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May 24, 2000

Via Hand Delivery

Sharyn L. Smith, Chief Judge
State of Florida
Division of Administrative Hearings
DeSoto Building
1230 Apalachee Parkway
Tallahassee, FL 32399-3060

980253-TX

Re: Consolidated Case No. 99-5368RP (BST/GTE Fresh Look Appeal)

Dear Ms. Smith:

Enclosed is an original and one copy of BellSouth Telecommunications, Inc.'s Proposed Order, which we ask that you file in the captioned case.

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.

Sincerely,

Michael P. Goggin /V.F.

Michael P. Goggin

cc: Judge E. J. Davis
All Parties of Record
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CERTIFICATE OF SERVICE
Consolidated Case No. 99-5368RP

I HEREBY CERTIFY that a true and correct copy of the foregoing was served via U.S. Mail this 24th day of May, 2000 to the following:

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Michael P. Goggin

BEFORE THE FLORIDA DIVISION OF ADMINISTRATIVE HEARINGS

GTE FLORIDA INCORPORATED,	)	Consolidated under Case No. 99-5368-RP
Petitioner	)	
vs.	)	
FLORIDA PUBLIC SERVICE COMMISSION	)	
Respondent.	)	
BELLSOUTH TELECOMMUNICATIONS, INC.	)	
Petitioner,	)	
vs.	)	
FLORIDA PUBLIC SERVICE COMMISSION	)	
Respondent.	)	Filed: May 24, 2000

BELLSOUTH TELECOMMUNICATIONS, INC.'S PROPOSED ORDER

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INTRODUCTION

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 Carrier ("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. Stip. Exh. 6. 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. Stip. Exh. 22. 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. Stip. Exh. 24.

Interested parties filed comments and testimony. *See, e.g.* Stip. Exhs. 34, 42, 45. A hearing on the proposed rules was held before the Commission on May 12, 1999. Stip. Exh. 45. On November 4, 1999, the Commission staff issued yet another recommendation that the Commission approve the rules, which had been further

revised after the May 12, 1999 hearing. The November 4 recommendation attached a Statement of Estimated Regulatory Cost ("SERC") dated September 13, 1999.[1]

At its November 16, 1999 agenda conference, the participation of interested parties was limited to addressing the SERC. Stip. Exh. 56. During this agenda, the Commission decided to revise the rules further, limiting the contracts affected by the rules to those contracts entered into before July 1, 1999, and voted to approve the proposed rules as revised. Stip. Exh. 68. The revised proposed rules were published in the *Florida Administrative Weekly* on December 3, 1999 pursuant to 120.54(3)(d), Florida Statutes. Stip. Exh. 60.

BellSouth contends that the proposed rules are an invalid exercise of delegated legislative authority. Section 120.52(8), Florida Statutes In particular, BellSouth maintains that the proposed rules: (i) would enlarge, modify or contravene the specific provisions of law they purport to implement, Section 120.52(8)(c); (ii) exceed the Commission's grant of rulemaking authority and would be unconstitutional, Section 120.52(8)(b); (iii) are not supported by competent substantial evidence, Section 120.52(8)(f); (iv) are arbitrary and capricious, Section 120.52(8)(e); (v) impose costs on BellSouth that could be avoided by the adoption of a less costly alternative --no rule -- that would substantially accomplish the same purported objective, Section 120.52(G); and, (vi) are invalid because the Commission materially failed to follow applicable rulemaking procedures, Section 120.52(8)(a).

[1] The November 4 recommendation together with the September 13 SERC (collectively the "Staff Rec.") are in the record of this proceeding as Stipulated Exhibit 57.

PROPOSED FINDINGS OF FACT

1. The public, including customers of BellSouth and GTE, received notice of the proposed rulemaking, each revised version of the propcsed rules, the hearing, and all agenda conferences concerning the proposed "Fresh Look" rules. *See, e.g.* Stip. Exhs. 6, 26, 27, 30, 32, 56, 60.

2. No customer with a contract that would be affected by these rules participated in the rulemaking proceedings, including the hearing, before the Commission. Stip. Exh. 69 at 8 ("no customers participated in the fresh look proceeding.")(Simmons/Tr. at 103).

3. The rulemaking was initiated at the request of Time Warner, a competitor of the ILECs whose contracts would be affected by the proposed rules. Stip. Exh. 1.

4. Time Warner and other competitors of BellSouth enter into contracts with their customers which, like the contracts that would be affected by the proposed rules, are long term contracts subject to termination liability. (Marek/Tr. at 137, 152).

5. The long term contracts of telecommunications companies other than ILECs, such as BellSouth, would not be affected by the proposed rules. Stip. Exh. 59.

6. The long term contracts of any telecommunications company present the same potential obstacle to a competing carrier trying to win a customer subject to such an agreement, whether the contract involves an ILEC or an ALEC. (Larsen/Tr. at 179; Hewitt/Tr. at 317).

7. Long term contracts are not barriers to entry into the local exchange market. (Simmons/Tr. at 85-86; Marek/Tr. at 156-158). Such contracts also are not anticompetitive or discriminating. (Simmons/Tr. at 95-96).

8. The proposed rules would affect both Contract Service Arrangements ("CSAs") and tariffed term plans. (Johnson/Tr. at 402-404). All CSAs were entered into in response to competitive offers received by the customer for products or services that were viewed by the customer as substitutes for the services offered by BellSouth and GTE. (Simmons/Tr. at 96; Marsh/Tr. at 206; Johnson/Tr. at 391-392). Tariffed term plans were also developed as a response to competition. (Simmons/Tr. at 65; Johnson/Tr. at 392-393). The affected contracts primarily involve medium and large business customers who are sophisticated consumers who were or were likely to be, aware of the competitive alternatives available to them. (Johnson/Tr. at 414, 393-394). There was no evidence that any of the affected contracts were entered into by customers who did not have competing alternatives from which to choose at the time.

9. Under the proposed rules, competitors that bid against BellSouth for an affected contract at the time it was formed would have an additional opportunity to bid to provide the same services. (Marek/Tr. at 130-131).

10. The Commission did not review the terms of the contracts to be affected by the proposed rules. (Menard/Tr. at 329).

11. Competing telecommunications providers are permitted to resell ILEC CSAs and tariff term plans by purchasing the services wholesale at a discount, and reselling the services to the customer. Competing telecommunications companies can and do resell such agreements. (Johnson/Tr. at 404-405).

12. Competing telecommunications providers can and do sell additional telecommunications services to customers subject to long term agreements with ILECs. Competing telecommunications companies can and do sell services to customers

subject to long term agreements with ILECs at the termination of such contracts. ILEC customers sometimes terminate long term agreements prior to their expiration and pay the termination liability in order to accept a competing offer from another telecommunications company. (Johnson/Tr. at 404-405; Marek/Tr. at 155-158). Competing telecommunications companies are not barred from competing for the business of customers with contracts that would be affected by the proposed rules. (Simmons/Tr. at 106-108).

13. Facilites-based ALECs have been offering switched local exchange service in competition with BellSouth since at least 1996. (Johnson/Tr. at 394). The number of such ALECs, and the geographic scope of their service areas, has increased steadily since that time. *Id.* ALECs tend to focus their marketing on densely populated areas, and, in particular at medium and large business customers. (Johnson/Tr. at 396).

14. In preparing the SERC, the Commission staff did not take into account the amounts of revenues to which ILECs were contractually entitled that would be at risk as a result of the proposed rules. (Lewis/Tr. at 270-71; Hewitt/Tr. at 293-294). Indeed, staff did not ask for such data. (Lewis/Tr. at 270). As a result Staff was unable to estimate the cost of the proposed rules to the ILECs.

15. In preparing the SERC, staff did not analyze the purported benefits of the rule, nor did it gather sufficient data to estimate any purported benefits. (Hewitt/Tr. at 296-321).

16. In preparing the SERC, the Commission Staff relied solely upon market share statistics in reports

prepared by the Commission in analyzing competition in the local exchange markets. *Id.*

17. Market share statistics, standing alone, do not indicate whether customers in the local exchange market had competing alternatives from which to choose at any given time, only the results of whatever choices were made by such customers.

PROPOSED CONCLUSIONS OF LAW

1. The Commission has the burden of proof.

The Commission has the burden to prove that the proposed "Fresh Look" rules would not be an invalid exercise of delegated legislative authority. § 120.56(2)(a), Florida Statutes (1997).

2. The Division has jurisdiction to hear BellSouth's Petition.

Under Section 120.56, Florida Statutes, the Division of Administrative Hearings (the "Division") has jurisdiction to hear and decide petitions requesting a determination that a proposed rule would be invalid. Any person who would be substantially affected by the proposed rule may seek a determination of the invalidity of the proposed rule by filing a petition within 20 days after the publication of the notice required pursuant to Section 120.54(3)(d), Florida Statutes. This petition is filed within 20 days after December 3, 1999, the date that the notice of the proposed "Fresh Look" rules was published pursuant to Section 120.54(3)(d), Florida Statutes.

3. BellSouth has standing to challenge the proposed rules.

BellSouth would be "substantially affected" by the proposed rules. Section 120.56, Florida Statutes. The proposed rules would give BellSouth customers the right

to abrogate contracts without paying the full termination liability to which they freely agreed. As a result, BellSouth risks millions of dollars in revenues that it bargained for and won in the competitive arena.

4. The proposed rules are an invalid exercise of delegated legislative authority.

For the reasons stated below, the Commission's decision to adopt the proposed "Fresh Look" rules is an invalid exercise of delegated legislative authority. Section 120.52(8), Florida Statutes.

A. The proposed rules would enlarge, modify or contravene specific provisions of the law implemented. Section 120.52(8)(c).

Section 120.536 limits the Commission's discretion to adopt rules:

> . . . An agency may only adopt rules that implement, interpret, or make specific the particular powers and duties granted by the enabling statute. No agency shall have authority to adopt a rule only because it is reasonably related to the purpose of the enabling legislation and is not arbitrary or capricious, nor shall an agency have the authority to implement the statutory provisions setting forth general legislative intent or policy. Statutory authority granting rulemaking authority or generally describing the powers and functions of an agency shall be construed to extend no further than the particular powers and duties conferred by statute.

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).

The Commission cites both Sections 364.01 and 364.19, Florida Statutes, as the laws to be implemented by the proposed "Fresh Look" rules. The proposed rules would go far beyond the bounds of either of them. Section 364.01 sets forth the general powers of the Commission and the intent of the Legislature. In its November 4, 1999 recommendation, the Commission staff suggests that general statements in Section 364.01 that the Commission should "promote competition by encouraging new entrants" and "[e]ncourage competition through flexible regulatory treatment among providers of telecommunications services" are among the "regulatory mandates" to be implemented by the proposed rules. Stip. Exh. 57 at 6-7. This is precisely the sort of rulemaking abuse the Legislature prohibits in Section 120.536. The provisions of Section 364.01 describe guidelines for the Commission to follow in exercising its jurisdiction – they do not provide specific statutory mandates which the Commission must implement through rulemaking. Moreover, the proposed rules appear to contravene portions of Section 364.01 not cited by the Commission that direct the Commission to ensure "that all providers of telecommunications services are treated fairly" and to "eliminat[e] unnecessary regulatory restraint." Section 364.01(g), Florida Statutes.

Similarly, the Commission's proposed rules would go well beyond the scope of Section 364.19, which states, in its entirety, that "[t]he Commission may regulate, by reasonable rules, the terms of telecommunications service contracts between telecommunications companies and their patrons." This provision permits the Commission to adopt reasonable rules regarding the terms of a contract to which a

telecommunications company and its customer may wish to agree. It is another matter entirely, however, for the Commission to claim that this provision gives it the authority to abrogate such agreements after the parties have entered into them. Section 364.19 simply cannot be stretched so far.

First, to interpret Section 364.19 to permit rules that would allow the abrogation of existing discount, long term agreements would directly contravene one of the features of the 1995 legislation designed to encourage competition. The Legislature has encouraged the formation of such term discount contracts by doing away with rate of return regulation and removing regulatory barriers to entry by competing providers. The legislature 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. Accordingly, 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).

Surely the Legislature would not have provided express permission to the ILECs to use discounted term agreements to meet competition if such agreements were barriers to competition, as the Commission suggests.[2] To adopt a rule that would authorize the abrogation of such agreements, the Commission must identify a specific provision of the law purported to be implemented to justify this contravention of the Legislature's purposes. Yet, the Commission has not identified any express provision that would authorize the Commission to adopt a rule that would allow the abrogation of such contracts.

Moreover, it is not surprising that the Legislature did not grant such express authority to the Commission; to do so would impair existing contracts, in violation of the Florida and United States Constitutions.[3] Given the constitutional dimensions of the rights the proposed rules would affect, the Commission must have very specific statutory authority to adopt the proposed rules. When an agency considers the adoption of a rule that would touch on the constitutional rights of those to be regulated, "the language of the statute delegating such power [must] do so in clear and unambiguous terms." *Dep't of Business and Professional Reg. V. Calder Race Course, et al.*, 724 So. 2d 100, at 104 (Fla. 1st DCA 1998). While Section 364.19 authorizes the adoption of reasonable rules governing the terms of agreements with telecommunications companies, it does *not* specifically provide that the Commission may adopt rules that would permit the abrogation of existing agreements.

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[2] The Commission fails to provide competent substantial evidence to back up this suggestion.
[3] The constitutional infirmities of the proposed rules are discussed in detail below.

B. The adoption of the proposed "Fresh Look" rules would exceed the powers, functions and duties delegated to the Commission by the Legislature. § 120.52(8) Florida Statutes

The Commission's approval of the proposed rules would exceed the Commission's rulemaking authority and would be unconstitutional. The proposed Fresh Look rules would require massive intervention by the Commission into private contracts between ILECs and their customers. As stated above, however, Chapter 364 of the Florida Statutes, does *not* confer such authority upon the Commission

The Commission cites two bases of rulemaking authority that it contends would authorize it to adopt the proposed rules, Section 350.127(2) and Section 364.19, Florida Statutes. Section 350.127(2) is a general grant of rulemaking authority. Section 364.19 authorizes the Commission to regulate the terms of contracts between telecommunications providers and their customers. Neither grant of authority identified by the Commission justifies encroaching upon the rights guaranteed to ILECs under the United States and Florida Constitutions.

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 attempting 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.

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).

Florida has taken a more narrow view of the circumstances in which the state may act in a manner that impairs contractual obligations. Even where statutory authority exists, the rule in Florida is that "essentially no degree of impairment will be tolerated, no matter how laudable the underlying public policy consideration of the statute may be." *State Farm Mutual Auto Ins. v. Hassen and Hassen*, 650 So. 2d. 128, 134 (1995). *See also, Pomponio v. The Claridge of Pompano Condominium,* 378 So. 2d 774, 780 (1979) ("[A]ny realistic analysis of the impairment issue in Florida must logically begin . . . with . . . the well-accepted principle that virtually no degree of contract impairment is tolerable in this state"). As a result, even if there were a specific statutory provision to be implemented in this case, the Commission may not, consistent with the Florida Constitution, impose a rule to implement it. Even under the more

agency-friendly analysis of the federal courts, however, the Commission's attempt to adopt the proposed rules would be unconstitutional.

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." Exh [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" would 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 proposed 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 Commission attempts 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," Commission Staff has suggested that such a public purpose already is being satisfied by Florida's existing

statutory and regulatory provisions. *See* Stip. Exh. 69 at 7. 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 customers of the ILECs whose contracts would be affected 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, the Commission seeks to use the police power of this State to undo the results of the competitive process so that ALECs may "cherry pick" the largest and most lucrative business customers. This is particularly egregious in view of the fact that many ALECs were competing with BellSouth when the affected contracts were signed. This impairment of BellSouth's contracts 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 seeks 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 Commission's' contention that the proposed rules would be constitutional is somewhat hollow. Its analysis suffers from a misreading of the key precedents. The Commission's arguments ultimately fail, however, because of the utter lack of any factual justification for the rules.

In a nutshell, the Commission contends that because telecommunications is a regulated industry, BellSouth could not reasonably expect that it has any constitutionally recognized rights in its contracts.[4]

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[4] The Commission decision to order a "Fresh Look" in another context in 1994 does not lend support to the notion that these proposed rules are within the power of the Commission to adopt. The

This surprising assertion apparently 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 Commission apparently misinterprets 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. If the Supreme Court had believed this to be true, its opinion in Energy

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1994 "Fresh Look" was accomplished by an Order, not by a rulemaking. Second, there is no indication that the Commission did not exceed its authority of issuing the 1994 Order -- the Commission has not indicated that DOAH or the Courts have reviewed the Order. Lastly, the 1994 Order was entered at a time when ILECs were subject to rate of return regulation. Even if entities subject to such regulation (as BellSouth was in 1994), could be appropriately assumed to have some lesser degree of reasonable

Reserves would have been a great deal shorter. On the contrary, 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.[5]

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 Commission[6] 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

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expectations that the state would not impair its contracts, that assumption would no longer apply after the legislature ended rate of return regulation in 1995.

[5] Similarly, the other authorities cited by the Commission below 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).

[6] Indeed, 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). Commission's attempt to limit the termination liability in the affected contracts under the proposed rules would, in effect, be an attempt exercise such authority.

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. Section 364.051(6)(a), Florida Statutes.

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.[7] Accordingly, it would be unreasonable to state that BellSouth has no contractual rights to impair.

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

[7] 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.

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 were themselves actively competing against BellSouth. In short, the Commission has identified no category of contracts that were signed "in a monopoly environment" or when BellSouth was the "only alternative.' The failure of the Commission 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.

C. The proposed "Fresh Look" rules are not supported by competent substantial evidence.

The APA requires that rules to be adopted be supported by "competent substantial evidence." Section 120.52(8)(f), Florida Statutes. "Competent substantial evidence has been described as such evidence as a reasonable person would accept as adequate to support a conclusion." Agrico Chemical Co. v. Dep't. of Env. Reg., 365 So. 2d 759, 763 (Fla. 1st DCA 1979). The Commission seeks to justify the reasonableness of the proposed rules on the basis of a number of factual assumptions. None of its assumptions or justifications is supported by "such evidence as a reasonable person would accept to support a conclusion."

The Commission Staff's recommendation indicates that the proposed rules were designed to give customers who entered into long-term contracts with ILECs like

BellSouth a chance to terminate those agreements to allow them to choose services from alternative local exchange carriers ("ALECs"). Stip. Exh. 22 at 1-3. The staff admitted that the contracts to be abrogated under the proposed rules were offered as a competitive response to alternative access vendors, interexchange carriers and providers of private branch exchange services that competed with services provided by the ILECs. *Id.* at 2. The Staff concluded, however, that competitive offerings from ALECs were not available, and for multi-line customers not interested in private branch exchange service, the ILECs had been "the only option." *Id.* These assertions are unsupported. The Commission did not produce any testimony from customers who had contracts that would be affected by the rules and who claimed not to have had competing alternatives from which to choose at the time they decided to choose BellSouth. By contrast, BellSouth and GTE submitted testimony regarding the competition they faced at the time they entered into the agreements that the rules would abrogate.

The basis for the Commission's conclusion that the contracts to be abrogated by the proposed rules were entered into at a time when insufficient competition existed is based *solely* upon the relatively small market shares of ALECs when compared with ILECs. Stip. Exh. 22. This data does not support the Commission's conclusion, however. First, as the Commission noted, the contracts to be affected by the rules were offered *in response* to competition. *Id.* at 10. Second, beginning in 1996, ALECs entered this already competitive market segment, and by July of 1998, there were 51 ALECs providing services in competition with the ILECs, alternative access vendors, interexchange carriers and private branch exchange providers, providing a multiplicity

of choices tc users of these services. *Id.* Accordingly, the market share data cited by the Commission staff (which apparently excludes all providers except ILECs and ALECs) does not indicate that choices were not available. Instead, the data shows only that, faced with competing alternatives, a large, but rapidly declining percentage of customers chose ILECs. Such data is not the sort of "competent substantial evidence" necessary to support the retroactive reversal of the results of the competitive market that these rules would effect.

More importantly, there was no evidence presented during this hearing or during the proceedings below that any BellSouth customer whose contract would be affected by the proposed rules had entered into the affected agreement at a time when no competitive alternatives existed. Indeed, the Commission witnesses conceded that all CSAs were entered into by BellSouth in response to competing offers. Furthermore, the Commission presented no evidence that it has performed any investigation or analysis to determine whether the rules would, in fact, benefit customers or increase competition. In short, the Commission failed to produce "such evidence as a reasonable person would accept" to support the proposed rules.

D. The proposed "Fresh Look" rules are arbitrary and capricious.

Under the APA, the proposed rules must be deemed invalid if they are arbitrary or capricious. Section 120.52(8)(e), Florida Statutes A capricious action is one taken "without thought or reason or irrationally." Agrico, 365 So. 2d at 763. An arbitrary decision is "one not supported by facts or logic." *Id.* In short, a rule that is not arbitrary or capricious must have a rational basis and be reasonably related to the statute it

purports to implement. Jax Liquors v. Div. Of Alcoholic Bev. and Tobacco, 388 So. 2d 1306, 1308 (Fla. 1st DCA 1980). The proposed rules clearly fail this test.

As noted above, the Commission had ample evidence to demonstrate that the customers who entered into the contracts to be abrogated by these rules had competing alternatives from which to choose at the time the contracts were entered, yet concluded without justification that "without fresh look, customers who are subject to long-term contracts will receive no benefit from competition for many years to come." Stip. Exh. 22 at 11-12. In addition, the record does not establish that the proposed rules are needed to serve their second purported purpose--to "enable ALECs to compete for existing LEC customer contracts." Stip. Exh. 22 at 3. The evidence produced at the hearing showed that, as a group, ALEC market shares for this segment of the market are tripling every year. BellSouth Exhs. 1-4. Moreover, the Staff noted that more than half of the contracts at issue that were entered into prior to June 30, 1999 would expire in 2000. Stip. Exh. 22 at 12. In addition, the Commission apparently did not consider at all the fact that ALECs can and do compete for the business of customers subject to long term agreements through resale, by selling additional services, at the termination of the agreements, and that customers occasionally terminate such agreements prematurely to take advantage of competing offers. Accordingly, the evidence indicated that ALECs were not foreclosed in any way from entering the market or from competing for the business of customers currently under contract to an ILEC. In the face of this evidence, it was arbitrary and capricious for the Commission to approve the rules.

Second, the rules are arbitrary and capricious because they affect only contracts entered into with ILECs. The stated purpose of the rules is to give customers a chance to take advantage of new competitive alternatives, and to give new market entrants a chance to compete for customers "locked-up" under long-term agreements. The Commission apparently overlooks the fact that ALECs, such as Time Warner, also are party to such long term agreements, and, to the extent that such agreements present an obstacle to customers and new entrants, Time Warner's would present precisely the same sort of obstacle as would BellSouth's. Yet, only ILECs and their customers would be affected by the rules.

Third, the proposed rules are arbitrary and capricious because the purported purpose of the rules would suggest that such rules should be forever renewed, casting doubt upon the reliability of any contractual arrangement, frustrating the purposes of a free, competitive market. New market entrants who arrive after the "fresh look" period had passed might reasonably contend that a new "fresh look" rule should be adopted at a later time, because customers would have additional competitive alternatives from which to choose that were not available during the original fresh look period, and customers remain "locked" into long term agreements. There is no logical end to the number of times the Commission might arbitrarily decide to "boost" competition, accordingly, uncertainty regarding the enforceability of contracts would result.

Fourth, the rules are arbitrary and capricious because they permit ALECs, such as Time Warner, who may have bid against BellSouth for the very contracts at issue, a second bite at the apple, by permitting customers to terminate their agreements in the

face of a second, better offer from the same ALEC, without paying BellSouth the entire termination liability to which the customer freely agreed.

In addition, the decision to modify the rules at the November 16, 1999 agenda conference was clearly arbitrary. When the Commission approved the rules, it changed the scope of the proposed rules to include only those contracts entered into prior to June 30, 1999 (rather than including all contracts entered into up to the effective date of the rule). Stip. Exh. 68 at 13-31. Apparently, the Commission concluded that there was no substantial evidence to show that contracts entered after June 30, 1999 were signed at a time when no competitive alternatives existed. *Id.* at 30. The Staff and the Commissioners explained that they could not identify a date before which insufficient competition existed, but after which, customers had sufficient choice. They settled on June 30, 1999 because it was the end of the time period for which they had data on how many contracts would be affected. *Id.* at 27-31. This highlights the arbitrary and capricious nature of the manner in which these proposed rules were structured and approved.

E. The proposed rules impose regulatory costs on BellSouth that could be reduced by the adoption of a less costly alternative that would accomplish the same objectives.

The staff prepared a Statement of Estimated Regulatory Costs in response to comments and testimony submitted by the ILECs indicating that the same purported objectives—increasing competition—could be achieved without the proposed rules. In the SERC, the Staff recognized that the rules would impose administrative costs on BellSouth and would cause the loss of a portion of the termination liabilities that

customers had freely obligated themselves to pay. Stip. Exh. 57 at 26-27. The Staff did not estimate, however, the substantial costs that would be imposed in the form of lost revenues from the abrogated agreements. More importantly, as stated above, there was no competent substantial evidence to suggest that the purported purposes for the rules--to enable customers to choose from competing providers and to enable ALECs to compete—were not best served by allowing the market to continue to operate. Indeed, the Commission staff admitted that it performed no analysis to determine whether the rule would produce any benefits to outweigh the costs. In the SERC the staff also ignored the evidence in the record that indicated that the contracts to be affected by the rules were signed at a time when customers had competing alternatives from which to choose. In short, the Commission staff (i) ignored an entire category of costs that would be imposed by the rules; (ii) assumed, without any facts or analysis, that the rules would have benefits to outweigh the costs; and, (iii) did not have any basis to conclude that there was "no evidence" to suggest that competition existed when the contracts were formed. This represents a material failure to follow the applicable procedures set forth in Section 120.541(c) and (f), Florida Statutes Moreover, the SERC's conclusion that there were no lower cost alternatives available is unsupportable. In fact, the same objectives the Commission stated that it hopes to serve would be best served (and at the least cost) by not adopting the proposed rules. Accordingly, the rules should be declared invalid pursuant to Section 120.52(8)(g).

F. The Commission materially failed to follow applicable rulemaking procedures.

On April 28, 1999, the Joint Administrative Procedures Committee notified the Commission that the proposed rules would amount to prohibited retroactive rulemaking and likely would violate the contracts clause of the Florida Constitution and sought a response from the Commission. Stip. Exh. 70. The Commission still has not responded to this letter. This failure to respond is inconsistent with the requirements of Section 120.545(2), Florida Statutes, which empowers the JAPC to request "such information as is reasonably necessary for examination of the rule." By its failure to respond, the Commission deprived the JAPC of information needed to complete its mandated review of these proposed rules. Section 120.545(1), Florida Statutes.

CONCLUSION

For all of the foregoing reasons, the proposed rules should be rejected as an invalid exercise of delegated legislative authority.

Respectfully submitted this 24th day of May, 2000.

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