BEFORE THE TENNESSEE REGULATORY AUTHORITY
Nashville, Tennessee

In Re: ***Complaint of XO Tennessee, Inc. Against BellSouth Telecommunications, Inc.***

Complaint of Access Integrated Networks, Inc. Against BellSouth Telecommunications, Inc.

Docket No. 01-00868

RESPONSE OF COMPLAINANTS TO BELLSOUTH'S PETITION FOR APPEAL

The Complainants[1] submit the following response to the "Petition for Appeal" filed by BellSouth Telecommunications, Inc. ("BellSouth") in response to the Initial Order of the Hearing Officer entered April 16, 2002 ("Initial Order").

This matter has already been extensively briefed by the parties. Moreover, the Initial Order by Hearing Officer Julie Woodruff includes a thorough discussion of the facts, which are not disputed, and a thorough analysis of the applicable law. BellSouth's appeal does not raise any new issues; it simply argues them in different ways. Rather than repeat arguments already made by the Complainants, this brief will merely summarize BellSouth's points and respond to them briefly.

Summary of Facts

This case is not complicated. The facts are not disputed. For three years, BellSouth operated a secret (non-tariffed) program called "BellSouth Select." To join the program, a customer had to (1) spend a minimum amount of money with BellSouth (the amount changed several times during the life of the program), (2) purchase from BellSouth or an affiliate at least one, unregulated service (such as a Yellow Page ad) and (3) give BellSouth a limited but

---

[1] The Complainants are XO Tennessee, Inc. and Access Integrated Networks, Inc. ITC DeltaCom Communications, Inc. intervened after the complaints were filed.

irrevocable waiver of the customer's right to maintain the privacy of the customer's proprietary network information. Once the customer joined the Select Program, he was entitled to earn a rebate of 2½% on all purchases of both regulated and non-regulated services. The customer could apply the rebate to his telephone bill, use it to purchase various goods and services, or just take it in cash. In addition, BellSouth often awarded "bonus" rebates in exchange for such things as ordering new services, staying with the program for more than a year or, in some cases, simply to compensate an unhappy customer for a service problem. Finally, Select members were assigned a "Select Service manager" and promised that they would receive better repair service than non-Select members.

None of this was tariffed. In Tennessee, about 10% of BellSouth's business customers were enrolled in the Select program. Through the end of 2001, BellSouth had made a total of 4,583 rebates worth approximately $784,000 to Tennessee customers. One Tennessee customer received a rebate of $10,000.

As Hearing Officer Woodruff found, the Select program, on its face, violates state law and the rules of the Tennessee Regulatory Authority ("TRA"). Although all business customers paid the same tariffed rates for regulated services, Select members received 2½% rebates on the purchase of those services; non-members did not. Therefore, BellSouth charged some customers more than others for the same service. Initial Order, 30. T.C.A. § 65-4-122(a) makes it illegal for a public utility, "directly or indirectly," to charge one customer more than another, similarly situated customer for the same, regulated service. Violation of the statute is a criminal offense and the Tennessee Regulatory Authority is required to report evidence of a violation to the appropriate District Attorney General. T.C.A. § 65-3-120(c). The law also creates a private right of action which allows someone injured by violation of the statute to sue BellSouth for damages. T.C.A. § 65-4-122(e).

Finally, the Hearing Officer found that BellSouth had violated the TRA's rules by failing to tariff the Select program and had violated the TRA's orders on resale by failing to make the Select program available to resellers. There is no dispute that BellSouth failed to tariff the program and failed to offer it to resellers.

I. Violation of the Anti-Discrimination Statute

BellSouth contends that the Hearing Officer improperly considers the "customer's perspective" in determining that BellSouth violated the statute. BellSouth contends that the statute contains no such requirement and that, since the total amount of rebates given to any single customer was not supposed to be greater than the total amount of unregulated service purchased by that customer, the customer was actually paying the full tariffed rate for regulated services and merely receiving a discount on non-regulated services.

BellSouth's argument is frivolous. The Hearing Officer did not rest her findings on "customer perception" but merely noted that, as perceived by the customer, it would appear that the cash rebates lowered the price of tariffed services. More importantly, the Hearing Officer noted that it does not matter whether nor not the size of the rebate was more or less than the customer's spending on unregulated services. It is just as illegal for BellSouth to give a customer $10,000 in free Yellow Page ads in exchange for the purchase of regulated service as it would be for BellSouth to give the customer a $10,000 cash rebate for the purchase of regulated services.

The statute prohibits the giving of rebates "directly or indirectly" in exchange for the purchase of regulated services. Whether the 2½% rebate is considered a reduction in the price of a tariffed service (a "direct" rebate) or a reduction in the price of a non-tariffed service (an "indirect" rebate), it is a per se violation of the statute to give a kickback of any kind in exchange for the purchase of tariffed services. Otherwise, carriers could easily evade the anti-

discrimination statute by giving some customers discounts on non-regulated services which are not available to other, similarly situated customers. There is ample case law on this point which BellSouth does not bother to address. See Complainants' Post Hearing Brief at pp. 4-8.

II. Similarly Situated Customers

BellSouth contends that the program did not discriminate among similarly situated customers because (a) the Select plan was open to anyone who wanted to join and who met the eligibility requirements and (b) it was reasonable for BellSouth to discriminate among those who met the program's eligibility requirements and those who did not.

The first argument is irrelevant. As pointed out by the Complainants in an earlier brief (filed May 24, 2002), BellSouth's argument confuses the anti-discrimination statute with the related, but distinct, tariff filing requirement. The plain terms of the statute prohibit charging some customers more than others for the same, regulated service. There is nothing in the statute which excuses discrimination on the grounds that some overcharged customers may have been aware of the illegal scheme but declined to participate.

The second argument, that it was reasonable to discriminate between customers who were eligible for the program and those who are not, conveniently overlooks the fact that some of the eligibility requirements had nothing to do with the purchase of regulated services. That is, to join the Select program, a customer must both waive his CPNI and agree to purchase at least one, non-regulated service from BellSouth or an affiliate. Not even BellSouth would argue that two, identical customers, each purchasing the same type and volume of regulated service, should be charged different rates solely because one agrees to purchase a Yellow Page ad and the other does not. But this is precisely how the Select program operated.

III. Remedies

BellSouth contends that the Authority has no jurisdiction to issue a finding that the carrier has violated the anti-discrimination statute nor is the Authority required to report such findings to the District Attorney General.

These issues have been adequately addressed by the Hearing Officer and the Complainants' earlier filings. It should be noted that BellSouth's entire argument rests on a typographic error in the state code which occurred during the 1995 revisions to Chapters 1 through 5 of Title 65. The Initial Order pointed this error out (Initial Order at footnote 212 on page 46). BellSouth's brief does not address the error or even acknowledge the Hearing Officer's explanation.

IV. An Unregulated Program

BellSouth's final argument is that the Select program is "unregulated" because, although rebates could be earned by purchasing both regulated and non-regulated services, the amount of the rebate to any one customer was never supposed to be larger than the total amount the customer had spent on non-regulated products.

As previously discussed, the anti-rebate statute prohibits both "direct" and "indirect" rebates. A sales program in which BellSouth gives a customer free, unregulated services (such as free Internet service or a free Yellow Page ad) in exchange for the purchase of regulated services is just as much a violation of the statute as giving the customer a cash rebate off the tariffed rate.

V. Conclusion

According to BellSouth's brief (at p. 1), the company discontinued the Select program (at least in Tennessee) on April 16, 2002, the day the Hearing Officer released the Initial Order. It is reasonable to assume that BellSouth would not have voluntarily ended the program weeks prior

to a ruling by this agency on the validity of the Initial Order if the company did not believe that the Hearing Officer's findings are correct. Each day that BellSouth continued the program risked additional, criminal and civil fines. Therefore, the company prudently ended the program.

In retrospect, it is remarkable that a carrier the size of BellSouth, with all the accumulated knowledge of state and federal regulatory requirements, would ever undertake a program of giving selected customers under-the-table cash rebates in exchange for the purchase of regulated services. If such a program is legal, the statutes and rules on tariffing and discrimination have no meaning whatsoever.

As the Tennessee Attorney General has recently pointed out, however, those statutes and rules are still very much in effect. In an opinion released May 31, 2002 (copy attached), the Attorney General emphasized (at p. 3) that the "guiding principle of our [regulatory] statutes is 'to secure equality of rates as to all and to destroy favoritism, these last being accomplished by requiring the publication of tariffs and by prohibiting secret departures from such tariffs, and forbidding rebates, preferences, and all other forms of undue discrimination.'" Citations omitted.

For three years, BellSouth openly and patently violated that "guiding principle" of regulatory law. The company has ended the Select program but must now be appropriately penalized for its illegal actions.

The Initial Order should be affirmed and the agency's findings referred to the District Attorney General for criminal prosecution.

Respectfully submitted,

BOULT, CUMMINGS, CONNERS & BERRY, PLC

By: _____

Henry Walker
414 Union Street, Suite 1600
P.O. Box 198062
Nashville, Tennessee 37219
(615) 252-2363

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document was faxed and/or mailed, postage prepaid, to the following this 6th day of June , 2002.

Guy Hicks, Esq.
BellSouth Telecommunications, Inc.
333 Commerce St., Suite 2101
Nashville, TN 37201-3300

Chris Allen, Esq.
Tennessee Attorney General's Office
Consumer Advocate and Protection Division
P.O. Box 20207
Nashville, TN 37202

Nanette Edwards, Esq.
ITC^DeltaCom, Inc.
4092 South Memorial Blvd.
Huntsville, AL 35802

Bob Bye, Esq.
Cinergy Communications, Inc.
8829 Bond St.
Overland Park, KS 66214

Henry Walker

ATTACHMENT

STATE OF TENNESSEE

00-00702

Office of the Attorney General

ANDY D. BENNETT
CHIEF DEPUTY ATTORNEY GENERAL

LUCY HONEY HAYNES
ASSOCIATE CHIEF DEPUTY
ATTORNEY GENERAL

PAUL G. SUMMERS
ATTORNEY GENERAL AND REPORTER

MICHAEL E. MOORE
SOLICITOR GENERAL

425 FIFTH AVENUE NORTH
NASHVILLE, TN 37243-0485

TELEPHONE (615) 741-3491
FACSIMILE (615) 741-2009

Tax Division
P. O. Box 20207
Nashville, Tennessee 37202-0207
Fax: (615) 741-3334

May 31, 2002

The Honorable K. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37243-0505

Re: Proposed Rulemaking Hearing Rules, Chap. 1220-4-2, Regulations for Telephone Companies

Dear Mr. Waddell:

My staff and I have reviewed the above-referenced set of rules, which you have submitted to this Office for approval as to legality in accordance with T.C.A. § 4-5-211. These proposed rules concern the provisioning of tariff term plans and special contracts, and establish regular procedures for consideration and approval of such plans and contracts by the Tennessee Regulatory Authority. I am unable to approve the rules in their present form because I believe, for the reasons hereinafter outlined, that proposed rules 1220-4-2-.59(6)(a) and 1220-4-8-.07(3)(a) violate the Public Records Act. In addition, I find that the definitions of "Affiliate" and "Revenue Price-out" contained in proposed rule 1220-4-2-.59(1)(a) & (d) are unclear and should be reworded. Consequently, I am returning the rules to you for appropriate modification by the TRA.

In addition, there are other features of the proposed rules that present serious legal issues, and I would appreciate it if any resubmission of revised special contract rules is accompanied by the Authority's comments on how the proposed rules address these issues. Fundamentally, I am concerned about the absence from the proposed rules of any mechanism to ensure that special contracts and tariff term plans are indeed justified by special conditions and

do not constitute discriminatory and illegal rates. Moreover, proposed rule 1220-4-2-.59(4) raises concerns because it recognizes termination charges that under some circumstances might constitute penalties for breach of contract. While I have not reached a final decision on these issues at this time, I would appreciate the benefit of the Authority's insights in these regards.

I must reject the rules in their present form because they violate Tennessee's Public Records Act, which is very broad in scope. T.C.A. § 10-7-503 provides that "[a]ll state, county and municipal records . . . shall at all times, during business hours, be open for personal inspection by any citizen of Tennessee, and those in charge of such records shall not refuse such right of inspection to any citizen, unless otherwise provided by state law." The provisions of proposed rules 1220-4-2-.59(6)(a)(2), 1220-4-2-.59(6)(a)(4)(i), and 1220-4-8-.07(3)(a), which would allow customer names and addresses to be redacted or filed under "proprietary seal," conflict with the Public Records Act. Except when it is conducting a contested case hearing and in that context may order information obtained in discovery or offered at the hearing to be filed under seal pursuant to T.C.A. § 4-5-311(a) and T.R.C.P. 26.03, the TRA is required by the Public Records Act to make its records available to the public. Moreover, while there is a federal policy against disclosure of proprietary customer information, *see* 47 U.S.C. § 222(c)(1), that policy yields to other requirements of law and is not implicated by the State requirement that tariff information must be publicly available.

The only exception for the TRA from the Public Records Act derives from T.C.A. § 65-3-109. While this provision now expressly refers to the Department of Transportation, it previously referred to the Public Service Commission and, I believe, continues to apply to the TRA through the general provisions of T.C.A. § 65-4-105(a). Section 65-3-109 provides:

> The Department shall not give publicity to any contracts, leases, or engagements obtained by it in its official capacity, if the interests of any company would thereby be injuriously affected, unless, in the judgment of the department, the public interest requires it.

Reading "Department" to mean, in this context, the TRA, this statute does allow the TRA to maintain the confidentiality of contracts when revealing their contents would injure a utility, unless the public interest requires disclosure.

Section 65-3-109 does not, however, allow the TRA by generally applicable rule to decide, in effect, that disclosure of special contracts would injure the companies involved, and further to conclude that the public interest does not override any such injury that may exist. Such a blanket rule would conflict with the spirit of both the Public Records Act and § 65-3-109. Therefore, I am unable to approve the legality of the portions of the proposed rules that would allow the TRA, as a general practice, to place under seal the identity of participants in special contracts. For this reason I am now returning these rules to you for appropriate revisions.

This initial finding also relates to my fundamental concerns about the present and future role of special contracts in utility regulation in Tennessee. Full compliance with the Public Records Act is particularly important in this context because disclosure of the identity of a customer benefitting from a special contract will often be essential to ensure that the favorable terms of such a contract are made available "to any other customer for service of a like kind under substantially like circumstances and conditions," which is the exact language of the proposed rules at 1220-4-2-.59(3) and 1220-4-8-.07(3)(b). As you know, the guiding principle of our statutes is "to secure equality of rates as to all and to destroy favoritism, these last being accomplished by requiring the publication of tariffs and by prohibiting secret departures from such tariffs, and forbidding rebates, preferences, and all other forms of undue discrimination." *New York, N.H. & H.R.R. Co. v. I.C.C.*, 200 U.S. 361, 391, 26 S.Ct. 272, 277 (1906). Thus the "filed rate" doctrine is the lynchpin of utility regulation in Tennessee, as it traditionally has been across the country. While our law does recognize "special rates," T.C.A. § 65-5-201, the courts have made clear that "[a] special rate, like the general rate, can only be established under supervision of the Commission ***and for reasons obviously stronger***." *New River Lumber Co. v. Tennessee Railway Co.*, 145 Tenn. 266, 293, 238 S.W. 867 (1921)(emphasis added). The whole thrust of these proposed rules, by making approval of special contracts a routine event occurring on an abbreviated timetable with little opportunity for review by the TRA or the public, and without any specification of the types of reasons that will be deemed to justify departure from the general tariffs, is of great concern to me.

The United States Supreme Court has recently reaffirmed that "[r]egardless of the carrier's motive — whether it seeks to benefit or harm a particular customer — the policy of nondiscriminatory rates is violated when similarly situated customers pay different rates for the same services." *AT&T v. Central Office Telephone, Inc.*, 524 U.S. 214, 223, 118 S.Ct. 1956, 1963 (1998). While the proposed rules recognize this principle, they do not incorporate any mechanism to give it vitality; rather, they appear to erode the traditional protection afforded through specific consideration by the TRA of special contract proposals. It is crucial in considering whether a proposal is discriminatory to follow the three-step inquiry: "(1) whether the services are 'like'; (2) if they are, whether there is a price difference between them; and (3) if there is, whether that difference is reasonable." *Competitive Telecommunications Ass'n v. F.C.C.*, 998 F.2d 1058 (D.C. Cir. 1993). In making this determination, the courts use the "functional equivalency" test developed by the FCC — that is, whether the services are "different in any material functional respect." *American Broadcasting Cos. v. F.C.C.*, 663 F.2d 133 (D.C. Cir. 1980).

Special contracts originally arose when needed services were not available under the general tariffs. They have been approved over the years when carriers have been able to establish that differences in circumstances and conditions justify different rates. *Southern Railway Co. v. Pentecost*, 205 Tenn. 716, 330 S.W. 321 (1959). I am aware that more modern cases recognize that in a competitive environment, negotiations between provider and customer

may produce packages suited to a customer's needs, in which the mix of services and features differs to such an extent that the options are not "like" services. The law "is not concerned with the price differentials between qualitatively different services or service packages." *Competitive Telecommunications Ass'n v. F.C.C.*, 998 F.2d 1058, 1064 (D.C. Cir. 1993). These cases also recognize that the existence of competition, at least in the general sense, may be a factor in determining whether a special rate is permissible.

A useful example of special contract consideration in the modern context is found in the rules of the Federal Communications Commission. Those rules permit contract service arrangements in strictly defined circumstances, depending upon the existence and general level of competition. 47 C.F.R. §§ 69.709; 69.711; 69.713. They require carriers seeking pricing flexibility through contract service arrangements to file a petition establishing carefully specified conditions in the relevant marketplace, and to submit to an elaborate process allowing for interested parties to oppose the petition. The FCC rules delay the effective date of such petitions for three to five months after the close of the pleading cycle. 47 C.F.R. § 1.774. And even though the FCC rules allow for volume and term discounts, *see* 47 C.F.R. § 61.55, they expressly provide that contract services must be made "generally available to all similarly situated customers . . . ." 47 C.F.R. § 69.727(a)(1). Thus while competition has expanded the circumstances in which special contracts may be appropriate, the filed rate doctrine has not been abandoned. The governing Tennessee statutes have not been amended, and the TRA has not deregulated telecommunications services in Tennessee. The presumption is always against a special contract rate and in favor of the general rate.

The TRA has the statutory duty to ensure that special contracts are allowed only when special circumstances justify a departure from the general tariffs. And it must also ensure that any special rate is realistically and in practice made available to all customers who are similarly situated. Active enforcement of the provisions of T.C.A. §§ 65-4-122 and 65-5-204 is essential to prevent the allowance of special contracts from degenerating into a significant and illegal departure from the requirement of uniform rates available to all customers and fixed by published tariffs. While a regime of special contracts might benefit a few customers in the short run, in the long run it would stifle competition and shift the great burden of utility cost recovery to the consumers who are unable to obtain special consideration. Tennessee law does not allow a regime of special rates or discriminatory discounts negotiated by each customer having sufficient bargaining power to command special treatment.

Our law does not specify the precise manner in which the TRA is to examine special contracts, leaving the Authority with considerable discretion in fulfilling its broad mandate. Nevertheless, I am concerned that several features of the proposed rules appear to reduce the level of scrutiny of special contracts and tariff term plans. Initially, the rules contain no standards at all to indicate any of the circumstances in which special arrangements will be deemed appropriate. In contrast to the FCC rules, for instance, these proposed rules give no hint

of the conditions that justify departure from the general tariffs. The proposed rules do place certain restrictions on provisions that may be included in special contracts, but the rules fail to address the conditions of inadequate utility service that would make a special contract appropriate in the first place. Moreover, the proposed rules provide that review by the full TRA is no longer necessary for approval of a special arrangement. Instead, special contracts with non-affiliate customers are "deemed approved" ten days after they are filed, and tariff terms plans are "deemed approved" thirty days after filing. Proposed rule 1220-4-2-.59(7). While the Executive Secretary has power under proposed rule 1220-4-2-.59(8) to intervene before the effective date and suspend implementation of a special contract to allow for further consideration, the very short timetable of these rules would often make such consideration impractical. Taken as a whole, these proposed rules appear to render special contracts not very "special," but routine.

Certainly under these proposed rules the TRA would retain power to review and deny permission for special contract arrangements. But the rules in practice appear significantly to undermine the general tariffs by creating a framework under which special contracts would ordinarily become effective after a very brief time, without close review by the TRA and without conforming to any standards for departure from the general tariffs. I am aware that the TRA customarily requires some evidence of the need for a special contract in each situation it reviews. And I realize that it is not unusual for tariffs to take effect on a relatively brief schedule without specific review by the Authority. But I am concerned that the proposed rules significantly reduce the likelihood of scrutiny for special contracts, without incorporating into the application process any showing of a need for departure from the general tariffs. Moreover, I would be particularly interested in any mechanism to ensure that special rates are, in practice, made readily available to other similarly-situated customers.

I realize that in the modern competitive setting, some of the traditional strictures on tariffing of services appear to be loosening. I am aware that incumbent local exchange carriers need to be able to compete in lucrative markets, so they can afford to provide service at reasonable rates in the rural areas where few competitors desire to venture. I know the TRA has worked diligently both to promote competition and to guarantee universal service. It would greatly assist this Office's review of any rules of this nature if the Authority could lend its insights on why the achievement of these things, under the current statutory framework, requires a multitude of special contract arrangements.

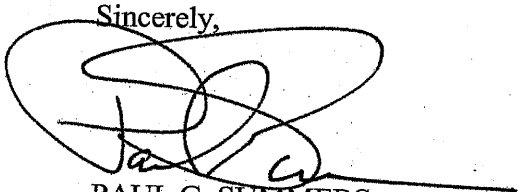
Further, proposed rule 1220-4-2-.59(4) raises concerns because it appears to allow for termination charges that in some instances might amount to impermissible penalties under Tennessee law. In *Guiliano v. Cleo, Inc.*, 995 S.W.2d 88 (Tenn. 1999), the Supreme Court made clear that contractual provisions that are designed to penalize for breach of contract rather than to give the nonbreaching party the benefit of its bargain are unenforceable in Tennessee as against public policy. The proposed rule does not appear to limit termination charges to the actual damages from breach of contract. Rather, it contemplates repayment of discounts, a measure that

may be unrelated to the actual damages the carrier has sustained on account of the breach. Under *Guiliano* the courts consider whether a liquidated sum was a reasonable estimate of potential damages at the time the parties entered into the contract. 995 S.W.2d at 100-01. Proposed rule 1220-4-2-.59(4)(c) caps termination charges at six percent of the special contract amount per year, or 24% of the contract amount for a term plan running longer than four years. This Office has insufficient factual information to determine whether the courts would construe these limits as a reasonable quantification of liquidated damages, rather than an impermissible penalty.

The TRA has very broad authority over the matters within its jurisdiction and, arguably, might establish particularized rules governing liquidated damages upon termination of utility services. But it is unclear whether the proposed limits accomplish this purpose, and, if they do not, whether the TRA has authority to sanction for utilities a practice that has otherwise been characterized by the Supreme Court as against public policy. Certainly, reducing high termination charges that stifle competition is a worthy goal; it is unclear whether the TRA may accomplish that goal through the means outlined in the proposed rules. I would be interested in any information the Authority may have to support the notion of termination charges that amount to repayment of discounts.

In summary, special contracts, in proper circumstances, are permissible, and the TRA has authority to make rules governing their terms. But public knowledge of such special contracts will often be essential in enabling customers to establish that they are similarly situated to another customer benefitting from a special rate. Therefore, the proposed blanket provisions allowing concealment of the names of favored customers are contrary to the proper operation of the Public Records Act, T.C.A. § 10-7-503, and are not saved by T.C.A. § 65-3-109, since they conflict with the TRA's duties to ensure uniform rates and to foster competition among providers of telephone services. Because of this conflict, I am unable to approve the proposed rules as submitted to this Office for review pursuant to T.C.A. § 4-5-211, and I am returning them to you with this letter. Should the TRA decide to resubmit revised rules that eliminate the Public Records violations but include other features of these rules, this Office would appreciate the Authority's comments on its vision for accommodating special contracts within our statutory framework that requires the TRA to ensure that unreasonable preferences in utility rates do not occur.

Sincerely,



PAUL G. SUMMERS
Attorney General and Reporter

PGS/CLL:kc
Enclosures