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August 24, 1999

VIA HAND DELIVERY

Mr. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37201

Re: *Proceeding for the Purpose of Addressing Competitive Effects of Contract Service Arrangements Filed by BellSouth Telecommunications, Inc. in Tennessee*
Docket No. 98-00559 TRA DD

BellSouth Telecommunications, Inc.'s Tariff to Offer Contract Service Arrangement TN98-6766-00 for Maximum 13% Discount on Eligible Tariffed Services
Docket No. 98-00210 TRA DD

BellSouth Telecommunications, Inc.'s Tariff to Offer Contract Service Arrangement KY98-4958-00 for an 11% Discount on Various Services
Docket No. 98-00244 TR ADD

Dear Mr. Waddell:

Enclosed for filing are the original and thirteen copies of the Brief of AT&T Communications of the South Central States, Inc.

A copy of the Brief has been served upon parties of record.

Yours very truly,

Val Sanford

VS/ghc
Enclosures

FILE

BEFORE THE TENNESSEE REGULATORY AUTHORITY
NASHVILLE, TENNESSEE

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Docket No. 98-00244

BRIEF OF AT&T COMMUNICATIONS OF THE SOUTH CENTRAL STATES, INC.

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BRIEF OF AT&T COMMUNICATIONS OF THE SOUTH CENTRAL STATES, INC.

APPROVAL OF THESE CSAs SHOULD BE DENIED

BellSouth is using these, and similar CSAs to retain its monopoly-derived market power and market share and to maintain its existing monopoly-based revenue stream, at the expense, not merely of the development of competition, but also of its over 200,000 business customers who continue to be charged grossly excessive rates.

The financial institution and the store are large, sophisticated businesses which perhaps need no protection. Nor are CLECs, either individually, or as a group, entitled to some special status, except insofar as they represent the development of competition. There are, however, other interests at stake here. Telecommunications is not an ordinary business; BellSouth is not an ordinary market participant; and BellSouth's over 200,000 business customers are not ordinary consumers in a free market.

Only the TRA has the power to protect the interests of the over 200,000 BellSouth business customers, who are the principal victims of BellSouth's anti-competitive and unjustly discriminatory, unduly preferential CSAs. The policy fostering competition in all telecommunications markets, the policy prohibiting anti-competitive practices, the policy prohibiting unjustly discriminatory and unduly preferential rates and practices, the policy requiring published tariffs, are all for the benefit of all Tennessee consumers of telecommunications services. The TRA must not allow itself to be diverted from carrying out these policies. The TRA must not allow BellSouth to use its market power to favor a select few large customers as a means of thwarting the development of competition in order that it may continue to exact excessive charges from its less powerful customers.

Even considered in isolation, there are serious issues as to the provisions of these CSAs, particularly the shortfall and termination liability provisions, and those issues should be addressed.

Moreover, under any approach to this proceeding, BellSouth has utterly failed to produce evidence justifying the TRA's approval of these CSAs.

In this brief, AT&T will demonstrate that: (i) the CSAs are unjustly discriminatory and unduly preferential and therefore, are unlawful; (ii) these CSAs violate the basic principles of the tariff process and the TRA's power to order deregulation; (iii) these CSAs constitute anti-competitive practices which should be prohibited; (iv) these CSAs violate basic contract law concerning liquidated damages; and (v) BellSouth has utterly failed to produce evidence justifying the TRA's approval of these CSAs.

I. THESE CSAs ARE UNJUSTLY DISCRIMINATORY AND UNDULY PREFERENTIAL AND FOR THIS REASON THEIR APPROVAL SHOULD BE DENIED

A. The Applicable Test

T.C.A. §§65-4-122, 65-4-115 and 65-5-204 prohibit unjustly discriminatory and unduly preferential rates and practices. The concepts of unjust discrimination and undue preference are derived from the common law governing common carriers; *see,* e.g., Vaught v. East Tennessee Tel. Co., 123 Tenn. 318, 130 S.W. 1050 (1910). The present section 65-4-122 is derived from the statutes creating the Railroad Commission in 1897, which in turn were based on the Interstate Commerce Act. The provisions of the Federal Communications Act prohibiting such practices were likewise derived from the Interstate Commerce Act. Decisions under the Federal Communications Act are thus persuasive authority for the construction of comparable provisions of the Tennessee statutes; *see,* e.g., New River Lumber Co. v. Tennessee Ry. Co., 145 Tenn. 266, 238 S.W. 867 (1922).

The opinion of the Court in Competitive Telecommunications Ass'n. v. FCC, 998 F.2d 1058 (D.C. Cir. 1993) sets forth definitively the pattern of analysis to be followed with respect to issues of unjust discrimination. At issue there was the lawfulness of four of AT&T's Tariff 12 offerings. As the Court explained, at page 1060:

> Under Tariff 12 AT&T provides each commercial customer with a customized package of integrated telecommunication services at a negotiated price. The package price is less than the sum of the rates that the customer would pay if it purchased each service individually from AT&T, but the customer forfeits the flexibility of determining the precise way in which AT&T will provide the services.

The Court began its analysis at page 1061:

> An inquiry into whether a carrier is discriminating in violation of § 202(a) involves a 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.

The Court then considered the test for "likeness," at page 1061:

> Likeness, as we said, depends upon "functional equivalence." See *Ad Hoc Telecommunications Users Comm. V. FCC,* 680 F.2d 790, 795 (D.C. Cir. 1982) (likeness inquiry "focuses on whether the services in question are different in any material functional aspect"). In applying this test, the FCC must "look to the nature of the services offered" and ascertain whether customers view them as performing the same functions. *MCI,* 917 F.2d at 39. If a user perceives the service "as the same with cost considerations being the sole determining criterion," then the services are "like." *Id.*

The Court then considered the three aspects of Tariff 12 that prompted the FCC to hold that Tariff 12 was not like the services of the piece-part tariffs:

> (1) network monitoring, (2) turn-key service and (3) provisioning flexibility. Although we hold that the first two are inadequate bases for the FCC's decision (as we explain below), we uphold the FCC's finding that Tariff 12 is not "like" the sum of the individual tariffs on the basis of the third rationale alone.

The Court based its decision on the "provisioning differences" between Tariff 12 and the separate offerings, at page 1062-63:

> Under a combination of individual service tariffs, AT&T is constrained to use the "specific facility type" (input) associated with each service. By contrast under Tariff 12 a customer generally cannot and does not direct the carrier to provide the services over dedicated facilities or particular media. *See id.* AT&T is obligated only to provide specific services (outputs) and generally retains the flexibility to do so however it may from time to time choose.

In upholding the FCC's decision that the Tariff 12 options 1 – 4 were functionally different from each other, the Court stated, at page 1064:

> Section 202(a) is designed to prevent a carrier from granting a discount to one (usually large) user that it would not grant were the same or a "like" service purchased by another (usually small) customer. By its nature, §202(a) is not concerned with the price differentials between qualitatively different services or service packages. In other words, so far as "unreasonable discrimination" is concerned, an apple does not have to be priced the same as an orange. (Emphasis added).

B. The Services Covered By These CSAs Are "Like" The Same Services Purchased Under BellSouth's Tariffs

Thus, in this case, analysis of unjust discrimination begins with a determination of whether the services covered by these CSAs are "like" the same services in BellSouth's general tariffs. The test is "functional equivalence." Here, however, there is no question but that the services are not merely "like," they are identical. Both CSAs expressly provide that all services that are included in the volume and term offering will be purchased in accordance with the approved BellSouth General Subscriber Services Tariff and Private Line Services Tariff in effect in each state (Article IV of the store CSA and Article IV of the financial institution CSA). There is, and can be, no qualitative difference whatsoever between the services covered by the Volume and Term Agreements and those same services purchased under BellSouth's general tariffs.[1] These CSAs have no "provisioning differences" such as distinguished AT&T's Tariff 12 offerings. The services covered by the Volume and Term Agreements and those same services under BellSouth general tariffs are identical, apples to apples. The Volume and Term Agreements are just

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1 Pricing differences cannot be a basis for finding services unlike; MCI Telecommunications Corp. v. FCC, 917 F.2d 30, 39 (D.C. Cir. 1990).

a mechanism for discounting rates. Therefore, the services under these two CSAs are "like" the identical services purchased under BellSouth's general tariffs.

C. There Is A Price Difference

The second test is whether there is a price difference. Obviously, there is. The purpose of the Volume and Term Agreements is to provide a set of discounts off the total revenues derived from the purchase of the discount eligible services on the designated list in each particular agreement. There is no question here that there is a price difference.

D. BellSouth Has Shown No Neutral Rational Basis For The Price Differences; And, Therefore, Those Differences Are Unreasonable.

The third test is whether those differences are "reasonable." Disparate charges, such as those here, are reasonable and lawful only if "there is a neutral, rational basis underlying [the disparity]"; MCI Telecommunications Corp. v. FCC, 917 F.2d, 30, 41 (D.C. Cir. 1990), quoting National Ass'n of Reg. Util. Comm'rs v. FCC, 737 F.2d 1095, 1133 (D.C. Cir. 1984).

BellSouth offers no proof whatever demonstrating the reasonableness of the price differences in the two CSAs either as between those CSAs and the general tariff, or as between those two CSAs and other CSAs – much less establish a "neutral, rational basis" for the obvious disparities.

Mr. Frame did testify that these differences were related to the differences in the product mix (Frame, Vol. I-C, p. 115); and to differences in "the volume of revenue that's committed to" (Frame, Vol. I-C, p. 116); and to differences in competitive pressure "that's brought to bear on an account-by-account basis" (Frame, Vol. I-C, p. 116). Mr. Frame, however, did not, and could not, relate those differences to the actual price disparities, or show that those disparities have any neutral, rational basis.

The key features of the Volume and Term Agreements are the discount levels, the services designated as volume and term eligible services, the services designated as discount eligible services and the minimum annual revenue base. BellSouth has no neutral, rational basis for determining any of these key factors.

For example, the discount level of 11% would be reached by the store at an annual revenue base of $3 million; but that discount level was not reached by the financial institution until an annual revenue base of $6,250,000; (Frame, Vol. I-C, p. 116). At page 117, of Volume I-C, Mr. Frame was asked and answered as to that difference.

> Q. What is the basis for that difference?
> A. The contracts were individually negotiated, one by an account team in Memphis, Tennessee, with a bank headquartered in Memphis, Tennessee, and one by an account team in Louisville, Kentucky, dealing with a customer headquartered in Cincinnati, Ohio.
> Q. Well, when you have fewer services, lower volume, and a greater discount, is that –
> A. That's the benefit that this customer bargained for.
> Q. That's just one of them made a better deal than the other one. Is that what it boils down to?
> A. I'm sorry. I didn't understand you.
> Q. One of them made a better deal than the other one. Is that what it boils down to.
> A. You can say that, yes.

Likewise, the volume and term eligible services category is based on whatever services the particular customer has at the time, which is negotiated with the particular customer, and BellSouth has no policy concerning what services go into this category; (Frame, Vol. I-B, pp. 63-64).

Likewise, the only common characteristic of the discount eligible services category is that when the discount is applied, they remain above BellSouth's computed costs; (Frame, Vol. I-B, p. 65). The actual services included in this category for any particular CSA are arrived at by negotiation with the particular customer (Frame, Vol. I-B, pp. 65-66).

Likewise, the amount of the minimum annual revenue base would be negotiated with a particular customer; (Frame, Vol. I-B, p. 75). BellSouth stated no standard or criteria to be followed in determining the minimum annual revenue base.

In addition, BellSouth sometimes uses a different structure for its CSAs, using an "annual growth incentive award," which awards are also negotiated with the particular customer; (Frame, Vol. I-C, p. 139). Again, BellSouth gave no neutral, rational basis for its use of that structure.

In short, BellSouth has no neutral, rational basis for the price differences between these CSAs, between these CSAs and other CSAs, or between these CSAs and BellSouth's general tariff rates. Instead, as Mr. Frame's testimony clearly shows, the essential features of each CSA are negotiated with each particular customer without reference to any general standards, criteria or policies, in the same manner as a contract would be negotiated in a deregulated, competitive market, without any reference to the statutory prohibitions against unjust discrimination and undue preference.

E. In The Absence Of Any Neutral, Rational Basis For Determining Eligibility For, Or Justification Of, Price Disparities, No Basis Exists For Determining Whether Other Customers Are In Like Circumstances Or Similar Situations; And BellSouth's Offer To Provide Such Discounts To Similarly Situated Customers Is Meaningless And Without Effect.

The principle is well settled, that if a contractual rate is made available to any customer who wants it on the same terms, the contractual rate is not unjustly discriminatory; Competitive Telecommunications Ass'n. v. FCC, 998 F.2d 1058, 1063 (D.C. Cir. 1993). However, that principle is based on the premise, as the holding in that case demonstrates, that the contract itself is valid, i.e., that the disparity in rates has a neutral, rational basis, as discussed above.

Where there is no neutral, rational basis for the rate disparity, there is no basis for determining whether some other customer is in like circumstances under T.C.A. §65-4-122(a) or, as it is sometimes put, is similarly situated. If there is no rational basis for making that determination, then the offer to make the rates available to other similarly situated customers is meaningless and can have no effect. There will never be any such similarly situated customers. Mr. Frame testified expressly that BellSouth had no rules and no process for determining when a customer was similarly situated; (Frame, Vol. I-C, p. 118; Vol. I-D, p. 191). Since the particular terms of any particular Volume and Term Agreement depend on the result of negotiations with each particular customer, and there are no neutral, rational bases for making the key determinations, there can be no rational basis for determining when some other customer is similarly situated. Saying that the answer depends on a case-by-case analysis is likewise meaningless without some standard to govern that analysis. Without some governing standard, any such determination is purely arbitrary.

Thus, BellSouth's failure to show a neutral, rational basis for the rate disparities in the CSAs makes it impossible to determine whether any other customer could be similarly situated, and, thereby, makes BellSouth's offer meaningless and of no effect.

F. Whether Or Not The Rates Of CLECs Are Unjustly Discriminatory Is Not Relevant To Any Issue In This Case.

This case involves BellSouth's practices, not those of the CLECs. It is true that CLECs are subject to the same statutes governing unjust discrimination as is BellSouth. To determine whether any CLEC practices violate these statutes requires the same sort of analysis as set forth above. There is no basis for undertaking such an analysis in this proceeding. Certainly there has been none. Even if some CLEC's practices were determined to be unjustly discriminatory, that would not justify BellSouth's practices.

G. The testimony Of Mr. Frame Clearly Shows That These CSAs Are Unjustly Discriminatory, Unduly Preferential, And Are Hence Invalid.

The TRA has wide discretion in many regards, but it has no discretion to disregard the express mandates of the statutes of Tennessee.

As demonstrated above, the testimony of Mr. Frame, BellSouth's only witness, clearly demonstrates that these CSAs are unjustly discriminatory and in violation of the statutes prohibiting unjust discrimination. In discriminating against other customers, these CSAs unduly prefer whatever customers may be found to have negotiated the best deal.

The statutes prohibiting unjust discrimination and undue preference protect all BellSouth's customers. BellSouth has no power under the law to favor certain of its larger customers and discriminate against all the rest. The CSAs should not be approved on this ground alone.

II. THESE CSAs VIOLATE THE BASIC PREMISES OF THE TARIFF PROCESS AND THE TRA'S POWER TO ORDER DEREGULATION UNDER T.C.A. § 65-5-208(b).

In MCI Telecomunications Corp. v. American Tel. & Tel. Co., 512 U.S. 218, 114 S.Ct. 2223, 2231, 129 L.Ed.2d 182 (1994), the Court emphasized the crucial role of tariff filing requirements in the regulation of carriers. The tariff filing requirement is the heart of the regulation of telephone companies as common carriers. It has been the means of preventing unreasonableness and discrimination in charges. The duty to file rates and the obligation to charge only those rates has always been considered essential to preventing price discrimination and stabilizing rates.

The published tariffs of a common carrier, such as a local exchange telephone company, are binding upon the carrier and its customers and have the effect of law; GBM Communications, Inc. v. United Inter-Mountain Tel.Co., 723 S.W.2d 109 (Tenn.App. 1986). Rights, as defined by the tariff, cannot be varied or enlarged either by contract or by tort of the carrier. The filed rate of the carrier is the only lawful charge and deviation from it is not permitted under any pretext; Maislin Ind. U.S. v. Primary Steel, Inc., 497 U.S. 116, 110 S.Ct. 2759, 2766, 111 L.Ed.2d 94 (1990).

Thus, in Maislin, the Court held that the ICC could not validly adopt a negotiated rates policy without statutory authority. In MCI Telecommunications Corp. v. American Tel. & Tel. Co., *supra*, the Court held that under the Federal Communications Act, as it then existed, the FCC could not adopt a detariffing policy for non dominant carriers; that policy was "effectively the introduction of a whole new regime of regulation (or of free-market competition) which may well be a better regime but is not the one that Congress established"; 114 S.Ct. at 2233.

When the Tennessee General Assembly adopted Chapter 408 of the Acts of 1995, it gave the TPSC, and then the TRA, the express authority, and the duty where warranted, to authorize deviations from the then-existing laws governing telecommunications company rates. T.C.A. §65-5-208(b) provides:

> (b) The authority, after notice and opportunity for hearing, may find that the public interest and the policies set forth herein are served by exempting a service or group of services from all or a portion of the requirements of this part. Upon making such a finding, the authority may exempt telecommunications service providers from such requirements as appropriate. The authority shall in any event exempt a telecommunications service for which existing and potential competition is an effective regulator of the price of those services.

Thus, if BellSouth thought that competitive circumstances warranted deviation from the existing regulatory system of filed tariffs, so as to authorize it to negotiate contracts with select customers on the basis of the presence of competition, BellSouth's remedy was to seek authority from the TRA pursuant to T.C.A. §65-5-208(b). BellSouth, however, had no right to arrogate unto itself the power to determine that tariff filing requirements, and the rules following therefrom, should be modified as it saw fit.

It is true that Rule 1220-4-1-.07 provides for "special contracts between public utilities and certain customers"; but that rule, which the administrative history shows was adopted in 1974, was never intended to cover the sort of contracts exemplified by these two CSAs. That rule was intended to authorize and cover what BellSouth has referred to as "Special Service Arrangement Agreements," which have historically been recognized as appropriate deviations from general tariffs.

"Special Service Arrangement Agreements" are defined and described in BellSouth Document No. 001769, as follows:

3. SPECIAL SERVICE ARRANGEMENT AGREEMENT
   DEFINITION: (Legal)
   Special Service Arrangements are used to offer customers services that are not currently tariffed or to provide customers capabilities that differ from the tariff offering. Special Service Arrangements are specifically defined in Section A.5 of the General Subscriber Services Tariff and Section B.5 of the Private Line Services Tariff. The term "Special Assembly" is often used to refer to Special Service Arrangements.

   TARIFF DESCRIPTION – GSST: *(See note*)
   Where practicable, special arrangements', not otherwise provided for in this tariff, are furnished if they are in accord with authorized service offerings and if they are to be used in connection with and not detrimental to any of the services furnished by the Company. Charges for such special service arrangements will be based on the estimated costs of furnishing them, such costs to consist of the following items to the extent they are applicable:
   1.) Cost of maintenance.
   2.) Cost of operation
   3.) Depreciation on the estimated cost installed of the facilities provided, based on the anticipated useful service life of the facilities with an appropriate allowance for the estimated net salvage.
   4) Administration and taxes on the basis of reasonable average charges for these items.
   5) Any other specific items of expense associated with the particular situation.
   6) A reasonable amount, computed on the estimated cost installed of the facilities provided, for return and contingencies.

   *NOTE: Tariff definitions may vary by state.

   SEE SECTION (3) FOR INPUT INSTRUCTIONS TO SAMS

The 1974 Rule could never have conceivably been intended to cover BellSouth's contract service arrangements, which are defined and described in BellSouth Document No. 001770, as follows:

> 5.) CONTRACT SERVICES ARRANGEMENTS
>
> DEFINITION:(Legal)
> Contact Service Arrangements are used by BellSouth to offer a customer special pricing or a discount off tariff rates to meet a threat of an economic bypass from a competitive service provider whose rates are below BellSouth's tariffed rates but above BellSouth cost. The specific requirements for Contract Service Arrangement are located in Section A.5 of the General Subscribers Service Tariff and Section B.5 of the Private Line Services Tariff.
>
> SEE ALSO VOLUME AND TERM (NUMBER 2 ABOVE)
>
> TARIFF DESCRIPTION - GSST: *(See note*).[2]
> When economically practicable, customer specific contract service arrangements may be furnished in lieu of existing tariff offerings provided there is reasonable potential for uneconomic bypass of the Company's services. Uneconomical bypass occurs when an alternative service arrangement is utilized, in lieu of Company services, at prices below the Company's rates but above the Company's incremental costs
>
> *NOTE: Tariff definition may vary by state.

There was no competition, or threat of competition, in 1974. Rule 1220-4-1-.07 was never intended to cover or authorize anything like BellSouth's CSAs.

The general tariff filing requirements and the rules following therefrom, still apply to BellSouth. No statute and no rule authorizes BellSouth to enter into contract service

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2 In BellSouth Document 001768, Volume and Term Agreements are defined as "Volume and Terms Agreements are being offered to BellSouth's largest customers. The Volume and Term Agreement is a Contract Service Arrangement that includes specified regulated local and intraLATA service purchased by the customer in each of the BellSouth states."

arrangements designed merely as a means of offering discounted rates to certain large customers.

BellSouth's CSAs are simply negotiated rates, dependent not on any rational standards or criteria but on the power and negotiating skill of each particular customer. No statute or rule authorizes such a scheme of negotiated rates for BellSouth. There is no lawful authority for these CSAs.

The only way, under the law, BellSouth can be authorized to enter into such contracts is by following the procedure specified in T.C.A. §65-5-208(b). Having not followed that course, BellSouth's CSAs are without statutory authority and are invalid.

For the TRA to continue to approve BellSouth's CSAs after hearing the proof in this case would be tantamount to the TRA's effectively introducing a whole new regime of ratemaking for BellSouth without following the procedures specified by law for that purpose. For this reason alone, approval of these CSAs should be denied.

III. THESE CSAs CONSTITUTE ANTICOMPETITIVE PRACTICES WHICH SHOULD BE PROHIBITED.

BellSouth's only witness, Mr. Frame, testified that BellSouth's objective in entering these CSAs was to preserve market share and retain and grow its revenues; (Frame, Vol. I-C, pp. 161-162, 148-149). The issue here is whether the use of CSAs for that purpose by BellSouth, a company having monopoly-derived market power constitutes an anti-competitive practice which the TRA should prohibit.

T.C.A. §65-5-208(c) provides, in pertinent part:

> The authority shall, as appropriate, also adopt other rules or issue orders to prohibit cross-subsidization, preferences to competitive services or affiliated entities, predatory pricing, price squeezing, price discrimination, tying arrangements or other anti-competitive practices.

The term "anti-competitive practices" and the specific stated practices, are derived from antitrust law and the law of trade regulation. Thus, an analysis of the legislative intent in using those terms in this statute should begin with the analysis typically followed in the antitrust cases.

The first step is the definition of the relevant market, *see*, e.g., U. S. Anchor Mfg., Inc. v. Rule Industries, 7 F.3d 986, 994 (11th Cir. 1993). Here the relevant market, from a geographic perspective, is BellSouth's authorized service area in Tennessee; and from a product perspective is intrastate intraLATA business telephone services; (Frame, Vol. I-C, pp. 163-64). Prior to the passage of Chapter 408, the Tennessee Telecommunications Act of 1995, BellSouth had an almost total monopoly over the provision of all intrastate intraLATA telephone services within its authorized service area. The 1995 Act authorized competition in BellSouth's service area, but did not change its geographic boundaries. By longstanding policy, the market for telephone services has been divided into two categories, business and residential, as is reflected in BellSouth's own marketing of business services through a separate subsidiary, BellSouth Business Systems. Thus, the relevant market for this proceeding is intrastate intraLATA business services within BellSouth's authorized service area.

The second step is to determine if, within the relevant market, BellSouth has monopoly or market power (the terms are synonymous) in that market. The principal measure of actual monopoly or market power is market share; *see*, e.g., U. S. Anchor Mfg., Inc. v. Rule Industries, Inc., 7 F.3d 986, 999 (11^{th} Cir. 1993). Thus, an 87% share or a two-thirds share of the market have been held to constitute market power; PSI Repair Services, Inc. v. Honeywell, Inc., 104 F.3d 811, 821 (6^{th} Cir. 1997).

As of 1998, when these CSAs were entered into, BellSouth had at least a 90% share of the relevant market; *see, Report to the Tennessee General Assembly, The Status of Local Telecommunications Competition in Tennessee*, 1997-1998, Tables 5 and 6. There is no question but that BellSouth continues to have effective market power in the relevant market.

A key consequence of market power is that its presence enables its possessor effectively to control prices within the relevant market. Since BellSouth is under price plan regulation, it has the statutory power to "set rates for non basic services (which includes almost all business services) as the company deems appropriate, subject to the limitations set forth in subsections (e) and (g), the non-discrimination provisions of this title, any rules or orders issued by the authority pursuant to §65-5-208(c) and upon prior notice to affected customers;" T.C.A. §65-5-209(h). BellSouth's recent tariff filing, No. 99-539, increasing various business service rates reflects the exercise of BellSouth's market power; see attached copy of "Tennessee Rate Change Matrix" attached to that filing.[3]

The third step is to determine if the particular conduct at issue is anti-competitive. Conduct is anti-competitive when it is "other than competition on the merits, or other than restraints reasonably 'necessary' to competition on the merits, *that reasonably appear[s] capable of making a significant contribution to creating or maintaining*

3 The TRA is requested to take official notice of that Matrix.

monopoly power;" PSI Repair Services, Inc. v. Honeywell, Inc., 104 F.3d 811, 822 (6th Cir. 1997) (Emphasis in original).

The use of market power to create or maintain that power can take a variety of different forms. One such form is an attempt to monopolize as prohibited by Section 2 of the Sherman Act. To show an attempt to monopolize, which is analogous to the issues here, the elements are (i) a specific intent to monopolize; (ii) anti-competitive conduct; and (iii) a dangerous probability of success; Arthur S. Langenderfer, Inc. v. S.E. Johnson Co., 917 F.2d 1413, 1431 (6th Cir. 1990). Mr. Frame's testimony demonstrates that BellSouth had the specific intent to maintain its market share and hence its market power; (Frame, Vol. I-C, pp. 161-162).

BellSouth's Volume and Term Agreements, such as these CSAs, are clearly anti-competitive conduct. They have the effect of locking in the customer for the term of the contract; and thereby effectively preventing meaningful competition for the volume and term designated services for that customer for that term. They accomplish this purpose by the carrot of discounts for meeting the volume specified in the minimum annual revenue base, with increased discounts for exceeding that minimum volume; and by two sticks, the imposition of a requirement to pay any shortfall for failing to meet the minimum annual revenue base and the imposition of substantial liability if the Volume and Term Agreement is terminated by the customer.

It should be noted here that the fact that CLECs may use similar contracts is not material. No CLEC has monopoly market power. Therefore, by definition, CLEC's contracts cannot be anti-competitive in the sense of the governing law, because the CLECs lack monopoly market power. If the legislative policy of fostering competition is to be met, BellSouth, as the possessor of monopoly market power must be subject to restraints and limitations which are not applicable to the CLECs. What is sauce for the goose may be sauce for the gander, but not for the wolf.

The third element in an attempt to monopolize claim, a dangerous probability of success, is clearly met here. BellSouth has successfully locked in some 200 of its larger customers, its target group, by use of CSAs. In addition, through its "Key Customer Program," BellSouth has been similarly targeting small businesses; (Frame, Vol. I-D, pp. 220-221). The fact that BellSouth has not retained all its large customers does not detract from the demonstrated success of its CSAs and the probability that, unless it's anti-competitive practices are stopped, that success will continue.

BellSouth did not offer any evidence justifying its anti-competitive conduct. The testimony of Mr. Frame certainly does not provide such justification. Implicit in BellSouth's position is the argument that in offering CSAs, it is meeting competition. Thus, Mr. Frame testified that CSAs were used by BellSouth "to respond to competitive offers"; (Frame, Vol. I-B, p. 76). However, in so doing, BellSouth is not responding to competition, as for example it might do by a general tariff provision, rather it is responding only to a particular competitor's offer. By so doing, BellSouth is not meeting competition, it is depriving its customers generally of the effect and benefits of competition; and, instead, is maintaining its existing revenue stream; (Frame, Vol. I-C, pp. 159-160).

Of course, this is not an action for antitrust damages, and all the principles involved in such actions are not applicable here. As a matter of clear statutory policy, adopted by the Legislature to foster the development of competition in all telecommunications markets, however, anti-competitive practices should be prohibited. The practices followed by BellSouth here, to maintain its monopoly-based market share and retain its monopoly-derived revenue stream, are clearly anti-competitive. Indeed, that is their stated intent and objective, as Mr. Frame testified; and that is their effect.

BellSouth is entitled to compete vigorously; but it is not entitled to perpetuate its monopoly market power by locking up select large customers under Volume and Term Agreements, while leaving over 200,000 of its business customers to continue to pay its admittedly high general rates.

For this reason alone, approval of these CSAs should be denied.

IV. THESE CSAs VIOLATE BASIC CONTRACT LAW CONCERNING LIQUIDATED DAMAGES.

The recent decision of the Tennessee Supreme Court in Guiliano v. Cleo, Inc., decided June 28, 1999, and not yet published (copy attached) provides a definitive roadmap for analyzing the validity of contractual provisions for liquidated damages. The first step is to determine if the provision is intended to provide damages for breach of contract or for some other purpose. In that case the issue in this regard was whether the provision in question was for severance pay. Here, Mr. Frame testified that the termination liquidation provision was for the customer's breaking its promise (Frame, Vol. I-C, pp. 124-125). Thus, the termination liability provision is clearly for damages for breach of contract.

The second step is to determine if the damages were likely uncertain and not easily proven (Guiliano at page 12). As the Court held in Wilson v. Dealy, 222 Tenn. 196, 434 S.W.2d 835 (1968), a late charge case, at page 201:

> Damages that are certain or that are readily susceptible to accurate proof are not subject to liquidation by the agreement of the parties prior to a breach of the contract. If a breach of contract will result in damages that are certain or that are subject to accurate proof the innocent party's remedy is to recover for the actual damages sustained.

Mr. Frame testified that BellSouth's actual damages could be readily determined and there was no uncertainty; (Frame, Vol. I-C, p. 127). Indeed, it is obvious that Mr. Frame was correct.

The provision for payment of a shortfall is also for the breach of the customer's promise to meet the minimum annual revenue base. Again, any damages resulting from the breach of that promise are not uncertain, but could be readily determined.

Therefore, the termination liability and shortfall provisions in these CSAs are invalid and unenforceable. No further analysis is necessary or appropriate.

V. BELLSOUTH HAS UTTERLY FAILED TO PRODUCE EVIDENCE JUSTIFYING THE TRA's APPROVAL OF THESE CSAs.

The only witness BellSouth saw fit to call to testify was Mr. Randall Frame, since July 1999, a "sales manager" for BellSouth Business Systems, Inc.,[4] supervising a group of account teams, who service complex business customers in Middle Tennessee; (Frame, Pre-filed Direct Testimony, p. 1). Prior to July 1, 1999, and at the time of the negotiation

4 BellSouth Business Systems, Inc. is a wholly owned subsidiary of BellSouth Telecommunications, Inc. which functions as its sales organization; (Frame, Vol. I-A, p. 47). BellSouth Business Systems developed and implemented the various programs for use of CSAs, *see,* e.g., BellSouth Documents Nos. 001768-001772.

of the two CSAs, Mr. Frame was "market assessment manager" for BellSouth Business Systems, Inc. in Tennessee, and in that capacity, he "provided support to account teams selling competitive services to business customers throughout Tennessee" by developing "information on BellSouth's competitors in this market"; (Frame, Pre-filed Direct Testimony, p. 1).

Mr. Frame did not play any role in the negotiation of these CSAs, or in their execution (Frame, Vol. I-A, p. 49; Vol. I-C, p. 111). The CSAs were not negotiated by persons under his supervision (Frame, Vol. I-C, p. 112). His only role was to ensure, before the account team begin negotiations, that there were competitive alternatives available and he "verified the information they had given me regarding those alternatives"; (Frame, Vol. I-C, p. 112). Thus, Mr. Frame had no personal knowledge about the negotiation or execution of these CSAs; (Frame, Vol. I-A, p. 56).

Mr. Frame did not know whether BellSouth Business Systems, BellSouth Corporation or BellSouth Telecommunications determined the policy for Volume and Term Agreements; (Frame, Vol. I-B, page 64). He knew that the "contract management group," "attached" to BellSouth Business Systems analyzed and determined costs for CSAs; but he did not know on what basis they did so; (Frame, Vol. I-B, p. 67). He did not know on what basis the minimum annual revenue figures for these CSAs was determined; (Frame, Vol. I-B, p. 70). He did not know on what basis the discount levels were determined; (Frame, Vol. I-B, pp. 71-72). He knew that there was a computer program, a billing system, by which billing is tracked, and that the expense of operating that system was readily ascertainable, but he did not know which BellSouth entity operated that system; (Frame, Vol. I-B, pp. 72-73), or which entity bore the costs of tracking; (Frame, Vol. I-B, p. 92).

Mr. Frame did not know the basis on which the cost figures submitted by BellSouth to the TRA were computed; (Frame, Vol. I-B, p. 104). Even though these revenues, costs, and contribution figures shown on the documents submitted to the TRA stated "Tennessee," and were followed by a chart of Tennessee tariffs, Mr. Frame thought they included all BellSouth states, but admitted that he did not know; (Frame, Vol. I-B, p. 106). He admitted he could not vouch for or testify as to the accuracy or validity of that cost study, which is an essential basis in this proceeding; (Frame, Vol. I-B, p. 107).

With respect to the provision in the termination liability section of these CSAs dealing with the assumption of obligations by resellers, Mr. Frame admitted he was not in a position to testify as to what actually would happen; (Frame, Vol. I-C, p. 133).

Mr. Frame knew that CSA's were targeted to BellSouth's top 500 customers, but he did not know how many of those customers were in Tennessee; (Frame, Vol. I-C, p. 152). He knew the "key customer program" was offered by "our small business unit," but he did not know why it was not tariffed; (Frame, Vol. I-D, p. 220).

Mr. Frame, who was admittedly not an expert entitled to express an opinion as such, nevertheless opined with respect to discrimination and anti-competitive effect and as to the reasonableness of these CSAs, *see*, e.g., the summary to his Pre-Filed Direct Testimony; but his opinions are entitled to no weight whatever. Moreover, his testimony does not even consider the established factors for determining issues either as to unjust discrimination or anti-competitive practices, as discussed above. Mr. Frame's job, as he put it, was to provide support to account teams by providing and verifying information on

BellSouth's competition in this market. That is all he knew about and as to that, there is no dispute material to the issues in this proceeding.

This is an important proceeding, involving issues highly significant for the regulation of business telecommunications services of Tennessee. BellSouth has vast resources and could readily have furnished knowledgeable witnesses to testify. Instead, for whatever reason, BellSouth chose only to offer the testimony of Mr. Frame. BellSouth did not even attempt to establish such basic facts as the revenues, costs, and contribution figures it has submitted to the TRA. In short, BellSouth utterly failed to produce sufficient evidence to support the approval of these CSAs. For this reason alone, approval of these CSAs should be denied.

CONCLUSION

BellSouth, beginning in 1996, embarked on a course of incremental deregulation of its rates without any authority by statute, or rule, or order. First, it negotiated contracts with its larger customers, such as the financial institution and the store in these CSAs. Then, it negotiated contracts with certain mid-level customers on its premier customer list (Frame, Vol. I-C, p.154-155). Then its small business unit began offering its key customer program to small businesses in the guise of a repeated short term promotion (Frame, Vol. I-D, p. 220). By submitting each CSA separately and sequentially, BellSouth for a time disguised the full scope of its efforts to put in place a system of negotiated rates – a system based on unjust discrimination, designed to maintain its market share and market power and to retain its revenue stream.

These CSAs are representative of BellSouth's efforts to attain deregulation of its rates and be governed by a system of negotiated rates for its principal customers. Not only are these CSAs contrary to the law, BellSouth utterly failed to provide evidence supporting their approval.

For the protection of all of BellSouth's business customers, to prevent BellSouth's continued violation of the statutes prohibiting unjust discrimination, to prohibit BellSouth's anti-competitive practices, and to uphold the law of this State, approval of these CSAs should be denied.

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CERTIFICATE OF SERVICE

I, Val Sanford, hereby certify that a copy of the foregoing Brief of AT&T Communications of the South Central States, Inc. has been served either by Hand Delivery or U. S. First Class mail, postage paid to the following counsel of record, addressed as follows, on this the 24th day of August, 1999.

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Tennessee
RATE CHANGE MATRIX

Service	Current Rate	Proposed Rate
Business		
Call Forward Variable	$3.75	$4.75
Call Forward Busy Line	$3.25	$4.25
Call Forward Don't Answer	$3.25	$4.25
Caller ID Deluxe	$9.99	$11.00
Call Return	$4.50	$5.50
RingMaster	$7.00	$8.00
Remote Access – Call Forwarding Variable	$7.75	$9.00
Three-Way Calling	$3.75	$4.50
Speed Calling (8 Code)	$3.20	$4.50
Speed Calling (30 Code)	$4.75	$5.50
Flexible Call Forwarding	$9.00	$10.00
Message Waiting Indication – Audible	$0.50	$1.00
Message Waiting Indication- Audible/Visual	$0.50	$1.00
Call Block	$4.50	$5.50
Call Tracing	$5.00	$5.50
Caller ID- Basic	$7.50	$10.00
Repeat Dialing	$4.50	$5.50
Residence		
Call Forward-Variable	$2.75	$3.50
3-Way Calling	$2.75	$4.00
Caller ID-Basic	$6.00	$7.00
Call Return	$4.00	$4.50

IN THE SUPREME COURT OF TENNESSEE
AT JACKSON

FILED

June 28, 1999

ANTHONY P. GUILIANO	)	
Plaintiff/Appellant	)	**FOR PUBLICATION**
	)	
	)	**FILED: June 28, 1999**
v.	)	
	)	SHELBY CIRCUIT
CLEO, INC.	)	
	)	Hon. James E. Swearengen
Defendant/Appellee	)	
	)	02S01-9801-CV-00002
	)	

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OPINION

Court of Appeals Reversed; Barker, J.

Trial Court Affirmed

OPINION

We granted this appeal to address the recovery of liquidated damages where a plaintiff/employee alleges that he has been constructively terminated from his employment. The trial court in this case granted summary judgment in favor of the appellant, Anthony P. Guiliano, based upon a finding that he had been constructively terminated from his employment and that he was entitled to recover the remainder of his salary under Paragraph 9 of his employment contract.[1] The Court of Appeals agreed that the appellant had been constructively terminated from his employment, but concluded that he was not entitled to any recovery. The intermediate court held that Paragraph 9 of the contract was a liquidated damages provision that imposed a penalty on the appellee, Cleo, Inc., (Cleo).

Both parties request this Court to determine whether Paragraph 9 of the employment contract contemplates the payment of severance pay or liquidated damages. For the reasons that follow, we conclude that the sums payable pursuant to Paragraph 9 are liquidated damages in the event that Cleo terminated appellant's employment without cause, effectively breaching the contract.

We affirm the trial court's grant of summary judgment for the appellant on the issue of constructive termination. In addition, because we find that the liquidated damages provision was a reasonable estimation of employee damages at the time the parties entered into the contract, we conclude that the appellant is entitled to recover the full amount stipulated in that provision. The judgment of the Court of Appeals is

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[1]The trial court awarded $90,125 in back salary plus $14,296.54 in prejudgment interest, for a total award of $104,421.54. The record is unclear whether the trial court treated that recovery as severance pay or liquidated damages.

reversed, and the trial court's grant of summary judgment for the appellant is affirmed.

BACKGROUND

The essential facts in this case are undisputed. The appellant had been employed as a director of marketing at Cleo[2] for approximately one year when he entered into a written employment contract with the company. The contract was in the form of a letter sent by Michael Pietrangelo who was then the President and Chief Executive Officer of Cleo. The letter agreement stated in pertinent part:

> Cleo Inc. and I are very pleased that you have agreed to serve as Vice President, Marketing of Cleo Inc. (the "Company"), a wholly owned subsidiary of Gibson Greetings, Inc. As Vice President, Marketing you will report to the President, and perform those functions currently assigned, which functions and responsibilities can be changed at the discretion of the Company. The following terms and conditions will govern your service to the Company:
>
> 1. You will serve the Company on a full-time basis as a senior executive employee, and the company will employ you as such, for a period of three years commencing November 1, 1992 and ending October 31, 1995 unless you are terminated at an earlier date pursuant to Paragraphs 6, 7, or 9 of this Agreement. Your annual salary will be $103, 000, which amount will be reviewed every fifteen months and which may be adjusted from time to time by the Company throughout the term of this Agreement in accordance with the Company's salary administration program. No later than six months prior to expiration of the original term, or any renewal term, of this Agreement, it will be reviewed by the Company for the purpose of deciding whether or not it will be renewed upon its expiration. You will be notified of a decision not to renew. If you are not notified of a decision not to renew, the Agreement will automatically renew from year to year.
>
> . . . .
>
> 6. In the event you are unable to perform your duties hereunder due to illness or other incapacity, which incapacity continues for more than six consecutive or nonconsecutive months in any twelve-month period, the Company shall have the right, on not less than 30 days written notice to you, to terminate this Agreement. . . .

[2]At all times relevant to this case, Cleo was a wholly owned subsidiary of Gibson Greetings, Inc.

7. In the event you voluntarily terminate your employment during the term of this Agreement, or if the Company terminates this Agreement and your employment for cause, your right to all compensation hereunder shall cease as of the date of termination. As used in this Agreement, "cause" shall mean dishonesty, gross negligence, or willful misconduct in the performance of your duties or a willful or material breach of this Agreement. Termination of employment shall terminate this Agreement with the exception of the provisions of Paragraphs 8, 9, 10, and 12.

8. Also in the event you voluntarily terminate your employment hereunder, or in the event the Company terminates this Agreement and your employment for cause, you agree that for a period of two years after such termination, you will not compete, directly or indirectly, with the Company or with any division, subsidiary, or affiliate of the Company or participate as a director, officer, employee, consultant, advisor, partner, or joint venturer in any business engaged in the manufacture or sale of greeting cards, gift wrap, or other products produced by the Company, or any division, subsidiary, or affiliate of the Company, without the Company's prior written consent.

9. In the event the Company terminates this Agreement and your employment without cause, you shall continue to be paid your then current salary from the date of termination through October 31, 1995.

In 1994, Cleo experienced several personnel changes in its upper management. Jack Rohrbach replaced Mr. Pietrangelo as the company's President and Chief Executive Officer and Marc English was later hired as the Senior Vice President of Marketing and "Creative." Mr. Rohrbach stated in his deposition that he began observing the appellant's work performance when he took over as the company president. Based upon his observations, he opined that the appellant had a poor work relationship with his peers and subordinates and that the appellant was not leading the marketing department in a direction best suited for the company. Mr. Rohrbach stated that he hired Mr. English as the new marketing Vice President because Mr. English had more industry experience and a successful track record.

In the Fall of 1994, the appellant received a series of letters from Mr. Rohrbach and Mr. English that diminished his employment responsibilities at Cleo. The first letter, dated September 13, 1994, informed the appellant that his employment contract would not be renewed after its expiration on October 31, 1995. Approximately two weeks later, the appellant received a second letter signed by Mr. Rohrbach that stated in pertinent part:

> Effective today and until October 31, 1995, you are relieved of your duties as Vice President Marketing of Cleo Inc. and shall be responsible for such assignments as may be given to you by the President of the Company. During this period, you will remain an employee of the Company and the Company will continue to honor its obligations to you under your employment agreement.
>
> However, you are specifically advised that you shall have no authority to bind, represent or speak for the Company in any manner except as may be stated in writing by the President of the Company.
>
> For all future assignments, you shall be based out of your home.
>
> Should you accept other employment prior to October 31, 1995, all benefits under your employment agreement shall immediately cease. Also, please take note of the confidentiality and non-compete provisions of your employment agreement.
>
> We will be in touch when an appropriate assignment becomes available. In the meantime, should you have any questions or comments, please do not hesitate to contact me.

In November, 1994, the appellant received two additional letters from Cleo informing him that he was no longer authorized to use company credit cards and that he was to return the company cards in his possession. In addition, he was informed that Cleo would no longer answer a telephone line for him. All telephone calls for the appellant were to be screened for personal or business, with the personal calls being directed to appellant's home. Cleo allowed the appellant to retrieve the personal telephone numbers from his office rolodex, but all business numbers were kept exclusively by Cleo as company property.

Following the letter of September 28, 1994, the appellant stayed at his home for three months without receiving a work assignment from Cleo. During that time, Mr.

English moved into appellant's old office and assumed the marketing responsibilities previously handled by the appellant.[3] On December 12, 1994, the appellant accepted new employment at Wang's International, Inc. with a starting salary of $110,000 per year. Cleo kept the appellant on the company payroll at $103,000 per year until he began his new employment.

The appellant filed suit against Cleo on January 26, 1995, claiming that the company had constructively terminated his employment without cause and that he was entitled to the remainder of his salary under Paragraph 9 of the employment contract. Cleo responded that its treatment of the appellant did not constitute a termination of his employment, but that even if it did, the provision in Paragraph 9 was an unenforceable penalty. Both parties filed motions for summary judgment. After a hearing, the trial court granted summary judgment to the appellant, awarding him $90,125 in salary remaining under his employment contract plus $14,296.54 in prejudgment interest.

On appeal by Cleo, the Court of Appeals affirmed the trial court's conclusion that the appellant was constructively terminated from his employment, but reversed the award of damages. The intermediate court interpreted Paragraph 9 of the employment contract as a provision for liquidated damages because it called "for payment of a sum certain in the event of a certain occasion." Finding no evidence in the record of actual damages suffered by appellant, the court concluded that enforcement of the liquidated damages provision would impose an unlawful penalty against Cleo.

[3]Mr. Rohrbach stated in his deposition that Mr. English took on other responsibilities at Cleo in addition to those previously handled by the appellant.

The appellant requests this Court to reverse the Court of Appeals and to reinstate the judgment of the trial court. His contention in this appeal is that Cleo constructively terminated his employment when it removed his title of Vice President of Marketing and sent him home for three months without any further assignments. However, in contrast to his argument in the courts below, the appellant now claims that Cleo had a right to terminate his employment, as it did in this case, without breaching the contract. He contends that, regardless of the issue of breach, he is entitled to recover severance pay under Paragraph 9 of the employment contract.

STANDARD OF REVIEW

The standards governing an appellate court's review of a motion for summary judgment are well settled. Summary judgment is appropriate only where the moving party demonstrates that there are no genuine issues of material fact and that he or she is entitled to judgment as a matter of law. Byrd v. Hall, 847 S.W.2d 208, 210 (Tenn. 1993); Tenn. R. Civ. P. 56.03. We review the summary judgment motion as a question of law in which our inquiry is *de novo* without a presumption of correctness. Finister v. Humboldt Gen. Hosp., Inc., 970 S.W.2d 435, 437 (Tenn. 1998); Robinson v. Omer, 952 S.W.2d 423, 426 (Tenn. 1997). We must view the evidence and all reasonable inferences in the light most favorable to the nonmoving party. Byrd, 847 S.W.2d at 210-11. If both the facts and conclusions to be drawn therefrom permit a reasonable person to reach only one conclusion, then summary judgment is appropriate. Robinson, 952 S.W.2d at 426; Bains v. Wells, 936 S.W.2d 618, 622 (Tenn. 1997).

DISCUSSION

I.

We shall first address whether summary judgment was appropriate on the question of constructive termination. Initially, we note that the issue of constructive termination in this case is distinguishable from cases where an at-will employee claims constructive discharge based upon a hostile work environment, discrimination, or some non-feasance on the part of the employer. See Phillips v. Interstate Hotels Corp., 974 S.W.2d 680 (Tenn. 1998); Campbell v. Florida Steel Corp., 919 S.W.2d 26 (Tenn. 1996). The appellant contends that Cleo removed his job title and all work responsibilities, effectively terminating his employment, without officially or formally ending the employment agreement. We view this issue strictly as one of breach of contract and conclude that the evidence clearly establishes that Cleo effectively terminated appellant's employment without cause, thereby breaching the contract.

Both the appellant and Cleo have agreed on the facts leading up to appellant's change of employment. Cleo contends, however, that it had a right to alter the appellant's work responsibilities under the employment contract, as it did in this case, without causing a termination. In support of that contention, Cleo relies on evidence that it allowed the appellant to stay on the company payroll as a senior executive employee until he obtained new employment.

The resolution of this dispute centers on the construction of the employment contract. Cleo refers to that portion of the contract which states:

> Cleo Inc. and I are very pleased that you have agreed to serve as Vice President, Marketing of Cleo Inc. ... As Vice President, Marketing you will report to the President, and perform those functions currently

> assigned, which functions and responsibilities can be changed at the discretion of the Company. The following terms and conditions will govern your service to the Company:
>
> 1. You will serve the Company on a full-time basis as a senior executive employee, and the Company will employ you as such, for a period of three years. . . .

The appellant relies on the same contractual language to argue that he was employed as the Vice President of Marketing for the company. According to appellant, once Cleo removed his title and work responsibilities, it effectively ended his employment.

The interpretation of a contract is a matter of law that requires a *de novo* review on appeal. See Hamblen County v. City of Morristown, 656 S.W.2d 331, 335-336 (Tenn. 1983). When resolving disputes concerning contract interpretation, our task is to ascertain the intention of the parties based upon the usual, natural, and ordinary meaning of the contractual language. Id. at 333-34; Bob Pearsall Motors, Inc. v. Regal Chrysler-Plymouth, Inc., 521 S.W.2d 578, 580 (Tenn. 1975). All provisions in the contract should be construed in harmony with each other, if possible, to promote consistency and to avoid repugnancy between the various provisions of a single contract. Rainey v. Stansell, 836 S.W.2d 117, 118-19 (Tenn. App. 1992), *perm. app. denied* (Tenn. 1992).

In this case, the contract refers to appellant's position of employment in two separate provisions. The opening provision states that he will "serve as Vice President of Marketing for Cleo, Inc.," reporting to the company president and conducting work functions that were currently assigned. The subsequent provision under Paragraph 1 describes his position as a full-time senior executive employee. We read those provisions together to mean that as Vice President of Marketing, the appellant was to be a full-time senior executive employee in the company.[4] Cleo promoted the appellant to that position with the condition that it could change his job functions and responsibilities during the course of the three-year contract. Those changes may have included altering his official job title. However, Cleo was contractually obligated to maintain appellant's employment as a full-time senior executive employee unless there was a cause for termination.[5] Cleo's contractual right to change the appellant's work duties did not include the right to remove all of his duties.

Cleo contends that it fulfilled its contractual obligation by keeping the appellant on the company payroll at his then current salary, even though it altered and effectively ended his work responsibilities. Cleo relies on the Court of Appeal's decision in Canady v. Meharry Med. College, 811 S.W.2d 902 (Tenn. App. 1991), *perm. app. denied* (Tenn. 1991). In Canady, the defendant/employer restricted the plaintiff's work duties and decided not to renew his employment contract as a hospital resident physician after the plaintiff received unsatisfactory job-performance ratings. Id. at 904. The court concluded, in part, that the restriction of plaintiff's work duties did not constitute a breach of the contract because the contract contained no express or implied assurance that the plaintiff would be given continuous, uninterrupted work assignments. Id. at 906.

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[4]The Court of Appeals determined that the appellant was employed exclusively as the Vice President of Marketing based upon the opening provision of the employment contract. The court held that to the extent the subsequent provisions described the appellant as a senior executive employee, those latter provisions were unenforceable as being in conflict with the preceding "Vice President of Marketing" provision. We hold to the contrary that the provisions can be read congruently without having to redact any portion of the contract.

[5]As previously mentioned, "cause" was defined in the contract as "dishonesty, gross negligence, or willful misconduct in the performance of work duties or a willful or material breach of [the employment] Agreement." Cleo also had a right to terminate the contract under certain conditions of illness or incapacity as defined in Paragraph 6 of the contract.

The circumstances in Canady are clearly distinguishable from the appellant's case. Here, we are not dealing exclusively with a change or restriction of appellant's work responsibilities. The facts are undisputed that Cleo not only demoted the appellant from his position as Vice President of Marketing, but also ordered him to stay at his home and wait for any future assignments. During the three months that the appellant stayed at home, he received no work assignments and apparently did not perform any functions on behalf of the company. In addition, Cleo reclaimed appellant's company credit cards and informed him that the company would no longer answer telephone calls for him. All business contacts for Cleo and authority to act on behalf of the company were taken away from the appellant.

The undisputed facts in this case support the lower courts' holding that the appellant was constructively terminated from his employment. Moreover, Cleo has not shown cause to justify the termination. We, therefore, conclude that summary judgment for the appellant was appropriate on that issue.

II.

We shall next address whether Paragraph 9 of the employment contract provides for severance pay or liquidated damages. The appellant contends that Paragraph 9 contemplates severance pay because its payment is not specifically conditioned upon a breach of contract. Cleo argues to the contrary that the sums under Paragraph 9 are liquidated damages because that paragraph calls for the payment of a set amount in the event of a certain occasion. Cleo contends, however, that no matter what label is given to the provision, it is unenforceable because the appellant suffered no actual monetary damages.

The Court of Appeals interpreted Paragraph 9 of the employment contract as a liquidated damages provision because it contemplates the "payment of a sum certain in the event of a certain occasion." We agree that Paragraph 9 provides for liquidated damages, not severance pay. However, our interpretation of Paragraph 9 is based upon the specific contract language that recovery is due in the event that Cleo "terminates this agreement and [appellant's] employment without cause," resulting in a breach of the contract.

The distinction between liquidated damages and severance pay is important in this case. If Paragraph 9 provides for liquidated damages, then recovery is conditioned upon a showing that Cleo breached the contract and that the amount of recovery was a reasonable estimation of damages. However, if the provision calls for severance pay, then recovery by the appellant is absolute in the event of his termination, regardless of whether Cleo breached the contract or whether the amount was a reasonable damage assessment.

The term "liquidated damages" is defined by case law as a "sum stipulated and agreed upon by the parties at the time they enter their contract, to be paid to compensate for injuries should a breach occur." V.L. Nicholson Co. v. Transcon Inv. & Fin. Ltd., Inc., 595 S.W.2d 474, 484 (Tenn. 1980); Kimbrough & Co. v. Schmitt, 939 S.W.2d 105, 108 (Tenn. App. 1996), *perm. app. denied* (Tenn. 1996). The stipulated amount represents an estimate of potential damages in the event of a contractual breach where damages are likely to be uncertain and not easily proven. V.L. Nicholson, 595 S.W.2d at 484.

In contrast, the recovery of severance pay is not conditioned upon a breach of contract or a reasonable estimation of damages. Generally, severance pay is a form of compensation paid by an employer to an employee at a time when the employment relationship is terminated through no fault of the employee. Black's Law Dictionary 1374 (6th ed. 1990). The reason for severance pay is to offset the employee's monetary losses attributable to the dismissal from employment[6] and to recompense the employee for any period of time when he or she is out of work. Bradwell v. GAF Corp., 954 F.2d 798, 800 (2nd Cir. 1992); 27 Am. Jur.2d *Employment Relationship* § 70 (1996). The amount of payment is generally based upon the types of services and the number of service years performed by the employee on behalf of the employer. See Balding v. Tennessee Dep't of Employment Sec., 212 Tenn. 517, 370 S.W.2d 546, 548 (1963).

[6]Those losses may include seniority rights, pension recovery, and re-training costs or other burdens associated with obtaining new employment.

With these principles in mind, we focus on the language in Paragraph 9 to determine whether liquidated damages or severance pay was contemplated. Paragraph 9 provides that if Cleo terminates the contract and appellant's employment without cause, the appellant shall continue to receive his then current salary from the date of termination until October 31, 1995, the contract expiration date. Paragraph 9 does not state that sums payable are based upon an estimation of damages in the event of a breach of contract. However, it is clear that the provision affords the appellant a set amount of compensation in the event that Cleo terminates the agreement and appellant's employment, without cause, before the end of the contract.[7] Relying on the plain meaning of the language in Paragraph 9, we conclude that recovery therein is conditioned upon Cleo's breach of contract.

A contractual provision need not explicitly include the term "liquidated damages" to constitute a liquidated damages provision. In cases as here, where a provision entitles one party to a stipulated recovery following an event that constitutes a breach of contract, courts must look to the substance of the provision and the intentions of the parties to determine whether the provision calls for liquidated damages. If the parties agree in the contract on the amount of damages to be recovered for compensation, upon the occurrence of a particular defaulting event,

[7]The appellant argues, in part, that the dollar amount established in Paragraph 9 cannot be construed as liquidated damages because it is not sufficiently definite to constitute a "sum certain." We afford no merit to this contention. Under Tennessee law, a contractual provision does not have to specify a set dollar amount to constitute liquidated damages. See Vanderbilt Univ. v. Dinardo, 974 F. Supp. 638, 640 (M. D. Tenn. 1997) (applying Tennessee law), *rev'd in part*, __ F.3d __, 1999 WL 211871 (6th Cir. Apr. 14, 1999) (upholding the liquidated damages provision, but remanding for trial on a contract addendum); Harmon v. Eggers, 699 S.W.2d 159, 160 (Tenn. Ct. App. 1985), *perm. app. denied* (Tenn. 1985).

then the damages are liquidated unless the contract states otherwise. See V.L. Nicholson, 595 S.W.2d at 484.

The language in Paragraph 9 reflects the parties' intentions to compensate the appellant with a set monetary amount in the event that Cleo terminated the contract and the employment relationship without cause, before the end of the three-year term. Having further determined that the termination in this case was a breach of contract, we interpret Paragraph 9 as contemplating the payment of liquidated damages.

III.

The remaining question is whether the appellant may recover any or all of the damages set forth in Paragraph 9. Under that paragraph, the sum payable is the remainder of appellant's then current salary from the date of termination until the end of the contract term on October 31, 1995. The appellant's salary as of December 1994, was $103,000. Based upon that amount and the formula provided in Paragraph 9, the trial court determined that the remainder of salary owed under the three-year contract was $90,125.[8]

Cleo does not dispute the calculation of damages in this case, but instead contends that the $90,125 amount plus prejudgment interest is grossly disproportional to any actual damages suffered by the appellant. Since the appellant obtained new employment on December 12, 1994, with an annual salary of $110,000, Cleo argues

[8]The record does not reflect the exact date found by the trial court as the date when appellant was terminated from his employment. However, based upon the $90,125 amount, it is apparent that the trial court treated December 15, 1994, as the approximate date of termination. That date coincides with a letter sent by Cleo to the appellant on December 22, 1994, stating that the appellant had been paid his employment wages through December 15, 1994.

that appellant's recovery of liquidated damages under Paragraph 9 would constitute an unlawful penalty.

The basis of Cleo's contention is that if the appellant suffered no actual damages from the termination of his employment, then his recovery under Paragraph 9 would have no compensatory function, but would instead simply punish Cleo for the termination. Both parties acknowledge that Tennessee law disfavors the enforcement of a liquidated damages provision when the provision serves only to penalize the defaulting party for a breach of contract. See Testerman v. Home Beneficial Life Ins. Co., 524 S.W.2d 664, 668 (Tenn. App. 1974), *perm. app. denied* (Tenn. 1975).[9]

The fundamental purpose of liquidated damages is to provide a means of compensation in the event of a breach where damages would be indeterminable or otherwise difficult to prove. V.L. Nicholson, 595 S.W.2d at 484; 22 Am. Jur. 2d *Damages* § 683 (1988); Restatement (Second) of Contracts § 356 cmt. (1979). By stipulating in the contract to the damages that might reasonably arise from a breach, the parties essentially estimate the amount of potential damages likely to be sustained by the nonbreaching party. "If the [contract] provision is a reasonable estimate of the damages that would occur from a breach, then the provision is normally construed as an enforceable stipulation for liquidated damages." V.L. Nicholson, 595 S.W.2d at 484 (citing City of Bristol v. Bostwick, 146 Tenn. 205, 240 S.W. 774 (1921); 22 Am. Jur. *Damages* § 227 (1965)). However, if the stipulated amount is unreasonable in relation to those potential or estimated damages, then it will be treated as a penalty.

[9]As distinguished from liquidated damages, a penalty is "a sum inserted in a contract, not as the measure of compensation for its breach, but rather as a punishment for default, or by way of security for actual damages which may be sustained by reason of nonperformance, and it involves the idea of punishment." 22 Am. Jur. 2d *Damages* § 684 (1988).

22 Am. Jur. 2d *Damages* § 686 (1988); Restatement (Second) of Contracts § 356 (1979).

Although most jurisdictions disfavor the enforcement of penalties under contract law, there is a split in authority on the proper method for determining whether a liquidated damages provision constitutes a penalty. One method, commonly referred to as the "prospective approach," focuses on the estimation of potential damages and the circumstances that existed at the time of contract formation.[10] Under this approach, the amount of actual damages at the time of breach is of little or no significance to the recovery of liquidated damages. 22 Am. Jur. 2d *Damages* § 723 (1988). If the liquidated sum is a reasonable prediction of potential damages and the damages are indeterminable or difficult to ascertain at the time of contract formation, then courts following the prospective approach will generally enforce the liquidated damages provision. See e.g. Gaines v. Jones, 486 F.2d 39, 46 (8th Cir. 1973) (applying Missouri law); Brazen v. Bell Atl. Corp., 695 A.2d 43, 48 (Del. 1997).

[10] See United States v. Bethlehem Steel Co., 205 U.S. 105, 119, 27 S.Ct. 450, 455, 51 L.Ed. 731 (1907); Gaines v. Jones, 486 F.2d 39, 44-45 (8th Cir. 1973); United States v. Le Roy Dyal Co., 186 F.2d 460, 462 (3rd Cir. 1950); Williwaw Lodge v. Locke, 601 P.2d 236, 239 (Alaska 1979); Omohndro v. Ottenheimer, 127 S.W.2d 642, 645 (Ark. 1939); McCarthy v. Tally, 297 P.2d 981, 986-87 (Cal. 1956) (in banc); Rohauer v. Little, 736 P.2d 403, 410 (Colo 1987); Hanson Dev. Co. v. East Great Plains Shopping Ctr., Inc., 485 A.2d 1296, 1300 (Conn. 1985); Brazen v. Bell Atl. Corp., 695 A.2d 43, 48 (Del. 1997); Lefemine v. Baron, 573 So.2d 326, 328 (Fla. 1991); Fickling & Walker Co. v. Gibbens Constr. Co., 376 S.E.2d 655, 659-60 (Ga. 1989); Anne Arundel County v. Norair Engr. Corp., 341 A.2d 287, 294 (Md. 1975); Frank v. Jansen, 226 N.W.2d 739 (Minn. 1975); Board of Trustees of State Inst. of Higher Learning v. Johnson, 507 So.2d 887, 890 (Miss. 1987); Knutton v. Cofield, 160 S.E.2d 29, 35-36 (N.C. 1968); Fisher v. Schmeling, 520 N.W.2d 820, 822 (N.D. 1994); Safari, Inc. v. Verdoorn, 446 N.W.2d 44, 46 (S.D. 1989); Woodhaven Apartments v. Washington, 942 P.2d 918, 921 (Utah 1997).

In contrast, a second approach has developed in which courts not only analyze the estimation of damages at the time of contract formation, but also address whether the stipulated sum reasonably relates to the amount of actual damages caused by the breach.[11] Under this retrospective approach, the estimation of potential damages and the difficulty in measuring damages remain integral factors for the courts' review. See e.g. Lake Ridge Academy v. Carney, 613 N.E.2d 183, 188-89 (Ohio 1993); Highgate Assoc., LTD. v. Merryfield, 597 A.2d 1280, 1282 (Vt. 1991). However, as part of that review, the actual damages at the time of breach are also relevant in determining whether the original estimation of damages was reasonable. See Kelly v. Marx, 694 N.E.2d 869, 871 (Mass. Ct. App. 1998); Wassenaar v. Panos, 331 N.W.2d 357, 361-62 (Wis. 1983). If the liquidated sum greatly exceeds the amount of actual damages, then courts following this latter approach will treat the estimated sum as a penalty and will limit recovery to the actual damages. Kelly, 694 N.E.2d at 871; Shallow Brook Assoc. v. Dube, 599 A.2d 132, 137 (N.H. 1991).

While this Court has not previously addressed the issue, we note that the Court of Appeals has followed the latter approach using both a prospective review of the circumstances at the time of contract formation and a review of the actual damages at the time of breach. See Kimbrough & Co., 939 S.W.2d at 108; Beasley v. Horrell, 864 S.W.2d 45, 50 (Tenn. App. 1993), *perm. app. denied* (Tenn. 1993); Kendrick v.

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[11] See Thanksgiving Tower Partners v. Anros Thanksgiving Partners, 64 F.3d 227, 232 (5th Cir. 1995) (applying Texas law); Southpace Properties, Inc. v. Acquisition Group, 5 F.3d 500, 505 (11th Cir. 1993) (applying Alabama law); Kelly v. Marx, 694 N.E.2d 869, 871-72 (Mass. App. Ct. 1998); Hawkins v. Foster, 897 S.W.2d 80, 85 (Mo. Ct. App. 1995); Browning Ferris Indus. of Nebraska, Inc. v. Eating Establishment 90th & Fort, Inc., 575 N.W.2d 885, 888-89 (Neb. Ct. App. 1998); Shallow Brook Assoc. v. Dube, 599 A.2d 132, 137 (N.H. 1991); Boyle v. Petrie Stores Corp., 518 N.Y.S.2d 854, 861 (N.Y. Sup. Ct. 1985), *supp. decision* (May 29, 1987); Lake Ridge Academy v. Carney, 613 N.E.2d 183, 189 (Ohio 1993); Highgate Assoc., LTD. v. Merryfield, 597 A.2d 1280, 1282 (Vt. 1991) (reviewing the totality of the circumstances); Wheeling Clinic v. Van Pelt, 453 S.E.2d 603, 609 (W. Va. 1994); Wassenaar v. Panos, 331 N.W.2d 357, 361-62 (Wis. 1983) (reviewing the totality of the circumstances, including actual damages).

Alexander, 844 S.W.2d 187, 190-91 (Tenn. App. 1992), *perm. app. denied* (Tenn. 1992); Harmon, 699 S.W.2d at 163; Eller Bros., Inc. v. Home Fed. Sav. & Loan Assoc., 623 S.W.2d 624, 628 (Tenn. App. 1981), *perm. app. denied* (Tenn. 1981). After careful consideration, we find that there are inherent problems with the retrospective analysis and are persuaded that a prospective approach is the better rule. Therefore, to the extent that the Court of Appeals has adopted a retrospective approach, those cases are overruled.

From our review of the law on liquidated damages, we recognize that there are two important interests at issue: the freedom of parties to bargain for and to agree upon terms such as liquidated damages and the limitations set by public policy. Generally, the parties to a contract are free to agree upon liquidated damages and upon other terms that may not seem desirable or pleasant to outside observers. See Chapman Drug Co. v. Chapman, 207 Tenn. 502, 341 S.W.2d 392, 398 (1960); 22 Am. Jur. 2d *Damages* § 686 (1988). In that respect, courts should not interfere in the contract, but should carry out the intentions of the parties and the terms bargained for in the contract, unless those terms violate public policy. See McKay v. Louisville & N.R. Co., 133 Tenn. 590, 182 S.W. 874, 875 (1916) (citing Baltimore & Ohio S.W. Ry. Co. v. Voight, 176 U.S. 498, 505, 20 S.Ct. 385, 387, 44 L.Ed. 560 (1900)).

Both the prospective and the retrospective approaches allow courts to review liquidated damages provisions together with the limitations set by public policy. However, we conclude that the prospective approach is the better rule based upon the consideration it affords to the intentions of the parties and to the freedom to contract.

When parties agree to a liquidated damages provision, it is generally presumed that they considered the certainty of liquidated damages to be preferable to the risk of proving actual damages in the event of a breach. 22 Am. Jur. 2d *Damages* § 726. Liquidated damages permit the parties to allocate business and litigation risks and often serve as part of the contractual bargain. In addition, they lend certainty to the contractual agreement and allow the parties to resolve defaults and other related disputes efficiently, when actual damages are impossible or difficult to measure. C.T. McCormick, *Handbook on the Law of Damages* § 157 (1935).

The retrospective approach, however, undermines the certainty and other benefits afforded by liquidated damages. Under that approach, the parties are allowed to fully litigate actual damages following a breach of contract. If the nonbreaching party fails to prove actual damages, then he or she is barred from recovering the liquidated sum originally agreed upon in the contract. We find that it is unfair to require the nonbreaching party to prove actual damages in cases where the parties agreed in advance to a liquidated damages provision. Such a requirement ignores the original intentions of the parties and defeats the purposes of stipulating in advance to potential damages.

We, therefore, adopt a prospective approach for addressing the recovery of liquidated damages. Under this approach, courts must focus on the intentions of the parties based upon the language in the contract and the circumstances that existed at the time of contract formation.[12] Those circumstances include: whether the liquidated sum was a reasonable estimate of potential damages and whether actual damages

[12]This prospective approach incorporates the cardinal rule of contract interpretation, requiring courts to ascertain the intentions of the parties based upon the language in the contract. See Bob Pearsall Motors, Inc., 521 S.W.2d at 580; Nunnelly v. Warner Iron Co., 94 Tenn. 282, 29 S.W. 124 (1895).

were indeterminable or difficult to measure at the time the parties entered into the contract. See V.L. Nicholson, 595 S.W.2d at 484. If the provision satisfies those factors and reflects the parties' intentions to compensate in the event of a breach, then the provision will be upheld as a reasonable agreement for liquidated damages. However, if the provision and circumstances indicate that the parties intended merely to penalize for a breach of contract, then the provision is unenforceable as against public policy.

IV.

We now turn to the liquidated damages provision in this case. The Court of Appeals found that the liquidated sum was a reasonable estimation of potential damages at the time the parties entered into the contract. We agree. Neither the appellant nor Cleo had certain knowledge, when forming the contract, that the appellant would be able to secure other employment in the event that Cleo terminated his employment without cause. It was within the fair contemplation of the parties that the appellant might not be able to find a similar professional position at the same salary and that he might suffer damages that would be difficult to prove, including loss of professional status, prestige, and advancement opportunities. The language in Paragraph 9 reflects the parties' intentions to compensate and to protect the appellant against those potential losses in the event of a breach by Cleo.

The Court of Appeals, however, went further in addressing whether the stipulated sum reasonably related to the appellant's actual damages. Cleo insists that the intermediate court's analysis was both proper and fair based upon the fact that the appellant obtained new employment at a higher salary after the termination. While we question whether the record is sufficient on the issue of actual damages,[13] we conclude that the extent of actual damages has no bearing on the appellant's recovery of liquidated damages under Paragraph 9. The liquidated sum is recoverable based upon our conclusion that it was reasonable at the time the parties entered into the contract and that it reflects the parties' original intentions to compensate for a termination of employment.

The parties themselves were in the best position to know what considerations influenced their bargaining at the time they entered into the contract. While "'[t]he bargain may be an unfortunate one for the delinquent party, ... it is not the duty of courts of common law to relieve parties from the consequences of their own improvidence.'" Watson v. Ingram, 881 P.2d 247, 250 (Wash. 1994) (quoting Dwinel v. Brown, 54 Me. 468, 470 (1867)). See also McKay, 182 S.W. at 875; Whaley v. Underwood, 922 S.W.2d 110, 112 (Tenn. App. 1995). Accordingly, to the extent the Court of Appeals based its decision upon a review of actual damages, that decision is overruled.

CONCLUSION

Based upon the foregoing, we conclude that summary judgment for the appellant was appropriate on the issue of constructive termination. Moreover, because Paragraph 9 was a reasonable estimation of damages at the time the parties

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[13] The trial court awarded summary judgment to the appellant without making a finding on actual damages or whether the recovery constituted severance pay or liquidated damages. Nevertheless, because we hold that actual damages are immaterial in this case, we need not address the sufficiency of the record in that respect.

entered into the contract, we conclude that the appellant is entitled to recover the full amount stipulated in that provision. The judgment of the Court of Appeals is reversed and the trial court's award of summary judgment for the appellant is reinstated. Costs of this appeal are taxed to the appellee, Cleo.

WILLIAM M. BARKER, JUSTICE

CONCUR:

Anderson, C.J.,
Drowota, Birch, Holder, JJ.