither of these purported justifications is true.

1. The contracts to be abrogated under the proposed rules were freely bargained for by customers with competitive alternatives.

In Time Warner's Petition, which initiated this docket, it suggested that the proposed rules were necessary to give customers a chance to choose from competing providers, and thus should apply to "contracts with LECs entered into in a monopoly environment" in order to give customers an opportunity "to avail themselves of

CERTIFICATE OF SERVICE
Docket No. 980253-TX

I HEREBY CERTIFY that a true and correct copy of the foregoing was served via U.S. Mail this 16th day of June, 1999 to the following:

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competitive alternatives now offered or to be offered in the future by alternative local exchange companies." Petition to Initiate Rulemaking Pursuant to § 120.54(5) F.S., by Time Warner AxS of Florida, Inc. ("Petition"), p. 1 (filed Feb. 16, 1998). The proposed rules, however, would apply to contracts entered into by customers who, as the Commission Staff explains in its recommendation, already had choices between the services offered by the ILEC, and those offered by competing providers at the time they entered into these contracts. March 4, 1999 Staff Recommendation, p. 2 ("Prior to ALEC competition, LECs entered into customer contracts covering local telecommunications services offered over the public switched network (typically in response to PBX-based competition")). Accordingly, the original purported justification for the rules--to benefit *customers* who purportedly lacked competitive alternatives at the time they entered into these contracts–is illusory.

In its recommendation, however, Staff suggests two additional justifications. First, although the customers who entered into such contracts had competitive alternatives from which to choose at the time, now they have more. Staff Recommendation, p. 2. Second, "[t]he purpose of the 'fresh look' rule is to enable ALECs to compete for existing LEC customer contracts." Staff Recommendation, p. 3. Upon examination, neither purported justification can legitimize the proposed rules.

With respect to Staff's first purported justification, that customers did not have *enough* choices at the time they chose to enter into these contracts, the Staff states that "ALECs are now offering switched-based substitutes for local service . . . where PBXs had previously been the only alternative. For multi-line users not interested in purchasing a PBX . . . the LEC was heretofore the only option. Consequently, it is

reasonable in this circumstance to give ALECs the opportunity to compete for this business . . . ." Staff Recommendation at 2. This reasoning includes a number of implicit assumptions that are not true.

For example, it would be wrong to assume, even in the case of contracts for services for which PBXs were an alternative, that they were the only alternative. As the Staff correctly points out, "ALECs are now offering switched-based substitutes for local service." Staff Recommendation at 2. The Staff apparently (and incorrectly) assumes, however, that all of the contracts to which the rule would apply were entered into prior to the time ALECs began to compete with BellSouth. It would certainly be untrue to suggest, however, that the rules, as currently proposed, would apply only to contracts entered into at a time when no ALEC competition existed.[1] ALECs have been actively competing with BellSouth since 1995. Direct Testimony of C. Ned Johnston at 4. Yet, the current proposed rules would apply to all contracts entered into by such customers up to the date that the rule becomes effective, (including those not yet entered into today) although ALEC competition exists and has for some time.

In addition, Staff's statement that for those who chose BellSouth services over PBX competition, BellSouth was the "only option," is clearly incorrect. Customers often decide to use PBX service, or services provided by an ALEC, rather than BellSouth. Each customer who does so presumably makes that choice based on its belief that the chosen alternative has some characteristic, such as price or the ability to receive interLATA service in the same bundle, that BellSouth cannot match. That does not

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[1] To be fair, the recommendation relates to the rules as originally proposed, which would have included only contracts entered into before 1997, a time when ALEC competition was not as robust as today.

imply that the customer had no option other than the one it chose. Moreover, most of the customers who would be affected by the rule (typically large, sophisticated commercial customers) entered into such contracts after the passage of Florida's price regulation statute in 1995 and the Telecommunications Act of 1996. Each of these customers likely was aware that ALEC competition existed, or would soon be available. Each had the option to choose a non-LEC alternative, to enter into contracts of shorter duration, or to purchase service month-to-month. Moreover, the bulk of the contracts that would be affected by these rules were entered into after January 1, 1997. By this time, BellSouth faced facilities based ALEC competition, and the number of such competitors has multiplied since that time. Direct Testimony of C. Ned Johnston at 4-5. Accordingly, it is not necessary to adopt the rules to afford these customers choice; they enjoyed the benefits of competition when they agreed to the contracts.

The second justification proffered by the Staff, "to enable ALECs to compete for existing ILEC customer contracts . . .which were entered into prior to switch-based substitutes for local exchange telecommunications services," Staff Recommendation at 3, is also without merit. As noted above, *most* of the contracts to which the rules would apply were entered into (or will be entered into) after ALEC competition was available. *All* of the affected contracts were entered into at a time when competition existed (even if the ALECs who have requested this rule were not among the competitors at the time). The Commission should not adopt rules designed to abrogate contracts freely entered into by customers who considered an array of competitive alternatives just to boost the business of would-be competitors who have not begun to offer service in Florida or, worse, an ALEC who was already competing when the contract was signed but who

simply failed to win the customer the first time. The Commission's statutory objective, as the Staff suggests, is to promote *competition*, not to promote *competitors*.[2]

The proponents of the proposed "Fresh Look" rules have had multiple opportunities in this docket to file testimony or other evidence that might lend some credence to their assertion that BellSouth was the only alternative available to the customers who would be affected by the proposed rules, yet none has done so. Each claims that the proposed rules are needed because BellSouth's customers purportedly entered into long term agreements "in a monopoly environment," when BellSouth was the only available alternative. *See, e.g.* FCCA at 1; AT&T at 1; and Responsive Comments of KMC Telecom Inc. ("KMC") at 16. In spite of prior Commission findings that competition, including switched-based competition from ALECs, has existed for some time in BellSouth's territory, none of the rules' proponents provides any evidence to suggest that the customers whose contracts would be affected by the proposed rules did not have competitive alternatives available to them when they selected BellSouth Instead, they offer market share statistics and claim that BellSouth's share

[2] Staff seems unconcerned with the impact that these rules would have on ILECs. The Staff admits that the rule would impose unrecoverable costs on an ILEC, described as "relatively minor" administrative and labor costs, which the ILEC would incur in connection with assisting customers to abrogate their agreements. Staff also recognizes that ILECs would "lose the revenues" to which the customers' freely negotiated contracts entitle them. Incredibly, the Staff then concludes that a LEC "would only experience a financial loss if its unrecovered, contract specific, nonrecurring costs exceeded the termination liability specified in the controlling contract or tariff." Lost revenues and additional labor and administrative costs clearly are financial losses to BellSouth. The Commission should see the proposed rules for what they are: an attempt by the ALECs to get the Commission to effectively transfer customers and revenues won by the ILECs through competition, to the ALECs, even though the ALECs remain free to compete for these revenues and customers. To reverse the results of the competitive process in this manner in the name of promoting competition would be tantamount to proclaiming that in order to save the free market, the Commission had to destroy it.

demonstrates the lack of competing alternatives. FCCA at 2; KMC at 6, 7-8.[3] In fact, the opposite is true.

While it is clear that competitive alternatives were available prior to 1996, it is also clear that the number of competitive alternatives has grown at an explosive rate. Within months of the 1996 Act's passage, six carriers of local exchange service were actively competing with BellSouth.[4] By mid-1998, the number of local exchange carriers had increased over 800 percent to 51.[5] Indeed, as the Commission found in BellSouth's proceeding under Section 271, by 1997, BellSouth faced competition for business customers from competing providers of local exchange service throughout its territory. *See,* Response Comments of BellSouth Telecommunications Inc., at 2. This is all, of course, in addition to providers of Shared Tenant Services, PBX vendors and others who had been competing for these customers long before the passage of Florida's price regulation statute or the Telecommunications Act.

More importantly, the number of access lines provided to business customers by these carriers is growing at a rate of over 300 percent annually and their share of the business market is increasing at a like rate.[6] These plain facts, which the rules'

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[3] It should be noted that the market shares cited by the rules' proponents are misleading to say the least. The figures include both business and residential access lines. Moreover, none of the figures attempt to gauge competition from local access line substitutes, such as PBXs, and KMC's figures fail to include data lines. Moreover, as BellSouth noted in its response comments in this docket, high market shares do not, as KMC suggests, equate to market power. Economists and the courts generally agree that to prove market power, it must be shown that a seller in a defined market has the power to raise prices and restrict output. *See e.g., Eastman Kodak Co. v. Technical Servs., Inc.,* 112 S. Ct. 2072, 2080-81 (1992). KMC has not attempted to even define a relevant market, much less offer proof of market power.

[4] Florida Public Service Commission, *Competition in Telecommunications Markets in Florida (1996 FPSC Report)* at 40-43. (Dec. 1996).

[5] Florida Public Service Commission, *Competition in Telecommunications Markets in Florida (1998 FPSC Report)* at 36-47. (Dec. 1998).

[6] *Id.* at 46-47. *Compare,* Florida Public Service Commission, *Competition in Telecommunications Markets in Florida (1997 FPSC Report)* at 66-73 (Dec. 1997).

proponents conveniently ignore, demonstrate that business customers have enjoyed competitive alternatives to BellSouth for years, and have seen their options multiply in the last three years at a dizzying rate.

Against these undeniable facts, the only purported "fact" offered by the rules' proponents to show that no competitive alternatives were available are misleading market share statistics. Even if the market shares offered related to the segment of the market in which the proposed rules are designed to intervene, they would not show a lack of competitive alternatives existed at any time. All they would indicate is that, given a plethora of competitors, a steadily decreasing majority of customers chose BellSouth.

In view of past Commission findings that business customers have had competitive alternatives to BellSouth for years, the rules' proponents had the burden to prove that the contracts to be abrogated under the proposed rules were signed at a time when no competitive alternatives to BellSouth existed. Merely repeating the assertion will not make it true. No party has produced evidence to support this assertion. Accordingly, the Commission should disregard any argument that it justifies the adoption of these rules.

2. The contracts to be abrogated under the proposed rules do not constitute a "barrier to entry" to any relevant market.

The rules' proponents also attempt to justify the abrogation of ILEC contracts by arguing that they constitute barriers to entry. The record in this proceeding proves otherwise. No party to this proceeding has argued, much less proven, that such contracts are barriers to entry in and of themselves. Indeed, Time Warner admits that it also signs long term contracts with customers that are subject to termination penalties,

Transcript of Hearing ("Tr.") at 19-20. KMC and AT&T have pointed out that they generally consider such contracts to be procompetitive, except, apparently when entered into by an ILEC. Comments of KMC Telecom Inc. and KMC Telecom II, Inc in Support of Adoption of a Fresh Look Rule at 2; AT&T at 3. Moreover, Time Warner maintains that a long term contract between, for example, Time Warner and a customer, would not be a barrier to entry for an ALEC. Tr. at 20. Accordingly, the rules' proponents would have to give some justification, apart from the structure of the contracts themselves, for their assertion that BellSouth's contracts constitute barriers to entry.

A good place to start would be to define a relevant market from which ALECs allegedly are barred. Not surprisingly, no party to this proceeding has been able to do so. Instead, KMC, for example, cites some market share statistics to allegedly demonstrate that the contracts in question constitute barriers to entry by ALECs. KMC at 6, 7-8. The market share statistics are misleading, however, for a number of reasons. When properly analyzed, these statistics tend to undermine the ALECs' assertions. For example, the share data cited by KMC purports to be for voice-grade access lines in the areas of Florida in which BellSouth is considered to be the incumbent provider. This data does not relate to any properly defined market. Data access lines, and access line substitutes, such as PBX systems, apparently are not included in the data, for example.

Moreover, even if a relevant market could properly be defined as access lines in the areas of Florida served by BellSouth, the contracts at issue could not reasonably be considered barriers to ALEC entry. As Mr. Johnston stated in his testimony, the

contracts at issue largely pertain to medium to large business customers. Tr. at 63. Business lines, of which the lines served under the contracts at issue are merely a subset, account for less than 30 percent of the access lines in provided by switch-based carriers in Florida. 1998 FPSC Report at 46. Accordingly, even if the contracts foreclosed ALECs from competing for the business of medium to large business customers (and they do not), they could not be considered "barriers to entry," as ALECs would remain free to compete for over 70 percent of the remaining access lines.

More importantly, there is no evidence in the record to suggest that the contracts at issue would bar entry into a market comprised only of medium to large business customers, if in fact such a relevant market could be defined. Indeed, there are a number of ways that ALECs can and do sell to such customers. The rules proponents provide no evidence as to what percentage of such customers are subject to long term contracts. It is reasonable to assume, however, that there are medium and large business customers who are in the market for telecommunications services, notwithstanding the existence of these contracts.

First, there are medium and large business customers who do not have long term agreements with BellSouth. In addition, there are new business customers being created in or moving to Florida every day with whom BellSouth has no prior relationship to whom ALECs may sell services. Also, complex business customers usually have changing needs for telecommunications services and often purchase telecommunications services from more than one provider, so the existence of a contract with BellSouth would not necessarily preclude an ALEC from also selling services to such a customer. Direct Testimony of C. Ned Johnston at 7.

Furthermore, even if a medium or large business customer has contracted with BellSouth for all the services it requires, this does not preclude an ALEC from selling to such a customer. The average duration of BellSouth's long term contracts is three years, so approximately one third of these contracts expire in any given year. Responsive Testimony of C. Ned Johnston at 4. Accordingly, at any given time there are many current BellSouth customers who are in the market for telecommunications services. Of course, faced with an attractive offer from an ALEC, a customer can always terminate its contract with BellSouth and pay the termination penalty.

In addition, pursuant to prior Commission rulings, ALECs are permitted to resell BellSouth's contracts. Although the rules' proponents have insinuated that resale of ILEC contracts is not "real" competition, it provides a means for an aggressive competitor to win a customer. Customers who wish to transfer contracts to an ALEC in this manner face no termination liability. In addition, while a reselling ALEC cannot offer a different package of service for the remaining term of the CSA, it can offer a better price, promise better customer service, and develop an ongoing relationship with the customer to better understand its telecommunications needs and, perhaps, earn the customer's loyalty.

The Commission should dismiss any suggestion that BellSouth's term contracts constitute barriers to entry. As detailed above, the explosive growth of ALEC business is enough to disprove this assertion. Indeed, the customers among whom ALECs have had the greatest success in penetrating the local exchange market are businesses, the

very customers ALECs claim are foreclosed to them.[7] More telling, however, is the fact that the rules' proponents recognize that long-term contracts are not barriers to entry. See, e.g. AT&T at 3. They argue that only long-term contracts entered into before the availability of competitive alternatives should be abrogated. Id. In view of the evidence of competitive alternatives and the absolute lack of any proof to the contrary, then according to AT&T's logic, there is no reason to assume that BellSouth's contracts are barriers to entry, any more than one would assume so of Time Warner's or the contracts of any other ALEC.

The proposed rules simply cannot be justified given the record evidence. ALECs have entered the market, despite their claims that ILEC contracts bar their entry. Indeed, their businesses are growing at an explosive rate and primarily among the very business customers they claim are foreclosed to them. In fact, in national terms, ALECs are gaining market share at a much more rapid rate than did interexchange competitors after that market was opened to competition. Rebuttal Testimony of David E. Robinson at 7-8. In response to the facts, all the proponents of these proposed rules can offer is rhetoric. The Commission should dismiss the rhetoric and reject the rules.

[7] It should be noted that the numerous cases before the Commission involving disputes over reciprocal compensation likely would not have arisen if ALECs faced the barrier to entry that they allege in this docket.

B. The Commission Lacks the Statutory Authority to Authorize the Abrogation of Contracts Between Telecommunications Carriers and Their Customers.

The proposed Fresh Look rules would require massive intervention by the Commission into private contracts between ILECs and their customers. Chapter 364 of the Florida Statutes, however, does not confer such authority upon the Commission. Because the Commission is a statutory creation and is granted authority in derogation of common law rights, it has only such authority as is clearly granted to it upon a strict construction of the statutes. See Florida Bridge Co. v. Bevis, 363 So. 2d 799 (Fla. 1978) (Commission's powers are only those that are conferred expressly or impliedly by statute; a reasonable doubt as to the lawful existence of a particular power exercised by the Commission must be resolved against exercise thereof).

To be sure, the Commission has specific statutory authority to "regulate, by reasonable rules, the terms of telecommunications service contracts between telecommunications companies and their patrons." Fla. Stat. § 364.19. Indeed, the Commission already has approved the terms of the contracts at issue. The Commission does not, however, have the statutory authority to authorize the abrogation of such agreements after the parties have entered into them, and have begun to perform in reliance on the promises they have exchanged.

If the Legislature had intended for the Commission to intervene in the marketplace in the obtrusive manner envisioned by proposed rules, the Legislature would have made a specific grant of authority to the Commission. The Florida Statutes grant no authority, whether express or implied, to the Commission to abrogate

private contracts between telecommunications carriers and their customers through its rules.

To the contrary, the legislature has encouraged the formation of such contracts by doing away with rate of return regulation and removing regulatory barriers to entry by competing providers. The legislature apparently recognized that in order for a competitive market to flourish, telecommunications carriers and their customers need to have the freedom to enter into contracts where the terms, including price, are determined by bargaining between them, rather than regulatory fiat. Indeed, the legislature specifically recognized in the 1995 legislation that discount contracts designed to meet competitive alternatives were in use and should be encouraged:

> Nothing contained in this section shall prevent the local exchange telecommunications company from meeting offerings by any competitive provider of the same, or functionally equivalent, non-basic services in a specific geographic market or to a specific customer by deaveraging the price of any non-basic service, packaging non-basic services together or with basic services, using volume discounts and term discounts, and offering individual contracts.

Florida Statutes Section 364.051(6)(a).

The proponents of the rule have not identified any express provision that would authorize the Commission to adopt a rule that would allow the abrogation of such contracts. Because the Commission is not empowered to abrogate existing contracts between a telecommunications carrier and its customers, promulgating the proposed rules clearly would be unlawful.

Although many alternative local exchange carriers (ALECs) sing the praises of Fresh Look as an essential element of local competition, many states that have

considered such petitions from ALECs have concluded that it would be improper to adopt such rules. For example, the North Carolina Utilities Commission recently rejected a similar demand by ALECs for a "Fresh Look" rule. Order Dismissing Fresh Look Petition on Jurisdictional Grounds, Docket No. P-100 Sub 133 (N.C.U.C. May 22, 1998). The North Carolina Commission noted that neither Congress, the Federal Communications Commission (FCC), nor the Legislature had decided to impose a "Fresh Look" requirement, although each had the opportunity to do so. Id. at 12. That Commission concluded that, although it has general authority to facilitate and promote local competition, it lacked specific statutory authority to adopt a rule authorizing the abrogation of existing contracts. Id. at 13. Other states have come to similar conclusions. See In re: New England Tel. & Tel. Co., Docket 5713 (Vt. Public Serv. Bd. Aug. 20, 1997) (holding that "NYNEX should not be required to give its customers a 'fresh look' because there was "no reason to free these customers from the obligations that they knowingly took on"); In re: City Signal, Inc., Case No. U-10647 (Mich. Public Serv. Comm'n Feb. 23, 1995) (rejecting "fresh look" proposal, noting that "customers should be aware of the risk involved in entering into long-term contracts" in an increasingly competitive marketplace); In re: Illinois Bell Tel. Co., Case No. 94-0096, 94-0117, 94-0146 (Illinois Commerce Comm'n April 7, 1995) (rejecting "fresh look" proposal and holding that, "[i]n the absence of evidence that the contracts were entered into for anti-competitive purposes, we will not disturb them"); In re: MFS Communications Co. Inc, PUC Docket No. 16189 (Texas Public Utility Comm'n November 7, 1996) (holding that "SWBT is not required to provide a fresh look opportunity for its customers currently under long term plans"); In re: Northwest

Payphone Association v. U.S. West, Docket No. UT-920174 (Wash. Utilities & Trans. Comm'n March 17, 1995) (rejecting "fresh look" proposal, noting that "the Commission ordinarily refrains from interfering in contracts between U.S. West and its customers").

Moreover, the FCC has only endorsed a "fresh look" approach in other contexts, and then only in very narrow circumstances not present here. Indeed, contrary to the suggestion of Time Warner in its initial Petition, the only Fresh Look requirement adopted by the FCC in its entire 700-page Interconnection Order, was in connection with Commercial Mobile Radio Services (CMRS) providers. In re: Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket 96-98 (rel. Aug. 8, 1996). The FCC had adopted rules requiring that interconnection agreements with CMRS providers comply with principles of mutual compensation and that each carrier pay reasonable compensation for transport and termination of the other carrier's calls. Concluding that many such agreements provided for little or no compensation, in violation of the Commission's rules, the FCC ordered that CMRS providers that were party to pre-existing agreements that provide for non-mutual compensation "have the option to renegotiate these agreements with no termination liabilities or other contract penalties." Id. ¶ 1094. The FCC did not seek to impose a Fresh Look requirement on all long-term contracts between incumbents and their customers, as these proposed rules would do. The FCC rule only applied to contracts that were in violation of the FCC's rules.

The other FCC decisions cited by Time Warner in its initial Petition in this docket illustrate that the FCC generally has limited its use of a Fresh Look requirement as a

means to remedy a contract containing legally questionable provisions.[8] The FCC has not endorsed a sweeping application of Fresh Look requirements as a means of promoting competition, notwithstanding any suggestion by Time Warner to the contrary.

Indeed, in In re: Federal-State Joint Board on Universal Service, CC Docket No. 96-45 (rel. May 8, 1997), the FCC expressly rejected a Fresh Look requirement for schools and libraries subject to long-term contracts, which Petitioners have proposed here. As the FCC reasoned:

> We find that these proposals would be administratively burdensome, would create uncertainty for those service providers that had previously entered into contracts, and would delay delivery of services to those schools and libraries that took the initiative to enter into such contracts. In addition, we have no reason to believe that the terms of these contracts are unreasonable. Indeed, abrogating these contracts or adopting these other proposals would not necessarily lead to lower pre-discount prices, due to the incentives the states, schools, and libraries had when negotiating the contracts to minimize costs. Finally, we note there is no suggestion in the statute or legislative history that Congress anticipated abrogation of existing contracts in this context.

Id. ¶ 547. Such reasoning is equally applicable here, and should be fatal to the proposed rules.

In short, the Commission should decline to adopt the proposed rules because they ask for something that the Commission lacks the statutory authority to do --namely, promulgate regulations that abrogate existing contracts between telecommunications carriers and their customers. The Commission cannot assume such authority simply in the name of increased competition.

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[8] For example, in In re: Amendment of the Commission's Rules Relative To Allocation of the 849-851/894-896 MHZ Bands, 6 FCC Rcd 4582 (July 11, 1991), the FCC held that airlines could terminate long-term contracts entered into with GTE for the provision of air-ground radiotelephone service without regard to the termination provisions in the contract. In reaching this holding, the FCC found that GTE had entered into contracts that bound airlines exclusively to GTE for periods exceeding the term of GTE's license,

C. The Proposed Rules Are Unconstitutional, Even Assuming The Commission Had the Statutory Authority to Promulgate Them

BellSouth also submits that there are significant constitutional problems with the proposed "Fresh Look" rules. The Commission is an administrative agency of the State whose statutory powers are dual in nature: legislative and quasi-judicial. Rulemaking by the Commission is an exercise of its delegated legislative, not judicial, authority. It is undisputed that, in exercising its legislative authority, the Commission may not exceed the limitations imposed upon the Legislature by the State and Federal Constitutions. See Riley v. Lawson, 143 So. 619 (Fla. 1932) ("authority given to regulate carriers must be considered as having been conferred to be exercised according to constitutional limitations").

The Commission is not being asked in its judicial capacity, to determine the constitutionality of an act of the Legislature. Instead, the Commission has been asked to use its quasi-legislative power to adopt a rule which will abrogate existing contracts, which BellSouth submits would be unconstitutional. BellSouth, recognizing the rulemaking authority of the Commission, is informing the Commission of the constitutional impact of the act which it has been asked to take. In so doing, BellSouth is ensuring that the Commission understands that its rulemaking authority is not unfettered, but is subject to, and constrained by, both the State and Federal Constitutions. BellSouth's position is simple: The Commission has been asked to make a rule which violates the constitutional protections afforded all citizens of this State and Nation, and the Commission cannot do that.

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which, according to the FCC, "was contrary to the public interest ...." Id. ¶ 8. No similar concern is present here.

1. The adoption of a fresh look requirement would violate the Contract Clause of the Federal and State Constitutions.

The Contract Clause provides that "No State shall . . . pass any . . . Law impairing the Obligation of Contracts. . . . " U.S. Const. Art. I, § 10. See also Fla. Const. Art. I, § 10. When applied to state actions that have the effect of impairing the obligations of one or more private parties under contracts, this prohibition has been interpreted to mean that no state may take legislative or administrative action that substantially impairs a contractual obligation, unless such action is justified as reasonable and necessary to achieve an important public purpose. United States Trust Co. v. New Jersey, 431 U.S. 1, 25 (1977).

The United States Supreme Court has noted that any action adjusting the rights of contracting parties must be upon reasonable conditions and of a character appropriate to the public purpose justifying its adoption. Id. at 22. For cases of severe impairment of contractual rights, a careful examination of the nature and purpose of the State action is necessary. Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 244 (1978). State action is especially egregious - in a constitutional sense - where, as here, it impairs the contracts of a narrow class of persons in order to meet its desired purpose. Id. at 248.

While telecommunications carriers are subject to the "police power" of the State, such "police power" does not give the State, or the Commission, the right to do as it pleases without regard for the rights of its citizens, including telecommunications carriers. Id. at 241. The State and Federal Constitutions place limits on the exercise by the States of this power. "If the Contract Clause is to retain any meaning at all,

however, it must be understood to impose some limits upon the power of a State to abridge existing contractual relationships, even in the exercise of its otherwise legitimate police power." Id. at 242. The question, then, is not whether the State's "police power" is greater than the right of the private parties to enter into valid, binding contracts--it is. The question is whether an action of the State, or the Commission, pursuant to this police power is within the constitutional limits which are placed upon the States.

Resolution of this question involves a tripartite analysis. Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400, 410-13 (1983). The initial inquiry is whether the state action has, in fact, operated as a "substantial impairment" of a contractual relationship. If a substantial impairment is found, the State, in justification, must have a significant and legitimate public purpose behind the regulation. If such a public purpose can be identified, the adjustment of the rights and responsibilities of the contracting parties must be based upon reasonable conditions and must be of a character appropriate to the public purpose justifying the state action. Id.

The threshold inquiry has three components: whether there is a contractual relationship, whether a change in law impairs that contractual relationship, and whether the impairment is substantial. General Motors Corp. v. Romein, 503 U.S. 181, 186 (1992). In this present case, there is no question that (1) "eligible contracts," as defined in the proposed rule, are valid, binding contracts between private parties and (2) a Fresh Look requirement would impair the obligations of these contracts. Indeed, the Staff's March 4, 1999 analysis of the proposed rules state that the rules could permit a

customer to "terminate a LEC contract ... subject to a termination liability less than that specified in the contract." Staff Recommendation, p. 3.

It is evident that the impairment of such contracts under the proposed rules would be "substantial." This inquiry is crucial because "[t]he severity of the impairment measures the height of the hurdle the state legislation must clear." Spannaus, 438 U.S. at 244. The United States Supreme Court has explained that:

> Minimal alteration of contractual obligations may end the inquiry at its first stage. Severe impairment, on the other hand, will push the inquiry to a careful examination of the nature and purpose of the state legislation.
>
> The severity of an impairment of contractual obligations can be measured by factors that reflect the high value the Framers placed on the protection of private contracts. Contracts enable individuals to order their personal and business affairs according to their particular needs and interests. Once arranged, those rights and obligations are binding under the law, and the parties are entitled to rely on them.

Id. at 245. While the United States Supreme Court has provided some guidance as to what constitutes a "substantial impairment" in cases where state action amounts to less than a total destruction of contractual expectations, such an inquiry is unnecessary in this case since the proposed rules would amount to a total impairment of the contracts in question, which is clearly a "substantial impairment."

Since "Fresh Look" will operate as a "substantial impairment" of ILEC/customer contracts, the Commission must have a significant and legitimate public purpose, "such as the remedying of a broad and general social and economical problem," behind the adoption of the requested amendment to the Commission's rules. Energy Reserves, 459 U.S. at 411-12. "The requirement of a legitimate public purpose guarantees that the State is exercising its police power, rather than providing a benefit to special interests." Id. at 412. Because the impairment caused by the proposed rules is

absolute, the height of the hurdle such a state action must clear is high. No such significant and legitimate public purpose underlies the proposed rules, much less one that can clear the highest of hurdles.

The proponents of Fresh Look attempt to justify the need to abrogate these contracts on the basis of a need to stimulate competition in the local exchange market. Even assuming that this were a sufficiently "significant and legitimate public purpose," or that such a public purpose were not already being satisfied by Florida's existing statutory and regulatory provisions, a close examination of Fresh Look reveals that its purpose is not public, but rather is private. The sole purpose behind Fresh Look is a one-time destruction of such contracts so that the competitors of ILECs can take ILECs' largest customers and commit them to extended contracts of their own. The only beneficiaries of such an action will be ALECs.

It would be inaccurate, based on the record in this proceeding, to suggest that the largest customers of the ILECs had no competitive alternatives when the contracts at issue were made, or that this imagined dearth of competitive alternatives is a "general social or economic problem." Under the guise of Fresh Look, ALECs seek to have the Commission use the police power of this State to undo the results of the competitive process so that they may "cherry pick" the largest and most lucrative business customers. This would not serve any public purpose, much less a significant and legitimate one.

Finally, and assuming some significant and legitimate public purpose could be found to justify a Fresh Look requirement, and it cannot, "the next inquiry is whether the adjustment of the rights and responsibilities of contracting parties [is based] upon

reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption." Energy Reserves, 459 U.S. at 412 (quoting U.S. Trust, 431 U.S. at 22). The proposed Fresh Look requirement cannot be characterized as either "reasonable" or "appropriate." It seeks to destroy contracts which are prima facie just and reasonable in order to stimulate competition in what is already the most competitive segment of the local exchange market. It seeks to destroy contracts which were entered into in situations where competition already existed, and allows one party to those contracts -- the customers -- to limit the termination liability to which they freely agreed. It is neither "reasonable" nor "appropriate" to adopt regulations to interfere with or nullify competition in the cause of promoting it.

The proposed Fresh Look rules are simply a request by the ALECs for a market share handout. ILECs stand to lose their customers, lose the revenue to which the contracts entitle them, lose the contractual right to full termination liability, and other contractual rights, all of which were won fairly in the competitive arena. ILECs, along with the Commission, would also bear much of the administrative burden that these rules would create. The Commission is asked to take these actions despite the fact that no express legal authority exists for the Commission to abrogate these contracts. There simply is nothing "reasonable" or "appropriate" about such a process, especially when its only effect would be to benefit one group of competitors at the expense of another.

The proponents' contention that the proposed rules would be constitutional is somewhat hollow. Their analysis suffers from a misreading of the key precedents.

Their arguments ultimately fail, however, because of their utter lack of any factual justification for the rules.

In a nutshell, KMC, FCCA and Time Warner all contend that because telecommunications is a regulated industry, BellSouth could not reasonably expect that it has any constitutionally recognized rights in its contracts. This surprising assertion is based on a misreading of the decision in Energy Reserves. In that case, a contract for the purchase of wellhead gas by a utility was found not to have been substantially impaired by a Kansas Statute that imposed price ceilings on the sale of wellhead gas, frustrating the price escalator clause in the producer's agreement. Id. at 410-420. The reasons for the Court's holding were that the parties' contract expressly recognized that gas prices were fixed by regulation; indeed the governmental price escalation clause would only operate in the event that Kansas or the federal government acted to raise prices. The court found that "at the time of the execution of the contracts, ERG [the producer] did not expect to receive deregulated prices. The very existence of the governmental price escalator clause indicates that the contracts were structured against the background of regulated gas prices." Id. at 415. The fact that the gas producer's stated expectation was that the contract price would be fixed under federal or state law meant that its reasonable expectations were not substantially impaired when Kansas adopted a price for intrastate gas sales that was lower than the rates adopted by the federal government for interstate sales. Id. at 416.

The fresh look proponents misinterpret the fact-specific holding in Energy Reserves as a broad statement that no participant in an industry regulated by a state can have any reasonable expectation that its contracts will not be substantially impaired

by the state. Time Warner, for example, says that such contracts "are simply not the type of private commercial contracts envisioned to be protected by the Contract Clause." Petitioner's Response to Comments by BellSouth Telecommunications, Inc. and in Support of the Proposed Rules ("Time Warner") at 7. If the Supreme Court had believed this to be true, its opinion in Energy Reserves would have been a great deal shorter. Contrary to Time Warner's assertion, the Commission must examine the proposed exercise of the State's police power to see if it violates the Contract Clause, not the other way around.[9]

As stated above, the first step in the analysis of a state regulation like the proposed rules is whether it would substantially impair a contract relationship. Id. at 411. Whether the industry to which the contract relates is regulated is a factor to be considered, but so is the degree to which the contract would be impaired. Id. The fact that an industry is regulated does not end the inquiry.

In this case, the degree and direction of regulation are substantially different than in Energy Reserves. BellSouth is not subject to rate of return regulation. The prices in the contracts at issue are not fixed by the

[9] Similarly, the other authorities cited by the proponents do not stand for the proposition that the fact of regulation alone negates constitutional protections. Rather, these cases recognize that a state's exercise of its police power must serve a significant and legitimate public purpose. *See, e.g., H. Miller & Sons v. Hawkins*, 373 So.2d 913, 914 (Fla. 1979) ("[C]ontracts with public utilities are made subject to the reserved authority of the state, under the police power on express authority or constitutional authority, to modify the contract *in the interest of the public welfare* without unconstitutional impairment of contracts.") (emphasis added).

Commission[10] and, unlike the parties in Energy Reserves, BellSouth and its customers have no reasonable expectation that they will be. That case concerned the gas industry at a time when regulators believed that regulation was a better governor of industries than free markets would be. The case also arose during the height of the energy crisis. The parties knew that the price provisions in their contracts would be determined by regulators and memorialized this fact in their agreement. By contrast, these contracts concern the sale of services in a deregulated telecommunications market. The legislature has encouraged the formation of such contracts by doing away with rate of return regulation and removing regulatory barriers to entry by competing providers. Indeed, the legislature specifically recognized in the 1995 legislation that discount contracts designed to meet competitive alternatives were in use and should be encouraged. Florida Statutes Section 364.051(6)(a).

Given the clear intent of the state to deregulate telecommunications markets and the clear statutory recognition and encouragement of precisely the sort of contracts at issue, no reasonable business would expect that the state intended to somehow override the constitutional protections that attach to all contracts.[11] Accordingly, it would be unreasonable to state that BellSouth has no contractual rights to impair.

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[10] Indeed, contrary to Time Warner's belief, the Commission lacks the statutory authority to determine just and reasonable rates for these contracts under Florida Statutes Section 364.14. *See* Florida Statutes Section 364.051(1)(c).

[11] It bears repeating that there is no express authority given to the Commission , in this section or elsewhere, that would permit rules to be adopted abrogating such contracts after they have been formed, nor do any of the rules' proponents cite any.

As stated above, the impairment of BellSouth's rights would be total – the proposed rules authorize the abrogation of BellSouth's agreements with its business customers. Accordingly, the analysis must be focused on whether a significant and legitimate public purpose would be served by the adoption of the rules. Energy Reserves, 459 U.S. at 410-14. The purpose of this requirement is to be certain that the state's police power is not merely being used to provide a benefit to special interests. Id. at 412.

The purported justification for the rule is to promote competition. Leaving aside for the moment the irony of asking regulators to pass additional regulation to make a deregulated market more competitive, the rules' proponents have not demonstrated how competition would benefit from the rule. The affected contracts were made by customers with a range of competitive alternatives. Moreover, most of the agreements were signed at a time when rule proponents like Time Warner and KMC were themselves actively competing against BellSouth. In short, the proponents have identified no category of contracts that were signed "in a monopoly environment" or when BellSouth was the "only alternative." The failure of the rules' proponents to put evidence into the record in this matter that would justify the rules demonstrates that they are not reasonably related to any significant or legitimate *public* purpose. The rules undoubtedly would benefit some competitors, but this is not the same thing as to benefit competition.

2. The adoption of a fresh look requirement would constitute an unconstitutional taking of property without just compensation.

The Fifth Amendment to the United States Constitution provides that "private property [shall not] be taken for public use, without just compensation." U.S. Const. Amend V.[12] Like the Contract Clause, the Taking Provision operates as a limit upon the State's inherent police power. The United States Supreme Court has explained that:

> [S]ome [values incident to property] are enjoyed under an implied limitation and must yield to the police power. But obviously the implied limitation must have its limits, or the contract and due process clauses are gone. One fact for consideration in determining such limits is the extent of the diminution. When it reaches a certain magnitude, in most if not all cases there must be an exercise of eminent domain and compensation to sustain the act. So the question depends upon the particular facts.

Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 413 (1922). This limitation on the police power prohibits the taking of private property except for a public, rather than private, purpose and without the payment of just compensation.

A taking can occur as to an intangible property interest. Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1003-04 (1984). Contract rights are a form of property and as such may be taken for a public purpose only if just compensation is paid. U.S.

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[12] This restriction is applied to the States through the Fourteenth Amendment. See, Chicago B.&O.R. Co. v. Chicago, 166 U.S. 226 (1897).

Trust, 431 U.S. at 19, fn. 16. Accordingly, the valid contracts entered into by ILECs with their customers are property rights protected by the Taking Clause of the Fifth Amendment.

"It has never been the rule that only governmental acquisition or destruction of the property of an individual constitutes a taking . . . ." Ruckelshaus, 467 U.S. at 1004. Instead, "'[g]overnmental action short of acquisition of title or occupancy has been held, if its effects are so complete as to deprive the owner of all or most of his interest in the subject matter, to amount to taking.'" Id. (quoting United States v. General Motors Corp., 323 U.S. 373, 378 (1945)). While no "set formula" has been developed for determining when a "taking" has occurred, the Supreme Court has identified several factors that should be considered. These include "the character of the governmental action, its economic impact, and its interference with reasonable investment-backed expectations." Id. at 1005. A "reasonable investment-backed expectation" has been defined as "more than a 'unilateral expectation or an abstract need'." Id. (citation's omitted).

Adoption of the proposed rules would undoubtedly constitute a "taking" of ILECs' property interest in the contracts at issue, as the rules would allow for the total abrogation of these contracts. Fresh Look would: (1) deprive ILECs of the benefit of their bargain, (2) inflict additional economic losses in the future as valuable customers are allowed to enter extended contracts with competitors, and (3) impose additional regulatory burdens and expenses on ILECs that are unnecessary, unfair and a cost that was not contemplated at the time the contracts were negotiated and for which, therefore, no recovery can be made.

The contracts are the embodiment of ILECs' "investment-backed expectations"; they are the bargained-for rights and obligations of ILECs with respect to their customers. They are also the means by which ILECs can protect their relationship with these customers, which represents a "property interest" that is constitutionally protected. Id. at 1011 (holding that a corporation had a reasonable investment-backed expectation with respect to its control over the use and dissemination of its trade secrets, and once same are disclosed to others the corporation has lost its property interest in the data.)

The "taking" of ILECs' property is impermissible unless the confiscated property is used for a "public purpose." The "public use" requirement of the Taking Clause is "coterminous with the scope of a sovereign's police power." Hawaii Housing Authority v. Midkiff, 467 U.S. 229, 240 (1984). The requisite "public purpose" exists where the government acts "to protect the lives, health, morals, comfort and general welfare of the people. . . ." Keystone Bituminous Coal Assoc. v. DeBenedictis, 480 U.S. 470, 503 (1987).

Although stimulating competition might constitute a valid "public purpose," as described above, the proposed rules would frustrate this purpose. The taking of ILECs' property solely for the benefit of a few large customers and competitors, who already operate in a competitive local exchange market, produces a private, rather than a public, benefit. Even if such a public benefit were to exist, ILECs bear the entire burden and receive no advantage from this process which in any way compensates them for

the "taking" of their property.[13] Thus, a Fresh Look requirement would take the private property of ILECs without just compensation in violation of the Fifth and Fourteenth Amendments to the United States Constitution.[14]

CONCLUSION

The Commission should reject the proposed rules. First, the Commission lacks the statutory authority to abrogate contracts freely entered into by customers and telecommunications carriers after they have been formed. Second, to do so would violate the United States and Florida Constitutions. Lastly, even if the Commission were able lawfully to adopt the rules, they are unjustified. The contracts in question are the product of competition. Any marginal benefits that might flow to a few, large customers from such rules are more than outweighed by the unfairness of such a rule to ILECs, who would lose the benefits of bargains freely struck in competitive circumstances. Indeed, the proposed rules would serve only to create a windfall for ALECs, who already are free to compete for such contracts. The Commission should not, in the name of promoting competition, reverse the results of the competitive process to favor a few chosen competitors. For all of these reasons, BellSouth respectfully urges the Commission to reject these proposed rules.

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[13] For example, there is no provision in the proposed rules for the destruction of extended contracts entered into by an ALEC in order to allow ILECs to enjoy the same benefit and to compete for the ALECs' customers.

[14] BellSouth believes that the proposed rules suffer from other constitutional infirmities, including violating the Equal Protection clause and constituting unlawful class legislation. U.S. Const., Amendment XIV; U.S. Const. Art. I, § 10; Fla. Const. Art. I, § 10.

Respectfully submitted this 16th day of June, 1999.

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