BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESSEE

DECEMBER 10, 1999

IN RE:	)	
	)	
BELLSOUTH TELECOMMUNICATIONS, INC.	)	**DOCKET NO.**
TARIFF FILING TO INTRODUCE TOLL	)	**99-00406**
FREE DIALING SERVICE	)	
	)	

ORDER DENYING TARIFF TO INTRODUCE TOLL FREE DIALING SERVICE

This matter came before the Tennessee Regulatory Authority ("Authority") on the tariff filing of BellSouth Telecommunications, Inc. ("BellSouth") for approval to introduce Toll Free Dialing Service. BellSouth filed Tariff No. 99-00406 on June 8, 1999, with a proposed effective date of July 8, 1999. On June 22, 1999, BellSouth filed a revision to the tariff and requested an effective date of July 14, 1999. At the regularly scheduled Authority Conference held on July 13, 1999, the Directors voted unanimously to suspend BellSouth's tariff for thirty (30) days, from July 14, 1999 through August 12, 1999. The Directors of the Authority considered this matter at a regularly scheduled Authority Conference held on August 10, 1999, and unanimously denied the tariff for the reasons set forth below.

Based upon careful consideration of the tariff filing and the attachments thereto, the Authority finds and concludes the following:

1. The purpose of this tariff is to introduce an optional inbound Toll Free Dialing ("TFD") Service for business subscribers. TFD Service (formerly 800 service) provides subscribers with ten-digit numbers (e.g., 1-888-xxx-xxxx) to permit their consumers to reach them without incurring long distance charges. This type of arrangement allows a business customer to advertise one telephone number to all customers, in lieu of advertising local telephone numbers for its local customers and separate numbers for customers located outside of the local calling area.[1]

2. TFD Service contains two separate rate schedules, one for calls received within the local calling area and one for calls received from customers located outside the local calling area. Usage rates range from $0.047 to $0.084 per minute, depending on whether the call originates inside or outside of the local calling area and on the monthly volume level to which a subscriber commits.[2] These rates are available on a monthly basis.

3. Additional discounts are available to subscribers who enter into a term plan for TFD Service. In order to receive discounts under the tariff filing, subscribers must commit to service periods of one, two or three years to receive a 5% to 11% discount off the monthly usage rates outlined above. Termination charges, however, are imposed if a subscriber prematurely terminates a term plan for TFD Service.

4. The Authority favors the concept of offering an optional TFD Service and considers that it may be beneficial to consumers.

5. In reviewing this tariff filing, the Authority must determine whether it complies with Authority rules and is otherwise consistent with the law. Pursuant to Tenn. Code Ann. § 65-5-

[1] BellSouth's TFD Service allows subscribers to receive calls within the LATA only. Business subscribers desiring to provide toll free calling for their customers located in another LATA must subscribe to another carrier.
[2] The minimum monthly usage level is 300 hours.

203, the burden of proof is on BellSouth to demonstrate, via its filing and supporting documentation, that its tariff provisions are reasonable, just, and consistent with the Authority's rules as well as state and federal law.

6. Under Tennessee state contract law, parties to a contract may determine or stipulate to an amount for damages should a breach occur. This ability to stipulate to damages, however, is not without some restrictions. In Tennessee, it is well-settled that stipulated damages must "bear a reasonable relationship to the amount of foreseeable damages from breach," *Harmon v. Eggers, 699 S.W.2d 159 (Tenn. App. 1985)*, and that any such liquidated damages be "reasonable in relation to the amount of damages that could be expected to result from the breach." *Beasley v. Horrell, 864 S.W.2d 45 (Tenn. App. 1993).*

7. If the stipulated amount is unreasonable in relation to the potential or estimated damages, then it constitutes a penalty and will not be enforced. *22 Am.Jur.2d Damages § 686 (1988); Restatement (Second) of Contracts § 356 (1979).* These principles have been continually reaffirmed in Tennessee jurisprudence; see the seminal case *V.L. Nicholson Co. v. Transcon Inv. & Fin. Ltd., Inc., 595 S.W.2d 474 (Tenn. 1980)*, see also *Guiliano v. Cleo, Inc., 995 S.W.2d 88 (Tenn., As Corrected August 2, 1999).*

8. The Supreme Court of Tennessee recently adopted a prospective approach for addressing the recovery of liquidated damages in *Guiliano v. Cleo, Inc., 995 S.W.2d 88, at 100.* To the extent that *Harmon* and *Beasley* relied on a retrospective approach, i.e., to the extent that those courts considered actual damages at the time of the breach when reviewing the reasonableness of the liquidated damages provisions, such retrospective approach is now specifically overruled. *(Id.)* The holding in *Cleo* ultimately concludes that the distinction between unlawful penalties and legitimate liquidated damages is determined by analyzing the

parties' intentions <u>solely</u> at the time of contract formation: "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." *Guiliano v. Cleo, Inc., 995 S.W.2d at 101.*

9. In this docket however, BellSouth's tariff filing is not simply a bi-lateral contract between two parties who have negotiated and consented to specific terms in the agreement. Rather, it is proposed as a regulated public utility's tariff which, upon approval by the Authority, will be offered "as is" or on a "take it or leave it" basis to the public at large. One justification of the Authority's regulatory power is as a guardian of the public interest. Because anyone who avails themselves of the services offered under this proposed tariff will also be bound to terms of an agreement they did not negotiate, the Authority must safeguard the interests of the public in the negotiating/contracting process.

10. For the Authority to accept the proposed termination charges as legitimate liquidated damages: (a) in its role as a surrogate for the "non-contracting public", the Authority must first determine a reasonable estimate of potential damages in the event of a breach, then it must have a "meeting of the minds" with BellSouth relative to such estimate; (b) in its role as a regulator and finder-of-fact, the Authority must determine whether it is BellSouth's intention, by inclusion of such termination charges, to recoup legitimate losses or merely to provide a financial incentive for the public not to breach the tariff.

11. BellSouth's tariff filing provides:

> Upon cancellation of a term plan, the customer will be billed an amount equal to the discounted local calling area rate times the monthly usage commitment for the number of months remaining on the plan.

In essence, this termination provision requires a 100% buy-out of the remaining service term, regardless of the length of service previously provided and irrespective of whether BellSouth has any unrecoverable costs remaining.

12. Although customers receive a discount on rates upon entering into a term commitment pursuant to the terms of the tariff filing, the associated liability for terminating the commitment disproportionately outweighs potential savings. For example, a subscriber who enters into a TFD Service commitment of 7,500 hours of use per month for 36 months will receive an 11% discount on monthly rates. The maximum the subscriber could save by taking the 36-month term commitment is approximately $2,800 per month; yet upon the subscriber's termination of the TFD Service, BellSouth would charge that subscriber approximately $18,800 for each month remaining in such term. Even if this subscriber remains with the term commitment for 31 months, upon canceling the service a mere five months early, the subscriber's termination charges would be greater than the subscriber's cumulative savings over the previous 31 months of service (e.g., $18,800 x 5 = $94,000 in termination charges vs. $2,800 x 31 = $86,800 in savings).

13. Under the tariff filing as proposed, assuming a TFD Service commitment of 7,500 hours of use per month and a 36-month term, if a customer terminates at 12 months, the termination charges would be approximately $450,000 ($18,800 x 24).

14. The Authority does not take issue with BellSouth's right to recover damages it may suffer if a subscriber breaches a term plan. Such damages can be directly shown by the specific costs that remain after a term plan is terminated. BellSouth, however, has not provided cost data or any other evidence indicating that it will continue to incur costs or suffer other damage after a subscriber terminates a TFD Service term plan. Since TFD Service is provided over BellSouth's existing facilities and network, no additional investment will have to be made to serve a TFD

subscriber. BellSouth will not incur any ongoing investment-related carrying costs or other foreseeable damages upon termination of service. As shown above, BellSouth seeks to recover amounts through termination charges that unreasonably exceed any anticipated costs or damages identified with terminating TFD Service.

15. In response to Authority data requests with respect to this tariff filing, BellSouth conceded that it had not performed a cost study or other financial analysis to justify potential damages incurred due to TFD Service subscribers terminating a term plan as opposed to month-to-month service. According to BellSouth, "[t]he basis of the termination liability charge described in the proposed tariff is to recover the remaining revenue the customer committed to pay the Company when it entered into the contract in exchange for receiving the discounted rates."[3] BellSouth's justification for the termination provisions is that "[t]he early termination provisions provide reasonable incentives for the customer to honor the term of the agreement in return for BellSouth's commitment to honor the level of discounts over the same term."[4]

16. If such a termination provision in the tariff filing is not intended to relate to the anticipated costs associated with a breach of contract, it cannot be reasonably related to foreseeable damage and cannot be considered as a legitimate liquidated damage provision. BellSouth does not contend in either its tariff filings or its data response that the proposed termination charges are related to costs estimated to be incurred in the event of a breach.

17. Recovery of an amount not reasonably related to as well as significantly greater than a reasonable estimation of the costs incurred due to termination constitutes a penalty, is unjust, unreasonable and is unlawful in Tennessee. As discussed above, this proposed tariff would

[3] BellSouth data response, Item No. 3, Page 1 of 1, filed July 23, 1999.
[4] BellSouth data response, Item No. 3, Page 1 of 1, filed July 23, 1999.

permit recovery of substantially more in termination charges than any foreseeable damage which might be suffered as a result of such service termination.[5]

18. For the foregoing reasons, the termination provision contained in the tariff filing constitutes a penalty and thereby violates state contract law, and further, it renders this tariff filing counter to the best interests of the public.

IT IS THEREFORE ORDERED THAT:

BellSouth Telecommunications, Inc.'s Tariff to Introduce Toll Free Dialing Service, Tariff No. 99-00406, is denied.

Melvin J. Malone, Chairman

H. Lynn Greer, Jr., Director

Sara Kyle, Director

ATTEST:

K. David Waddell, Executive Secretary

Legdata/Orders/99-00406

[5] Excessive termination charges which recover more than the remaining portion of customer-specific costs at the time of default may be characteristic of a potentially anti-competitive contract as well.