Southwestern Bell Telephone

October 1, 1993

Alfred G. Richter, Jr.
Vice President and
General Counsel
(Missouri)

Mr. David L. Rauch
Executive Secretary
Missouri Public Service Commission
301 West High Street, Floor 5A
Jefferson City, Missouri 65101

Re: Case No. TC-93-224, et al.

Dear Mr. Rauch:

Enclosed for filing with the Commission in the above-referenced case is an original and 14 copies of the Reply Brief of Southwestern Bell Telephone Company.

Please stamp "Filed" on the extra copy and return the copy to me in the enclosed self-addressed, stamped envelope.

Thank you for bringing this matter to the attention of the Commission.

Very truly yours,

Alfred G. Richter, Jr.

Enclosures

cc: Parties of record

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OCT 1 1993
MISSOURI
PUBLIC SERVICE COMMISSION

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

The Staff of the Missouri Public Service Commission, Complainant, v. Southwestern Bell Telephone Company, a Missouri corporation, Respondent.	)	Case No. TC-93-224
In the matter of proposals to establish an alternate regulation plan for Southwestern Bell Telephone Company.	)	Case No. TO-93-192

REPLY BRIEF OF
SOUTHWESTERN BELL TELEPHONE COMPANY

FILED

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October 1, 1993

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I. INTRODUCTION

In a proceeding which it initiated with a complaint seeking a reduction in SWB's revenues of $150M, the Staff begins its Brief by stating that this case has been "litigated to the hilt" and wonders "why?" Staff Brief,p.7 Staff's Brief then goes on to imply that the Commission should decide the issues in this case in such a way as to "encourage parties . . . primarily the companies" to settle issues and not bring them to the Commission for decision. This argument echoes a theme in Staff's opening statement in which Staff's counsel wondered who was responsible for SWB's "lousy settlement offers." T.44 Staff's ongoing references to settlement discussions seem to violate the spirit if not the letter of 4 CSR 240-2.090(7). Comments about settlement discussions on the record do not encourage parties to seriously discuss settlement.

Staff brought this proceeding and raised the "sheer number of revenue requirement issues that have been put to you for decision." T.43 The Complaint initially alleged overearnings of $150M. When Staff filed its testimony on February 1, 1993, its number ranged from $176.9M to $190.7M. By the time the hearings were underway, Staff's number was back to $150M. Ex.244 In its opening statement Staff said it did not actually expect the Commission to order a $150M revenue reduction, but warned that if the Commission does not order a revenue reduction of $95M "something is really wrong." T.41 Staff's Brief now claims that SWB is overearning by $135M.

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[1]The defined phrases, terms, and acronyms used herein are as defined in SWB's Brief filed September 10, 1993.

Staff Brief,p.181 The constant changes in Staff's case made even reconciliation difficult, let alone settlement of issues. T.16-17,183-84,467-68,1040,1752-54,2355-56;Ex.7,p.2,4

Staff suggests that the Commission should exercise its decision-making authority in this case to penalize and punish SWB in order to send a message to the Company and other utilities that dire consequences will flow from challenges to Staff's audit results or issue selection. SWB is not the only party with such a perception. GTE is worried that FAS 106 will be rejected by the Commission because of its displeasure with SWB for seeking legislative changes. GTE goes so far as to suggest that if the Commission wants to punish SWB, it should do so on some other issue. GTE Brief,p.2 Is this the message the Commission wants to send? Are utilities in this State to understand that if they dare disagree with Staff or exercise their right to seek legislative change they risk sanctions from the Commission?

II. REVENUE REQUIREMENT

1. TEST YEAR ISSUES, ERRORS AND ISOLATED ADJUSTMENTS

Staff argues that there is "no dollar value associated" with test year as a single issue in the reconciliation. Staff Brief,p.9 While this is true, test year does have a significant dollar impact. Otherwise, why would Staff spend five pages arguing about the issue? The Company summarized the amount in its Brief as $9M. SWB Brief,p.6 The dollars in the reconciliation are not indistinguishable, as the Staff implies, but are set out separate and apart and clearly labeled "Test Period." Ex.244 The test year issues and the dollars associated with these issues are not the result of "SWB's attempt to move the test year from December 31, 1991 to September 30, 1992," but are included to identify the dollar impact of Staff's failure to maintain the rate base/revenue/expense relationship consistent with the test period set out by the Commission in its order. Order Adopting Procedural Schedule and Granting and Denying Interventions, March 9, 1993

Based on that Order, SWB filed a full reconciliation of all the issues in the case using 1991 data. The Order further stated that updates "may be made to the test year for items where significant changes have occurred." Id.,p.3 SWB updated the test period for all the significant changes that occurred through September 1992, whereas Staff adjusted its case through that period for only certain items, excluding over $9M in significant changes that had occurred as follows:

> $4.293M - Nonwage Expense, Including RTU Fees, Affiliate Transactions, and Other Expense. These transactions include the most current cost of supplies and services necessary to maintain the test period rate base and generate the test period revenues. Ex.43,p.55-63
>
> $1.518M - Access and Billing and Collection Expense. These expenses are directly related to the toll revenue annualized to the September 1992 level by Staff. Ex.7,p.93-94
>
> $1.372M - Income Tax, Pre-1981 Cost of Removal and Salvage. Cost of Removal/Salvage is the one and only component in Staff's entire income tax calculation not at the September 1992 level. Ex.37,p.77-92
>
> $1.274M - Deregulated Services. This adjustment removes the revenues and expenses for deregulated services. Ex.7,p.56-60
>
> $.639M - Salaries and Wages, TEAM and Other. Staff adjusted all salaries and wages to the September 1992 level except these two small components. Ex.43,p.3-22

SWB Brief,p.6

Staff also attacks SWB's inclusion of "isolated adjustments" which are known and measurable and occur after September 30, 1992. Staff Brief,p.13 Yet, the test year Order, which was almost fully included in Staff's Brief, clearly supported the inclusion of these pro forma adjustments.[2]

> Isolated adjustments can be proposed for items beyond the updated period. These are items which a party contends are known and measurable and for which the adjusted numbers should be used to calculate the company's revenue requirement.

Order,p.3-4

Staff aggregated all the isolated adjustments and recommends these issues be disallowed by the Commission based on the unsupported contention that each of the isolated adjustments <u>under disagreement</u> is positive and that SWB has failed to include any offsetting expense decreases. Staff Brief,p.13

This is not true; SWB's case in fact included adjustments which decreased the revenue requirement. Examples include the removal of Step-by-Step and Crossbar depreciation expense, eliminated 12/31/92 (Ex.7,Sch.6-1); Customer Premises Wiring amortization, eliminated 12/31/92 (<u>id</u>.); exclusion of Step-by-Step and Crossbar amortization of reserve deficiency, completed 12/31/92 (Ex.24,p.25); and the inclusion of the full expense savings associated with the EP retirement plan. Ex.43,p.78 Some issues were settled prior to the hearings which included adjustments

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[2]The Order is consistent with previous Commission decisions finding that post test year increases are appropriate when "the increase is an expense that the Company will actually be experiencing at the time the rates established herein go into effect." <u>In re: St. Louis County Water Company</u>, 29 Mo.P.S.C. (N.S.) 425,435 (1988)

decreasing expense. Staff's only argument for disallowing isolated adjustments is not persuasive or even accurate, since SWB included adjustments which increased as well as decreased its revenue requirement.

By reference to the recent St. Joseph case, Staff implies that SWB disregarded the Commission test year Order. Staff Brief,p.9 This also is not true; the Company fully complied with the Commission Order. The Company was instrumental in the preparation of a reconciliation (Ex.244), making it possible to try the case on an issue-by-issue basis and in no way prolonged the hearing. In fact, the hearings were actually concluded ahead of schedule.

SWB has followed the March 9, 1993, Order regarding test year which expressly provided for updates to the test period and the inclusion of isolated adjustments for subsequent events. SWB has proven that the adjustments included in its case are known and measurable as required by that Order, and are necessary to maintain the revenue/expense/rate base relationship. Therefore, these adjustments are appropriate for inclusion in the test year.

2. SENATE BILL 380, STATE TAX INCREASE

Staff opposes the increased property tax portion of Senate Bill 380 (SB 380) because it will occur after the end of the September 1992 updated test period. Staff Brief,p.14 Staff further faults SWB for assuming that all school boards will increase tax levies to account for this change in state funding for school budgets.[3] Staff Brief,p.14 SWB witness Toti logically and

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[3]Staff then contradicts itself by admitting that many school budgets will increase with the passage of SB 380. Staff (continued...)

reasonably calculated the new tax change; the change is known and measurable with reasonable accuracy. Ex.5,p.3,11-12

Staff then goes on to support its opposition with factual points that are not in the record. Staff states that some school districts will increase their levy by "200%."[4] Staff Brief,p.15 The transcript cite in Staff's Brief (T.211-12) doesn't reflect any math of that caliber. Staff then states that the levies for the "massive and valuable" Callaway plant (a Kingdom Telephone Company exchange) would nearly double.[5] This might be a 100% increase, but whether it is an unreasonable assumption is not borne out by the Staff's citation to the record. T.213

SWB's assumption is not "patently flawed;" what is flawed is Staff's refusal to recognize this change and its attempt to commingle SB 380 with its attack on "accrual accounting." Staff Brief,p.6 The SB 380 adjustment is a "known and measurable" change unrelated to either "cash" or "accrual" accounting.

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[3](...continued) Brief,p.183 This change will be significant -- what Staff is suggesting, <u>i.e., no recognition at all</u>, is clearly the unreasonable choice.

[4]What Staff has done is cite its own counsel's questions as statements of fact. In Case No. TC-89-14, the Commission stated that "facts are only adduced from a witness. An attorney's questions do not establish facts" and "should not be cited as facts in parties' briefs." <u>Staff of the Mo. P.S.C. v. SWBT</u>, 104 PUR 4th 381,431-32 (1989)

[5]Even so, the impact on SWB's cost of service is very insignificant. T.214

3. RATE OF RETURN

A. COST OF EQUITY

The Commission's Order in Case No. TO-90-1 approved a return on equity (ROE) range for SWB of 12.61% to 17.25%. If earnings fell below 12.61%, the Company received no automatic rate relief but could file for rate increases with the Commission.[6] The Company was authorized to retain all earnings up to 14.1% ROE, but had to agree to automatically share earnings between 14.1% and 17.25%, and to automatically return all earnings above 17.25% to customers. The Company also agreed to $82M in rate reductions, $180M in specific network improvements, and to freeze prices on a significant portion of its services for a three (extended to four) year period of time.

The Commission has a good deal of discretion in setting a range of return in this case.[7] In this proceeding, testimony regarding SWB's required minimum return on equity includes an estimate as low as 10% and as high as 14.98%.[8] Ex.18,p.66 SWB has

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[6]Numerous parties refer to the 12.61% as SWB's last authorized ROE. In Case No. TC-89-14 the Commission found that SWB's required ROE was 12.61%. That decision was appealed. In its subsequent Order in Case No. TO-90-1, there is no designation of 12.61% as SWB's ROE. Rather, 12.61 was the floor below which SWB could file for rate relief, and SWB was permitted to retain all earnings up to 14.1% ROE before sharing. T.1278-79

[7]In its Brief, SWB pointed out that in a recent order involving Orchard Farm in Case No. TR-93-153, the Commission had approved a change in rates without setting any return at all. SWB Brief,p.12n.6 On September 10, 1993, the Commission issued an order in Case No. TR-93-268 involving Citizens Telephone Company in which it again approved a change in rates without establishing a return.

[8]Staff incorrectly states at page 4 of its Brief that SWB presented no evidence of an ROE as high as 14.1%. In fact, Staff later cites such evidence at page 16 of its Brief.

proposed that, if the Commission will agree not to include Yellow Pages' earnings in calculating SWB's earnings during an extension of the incentive plan, the initial sharing point be lowered to 10.7% ROE, a figure within Staff's recommended rate of return range.[9]

The Commission is not required to set a fair return for SWB in this case on the basis of a minimum cost of capital. Ex.18,p.13, 26-28,243,286-88,299-302 The Commission can set a fair range of return within which it will permit the Company to earn, in order to accomplish specific goals, provide incentives, or to reward management efficiencies, just as it did in approving the current plan. In recognition of accomplishments under the current plan (see SWB's Brief,p.177-81) and SWB's commitments to additional rate reductions, discretionary network upgrades and ongoing price freezes, the Commission has the discretion to set a broad return range. Another factor the Commission can consider in setting such a range is SWB's offer to share earnings automatically with customers at various points within that range. Since price freezes, discretionary network investment, and sharing of revenues resulting from approved rates could not be accomplished in the absence of such commitments by SWB, these factors should be taken

[9]Staff witness Moore testified that in establishing a return requirement for a utility he does not adjust the return up or down as a result of Staff recommended expense or revenue adjustments. T.321 Yellow Pages imputation is an accounting adjustment to SWB's revenues and expenses. T.323

into account by the Commission in setting a return range in this case.[10]

SWB has proposed that sharing begin at 10.7% ROE. SWB would return to customers 60% of all earnings between 10.7% and 11.1% and would share 50/50 between 11.1% and 17.25%.[11] Ex.18,p.4 The effective cap on the earnings which SWB could actually achieve under the extended plan would be approximately 14% ROE (Ex.69, p.41,47) because earnings above 10.7% would be shared.[12]

B.& C. COST OF DEBT AND CAPITAL STRUCTURE

Staff takes the position that use of SBC's cost of debt and capital structure, rather than that of SWB, is appropriate because it is consistent with the Commission's decision in Case No. TC-89-14. Staff Brief,p.27 Staff states that SBC's capital structure is an appropriate proxy for SWB because SBC's consolidated asset base is dominated by the assets of SWB. If the Commission adopts Staff's proposal on capital structure and debt, it should then

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[10]In the absence of SWB's agreement, sharing would constitute unlawful retroactive ratemaking. Likewise, the Commission has no authority to order SWB to make discretionary investments or freeze rates outside the context of an agreement with the Company.

[11]The 17.25% CAP would be calculated on the basis of SWB's actual capital structure, as is the case under the current plan. Yellow Pages' earnings were excluded from the calculation of the CAP under the current plan. Ex.48,p.14

[12]In the third year of the current plan, SWB's achieved ROE, even with Commission adjustments (including Yellow Pages' earnings at 1985 adjusted levels) was only 12.9% (or only 9.5% without Yellow Pages' revenues). In its Brief Staff notes that SBC's achieved return declined from 13.06% ROE in 1989 to 12.14% ROE in 1991, but states that the 12.14% was above the industry average (10.9% ROE). However, Staff witness Moore conceded that in 1987, 1988, 1989, 1990 and 1992, SBC's achieved ROE was below the industry average. T.289-90

reject Dr. Johnson's proposed adjustment to SBC's return requirement.

In Case No. TC-89-14 the Commission used SBC's capital structure and debt as a proxy for SWB, but did so because it also used SBC's required ROE as a proxy and rejected Staff's proposed adjustment to that return to arrive at a return for SWB. Alternatively, if Dr. Johnson's adjustment is adopted, the Commission should reject Staff's proposal to substitute SBC's cost of debt and capital structure for SWB, and consistently use SWB's actual cost of debt and capital structure.

D. CONCLUSION

Dr. Avera's risk premium analyses did not focus on SBC as did Staff's DCF analysis. Dr. Avera developed his range of 11.91% to 14.98% ROE by determining risk premiums for SWB itself. The evidence thus supports use of SWB's actual cost of debt and capital structure and an initial sharing point of 14.1% ROE or 10.7% ROE (excluding Yellow Pages' earnings) under an extended incentive plan. If the Commission decides not to continue with incentive regulation, Dr. Avera testified that SWB's return requirement under a properly conducted DCF would range from 12.77% to 13.77% ROE, and would average 13.04% ROE under his various risk premium analyses. Ex.18,p.6,36,66-67 While there are lower return recommendations in the record, the Commission should set a return range on the basis of the goals it wishes to accomplish. The higher the allowed return is set, the greater the incentive and ability for discretionary investment in this State.

4. DEPRECIATION

Staff introduces the depreciation section of its Brief with a discussion of Case No. TR-90-98 wherein SWB's depreciation rates were last considered. By Staff's account, SWB did something improper by seeking new depreciation rates in a public docket -- an act specifically authorized by statute. This criticism echoes the introduction to Staff's Brief which suggests that SWB should be penalized for contesting, rather than settling issues raised in Staff's Complaint. Neither criticism is appropriate. The Company did not attempt to deceive the Commission by publicly coming before it to seek approval of the new (lower) depreciation rates insisted upon by Staff at the 1989 Three-Way meetings. The hearing in Case No. TR-90-98 occurred after Case No. TC-89-14 and after the incentive regulation plan was approved. The new depreciation rates would have reduced expenses and thus increased earnings and sharing. The Commission rejected the new rates stating reduced expenses through efficiency gains were a better measure of the effectiveness of the plan. R&O,p.7

The more significant aspect of the order in that case, ignored by Staff, is the Commission's long term view of SWB's depreciation rates:

> In addition, under current conditions technological advances and modernization of Southwestern Bell's network indicate that depreciation rates should increase or remain constant not decrease. The Commission cannot approve of rates which are contrary to these conditions.

R&O,p.7 These conditions are even more prominent today, yet Staff proposes rates which would reduce the pace of recovering investments consumed by accelerated network modernization in direct conflict with the signal sent to the parties to the prior depreciation case.

Staff then criticizes the effort that brought about the network modernization element of the incentive plan, claiming that, but for the Commission, such changes would not have occurred. Staff Brief,p.31 The Company cannot disagree with that statement, but does not see the genesis of network modernization in the same negative light that Staff apparently does. SWB was able to bring the advantages of more than 100 new digital switches to its customers in just two years only because the Commission provided an environment conducive to such a massive undertaking. The relevance of network modernization to the depreciation issue is the fact that so long as customers are to receive the advantages of services available exclusively through network upgrades, capital recovery must keep up. SWB's proposed rates will allow appropriate capital recovery. Staff's rates, which are lower than the existing rates and based upon agreements from the 1986 Three-Way meeting, will not.

Staff then charges that SWB's proposed rates are based exclusively on unknown future events.[13] They are not. Even Staff witness Richey admits that known future events should be factored into the rate setting process. T.427-28 The proposed rates in the

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[13]Staff criticizes SWB for not making Staff aware of information about future events. All information relied upon by the Company in this case, with the exception of recent retirement data, was contained in the depreciation study provided to Staff at the 1992 Three-Way. The information regarding the most recent retirements was contained in Mr. Ghanem's Rebuttal testimony. Ex.26,p.5,22 Staff did not address that information, or any other aspect of Mr. Ghanem's testimony, in its Surrebuttal testimony.

two Digital Accounts are derived from SWB's study, which relied upon both historical and projected retirements (including those scheduled pursuant to the current network modernization schedule). Retirements in 1992 turned out to be higher than the figures underlying the study. Accordingly, SWB's proposed rates are well supported by the most recent data. Ex.27,p.5,22

Finally, Staff makes the argument that SWB's amortization proposal, which restores parity to interstate and intrastate rates, is merely an attempt to usurp Commission authority. Staff Brief,p.31 The Commission need not disagree with the FCC just because it has the power to do so. Instead, it seems logical that disagreements would be reserved for situations when the FCC's policies simply do not work for Missouri. The depreciation rates in this case are not such a situation. This Commission can set whatever depreciation rates it believes will best match capital recovery to the consumption of assets. SWB's rates are better able to provide a match because they are based upon the most current information, rather than selective history used to develop 1986 parameters. The Company's proposed rates, coupled with the amortization, also recognize the reality that property used in the two jurisdictions really has only one life. Ex.24,p.21-22;T.417 SWB, like the Commission's Project Team, believes parity makes sense and is a worthwhile goal. Ex.24,p.12

5. **COMPENSABLE PROPERTY DEPRECIATION RESERVE**

Staff faults SWB for the disagreement on depreciation reserve and deferred taxes -- "because SWB doesn't identify the reserve and deferred taxes" for compensable property, although it has the ability to do so. Staff Brief,p.38-39 As a matter of "fairness," Staff then claims it had to develop a new "specific asset" method because two pieces of property -- OBC & the new St. Louis Data Center (the Data Center) -- are relatively new and a new approach was needed.[14] Staff Brief,p.39-40

SWB agrees OBC and the Data Center are relatively new -- beyond that, most of Staff's arguments are wrong and misleading. First, SWB's annual compensable property study (Staff Brief,p.38) does identify reserves and deferred taxes, in addition to other rate base and expense components. The results of the prescribed method from Case No. TC-89-14 have been reviewed and accepted by the Commission in each of the three annual monitoring reports produced under Case No. TO-90-1. Ex.93,Sch.1-78,1-79

Second, all of SWB's accounts are maintained using the Commission's group accounting and depreciation techniques which impact both the depreciation rates and reserve levels in the compensable property study. Ex.25,p.2-6,Sch.1,Sch.2 Staff's changes ignore this basic group accounting foundation.[15]

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[14]The annual SWB compensable property study represents only a fraction of the total plant invested in Missouri. T.595-96 Because compensable property is made up of a significant quantity of different items, the study has to incorporate the use of averages. Ex.24,p.33,37-40 So long as averages are consistently applied, it does not diminish the accuracy of the study - but allows the study to be completed in a timely and consistent manner. Staff's new modified method ignores these averages. Then, Staff's selective specific asset identification method further compounds the other errors in Staff's method. Id.;Ex.25,p.3-6

[15]Staff's method also does not comply with Internal Revenue Code Section 167 - normalization provisions - which makes SWB ineligible for accelerated tax depreciation. See SWB Brief,p.42 Staff does not contest these points.

Third, Staff's "massive new investment" contention overlooks that OBC has been in service for 10 years (Ex.40,p.9;T.624), proving the reserves are substantial, not the artificially low level Staff's modified method produces.[16]

Fourth, Staff states "fairness" dictates that it apply the Missouri FR16 (Intrastate) report reserve percentages to each primary asset account (except OBC and the Data Center) because this percentage represents the depreciation reserve paid by Missouri customers. Staff Brief,p.39-40 Staff's Brief overlooks its own testimony that it did not use only this Missouri FR16, it also used Kansas and Oklahoma's FR16 (Total) and Texas' MR16 (Total) reports.[17] T.604-06 Staff then claims that OBC and the Data Center should be treated differently because "it is not appropriate to apply the FR16 reserve percentage for OBC or the Data Center." Staff Brief,p.39 Staff tries to explain this inconsistency with a casual reference to its "I know its wrong, but it's the only fair result" argument. Staff Brief,p.42-43 Staff's method is not only wrong, it is not a fair result as illustrated by a conspicuous absence of any evidence cited for this different treatment.

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[16]Staff cites to the Callaway and Wolf Creek cases, implying some similarity with OBC & the Data Center in the relative impact on total investment. The Callaway and Wolf Creek plants were approximately $3 Billion each -- a substantial part of total investment. Re: Union Electric, 66 PUR 4th, 209 (Mo.P.S.C. 1985) and Re: Kansas City Power and Light, 76 PUR 4th, 49 (Mo.P.S.C. 1986) OBC and the Data Center combined represent a fraction of total SWB investment -- less than 8% or about $350 million. T.596;Ex.41

[17]These are obviously not reserves paid by Missouri customers.

Fifth, Staff asserts that the Data Center's "computers were new" and thus had very little reserve. Again, Staff overlooks its own testimony. T.630-31 Staff witness Doerr first stated that none of the computer equipment was transferred from 14 South Fourth Street. T.618;Staff Brief,p.40 Next he confirms that no computer equipment has been retired.[18] Staff Brief,p.41 Finally, Staff conceded these computers were transferred from 14 South Fourth Street (T.631), thus they have the historical depreciation reserves. T.618-19,645

Finally, Staff admits that its new simplified method is laden with errors but it is "convinced that these errors are irrelevant." Staff excuses its errors because "SWBT showed little interest in resolving this issue." Staff Brief,p.42-43 In reality, SWB showed significant interest in correcting Staff's method. Indeed, Staff's method contains a significant number of errors that have been documented and subsequently recognized (albeit in part) in Staff's Surrebuttal testimony and during cross-examination. Ex.24,p.54-55; Ex.39,p.1-2;Ex.4,p.14;Ex.25,p.6-9 There are still more errors as the cross-examination confirmed. T.602,603,605,608,610,614,618, 619,623-25 The Commission should continue with the current method because it is the only accurate and fair proposal before it.

6. ST. LOUIS DATA CENTER

The issue concerns the correct operating and maintenance (O&M) expenses to include in cost of service. Staff admits that, while it accounted for the new investment of the Data Center, it did not

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[18]The obvious reason for "no retirement" is that the equipment (along with the reserves) was transferred to the Data Center and is still in service.

recognize any of the associated O&M expenses. T.626-27; Staff Brief,p.43 Staff's Brief now argues two reasons for its omission: (1) that Staff's result is "close enough" because it allowed for the O&M at the 14 South 4th Street Facility (which is no longer in service), and (2) the Missouri O&M expense has actually decreased $3M, not increased $7M as SWB claims.[19] Both arguments are wrong because Staff incorrectly states this issue is "closely related to" the compensable property issue. Staff Brief,p.43-44 It is not a compensable property issue -- it is an issue of what O&M expenses are to be recognized in SWB Missouri's test period results. T.627;T.645;Ex.24,p.58-59;Ex.24,p.62-64; Ex.29,p.4-5;Staff Brief,p.43

The purpose of the compensable property study is <u>not</u> to identify what are the amount of property and expenses on SWB's Missouri books of accounts. Net compensable property is <u>an adjustment to remove</u> from Missouri's book results, property and expense benefitting other states. T.594-95;Case No. TC-89-14 R&O p.16;SWB Brief,p.45 Before compensable property <u>removes</u> expenses, those expenses must first be accounted for in Missouri operating results. Staff has admittedly failed to do this accounting before applying its compensable property adjustment. T.627 Staff's incorrect inclusion of the 14 South Fourth Street expense as a substitute for the Data Center's O&M expense is understates

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[19]Staff now states that SWB failed to adjust for 14 South Fourth Street. Staff Brief,p.44 This is not correct. T.645 Further Staff claims SWB failed to account for "vacancies" at other locations. Staff Brief,p.43. The vacancies (12 people & 32 people) would not impact O&M costs. T.642

expenses.[20] The total Data Center expenses, which are not challenged by Staff, were identified by Mr. Edmundson as $7M. Ex.42,p.2,Sch.2 Mr. Barfield used that amount, less the $2M for 14 South 4th Street, to adjust O&M "upwards" by $5M, not the $7M Staff asserts.[21] Ex.24,p.58-59;Staff Brief,p.43

Staff is correct that the 1993 compensable property study shows $3M less compensable expense (because there were 18 fewer cases in 1993). Ex.38,p.10 The 1993 compensable property study only indicates the decline in total compensable service activity -- it does not indicate what should be the beginning Missouri O&M test period expense. It is from this beginning balance that the compensation study results are adjusted. The test period Missouri O&M expense is $5M higher because of the new St. Louis Data Center and Staff has not accounted for this increased test period expense. Ex.29,p.5;T.626-27 Both the investment and the expense must be recognized.

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[20]Staff's admission that its case included 14 South 4th Street O&M expense (Staff Brief,p.43;Ex.29,p.5) is determinative of this issue. Staff now recognizes some O&M must be put in the test period beginning balance -- before any compensable property adjustment removes that expense. Therefore, the correct O&M expense must be included.

[21]Staff says SWB "proposes to adjust this amount upward by roughly $7 million to reflect the St. Louis Data Center . . . in the 1991 Compensable Property Study." Staff Brief,p.43-44 Staff incorrectly states the issue. SWB and Staff have agreed to use the allocations from the 1991 study results, but have not agreed on test period O & M expense -- namely the change to reflect the Data Center. SWB and Staff have agreed on the Data Center's investment, with Mr. Edmundson testifying that the O & M expense associated with that investment is $7 million. This is the issue -- not how much investment and expense is allocated through the compensable property study by the 1991 study.

7. **INTEREST DURING CONSTRUCTION (IDC)**

Staff's Brief principally restates its pre-filed direct testimony; it overlooks Staff witness Riley's admissions during cross-examination. Staff also incorrectly cites the actual facts the only time it references the transcript. Staff Brief,p.47

Basically, Staff argues that construction was funded 100% from depreciation and that depreciation is "cost free." Staff Brief,p.45 On both counts, Staff is wrong. First, the unrebutted record reflects that construction was not 100% funded through depreciation, since gross plant increased over $200M more than depreciation expense. Ex.37,p.64-65 Mr. Riley first raised this issue in his pre-filed direct and recanted this erroneous conclusion during cross-examination.[22] T.557-58 Second, Mr. Riley also admitted that depreciation is not cost free. T.550

Next, Staff argues that SWB attributes its "authorized equity return (12.61%)" as the "cost" for IDC. Staff Brief,p.45 This is also incorrect as reflected by the record which states that SWB is recommending the same cost assignment as previously used by the Commission -- the overall weighted cost of capital. Ex.37,p.61-62,65-66

Staff contends that SWB has not had any new debt issue, equity infusion, or new common stock during the applicable period. Staff Brief,p.45-46 This fact, however, fails to support Staff's

[22]In an attempt to override this admission by Mr. Riley, Staff's Brief cites Ex.30,p.17;Ex.36,p.14-15. These two cites are not appropriate. Ex.30 deals with total company results, not intrastate Missouri. The conclusion arrived at in Ex.36 was based on Mr. Riley's analysis of MR reports through 1991 (T.579), which as SWB witness Barfield noted, are often misused. Ex.24,p.19-21

argument. Since Staff argues depreciation is "zero cost" and represents SWB's only source of funding construction, the issuance of debt and equity are not relevant to Staff's position.

Finally, Staff concludes by stating that the FCC bases the IDC "in part on the prime rate (i.e., common equity is not a part of the equation. . . .)."[23] Staff Brief,p.46-47 It incorrectly cites the testimony of SWB witness Toti at T. 585-86 as the sole support for this statement. A review of the record, however, clearly illustrates that this cite does not support Staff's conclusion. Mr. Toti said:

> Q. Okay, that's fine. Is the prime rate a component of the AFUDC rate calculated in accordance with current FCC practices?
>
> A. Well, The FCC's Part 32 requires you to capitalize AFUDC based on the cost of both debt and equity funds. And that's the way we record AFUDC on our books.
>
> Q. So am I to take it by that answer that you believe that the prime rate is not a component of the FCC's AFUDC rate?
>
> A. Not for purposes of booking in accordance with Part 32.

T.584-85 Mr. Toti then stated again that "But as far as Part 32 books go, they [FCC] require both cost of debt and equity." T.585 This is also what Part 32 states. 47 CFR 32.2000(x)

Using the overall cost of capital is not only required by Part 32, past Commission practice, and reason, it is also consistent with how that same investment is treated when placed

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[23]This misstated reliance upon the FCC to support Staff's position is highly selective--even if Staff had quoted it correctly. Note that in the TPUC issue, Staff does not show such a keen interest in the FCC's Part 32 procedure. The new proposed FCC rule --if adopted--would use the cost of debt along with inclusion of all TPUC in the rate base. T.584-87.

into service. If indeed, the construction is supported "100%" by "cost free" depreciation, there should be no difference in the "return" allowed when it is transferred to plant in service. If it is a "cost free" source of investment, then it should be equally cost free when placed into plant in service. Yet, when the plant is placed into service, Staff suddenly assigns the overall cost of capital to the same investment. T.536-37 Staff simply fails to present any logical reason for assigning different costs for the same investment dollars.

8. SHORT TERM - TELEPHONE PLANT UNDER CONSTRUCTION (ST-TPUC)

Staff argues that inclusion of ST-TPUC (as Part 32 requires) would create intergenerational inequities. Staff Brief,p.48 SWB disagrees. There is a current period cost associated with ST-TPUC. In fact, neither party is asserting that no cost should be assigned to TPUC. The issue is determining when to pay for that cost. The test period ST-TPUC projects are already serving current customers. Ex.37,p.73-76;T.571 Intergenerational equity requires current customers to pay for the costs incurred to provide service to them. Since the ST-TPUC is already in service, current customers should pay the related costs. Inclusion of ST-TPUC in rate base would promote better intergenerational equity than deferral of the costs through the IDC calculation which would transfer the current cost to future generations of customers.

Finally, the Staff concludes with the old "flood gate" cry; that unless the Commission rejects SWB's proposal, other LECs will request inclusion of ST-TPUC in the rate base. Staff Brief,p.48-49

This is not necessarily true.[24] The applicant would still be obligated to comply with the typical standards which require the investment is reasonable for the undertaking. But either way, the current customer should be neutral to the question since the same cost -- IDC or cost of capital -- applies.

9. CASH WORKING CAPITAL (CWC)

As SWB anticipated, Staff is arguing that the 28.46 day collection lag calculation is "suspicious" and "could be" wrong, but even if correct, it is excessive and unreasonable. Staff Brief,p.50

There cannot be any serious question that SWB's collection lag is 28.46 days; Staff's many attempts to calculate the lag all resulted in similar time periods. T.1776-80 Nor can there be serious question that SWB's collection procedures are unreasonable. Staff has no factual basis to dispute SWB's collection practices; it has made no attempt to examine those practices or the practices of other utilities.[25]T.1810,1817 Merely because the collection lag is longer than the minimum residence payment due date (21 days) is not a basis to conclude any practice -- much less the lag period -- is unreasonable.[26]

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[24]Most other states already permit ST-TPUC in the rate base without apparent problems. Ex.37,p.72

[25]Staff witness Boczkiewicz even admitted that the collection policies were not used as a basis for Staff's 21-day proposal. T.1817 Staff's reliance upon this argument demonstrates an after-the-fact approach to try and bolster a flawed position.

[26]Staff now relies upon the claim (first and only raised during cross-examination of SWB witness Wepfer) that the recent SWB consolidation of the customer payment remittance operations to Texas and the U.S. Postal system are to blame for this

(continued...)

Finally, as a counteroffer, Staff now suggests that SWB should institute a late payment charge. Staff Brief,p.50-51;T.1830 Staff's rate design witnesses do not recommend this new rate, and such a post-test period revenue change is not part of the revenue requirement suggested by Staff; it is a tacit admission that Staff's 21-day proposal is simply not justified by Staff's evidence.

10. POST EMPLOYMENT BENEFITS

Many of the arguments addressed in Staff's and OPC's Briefs concerning FAS 87, 112 and 106 were discussed in SWB's Brief and will not be repeated here. Instead this Reply will focus on the issues identified by those parties.

Staff introduces the FAS issues with a quote from State ex rel. Associated Natural Gas Company v. Public Service Commission: "the ratemaking function must provide sufficient income to cover the utility's operating expenses and debt service . . . ." 706 S.W.2d 870,873 (Mo. App. 1985) SWB agrees; the question is what are the Company's expenses. The only issue remaining after the FAS portion of the hearing was whether or not FAS 87, 106 and 112 could reasonably measure current period expenses and thus serve as a proper foundation for rates. Both Staff and OPC witnesses admitted that if accrual accounting could provide the proper measure of expense that it would be the preferred method. T.1495,1601-02

The measurement of the periodic post employment/retirement

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[26](...continued)
excessive lag -- i.e., it takes longer to mail the bill to Texas. Staff Brief p.49-50 The record confirms that the 28.46 was calculated before the consolidation and the post consolidation lag data is similar. T.1776-80;Ex.43,p.35

benefit expense is unquestionably an actuarial function. T.1520-23 The only actuary who testified in this case was Joseph Vogl and he attested to the accuracy of SWB's expense levels. Ex.166 Thus, it is difficult to see how Staff's or OPC's unsubstantiated and unqualified actuarial opinions can form the basis for a valid denial of FAS 87, 106 or 112. Staff and OPC made no effort to investigate their concerns through discussions with an actuary of their own choosing or through meetings with SWB's outside actuary. T.1521 As a result, it has been impossible for the Company to dispel Staff's concerns which are based solely upon an intense distrust of actuarial processes. Id. Because Staff failed to sit down with Mr. Vogl to discuss the study, passed up the opportunity to cross-examine him at the hearing, and admitted that a study done by the Einstein of actuaries would not be acceptable, there has been no room for education or compromise. T.1520-22

Many of the jurisdictions which have adopted FAS 106 have found room for compromise by using a variety of ratemaking safeguards to ensure that the adoption of the new FAS pronouncement would be fair to utilities and their customers. Ex.37,Sch.4 A serious discussion of ratemaking safeguards cannot occur in this State until a dialogue is opened. As long as the standoff continues, utilities in Missouri whose true (i.e., booked) expenses will be ignored and utility customers, who in the long run will pay higher rates for deferred benefit expenses, will be harmed.[27]

[27]Eight to ten years from now when SWB's revenue requirement for OPEBs may actually be lower under FAS 106 than pay-as-you-go, it will be interesting to see if Staff and OPC find the accrual methodology suddenly more acceptable, as Staff did with FAS 87 in 1989 when it reduced customer rates by $19M.

A. FAS 87 IS THE PROPER MEASURE OF SWB'S PENSION EXPENSE.

Staff makes the circular argument that funding is superior to FAS 87 because accrued expenses do not correspond to contributions to the pension fund. Staff Brief,p.53 Staff misses the point. Accrual entries and funding entries do not correspond because funding is not directly related to the level of pension expense. The need to fund is driven in large part by how well the pension fund has performed and not by the day-to-day earning of benefits by employees as they perform service for the Company. It is the earning of benefits and the corresponding liability that the earning creates, which is the true measure of the Company's pension expense. Ex.37,p.4-5,11-12 FAS 87 was an acceptable measure of pension expense in 1989 when it drove SWB's revenue requirement down by $19M. That measuring device is no less accurate and appropriate today.

Staff also claims that funding is a better method of calculating pension expense because SWB cannot withdraw cash from the pension fund to meet other expenses. The innuendo that the Company would somehow misappropriate pension dollars in excess of the funded amount is improper at best, particularly since it is wholly unsupported by the record. The well-funded status of SWB's plan resulted from favorable earnings on the fund, not excessive contributions. Ex.37,p.10-12;Ex.166,p.23 The reduction in revenue requirement and resulting lower customer rates produced by that well-funded status should be viewed as a positive feature of FAS 87, as recognized in the R&O of Case No. TC-89-14, rather than some improper hidden agenda. R&O,p.14 Finally, in order to clarify the record, it should be pointed out that withdrawal of funds, even "excess" funds, from pension plans are not prohibited in all cases. IRC 401(h) and 420 allow a transfer of pension funds to pay current OPEB expenses. The evidence reflects that SWB has made a 401(h) transfer in the past. T.1518,1647 Such transfers allow pension funds to work twice as hard by covering pension expenses and paying OPEB claims as well. Id.

Staff also states that "ERISA calculations will alleviate cash flow problems." Staff Brief,p.54 SWB cannot imagine, in the context of this docket and given the overall tone of Staff's Brief, that Staff is actually concerned about the Company's cash flow.[28] If Staff were that concerned, it would recognize the problem SWB will have if it is not permitted to recover booked pension expense in rates because the obligation to pay such expenses will not change with the ratemaking method.

Adoption of the ERISA minimum method Staff has proposed will not achieve their stated goal of discouraging the funding of pension plans in excess of the bare minimum. The need to fund above the ERISA minimum exists as a matter of good business judgment.[29] The Company will continue to be concerned about the

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[28]It is ironic that Staff implies concern about SWB's cash flow while supporting a $150M reduction in rates -- a substantial portion of the Company's cash flow! It is also contradictory to Staff witness Riley's testimony that SWB's cash flow was "adequate" in the 1988-1992 time period. Ex.36,p.10 That time period is when SWB was using FAS 87 to account for pension expense.

[29]Maintaining pension assets in excess of the ERISA minimum is a common practice of unregulated businesses because it prevents poor earnings from adversely affecting a company's ability to meet its pension obligation. Ex.166,p.23

risk that minimum contributions will lead to inadequate funding. The sufficiency of the pension plan for the past 10 years has been exclusively due to earnings on the fund, which are outside of the Company's control. Ex.37,p.10-12;Ex.166,p.23

Staff opposes an amortization of the remaining pension asset if the Commission adopts the ERISA minimum method, claiming that the difference between FAS 87 and ERISA is only timing and will not harm SWB. If timing is truly the only difference, then the example in SWB's Brief (p.62), which demonstrates that choosing the lowest revenue requirement method from rate proceeding to rate proceeding as Staff has done in the past two cases, can and will hurt the Company. In 1989, the adoption of FAS 87 reduced customer rates by $19M annually as the pension asset (the reverse of the TBO on the FAS 106 side) was returned to customers. T.1621-22 Now that customers have received that $19M benefit for the past 4 years and the pension-related revenue requirement under FAS 87 is positive, Staff advocates switching back to a funding method, without any credit for the remaining pension asset. That is just not fair. The only way to remove the asset from the Company's books is to write it off or amortize it. Mr. Toti explained the necessity for recognizing the asset in his Rebuttal testimony:

> In order to [continue] to record this asset, there must be economic value to it. Under SFAS 87, the pension asset has economic value because it will be recovered when pension expense exceeds funding . . . . A Commission order in favor of Staff's proposed method could effectively prohibit recovery of the pension asset . . .
>
> If a regulator affects the recoverability of an asset, SFAS 71 requires the asset to be written off to reflect that those costs will not be recovered in rates.

Ex.37,p.15

Finally, in deciding this issue the Commission should consider why FAS 87 was adopted in the first place. In Case No. TC-89-14, Part 32 (including FAS 87) was found to bring

> SWBT's accounting procedures more in line with competitive companies, thus making SWBT better able to meet the requirements of a more competitive industry.

R&O,p.14. That statement is no less true today than it was 4 years ago. With competitors like IXCs, cable companies and coin phone providers all intervening to push their own agendas in this docket, it is clear SWB's need to meet such forces on even terms is more important today than it was in 1989.

B. FAS 106 IS THE PROPER MEASURE OF SWB'S OPEB EXPENSES

Staff suggests initially that the problem with the calculation of OPEB expenses was created by the FASB because it failed to take into consideration the needs of the regulatory sector when FAS 106 was adopted. Whether that is true or not, the utilities in Missouri had no hand in causing the issuance of FAS 106, and have had no choice in whether to adopt it for financial reporting purposes. Thus utilities should not be punished because of "the rock and a hard place" Staff acknowledges at page 63 of its Brief. It does not serve any useful purpose to view the FASB as an encroacher into this Commission's jurisdiction (even if it reasonably feels that way). It would be more productive to try and find some middle ground where utilities and the Commission can find a way to make the new financial accounting standards work in the Missouri regulatory community.

The 38 of 42 jurisdictions which have adopted FAS 106 have not expressed a belief that they were laying down their regulatory mantle to a conquering FASB.[30] Instead, their decisions reflect a careful examination of the new standard and a realization that its provisions (with some modifications in certain instances) are consistent with sound ratemaking. After determining what their concerns were, each regulator addressed those concerns through the adoption of the new statement with safeguards, unique to their needs. Ex.37,Sch.4 Missouri can do the same. If the concern is whether the dollars to cover the OPEB liability will be there when the liability comes due, the Commission can require funding like Texas and Kansas have done. T.1639 If the concern is whether the liability will be there years down the road, the Commission can require periodic reports and advance notice of plan curtailments.[31] If the concern is actuarial manipulations, require standard actuarial assumptions (as Rhode Island did), require Staff to engage its own actuary or mandate the immediate recognition of gains and losses as a cross check of the accuracy of the actuarial study. <u>See</u> Ex.37,Sch.4 There are many ways to make FAS 106 work well within the regulatory framework.

Staff relies upon the alleged lack of a legal obligation to provide OPEBs as a reason to deny the use of accrual accounting. The Company addressed this point in its Brief and will not repeat any of those arguments here. One new point should be noted,

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[30] OPC's tenacious reliance upon the few remaining jurisdictions which have retained pay-as-you-go is misleading because those cases advocated a regulatory asset approach. The evidence in this case is markedly different. Staff witness Traxler confirmed the unavailability of a regulatory asset for FAS 106 expense. T.1558-59

[31] FAS 106 specifically addresses curtailments and how to handle them at paragraphs 96-99.

however, where Staff tries to draw a distinction between OPEBs and pensions. Staff correctly notes that SWB's use of the 401(h) transfer mechanism obligates the Company to maintain the current level of OPEB costs for five years after a transfer, but suggests that this obligation is not long term like ERISA pension requirements.[32] Staff witness Traxler admitted on the stand that the only part of the pension obligation which cannot be curtailed is the vested portion. T.1511 A review of ERISA provisions reveals that pension rights vest at five year intervals, no shorter and no longer a period of time than the cost maintenance period required by the IRC. See ERISA 29 USC 1053 The point is not that pensions are also at risk, but instead that the same forces which make the reduction or elimination of pension benefits unlikely are operating in the OPEB area, too. Simply put, employees both union and management, view pensions and OPEBs as an integral part of their compensation package. T.1514-18,1641 A reduction or curtailment of such benefits will lead to either an increase in another area of compensation or extreme employee dissatisfaction, potential strikes and ultimately a compromise in customer service.[33] Id. The Company has no plans to reduce those benefits and the Commission would be the first to know if a change in plans were ever contemplated because of ongoing regulatory oversight.

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[32]Staff's Brief failed to note that the 5-year cost maintenance period is renewed with each transfer. This could effectively restrict major plan changes through the end of the century. T.1571-73,1613-14

[33]For example, when certain reductions in medical benefits were incorporated into the current CWA contract (Ex.169), the changes were accompanied by an increase in another area of compensation, the Success Sharing Plan. See Ex.183

Staff also suggests that markets are indifferent to OPEB expense recovery and notes a speech given by SBC Chairman Ed Whitacre and SBC stock prices shortly after the TBO write-off. Mr. Whitacre advised the investment community that the write-off of the TBO (not ongoing FAS 106 expense) on the financial books would not cause cash flow problems. That was true at the time and would continue to be true today, if ratemaking treatment for OPEBs was guaranteed in all six (including interstate) SWB jurisdictions. Mr. Whitacre clearly contemplated ultimate recovery of the OPEB expenses as two of SWB's six regulatory jurisdictions had already promised recovery and ultimately all but one has indicated it will at this time. Ex.170,p.9 SBC's stock competes primarily with other utilities, particularly RBOCs. The Company's equity competitors wrote-off their TBOs at the same time as SBC, so the effect in the investment community was a wash. See Ex.170,p.9;Ex.18,p.39 Mr. Traxler admitted that interest rates and other indicators, such as recovery in two SWB jurisdictions, may have been a factor in the rise in SBC's stock prices this spring. T.1530-33 The more relevant time to determine whether failure to recover FAS 106 expenses will harm SWB will come when investors discover which companies have actually been allowed to recover those expenses and which have not. See Ex.163 (CreditWeek Report) To date, only utilities with major operations in the District of Columbia, South Dakota, Louisiana and Arizona will be disclosing their failure to obtain current recovery of those expenses. The investment community has suggested that such a failure will harm the affected companies with reduced cash flow and as a result, reduce ratings. Id.

Finally, Staff renewed its criticism of the Company's actuarial evidence. The focus on actuarial issues fails to take into consideration SWB's cap on retiree medical expenses. Actuarial concerns will be eliminated as the DDB cap begins to cover all retirees. T.1667-68;Ex.166;Ex.170 The cap will severely mitigate any measurability concerns because SWB's OPEB costs will equal the fixed DDB amount and the FAS 106 calculation will be superseded by the cap. Id. Even if actuarial concerns were still a legitimate issue after the cap is considered, Staff's criticism is not based upon an indepth analysis. Staff has never been interested in understanding SWB's actuarial study. The testimony at the hearing demonstrated that Mr. Vogl took all plan changes into account when he performed the study and that the declining health care trend rate reflects those changes, as well as inflationary factors outside of the Company's control. T.1666-67;Ex.166,p.17

Staff cannot understand why the study forecasts a 12% trend rate for health care expenses when the Company's experience in 1992 was 4.77% percent. First the 4.77% discussed in SWB witness Zishka's testimony represented the growth rate for active employees and retirees, whereas the study itself focused on retirees alone.[34] Ex.170,p.6-8;T.1666-67 Second, the Company's ability to absorb inflationary factors and contain expenses in any given prior year

[34]Plan amendments such as co-payments and caps are put in on a going forward basis and do not reduce any existing benefits for retirees. Instead, benefits stay the same, but employees, as they retire, will be expected to share a greater portion of the costs.

is not an indication of the trend rate going forward. In the year a co-pay increase is introduced, for example, health care providers may increase their charges by 10%, but the Company's expense level will not increase at the same pace because employees/retirees will be sharing the higher expense. Id. In the next year however, if health care providers increase their charges by an additional 10%, the entire increase would be borne by the Company, unless yet another program is introduced. An illustration using a straight 10% medical inflation rate per year demonstrates this point:

-A- YEAR	-B- DR. BILLS	-C- CO-PAY	-D- CO. EXPENSE	-E- TREND
1	$50	$0	$50	-
2	$55	$5	$50	0%
3	$61	$5	$56	12%
4	$67	$5	$62	11%
5	$73	$5	$68	10%

As the illustration suggests, in the first year a co-pay, or other cost containment measure, is introduced the Company does not experience the full effect of medical inflation. However, unless similar measures are added on top of the existing measure in every subsequent year, the trend experienced by the Company will correspond closely to the overall trend in medical inflation. In year two of the example, when the co-pay is introduced, even though inflation is 10%, the Company's trend rate is zero. But by the end of the five years it is right back at 10%. Mr. Vogl, in his actuarial wisdom, knew that while SWB may be good at controlling health care expenses, it cannot control inflation and thus, like every other entity, SWB will experience increases in medical charges.[35] Even so, SWB's study shows the trend rate receding from 12% to 6% over a 12 year period.

Although Staff has never proposed a disallowance of the TBO, it now cites the past nature of the TBO as a reason to reject FAS 106. Good Grief! Pay-as-you-go is the TBO and by definition pay-as-you-go expenses are past expenses. At least after the transition period, FAS 106 will provide perfect matching and prevent the perpetuation of intergenerational inequity. Ex.167, p.26

C. FAS 112 SHOULD BE ADOPTED IF FAS 87 OR 106 IS ORDERED.

The first time anyone saw Staff's position of FAS 112 was in its Brief. Staff's prefiled testimony on FAS 112 was exactly 1/2 page and only stated that if FAS 112 is adopted it should be recognized in 1993 sharing. Any order relying upon the position revealed in Staff's Brief would be lacking in evidentiary support. SWB believes FAS 112, like FAS 87 and 106, provides a more accurate measure of post-employment expenses. FAS 112 has a manageable revenue requirement (approximately $3.8M) associated entirely with the transition mechanism because pay-as-you-go and FAS 112 periodic expenses are nearly the same. The Company did not adopt FAS 112 early to increase revenue requirement by $3.8M in a $150M case.[36]

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[35]The health care trend rate as used in the FAS 106 actuarial calculation attempts to capture the inflationary factors outside of a Company's control (Column B), not the way in which a Company handles those expenses (Column E). Compare Columns B and E in the example.

[36]Staff also ignores paragraph 12 of FAS 112 which encourages early adoption of the new standard. SWB's adoption in 1993 is in full compliance with that provision.

FAS 87, 106 and 112 make sense because they allow the Company to account for significant expenses the same way the competitors do. Additionally, though each statement has a positive revenue requirement at this time, they can be adopted without a rate increase in this consolidated proceeding.[37]

11. DEREGULATED SERVICES

Staff's Brief on deregulated services is a prime example of contradictory reasoning. On one hand Staff confirms CAM as the approved method to adjust deregulated service expense from the operating results; while on the other hand, Staff questions the validity of the CAM data. Staff Brief,p.64 In most instances Staff supports the use of the most current 1992 data (i.e., revenue annualization (Ex.27,p.6), salary and wage annualization (Ex.175, p.7-8)); while on the other hand, Staff proposes the use of 1991 CAM results as representative of the ongoing level. Staff Brief,p.64

Staff suggests that "changes" in CAM results are reason enough to reject 1992 data. Id. To the contrary, it is all the more apparent that the occurrence of changes make it even more important to use the most current information. Company witness Doherty's Rebuttal testimony fully supports the enhancements made to CAM. Ex.32,p.23-26

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[37]The approximately $35M revenue requirement associated with the FAS issues will drive SWB's net income down even though rates would not be reduced by that amount in SWB's proposal. Customers will benefit from the matching of expenses to the period in which active employees earn the associated benefits rather than deferring expenses to future periods when inflation will exacerbate the problem.

Staff's claimed inability to review the SWB external auditor's workpapers is unfortunate. Staff Brief,p.64 However, when the workpapers did become available in July (prior to the hearing on this issue), Staff's review should have assured the appropriateness of the CAM changes. After more than a year of auditing, Staff had ample opportunity to evaluate all phases of SWB's operations -- it can hardly justify its lack of information on the absence of an audit by others.

12. SEPARATIONS

The Staff argues that SWB's B&C adjustment is an isolated March 1993 separations factor change and that if adopted by the Commission would distort an appropriate revenue/expense/investment relationship. Staff Brief,p.65-66 This is not SWB's proposal. SWB's proposal is based upon the FCC's March 1993 Clarification Order, and restates separations factors (Ex.7,p.22,Sch.10-2) for the test period January through September 1992, to the correct results by directly assigning 100% of the intraLATA PTC Plan B&C charges to the intrastate jurisdiction.[38] SWB is not (as Staff suggests) advocating use of separations factors that were developed using data up through March 1993 for any expense category. Id. SWB's proposal simply restates the Staff and SWB agreed-upon separations factors based on the March 1993 Memorandum Opinion and Order, FCC 93-95. Ex.184 This March 1993 order clarified and confirmed that 1992 B&C costs should be directly assigned 100% to

[38]It is not a March 1993 Separations Factor as Staff argues. It is the March 1993 FCC Order that clarified how the 1992 test period factors should have been originally assigned. Ex.185, p.28-32;Ex.7, p.25

the intrastate jurisdiction. SWB Brief,p.92 Staff witness Meyer concurs that intraLATA PTC B&C charges are 100% intrastate. T.1747 The direct assignment (100%) of intraLATA PTC B&C charges to the intrastate jurisdiction maintains the appropriate revenue/expense/investment relationship.

Even if this issue is viewed as a March 1993 change, it is a valid adjustment. This is an item which is known and measurable and which should be used to calculate the Company's revenue requirement (Ex.185,p.28-32;Ex.7,p.22,Sch.10-2), because it correctly reflects the appropriate intrastate test year expense with the underlying account balances as of September 1992. SWB Brief,p.92-93

13. RIGHT TO USE/LICENSE (RTU/LTU) AMORTIZATION FEES

Both SWB and Staff concur that 1992 is not a representative period to determine the level of RTU/LTU fees includable in the ongoing cost of service. The 1992 level was abnormally high, not consistent with either historical levels or levels expected in the immediate future. Ex.7,p.47 Consequently, SWB used the 1993 budget for RTU/LTU fees because it is reflective of ongoing operations and represents a significant change that should be used to compute the Company's revenue requirement. Order Adopting Procedural Schedule and Granting and Denying Interventions, Case No. TC-93-224,p.3-4

Staff argues that SWB failed to explain the "significant variances" in LTU activity and that SWB has not shown that the level is a "recurring" event. Staff Brief,p.68-69 As the evidence shows, SWB has the tracking data to confirm this increased budget amount (over 1991 actuals) is on target and that, as mechanization increases, payments for LTU fees will only increase, not decrease.[39] T.667-68;Ex.69,p.22-23

14. EMPLOYEE COMPENSATION

Nowhere in testimony or during cross-examination did Staff state that the SWB wage and salary expenses were "extravagant or unnecessary" as Staff now contends in its Brief. Staff Brief, p.70;Ex.175;Ex.176

A. SENIOR MANAGEMENT INCENTIVES

Ironically, Staff contends that "given all the corporate reorganizations of SWB in recent times, it is difficult to imagine that any incentive plan could increase the efficiencies of the Company." Staff Brief,p.72 Those reorganizations, however, are compelling evidence that SWB's senior manager incentive plans work. Staff is blindly ignoring business reality if it fails to recognize that decisive, sometimes drastic, actions must be implemented by senior managers to position this Company to effectively meet the dynamic changes affecting this industry. Without a long term focus, incented by SWB's long term plan, such major changes could be ignored or left for the future when it could be too late.

Gone are the days when telephone companies could count on monopoly profits and a reasonably stable earnings or operating environment. In order to preserve the financial viability of this Company, both for its customers and shareholders, today's leaders

[39]Staff's reference that SWB "utterly" failed to present evidence on the LTU expense is not correct. Staff Brief,p.69 SWB witness Duncan discussed RTU expenses (Ex.138) -- SWB witness Martin discussed LTU expenses and mechanization. Ex.69,p.22-23

must be incented to look to the future, to make the hard decisions today to ensure that SWB keeps pace with this industry, and to make whatever adjustments are deemed necessary to better position the Company to deal with a dynamic environment. These hard decisions include continuing to modify the Company's structure to ensure all efficiencies are explored in order to effectively compete and at the same time, effectively meet customers' needs. Staff's complaints about the Company's reorganization activities are misplaced and demonstrate a lack of business savvy. SWB does not apologize for its continuing efforts to tailor its organizational structure to meet a rapidly changing operating environment.

Similarly, Staff's contention that the profit performance of SBC and the price of SBC's stock are too remote to Missouri's customers ignores important realities about how publicly held companies effectively design executive compensation programs so as to align management's objectives with those of the Company's stakeholders, including SWB's customers.[40] Ex.181,p.38 Linking compensation to profit objectives is the only sensible way to structure executive compensation. Moreover, Staff's position would result in a plan that forfeits the valuable benefits derived from SBC's publicly-traded stock. Stock price captures the effect of long term decisions on a present value basis and, therefore, stock incentives are appropriate in an executive compensation plan. Ex.181,p.45 This is primarily why so many companies have similar long term plans. Stock price is also a valuable indicator of how

[40]It also ignores Staff's reliance upon SBC stock prices in its Rate of Return and FAS 106 arguments. Staff Brief,p.15,21,59-60

the outside market evaluates the senior management of a company. Ex.181,p.38-39

B. TEAM AWARDS

Staff's Brief fails to explain the obvious inconsistency inherent in its position on this issue. Staff specifically finds that the functions performed by GHQ employees are beneficial to Missouri customers. Ex.182,p.12 Staff states that GHQ employees perform centralized functions for SWB's five states and Staff finds that the centralized functions are more efficient than having employees in each state perform these functions.[41] Ex.182,p.12 Recognizing the efficiencies and benefits of this approach, Staff seeks to disallow the GHQ TEAM expense which rewards GHQ employees for and encourages these efficiencies and the centralized contribution to Missouri operations. This makes no sense. Both base salary and TEAM are part of the GHQ employees' total compensation. Staff has not found this total compensation package to be excessive. T.1693 Therefore, Staff has provided no competent evidence to disallow the GHQ TEAM award. As this Commission did in Case No. TC-89-14, it should appropriately allow the expenses associated with the GHQ employees TEAM award.

In addition, the Company's use of the 1992 performance year

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[41]Staff again in this section of its Brief criticizes the Company's reorganization. This criticism is puzzling since Staff apparently finds benefits in centralization and the Company's reorganizations have typically incorporated greater centralization resulting in greater efficiencies. T.1720 Each reorganization has fostered greater operating efficiency by permitting SWB to further downsize its work force. Finally, it should be pointed out that although organizations are becoming more centralized, the goals associated with the TEAM awards do not change. This is one of the strong attributes of a TEAM program.

TEAM award is reflective of September 1992 salary and employee levels; Staff's use of the 1992 payment (1991 performance year) is not and does not maintain the appropriate revenue/expense/rate base relationship. Staff is also incorrect when it states that "...Staff's version is a more accurate valuation of the cost of TEAM awards." Staff Brief,p.75 Staff's valuation understates SWB's revenue requirement by more than $600,000. SWB Brief,p.103 This is not reflective of ongoing operations given the 1991 modification of TEAM award parameters which increased the total TEAM earnings potential. Ex.182,p.7-11

C. EXPENSE PERCENTAGE

Staff's exclusion of clearing account activity in the computation of the expense percent is not reflective of "ongoing operations." As conceded by Staff in cross-examination, costs are continually charged to the CWO clearing account and for any given twelve-month period there will always be a balance in the account. T.1702

Further, the level of CWO activity has steadily and dramatically decreased, from $3.7M in 1991 to $.01M during the first five months of 1993. T.1702-04 One need only to look at Staff's own expense percent calculations to see that the level of CWO activity is decreasing, the September 1992 CWO level is not reflective of ongoing operations, and the expense percent has been increasing since 1991. Ex.177 The Company's expense calculation is the more accurate valuation of the expense percent going forward.

D. SEVERANCE PAYMENT PLANS

Staff's "prospective" view of force reduction expenses, current expenses matched with future wage and salary savings, does not allow the Company to recover the reasonable costs which directly produce the savings. Even under Staff's "prospective" view of force reduction expenses and savings, 1991 severance payment plan expenses must still be included in the cost of service. Staff's use of September 1992 force levels in its payroll annualization captured the future savings associated with the 1991 severance plan expenses. The September 1992 employee level excludes recipients of severance payments between January and September 1992, thus the future savings are included in Staff's payroll annualization. SWB Brief,p.106 The future savings have been included in the cost of service, but the current expenses have been excluded. Staff's rationale cannot be used to support its proposed disallowance because Staff disallowed 1991 expenses and annualized 1992 future savings.

E. ENHANCED MANAGEMENT PENSION (EMP) AND ENHANCED PENSION (EP)

Staff's exclusion of EMP and EP costs because they are non-recurring contradicts its own testimony and that of the Company. Ex.30,p.20;Ex.175,p.4-5;Ex.43,p.77;Ex.69,Sch.10-11;Ex.182,p.19-20 Further, as noted in the Company's Brief and testimony (Ex.182,p.20), although SWB's specific force reduction plans were unrelated to each other and conceived at different times for different reasons, the fact remains that force reduction programs have been ongoing at SWB since 1986. T.1714-16 Moreover, any review of business publications provides overwhelming industry-wide evidence that downsizing is a common and continuing practice. Ex.182,p.19,Sch.2;Ex.30,p.22-23

Staff also argues that no provision was made in their case for future employee reductions. The fact remains, however, that Staff's use of September, 1992 employee levels takes full advantage of the significantly lower 1992 wage and salary expenses without allowing for the recovery of any of the costs which directly resulted in the decreased employee force levels and associated expenses.[42]

F. COMPENSATED ABSENCES

Staff's premise that the ten-year amortization reflects expenses that SWB will never pay unless it goes out of business reflects Staff's unwillingness to accept accrual accounting for compensated absences. The amortization represents 1988 vacation expense, earned in 1987 and paid in 1988, recognized over the next ten years on the books of the Company. Ex.44,p.2-3 The amortization averted recognizing two year's of vacation expense in 1988 when Part 32 and accrual accounting for Compensated Absences were adopted. Ex.44,p.2-3 The amortization did not prevent or change the fact that 1988 vacations were paid in 1988; that is, the cash transaction actually occurred.

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[42]The inclusion of EMP and EP costs in the 1992 Customer Credit calculations also does not justify Staff's exclusion of these costs. Staff admitted during cross-examination that the level of Right-to-Use fees precluded the sharing of 1992 revenue. T.1713 Staff further stated that these costs would only be recovered twice (even though they technically have not been recovered once) if these "one-time" costs are built into rates. But as cited above, these costs are not "one-time," they are recurring and, therefore, part of the normal cost of doing business and includable in the cost of service.

The Company established a deferred charge in 1988 for the unrecorded liability associated with the 1988 vacations and amortized this deferred charge on the books of the Company in accordance with Part 32. 47 CFR 32.24(b)[43] The Company's revenue requirement reflects the continuation of the amortization. Ex.44,p.5 The Staff's proposed disallowance of this amortization changes the books of the Company and, as such, Staff has the burden of proof on this issue. T.1834 The Company is not using "accounting gimmickry" to recognize the amortization; the Company is merely following the prescribed accounting procedures for compensated absences mandated by Part 32 and adopted by this Commission for ratemaking purposes in Case No. TC-89-14.

G. OTHER COMPENSATION ISSUES

Staff excludes SWB's stock plans[44] as well as its March 1, 1993 management salary increase arguing that such expenses are isolated adjustments outside the test year and update period. However, the stock plans were both established during Staff's updated period. The Company appropriately accrued expenses associated with those plans in accordance with GAAP and Part 32. These expenses, therefore, are proper costs and should be annualized and included in the cost of service with other wage and salary expenses.

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[43]Part 32 was adopted for accounting purposes by the Commission in 4 CSR 240-30.040 and for ratemaking purposes by the Commission in Case No. TC-89-14, R&O, pages 13-14.

[44]The Success Sharing Plan and the Stock Value Appreciation Plan.

As detailed and supported on pages 111-113 of SWB's Brief, the "known and measurable" March 1, 1993 management salary increase is much more accurate and reflective of ongoing operations than Staff's 1992 level and, therefore, should be included in SWB's cost of service. Staff simply argues it is outside the test year. As discussed in SWB's Brief, the Commission has found that known post-test year increases are properly included in the cost of service because "the increase is an expense that the Company will actually be experiencing at the time the rates established herein go into effect." See In Re St. Louis County Water Co., 29 Mo. P.S.C. (N.S.) 425, 435 (1988) The March 1 increase has occurred, will be in effect when the order in this case is issued, and therefore, should be included in cost of service.

15. SBC PARENT COMPANY COSTS

Staff claims its SBC adjustments are necessary to prevent SWB's monopoly service ratepayers from cross-subsidizing the unregulated ventures of SBC. Staff Brief,p.85-87,95-96 This argument ignores the fact that the rates of SWB's Missouri basic local exchange service customers have not been increased in almost a decade and would not be increased for at least another three years under the Company's proposal in this case. Thus, SWB's basic local exchange service customers have not been and will not be subsidizing anything, including any increased SBC charges. Staff's argument is without merit.[45]

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[45]Staff's argument also ignores that SBC's cost assignment process is designed to and does assign a significant portion of the SBC costs to its unregulated subsidiaries. This is shown by the fact that increasingly more of SBC's total costs have been (continued...)

Staff asserts it discovered a high percentage of problems in the SBC material that was reviewed. Staff Brief,p.87,89-91 The evidence does not support Staff's claim.[46] Nor does the record reflect that Staff made any detailed investigation into or engaged in any statistically valid sampling of the 35,000 or more SBC vouchers to determine whether there were in fact significant misallocations or just a few simple reporting errors. To the contrary, Mr. Schallenberg admitted that he did not even know how many vouchers SBC processed and that he made no attempt to look at vouchers or even at the total amount. T.2285 Staff acknowledges that it has the burden of proof on this issue (Staff Brief,p.89), and the absence of a detailed investigation or statistically valid sampling demonstrably denies any legitimate support for Staff's position. T.2285-86;2289

Staff also claims that the vouchers it references are evidence of SBC's failure to direct charge and alleges that such failure calls into question all of SBC's expenses. Staff Brief,p.89 However, the evidence shows SBC direct charges a large percentage of its expenses (24%); that it has increased the amount of direct

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[45](...continued)
directly assigned and/or allocated to the unregulated subsidiaries, while SWB's portion of such costs has steadily decreased. Ex.219,p.10,29-30;p.II-6,V-55 and V-56

[46]Staff found one error on a list of eighteen vouchers and contends that is a high percentage. Ex.218,p.36-37 The error which Staff found was an isolated instance amounting to approximately $130 on a Missouri intrastate basis. The allocation was due to a coding mistake made by a temporary employee. SWB Brief,App.C,No.8 SWB would submit that no cost allocation system is perfect and that mistakes will be made. But an isolated error is not a proper basis for questioning the efficacy of the entire SBC cost allocation process.

charging; and that most of its direct charges are to its unregulated subsidiaries. Ex. 220,p. II-6,V-55,V-56 and Study Ex.V-3 and V-5 Thus, SBC does direct charge costs to the unregulated entities. Staff's contention to the contrary is incorrect.[47]

Staff contends the use of the investment and employee factors does not comply with the requirements of the FCC's order in CC Docket No. 86-111 and SWB's CAM (Staff Brief,p.91,93). The use of such factors is not only supported by industry practice and the accounting literature, but is the method referenced in CAMs on file with the FCC. Ex.220,p.II-4 and p.IV-1,et seq.;T.2221-23[48] Staff's position on this issue is also contradictory. On the one hand, Staff acknowledges that SWB is largely responsible for the creation of most of the functions performed by SBC. However, in this instance, Staff wants the Commission to ignore that SWB causes the majority of the SBC costs. Staff Brief,p.1-2,85,93[49]

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[47]SBC may not be direct charging as many costs to the unregulated entities as Staff may want it to, but that is not a legitimate basis for impugning the process or for changing the SBC cost assignment process. When viewed in its entirety, the SBC process is clearly a reasonable and equitable method for assigning parent company costs. Ex.219,p. 10-11;Ex.220,p.II-5,II-6,II-7 and II-8

[48]Although Staff claims that there is threadbare support and no analysis to support the use of the investment and employee factors, the record is replete with both analyses and support for the use of those factors in each and every instance where they have been employed. Ex.220,p.V-58 through V-82,Study Ex.V-47 This is in marked contrast to Staff's business unit approach which has no support either in practice or the accounting literature, and does not even purport to assign costs according to any cost causative basis. Ex.219,p.33-36

[49]While Staff claims the expenses in these cost centers are largely fixed (Staff's Brief,p.91-92), it admitted that some of (continued...)

Staff also urges the Commission to ignore the fact that SWB pays less under this arrangement than it would on a stand-alone basis, claiming this matter to be "irrelevant." Staff Brief,p.93 Yet, it was precisely because these costs would be incurred by SWB on a stand-alone basis that they were allowed by the Commission in Case No. TC-89-14:

> The Staff has not been able to establish any of the allocated costs which would not be incurred if SWB operated on a stand-alone basis.... Since the involved services need to be performed regardless of the corporate structure, the proposed disallowance is unreasonable.

R&O,p.40

Staff further states that the other (non-SWB) subsidiaries and SBC itself obtain the most benefit from the SBC activities in terms of reducing costs from a stand-alone level. Staff cites no evidence to support this statement because there is none. Staff Brief,p.93 Were it not for SBC's centralized performance of these activities, SWB would have to perform most of them on its own and, in that event, would not share the costs with the other SBC subsidiaries. That arrangement would increase SWB's costs. Ex.219,p.13-15;Ex.221,p.VII-1 and VII-2 In addition, contrary to Staff's contention, the evidence shows the other subsidiaries, because they are much smaller than SWB, would not have the same or

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[49](...continued)
the costs are variable and offered no quantification as to the amount which is variable and the amount which is fixed. T.2245-46 Whether they are fixed or not, however, is not the issue and does not change the fact that SWB is predominantly responsible for SBC incurring both investment (e.g., shareowner services) and employee (e.g., benefits) related costs. The use of the investment and employee factors properly recognizes the causes of these costs and assigns them accordingly. Ex.219,p.19-23;Ex.220, p.V-58 through V-82,Study Ex.V-47

as great a need for these activities, and that SBC would have no need for such activities on its own. Ex.219,p.19-24,36.

Finally, Staff claims the exclusion of retained expenses from the general allocator violates the FCC requirement that the general allocator be computed using <u>all</u> expenses directly assigned or attributed. Staff Brief,p.94 However, Staff ignores the fact that <u>retained expenses are neither directly assigned nor attributed</u> and therefore are properly excluded from the calculation of the general allocator. Only by suggesting that retained expenses are directly assigned expenses (when they are not) can Staff claim they should be included in the calculation of the general allocator. This fundamentally ignores that the allocation process is concerned with parent company costs that are <u>actually allocated or assigned to subsidiaries</u>. Pretending, as Staff does, that the parent company is a subsidiary has no factual or logical basis, and serves only to distort and artificially manipulate the actual assignment of costs.[50]

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[50]Similarly, Staff makes the unfounded assertion that SBC retains <u>none</u> of its mergers & acquisitions (M&A) costs (Staff,p.95), when almost all of those costs are retained. Ex.220,p.V-46 and V-47 The only exceptions are for the Office of the Chairman and Board of Directors activities which are generally allocated because their activities are too broad to be segregated and cannot be reasonably assigned based on either direct assignment or an indirect cost causative measure of use. Ex.219,p.27;Ex.220,p.V-65 and V-66 Thus, it would be impractical, a waste of time, and of no material effect to attempt to isolate the amount of time spent by the Office of the Chairman or the Board on M&A activities or to change from the current method of generally allocating their costs. Ex.219,p.26-7;Ex.220,p.V-79 Under somewhat similar circumstances, it has been held that a further segregation of costs is not required. <u>See Panhandle Eastern Pipe Line v. Federal Power Commission</u>, 324 U.S. 635,645-46 (1945)

16. AFFILIATE TRANSACTIONS

Staff's Brief on this issue and its operational recommendations are largely dependent on complaints regarding SWB's alleged lack of an audit trail for affiliate transactions, analogizing SWB's documentation to a puzzle where the pieces lack identifying numbers. In reality, SWB's audit trail is more like an unbroken, straight line, drawn in accordance with Company Operating Practices (OPs) 125 and 112, two documents which were given to the Staff in response to DR 42. In a very clear manner, those OPs explain that affiliate transactions are generally conducted through written contracts that reduce the terms and conditions of the relationship to writing.[51] A well-defined, detailed audit trail is the result.[52] Ex.222,p.21-30,Sch.4

Essentially ignoring this foundation by failing to start with the documents generated pursuant to those OPs and following specific transactions through the process, TAI instead chose to ask for all documents associated with affiliate transactions[53] and then complained when it could not relate the components of that self-

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[51]Those OPs as well as the Affiliate Services Policy and Procedure Manual are widely distributed among SWB employees. Ex.242,p.9 These three documents more than adequately fulfill Staff's recommendation (3).

[52]To the extent that a puzzle analogy is at all helpful, applying it to the review conducted by TAI is only minimally apt if one also adds that TAI chose to do its review by mixing the pieces of many different transaction puzzles in a single pile, ignoring the numbers provided, and then complaining that the puzzles are not already put together.

[53]See e.g., Ex.240,p.6 (quoted DRs demand information on all services, rather than information on a service-specific basis) TAI apparently compounded its own discovery problems by expanding its review to affiliate transactions that Staff did not contract with TAI to review. Compare Ex.229,p.1,2 and Ex. 235,p.1

inflicted paper avalanche. As SWB witness Taylor demonstrated, one could find the audit trail and the necessary information if one was only willing to look. Ex.243,p.19-21;Sch.4 TAI's effort in sorting through its own paper mess cannot be blamed on SWB when the clear audit trail actually made and used for internal purposes was ignored. SWB also cannot assure that the materials provided were actually understood, nor confirm Staff's level of understanding especially when the first indication of confusion is in testimony.

Staff's Brief also confirmed its hunt for "gotchas" instead of an objective review of affiliate transactions against applicable standards, as illustrated by Staff's refusal to acknowledge factual rebuttals and TAI's use of unique, heretofore unknown standards. Staff's claims regarding the understatement of FDCs and its erroneous belief that revenue has been used as an allocator have been refuted by SWB witness Lundy and cannot be reiterated in the space available. Ex.222,p.4-27 Staff's charge that SWB cannot substantiate the reasonableness of affiliate purchases rings hollow when confronted with the facts, of which the purchases from the Hotel Majestic[54] and Telecom[55] are just examples. Likewise,

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[54]SWB clearly established that not only is the room rate at the Hotel Majestic in compliance with the FCC affiliate transaction rules, but is also market-driven as confirmed by the Runzheimer Report used by SWB to monitor that rate. In contrast, Staff claimed that the Adams Mark Hotel "had a rate of $70 per night." Staff Brief,p.102 Staff witness Cassidy's testimony is not so definitive - Adams Mark "was willing to offer a rate of $70." Ex.139,p.15 Inasmuch as the claim arises from a Staff "investigation," one is left with the distinct impression that Staff got the unsubstantiated rate by calling the Adams Mark, speaking with some unknown employee, and being given a ballpark quote based upon undisclosed assumptions (e.g., advance bookings, every other Monday bookings, after midnight bookings). Ironically, Staff itself uses the Runzheimer Report on travel and (continued...)

contrary to Staff's allegations regarding sales to affiliates, SWB does perform market reviews when appropriate and where appropriate market-comparable data is available for comparison purposes. Ex.242,p.13 SWB uses the type of data recommended by Staff witness Oligschlaeger in Case No. TC-89-14 in setting a market-like price, data provided to Staff and TAI in this case.[56]

In sum, SWB understands and appreciates the level of concern associated with affiliate transactions. As reflected in its testimony, SWB's day-to-day practices ensure compliance with applicable FCC and state affiliate transaction safeguards. Going a step further and aggressively pricing its non-tariffed affiliate services, SWB generated over $2M in excess of the FDCs for those services during 1991. In the face of that surplus, Staff's operational recommendations are simply unnecessary and costly,[57] as

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[54](...continued)
lodging to establish lodging and meal expense levels for consultants. Ex.222, p.42-45,Sch.11-2

[55]See SWB Brief,p.144-45 for the $690,177 in real, concrete 1991 savings garnered by doing business with Telecom, including $228,600 on one item alone that absolutely could not have gotten but for a price available to Telecom, but not SWB. Ex.243,p.23

[56]Mr. Oligschlaeger stated in his deposition in Case No. TC-89-14, that market information for the sale of services to affiliates should follow the example set forth in DR 53 from Case No. TR-86-94. He made more than 19 separate references to this type of data as being sufficient.

[57]Staff ignores the real $1.08M cost of performing market studies (54 services at an estimated $20,000 each) without any assurance that increased revenues would result, while placing at risk levels of contribution similar to the $10.1M generated from 1988 to 1991. Ex.242,p.20;SWB Brief,p.134-35

well as redundant to current processes[58] and intrusive upon management's prerogatives.[59] Staff has not provided any substantial and competent evidence supporting its claims, relying instead on unproven and legally deficient suppositions and innuendo on which to base its flawed recommendations.

17. KANSAS CITY DATA CENTER

There are two issues related to the KCDC. The first is whether the KCDC should be "deregulated." While Staff claims it is "not sure" if it should be, it argues for inclusion as a regulated service because of "flaws" in SWB's proposal. Staff Brief,p.104 One alleged flaw is that the event is not known or measurable because it did not happen until January 1993. SWB's proposal is to adjust the KCDC from the 1991 test period results. Staff's adjustment is also based on 1991 test period data; so both use 1991 data which is certainly "known and measurable" as the foundation for the KCDC adjustment. Ex.7,p.26-32;Ex.29,p.27; Ex.28,p.2

The second issue is the correct adjustment value. Staff's initial adjustment was in error; the revenue portion was subsequently corrected by Staff witness Rucker. Ex.28,p.2 The remaining question is the expense valuation. Ms. Rucker said she would "review" the errors (which Company witness Martin listed),

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[58]The testimonies of SWB witnesses Larkin, Powers, Lundy, and Taylor demonstrate that SWB already performs the substance of Staff recommendations (2), (4), (6), and (7). <u>See</u> Ex.222,242,241,243

[59]Some of the recommendations appear to traverse the line between the Commission's jurisdiction and management discretion (<u>e.g.</u>, formation of a centralized affiliate group). There is also some question about the extent of the Commission's jurisdiction in the area of non-tariffed affiliate services.

but she never corrected those errors.[60] SWB's evidence that Staff has undervalued KCDC expense by \$1.8M (\$17.0M less \$15.2M) is unrebutted evidence and cannot be disregarded. Ex.7,p.32 Whether deregulated or not, the correct data center expense and investment must be included in Staff's adjustment.

18. INCOME TAXES

A. VACATION PAY

Staff quotes the Commission's Order in Case No. TR-79-213 that provides "the Company should flow-through the benefits of the tax timing difference relating to relief and pensions, social security taxes, cost of removal and salvage, and vacation pay accrual." Staff Brief,p.107 (emphasis added) Staff then claims that this same Order did not order SWB to use flow-through treatment for vacation pay tax timing differences. Staff Brief,p.106

Staff does not explain why it takes the position that the words of the Order mean something exactly opposite its plain language.[61] Staff adds confusion to the issue by stating that the book and tax treatment of vacation pay "both changed" and therefore flow-through treatment should have ended before Case No. TC-89-14.

Staff's confusion may be due to the fact that the basis for its "changed" argument was shown to be incorrectly stated by Mr.

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[60]Staff says it is a "test year" difference. Staff Brief,p.105 There is no evidence by Staff on any "test year" differences. Staff's reference is not supported by any Staff testimony. The only evidence is Ms. Martin's statement on expense calculation errors.

[61]Staff says the Order only relates to an "item" -- not "all" vacation pay -- an interesting thought, but one that is at odds with the Order in Case No. TR-79-213.

Schallenberg in his Surrebuttal testimony. There, Mr. Schallenberg based the "change" on the TRA of 1986. During cross-examination he agreed that was incorrect. T.2352 Staff now admits the 1987 Revenue Act was the basis for the timing "change." Staff Brief,p.108 The 1987 Act, which applied to tax years beginning 1988, coincided with the 1988 adoption of Part 32 vacation pay accounting. These two simultaneous changes -- tax and book -- for vacation pay continued the book/tax timing difference.

There was no period of time prior to the June 1989 Order in Case No. TC-89-14 where flow-through was not applicable for the book/tax timing difference. That Order for the first time adopted normalization.

Staff notes that SWB "admits" the Commission ordered tax normalization in Case No. TC-89-14, but misstates the extent of the admission. SWB's admission excepts the transition amount (the Part 32 10-year amortization) that provided flow-through treatment. Ex.37,Sch.8-3,Sch.7-1 to 7-3 Even Staff witness Schallenberg admits that there was a vacation pay adjustment reflected in the Case No. TC-89-14 tax schedule. T.2353

Finally, Staff depicts a chart as portraying annual book and tax treatment of vacation pay expense. Staff Brief,p.110 Staff's chart shows that SWB has received a tax deduction of only $27M annually. Yet Staff now proposes that for ratemaking purposes SWB should compute tax expense assuming $29.7M in annual vacation pay tax deductions (110%). There are no tax laws or prior Commission precedence which support Staff's inequitable proposal.

The Commission should reaffirm its decision in Case No. TC-89-14 and again approve SWB's tax treatment of vacation pay expense.

B. & C. AMORTIZATION OF INVESTMENT TAX CREDIT (ITC) AND EXCESS DEFERRED INCOME TAX AMORTIZATION (EDITA)[62]

Staff claims that SWB's calculation is incorrect (Staff Brief,p.112); however, it is the same methodology approved by this Commission in Case No. TC-89-14. SWB's methodology does not assume that all compensable property investment generated ITC, nor does it assume that the New Data Center generated ITC as Staff claims. Staff Brief,p.112 Likewise, SWB's calculation does not assume that all compensable property was placed into service before the 1986 TRA. Staff Brief,p.113 SWB developed a ratio of compensable property depreciation expense divided by total booked depreciation expense and applied that ratio to ITC and EDITA to remove the compensable property portion. T.2337

Removal of the compensable property that did not generate ITC or EDITA from the numerator of this ratio would also require removal of all "booked" property that did not generate ITC or EDITA from the denominator. But, the key is that the IRS requires that if any estimates are used for plant adjustments, the same estimates must be used, consistently, for ITC and EDITA. Ex.227,Sch.2 SWB uses consistent estimates (ratio); Staff does not follow this IRS requirement.

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[62]Staff's Brief at page 112 states that SWB was "deceived into using a ratio approach." This statement is not supported by the citation listed or by any other evidence presented in this case and should therefore be disregarded. This may be a typographical error in Staff's Brief.

Staff claims that SWB's methodology is incorrect, yet provides no evidence to support that claim.[63] Staff witness Meyer even admits that SWB's method is similar to the method supported by Staff witness Doerr to adjust Staff's rate base for compensable property. T.2335

Staff also claims on page 111 of its Brief that its proposed adjustment is no longer in violation of the IRS normalization rules, yet Staff witness Meyer stated under cross-examination that he does not even know whether his adjustment is consistent with the IRS rules (the average rate assumption method [ARAM]).[64] T.2340 Staff's arbitrary adjustment of $50,000 to ITC and EDITA is not based upon any Staff analysis or workpapers (T.2326-28,2338), and Mr. Meyer admits it is not the right number. T.2339

D. COST OF REMOVAL/SALVAGE FOR PRE-1981 PROPERTY

About all Staff can say in its Brief is that it "won the issue" in Case No. TC-89-14. SWB agrees -- but additional facts revealed in Mr. Meyer's cross-examination indicate that the foundation for the Order in Case No. TC-89-14 is not present in this case.

Mr. Meyer agreed there was a flow-through for pre-1981 property. T.2306,2311 Mr. Meyer also agreed the flow-through is related to book/tax timing differences.[65] T.2297-98 Mr. Meyer

[63]Staff alleges the adjustment to remove deregulated ITC is different than what was reported to the FCC. Staff Brief,p.112 There is nothing in the record to support this allegation.

[64]Consistency with ARAM is a requirement of the IRC normalization rules. Ex.227,p.4-11

[65]Not book COR/salvage differences, upon which Staff's premise is based. T.2317-18

also agreed he was recognizing the flow-through in his test period income tax calculation. T.2306 Therefore, the rate base recognition proposed by SWB should also be adopted.

Staff's Brief conspicuously says nothing about its 1991 "flow-through" income tax proposal (e.g., why this is the only tax adjustment not based at a 1992 level; why it is proposed without a corresponding rate base flow-through; why the "positive" adjustment is inconsistent with historical results). T.2305,2314-15,2321-22 The facts do not justify the same result in this case.

E. NONPROPERTY RELATED DEFERRED TAXES

SWB offered the only evidence on this issue. Staff's Brief either argues from facts which are in the record, but which are not tied to nonproperty deferred tax,[66] or from "facts" which are not in the record. Staff Brief,p.114-15 Thus, Staff's arguments should be rejected by the Commission.

The accumulated deferred income taxes included in SWB's rate base are based upon balances on its September 30, 1992 general ledger, not upon "estimates" as Staff claims. Ex.37,p.87-89 Staff's claim that the balance "varies and fluctuates" is also not supported by anything in the record. Staff Brief,p.114-15

Staff concludes by stating that the deferred tax is related to RTU expense and then asks the Commission to examine this issue on the "basis of income tax concepts." Staff Brief,p.115 Ironically, it fails to provide <u>any</u> evidence of income tax concepts used by Staff itself nor does it rebut Mr. Toti's tax basis for the

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[66]For instance, Staff cites Mr. Flaherty's testimony. That testimony deals with SBC cost center allocations to SWB -- not with nonproperty deferred tax.

adjustment -- the only tax concept which is in the record. Ex.37,p.87-89

19. BUSINESS MEALS

Staff's Brief mistakenly alleges that the "types of problems that are referred to by the Commission in Case No. TC-89-14 still exist today." Staff Brief,p.115-16 This allegation is based solely on selective SWB auditor's opinions that are contained in Exhibit 46P. Staff's contention is indeed ironic because Staff witness Meyer, when asked during cross-examination about the types of problems that existed in Case No. TC-89-14, admitted that he had not looked at those problems.[67] T.680

Audit results since Case No. TC-89-14 reflect significant improvement in documentation necessary to substantiate business meal expenses. SWB Brief,p.156;T.675-81 For instance, the auditor's opinion from the December 17, 1991 Audit Report states, "When compared to a similar audit conducted last year, the exception rate improved to 14% from 49% in the previous audit." T.679 Even Staff witness Meyer admitted that improvement has been shown. Id.

SWB controls, such as OP 56 (Bill Payment Practice), the Management Employee Expense Guidelines, and the detailed reporting requirements (Employee Expense Reimbursement Form, Ex.47) are responsible for the improvement. SWB Brief,p.155-57 Since Mr. Meyer did not audit any meal expense vouchers and did not

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[67]It is impossible to claim that "problems still exist" if you don't know what those problems were to begin with! Ms. Martin -- not Mr. Meyer -- is the only witness that reviewed both events.

review specific items in the Audit Reports to determine the type of exceptions noted, he has no factual basis to claim otherwise. SWB Brief,p.155

Finally, Staff has characterized SWB's current position as a "blatant disregard" for the previous Commission order. Staff Brief,p.119 This is inaccurate.[68] SWB witness Martin analyzed the current audit results in order to determine the nature of the exceptions found. Not only were the results improved overall, but Ms. Martin concluded that the type of errors found were primarily clerical, not documentary. Ex.7,p.80 The one occasion of fraud discovered in the October 4, 1991 audit was not, as Staff suggests, taken lightly but produced a follow-up audit and management corrective action. Ex.7,p.81 Staff's continued insistence on a 100% adjustment is unreasonable.

20. **YELLOW PAGES**

If the Commission elects to continue with incentive regulation, SWB has proposed that the 1985 adjusted level of Yellow Page earnings, which is used in measuring SWB's earnings under the current plan, be frozen in the extended plan by reducing the initial sharing point down to 10.7% ROE. SWB Brief,p.189-90 The 1985 adjusted level of Yellow Page earnings is already reflected in current prices for SWB services.

If the Commission elects to end incentive regulation, SWB requests that the Commission consider not imputing Yellow Pages earnings in determining SWB's revenue requirement in this case, in

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[68]Again, since Mr. Meyer has not examined any of the OPs or the voucher process itself, Staff has no basis to suggest in its Brief anything about SWB's compliance with past Commission order.

which there is no proposal to either increase the Company's revenues or local exchange rates. Additionally, only the largest rate reduction proposed by Staff would result in a reduction in local exchange rates. Protection of local exchange ratepayers has been advanced as the primary reason why Yellow Page operations were left with the RHCs at divestiture and why the ability of the Commission to impute is needed in the regulatory process. This is not a proceeding in which the Commission needs to exercise its discretion to impute in order to protect local exchange customers.[69]

If the Commission elects not to continue with incentive regulation and decides to impute, SWB recommends the use of SWBYP's results from the twelve-month period ending September 30, 1992, which on an unadjusted basis are better than the 1985 adjusted results imputed in Case No. TC-89-14.[70] SWB proposes two

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[69]Staff states in its Brief that in December, 1983 SWB committed that the formation of SWBYP as a separate company "would not harm positions of Staff and Public Counsel with respect to the continued use of directory revenues and expenses in the ratemaking process." Staff Brief,p.134 At the December 18, 1983 on the record conference in Case No. TM-84-85 (Ex.200,Sch.6), SWB officials stated to the Commission that formation of a separate subsidiary would not preclude the Commission from imputing Yellow Page results to SWB. It still does not. But the current law does give the Commission the discretion to impute or not. SWB is asking the Commission to exercise its discretion not to impute under the facts of this case.

[70]Staff also asks the Commission to reconsider the uncollectibles adjustment that was adopted in Case No. TC-89-14, because Staff believes the level of uncollectibles used in that case was abnormally high. Staff Brief,p.127-29 In fact, it was the level of revenues for that year which turned out to be abnormal, which is why the uncollectibles adjustment was appropriate - namely, to reflect the fact that SWBYP never collected the recorded amount of 1985 revenues. It is true that (continued...)

adjustments to those earnings levels and also proposes that, for ratemaking purposes, the Commission allow an equity return on SWBYP's Missouri investments that produce the imputed earnings. Staff recommends rejecting one of the adjustments and the return allowance, but Staff's Brief does not discuss why they should be rejected.[71] Staff Brief,p.131 If the Commission adopts SWB's adjustments and allows a return, the imputation amount would be only slightly below the adjusted 1985 results,[72] but the precise

[70](...continued) SWBYP's uncollectibles have changed since 1985, but so have its other expenses and revenues. If post-1985 changes are to be considered, then to be consistent, all such changes should be considered and not just a change to uncollectibles. Ex.213,p.13-14 SWB also disputes Staff's contention that the amount of the uncollectible adjustment in Case No. TC-89-14 ($5.9M) was improperly calculated. Staff Brief,p.128 The $4.6M referenced by Staff is not a correct figure. The $4.6M was developed by using an 8.75% allocation to Missouri (Ex.196HC,p.82), which is based on the years 1984-1986 and is not the appropriate allocator to use for 1985 specific uncollectibles.

[71]SWB's return proposal would allow a return on the assets that produce SWBYP earnings. SWB Brief,p.162-64;Ex.7,p.67-70 SWB's proposal does not involve placing SWBYP accounts receivables in the rate base as Staff states on pages 56 of Exhibit 202, therefore, Staff's testimony regarding a cash working capital requirement (Ex.202,p.56-62) is not applicable. SWB's adjustment uses state specific accounts receivables and prepayments, which constitute the largest portion of SWBYP investment, merely as a method of allocating a portion of SWBYP's total shareholder's equity to Missouri. Ex.7,p.68;SWB Brief,p.163-64 Also, SWB's adjustment starts with equity, which is why Staff's arguments (Ex.202 and 202HC,p.63-66) regarding SWB's cost of equity methodology are not applicable. Staff recognizes that its adjustment, which includes only the level of prepayments (deferred directory charges) in the rate base (Ex.195HC,Sch.1), is not sufficient, which is why Staff attempted to calculate more Missouri-specific assets. Ex.202HC, p.55 Allowing a return on SWBYP's equity is no different than the Commission allowing SWB a return on its investment and assets used to provide telephone service. SWB Brief,p.162

[72]The amount imputed would be $39.6M (Ex.7,p.63) based on the twelve months ending September 1992 at a 14.1% ROE. The (continued...)

amount will depend on the return level approved in this case. SWB Brief,p.162-64

Staff, OPC, and MCTA assert that the Yellow Pages are a natural extension of and are essential to the provision of basic telephone service. OPC Brief,p.18;Staff Brief,p.137;MCTA Brief, p.18-19 Most courts which have considered this issue have overwhelmingly rejected that claim, and have held that the publication of Yellow Pages advertising is not essential to or part of the provision of public service.[73]

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[72](...continued)
adjustment to Staff's 1985 number would be $5.1M and $6.8M to Staff's 1991 proposal. Ex.7,p.69

[73]See Mitchell v. Southwestern Bell Telephone Company, 298 S.W.2d 520 (Mo. App. 1957); Mountain States v. Public Service Commission, 745 P.2d 563 (Wyo. 1987); Classified Directory Subscribers Association v. PSC, 383 F.2d 510 (D.C. Cir. 1967); A-ABC Appliance v. Southwestern Bell Telephone, 670 S.W.2d 733, 735 (Tex. App.-Austin 1984); Wille v. Southwestern Bell Telephone, 549 P.2d 903 (Kan. 1976); Robinson Insurance & Real Estate v. Southwestern Bell Telephone, 366 F. Supp. 307 (W.D. Ark. 1973); McTighe v. New England Telephone & Telegraph 216 F.2d 26 (2d Cir. 1959); University Hills v. Mountain States, 554 P.2d 723 (Colo. App. 1976); Executive Services v. Southern Bell Telephone & Telegraph, 514 F. Supp. 430 (S.D. Fla. 1981); and Modern Equipment Company v. Puerto Rico Telephone Company, 440 F. Supp. 1242 (D. Puerto Rico 1977). Copies of these cases are included in Tab A of the Appendix to this Reply Brief. MCTA's reliance on Videon v. Burton, 369 S.W.2d 264 (Mo. App. 1963) as contrary authority is misplaced because: (1) the Missouri legislature subsequently changed the law expressly to remove Yellow Pages advertising and listings from the Commission's complaint jurisdiction, thus contradicting the reasoning in Videon that the Commission can regulate the terms and conditions of buying Yellow Pages advertising; (2) the Videon decision, when issued, was contrary to another Missouri Court of Appeals' decision on the same subject, see Mitchell, supra; (3) the Videon decision erroneously concluded that there were no alternatives to Yellow Pages advertising which, if true then, is not true today (Ex.209,p.2-5,14;Ex.197-98); and (4) Videon does not represent a correct interpretation of the current law in Missouri and is contrary to the interpretation given similar laws by the overwhelming majority of Courts.

21. ANNUALIZATION/YEAR-ENDING

A. REVENUES

Staff's Brief ignores Staff witness Rucker's cross-examination testimony on this issue. Staff's Brief merely repeats Ms. Rucker's original prefiled testimony. During cross-examination, Ms. Rucker agreed that seasonal trends do exist in both toll and access revenue. T.490-01,505 Graphs presented in SWB witness Martin's testimony for business and residential toll and for access minutes-of-use demonstrated beyond question the seasonal nature of this data. Ex.7,Sch.11-1,11-2 Staff ignores this acknowledgement of seasonality in its Brief.

For seasonal revenues such as access and toll, Staff's Brief incorrectly argues that both Staff and Company use end-of-period units multiplied by a rate (revenues/units) and "the sole difference between the Staff and the Company is the Company's use of the average rate versus the Staff's use of the end-of-period rate." Staff Brief,p.158 The sole difference is Staff's failure to recognize seasonality and trends. Ex.7,p.43

The Company does not, as Staff suggests, oppose using forecasted data. What the Company opposes is the use of forecasted data to validate an annualization for revenues <u>only</u>. The Company does not deny the existence of future growth, but the growth in revenue is always accompanied by growth in telephone plant and growth in expense, both wage and nonwage expense. Ex.7,p.46 As Ms. Rucker conceded during cross-examination, she did not perform the same analyses against forecasted expense and investment changes as she did for revenue changes. T.513 Since the forecast reflects growth in these areas as well (Ex.74P), the rate base/revenue/ expense relationship was not maintained by Staff. It is not only the reasonableness of Staff's overall revenue annualization which is important, but the reasonableness of Staff's overall revenue requirement including investment and expense relationships. Ex.7,p.19;T.197 Maintaining this appropriate relationship was a principal goal of Staff witness Meyer (Ex.2,p.2-3) which is not achieved with Ms. Rucker's revenue proposal. T.512

B. NONWAGE EXPENSE

Staff argues SWB's proposal is "no more than an inflation adjustment. . . ." Staff Brief,p.165 Staff mischaracterizes this issue.[74] SWB adjusts nonwage expense for the significant changes that occurred through September 1992. SWB Brief,p.6-7;SWB Reply Brief, p.3;Ex.7,p.12,19 SWB then "year-ended" the activity using the GNP change that occurred during the test period. SWB is not requesting an inflation adjustment -- SWB annualizes the test period results using the test period GNP-IPD.[75]

Staff also states that "inflation factors" are regularly not allowed by the Commission. Staff Brief,p.165-66 This is not totally correct. As proposed by SWB, the use of indices to adjust test period (not future period) results has been allowed. See In

[74]The adjustment is (a) $4.3M to adjust test period and (b) $2.5M to year end using the GNP-IPD. Ex.244

[75]Staff argues that SWB's "year-end" adjustment is based on an outdated study. Staff Brief,p.166 The study identified the specific products measured and used to compute the GNP-IPD index. T.665 The nonwage expense items included in SWB's nonwage "year-end" and test period adjustments, and identified and accepted by both SWB and Staff in their respective CWC calculations, namely gasoline, office supplies, rent, etc. (T.660;Ex.43,p.61), are all items included in the study and GNP-IPD index.

Matter of Midwest Motor Freight Bureau, 24 Mo. P.S.C.(N.S.) 202 (1981) (PPI to Adjust in Period Data); See also, In the Matter of Application of National Bus Transportation Association, 23 Mo. P.S.C.(N.S.) 545 (1980) The use by SWB of the GNP-IPD to "year-end" test period results is not objectionable.

Staff casually alleges the nonwage expenses are "probably unknown." Staff Brief,p.166 All components of nonwage expense, including the component of "other," are known and were examined and accepted by Staff for its CWC calculation. Ex.189 Staff has no basis to now contend that those expenses are "unknown."[76]

C. ACCESS AND BILLING AND COLLECTION EXPENSE

Staff's Brief simply states SWB's adjustment to annualize access expense and billing and collection expense "suffers from the same flaws as toll revenue." Staff Brief,p.164-65 It is not clear what "same flaws" means since Staff failed to offer any testimony on its access expense adjustment. Staff failed to review this expense, to understand its direct relationship to PTC revenue, and has failed to include the most current level of expense in the revenue requirement calculation. Ex.7,p.93 Access expense will increase as toll revenue increases. Id. Staff does not deny that fact. Since revenues are adjusted forward to September 1992, as Staff proposes, then the associated expense must be consistently adjusted. Leaving the expense at December 1991, while the

[76]Staff also incorrectly asserts that the increase in affiliate transaction expense from December 1991 to September 1992 for EMP relocations is a one time event and should be excluded from the cost of service. Staff Brief,p.167 SWB witness Wepfer confirmed these costs were accrued in 1991 and reversals offset the actual vouchered expenses in 1992, thus netting to approximately zero. T.663

associated revenues are moved forward to September 1992, does not maintain the rate base/revenue/expense relationship.

22. ACCRUAL ACCOUNTING

In the introduction to its Brief, Staff notes that Commission resolution of certain accounting issues will set "new" policy related to the use of accrual accounting in this case. Staff Brief,p.6-7 Staff is wrong. OPC witness Robertson admitted that accrual accounting is normally used for ratemaking. T.1601 Staff witness Traxler agrees that accrual accounting per se is normally accepted for ratemaking purposes. T.1481 Staff itself supports accrual accounting for pensions, cost of removal, depreciation, income taxes, as well as many other issues in this very case. The Commission has recognized the propriety of accrual accounting for ratemaking for SWB in its Case No. TC-89-14 R&O, p.13-14. Ex.37,p.3,8,9 The use of accrual accounting in this case will not set new policy, but merely re-emphasize the positive aspects of principles previously recognized and adopted by this Commission.

It is Staff, not SWB, which has proposed the "willy-nilly" use of accrual accounting. SWB supported accrual accounting as required by Part 32 consistently throughout its case. Staff picks and chooses when to use accrual accounting, much like it chose to accept FAS 87 in Case No. TC-89-14 when it reduced SWB's rates by $19M per year; however, now that the FAS 87 revenue requirement has turned positive, Staff has done a flip-flop.

Staff suggests that the Commission refer to a lawyer's textbook to gain an understanding of accrual accounting. Staff Brief,p.7 With all due respect to the legal profession, Staff's definition is lacking and inaccurate. It is lacking because it fails to describe the matching concept inherent in accrual accounting.[77] It is inaccurate because it states "even though no event in respect to cash or an <u>obligation</u> happened during the period." Staff Brief,p.7 (emphasis added) Accrual accounting requires recognition of an obligation even if there is no cash event; there is no required recognition if there is no obligation.

The Commission should look to accounting experts for the proper definition of accrual accounting. The FASB defines accrual accounting as follows:

> Accrual accounting attempts to record the financial effects on an entity of transactions and other events and circumstances that have cash consequences for the entity in the periods in which those transactions, events and circumstances occur rather than only in the periods in which cash is received or paid by the company. It recognizes that...events that affect enterprise performance often do not coincide with the cash receipts and payments of the period.

Statement of Financial Accounting Concepts No. 1, para. 44. Ex.37,p.22

The FASB also states that the goal of accrual accounting is to "relate the accomplishments and the efforts so that reported earnings measures an enterprises performance during a period instead of merely listing its cash receipts and outlays." Statement of Financial Accounting Concepts No. 1, para.45

Accrual accounting requires that costs incurred during the period (whether there is a cash event or not) be matched with the

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[77]GTE witness Blanchard describes the matching concept in relation to FAS 106. Ex.174,p.3-5 The matching concept for accounting is equivalent to intergenerational equity concepts in ratemaking.

benefits resulting from the costs. This is obviously consistent with ratemaking theory. Ratemaking is designed to charge customers for the cost of providing service to those same customers (not future customers). Each "accrual accounting" issue listed by Staff, with the exception of SB 380,[78] involves an obligation earned by employees that should be recognized as earned, rather than when paid so that intergenerational equity can be achieved. Therefore, accrual accounting which is already pervasive, remains the most appropriate method for ratemaking. Ex.37,p.22-24 Even so, failure to adopt FAS 106 and FAS 87 (as Staff suggests) would not constitute an indictment of accrual accounting.

III. INCENTIVE REGULATION

If the Commission elects to significantly reduce SWB's earnings in Staff's Complaint proceeding and change the sharing grid to begin sharing at 12.61% ROE, including Yellow Pages earnings, the Commission's decision on incentive regulation becomes easy. SWB is unable to commit to price freezes, its proposed TF2 discretionary investments, or ongoing sharing of revenues under those conditions. In that event, the Company would elect to return to traditional regulation under which it is able to retain all earnings between rate proceedings, has the option of seeking rate increases on all services, and can make its investment decisions strictly on the basis of its earnings opportunities and franchise obligations. Staff itself notes that, depending on the level of

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[78]SB 380 is not in fact an accrual accounting issue as Staff implies. <u>See</u> Section II (2) of this Reply Brief.

rate reductions in this case, SWB may be better off financially by returning to traditional regulation. Staff Brief, p. 184

SWB is not asking the Commission to trade rate reductions for investment. The Company itself has proposed rate reductions. It simply takes the position that the earnings levels achievable under Staff's proposed reductions would be unreasonable and would make significant additional investment commitments imprudent. To demonstrate that it would in fact make significant investments in this State if permitted a fair earnings opportunity, the Company has proposed discretionary, incremental investments of $140M to $150M over a three-year period if it has the opportunity to retain all earnings up to a sharing point of 10.7% ROE,[79] and to share earnings from that point up to a CAP of 17.25% ROE.[80]

Nor is SWB taking the position that it will not invest money in this State in general, or in its TF2 proposals specifically, if the incentive plan is not approved as proposed by the Company. T.800-01,849 Investment levels, particularly discretionary investment levels, will depend on earnings opportunities under either traditional or incentive regulation. If the Commission wishes to return to traditional regulation under Staff's Complaint, it obviously can do so. Frankly, the way "traditional" regulation is applied to a majority of the LECs in this state (that being earnings are not subject to review if a company does not file for

[79]This assumes Yellow Pages earnings are not used in calculating SWB's earnings under the plan.

[80]Because earnings above 10.7% ROE would be shared, the actual cap on what the Company can earn under the plan would be approximately 14% ROE.

rate changes) may be preferable to "incentive" regulation as SWB has experienced it under the current plan. No other LEC has had to contend with annual earnings reviews, monitored network investment, and shared earnings over the last three years.

1. LEGAL ISSUES INVOLVING INCENTIVE REGULATION

Several parties, including Staff, OPC, and MCI, have taken the position that the law precludes the Commission from approving an extension of the current incentive plan until it first rules on the merits of Staff's Complaint. Others, MICPA, MCTA, CompTel and the Attorney General maintain that portions of the current incentive plan are unlawful and cannot be extended under any circumstance. Finally, OPC also takes the position that incentive regulation can be extended by the Commission only if all parties agree to all provisions of any extended plan.

A. THE COMMISSION CAN EXTEND THE CURRENT PLAN DESPITE THE STAFF'S COMPLAINT.

SWB has pointed out in its Brief that the Staff did not have the authority to file its Complaint and that the only case properly before the Commission for decision is Case No. TO-93-192, involving the proposed extension of the current incentive plan. SWB Brief, p.3-4 Even if the Commission determines that it has jurisdiction to consider the merits of Staff's Complaint, the Commission has the authority to adopt SWB's proposal for extending the current incentive plan as a resolution of that Complaint.

SWB is not asking, as several parties suggest, that the Commission adopt its TF2 proposal in lieu of a $150M rate reduction. First, it is not entirely clear what revenue reduction Staff actually seeks in this case. In its opening statement, Staff stated it did not really expect a $150M rate reduction. It mentioned $95M. In its Brief, Staff claims overearnings of $135M. Staff Brief,p.181

SWB's response to Staff's Complaint and its testimony indicated no overearnings exist if the Commission uses the 14.1% ROE sharing point in assessing the Company's revenue requirement. The same would be true if the Commission uses a 10.7% ROE and does not include Yellow Pages earnings in computing SWB's earnings. Additionally, SWB has proposed $22M in rate reductions which would reflect the decrease in capital costs which the Staff alleges has occurred since the decision in Case No. TC-89-14.

Regardless of whether the Commission proceeds with incentive regulation or returns to traditional regulation, rate reductions of more than $22M are unwarranted. This is in part based on the Company's proposal that the Commission adopt an ROE range sufficient to encourage ongoing aggressive investment by SWB in this State, including the more rural areas. Such a forward looking concept is well supported under Missouri law. In an early Laclede Gas case, the Supreme Court acknowledged "[i]t is well settled that a utility is entitled to earn a return reasonably sufficient to keep it abreast of advancements affecting the business it conducts." State ex rel. City of St. Louis v. Public Service Commission, 110 S.W.2d 749, 776 (Mo. banc 1937) That is all SWB is seeking in this case - to keep up with changing times - something the Commission should facilitate. In State ex rel. Public Service Commission v. Frass, 627 S.W.2d 882, 886 (Mo. App. 1981), the appellate court noted:

> **Despite that hazard [of predicting future inflation], the Commission must make an intelligent forecast with respect to the future period for which it is setting the rate; ratemaking by necessity is a predictive science.**

TF2 gives the Commission the vehicle to accommodate future changes in a way that is fair and reasonable to customers as well as the Company.

Nor is SWB proposing, as some parties suggest, that the Commission engage in single-issue ratemaking by evaluating earnings solely on the basis of an ROE established for an extended incentive plan. Nor is it requesting that customers pay rates established on the basis of future investments committed to under the plan, or that customers be required to contribute payment for aid to construction. Under the current and proposed plans, SWB's earnings levels would continue to be measured on the basis of its actual revenues, expenses and rate base as reflected on its books and adjusted pursuant to the provisions of the plan.[81] These three items are the same as those evaluated in a traditional rate proceeding. In State ex rel. UCCM v. Public Service Commission, 585 S.W.2d 41 (Mo. banc 1979) ("UCCM"), the Missouri Supreme Court struck down a fuel adjustment clause (FAC) because it focused on a single item of cost - purchased gas - and adjusted rates accordingly. The TF2 proposal, like the existing plan, looks instead at all items of investment, cost and revenue and provides for SWB to share revenues, rather than rates, according to earnings calculated from all three. As a result, a "maximum" rate is set and it never varies. Additional expenses, or lower revenues, would

[81]These adjustments are those adopted by the Commission in Case No. TC-89-14.

never increase customer rates or entitle the Company to a surcharge.

Staff has recommended the monitoring provisions be updated to include additional adjustments recommended in its Complaint.[82] The Company has recommended that the Commission continue to use the adjustments adopted in Case No. TC-89-14. Surely the Staff, which is recommending that the Commission continue to impute the adjusted 1985 level of Yellow Page earnings (data six years prior to the test year), does not take the position that the Commission cannot continue to use the other adjustments approved in Case No. TC-89-14, both to measure the Company's current earnings and earnings under an extended plan. Unlike the Yellow Page adjustment, which involves the ongoing use of 1985 data, all the other adjustments included in the plan are applied to current SWB operating results.

In assessing the reasonableness of SWB's current rates as a prelude to an extended incentive plan, the Commission can assess the impact of the Company's proposal:

- To use 10.7% ROE, both as an initial sharing point and as a basis for rates if Yellow Pages earnings are not included for purposes of this case;
- To reduce rates by $22M;
- To forego its COS revenue requirement ($6M);

[82]Staff also proposes applying interest to customer credits. SWB believes this is inappropriate because it treats sharing as a refund, which it clearly is not. Ex.7,p.111-12 Should the Commission adopt Staff's recommendation, such interest should be treated similarly to interest on customer deposits which is recovered from customers as part of the Company's revenue requirement. Ex.7,Sch.6-2 It would be wasteful to establish such a "pass-through" expense.

- To adopt SWB's depreciation proposals ($11.5M) and FAS 106 ($28M);[83] and

- To continue to apply the adjustments included in the current plan (adjustments from Case No. TC-89-14) to the Company's actual books and records for 1991, or updated through September 1992, or during the course of an extended incentive plan.

Considering these factors, the Commission could determine that an extension of the plan as proposed by SWB would result in just and reasonable rates for customers and a fair return for SWB.

B. THE COMMISSION HAS THE AUTHORITY TO EXTEND THE CURRENT PLAN.

Some parties take the position that any extension of the incentive plan that includes sharing would constitute retroactive ratemaking. It has also been suggested that extension of the plan for a three-year period would constitute an unlawful moratorium or an abdication by the Commission of its responsibility to insure rates remain just and reasonable. It has also been alleged that a sharing plan results in unlawful variable rates and that SWB's TF2 proposal involves customer contributions in aid of construction. Finally, it has been argued that recent legislative actions preclude or limit the Commission's ability to consider SWB's TF2 proposal.

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[83] The current plan specifically states the Commission may consider and approve updated depreciation rates. Ex.93,Sch.1-57(b) It also provides that the impact of FAS changes can be incorporated unless the Commission rejects their incorporation after a challenge by OPC or Staff. Id.,Sch 1-59(h)

(i) SHARING AND RETROACTIVE RATEMAKING

If the Commission were to order SWB, against its will, to share revenues resulting from approved current rates, it would constitute retroactive ratemaking. But neither the current plan nor SWB's proposed plan permit the Company to raise prices to recover past losses retroactively from customers. Rather, SWB has offered to prospectively share revenues within a proposed range of return if its TF2 proposal is approved. The Company can agree to share its revenues without violating the ban against retroactive ratemaking.[84] The concept of retroactive ratemaking prohibits charging customers for past losses of the Company or requiring refunds based upon an after-the-fact finding of overearnings. See e.g., UCCM, supra at 58-59. The TF2 proposal, like the current plan, does not result in automatic rate changes; rather it allows SWB to commit to share revenues based upon the Company's ROE performance. Though SWB has a right to retain such efficiencies under traditional regulation, it can forego that right in exchange for a reasonable earnings potential.

(ii) THE INCENTIVE PLAN DOES NOT REQUIRE THE COMMISSION TO ABDICATE ITS ROLE OF INSURING THAT RATES REMAIN JUST AND REASONABLE.

The current incentive plan resulted from an agreement among all parties to the appeals of Commission decisions in Case Nos. TC-89-14 and TO-90-1. The signatories to the agreement committed not

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[84] Although an Illinois court has held that a sharing plan can constitute retroactive ratemaking even if the utility consents, there has been no such finding by a Missouri court and the current incentive plan has included a sharing arrangement for almost four years. Illinois Bell v. Illinois Commerce Commission, 561 N.E.2d, 426 (Ill.App.1990).

to seek changes in the plan until it had been in operation at least three years. That agreement and the Commission's Order approving it did not preclude entities who were not a party to the agreement from filing a complaint concerning aspects of the plan. No such complaints were filed, however.

The current proceeding has not resulted in an agreement among all parties. Staff and SWB have suggested that if the Commission continues with incentive regulation it should extend the plan at least three years and, thereafter, the plan would continue until someone seeks a change in its operation. Just as with the current plan, any party who does not concur in any extended plan approved by the Commission would have the right to file any complaint allowed by law. Assuming that party had standing to pursue the relief sought, the Commission would determine whether and how to proceed. Because the approval of an extended plan would not preclude the Commission from considering complaints, the agreement of all parties to all provisions of the plan is not required, as suggested by OPC. As other parties are quick to highlight, the Commission is charged with ensuring rates are just and reasonable; the concurrence of OPC and other intervenors is not necessary before a Commission Order setting just and reasonable rates becomes effective.

Section 392.140 envisions the Commission investigating rates "whenever" they appear unjust and unreasonable. For some companies that occurs rarely, if ever; whereas for companies like SWB, it occurs like clockwork. The statute does not set a schedule, but instead provides the Commission with discretion. Incentive regulation actually allows the Commission to establish parameters for the exercise of its own discretion to initiate a complaint. That is a power it has always possessed under traditional regulation. See State ex rel. Laclede Gas v. Public Service Commission, 535 S.W.2d 561, 566 (Mo. App. 1978)[85] TF2 merely establishes ceilings and floors to manage the Company's earnings within a reasonable range. At the same time, it does not affect the rights of customers and other qualified entities to challenge SWB's rates. The Commission is in no way abdicating its jurisdiction.

For its part, if the TF2 proposal is adopted, SWB would commit to not seek any changes in the plan, either through legislation or regulatory proceedings, during the first three years.

(iii) THE SHARING PROVISIONS OF THE CURRENT AND PROPOSED PLANS DO NOT RESULT IN VARIABLE RATES

Rates were reduced by $82M at the onset of the current plan. SWB has proposed additional rate reductions of $22M as part of its proposed extension of the plan. Additionally, SWB has committed to continue to freeze local exchange rates during the course of the plan, and no rates would change during an extended plan except as approved by the Commission; any such change would be on a prospective basis only. Shared earnings from approved rates do not involve rate changes, variable or otherwise, because tariffed rates do not change unless authorized specifically by the Commission on

[85] The Laclede case discusses the Commission's broad discretion under the file and suspend method of ratemaking where every tariff filing need not lead to a protracted rate proceeding.

a prospective basis. SWB's rates will not change without a rate proceeding or tariff filing as contemplated by the statutes. The statutes may require fixed rates, but they do not requires a fixed rate of return. The Supreme Court noted "...the law of the State only provides for the fixing of rates and does not fix the maximum return thereunder." Straube v. Bowling Green Gas Co., 227 S.W.2d 666,671 (Mo. 1950)

(iv) SWB'S TF2 PROPOSAL DOES NOT REQUIRE CUSTOMER CONTRIBUTIONS IN AID OF CONSTRUCTION

SWB has not requested that the Commission trade rate reductions for investment. As set forth in Section III.,A.,1 of this Reply Brief, supra, SWB takes the position that whether the Commission elects to continue with incentive regulation or return to traditional regulation pursuant to Staff's Complaint, rate reductions in excess of $22M are unwarranted. If the Commission agrees, and if it then approves an extension of the incentive plan as proposed by SWB, the Company has committed to certain investments over the next three years. Those investments have not been included in rate base in the Company's response to Staff's earnings Complaint. Nor have such investments been used as the basis for the level of any rate or price recommendation in this case.

Assuming the incentive plan is continued, as investments are implemented over the next three years, such investments would go into rate base and, in conjunction with revenues and expenses associated with such investments, would impact the level of SWB's earnings as measured under the plan. That is exactly how investments under the current plan are treated, and exactly how they are treated under traditional regulation. Customers' rates would not be increased to cover such investments for at least the next three years and then only if the Company filed for increased rates and the Commission found them appropriate.

SWB is not requesting "excess earnings" to fund its TF2 investment. SWB has committed to make the TF2 investment if it is permitted a fair opportunity to earn on that investment prospectively.

(v) LEGISLATIVE ACTIVITIES

MCTA suggests that because certain legislation did not pass in 1992 the Commission is precluded from approving any form of incentive regulation. The current plan was implemented in 1989, prior to the legislation to which MCTA refers. In its Order in Case No. TC-89-14, the Commission did express doubts about its ability to approve an incentive regulation plan that included price caps, and the 1992 proposed legislation would have clearly given the Commission the authority to adopt a price cap plan. Whether the Commission can in fact adopt a price cap plan under current law is academic since no price cap provisions are included in either the current plan or SWB's proposed extension.

Legislative proposals which do not subsequently become law do not always suggest that the existing law does not permit what the proposed amendment would have explicitly authorized. See State ex rel. Missouri Power & Light Co. v. Riley, 546 S.W.2d 792, 797 (Mo. App. 1977) In any event, statutory construction is not necessary when a statute is clear. Farmers' & Laborers' Coop Ins. Assoc. v. Director of Rev., 742 S.W.2d 141 (Mo. 1987) SWB is asking for nothing more than a continuation of the plan tacitly deemed lawful by all parties in 1990. Thereafter, Staff's August 1991 Network Modernization and Incentive Regulation Report concluded that although the current statutes do not specifically address incentive regulation, they contain no prohibition against the type of provisions included in the current or proposed plans.[86] The statute is no less clear now than it was at that time.

Alternatively, MCTA, as well as the Attorney General, and OPC suggest that the Commission should defer any consideration of TF2 because of the passage of House Bill 566 (HB 566) in the last Missouri legislative session. Among other things, that bill created a Commission on Informational Technology within the Department of Economic Development. That commission is charged with developing a State telecommunications strategy to enhance and equalize educational opportunities for Missouri students by facilitating expanded access to information; to enhance the State's delivery of health care; and to enhance economic development opportunities. The first report of that commission to the legislature is not due until January 1995.

SWB's TF2 proposal is consistent with and supportive of all the goals and objectives set forth in HB 566. Representatives from the educational and medical communities have stated their support for the proposal on the record of this case, as have business representatives seeking to enhance economic development

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[86]See Section VI of the report which is included in Tab B of the Appendix to this Reply Brief. The analysis also concludes that price cap regulation may be permissible under current law.

opportunities.[87] SWB's proposal addresses not only the technological requirements discussed in the bill, but also funding concerns.

MCTA implies that the commission created by HB 566 in some way usurps this Commission's authority to consider SWB's proposal. This Commission has sole responsibility for telecommunications policy in this state and has sole authority to deal with SWB's TF2 proposal. §386.250 If anything, HB 566, by recognizing the importance of delivering rural health care and education, should encourage Commission action to begin bringing the types of technology envisioned by this legislation to the State of Missouri as soon as possible. HB 566 does not eliminate the Commission's jurisdiction over telecommunications development in the State. Rather, it seeks only to facilitate what is being proposed for SWB's territory in this case throughout the entire State.

As noted above, HB 566 envisions a "report" by January 1995. Under SWB's proposal, Distance Learning and Telemedicine will be well underway in SWB's territory by 1995. HB 566 encourages expanding this technology on a statewide basis. It is quite ironic

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[87]The Regional Consortium for Education and Technology of Southwest Missouri, a group of public schools, colleges and universities supports SWB's proposal and noted that one of the primary advantages of SWB's plan is that "it's ready to go now so the waiting will not have to last that much longer". T.97 Others expressing support for the Company's proposal at the hearing include the Missouri Industrial Development Council Coalition (consisting of eight statewide or regional organizations) (T.105), Jackson County Economic Development Council (T.139), Freeman Hospital, St. Louis Children's Hospital, Jefferson Hospital (T.99-104), the St. Louis County Chambers of Commerce (T.108-111), and the Intervenors for Independence Options (T.89-94). MCTA's suggestion that the support of SWB's TF2 proposal by these groups was "bought" by SWB would be humorous if not so pathetic.

that opponents to SWB's proposal would use HB 566 - a bill designed to encourage just the type of infrastructure development envisioned by TF2 - to delay bringing such technology to Missouri. The Commission, therefore, should reject any suggestion to delay consideration of SWB's proposal, which will facilitate achieving the very objectives of the legislation. Delay will only serve to cause the State to fall behind other states in moving forward in these areas.

Although Staff realizes the benefits of TF2 for Missouri students and health care patients, Staff half-heartedly submits that the additional interoffice network investment portion of TF2 may eventually cause unlawful cross-subsidization for transitionally competitive or competitive services that may potentially use such facilities. Staff's view disregards the procedures and requirements established by the Commission and the legislature to assure there is no improper cross-subsidy for these services.

After several years of study, the Commission has implemented the safeguards set forth by the General Assembly which appropriately calculate the costs and ensure that transitionally competitive and competitive services are not being cross-subsidized. §392.400 R&O,Case No. TO-89-56. These safeguards include the submission of Cost Accounting Procedure studies to the Commission every three years for each service so classified. Any stated concerns of Staff relating to costs or cross-subsidy already are accounted for by the safeguards in place today.

2. CHANGES SUGGESTED BY OTHER PARTIES IN THE STRUCTURE OF THE SHARING GRID

OPC suggests a tapered sharing grid under which customers receive a greater share of earnings in the lower portion of the grid and the Company retains a larger share of earnings in the upper portion of the grid. OPC believes a grid designed in this way will provide better incentives for SWB to be efficient. MCI and CompTel made similar proposals.

The current grid and the grid proposed by SWB for an extended plan both incorporate this concept. Customers receive a greater share of earnings between the first and second sharing point (60/40), and then the sharing is 50/50 between the second sharing point and the CAP. But the further proposal made by OPC, MCI and CompTel, that sharing begin at a "base ROE" and not at some point above it (currently 1.49 basis points; the difference between 14.1% and 12.61% ROE), would be more restrictive than what occurs under traditional regulation. Under traditional regulation, SWB would typically be able to retain all earnings within a zone of reasonableness <u>above</u> its base return. Under MCI and OPC's proposal, a portion of all earnings above such a base return would be returned <u>automatically</u> to customers. Since such proposals are more stringent than traditional regulation, they should not be incorporated into any extended incentive plan.

3. THE RELATIONSHIP OF INCENTIVE REGULATION AND COMPETITION

MCI takes the position that incentive regulation is not a "tool for dealing with increased competition," but "merely a way of improving traditional regulation of a monopoly provider." Incentive regulation in Missouri and in a majority of the other states in the country is not designed to make traditional regulation of "monopoly telephone companies" more effective. It is designed to allow state regulators more flexibility in the way they regulate an industry that is in a transition from one of monopoly to competition. In fact, this Commission has previously recognized that incentive regulation does provide an incentive to increase operating efficiency and the ability to compete. Case No. TC-89-14, Order Concerning Motion for Stay, p.3, June 30, 1989

There can be no dispute that as a direct result of state and federal legislation and regulatory decisions, SWB is facing growing competition in more and more of its markets. There is but one area of its market where competitors cannot easily obtain a certificate of service, basic local service, or two-way switched voice service within a local calling scope.[88] Thus, the Commission finds itself attempting to adjust its regulatory policies to deal with an industry in transition. It must continue to insure quality service and reasonable prices for basic local exchange services, but also permit LECs to deal with the competitive pressures being experienced in all its other markets. This includes not only pricing flexibility (which is not an issue in this case), but also earnings flexibility and incentives to promote investment

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[88]Even so, a recent Staff report in Case No. TA-92-145 indicates some carriers do in fact provide such services on an incidental basis (see copy of Staff Report in Tab C of the Appendix to this Reply Brief). Nor is it currently clear what is and what is not two-way switched voice service, and this ambiguity will continue to exist until the Commission defines such a term in a rulemaking. T.1293-97 Additionally, cellular carriers, which are not subject to this Commission's jurisdiction, are rapidly expanding their coverage areas allowing them to increase the number of local exchange customers they serve.

throughout the State, including the more rural areas that are largely shunned by competitors.

MCI is wrong when it says alternative regulation is needed to provide incentives to a monopoly market. If complete monopoly prevailed there would be no need to deviate from traditional regulation. It is the introduction of competition and the ongoing transition away from monopoly markets that has caused state commissions to move away from traditional forms of regulation towards alternatives such as incentive regulation.

SWB is not seeking incentive regulation as an "artificial incentive to become efficient." It seeks such a form of regulation in order that it can benefit from increased efficiencies, like competitive companies. MCI states that if there truly were competition, cost reductions and efficiencies would lead to price reductions. In fact, SWB has proposed $22M in price reductions in this case. This is in addition to $82M in price reductions in 1989. Price reductions of $100M in a 5-year period are significant by any measure. In contrast, MCI does not lower its prices on the basis of its earnings. T.863 It sets its prices on the basis of its costs and the market.[89]

4. THE RELATIONSHIP BETWEEN INCENTIVE REGULATION AND INVESTMENT

MCI and OPC argue that SWB's network modernization proposal should not be tied to incentive regulation and contend that the Commission cannot expect to stimulate accelerated network

[89]If MCI's annual report to shareholders touted returns to its shareholders that are in excess of SWB's, would such earnings mean MCI is overearning or that its prices are excessive?

modernization by adopting an extended incentive regulation plan. However, the evidence clearly indicated that incentive plans in most states do tie earnings opportunities to committed network upgrades. Ex.61,p.25,Sch.1 The accelerated network investments completed under SWB's current plan substantiate the relationship between incentive regulation and accelerated network modernization. As SWB witness Crossley explained in his testimony, citing data requests produced to Staff in Case No. TC-89-14, the capital expenditures under the current plan were over and above budgeted business as usual projects. Ex.76,p.25

Absent the current agreement, rural Missouri customers would not have the additional services and quality of service available today. As Mr. Crossley emphasized, the network modernization program -- 100 central office upgrades, upgrades of approximately 750 miles of interoffice facilities, and the elimination of 60,000 party lines -- would not have been undertaken by SWB in this accelerated time frame. Ex.76,p.24-25 There were no plans to expend capital resources on these rural infrastructure improvements at the time the current plan was adopted.[90]

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[90]The Attorney General (p.21 of its Brief) argues that infrastructure investments must always be economically justified. If that were the case, most rural network investments would never be made and outstate Missouri would not have access to its present modern telecommunications network. Certain improvements such as party line elimination could never be accelerated. In Case No. TC-89-14, this Commission itself recognized that there are factors other than economics, such as expanded service to customers, improved quality of service and attraction of customers, which must be weighed in determining whether technology should be deployed. R&O,p.56 Further, Rule 4 CSR 240-32.100 defining basic local service standards appears to require certain investments by LECs without regard for any economic justification.

The Commission can find further confirmation of the relationship between incentive regulation and accelerated infrastructure improvements by comparing the network modernization plans filed by the next two largest Missouri local exchange companies in response to 4 CSR 240-32.100, the Commission's new rule defining basic local service.[91] These filings indicate that the network investments completed under SWB's current plan resulted in its customers receiving the benefits of an upgraded network and many new services on a significantly expedited basis and without any rate increase.[92] Ex.76,p.24-25,37-38

As with the current plan, SWB is now proposing with TF2 to make significant incremental capital investments in Missouri's infrastructure over and above the Company's business as usual infrastructure plans. Mr. Robertson explained that these incremental investments are part of an incentive regulation package. T.711 SWB's Brief at pages 182-83 provides details regarding these investments. Such agreements or packages are premised on the idea that proper incentives stimulate companies to accelerate or increase infrastructure development.

Parties in this case who suggest that SWB's proposal to make

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[91]At the time SWB made its investment commitment for the current plan, there was no Commission rule requiring any such upgrades. The fact such a rule was later deemed necessary itself demonstrates the failure of traditional regulation to incent sufficient modernization.

[92]While some smaller LECs may not require rate increases to modernize pursuant to the rule, the evidence indicates most of them actually operate under a form of incentive regulation - price regulation, under which their earnings are by default not subject to Staff audit or Commission review unless they file for price increases. T.285

these discretionary investments as part of its TF2 package constitutes "blackmail" are either being disingenuous or absolutely ignoring business realities and the necessity of making prudent investment decisions. None of these investments are required by the Commission rules or are necessary to meet franchise service obligations. This Company has and will continue to meet its franchise obligation and provide quality service to all of its customers. Prudent business management, however, obligates SWB to invest its discretionary capital where it will receive the best return. This is not "blackmail;" it's how any reasonable and responsible company conducts business.[93]

5. FIBER IS NECESSARY FOR EFFECTIVE INTERACTIVE APPLICATIONS

OPC's and the Attorney General's claims that copper transmission is adequate, greatly exaggerates the capabilities of copper and exhibits a lack of understanding of the educational and medical activities inherent in Distance Learning and Telemedicine programs. OPC has admitted that the quality of live interactive video over copper is not equivalent to broadcast quality but contends that this would only be a detriment for an activity that requires a lot of motion. OPC Brief,p.32 Distance Learning and Telemedicine are just such activities. Distance Learning is not limited to classroom lectures as apparently envisioned by OPC. Interactive Distance Learning can and should allow and encourage live interaction not only between teacher and student but between

[93]SWB is not alone in this regard. MCI responded in a data request that as it rolls out new services and infrastructure developments, it evaluates the profitability that such services and developments are likely to return. T.715

students in different classrooms using charts as well as other video and multimedia applications. Ex.84,p.7

Limiting the technology to copper necessarily limits the applications available to teachers and students in the Distance Learning environment. Classroom instruction today involves many activities requiring motion -- science experiments, cooking classes, using maps and charts for geography classes, performances and plays for drama class, illustrating math problems on the chalkboard, to name just a few. As SWB witness Crossley emphasized, classroom instruction is using more and more multimedia applications. Computer graphics and animation will become part of the curriculum. Ex.76,p.16-17 These activities simply would not be effective on a copper network.

Despite OPC's contentions, quality and speed is even more important for medical applications. Despite the fact that OPC is "dubious" about the ability of a doctor to diagnose from a remote location, it is done and it may lead to the survival of rural hospitals. T.101-04 Remote diagnosis is one of many applications medical providers are planning to use with Telemedicine.[94] As explained by SWB witness Tung, the increased bandwidth and the resultant increased quality and speed associated with fiber are necessary for an effective Telemedicine application. Ex.84,p.5

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[94]Other examples include: Sharing databases and resources transmission of x-rays, cost containment, doctor consultations, etc. T.99-104

IV. RATE DESIGN

In the event the Commission does not adopt SWB's proposal to continue with incentive regulation under the TF2 proposal, SWB supports the rate design stipulation submitted as Exhibit 159. SWB opposes the four additional rate design issues recommended by MICPA, OPC and the Federal Executive Agencies as explained below.

1. PRIVATE PAYPHONE INTERCONNECTION RATE

MICPA's Brief makes self-serving and unfounded assertions not derived from either the record or reality. The underpinning for MICPA's perceived concerns appears to be a self-inflicted feeling that SWB's current payphone interconnection rate structure somehow has inhibited the growth of private payphone (aka Coin Operated Pay Telephone or COPT) providers in Missouri. This simply is not true.

The current payphone interconnection rates were approved by the Commission following a 1989 joint stipulation submitted by Staff, SWB and MICPA in SWB's last complaint case (Case No. TC-89-14) which significantly reduced the charges imposed on private payphone providers. Since then, the number of COPT lines have increased from 835 in 1989 to 2752 in 1992, an increase of 230%. In addition, the number of COPT providers certificated by this Commission increased from 25 in 1989 to 78 in 1993, an increase of 212%. Ex.133,p.12 During this same period, total gross intrastate revenues for private payphone providers increased from $773,980 in 1989 to $5,839,355 in 1992, an increase of over 650%.[95] .1356-58

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[95]The MICPA members themselves have done particularly well. For example, KNS Enterprises has increased annual intrastate revenues from $104,612 in 1989 to $696,884 in 1992 (566% growth). During this same period, World Communications (Mr. Gary Pace) (continued...)

In spite of such tremendous growth, MICPA asserts that it is "entitled" to a complete elimination of usage-sensitive rates and, instead, the application of the single line business rate in a resale environment. This rather bold proposal would grant private payphone providers the most favorable rate offered to any reseller within the State.[96] MICPA equates its desire for lower interconnection rates with the need and rationale for residually priced basic local service (characterized as a Category II service under Case No. 18,309), which specifically was designed to enhance universal service for basic residential and business local exchange service customers. Suffice it to say, the social value, goals and principles that have directed subsidies to basic local service rates do not and should not apply to the interests of MICPA.

The present COPT interconnection rate is reasonable and fair in relation to the rates charged other resellers. SWB's position consistently has held that access-like services that are resold, in whole or in part, should be priced on a usage-sensitive basis. Ex.133,p.6 Contrary to MICPA's claim, the purpose of the usage-sensitive charge is not simply to send a signal. The measured rate actually is designed to recover the costs which genuinely are incurred on a usage-sensitive basis. While SWB realizes that neither the Company nor the private payphone provider can charge for local coin service on a per-minute basis, the solution is not

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[95](...continued) increased annual revenues from $460,444 to $2,752,976, (nearly 500% growth). T.1356-57

[96]MICPA's proposal also would grant itself one of the most if not the most favorable interconnection scheme in the country. T.1359

eliminating a cost-driven per-minute COPT charge. Usage-sensitive costs will continue to be incurred and any flat-rate scheme will simply result in a mismatch between cost causation and rate design. As such, COPT usage charges are economically efficient and appropriate. Ex.133,p.7

Moreover, MICPA's own testimony undermines its plea for flat-rate interconnection. MICPA witness Harvey provides an example of what she says is a typical bill for a private payphone provider. Ex.134,Attachment A In this typical bill, the average duration for a local call was only 4.3 minutes. Ex.133,p.14 This produces an average usage cost of $.0738 per call to the private payphone provider. With a $.25 local coin rate, however, the private payphone provider receives a margin on the usage cost of over $.17 per call. In contrast to MICPA's hollow cry for help, the existing interconnection rate is not a problem for the private payphone industry and, therefore, does not deserve consideration.[97]

MICPA also argues that it is being treated unfairly in relation to other resellers. This is far from the truth. Although MICPA uses the present shared tenant services (STS) rate as the sole example for flat-rate pricing,[98] not even STS providers receive the most beneficial basic local business rates sought by

[97]MICPA's claim that SWB's payphones do not benefit the Company also is not supported by MICPA's own evidence. By its own admission, MICPA's analysis contains "apples to oranges" comparisons and contains numerous flaws such as excluding significant revenues. Ex.157,p.15;Ex.133,p.15-20

[98]MICPA also argues private payphones should be treated more like hotels, motels and hospitals. This analogy is flawed because these other entities are specifically excluded by law from regulation and consideration as a reseller. §386.020(40)

MICPA. (STS providers are required to pay PBX trunk rates, not basic local business rates.) Furthermore, the Commission implemented flat-rate pricing for STS providers for very unique reasons. In Case No. TO-86-53, the Commission reasoned that since non-resale PBX users are charged a flat PBX rate, so also should STS providers. R&O,p.23 In addition, the Order expressed that the Commission would reconsider its pricing decision when STS arrangements began to significantly impact the cost of telephone service for other telephone service customers. Id. In the seven years since STS was authorized in 1986, there have only been 10 providers certified, and two of those are no longer in business in spite of the Commission's generous rate treatment. Ex.133,p.8 This rather anemic growth rate is much different from the significant COPT growth rate in Missouri.

Furthermore, the existing COPT interconnection rate is already very reasonable in relation to the charges applicable for other resellers. COPT providers currently pay significantly lower usage rates than both interexchange carriers and enhanced service providers. For instance, the COPT charge is 65% less than interexchange carriers pay and 40% less than what enhanced service providers pay for usage.[99] Ex.133,p.9-10 This existing and already generous COPT discount becomes even more obvious and more favorable to the COPTs as the call duration becomes longer. Id.

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[99]MICPA's argument that private payphones rates contain greater contribution than switched access is based on cost information that is off by a full decimal point, thereby undermining its analysis by over 500%. MICPA Brief,p.28 Nonetheless, MICPA's flawed contribution analysis would support lowering the significantly higher IXC and ESP access rates to levels closer to COPT rates, not lowering COPT rates further.

MICPA also argues that the per call charge should be eliminated because the charge allows payment to SWB twice for some calls that have been converted from toll to local due to the implementation of Case No. TO-92-306. This logic is flawed, first, because MICPA's explanation of how this alleged result occurs misrepresents SWB's calculation of its expanded calling revenue impacts. Second, even if MICPA's description of the calculation were accurate, the result would be that the $6.1M expanded calling revenue impact estimate would be incorrect; it would not lend support to the position that the per call charge should be eliminated.

MICPA explains its rationale based on a sample call where SWB would lose $.20 in access revenue from IXCs due to the implementation of TO-92-306. MICPA states that SWB included that entire $.20 in its estimate of expanded calling losses, but then will charge the pay phone provider $.07 for the call when it becomes local (thus resulting in $.07 of double charging).

However, due to time and data limitations in Case No. TO-92-306 and the relatively small volume of this kind of traffic in relation to total traffic, SWB included nothing in its expanded calling revenue impacts for the type of call MICPA describes. That is, using MICPA's sample call, SWB included zero loss for that call in its expanded calling estimates, not $.20 as MICPA contends. Furthermore, since SWB will receive $.07 on the call when it becomes local, then the loss that should have been estimated, if it were possible, is the difference between the $.20 toll revenue and the $.07 local revenue, or $.13.

Ideally, SWB should have included this $.13 loss in its expanded calling impacts, not zero as was actually done or $.20 as MICPA erroneously contends was done. This would result in expanded calling losses greater than the estimated $6.1M, but once again MICPA provides no rationale to support the elimination of the per call charge.

In summary, there is neither evidence nor any rational basis to support the elimination of the present usage-sensitive charge paid by COPTS. MICPA's proposal would no longer provide the assurance of cost recovery for a resold service. In addition, MICPA's proposal would entice other resellers such as interexchange carriers and enhanced service providers to press for similar flat rate only pricing for their access services. SWB joins Staff in opposing any change in the present COPT interconnection tariff.

2. CALL TRACE RATE

OPC substantially modified its proposal in its Brief to the point where OPC goes well beyond its prefiled testimony and SWB was not able to reply to this new proposal in the record. OPC witness Thompson clearly characterized his recommendation in rebuttal testimony as a proposal "that the price be lowered from the current $8.00 per activation to $1.00 per activation." Ex.106,p.38,42 Company witness Bailey's Surrebuttal testimony refuted OPC's initial proposal by illustrating that it would require provision of this service far below incremental cost and it could severely overload both SWB personnel and law enforcement with less serious complaints of improper telephone use. Ex.91,p.36-37

OPC's Brief, on the other hand, makes two new proposals relating to SWB's Call Trace service. First, OPC suggests the activation charge should be unbundled so that the customer is charged $1.00 per activation <u>and</u> $7.00 more if the customer thereafter requests the Company to provide the trace information to the police. OPC Brief,p.41 As this proposal was not presented in OPC's testimony, SWB did not respond to it.[100] In addition, nowhere in OPC's testimony is there a recommendation to eliminate all nonrecurring charges associated with the service. Nonetheless, this proposal also is presented in OPC's Brief. OPC Brief,p.44

Lastly, it should be emphasized that SWB has received no customer complaints regarding the present rate for Call Trace Service. OPC merely is attempting to continue to wage its battle against Caller ID service by urging modification to other services.

3. CELLULAR INTERCONNECTION SERVICE RATE

OPC attempts to reintroduce a cellular interconnection issue that was litigated extensively twice in the last six years.[101] Both Case Nos. TC-86-158 and TR-90-144 specifically analyzed SWB's cellular interconnection tariff after consideration of significant evidence from numerous expert witnesses regarding the appropriate rate application.

The same rationale against OPC's proposal exists today as it

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[100]Mr. Bailey stated during cross-examination: "But I didn't see that in the testimony and I did not rebut that in my surrebuttal testimony." T.1378 While pursuing further, it became evident that OPC's proposal would add costs, complicate marketing and reduce sales for the service. T.1380

[101]Refer to the joint Brief of CyberTel and McCaw (p.1-3) for a complete history of this issue.

did previously. First, the FCC has indicated the application of an access tariff treating cellular companies as interexchange carriers would be inappropriate. Ex.91,p.31,App.B In addition, Mr. Dunkel's proposal simply is not workable. Ex.91,p.29 SWB has no way of determining the exact location of the mobile phone. SWB would have to rely completely upon the self-reporting of the cellular carrier and, in many instances, the cellular user. Even OPC admits that cellular areas (cells) that overlap various landline calling scopes would cause problems with its proposal. OPC Brief,p.48-9 In short, OPC's proposal is unnecessary and unworkable.

4. DIRECT INWARD DIAL (DID) TRUNK RATE

The Department of Defense and Federal Executive Agencies (FEAs) generally support the Joint Stipulation on Rate Design submitted by several of the parties. FEAs' offer one additional rate design recommendation, however, relating to DID rates.

The FEAs proposal lacks any evidentiary support whatsoever. FEAs witness Gildea recommended that "*if* the present rates are excessive relative to costs, a high priority should be given to rate reductions for [DID]." Ex.9,p.6 The FEAs, however, candidly admit that there is no record evidence regarding costs, usage or revenues upon which the Commission can adopt any modifications for DID service. FEAs Brief,p.4 Furthermore, there is no evidence that the number of service units "should be sufficiently small" or that the revenue effects would be "relatively minor." *Id*. In addition, the FEAs proposed rates of $20.00 monthly per trunk and $5.00 per group of numbers are absent from witness Gildea's testimony or any other place in the record. In summary, the FEAs proposal inherently lacks any evidentiary support.

5. SWB'S LIFELINE PROPOSAL

MICPA is the only party opposing SWB's expanded LifeLine proposal. Contrary to its views, the proposal complies with Missouri law since it is rationally related to promotion of the goal of universal service and treats all customers falling within the federal government's poverty guidelines as appropriate recipients of a preferred rate. MICPA's other arguments and citations to the record also are mistaken. Private payphone providers will not be funding this proposal. T.1425 In addition, meaningful attempts to target and assist needy customers should be fostered.

V. CONCLUSION

Southwestern Bell urges the Commission to proceed as follows:

- Adopt the Company's proposal to continue with incentive regulation and use 10.7% ROE (excluding Yellow Page earnings) both as the initial sharing point and in assessing the reasonableness of SWB's current rates. Additionally adopt SWB's actual cost of debt and capital structure for use in an extended plan;

- Adopt SWB's proposed depreciation rates and amortization of the reserve deficiency;

- Adopt FAS 106 and retain FAS 87;

- Continue to apply the adjustments (with the exception of the Yellow Page earnings adjustment) adopted in Case No. TC-89-14, both in judging the reasonableness of current rates, and in measuring SWB's earnings under an extended plan; and

- Adopt the Company's proposals to reduce revenues by $22M and forego its COS revenue requirement ($6M).

When the impact of adopting these proposals is applied to the Company's 1991 or September 1992 operating results, the Company's earnings level and its rates are reasonable.

Adoption of such proposals will also enable the Commission to accomplish the following goals:

- An ongoing freeze in the prices of local exchange rates;
- Incremental discretionary investments in SWB's Missouri network of $140M to $150M over and above SWB's normal construction budget, making possible both Distance Learning and Telemedicine applications that will help boost economic development opportunities, particularly in rural Missouri; and
- The ongoing opportunity for customers to automatically share in Company earnings over the course of an extended plan.

Adoption of SWB's TF2 proposal will permit the Commission to put Missouri into the forefront of the information age. The alternatives suggested by Staff and OPC are repressive in nature, cannot accomplish the above goals, and will leave Missouri behind other states which are aggressively seeking to encourage additional infrastructure development.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing document were served to all parties on the Service List by first-class postage prepaid, U.S. Mail.

Dated at St. Louis, Missouri, the 1st day of October, 1993.

Attorney

at the time of the robbery, nor was the money being conveyed.

For the reasons stated, it is the recommendation of your Commissioner that the judgment be reversed.

PER CURIAM.

The foregoing opinion of WOLFE, C., is adopted as the opinion of the court.

The judgment of the circuit court is accordingly reversed.

ANDERSON, P. J., MATTHES, J., and JAMES D. CLEMENS, Special Judge, concur.

Cecil C. MITCHELL, Vera Mitchell, George Croft and Lena Croft (Plaintiffs), Appellants,

v.

SOUTHWESTERN BELL TELEPHONE COMPANY, a Corporation (Defendant), Respondent.

No. 29599.

St. Louis Court of Appeals. Missouri.

Feb. 5, 1957.

Subscribers brought action against telephone company for damages for breach of advertising contract because one of the telephone numbers in advertisement was not the correct number and subscribers allegedly lost business because of such error, and company counterclaimed for contract price of other advertisements which were correctly printed. The St. Louis Circuit Court, James E. McLaughlin, J., entered judgment adverse to the advertisers, and they appealed. The Court of Appeals, Wolfe, C., held that proof of alleged loss of profits was insufficient to entitle subscribers to damages for loss of profits, but that evidence was sufficient to justify a finding that advertisements were worthless and that subscribers were entitled to award of damages in amount paid for advertisements.

Judgment reversed and cause remanded.

1. Courts ⟹231(52)

The Court of Appeals is not restricted to pleadings in determining its jurisdiction on appeal. V.A.M.S.Const. art. 5, § 3.

2. Courts ⟹231(51)

Where prayer of plaintiffs' petition asked for $50,000 as damages, but record disclosed that maximum damages claimed by plaintiffs were $3,714.08, Court of Appeals had jurisdiction of appeal by plaintiffs. V.A.M.S.Const. art. 5, § 3.

3. Damages ⟹40(1)

In action for loss of profits, recovery of speculative or conjectural profits cannot be had.

4. Telecommunications ⟹284

In action by subscribers against telephone company for damages for breach of advertising contract, because one of the telephone numbers in advertisement was not the correct number and subscribers allegedly lost business because of such error, proof of alleged loss of profits was insufficient to entitle subscribers to recover for loss of profits.

5. Telecommunications ⟹277

In action by subscribers against telephone company for damages for breach of advertising contract, because one of the telephone numbers in advertisement was not the correct number and subscribers allegedly lost business because of such error, cost of radio and newspaper advertising said by subscribers to have been used to minimize their loss of profit because of the error, was not allowable, where there was no proof that the radio and newspaper advertising reduced the loss, and such advertisements were for the most part quite remote in point of time from date when telephone directory was issued.

6. Telecommunications ⟹280

Running of advertisements in classified section of a telephone directory is not a public service but a matter of private contract between subscriber and telephone company, and a contractual limitation of liability for breach of such contract is a valid limitation.

7. Telecommunications ⟹284

In action by subscribers against telephone company for damages for breach of advertising contract, because one of the telephone numbers in advertisement was not the correct number and subscribers allegedly lost business because of such error, evidence was sufficient to justify finding that advertisements were worthless, and was sufficient to support an award of damages in amount paid by subscribers for the advertisements.

Not to be reported in State Reports.

Kappel & Neill, Walter S. Berkman, St. Louis, for appellants.

John Mohler, George J. Meiburger, St. Louis, for respondent.

WOLFE, Commissioner.

This is an action wherein the plaintiffs seek to recover damages for breach of an advertising contract. The advertisement in question was in the classified section of the defendant's telephone directory. One of the telephone numbers in the advertisement was not the correct number, and the plaintiffs contended that they were damaged by the error to the extent of $3,741.08. The defendant counterclaimed for the contract price of two other advertisements which were correctly printed. One was in the East St. Louis classified directory and the contract price was $25; the other was in the St. Louis County classified directory and the contract price was $288. It was stipulated that the defendant was entitled to a judgment for the two amounts last mentioned, and the court directed a verdict for the defendant on the two claims and further directed a verdict in favor of the plaintiffs in the sum of $1. From the judgment that followed, the plaintiffs prosecute this appeal.

The plaintiffs were in the business of renting trailers and concrete mixers. As partners they operated under the name of "Croft Rental Company". They contracted for advertisements in the St. Louis classified phone directory. One advertisement took up a quarter of a page under the classification of trailers. It carried their name, pictures of various types of trailers that they rented, picture of a concrete mixer, and stated that they were members of a nation-wide rental system which permitted the renter to leave the trailer at the city of the renter's destination when rented for a one-way trip. The other advertisement was under the classification of concrete mixers. It was smaller and merely advertised the rental of the mixers.

In the larger advertisement classified under "trailers", two phone numbers were listed. One was Evergreen 1-9384 for a rental lot on North Broadway and the other was Garfield 1-3144 for the main office and rental lot on Salisbury Street. The last number was wrong and it should have been Central 1-3144. The same error was made in the small ad for the rental of concrete mixers which carried but one number. The term of the contract was for twelve months and the plaintiffs agreed to pay the defendant $1,344 on which amount they had paid $112. The correct number of the company appeared in that part of the directory where all subscribers are listed alphabetically.

Mrs. Vera Mitchell, one of the plaintiffs, who took phone calls at the Salisbury

Street address and kept the books of the company, was the only witness who testified. As most of the facts above stated were admitted, her testimony was chiefly confined to that which the plaintiffs considered proof of their damages. She testified that the Croft Company was open for business seven days a week, and that their busiest time was on weekends. The number in the classified section (Garfield 1-3144) was the number of the Senack Shoe Company, and she said that after it appeared in the advertisement instead of their proper number (Central 1-3144) she called the Senack Shoe Company to have them refer calls, erroneously made to them, to the right number. She said that she did not receive full assistance from the shoe company in this respect and that the shoe company was not open on Saturdays and Sundays.

The witness stated that she had never counted the number of phone calls the Croft Company received prior to the issues of the 1954 directory, and, over the objection of the defendant, she estimated that on Monday, Tuesday, Wednesday, Thursday, and Friday the calls had averaged twenty-five a day. She also estimated that an average of forty calls had been received on Saturdey and fifteen on Sunday. She said that after the 1954 directory was circulated she made a count of calls received on Saturday and Sunday but not on a weekday. The witness then estimated that the calls dropped from fifteen on Sunday to five, on Saturday from forty to fifteen, and on the other days of the week from twenty-five to ten. She also estimated that fifty per cent of the calls received resulted in rentals. She said that about eighty per cent of the rentals were for two dollars and twenty per cent of the rentals were for four dollars. The percentage of profit on a rental was said to be forty-five per cent. The witness further testified that under the Nationwide Trailer Rental System, of which they were members, they occasionally rented trailers for cross-country use for which they received from \$7.50 to \$125.

The witness stated that they had advertised by radio and television to offset the mistake in the directory and for this they had expended \$1,236.88. The company earned more in 1954 than it had the previous year when its number was correctly carried in the directory. The witness attributed this to the fact that they had more trailers. She also stated that when the 1955 directory came out, with the correct number in it, their phone calls increased immediately, being almost double the number received before.

[1, 2] The defendant questions our jurisdiction of this appeal because the prayer of plaintiffs' petition asks for \$50,000 as damages. The defendant states that since the appellants seek a new trial upon this petition the amount in controversy is \$50,000 and that consequently it is in excess of \$7,500, to which our jurisdiction is limited. Mo.Const. Art. V, Sec. 3, V.A.M.S. The defendant has overlooked the fact that we are not restricted to the pleadings in determining our jurisdiction. We may look at the record, and here the record discloses that the maximum damages claimed are \$3,714.08, and the jurisdiction of this appeal is properly with us. Beasley v. Athens, Mo., 277 S.W.2d 538; Baer v. Baer, 364 Mo. 1214, 274 S.W.2d 298.

It is contended by the plaintiffs that the court erred in directing a verdict for nominal damages and they maintain that the various estimates made by their witness presented a reasonable basis for fixing the damages. They estimate that 50% of their phone calls resulted in sales and they estimate that they lost 4,430 calls during the year. They estimate that 80% of their rentals are for \$2, and 20% for \$4, and by this they arrived at an estimated gross loss on rentals of \$5,316, upon which they claim a net loss of 45%, which would have been their profit. To this they add the sum paid for other advertising and the $112 paid on the contract in question to reach the total of $3,741.08 which they claim as damages. Against this contention and in support of the trial court's ruling the defendant, respondent, maintains that such evidence did not afford the jury a reasonable basis for determining that plaintiffs would have had a greater net profit, or if they would have had a greater net profit no proper proof of the amount of such additional profit was made.

The plaintiffs, in support of their contention that there was a sufficiency of proof of damages to make a submissible case, state that a plaintiff should not be denied substantial recovery if he has produced the best evidence available and it is sufficient to afford a reasonable basis for estimating his loss. We are cited to a number of cases but those upon which the plaintiffs principally rely are Faire v. Burke, 363 Mo. 562, 252 S.W.2d 289, Smalley v. Wunderlich, Mo.App., 62 S.W.2d 919, and Masterson v. Chesapeake & Potomac Telephone Co., 55 App.D.C. 23, 299 F. 890.

The first case, Faire v. Burke, had to do with crop damages due to faulty spraying. There was proof of the condition of the crop before and after the spraying took place and proof of the extent of the damage done. There appears to be no similarity between this and the situation before us. The same may be said of Smalley v. Wunderlich, which had to do with the breach of a contract to supply gravel and the proof of the profit lost was clearly shown by the evidence.

The case of Masterson v. Chesapeake & Potomac Telephone Co., comes somewhat closer in point of fact than the first two cited, inasmuch as it has to do with the complete omission of a doctor's name from a telephone directory. There was evidence that his calls fell from an estimated twenty-five a day to five or seven by reason of the omission. There was evidence that a patient seeking his office could not reach him by telephone and there was also evidence that he suffered an actual loss of $5,000, which could have been attributed to no other reason than the omission of his name from the directory. This was a proven loss of profit.

[3, 4] None of the foregoing cases nor the others cited present facts that are analogous to the facts before us. We must weigh the evidence under the established rule that a recovery of speculative or conjectural profits cannot be had. In Tnemec Co. v. North Kansas City Development Co., Mo., 290 S.W.2d 169, 174, our Supreme Court had under consideration a suit for loss of profit by reason of delay in paving a street next to plaintiff's factory. In passing upon the sufficiency of proof it had this to say:

> "In order to prima facie prove plaintiff's case, evidence in the form of reliable data should have been forthcoming so that a jury could reasonably find a loss or a lesser profit for the stated months was due to the delay and could also make a reasonably accurate estimate or approximation of the amount of the loss. It seems that plaintiff was relying solely upon the estimate given by its secretary-treasurer as proof of loss of profits (and of the amount thereof) due to defendant's delay. * * * This court and the courts of appeal of this state have been strict in evaluating the sufficiency of the evidence warranting a recovery of damages for loss of profits. Our courts have refused to permit a jury to speculate, without substantial basis, as to what might be probable or expected profits as an element of damages."

Applying the foregoing to the evidence before us, it appears that the proof of loss of profits was insufficient. In the first place the earnings of the company were greater than the year before and the estimated loss was reached by estimate upon estimate, which left the whole matter in the realm of conjecture or speculation. Shealy's Inc., v. Southern Bell Telephone & Telegraph Co., D.C.S.C., 126 F.Supp. 382.

[5] As to the cost of radio and newspaper advertising said to have been used to minimize plaintiffs' loss of profit, this might have been an item of damage if there had been proof of a loss of profit, proof that these advertisements did reduce the loss and were expenditures necessary to do so. There was no such proof and the advertisements for the most part were quite remote in point of time from the date when the directory was issued. For these reasons they were not allowable as damages.

[6] The question is also raised as to the validity of the clause in the contract between the parties limiting the liability of the telephone company. It is as follows:

> "The applicant agrees that the Telephone Company's maximum liability for damages arising out of errors or omissions in the directory advertising to be provided shall be limited to the amount to be charged for such directory advertising."

The plaintiffs contend that this clause is invalid and rely upon Jacobs v. Western Union, 196 Mo.App. 300, 196 S.W. 31. This was an action arising out of defendant's failure to deliver a telegram. It was an action *ex delicto* bottomed on the breach of a public duty wherein the court held that a contractual limitation of liability was invalid. The running of advertisements in the classified section of a telephone directory is not a public service but a matter of private contract between the subscriber and the telephone company and a contractual limitation of liability for the breach of such a contract is a valid limitation. Baird v. Chesapeake & Potomac Telephone Co., 208 Md. 245, 117 A.2d 873; McTighe v. New England Telephone & Telegraph Co., 2 Cir., 216 F.2d 26; Russell v. Southwestern Bell Telephone Co., D.C.Tex., 130 F.Supp. 130.

The plaintiffs contend that they at least were entitled to the $112 that they had paid on the contract, but the defendant maintains that before they can recover the amount paid there must be shown a total failure of consideration. We are cited to Western Outdoor Advertising Company of Nebraska v. Berbiglia, Mo.App., 263 S.W. 2d 205. That case had to do with advertising by the erection of signs or billboards. These were erected but there was evidence that some of them were not maintained properly as provided by the contract. The Kansas City Court of Appeals held that since there was no complete failure of consideration, the advertiser could not recover the amount paid for the signs.

[7] This is quite different from the facts here under consideration. The purpose of the advertisement was to inform the public of the plaintiffs' telephone number. It is true that the number for the Broadway rental lot was correctly printed, but the evidence was that the business done from this place was quite negligible. The telephone number of the main rental lot was improperly listed in both advertisements. This presented sufficient evidence from which it could be found that the advertisements were worthless and would support an award of damages in the amount paid for the advertisements.

For the reasons stated, it is the recommendation of the Commissioner that the judgment be reversed and the cause remanded.

PER CURIAM.

The forgoing opinion of WOLFE, C., is adopted as the opinion of the court.

The judgment of the circuit court is accordingly reversed and the cause remanded.

ANDERSON, P. J., MATTHES, J., and JAMES D. CLEMENS, Special Judge, concur.

745 P.2d 563 printed in FULL format.

In The Matter of The Investigation By The Commission of The Directory And Yellow Page Service of The Mountain States Telephone And Telegraph Company, Pursuant to Wyoming Statutes and Commission Rules requiring Commission Authority Prior To Any Change In Rates, Service Or Change Of Ownership of Utility Facilities; The Mountain States Telephone And Telegraph Company, Petitioner, U S West Direct Company, Petitioner, v. Public Service Commission of Wyoming, Respondent

No. 86-134

Supreme Court of Wyoming

745 P.2d 563

November 20, 1987

PRIOR HISTORY:
Rule 12.09 Certification from the District Court of Laramie County, the Honorable Joseph F. Maier, Judge.

DISPOSITION: Reversed.

COUNSEL: Paul J. Hickey, Rooney, Bagley, Hickey, Evans & Statkus, and W. Dougla Hickey, for petitioner The Mountain States Telephone and Telegraph Company.

Nicholas G. Kalokathis, Lathrop & Uchner, P.C., and Laurie J. Bennett, for petitioner U S West Direct Company.

A. G. McClintock, Attorney General; Steven R. Shanahan, Senior Assistant Attorney General; and Roger C. Fransen, Assistant Attorney General, for respondent.

JUDGES: BROWN, C.J., THOMAS, CARDINE, URBIGKIT and MACY, JJ.

OPINIONBY: THOMAS

OPINION: [*564] THOMAS, Justice.

The question raised in this case is whether the Public Service Commission (PSC) has been authorized to regulate the publication of an advertising directory by The Mountain States Telephone and Telegraph Company (Mountain Bell). PSC concluded that it has been invested with such authority, and it ordered Mountain Bell to rescind a transaction, pursuant to which Mountain Bell had transferred the directory publishing division of its business to a sister corporation, and thereafter to submit the directory publication to competitive bidding. The significant publications are the yellow pages portions of Wyoming telephone directories. The decision of PSC was presented to the district court for review which certified the question to this court. We reverse the decision of PSC.

In the summer of 1984, Mountain Bell filed an application for a general rate increase [*565] with PSC. In considering the application for a rate increase, the consumer representative staff of PSC raised the question of the transfer of Mountain Bell's directory publishing business to an affiliated corporation named U S West Direct Company (Direct). PSC proceeded to hold a separate hearing on the matter of the transfer and determined that it was not i the public interest. PSC then ordered Mountain Bell not to renew its contract with Direct for publishing Mountain Bell's directories in Wyoming and to either resume publishing the directories itself or to receive competitive bids for the publishing of the directories. Mountain Bell filed a petition for rehearing wit PSC which was denied. Mountain Bell then filed a petition for review in the District Court of the First Judicial District of the State of Wyoming, in and for Laramie County. Direct also filed a petition for review asserting that it was an aggrieved party entitled to seek review under Rule 12.01, W.R.A.P. These petitions were consolidated by the district court, and the case then was certified to this court pursuant to Rule 12.09, W.R.A.P.

In its brief, Mountain Bell presents the following issues:

"1. The Public Service Commission order dated December 24, 1985, in this matter exceeded the statutory power and authority of the Public Service Commission.

"2. The Public Service Commission order is in excess of the power and authority of the Public Service Commission since it was directed at non-utility functions of The Mountain States Telephone and Telegraph Company.

"3. The Public Service Commission order is in excess of the power and authority of the PSC in that it involves the 'management' function of The Mountain States Telephone and Telegraph Company rather than the 'regulation' function of the Public Service Commission.

"4. The Public Service Commission order is violative of the commerce clause of the Constitution of the United States."

Direct sets forth the issues in its brief in this way:

"1. Should the Order of the Wyoming Public Service Commission dated December 24, 1985 be set aside under 16-3-114(c)(ii)(C), W.S.1977, as being in excess of the statutory jurisdiction and authority of the Commission, in that it purports to regulate non-public utility activities?

"2. Should the Order of the Wyoming Public Service Commission dated December 24, 1985 be set aside as violative of the Commerce Clause of the United States Constitution?

"3. Should the Order of the Wyoming Public Service Commission dated December 24, 1985 be set aside as violative of the due process clauses of the United States and the Wyoming Constitutions, in that it purported to impose obligation upon petitioner U S West Direct Company, a non-party to the proceedings below, without proper notice and opportunity for hearing?

"4. Should the Order of the Wyoming Public Service Commission dated December 24, 1985 be set aside in that the remedy imposed (a) constitutes a taking of property from appellant U S West Direct Company without just compensation in violation of the United States and Wyoming Constitutions, and (b) is arbitrary and capricious and not in accordance with law?"

In responding to the briefs of Mountain Bell and Direct, PSC asserts that these questions must be resolved:

"I. Does the Public Service Commission have authority to regulate and supervise Mountain Bell's directory publishing operations?

"II. Was the remedy imposed by the Public Service Commission proper?

"III. Was the Public Service Commission correct in its determination that th transactions at issue were within the statutory prohibition against unreasonabl discrimination and undue preferences?

"IV. Does the Public Service Commission's order violate U S West Direct's right to due process or constitute an unlawful taking?

[*566] "V. Does the Public Service Commission's order violate the Commerce Clause of the United States Constitution?"

As of January 1, 1984, American Telephone and Telegraph Company (AT&T) was required to withdraw from furnishing local telephone service. That was accomplished by transferring its local telephone service to seven regional companies which encompassed the United States. One of these regional companies is U S West, Inc. This divestiture was ordered by the United States District Court for the District of Columbia in United States v. American Telephone and Telegraph Company, 552 F. Supp. 131 (D.C. Cir. 1982), appeal dismissed by Unite States v. Western Electric, 250 U.S. App. D.C. 23, 777 F.2d 23 (1985), cert. denied U.S. West, Inc. v. United States, 480 U.S. 922, 107 S. Ct. 1384, 94 L. Ed. 2d 698 (1987).

Prior to the divestiture order, Mountain Bell, as a wholly-owned subsidiary of AT&T, serviced Wyoming and other states in the Rocky Mountain region. After the divestiture, it continued to provide the same services as a wholly-owned subsidiary of U S West, Inc. Prior to the divestiture, Mountain Bell published its own telephone directories which consisted of both an alphabetical listing c the published telephone numbers of its subscribers, the white pages, and a topical business listing with advertising space available on request, the yellc pages. The directory publishing operations were subdivided into a listing service and a publishing service. The listing service provided a current alphabetical list of all telephone subscribers having a published telephone number, which was available to anyone desiring to purchase a subscriber list. The publishing service performed the actual function of printing both the white and yellow pages, and as a part of its business, it solicited advertising for the yellow pages. The publication of the telephone directories traditionally wa a profit-making aspect of Mountain Bell's business which served to subsidize th service rates of telephone subscribers. The revenues which were derived were included by PSC in calculating permitted rates for telephone service.

Sometime prior to the effective date of the United States district court divestiture order, Mountain Bell considered the creation of a subsidiary corporation to assume the function of publishing the telephone directories. Thi was accomplished by a series of transactions which were effective on January 1, 1984, pursuant to which Mountain Bell transferred the assets utilized in publishing the telephone directories to a newly created subsidiary, Landmark Publishing Company (Landmark), for all of the stock of Landmark. The agreement for that transfer made it contingent upon state approval where necessary, but apparently, prior approval was sought only in the state of Colorado. Immediatel following the transfer, Mountain Bell declared a dividend of the shares of Landmark to its parent and sole shareholder, U S West, Inc. The assets for publishing the telephone directory then were transferred by Landmark to Direct. Direct is a wholly-owned subsidiary of Landmark. The arrangement was completed by a contract, negotiated between Mountain Bell and Direct, pursuant to which Direct agreed to publish the telephone directories which Mountain Bell previously had provided to its telephone subscribers. The contract's term was for three years, 1984 to 1986, and it covered the seven-state area serviced by Mountain Bell. Under the contract, Direct agreed to pay Mountain Bell $ 315 million for Mountain Bell's promise to provide the listing service information to Direct, its billing and collection service and the exclusive right to use th Mountain Bell logo. In addition, an agreement for the transition period was mad pursuant to which Mountain Bell assigned the rights under certain other contracts to Direct. It is clear that the only negotiation for the publication of the telephone directories was between Mountain Bell and Direct.

After completing this arrangement for Direct to publish its telephone directories, Mountain Bell sought the approval of PSC to increase its rates for telephone service. A hearing on that application was set, but, upon the suggestion of the consumer representative staff, a separate proceeding was conducted concerned with the possible [*567] harm to the public interest attributable to the transfer by Mountain Bell of its publishing assets to Direc together with the agreement made with Direct to publish the telephone directories. Following that hearing PSC found that Mountain Bell had failed to demonstrate that the Publishing Agreement, as it presently exists, achieves the greatest economic benefit which may reasonably be achieved for Wyoming ratepayers, or is in the public interest * * *;" that the agreement "unjustly discriminated against Direct's competitors and has granted Direct an undue preference;" and that the agreement constituted "subsidization of an affiliate'. publishing endeavors through favoritism and special considerations."

The first paragraph of the operative portion of the order entered by PSC provides:

"Insofar as they affect Wyoming assets, services or revenues, Mountain Bell shall immediately undertake to meet all of the conditions on its asset transfer to Landmark and Publishing Agreement with Direct as set out in para graph 30 above. In the alternative, Mountain Bell shall immediately undertake to effect a return to the status quo existing prior to January 1, 1984 with respect to the business relationship between itself and Landmark and Direct, i.e., Mountain Bell shall recover ownership of all assets transferred to Landmark and rescind its publishing related agreements with Direct."

Paragraph 30 of the PSC's Findings and Conclusions states:

"30. The conditions are as follows:

"a. Direct shall return an updated and current Yellow Pages On Line n1 to Mountain Bell upon termination of the Publishing Agreement. If Direct ceases use of Yellow Pages On Line or fails to keep Yellow Pages on Line updated and current during the term of the Publishing Agreement, then Direct shall transfer the updated and current software and data base actually being used by Direct in place of Yellow Pages on Line.

"b. The Publishing Agreement between Mountain Bell and Direct shall terminat on December 31, 1986. Not later than 180 days prior to termination of the Publishing Agreement Mountain Bell shall submit bid specifications for a new publishing agreement to the Commission for approval. Immediately upon approval of the bid specifications or any modifications thereof as ordered by the Commission, Mountain Bell shall solicit bids directly from no fewer than five publishers which are qualified and able to sell yellow page advertising and publish directories for all of Wyoming. Mountain Bell shall also announce a general bid solicitation in media of general circulation in both the telephone and publishing industries. Not later than 90 days prior to termination of the Publishing Agreement Mountain Bell shall submit the bid which it proposes to accept to the Commission for approval. The bid shall be awarded immediately upc approval by the Commission.

"c. Prior to termination of the Publishing Agreement, the parties to the Publishing Agreement will negotiate, and submit for Commission approval, a plar for termination of the Publishing Agreement including payment of transition fees.

"d. Mountain Bell shall have the exclusive right to use the standard cover design upon termination of the Publishing Agreement."

n1 Yellow Pages On Line is a computer software program incorporating busines advertising information utilized in publishing the yellow pages portion of the telephone directory. It was transferred by Mountain Bell to Landmark as a publishing line asset at zero value and then from Landmark to Direct.

In answering the arguments of Mountain Bell and Direct, PSC asserts statutor authority exists to regulate Mountain Bell's transfer of its publishing assets under its power to regulate all "matters related to rates and utility services and facilities" of a public utility. It argues that the publication of a telephone directory, including advertising encompassed in the yellow pages section, properly is understood to be a public service. Since Mountain Bell is recognized [*568] public utility, PSC argues it has power to regulate the service of publishing telephone directories, including the manner of dispositic of the assets devoted to publishing such directories, in order to assure the protection of the public interest.

Mountain Bell concedes its status as a public utility in Wyoming and recognizes that it is subject to the jurisdiction of PSC in delivering its utility services. It contends, contrary to the position of PSC, that the yellow pages advertising portion of the telephone directories historically has been a matter of contract between the publisher and the advertisers and not subject tc the regulatory authority of PSC. For this reason, Mountain Bell contends that i was free to dispose of the directory publishing assets without seeking either prior or subsequent approval by PSC. Direct supports Mountain Bell's position i this respect.

The parties agree that the disposition of this case is controlled by the statutes. All recognize that this court cannot constructively expand statutory powers conferred upon an agency by the legislature, and the statutes which create and delegate authority to PSC must be construed strictly with any reasonable doubt as to the existence of regulatory power resolved against the exercise of such power. Public Service Commission v. Formal Complaint of WWZ Company, Wyo., 641 P.2d 183 (1982); Tri-County Electric Association, Inc. v.

City of Gillette, Wyo., 525 P.2d 3 (1974). When it issued its order, PSC found the requisite statutory authority pursuant to @@ 37-2-112, 37-2-117, 37-2-119, 37-2-122, 37-2-127, 37-3-111 and 37-3-112, W.S.1977. In answering this appeal, PSC has narrowed its reliance upon statutory authority primarily to that contained in @ 37-2-112, W.S.1977, which provides:

"The commission shall have general and exclusive power to regulate and supervise every public utility within the state in accordance with the provisions of this act."

In making this more limited assertion of its statutory authority, PSC also relies on the definition of "rate" found in @ 37-1-102, W.S.1977:

"The term 'rate,' when used in this act, shall mean and include, in the plural number, as well as in the singular, every individual or joint rate, classificat:on, fare, toll, charge or other compensation for service rendered o to be rendered by any public utility, and every rule, regulation, practice, act requirement or privilege in any way relating to such rate, fare, toll, charge o other compensation, and any schedule or tariff or part of a schedule or tariff thereof."

There is no question that the legislature conferred broad powers upon PSC with respect to setting rates. That power does have limitations though, and it does not necessarily extend to every matter affecting rates, as PSC urges. We said in another case:

"PSC is not in a position to take on any aspect of utility management. It must restrict its position to 'regulation' with management decisions being entirely that of the utility." Pacific Power and Light Company v. Public Servic Commission of Wyoming, Wyo., 677 P.2d 799, 807, cert. denied 469 U.S. 831, 105 S. Ct. 120, 83 L. Ed. 2d 62 (1984).

We noted there the difficulty confronting a court in ascertaining what should b understood as managerial function as opposed to appropriate regulation. Efforts to define that distinction have led to confusion and apparently ad hoc decision with respect to what is an invasion of the management domain as opposed to authorized regulation in the public interest.

In some instances, public utility activities which the courts once protected from regulation as a perceived invasion of management later have been held to b subject to regulation without any perceptible change in the scope of the regulatory power granted by the legislature. Compare Pacific Telephone and Telegraph Company v. Public Utilities Commission, 34 Cal. 2d 822, 215 P.2d 441 (1950), with General Telephone Company of California v. Public Utilities Commission, Calif., 34 Cal. 3d 817, 670 P.2d 349, 195 Cal. Rptr. 695 (1983), an [*569] Southern Pacific Company v. Public Utilities Commission, 41 Cal.2d 354 260 P.2d 70 (1953). See generally, Note, Management Invaded -- A Real or False Defense?, 5 Stan. L. Rev. 110 (1952). In fact, in General Telephone Company of California v. Public Utilities Commission, supra, at n.10, the court said "that the 'invasion of management' rationale now appears to be disfavored" because judicial limitations were increasingly imposed upon what once had been perceive as within "management functions" of utilities.

This prognostication by the Supreme Court of California may not be entirely accurate. It does not cognize a rather delicate but definite line that must be drawn between regulated but free enterprise and socialization. Free enterprise assumes the responsibility of management to investors for management's decisions. Permitting civil servants to make those determinations instead of management results in no accountability for those decisions to investors in the business. That is not compatible with even regulated monopolies in a free enterprise system. We prefer the view heretofore espoused that extensions of power by judicial construction beyond that conferred upon an agency by the legislature, either specifically or generally, is inappropriate because:

"An administrative board has no power or authority other than that particularly conferred upon it by statute or by construction necessary to accomplish the aims of the statute." Tri-County Electric Association, Inc. v. City of Gillette, supra, 525 P.2d at 9.

See also 1 A. Priest, Principles of Public Utility Regulation, at 9-10 (1969).

We then look to the statutes to decide whether the legislature granted to PS the authority it purported to exercise in issuing its order to Mountain Bell. Section 37-2-112, W.S.1977, grants to PSC the "general and exclusive power to regulate and supervise every public utility" within this state in accordance with the statutes. Section 37-2-127, W.S.1977, further provides:

"In addition to the powers herein specifically granted, the commission shall have such implied or incidental powers as may be necessary and proper, effectually to carry out, perform and execute all the power so granted."

These broad powers can be exercised only over a public utility, however. Public Service Commission v. Formal Complaint of WWZ Company, supra; @ 37-2-112, W.S.1977. The definition of telephone service as a "public utility" is:

"Any plant, property or facility for the transmission to or for the public o telephone messages, for the conveyance or transmission to or for the public of telegraph messages, or for the furnishing of facilities to or for the public fo

the transmission of intelligence by electricity; * * *." @ 37-1-101(a)(vi)(B), W.S.1977.

The rule of strict construction dictates that any jurisdiction in PSC is limite to those functions of Mountain Bell that are "to or for the public."

The conclusion that the legislature did not intend to extend to PSC jurisdiction over services which are not furnished to or for the public is consistent with generally accepted jurisdictional limits on regulatory bodies. We have espoused the general proposition that a utility service may have both public and private functions, and while it is subject to regulation in matters of public function, it is not when it operates in its private mode. State Board of Equalization v. Stanoli nd Oil and Gas Company, 54 Wyo. 521, 94 P.2d 147 (1939). See also Southern Pacific Company v. Arizona Corporation Commission, Ariz., 98 Ariz. 339, 404 P.2d 692 (1965); City of Phoenix v. Kasun, 54 Ariz. 470, 97 P.2d 210 (1939); Associated Mechanical Contractors of Arkansas v. Arkansas Louisiana Gas Co., Ark., 225 Ark. 424, 283 S.W.2d 123 (1955); University Hills Beauty Academy, Inc. v. Mountain States Telephone and Telegrap Company, Colo.App., 38 Colo. App. 194, 554 P.2d 723 (1976); Oklahoma Gas and Electric Company v. Corporation Commission, Okla., 543 P.2d 546 (1975); 64 Am.Jur.2d Public Utilities @ 1, at 550 (1972); 73B C.J.S. Public Utilities @ 66 at 314-315 (1983).

[*570] This conclusion also is consistent with the extent to which a state may regulate private business under its police powers; any regulation must further a public purpose, Steffey v. City of Casper, Wyo., 357 P.2d 456 (1960); Minnesota Gas Company v. Public Service Commission, Department of Public Services, State of Minnesota, 523 F.2d 581, (8th Cir. 1975), cert. denied 424 U.S. 915, 96 S. Ct. 1114, 47 L. Ed. 2d 320 (1976). In Steffey v. City of Casper supra, at 461, we held that, in Wyoming, a business may be regulated by the legislature pursuant to the police power only when that business involves matters "affected with a public interest." In defining what "affected with a public interest" means, we said:

"* * * So it seems that the fact that the business of a merchant is not a business affected with the public interest does not itself mean a great deal. To make that statement is to a more or less extent an arbitrary determination. It is somewhat like the ipse dixit used in connection with Aristotle in the past ages. We must go further and determine whether or not good may be accomplished by the legislation here in controversy." Steffey v. City of Casper, supra, 357 P.2d at 461.

In Phillips Petroleum Company v. Public Service Commission, Wyo., 545 P.2d 1167 (1976), we considered the effect of the service upon the public and whether or not it was offered to all of the public. Because the sale of oil and gas in that case was not made directly to the public, we found that the service was not "to and for the public," and thus, we concluded PSC had no jurisdiction to regulate the terms or manner of the sale. The critical question, then, is whether the directory publishing activities that PSC sought to regulate were services "to or for the public."

In this instance, PSC made no findings with regard to whether or not the directory publishing activity of Mountain Bell was a service "to or for the public. " Instead, PSC asserted its jurisdiction by establishing a connection between the revenue produced by the directory publishing service and the rates that Mountain Bell ultimately charged for those services which are furnished "to or for the public." This is not a sufficient basis for the exercise of jurisdiction. As we noted in Phillips Petroleum Company v. Public Service Commission, supra, 545 P.2d at 1171:

"* * * It doe s not, however, require much imagination to suggest that if jurisdiction may be based upon this broad theory, it is possible to follow any producer's line to the Christmas tree."

See also Pacific Telephone and Telegraph Company v. Public Utilities Commission, supra, 215 P.2d at 445 ("Almost every contract a utility makes is bound to affect its rates and services.").

We recognize that a listing of telephone numbers like the white pages is part and parcel of the "service to or for the public." The majority of courts, with which we agree, have held, however, that the yellow pages portion of a telephone directory primarily is a matter of private business. Mendel v. Mountain States Telephone and Telegraph Company, 117 Ariz. 491, 573 P.2d 891 (1977); Gas House, Inc. v. Southern Bell Telephone and Telegraph Company, 289 N.C. 175, 221 S.E.2d 499 (1976); and the cases cited in those authorities. These courts have found generally that the yellow pages portion of a telephone directory is simply one source of advertising and does not constitute a monopoly service such as the furnishing of telephone service proper. They have concluded that unlike the white pages portion of the directory, the advertising contained in the yellow pages is not such an essential or integral service of telephone communication that the telephone service would be limited substantially if it were not available. Only a minority of jurisdictions have held that the yellow pages advertising is an integral function of the telephone service and a monopoly. Se Allen v. Michigan Telephone Company, 18 Mich. App. 632, 171 N.W.2d 689 (1969); Videon Corporation v. Burton, Mo., 369 S.W.2d 264 (1963).

We adopt the view of the majority of the courts. The yellow pages in the Mountain Bell directories, now published by Direct, may be preferred by the public, but we see no indication of a monopoly. The evidence [*571] in this record demonstrates that other companies throughout Wyoming are publishing alternative telephone books to that provided by Direct, including the business advertising section. When additional advertising media, such as television, newspaper, magazines and billboards, are acknowledged! the mode of advertising through the directory published by Direct cannot be perceived as a monopoly. Ar need to regulate a business in the public interest is substantially diminished in the absence of a monopoly. As one commentator has pointed out, the very purpose of the regulation of public service utilities is founded on the principle of natural monopolies. 1 A. Priest, Principles of Public Utility Regulation, supra, at 1.

We conclude that the primary purpose of the yellow pages portion of the telephone directory is to provide a mode of advertising to businesses so that they may solicit the general public to patronize their businesses or purchase a particular product. That advertising function cannot be found to be such an integral part of telephone service that it is necessary to regulate it for the protection of the public. Consequently, even though PSC made no finding that th directory publishing activities, over which it had attempted to exercise its jurisdiction, constituted a service to or for the public, there is no justification for remanding the case for that factual matter to be addressed.

Our conclusion is compatible with that reached earlier by PSC that its jurisdiction did not extend to contractual disputes over yellow pages advertising. See In the Matter of the Formal Complaint of Bruce Bergland v. Mountain States Telephone and Telegraph Company, PSC Docket No. 9343 SUB 24 (January 26, 1983). Furthermore, PSC historically has not required a certificat of public convenience and necessity over any other business which engaged simpl in the publishing of telephone directories, and normally that requirement is essential to subjecting a business to the jurisdiction of PSC. See § 37-2-205, W.S. 1977. Finally, the rules which PSC has promulgated require a telephone company to publish only the white pages portion of the directory. Rules of Practice and Procedure of Public Service Commission of the State of Wyoming, § 513 (1979). The represent attempt by PSC to expand its jurisdiction is not only inconsistent with its practice but beyond its statutory powers.

We hold that PSC had no statutory authority to justify its order requiring Mountain Bell to adjust the terms pursuant to which it disposed of its director publishing assets or activities. We specifically do not include in that ruling nay suggestion that PSC is without power to require Mountain Bell to account fo the financial impact of the transfer of its directory publishing activities upo any rate Mountain Bell seeks to charge the public in any future proceedings. Th legislature indeed has conferred upon PSC broad owners in assessing rates. See Application of Northwestern Bell Telephone Company, Minn. App., 367 N.W.2d 655 (1985); Mountain States Telephone and Telegraph Company v. Corporation

Commssion, N.M., 99 N.M. 1, 653 P.2d 501 (1982); State ex rel. Utilties Commission v. Southern Bell Telephone and Telegraph Company, N.C., 307 N.C. 541 299 S.E.2d 763 (1983). All of the parties agreed at the time of oral argument that PSC could account from any adverse impact the transfer of the publishing line of assets to Direct might have on rates charged by Mountain Bell and refus to allow any increase in rates premised upon the loss of revenue from the directory publishing activities. We agree that their view is correct.

In its brief, Direct argues, in addition to the proposition that PSC had no jurisdiction over directory publishing activities without regard to the identit of the publisher, that it is a private company which is not subject to PSC jurisdiction. It contends that PSC had no power to issue an order affecting its assests. PSC did not argue its jurisdiction over Direct, and because of the disposition of this case, there is no need to address the question of any apparent assertion of jurisdiction over Direct. Furthermore, because we agree with appellants that the order of PSC exceeded its jurisdiction, there is no need to address the constitutional questions [*572] asserted by the appellants. Marion v. City of Lander, Wyo., 394 P.2d 910 (1964), cert. denied 380 U.S. 925, 85 S. Ct. 929, 13 L. Ed. 2d 810, reh. denied 380 U.S. 989, 85 S. Ct. 1352, 14 L. Ed. 2d 283 (1965).

This case came to us as a certified case pursuant to Rule 12.09, W.R.A.P. Ir accordance with @ 16-3-114(c)(ii)(C), W.S.1977, we must:

"(ii). Hold unlawful and set aside agency action, findings and conclusions found to be:

"(C) In excess of statutory jurisdiction, authority or limitations or lackir statutory right; * * *."

The order of PSC is reversed. n2

n2 We reject the broad constructions argued by PSC for specific provisions contained in the statutes, @@ 37-1-101, et seq., without addressing each statutory provision because of our conclusion that the jurisdiction of PSC does not extend to matters such as the publication of the yellow pages directory which is not a service furnished to or for the public.

facilities are and will be if it does not prevail. The producer, not the Commission, here decides what is done with the gas. The traditional prejudice flowing from granting temporary authorization is simply not present in this case.

The Commission made the grant of temporary authority contingent upon Sinclair's amending its permanent application, specifically requiring it to apply for authorization to construct facilities. Such a requirement might seem inconsistent with the position which we now take, and which the Commission took, in granting such temporary authority. Our view is that out of an abundance of caution the Commission wanted to make it plain that at the hearing for a permanent certificate it would have before it Sinclair's application for a complete resolution on the merits unaffected by any temporary grants. This is, of course, as it should be.

The regulation distinguishes between pipeline companies and independent producers,[10] and to say that the Commission need treat an independent producer having a specified producer emergency as a pipeline company because it seeks to lay pipe to relieve itself of such emergency is unnecessary.

[5] The factor which triggers 157.28 is one of record in this case; *id est*, an allegation of the payment of shut-in royalties by an independent producer. Because the facilities involved are those of one particular company, with no alternative right being granted by the Commission, the *Ashbacker* argument that no facilities should be authorized which would prejudice a subsequent hearing on the merits in favor of the temporary grantee is not valid in this case. The question is merely one of statutory construction. The Commission has in the past allowed such "pipelines" to be built as part of a temporary authorization. The wording of the regulation permits such interpretation, and the alternatives would be so restrictive as to effectively destroy such a regulation's usefulness in alleviating those emergencies therein enumerated. Our view is that a producer having a specifically enumerated producer emergency may, as part of the authorization under regulation 157.28, lay behind-the-plant pipe of the length here involved to transport the gas so as to alleviate its emergency. The Commission action shows clearly, as do the facts, that these facilities are normal behind-the-plant facilities for an independent producer. The Commission action is therefore

Affirmed.

The CLASSIFIED DIRECTORY SUBSCRIBERS ASSOCIATION, Appellant,

v.

PUBLIC SERVICE COMMISSION OF the DISTRICT OF COLUMBIA et al., Appellees.

No. 20775.

United States Court of Appeals District of Columbia Circuit.

Argued June 22, 1967.

Decided Sept. 14, 1967.

Appeal from judgment of the United States District Court for the District of Columbia, Leonard P. Walsh, J., affirming certain orders of the Public Service Commission of the District of Columbia. The Court of Appeals, J. Skelly Wright, Circuit Judge, held that "Yellow Pages" advertising was not a public utility "service" or "facility" within statute provid-

10. An independent producer is defined in regulation 154.91 as:

(a) * * * [A]ny person as defined in the Natural Gas Act who is engaged in the production or gathering of natural gas and who sells natural gas in interstate commerce for resale, but who is not engaged in the transportation of natural gas (other than gathering) by pipeline in interstate commerce.

ing that every public utility doing business within the District of Columbia is required to furnish service and facilities in all respects just and reasonable, and hence the Public Service Commission lacked jurisdiction to regulate rates and practices of telephone company with respect to its yellow pages classified telephone directory.

Affirmed.

1. **Telecommunications ⟹269**

"Yellow Pages" advertising was not a public utility "service" or "facility" within statute providing that every public utility doing business within the District of Columbia is required to furnish service and facilities in all respects just and reasonable, and hence the public service commission lacked jurisdiction to regulate rates and practices of telephone company with respect to its yellow pages classified telephone directory. D.C.Code 1961, §§ 43–301, 43–303.

See publication Words and Phrases for other judicial constructions and definitions.

2. **Public Service Commissions ⟹7.1**

Not all services offered by a public utility are regulable under statute providing that every public utility doing business within the District of Columbia is required to furnish service and facilities in all respects just and reasonable. D.C.Code 1961, §§ 43–301, 43–303.

3. **Statutes ⟹219**

When faced with problem of statutory construction, the United States Court of Appeals shows great deference to the interpretation given the statute by the officers or agency charged with its administration.

4. **Public Service Commissions ⟹32**

To sustain the public service commission's application of a statutory term respecting its jurisdiction, the United States Court of Appeals need not find that its construction is the only reasonable one, or even that it is the result the court would have reached had the question arisen in the first instance in judicial proceedings.

Mr. Stephen L. Gelband, Washington, D. C., for appellant.

Mr. George F. Donnella, Asst. Corp. Counsel for District of Columbia, with whom Messrs. Charles T. Duncan, Corp. Counsel, and C. Belden White II, Asst. Corp. Counsel, were on the brief, for appellee Public Service Commission.

Mr. Robert A. Levetown, Washington, D. C., with whom Messrs. Howard C. Anderson and John P. Barnes, Washington, D. C., were on the brief, for appellee Chesapeake & Potomac Tel. Co.

Before FAHY, Senior Circuit Judge, and WRIGHT and ROBINSON, Circuit Judges.

J. SKELLY WRIGHT, Circuit Judge.

This is an appeal from a summary judgment granted by the District Court affirming two orders of the Public Service Commission of the District of Columbia dismissing a complaint filed before the Commission by the appellant, Classified Directory Subscribers Association. The complaint urged that the Commission assert comprehensive regulatory jurisdiction—particularly rate-making jurisdiction—over the Classified Telephone Directory published by the Chesapeake and Potomac Telephone Company, a defendant-intervenor before the District Court and an appellee here.

In Order No. 5038 the Commission concluded that it was statutorily authorized to assert jurisdiction over the "Yellow Pages" only when necessary to protect and insure "adequate telephone service and reasonable rates for telephone service." It then found that the basic lightfaced classified listings, which all subscribers are entitled to as part of their service, perform a necessary reference function in connection with telephone service and ruled that it had regulatory power over such listings. The Commission also ruled that it could assert jurisdiction over advertising published in the "Yellow Pages" where the rates or practices associated with such advertising "adversely affect the recognized regulated services and rates."

The Commission indicated that discriminatory practices in the sale of "Yellow Pages" advertising would, by their very nature, disrupt overall telephone operations and consequently would be regulable. Similarly, if the Telephone Company's policies or practices rendered the "Yellow Pages" inadequate as a convenient reference to telephone subscribers, or if variations in advertising rates resulted in evasion or frustration of the basic service rates which the Commission was empowered to regulate, then the Commission could, and would, act. But the Commission concluded that absent these special factors it did not have jurisdiction over the advertising published in the Classified Directory because such advertising was not essential to telephone service and did not, in itself, constitute a public utility service or facility within the meaning of the relevant jurisdictional statute. It therefore dismissed that portion of the complaint calling upon the Commission to undertake comprehensive rate regulation of "Yellow Pages" advertising.

The Commission then went on to review the Association's allegations concerning Telephone Company "Yellow Pages" advertising practices of the sort over which the Commission felt it had jurisdiction and found that the allegations of discrimination and unreasonable treatment had no basis in fact. It ordered that the whole of the Association's complaint be dismissed. In Order No. 5053, the Commission denied an application for reconsideration.

The Association appealed these orders to the District Court, claiming that the Commission's jurisdictional decision was wrong as a matter of law. The District Court found that the Commission's construction of the jurisdictional statute was a reasonable one "supported by rational distinctions between advertising and the basic classified listings" and, in effect, affirmed the Commission's orders by granting the defendant-intervenor's cross-motion for summary judgment.[1] This appeal followed. For the reasons developed below we affirm the District Court's summary judgment upholding the orders of the Commission.

[1] The only question raised by this appeal is whether, under the relevant statutes, the Public Service Commission has jurisdiction to regulate the rates and practices of the Chesapeake and Potomac Telephone Company with respect to the Washington Yellow Pages Classified Telephone Directory. If there is jurisdiction, it arises from 43 D.C.CODE §§ 301 and 303 (1961). Section 301 states that "[e]very public utility doing business within the District of Columbia is required to furnish service and facilities * * * in all respects just and reasonable. The charge made by any such public utility for any *facility or services* furnished, or rendered, or to be furnished or rendered, shall be reasonable, just, and nondiscriminatory." (Emphasis added.) And Section 303 empowers the Commission to enforce various chapters of the Code, including Section 301. At issue, then, is whether "Yellow Pages" advertising is a public utility "service" or "facility" within the meaning of the statute.

[2] Though the District of Columbia Code states explicitly that the term "service" must be interpreted "in its broadest and most inclusive sense," 43 D.C.CODE § 104 (1961), it is clear that not all services offered by a public utility are regulable under Section 301. The statute itself, 43 D.C.CODE § 309 (1961), contemplates that utilities may transact non-utility business, for it authorizes the Commission to require separate accounting for such non-utility services. And many courts and agencies in other jurisdictions have found that activities such as the rental of land and the sale of appliances by utilities are not regulable as public utility services.[2] Indeed, appellant

1. Classified Directory Subscribers Ass'n v. Public Service Comm'n of D. C., D.D.C., 274 F.Supp. 261 (November 29, 1966).

2. *See, e. g.,* City Ice & Fuel Co. v. Consolidated Edison Co. of New York, Inc., 29 P.U.R.(n.s.) 193 (1939). *See also* the accounting practices under the Code of

apparently conceded as much in oral argument before the Commission.

The question whether classified advertising is a service under Section 301 is one of first impression for this court. We do not subscribe to appellant's contention that District of Columbia v. Chesapeake & Potomac Tel. Co., 86 U.S. App.D.C. 124, 179 F.2d 814 (1950), is a controlling precedent establishing jurisdiction in the Commission. For though that case held that classified advertising was a service of a public utility within the meaning of a then existing statute which taxed gross receipts "from the sale of public utility commodities and services" within the District, it did not decide that classified advertising was a public utility service subject to total regulation under Sections 301 and 303. It is, we think, significant that, while many state commissions consider revenues from directory advertising as part of a telephone company's gross revenue for purposes of rate-making,[3] in only one state, California,[4] has a regulatory commission or a state court found that the rates of classified advertising are subject to comprehensive regulation.[5] And while some state statutes may be significantly different from our own, others are strikingly similar.[6]

The Telephone Company certainly is in a uniquely advantageous position as a publisher of directory advertising. But its monopoly in that capacity is not so strong as the one it holds as the exclusive provider of telephone services. Even if no one else has yet found it profitable to publish a competitive directory, certainly the availability of other advertising media does exert some competitive restraining influence on Telephone Company pricing. Thus the distinction which the Commission drew between the classified listing, as an integral part of telephone service, and the directory advertising, as primarily a matter of private contract, was not without some reasonable basis. Neither was the distinction drawn between those advertising practices and policies which may be disruptive of basic telephone service itself and those which merely invoke non-discriminatory pricing. Several other jurisdictions have drawn similar lines.[7]

[3, 4] It would seem, then, that there is no "plain meaning" to the words "public utility * * * facility or services" as used in Section 301. The Commission's interpretation conforms to that given comparable statutes by all but one of the commissions or courts which have faced the question; it is consistent with over 50 years of administrative practice here and with several opinions submitted to the Commission by the District of Columbia Corporation Counsel. It is a reasonable, and hence a permissible, interpretation. Even if other constructions

Federal Regulations, 47 C.F.R. § 31.-524, 18 C.F.R. § 101.454, 18 C.F.R. § 204.493; and 18 C.F.R. § 101.914, 18 C.F.R. § 204.914 (Supp.1967).

3. *See, e. g.*, Solomon v. Public Service Commission, 286 App.Div. 636, 146 N.Y.S.2d 439 (1955).

4. California Fireproof Storage Co. v. Brundige, 199 Cal. 185, 248 P. 669, 47 A.L.R. 811 (1926).

5. It should be noted that, as the Commission here points out, it too considers revenues from classified advertising as part of the Telephone Company's gross revenues in calculating the return the Company is entitled to from its basic telephone services. Consequently, the telephone rates of the general telephone-using public would increase if the advertising revenues were diminished.

6. For instance, the Pennsylvania statute, which also requires that "service" be interpreted broadly, has been construed not to give jurisdiction over advertising rates. Felix v. Pennsylvania Public Utility Commission, 187 Pa.Super. 578, 146 A. 2d 347 (1958); Steerman v. Bell Telephone Co. of Pennsylvania, 48 P.U.R. (n.s.) 83 (1943).

7. *See, e. g.*, Solomon v. Public Service Commission, *supra* Note 3; Frank v. New York Telephone Company, 34 Misc. 2d 395, 228 N.Y.S.2d 536 (1962). *See also* Videon Corporation v. Burton, Kansas City Ct.App., 369 S.W.2d 264 (1963), where the court held that the state commission did have jurisdiction where unreasonable discrimination among advertisers was alleged.

would also be reasonable, the Commission should be sustained. For "[w]hen faced with a problem of statutory construction, this Court shows great deference to the interpretation given the statute by the officers or agency charged with its administration. 'To sustain the Commission's application of this statutory term, we need not find that its construction is the only reasonable one, or even that it is the result we would have reached had the question arisen in the first instance in judicial proceedings.'" Udall v. Tallman, 380 U.S. 1, 16, 85 S.Ct. 792, 13 L.Ed.2d 616 (1965). This applies where, as here, the statutory question is one of jurisdiction. Philadelphia Television Broadcasting Co. v. F.C.C., 123 U.S.App.D.C. 298, 359 F.2d 282 (1966).

Affirmed.

PHILLIPS PETROLEUM COMPANY, Appellant,

v.

Edward J. BRENNER, United States Commissioner of Patents, Appellee.

PHILLIPS PETROLEUM COMPANY, Appellant,

v.

GOODRICH-GULF CHEMICALS, INC., and Monsanto Company, Appellees.

Nos. 20628, 20677.

United States Court of Appeals District of Columbia Circuit.

Argued May 12, 1967.

Decided June 29, 1967.

Petition for Rehearing Denied Aug. 16, 1967.

Action for decree declaring right of patent applicant to participate fully in interference proceeding, including portion restricted by Patent Office to the two competing applicants. The United States District Court for the District of Columbia, Alexander Holtzoff, J., 260 F.Supp. 45, dismissed the complaint on ground that the court should not interfere with pending proceeding in the patent office until it was brought to conclusion, and appeal was taken. The Court of Appeals, Leventhal, Circuit Judge, held that the action was premature in view of possibilities that applicant might prevail on its motion to dissolve interference proceeding, that competing applicants might acquiesce in review by Court of Customs and Patent Appeals, or that applicant might persuade Patent Office to extend its practice of withholding issuance of patent so as to avoid giving extra benefit to patentee who elects to require that appeal to Court of Customs and Patent Appeals be displaced by new action.

Affirmed.

1. Patents ⟹97

The Patent Office has authority to act in accordance with fundamental principles of justice by appropriate issuance and application of rules and use of good judgment on matters not covered by rules.

2. Patents ⟹113(1)

The Patent Office is subject to judicial review and restraint in case of arbitrary rules or rulings that infringe on private rights.

3. Patents ⟹114.3

Judicial review of Patent Office action in interference proceedings by civil action is available only to an applicant who has been finally denied a patent because of Patent Office decision against him and in favor of adversary on priority. 35 U.S.C.A. § 146.

4. Patents ⟹113(1), 114

Mere denial of motion to dissolve patent interference proceeding was interlocutory, and movant could neither protest that action directly by appeal to

Issue No. 3 did not find that Pam Wiley failed to stop before entering the intersection, the evidence conclusively shows that Pam Wiley failed to yield to the vehicle driven by John Browning.

[10] It is not erroneous for the court to assume facts that are conclusively established by the evidence. *Beaumont City Lines, Inc. v. Williams*, 221 S.W.2d 560, 563–564 (Tex.Civ.App.—Beaumont 1948, writ ref'd n.r.e.); *Collier v. Hill & Hill Exterminators*, 322 S.W.2d 329, 332 (Tex. Civ.App.—Houston 1959, no writ); 59 Tex. Jur.2d Trial § 490.

[11] Furthermore, even if the court erred in assuming that Pam Wiley failed to yield to the Browning vehicle in the submission of Special Issue No. 5, such error, if any, would be immaterial and harmless in view of the jury's answers to Special Issues 1 and 2. Appellants' sixth point is overruled.

The judgment of the trial court is affirmed.

KEY NUMBER SYSTEM

A-ABC APPLIANCE OF TEXAS, INC., et al., Appellants,

v.

SOUTHWESTERN BELL TELEPHONE COMPANY, Appellee.

No. 13953.

Court of Appeals of Texas, Austin.

April 25, 1984.

Rehearing Denied May 23, 1984.

Plaintiff brought action challenging telephone company's refusal to accept proposed advertising to be printed in classified directory. The 98th Judicial District Court, Travis County, Jon N. Wisser, J., entered judgment for defendant, and plaintiff appealed. The Court of Appeals, Earl W. Smith, J., held that: (1) defendant was not under a duty as a matter of law to accept plaintiff's proposed advertising; (2) plaintiff failed to show that defendant's advertising regulation was unreasonable or unnecessary; and (3) findings supported conclusion that defendant's denial of plaintiff's application was not arbitrary, capricious or discriminatory.

Affirmed.

1. Telecommunications ⇐269

Since sale of classified directory advertising in telephone directory was not a part of telephone company's public utility function, telephone company had no statutory or common-law duty to accept plaintiff's advertising. Vernon's Ann.Texas Civ.St. art. 1446c § 3(s).

2. Telecommunications ⇐264

Rules and regulations made by a telephone company for furnishing service to patrons and for conduct of its business are presumed to be reasonable and necessary, unless the contrary is shown.

3. Telecommunications ⇐269

Plaintiff failed to show that telephone company's regulations relating to classified directory advertising was unreasonable or unnecessary.

4. Appeal and Error ⇐931(5)

In a review of a trial court's judgment in which findings of fact and conclusions of law are filed, Court of Appeals may only consider, on a no evidence point, evidence favorable to findings and judgment rendered thereon and must disregard all evidence to the contrary.

5. Telecommunications ⇐284

Findings supported conclusion that telephone company's denial of plaintiff's application for classified directory advertising was not arbitrary, capricious or discriminatory.

Roger B. Greenberg, Jane Cooper-Hill, Richie & Greenberg, Houston, for appellants.

Donna Lynn Snyder, San Antonio, for appellee.

Before SHANNON, EARL W. SMITH and GAMMAGE, JJ.

EARL W. SMITH, Justice.

Appellant, A-ABC Appliance of Texas (A-ABC) seeks reversal of a trial court's judgment in favor of appellee Southwestern Bell Telephone Company (Bell). In a trial before the court A-ABC challenged Bell's refusal to accept its proposed advertising to be printed in the Austin Yellow Pages. We affirm the judgment of the trial court.

The president of A-ABC Appliance of Texas has operated a home appliance sales and service business in Houston, Texas since 1972 and advertised heavily under that name (and several others) in the Yellow Pages for many years. In 1981, appellant decided to expand its business to Austin and began by assuming an existing but abandoned telephone number which had been assigned to a defunct corporation named ABC Appliance. This enabled appellant to advertise under the ABC name until it had an opportunity to advertise under A-ABC Appliance of Texas, Inc., in the next regularly published Yellow Pages in December of 1982.

Appellant's president met with a Bell sales representative on June 25, 1982 to submit his proposed advertising under the names A-ABC Appliance and General Appliance, using the same phone number for both. On July 13, 1982 Bell informed appellant that it would not advertise the name A-ABC Appliance of Texas, Inc. in its Austin directories because the name violated Bell's advertising standards regarding names adopted for alphabetical preference in advertising. The name A-ABC Appliance of Texas, Inc. as well as other company names were accepted for the free listing in both the White and Yellow Pages.

[1] A-ABC's first point of error asserts that "appellee was under a duty as a matter of law to accept the proposed advertising, and the court's conclusions to the contrary (conclusions 4, 6, 9, 10, 11, and 12) are erroneous." We disagree. The conclusions appellant complains of are as follows

4. Defendant's directory advertising services are not rendered as a part of its public utility function.

* * * * * *

6. Defendant, Southwestern Bell Telephone Company, has no statutory nor common law duty to accept the advertising submitted by Plaintiffs.

* * * * * *

9. Pursuant to § 18 of the Public Utility Regulatory Act, Article 1446 Vernon's Annotated Statutes, the classified directory, except insofar as service regular listings which are furnished to business subscribers as a part of their regular business service are concerned, is an advertising medium and not a public service

10. Defendant in its role as a directory publisher has no duty not to discriminate against potential advertisers.

11. Defendant's duty to publish listings in its directories extends only to listings in the white pages and the service regular listings in the yellow pages, both of which are provided as part of basic business telephone service.

12. Defendant Southwestern Bell Telephone Company's provision of advertising services is not subject to the common law standards applicable to its provision of regulated communications services.

Appellant relies primarily on *Southwestern Bell Telephone Co. v. Texas State Optical*, 253 S.W.2d 877 (Tex.Civ.App.19 no writ) (hereinafter cited as *TSO*), to support its arguments about Bell's common law duties. While the case contains broad language, it is easily distinguishable on facts and, as regards advertising, is p empted by the Public Utility Regulatory Act. Tex.Rev.Civ.Stat.Ann. art. 1446c (1980). The court in *TSO* was dealing with Bell's duty to the public regarding the classified yellow pages *listings* not its *advertisements.*

The *TSO* case is not controlling since the Legislature enacted the Public Utility Regulatory Act [PURA] in 1975. Art. 1446c, *supra.* Finding that public utilities were monopolies in the areas they served, the Legislature passed the Act to "establish a comprehensive regulatory system ... adequate to the task of regulating public utilities ... to assure rates, operations and services which are just and reasonable to the consumers and the utilities." Art. 1446c § 2. Article 1446c § 3(s) provides:

> (s) "Service" is used in this Act in its broadest and most inclusive sense, and includes any and all acts done, rendered, or performed and any and all things furnished or supplied, and any and all facilities used, furnished, or supplied by public utilities in the performance of their duties under this Act to their patrons, employees, other public utilities, and the public, as well as the interchange of facilities between two or more of them. *Service shall not include the printing, distribution, or sale of advertising in telephone directories.*

(emphasis added). Thus the Legislature made it clear that not only would the Public Utility Commission not have jurisdiction over directory advertising but that such was *not* part of Bell's public service function.

Appellant argues that "[l]egislation does not necessarily abrogate the common law" citing *TSO* and *Southwestern Bell Telephone Co. v. Reeves,* 578 S.W.2d 795 (Tex. Civ.App.1979, writ ref'd n.r.e.). Reliance on these cases is misplaced since neither involves a situation such as this where it is clear that the Legislature intended to decide the exact issue in question.

The Legislature's exclusion of directory *advertising* from its definition of public service is in line with, as appellee argues, "the overwhelming weight of authority throughout the country ... that the publication of advertising in telephone directories is not an essential public service and is not a part of a telephone company's public utility business." *See Classified Directory Subscribers Association v. Public Service Comm.,* 383 F.2d 510, 512-13 (D.C.Cir. 1967); *McTighe v. New England Telephone & Telegraph Co.,* 216 F.2d 26 (2nd Cir.1954); *Berjian, D.O., Inc. v. Ohio Bell Telephone Co.,* 54 Ohio St.2d 147, 375 N.E.2d 410, 415 (1978); *Gas House, Inc. v. Southern Bell Telephone & Telegraph Co.,* 289 N.C. 175, 221 S.E.2d 499, 505 (1976); *Abco Moving & Storage Corp. v. New York Telephone Co.,* 193 Misc. 96, 83 N.Y.S.2d 448; aff'g 274 A.D. 779, 81 N.Y. S.2d 146; leave to appeal den'd, 273 A.D. 823, 81 N.Y.S.2d 457; aff'd. 298 N.Y. 637, 82 N.E.2d 32 (1948).

Bell does not have a monopoly on advertising and the Legislature has determined that its advertising is not part of its public service. Thus, Bell is free to contract in its private capacity as any other advertiser. In Texas, publishers are free to deal or decline to contract as they please. *Mid-West Electrical Cooperative v. West Texas Chamber of Commerce,* 369 S.W.2d 842, 843 (Tex.Civ.App.1963, no writ). *See also, Right of Publisher of Newspaper or Magazine, in Absence of Contractual Obligation, to Refuse Publication of Advertisement,* 18 A.L.R.3d 1286 (1968). The trial court correctly held that since the sale of classified directory advertising in Bell's telephone directory is not a part of appellee's public utility function, appellee has no statutory or common law duty to accept appellant's advertising. Appellant's first point of error is overruled.

In its point of error number two, appellant complains that conclusion of law number eight is erroneous and the findings of fact in support of it (18, 19, 50, 54, and 55) are "based on insufficient evidence and are against the great weight and preponderance of the evidence. The evidence proved that the standard is unreasonable as a matter of law."

Conclusion of law number eight is that:

Defendant's Yellow Page Advertising Standard No. 2, entitled "Listings Chosen for Alphabetical Preference in Advertising" is a reasonable exercise of Defendant's discretion concerning whether or not to accept a particular listing or name for inclusion in its Yellow Page directories.

The findings of fact that appellant complains of are as follows:

18. Defendant's "A" listing policy is necessary to protect the value of the Yellow Pages to both the consumer and the publisher by preventing the proliferation of "A" listings and which give unfair alphabetical preference in listings resulting in confusion to the consumer. Unchecked, "A" listings have proliferated and diminished the value of the Yellow Page Directory in terms of goodwill and return on the publisher's investment.

19. Defendant's "A" listing policy is a reasonable exercise of its discretion as a publisher to limit those listings which may cause confusion to the directory user and ultimately result in diminishing the value of the publisher's directory.

• • • • • •

50. The use of the name ABC Appliance by the Plaintiffs in their Yellow Page advertisements will not adversely affect Plaintiffs' effective competition as an appliance sales and service company.

• • • • • •

54. Plaintiffs will not be harmed by their advertising appearing as ABC Appliance in the Yellow Pages inasmuch as the names A-ABC and ABC Appliance are so similar.

55. There is substantially no difference between the names A-ABC Appliance and ABC Appliance such that the use of the name ABC Appliance in yellow page advertising would cause confusion in the mind of consumers.

[2, 3] Rules and regulations made by a telephone company for furnishing service to patrons and for the conduct of its bu ness are "presumed to be reasonable a necessary, unless the contrary is show *Southwestern Bell Telephone Company Rucker*, 537 S.W.2d 326, 331 (Tex.Civ.A 1976, writ ref'd n.r.e.) quoting *Kelly Southwestern Bell Telephone Compa* 248 S.W. 658 (Tex.Comm.App.1923, jdg adopted). Appellant has not shown t contrary.

[4] In a review of a trial court's ju ment in which findings of fact and conc sions of law are filed, this Court may o consider, on a no evidence point, that e dence favorable to the findings and t judgment rendered thereon and must dis gard all evidence to the contrary. *Ray Farmers' State Bank of Hart*, 576 S.W 607 (Tex.1979). Our review of only evidence supporting the judgment conv es us that the judgment rendered by trial court has ample support in the rec Furthermore, after reviewing all the dence, we are of the opinion that th findings are not so against the gr weight and preponderance of the evid as to be clearly unjust. *In re King's tate*, 150 Tex. 662, 244 S.W.2d 660 (1 Appellant's second point of error is o ruled.

A-ABC's third point of error compl that appellee's "A" listing policy is a trary and discriminatory as a matter law. Appellant relies on its argument Bell has a public service duty in this a not to discriminate. As noted above we not agree and this point is overruled.

[5] A-ABC's fourth point of error c lenges the court's conclusion of law n ber 7 and states that "the findings in s port thereof (findings of fact Nos. 40, and 65) are against the great weight preponderance of the evidence. The dence proved that the standard was un sonably and discriminatorily applied to pellant."

Conclusion of law number seven is follows: "Defendant's denial of Plaint application for advertising under nam A-ABC Appliance was neither arbitr capricious nor discriminatory." The findings of fact which A-ABC complains of are:

40. Plaintiffs' Application for Directory Advertising under the name A-ABC Appliance was rejected for inclusion in the 1982 Austin and Austin Northwest Directories because it is in contravention of Southwestern Bell's "A" listing policy inasmuch as the name A-ABC was chosen for alphabetical preference, and because its inclusion in the directories may result in confusion to users of the directoires [sic].

* * * * * *

42. The rejection of Plaintiffs' requested advertising was in accordance with Southwestern Bell Telephone Company's publishing standards and guidelines. Southwestern Bell Telephone Company's "A" listing standard which resulted in the rejection of advertising under the name A-ABC is reasonable and was applied in a nondiscriminatory manner.

* * * * * *

65. Plaintiff's "A" Listing Publishing Standard which resulted in the rejection of Plaintiffs' request for advertising under the name of A-ABC is reasonable and was properly applied to Plaintiffs' request for advertising.

Reviewing the evidence under the standards discussed above, we hold that appellant's third point of error should be, and is hereby overruled.

Judgment of the trial court is affirmed.

KEY NUMBER SYSTEM

Sheila Ann HOWARD, Appellant,

v.

Richard P. HOWARD, Appellee.

No. 04-83-00579-CV.

Court of Appeals of Texas,
San Antonio.

April 25, 1984.

Rehearing Denied May 24, 1984.

Following modification of stay of divorce proceeding by Bankruptcy Court, wife and attorney filed joint motion for new trial complaining of default judgment in favor of husband and filed petition for writ of error which challenged default judgment. The 288th District Court, Bexar County, Raul Rivera, J., ordered new trial, and husband filed motion to dismiss writ of error for want of jurisdiction. The Court of Appeals held that: (1) automatic stay imposed in bankruptcy proceeding suspended running of time limit within which motion for new trial must be filed, and (2) granting of motion for a new trial had effect of reinstating case so that there was no final judgment from which writ of error could be taken.

Writ of error dismissed.

1. Bankruptcy ⇐659(1.5)

Automatic stay imposed in bankruptcy proceedings pursuant to federal Bankruptcy Code suspends running of state time limits within which motion for new trial must be filed. Bankr.Code, 11 U.S.C.A. § 362; Vernon's Ann.Texas Rules Civ. Proc., Rule 329b.

2. Bankruptcy ⇐659.5(1)

Bankruptcy court, by lifting stay, necessarily determined that stay was in effect during previous proceedings.

3. Bankruptcy ⇐659(1.5)

Automatic stay provision of federal Bankruptcy Code halts pending judicial proceedings involving debtor. Bankr.Code, 11 U.S.C.A. §§ 362, 362(a)(1).

549 P.2d 903 printed in FULL format.

Frank Wille d/b/a Frank Wille Company and Frank Wille's Coleman Comfort Center, Appellant, v. Southwestern Bell Telephone Company, Appellee

No. 47,986

Supreme Court of Kansas

219 Kan. 755; 549 P.2d 903; 19 U.C.C. Rep. Serv. (Callaghan) 447

May 8, 1976, Opinion Filed

PRIOR HISTORY:
Appeal from Sedgwick District Court, division No. 2; Howard C. Kline, Judge.

DISPOSITION: Affirmed.

SYLLABUS: SYLLABUS BY THE COURT

Contracts -- Advertising in Yellow Pages -- Limits on Company's Liability -- Public Policy Not Violated. In an action by an advertiser against a telephone company for damages by reason of an omission of advertising contracted for in the yellow pages directory, it is held that under the particular circumstances the contract which limited the company's liability for errors and omissions to an amount equal to the cost of the advertising was not unconscionable and contrary to public policy.

COUNSEL: Charles E. Cole, Jr., of Foulston, Siefkin, Powers and Eberhardt, of Wichita, argued the cause, and Robert C. Foulston of the same firm was with him on the brief for the appellant.

Durward D. Dupre, of Topeka, argued the cause, and T. Larry Barnes and Rober A. Lewis, both of Topeka, were with him on the brief for the appellee.
JUDGES: The opinion of the court was delivered by Harman, C.

OPINIONBY: HARMAN

OPINION: [*755] [**904] This appeal presents the question whether an advertiser can recover damages for negligence or breach of contract from a telephone company for an omission in the yellow pages of a telephone directory when the contract entered into by the parties limits the company's liability fo: errors and omissions to an amount equal to the cost of the advertisement. The trial court granted summary judgment for the telephone company and the advertiser has appealed.

The facts, as revealed by the pleadings and appellant's deposition, are undisputed. Appellant Frank Wille operates a heating and air conditioning sale: and service business in Wichita under the trade names, Frank Wille Company and Frank Wille's Coleman Comfort Center, and for the thirteen years prior to 1974 had purchased some form of yellow page listing for his business in the telephon directory published by appellee Southwestern Bell Telephone Company for the Wichita district.

In February, 1974, a sales representative for Bell contacted appellant to discuss his yellow page listings in the directory to be published in July, 1974 As a result appellant agreed to purchase certain listings for both of his business trade names. Appellant [*756] received a copy of the written contract which was executed. At this time appellant's business was located at 1633 East Second street and his business phone numbers were 265-2609 and 265-7231.

In April, 1974, appellant contacted Bell regarding changing his telephone service to a new business location at 1909 East Central street and expanding hi service through additional rotary or sequential telephone numbers. Appellant was advised numbers were not available to him to expand his present numbers sequentially. Hence he decided to subscribe to a new [**905] number, 265-4685, in order to have additional telephone lines available for his busines in sequential numbers. As part of this decision appellant cancelled the phone service to him under the number 265-7231. However, because his other telephone number, 265-2609, was displayed on some equipment previously sold, appellant decided to retain that service in the yellow pages but not in the white.

In July, 1974, Bell distributed the new directory. Certain of appellant's yellow page listings under various headings for the business name Frank Wille's Coleman Comfort Center and telephone number 265-2609 were omitted. The yellow page advertising sold in February, 1974, applicable to the Frank Wille Company, phone number 265-7231, appeared in the directory. That advertising listed appellant's new address, 1909 East Central, and the new telephone number, 265-4685. Upon learning of the omission appellant began advertising his business on local television stations and in alternate forms of advertising, with total expenditures being between four and five thousand dollars.

Appellant was never billed nor has he paid for the omitted listings. The written contract between the parties was subject to thirteen terms and conditions which were set out on the back of the contract. The fourth paragrap of those conditions provided:

"The applicant agrees that the Telephone Company shall not be liable for errors in or omissions of the directory advertising beyond the amount paid for the directory advertising omitted, or in which errors occur, for the issue life of the directory involved."

Appellant filed this action October 24, 1974, alleging breach of contract an negligence by Bell in the omission. Damages were sought in the amount of $ 9,990 for lost profits and expense for alternative advertising.

The trial court entered summary judgment for Bell because of the contractual limitation of liability for errors and omissions and the matter is now here for review.

[*757] Appellant contends the exculpatory clause upon which appellee relie is contrary to public policy and should not be enforced. He asserts unconscionability of contract in two respects: The parties' unequal bargaining position and the form of the contract and the circumstances of its execution.

American courts have traditionally taken the view that competent adults may make contracts on their own terms, provided they are neither illegal nor contrary to public policy, and that in the absence of fraud, mistake or duress party who has fairly and voluntarily entered into such a contract is bound thereby, notwithstanding it was unwise or disadvantageous to him (Anno.: Sales -- "Unconscionability", 18 ALR 3d 1305, @ 2, p. 1307). Gradually, however, th. principle of freedom of contract has been qualified by the courts as they were confronted by contracts so one-sided that no fair minded person would view the as just or tolerable. An early definition of unconscionability was provided b Lord Chancellor Hardwicke, in the case of Chesterfiield (Earl of) v. Janssen, 2 Ves. Sen. 125, 28 Eng. Rep. 82 (1750):

". . . [a contract] such as no man in his senses and not under delusion wou make on the one hand, and as no honest and fair man would accept on the other; which are unequitable and unconscientious bargains; and of such even the commo law has taken notice. . . ." (p. 100.) (Discussed in Hume v. United States, 1 U.S. 406, 411-413, 33 L. ed. 393, 10 S. Ct. 134 [1889].)

The doctrine was first applied by early equity and some common law courts in cases which approached clear fraud. (See a discussion of these cases in the Anno.: 18 ALR 3d, @ 3, p. 1309.)

The doctrine, however, received its greatest impetus when it was enacted as [**906] a part of the Uniform Commercial Code. K. S. A. 84-2-302 provides i part that:

"(1) If the court as a matter of law finds the contract or any clause of th contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result. . . ."

(The doctrine of unconscionability in the area of private contract has come into our Kansas law by three other recent enactments: K. S. A. 16a-5-108, Uniform Consumer Credit Code; K. S. A. 1975 Supp. 50-627, Consumer Protection Act; and K. S. A. 1975 Supp. 58-2544, Residential Landlord and Tenant Act.)

Although the UCC's application is primarily limited to contracts for the present or future sale of goods (K. S. A. 84-2-102; 84-2-105), [*758] many courts have extended the statute by analogy into other areas of the law or have used the doctrine as an alternative basis for their holdings (Leff, "Unconscionability and the Code -- The Emperor's New Clause", 115 U. Pa. L. Rev 485). The UCC neither defines the concept of unconscionability nor provides the elements or perimeters of the doctrine. Perhaps this was the real intent of th drafters of the code. To define the doctrine is to limit its application, and to limit its application is to defeat its purpose. (Note, "The Doctrine of Unconscionability", 19 Maine L. Rev. 81, 85.)

The comment to K. S. A. 84-2-302 sheds some light on the drafters' intent. It provides in part:

". . . The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clause involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. . . . The principle is one of the prevention of oppression and unfair surprise . . . and not of disturbance of allocation of risks because of superior bargaining power. . . .

One commentator has elaborated on the two types of situations which UCC is designed to deal with:

". . . One type of situation is that involving unfair surprise: where there has actually been no assent to the terms of the contract. Contracts involving unfair surprise are similar to contracts of adhesion. Most often these contracts involve a party whose circumstances, perhaps his inexperience or ignorance, when compared with the circumstances of the other party, make his knowing assent to the fine print terms fictional. Courts have often found in these circumstances an absence of a meaningful bargain. [See Henningsen v. Bloomfield Motors, Inc., 32 N. J. 358, 161 A. 2d 69 (1960).]

"The other situation is that involving oppression: where, although there has been actual assent, the agreement, surrounding facts, and relative bargaining positions of the parties indicate the possibility of gross over-reaching on the part of either party. Oppression and economic duress in a contract seem to be inseparably linked to an inequality of bargaining power. The economic position of the parties is such that one becomes vulnerable to a grossly unequal bargain." (19 Maine L. Rev., supra, pp. 82-83.)

(Accord: Spanogle, "Analyzing Unconscionability Problems", 117 U. Pa. L. Rev 931.)

Although the doctrine of unconscionability is difficult to define precisely courts have identified a number of factors or elements as aids for determining its applicability to a given set of facts. These factors include: (1) The use of printed form or boilerplate contracts drawn skillfully by the party in the strongest economic position, which establish industry wide [**907] standard offered on a take it or [*759] leave it basis to the party in a weaker economic position (Henningsen v. Bloomfield Motors, Inc., supra; Campbell Soup Co. v. Wentz, 172 F. 2d 80); (2) a significant cost-price disparity or excessiv price; (3) a denial of basic rights and remedies to a buyer of consumer goods (Williams v. Walker-Thomas Furniture Company, 350 F. 2d 445; 18 ALR 3d 1305); (4) the inclusion of penalty clauses; (5) the circumstances surrounding the execution of the contract, including its commercial setting, its purpose and actual effect (In re Elkins-Dell Manufacturing Company, 253 F. Supp. 864, [E. D Pa.]); (6) the hiding of clauses which are disadvantageous to one party in a mass of fine print trivia or in places which are inconspicuous to the party signing the contract (Henningsen v. Bloomfield Motors, Inc., supra); (7) phrasing clauses in language that is incomprehensible to a layman or that diver his attention from the problems raised by them or the rights given up through them; (8) an overall imbalance in the obligations and rights imposed by the bargain; (9) exploitation of the underprivileged, unsophisticated, uneducated and the illiterate (Williams v. Walker-Thomas Furniture Company, supra); and (10) inequality of bargaining or economic power. (See also Ellinghaus, "In Defense of Unconscionability", 78 Yale L. J. 757; 1 Anderson on the UCC, @ 2-302, and cases cited therein.)

Important to this case is the concept of inequality of bargaining power. The UCC does not require that there be complete equality of bargaining power or that the agreement be equally beneficial to both parties (1 Anderson, @ 2-302:11, p. 401). As has been pointed out:

"[The language of the comment to @ 2-302 means] . . . that mere disparity o: bargaining strength, without more, is not enough to make out a case of unconscionability. Just because the contract I signed was proffered to me by Almighty Monopoly Incorporated does not mean that I may subsequently argue exemption from any or all obligation: at the very least, some element of deception or substantive unfairness must presumably be shown." (78 Yale L. J., supra, pp. 766-767.)

The cases seem to support the view that there must be additional factors suc as deceptive bargaining conduct as well as unequal bargaining power to render the contract between the parties unconscionable. In summary, the doctrine of unconscionability is used by the courts to police the excesses of certain parties who abuse their right to contract freely. It is directed against one-sided, oppressive and unfairly surprising contracts, and not against the consequences [*760] per se of uneven bargaining power or even a simple oldfashioned bad bargain (1 Anderson, supra, @ 2-302.11, p. 401).

The most recent application of the common law doctrine of unconscionability in Kansas occurred in Steele v. J. I. Case Co., 197 Kan. 554, 419 P. 2d 902. There the plaintiff, a large scale wheat and barley farmer, purchased from defendant three combines which were delivered shortly before harvest. The sal were evidenced by form contracts furnished by defendant. According to the ter on the reverse side of the contract, defendant warranted its equipment to be properly made and capable of performing the work for which it was designed und ordinary conditions. The contract further provided that should defendant's product fail to operate as warranted, written notice of the problem should be given to defendant's dealer. If the dealer failed to correct the deficiencies then defendant was to be given a reasonable time to remedy the defect or advis its local dealer of the appropriate remedy. In the event, however, defendant was not able to remedy the defect, then, according to the contract terms, defendant had the option either of replacing the equipment or rescinding the sales contract by returning the purchase price. The contract excluded [**908] all other express, implied or statutory warranties, and limited defendant's liability for any breach of the contract's express warranties to returning the purchase price of its product.

Immediately after the combines were delivered to plaintiff, he began having numerous difficulties. Complaints were made of these deficiencies, and severa attempts were undertaken by defendant to correct them. After repeated attempt by defendant to remedy the defects failed, plaintiff made several demands for return of the purchase price. Each of plaintiff's demands was refused. Thereafter, plaintiff agreed to trade in the defective combines, and pay the difference for three new 1961 Case combines, which were subsequently delivered to him.

Plaintiff brought suit to recover for damages to his crops caused by the delay incident to defendant's numerous attempts to correct the deficiencies in the combines initially purchased. The matter was tried to a jury which returne a verdict in plaintiff's favor. Judgment was entered on that verdict, and defendant appealed.

The trial court instructed the jury to disregard the contractual proviso limiting defendant's liability to any breach of its warranty to the return of the purchase price. Defendant Case maintained the broad accepted freedom of contract policy should control. In [*761] affirming the judgment we noted the disparity of position in the contracting parties in that the plaintiff had no part in the preparation of the printed form contract, the plaintiff lacked knowledge of the exculpatory clause and further that defendant knew of the special business needs of plaintiff and their urgency and despite this knowledg was dilatory in making amends either by timely repair of the combines, their replacement or return of the purchase price. Within this framework, we held th exculpatory clause in the contract was void, saying:

"Liability for consequential or special damages may be limited or excluded t the terms of a warranty unless, under all the surrounding facts and circumstances, the limitation or exclusion would prove to be inequitable." (Syl para. 4.)

Clearly there were other factors present in Steele besides mere disparity of bargaining power which resulted in the ruling. Also to be noted is the fact th contract called for equipment to be used for a specific purpose -- harvesting grain -- the breach of which would cause the farmer to lose everything he had invested in that grain crop. This latter factor presents a different situation from that of the advertiser who is no worse off by reason of an omission of his ad in the yellow pages than if he had made no contract at all.

We have never dealt with contractual limitation of liability for errors and omissions in the yellow pages directory but many courts have. One case on the subject, relied upon heavily by appellant, is Allen v. Mich. Bell Telephone Co. 18 Mich. App. 632, 171 N. W. 2d 689. In a factual situation essentially identical to that here the court declined to give effect to the limitation of liability clause principally on the basis of unconscionability by reason of the inequal positions of the parties in bargaining for services for which no realistic alternative was available.

All other courts which have considered the matter, so far as we can ascertain, have reached a contrary conclusion, that is, a telephone company may by contract limit the amount of its liability resulting from omissions and mistakes in the yellow pages directory so long as it does not seek immunity frc gross negligence or wilful misconduct (see Gas House, Inc. v. Southern Bell Tel & Tel. Co., 289 N. C. 175, 221 S. E. 2d 499, and cases from fourteen other jurisdictions cited therein [221 S. E. 2d 504]; also Anno.: Telephone Directory -- Mistake -- Omission, 92 ALR 2d 919).

In Gas House, Inc. the North Carolina supreme court had this to say on the subject:

[*762] "The general principle governing the validity of contracts against the charge that they are unreasonable is thus stated [**909] in 14 Willistc on Contracts, 3d Ed., @ 1632:

"'People should be entitled to contract on their own terms without the indulgence of paternalism by courts in the alleviation of one side or another from the effects of a bad bargain. Also, they should be permitted to enter int contracts that actually may be unreasonable or which may lead to hardship on or side. It is only where it turns out that one side or the other is to be penalized by the enforcement of the terms of a contract so unconscionable that no decent, fairminded person would view the ensuing result without being possessed of a profound sense of injustice, that equity will deny the use of it good offices in the enforcement of such unconscionability."'

"The leading case on the question of the validity of such a Limitation of Liability Clause in a contract for telephone directory advertising is McTighe v New England Tel. & Tel. Co., supra where Circuit Judge Medina, speaking for the Court of Appeals for the Second Circuit, said:

"'The publication of the classified directory [i. e., the 'yellow pages'] * * is wholly a matter of private contract and contracts relating thereto are not required to be filed with the Public Service Commission [of Vermont] which has no jurisdiction except over matters relating to the public utility services rendered by the company and the rates relative thereto.

. . .

"'True it is that the courts will scrutinize with care clauses exonerating public utility companies, such as railroads, telegraph and telephone companies and others, from liability for the consequences of their own negligence, with reference to the public services rendered by them. The fact that the member of the public patronizing such public utility companies must take the contract proffered by the company or forego using the service has enabled the courts to inquire into the reasonableness of the type of clause now under discussion and by this test the clause applicable to the alphabetical [i. e., white pages] directory would as a matter of contract law be considered unreasonable and unenforceable. But the principle which enables courts to strike down and condemn clauses affecting the performance by the company of its functions as a public utility is limited to the area in which the public services are rendered and has no application whatever to the domain in which the public utility may freely contract in its private capacity. The obtaining of the services of the public utility by way of transportation or communications or providing gas or electricity is quite apart from the leases, advertising contracts and a host of other miscellaneous agreements commonly made by members of the public with public utility companies. If there be some disparity in the bargaining power o the contracting parties it is no more than may be found generally to exist; and the courts follow the general rule that the parties are free to contract according to their own judgment and the reasonableness of their engagements wil not be entered into.' (Emphasis added.)

"The reason for the rule that a common carrier, or other public utility, may not contract away its liability for negligence in the performance of its public utility service and may not claim the benefit of an unreasonable contract [*763] limiting the amount of its liability therefor, is that every member of the public is entitled by law to demand such service with full liability as a reasonable rate therefor. For the company to refuse to serve unless the customer agrees to release it from liability for its negligent performance of its obligation to serve would be a denial of this legal right in the would-be customer. Thus, such a contract limiting the liability of the carrier, or othe public utility, unless reasonable, is contrary [**910] to public policy and invalid. This limitation upon the right of the common carrier, or other public utility, to contract applies, however, only to its undertakings to render services which fall within its public service business. For example, a telephone company leasing office space to a tenant, or an electric power compan selling an electric stove, is free to contract with reference to those matters as is any other owner of a building or dealer in electric stoves. The business of carrying advertisements in the yellow pages of its directory is not part of telephone company's public utility business.

"The inequality of bargaining power between the telephone company and the businessman desiring to advertise in the yellow pages of the directory is more apparent than real. It is not different from that which exists in any other case in which a potential seller is the only supplier of the particular article or service desired. There are many other modes of advertising to which the businessman may turn if the contract offered him by the telephone company is nc attractive.

"We find in this record no basis for a conclusion that the application of th Limitation of Liability Clause could lead to a result so unreasonable as to shock the conscience. In the absence of most exceptional circumstances, which do not appear in this record, the insertion of a 'Yellow Page' advertisement under the wrong classification heading will not produce a different result fror that which would follow a complete omission of the advertisement from the directory. It would be virtually, if not completely, impossible to determine what portion of the business done by an advertiser is attributable to its use c 'Yellow Page' advertising. There are many factors which enter into periodic fluctuations in the volume of business done by a seller of goods. The purpose of the Limitation of Liability Clause is to protect the telephone company from the danger of verdicts primarily speculative in amount. This is not an unreasonable objective. In this respect, the telephone company is not in a different position from the local newspaper, radio or television station, or other advertising media." (221 S. E. 2d 504-505.)

Appellant here attacks the limitation of liability clause in several respects. He says it was buried in a number of other terms and conditions of the same size print on the reverse side of the contract from where the parties sign and that the particular proviso was not effectively brought home to him at the time he signed. He in effect asserts unfair surprise.

The front page of the contract provides space for setting out the name or style of the business and other essential data in connection with the listings covered. In two different places attention is directed to the terms and conditions contained on the reverse [*764] side of the contract, one at the top of the form and the other in block letters immediately above the signature line for the purchaser. The latter states:

"THE APPLICANT HEREBY REQUESTS THE TELEPHONE COMPANY TO INSERT THE ABOVE ITEMS OF ADVERTISING IN THE ABOVE NAMED DIRECTORY SUBJECT TO THE TERMS AND CONDITIONS ON THE REVERSE SIDE HEREOF."

The terms and conditions on the reverse side are set out in clearly legible type in thirteen numbered paragraphs, and are written in common words. It cannot be said they are one-sided. Some are for the protection of and inure to the benefit of the advertiser. The language of the challenged paragraph 4 is not couched in confusing terms designed to capitalize on carelessness but is clear and concise. Appellant did testify he had not attempted to read the various terms and conditions listed on the reverse side of the contract. He wa an experienced businessman and for at least thirteen years had used the yellow pages. In his business it is reasonable to [**911] assume he as seller and serviceman had become familiar with printed form contracts that are frequently used in connection with the sale and servicing of heating and air conditioning equipment and their attendant warranties and limitations of liability. And, as pointed out in Gas House, Inc. v. Southern Bell Tel. & Tel. Co., supra, and in several other cases cited therein, yellow pages are not a unique or monopolistic form of advertising. Numerous alternative forms exist.

There is no indication here either of gross negligence or wilful or wanton conduct in the omission of appellant's listing and he asserts nothing beyond simple neglect. It appears the omissions arose from clerical error in the handling of appellant's request for changes after the original contract.

In Steele v. J. I. Case Co., supra, we recognized that liability for consequential damages may be limited or excluded contractually unless under all the surrounding facts and circumstances, the limitation or exclusion would be inequitable (Syl. para. 4). Each case of this type must necessarily rest upon its own facts but after examining the terms of the contract, the manner of its execution and the knowledge and experience of appellant we think the contract was neither inequitable nor unconscionable so as to deny its enforcement.

Our conclusion that the trial court ruled correctly is not affected by anything said in Milling Co. v. Postal Telegraph Co., 101 Kan. 307, [*765] 166 Pac. 493. There this court held that a telegraph company could not by contract limit its liability for negligence in transmitting telegraphic messages. The contract limitation was sought to be applied to the public duty of the company -- the transmission of messages -- and not to a matter of privat contract in an area of private service as here. The court did recognize that not all contracts against liability are void.

The judgment is affirmed.

Approved by the court.

MacArthur much less attractive. Adverse effects on municipalities and taxpayers can be expected. But power to rectify priorities lies with Congress and to create warranties with the New York Legislature.

The motion for summary judgment of the County, Town, Village and School District against the cross claimants is granted.

So ordered.

ROBINSON INSURANCE & REAL ESTATE INC., Plaintiff,

v.

SOUTHWESTERN BELL TELEPHONE CO., Defendant.

Civ. No. FS-71-C-83.

United States District Court,
W. D. Arkansas,
Fort Smith Division.

Aug. 27, 1973.

Breach of contract suit by an Arkansas real estate corporation against a telephone company to recover for loss of profits allegedly resulting from defendant's failure to publish certain listings and advertising plaintiff contracted for in defendant's telephone directory. The District Court, Paul X Williams, J., held that exculpatory clause stating that "the applicant agrees that the Telephone Company shall not be liable for errors or omissions in directory advertising beyond the amount paid for the item or items omitted, or in which errors occur, for the issue life of the directory involved" was not unconscionable, that evidence established that telephone directory omission of advertising contracted for was caused by simple clerical error, not constituting gross negligence or willful and wanton misconduct, and that such exculpatory clause was a limitation provision, and, therefore, enforceable irrespective of relationship between limit and actual probable damage.

Judgment accordingly.

1. Telecommunications ⇨280

Exculpatory clause, in contract between real estate company and telephone company for yellow page advertising and bold face listings in white pages, stating that "the applicant agrees that the Telephone Company shall not be liable for errors or omissions in directory advertising beyond the amount paid for the item or items omitted, or in which errors occur, for the issue life of the directory involved" was not unconscionable, but rather was a valid limitation of liability within universally accepted and applied rule permitting parties to freely contract concerning their responsibilities arising from a breach.

2. Telecommunications ⇨280

Ordinary negligence would not be sufficient to overcome exculpatory clause, in contract between real estate company and telephone company for yellow page advertising and bold face listings in white pages, stating that "the applicant agrees that the Telephone Company shall not be liable for the item or items omitted, or in which errors occur, for the issue life of the directory involved."

3. Telecommunications ⇨280

Exculpatory clause, in contract between real estate company and telephone company for yellow page advertising and bold face listings in white pages, stating that "the applicant agrees that the Telephone Company shall not be liable for errors or omissions in directory advertising beyond the amount paid for the item or items omitted, or in which errors occur, for the issue life of the directory involved" could not stand in face of willful and wanton misconduct or negligence.

4. Negligence ⇨12

"Gross negligence" is failure to observe even slight care; it is carelessness or recklessness to a degree that shows utter indifference to consequences that may result.

See publication Words and Phrases for other judicial constructions and definitions.

5. Negligence ⚖11, 13

Willful and wanton misconduct goes beyond gross negligence in that the party must be aware of the fact that his conduct will probably result in injury; element of willfulness is absent in gross negligence.

6. Telecommunications ⚖284

Evidence established that telephone directory omission of advertising contracted for was caused by simple clerical error, not constituting gross negligence or willful and wanton misconduct.

7. Telecommunications ⚖280

Exculpatory clause, in contract between real estate company and telephone company for yellow page advertising and bold face listings in white pages, stating that "the applicant agrees that the Telephone Company shall not be liable for errors or omissions in directory advertising beyond the amount paid for the item or items omitted, or in which errors occur, for the issue life of the directory involved" was a limitation provision, and, therefore, enforceable irrespective of relationship between limit and actual probable damage.

Robert T. Dawson of Hardin, Jesson & Dawson, Fort Smith, Ark., and Ralph Robinson, Van Buren, Ark., for plaintiff.

Douglas O. Smith, Jr., of Warner, Warner, Ragon & Smith, Fort Smith, Ark., and Donald K. King and Ronald T. LeMay, Little Rock, Ark., for defendant.

MEMORANDUM OPINION

PAUL X WILLIAMS, District Judge.

Plaintiff is an Arkansas corporation. Prior to May of 1969, Earl Robinson had been in the insurance business for approximately 20 years in Van Buren, Arkansas. He had also been in the real estate business for most of this period. In May of 1969, Robinson and his associate, Robert Bell, incorporated under the name of Robinson Insurance and Real Estate, Inc.

Defendant, Southwestern Bell Telephone Co., a Missouri corporation, is engaged in the provision of local and long distance telecommunications service in Arkansas and other states. In connection with its business it publishes telephone directories for its service areas. These directories consist of two sections, the alphabetical section or white pages, and the classified section or Yellow Pages. Publication of the alphabetical section is mandated by the Arkansas Public Service Commission. There is no similar requirement regarding the Yellow Pages. Defendant, with respect to this activity, is engaged in a private business enterprise as opposed to a public service offering. Associated Mechanical Contractors of Ark. v. Ark. La. Gas Co., 225 Ark. 424, 283 S.W.2d 123 (1955).

This is a Breach of Contract suit to recover for loss of profits allegedly resulting from defendant's failure to publish certain listings and advertising plaintiff contracted for in defendant's 1970 Fort Smith-Van Buren, Arkansas, telephone directory.

On March 19, 1970, Mr. Robert Bell, acting for plaintiff, and Mr. Tom Ogden, defendant's directory representative, entered into a written contract for Yellow Page advertising and bold face listings in the white pages. The items ordered included a two inch Yellow Page ad, two Yellow Page trade-mark listings, two white page bold face listings and a Yellow Page bold face listing. The total charges for the items amounted to \$14.40 per month or a total of \$172.80 for the 12 month life of the directory.

In June 1970 when the Fort Smith-Van Buren directory was distributed, plaintiff discovered that its advertising was omitted and thereafter filed this action. In its answer, defendant admitted plaintiff's advertising was omitted. Defendant further admitted liability up to the sum of $172.80 and moved to dismiss plaintiff's action for all sums above that amount based on the following exculpatory clause contained in the parties' contract:

> "4. The applicant agrees that the Telephone Company shall not be liable for errors or omissions in directory advertising beyond the amount paid for the item or items omitted, or in which errors occur, for the issue life of the directory involved."

Plaintiff then amended its complaint alleging that the omissions were the result of defendant's intentional wrongdoing or "gross negligence." Defendant in answering plaintiff's amended complaint and in its trial briefs agrees that the limitation clause contained in the parties' contract does not afford protection in the case of intentional wrongdoing or perhaps gross negligence but denies that such occurred.

Plaintiff's position at trial and in its trial brief is a three-fold one. First, plaintiff contends the limitation clause is unenforceable as being contrary to public policy or in modern parlance, "unconscionable." Secondly, it contends that ordinary negligence alone will overcome the limitation or, in the alternative, that gross misconduct in the form of wilful and wanton misconduct or gross negligence has been proved. Thirdly, plaintiff contends that the clause is an unenforceable liquidated damages clause because the limit set is grossly disproportionate to the probable actual damages resulting from the breach. Plaintiff's contentions will be considered *seriatim*.

Plaintiff contends that the limitation clause is unconscionable and should be disregarded since it is contained in a form contract entered into by parties in disparate bargaining positions. In support of this contention, plaintiff cites Allen v. Michigan Tel. Co., 18 Mich.App. 632, 171 N.W.2d 689 (1969). The Michigan appellate court in Allen held exculpatory language similar to that contained in the instant contract to be unconscionable and, consequently, unenforceable. The Michigan court relied upon what it perceived to be the monopolistic character of Yellow Pages and the disparity of bargaining power between the parties to the contract.

The unconscionability argument is not a novel one in telephone directory cases. The first reported case considering such an argument is McTighe v. New England Tel. & Tel. Co., 216 F.2d 26 (2d Cir. 1954). In *McTighe*, Judge Medina speaking for the Second Circuit, commented on the unconscionability argument as follows at page 28:

> "But the principle which enables courts to strike down and condemn clauses affecting the performance by the company of its functions as a public utility is limited to the area in which the public services are rendered and has no application whatever to the domain in which the public utility may freely contract in its private capacity. The obtaining of the services of the public utility by way of transportation or communications or providing gas or electricity is quite apart from the leases, advertising contracts and a host of other miscellaneous agreements commonly made by members of the public with public utility companies. If there be some disparity in the bargaining power of the contracting parties it is no more than may be found generally to exist; and the courts follow the general rule that the parties are free to contract according to their own judgment and the reasonableness of their engagements will not be entered into."

The same argument was advanced in Georges v. Pacific Tel. & Tel. Co., 184 F.Supp. 571 (U.S.D.C.Or.1960) to which the Court responded:

> "Now, what can this Court say the Oregon Supreme Court would do if they were dealing not with a business affected by the public interest but was merely engaging in its own pri-

vate capacity? Would the Oregon Supreme Court say that notwithstanding the firm and universal rule of private contracts that parties are not bound by them? That the telephone companies hold a virtual monopoly and, therefore, any member of the public wishing to have any service from them, even though it was in their private capacity, must take it or leave it, and that such is against public policy? I do not think the Oregon Supreme Court would so overrule the basic concepts of contract law that are reiterated so plainly by the Second Circuit in McTighe.

"I would anticipate that the Oregon Supreme Court would say that if such be an evil it is a matter for the Legislature and not for the judiciary. So, it is the conclusion that the contract involved in this case is merely a contract on behalf of the plaintiff's business for advertising space in the Telephone Company's directory, particularly the yellow pages thereof, which is nothing more than a business venture engaged upon by the telephone people in their own private capacity. I am forced to follow the rule of the Second Circuit case." 184 F.Supp. 571, 578.

Allen represents a departure from the majority view recognizing freedom to contract, is based upon faulty notions of the public interest, and is not in keeping with commercial realities. This Court prefers to follow *McTighe* and *Georges*. Yellow Pages is but one form of advertising. It is in no way unique or monopolistic. Numerous alternative advertising forums exist. Moreover, the disparity of bargaining power claimed to exist in the instant case is no more than is generally found to exist in commercial transactions. The Court perceives its responsibility to strike down such a clause to arise only upon a clear showing of palpable unfair and overreaching language or conduct on the part of the defendant. The present clause represents nothing more than an application of a basic concept of contract law which r ognizes the propriety of parties c tracting to limit their liability. T viewpoint was recently adopted by Supreme Court of Montana in the c of State ex rel. Mountain States Tel. Tel. Co. v. District Court, 503 P.2d (Mont.1972). Therein, the Court st ed:

> The monopolistic character of the y low pages which the Michigan Co (Allen) decries as resulting in meaningful choice or no competing ternate, except at a prohibitive disp portionate cost, is not exactly, as h been discussed, a one way street, pa ticularly when one considers furth that by the Michigan Court's own de inition the service is desirable and a more reasonable cost than "mark place" advertising. It necessarily f lows that in some cases it may appe harsh at times but not unconscionab The mere fact of claimed unequal ba gaining position does not render it in today's world of commerce, whe situations of this nature are not u common. McAlear v. Saint Paul I surance Companies, 158 Mont. 45 493 P.2d 331
>
> * * * * * *
>
> Without a demonstration of bad faith fraud, or willful or wanton conduct b Mountain States, a limitation of liabi ity for errors and omissions in its ad vertising expressed in a written an signed contract is reasonable and no wise against public policy and it is within the power of the company and subscribers to its directory to make such contracts and they become a valid and binding limitation. 503 P.2d 530, 531

This precise issue has not been decided by the Arkansas Supreme Court. However, Arkansas law respecting the propriety of judicial interference with private contractual obligations on public policy grounds is well settled and clearly stated in the case of Sirman v. Sloss Realty Co., 198 Ark. 534, 129 S.W.2d 602

(1939), wherein the Arkansas Court stated *inter alia:*

> "The power of the courts to declare a contract void for being in contravention of sound public policy is a very delicate and undefined power, and like the power to declare a statute unconstitutional, should be exercised only in cases free from doubt."

The instant case clearly does not meet the exacting standard set by *Sirman* for justifying judicial abrogation of such clauses.

[1] The Uniform Commercial Code provision relied upon by plaintiff (*i. e.*, Ark.Stats.Ann. 85–2–106) is specifically inapplicable since it applies only to contracts for "the present or future sale of goods." The U.C.C. was legislatively enacted to cope with specific commercial needs. Its provisions should not be extended outside the context of such commercial needs. Consequently, we conclude that the clause contained in plaintiff's contract is not unconscionable, but rather, it is a valid limitation of liability within the universally accepted and applied rule permitting parties to freely contract concerning their responsibilities arising from a breach. 57 Am.Jur.2d Negligence § 23.

[2] With respect to plaintiff's second argument, the authorities are in accord that ordinary negligence is not sufficient to overcome a telephone directory advertising contract limitation like the one in the instant case.[3] The Oklahoma Federal District Court's decision in Wheeler Stuckey, Inc. v. Southwestern Bell Telephone Company, 279 F.Supp. 712 at 714 (U.S.D.C.Okl.1967) is representative of the holdings in the 14 states that have decided this issue.

> "The Court is further of the opinion that the telephone company may, by contractual stipulation, or by general exchange tariff, rules and regulations applying to all customer's contracts, which are on file and approved by the Oklahoma Corporation Commission limit the amount of its liability for injuries resulting from omissions and mistakes, both in the listings and the advertising portions of its telephone directory, so long as it does not seek immunity from gross negligence or wilful misconduct. However, mere inadvertent errors, even if resulting from the carelessness or negligence of an employee or agent is insufficient to support gross negligence."

[3–5] As indicated in the decisions previously quoted, the contract limitation provision relied on by defendant cannot stand in the face of wilful and wanton misconduct or gross negligence. Gross negligence is the failure to observe even slight care; it is carelessness or recklessness to a degree that shows utter indifference to the consequences that may result. Spence v. Vaught, 236 Ark. 509, 367 S.W.2d 238 (1963). Wilful and wanton misconduct goes beyond gross negligence in that the party must be aware of the fact that his conduct will probably result in injury. The element of willfulness is absent in gross negligence. Froman v. J. R. Kelley

3. *California*: Riaboff v. Pacific Tel. & Tel. Co., 39 Cal.App.2d Supp. 775, 102 P.2d 465 (1940); Davidian v. Pacific Tel. & Tel. Co., 16 Cal.App.3d 750, 94 Cal.Rptr. 337 (1970); *Maryland*: Baird v. Chesapeake & Pot. Tel. Co., 208 Md. 245, 117 A.2d 873 (1955); *Oregon*: Georges v. Pacific Tel. & Tel. Co., 184 F.Supp. 571 (D.C.1960); *Tennessee*: Smith v. So. Bell Tel. & Tel. Co., 51 Tenn. App. 146, 364 S.W.2d 952 (1962); *Texas*: Wade v. Southwestern Bell Tel. Co., 352 S.W.2d 460 (Tex.Civ.App.1961); *New York*: Hamilton Emp. Service v. New York Tel. Co., 253 N.Y. 468, 171 N.E. 710 (1930); *Florida*: Neering v. So. Bell Tel. & Tel. Co., 169 F.Supp. 133 (D.C.1958); *Missouri*: Warner v. Southwestern Bell Tel. Co., 428 S.W.2d 596 (Mo.1969); *Ohio*: Cunha v. Ohio Bell Tel. Co., 26 Ohio Misc. 267, 55 O.O.2d 430, 271 N.E.2d 321 (1970); *Montana*: State ex rel. Mountain States Tel. & Tel. Co. v. District Court, Mont., 503 P.2d 526 (1972); *Oklahoma*: Wheeler Stuckey, Inc. v. Southwestern Bell Tel. Co., 279 F.Supp. 712 (1967); *Vermont*: McTighe v. New England Tel. & Tel. Co., 216 F.2d 26 (2nd Cir. 1954); *Louisiana*: Wilson v. So. Bell Tel. & Tel. Co., 194 So.2d 739 (La.Ct.App. 1967).

Stave & Heading Co., 196 Ark. 808, 120 S.W.2d 164 (1938).

The evidence shows that subsequent to execution of the contract, plaintiff changed its telephone number to obtain an additional line. Defendant's business office issued an order to change the number and transfer the advertising from the old number to the new number. This order carried the designation "resume advertising" which was the indication to transfer the advertisements and listings to the new number. One of defendant's clerical employees in its directory operations office inadvertently missed the notation and caused the items to be cancelled along with the old number.

Plaintiff attempted to show that defendant's administrative procedures were so deficient as to constitute gross negligence. However, plaintiff failed to offer evidence of any standard by which defendant's procedures could be tested. Defendant, on the other hand, offered evidence to show that its accuracy in the publication of its Fort Smith-Van Buren directory is comparable to its statewide performance and further, that its statewide accuracy percentage exceeded the five-state Company average and, in fact, ranked first much of the time.

Plaintiff also introduced evidence of an omission of a bold face listing in the 1969 directory and an overbilling for advertising these errors and the omission that occurred in the 1970 directory. Without establishing such a relationship, they must be viewed as completely separate incidents and as such lacking in materiality.

[6] After weighing the evidence the Court concludes and finds that the directory omission in this case was caused by simple clerical error, not constituting gross negligence or wilful or wanton misconduct. In view of this finding it is unnecessary for this Court to decide whether under Arkansas law, as argued by defendant, wilful and wanton misconduct rather than gross negligence is necessary.

Plaintiff's final argument is that the clause constitutes a liquidation of damages provision which is ineffectual because the specified limit is grossly disproportionate to the probable actual damages. The distinction between limitation of liability clauses and liquidated damages clauses is clearly established. Williston discusses the distinction in the following terms:

> "The limitation of liability is neither a penalty in that it does not normally operate *in torrorem* to induct proper performance, nor is it of the nature of liquidated damages since it does not purport to be a pre-estimate of probable damages resulting from a breach. Sometimes the sum so fixed is regarded by the parties as an outside estimate of what would otherwise be the probable liability, but in determining the amount of recovery it is immaterial whether this is the case or not." Williston on Contracts § 780A at 710.

[7] We do not mean to imply that the subject clause would be unenforceable if construed to be a liquidated damages clause. However, even a cursory examination of the negative language and the use of the word "beyond" in the clause reveals that it is a limitation provision, and, therefore, enforceable irrespective of the relationship between the limit and the actual probable damage. See Western Union Tel. Co. v. Nester, 309 U.S. 582, 60 S.Ct. 796, 84 L.Ed. 960 (1940).

Based on the above, this Court concludes that the limitation clause contained in the parties' contract is valid and that defendant's liability should be limited to $172.80 in accordance therewith. Having determined that the subject limitation is valid, it is unnecessary for this Court to reach the question of additional damages.

Findings of fact and conclusions of law have not been separately stated but are included in the body of the foregoing Memorandum Opinion as authorized by Rule 52(a) F.R.Civ.P. A proper judgment will be entered accordingly. Each party pay his own cost.

Hazel B. McTIGHE, Appellee,

v.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, Appellant.

No. 174, Docket 22920.

United States Court of Appeals Second Circuit.

Argued June 14, 1954.

Decided Sept. 21, 1954.

Action against telephone company for damages for breach of contract by omitting plaintiff's name from both alphabetical and classified directories. The United States District Court for the District of Vermont, Ernest W. Gibson, J., rendered judgment for plaintiff, and defendant appealed. The Court of Appeals, Medina, Circuit Judge, held that where contract clause limiting telephone company's liability for omission of subscribers' names from alphabetical directory was sanctioned by the Vermont Public Service Commission as a part of the rate schedule, subscriber whose name was omitted could not recover beyond the limitation.

Reversed and remanded.

1. Telecommunications ⇨269

The publication of an alphabetical directory is an essential feature of service rendered by telephone company, and regulations and requirements relative thereto must appear with tariffs as filed with the Vermont Public Service Commission.

2. Telecommunications ⇨269

Publication of classified telephone directory is wholly a matter of private contract, and contracts relating thereto are not required to be filed with the Vermont Public Service Commission.

3. Telecommunications ⇨31

The Vermont Public Service Commission has no jurisdiction over telephone companies except over matters relating to the public utilities services rendered and the rates relative thereto.

4. Railroads ⇨222(1)
Telecommunications ⇨269, 280

Courts will scrutinize with care clauses exonerating public utility companies, such as railroads, telegraph and telephone companies and others, from liability for the consequences of their own negligence, with reference to the public services rendered by them.

5. Contracts ⇨114

Courts' power to strike down contractual clauses which relate to performance by public utility of its functions as a public utility and which purport to limit company's liability for own negligence is limited to area in which the public services are rendered and has no application whatever to the domain in which the public utility may freely contract in its private capacity.

6. Corporations ⇨447

In respect to leases, advertising contracts and other miscellaneous agreements commonly made by members of the public with public utility companies, the parties are free to contract according to their own judgment and the reasonableness of their engagements will not be entered into.

7. Public Service Commissions ⇨6.1

Under Vermont law, the Vermont Public Service Commission is an administrative body, clothed in some respects with quasi judicial functions, and having, in a sense, auxiliary or subordinate legislative powers which have been delegated to it by the General Assembly.

8. Public Service Commissions ⇨7.1

The Vermont Public Service Commission, in promulgating future rates, exercises a legislative rather than a judicial function.

9. Telecommunications ⇨269, 282

Vermont Public Service Commission acted reasonably and within its regulatory powers in approving contract clause which related to publication of subscribers' names in telephone directories and which limited liability for omissions, and the determination was not subject to collateral attack in action against telephone company for damages for omission. Acts Vt.1908, No. 116, § 1 et seq.

10. Telecommunications ⟹280

Where contract clause limiting telephone company's liability for omission of subscribers' names from alphabetical directory was sanctioned by the Vermont Public Service Commission as a part of the rate schedule, subscriber whose name was omitted could not recover beyond the limitation. Acts Vt.1908, No. 116, § 1 et seq.

11. Telecommunications ⟹280

Contract for publication of subscriber's name in classified telephone directory was a matter outside scope of company's public service functions, and one with which company was free to include a contractual limitation on liability, defining subscriber's right to recover for omission of his name. Acts Vt. 1908, No. 116, § 1 et seq.

Guy M. Page, Burlington, Vt., for appellant; Guy M. Page, Jr., and Phyllis W. Page, Burlington, Vt., of counsel.

Gannett & Oakes and John G. Kristensen, Brattlesboro, Vt., for appellee. James L. Oakes, Brattlesboro, Vt., of counsel.

Before SWAN, MEDINA and HARLAN, Circuit Judges.

MEDINA, Circuit Judge.

We are concerned on this appeal only with questions of the validity of two clauses of separate contracts limiting the liability of the telephone company for omission to include the name of a service subscriber in its alphabetical and classified directories. These questions are presented by exceptions to refusals by the court to charge the jury that their verdict in the case of each alleged breach of contract must be limited to the amount specified in these clauses.

[1] As the publication of the alphabetical directory is an essential feature of the service rendered by the telephone company, regulations and requirements relative thereto appear together with the tariffs as filed with the Vermont Public Service Commission. Upon the approval by the Public Service Commission of the rates and collateral requirements such as those affecting the publication of the alphabetical directory such rates and requirements become effective and not otherwise. The limitation of liability clause thus in effect here, on approval of the Public Service Commission, follows:

> "The Telephone Company's liability arising from errors or omissions in directory listings * * * shall be limited to the amount of actual impairment to the customer's service in no event shall exceed one-half the amount of the exchange service charges for main telephones, extension telephones, and private branch exchange telephones, auxiliary lines, private branch exchange trunks, and private branch exchange switchboards involved during the period covered by the directory in which the error or omission occurs."

[2, 3] The publication of the classified directory, however, is wholly a matter of private contract and contracts relating thereto are not required to be filed with the Public Service Commission which has no jurisdiction except over matters relating to the public utility services rendered by the company and the rates relative thereto. The clause applicable to the classified directory is:

> "The directory service described on the reverse side of this application is for insertion in the next directory issue and each subsequent directory issue until it is cancelled in full or in part by either party by notice in writing not less than fifteen days prior to the closing date

of the issue from which the directory service is to be removed. The applicant agrees that the company shall not be liable for errors or omissions (including total omissions) in such directory service beyond the amount paid for the item or items in which errors or omissions occur for the issue life of the directory involved. The said Company reserves the right at all times to reject or discontinue any or all advertising matter."

Notwithstanding these clauses the trial court charged that, in the event that the jury found that plaintiff's name had been negligently omitted, the damages to be assessed might exceed the amounts prescribed by the terms of the contracts.

[4-6] The instructions as given were erroneous on both counts. True it is that the courts will scrutinize with care clauses exonerating public utility companies, such as railroads, telegraph and telephone companies and others, from liability for the consequences of their own negligence, with reference to the public services rendered by them. The fact that the member of the public patronizing such public utility companies must take the contract proffered by the company or forego using the service has enabled the courts to inquire into the reasonableness of the type of clause now under discussion and by this test the clause applicable to the alphabetical directory would as a matter of contract law be considered unreasonable and unenforceable. But the principle which enables courts to strike down and condemn clauses affecting the performance by the company of its functions as a public utility is limited to the area in which the public services are rendered and has no application whatever to the domain in which the public utility may freely contract in its private capacity. The obtaining of the services of the public utility by way of transportation or communications or providing gas or electricity is quite apart from the leases, advertising contracts and a host of other miscellaneous agreements commonly made by members of the public with public utility companies. If there be some disparity in the bargaining power of the contracting parties it is no more than may be found generally to exist; and the courts follow the general rule that the parties are free to contract according to their own judgment and the reasonableness of their engagements will not be entered into.

But legislation by a state may change the law. The fixing of rates is a legislative function, and the power to fix rates and regulate matters affecting rates is commonly delegated to state administrative bodies such as Public Service Commissions. For example in Vermont the Act of 1908, Laws 1908, No. 116, gave the Vermont Public Service Commission jurisdiction over the conduct of the public telephone business together with broad powers for its effective and complete supervision. Among other things the statute requires supervised companies to file rate schedules and "as a part thereof * * * the rules and regulations that in any manner affect the tolls or rates". The alphabetical directory, "as an aid to the use of the telephone system," was under the control of the Public Service Commission and subject to the rules and regulations for directory listings. The reasonableness of these rules and regulations is determined by the Public Service Commission in the exercise of the power delegated to it by the legislature. Accordingly, the "contract" with reference to the alphabetical directory, having been sanctioned as reasonable by the Public Service Commission in the exercise of its regulatory functions, is no longer one in connection with which the courts have the power to examine into the question of reasonableness on a collateral attack. Thus, for different reasons, each of the two clauses under attack here would, by the application of sound general principles, be considered valid and enforceable.

But this diversity case is governed by the law of Vermont; and we must now examine the course of judicial decisions in Vermont and determine whether they conform to the general pattern.

[7, 8] The Supreme Court of Vermont has recognized that "[t]he Public Service Commission is an administrative body, clothed in some respects with quasi judicial functions, * * * and having, in a sense, auxiliary or subordinate legislative powers which have been delegated to it by the General Assembly." Trybulski v. Bellows Falls Hydro-Electric Corp., 1941, 112 Vt. 1, 20 A.2d 117, 120; McFeeters v. Parker, 1943, 113 Vt. 139, 30 A.2d 300. Such a commission, in promulgating future rates, is exercising a legislative rather than a judicial function. Prentis v. Atlantic Coast Line Co., 1908, 211 U.S. 210, 29 S.Ct. 67, 69, 53 L.Ed. 150. In that case, the Supreme Court of the United States, in the course of its discussion of the distinction between legislative and judicial proceedings, stated that "[t]he establishment of a rate is the making of a rule for the future, and therefore is an act legislative, not judicial, in kind". And in Sayers v. Montpelier & W. R. R. R., 1916, 90 Vt. 201, 97 A. 660, 664, the Vermont Court said:

"Argument is unnecessary to support the conclusion that primary interference of the courts with the administrative functions of a commission, like our Public Service Commission, is incompatible with the proper exercise of governmental powers. If the valid orders of the commission were open to collateral attack at the option of any party aggrieved, it would give rise to confusion and result in delay—in short, wholly defeat the purpose of the statute creating the commission. Though exercising special and limited powers, as to which nothing will be presumed in favor of their jurisdiction * * *, still, within the proper limits of the authority conferred upon them by the Legislature, their jurisdiction is exclusive and can be reviewed only in the manner provided by the statute."

[9] Appellee's argument, however, completely ignores the statutory law of Vermont relating to the regulation of public utilities, and is based primarily upon Gillis v. Western Union Tel. Co., 1889, 61 Vt. 461, 17 A. 736, 738, 4 L.R.A. 611, where the Supreme Court of Vermont held that a telegraph company could not restrict its liability "to the extent of immunity from the consequences of [its] own negligence". But the Gillis case, and Davis & Gay v. Central Vermont R. Co., 1893, 66 Vt. 290, 29 A. 313, and Sprigg's Adm'r v. Rutland R. Co., 1905, 77 Vt. 347, 60 A. 143, which followed it, were decided prior to the Vermont statute of 1908, and at a time when there was no similar legislation in force. And the course of the Vermont decisions leaves no reason to doubt that the Vermont courts would follow the general pattern of law to the effect that determinations of the Public Service Commission, approving such clauses as are now before us as reasonable limitations of liability, are within its regulatory powers and are not subject to collateral attack.

In the Sayers case, supra, the Vermont Court pointed out that the purpose and function of the Vermont Public Service Commission were analogous to those of the Interstate Commerce Commission, and that, therefore, decisions of the Supreme Court of the United States relating to the jurisdiction and power of the Interstate Commerce Commission would be helpful in determining the jurisdiction and power of the Vermont Public Service Commission. Accordingly, the views of the Supreme Court expressed in Western Union Tel. Co. v. Esteve Brothers & Co., 1921, 256 U.S. 566, 41 S.Ct. 584, 585, 65 L.Ed. 1094, and Western Union Tel. Co. v. Priester, 1928, 276 U.S. 252, 48 S.Ct. 234, 72 L.Ed. 555, would, we think, be followed by the Vermont Court.

In the Esteve case, the Supreme Court, in upholding the validity of the limitation of liability "'for mistakes * * * in transmission * * * of any unrepeated message,'" contained in the tariff schedule filed by Western Union with the Interstate Commerce Commission, stated that

> "The limitation of liability was an inherent part of the rate. The company could no more depart from it than it could depart from the amount charged for the service rendered.
>
> "The act of 1910 introduced a new principle into the legal relations of the telegraph companies with their patrons which dominated and modified the principles previously governing them. Before the act the companies had a common law liability from which they might or might not extricate themselves according to views of policy prevailing in the several states. Thereafter, for all messages sent in interstate or foreign commerce, the outstanding consideration became that of uniformity and equality of rates. Uniformity demanded that the rate represent the whole duty and the whole liability of the company. It could not be varied by agreement; still less could it be varied by lack of agreement. The rate became, not as before a matter of contract by which a legal liability could be modified, but a matter of law by which a uniform liability was imposed. Assent to the terms of the rate was rendered immaterial, because when the rate is used, dissent is without effect."

The Esteve case was cited and followed in two state cases involving omission from the telephone directory, both of which upheld the validity of the limitation of liability provision in the filed tariff. Correll v. Ohio Bell Tel. Co., 1939, 63 Ohio App. 491, 27 N.E.2d 173; Cole v. Pacific Tel. & Tel. Co., 1952, 112 Cal.App.2d 416, 246 P.2d 686. See also Wilkinson v. New England Tel. & Tel. Co., 1951, 327 Mass. 132, 97 N.E.2d 413, Riaboff v. Pacific Tel. & Tel. Co., 1940, 39 Cal.App.Supp.2d 775, 102 P.2d 465.

Although it appears that in the Esteve and Priester cases the sender of the telegram had the option to secure the company's unlimited liability by paying a higher rate for a repeated message, the Supreme Court did not base its decision on the existence of the option provision, and the holding that "[t]he limitation of liability was an inherent part of the rate" remains unaffected.

[10] Thus, the limitation of liability arising from "errors or omissions" as to the alphabetical directory, when sanctioned by the Vermont Public Service Commission as a part of the rate schedule, became the law of Vermont, and could not be nullified by the trial judge in his charge to the jury.

It was not disputed that the classified directory was outside appellant's duties of public service and was "a vehicle to secure advertising." The trial judge also recognized that the classified directory was not controlled by the Public Service Commission, but was "governed by the general law of contracts." Notwithstanding this, however, in his charge to the jury, the trial judge attached to the limitation of liability provision in the advertising contract the same qualification as he attached to the limitation of liability provision in the service contract.

[11] Here, again, the instructions were not in accord with the law as declared by the decisions of the Supreme Court of Vermont. In entering into the advertising contract, the telephone company in its private capacity contracted as to matters outside the scope of its public service functions, and was free to include in the contract a limitation of liability, as this would not operate to defeat its public purpose. Osgood v. Central Vermont R. Co., 1905, 77 Vt. 334, 60 A. 137, 70 L.R.A. 930; Manchester Marble Co. v. Rutland R. Co., 1927, 100 Vt. 232, 136 A. 394, 51 A.L.R. 628. The Gillis case, relied on by appellee, does

not apply, as the contract there involved related solely to the telegraph company's public service function.

Accordingly, there must be a new trial.

Reversed and remanded.

Victoria VAN NIEUWENHOVE and Jeanne Van Nieuwenhove, Plaintiffs-Appellants,

v.

The CUNARD STEAM-SHIP CO., Limited, etc., Defendant-Appellee.

No. 11130.

United States Court of Appeals, Seventh Circuit.

Oct. 19, 1954.

Passengers brought action against steamship company for injuries sustained when ladder used to reach upper berth in stateroom in steamship came out of slots in bulkhead during rough sea and fell on passengers after ladder had been shifted from bedside to bulkhead by one of the passengers. The United States District Court for the Northern District of Illinois, Eastern Division, Win G. Knoch, J., entered judgment for steamship company, and passengers appealed. The Court of Appeals, Finnegan, Circuit Judge, held that evidence was insufficient to sustain verdict for passengers and that District Court properly set aside the verdict.

Judgment affirmed.

1. Shipping ⇨166(4)

In action by passengers against steamship company for injuries sustained when ladder used to reach upper berth in stateroom of steamship came out of slots in bulkhead during rough sea and fell on passengers after it had been moved from bedside to bulkhead by one of the passengers, evidence was insufficient to show passengers were injured by company's negligence and was insufficient to sustain verdict for passengers.

2. Federal Civil Procedure ⇨839

Where verdict for plaintiffs was set aside because not predicated on substantial evidence, and judgment was entered for defendant, and thereafter plaintiffs sought to amend their complaint, but amendment merely supplied opinions of pleader and his conclusions of law in an effort to bridge hiatus in nonexistent chain of causation, motion to amend was properly denied. Fed.Rules Civ.Proc. rule 15, 28 U.S.C.A.

George C. Rabens, Isadore I. Feinglass, Chicago, Ill., for appellants.

Daniel M. Healy, Walter C. Healy, Chicago, for appellee.

Before MAJOR, FINNEGAN and SCHNACKENBERG, Circuit Judges.

FINNEGAN, Circuit Judge.

In this appeal plaintiffs ask us to reverse an order, entered below, setting aside a jury verdict awarding damages of $5,000 to Victoria Van Nieuwenhove and $1,000 to Jeanne Van Nieuwenhove, respectively. At the close of plaintiffs' evidence and after all the evidence, defendant, The Cunard Steam-Ship Co., Limited, a foreign corporation, moved for a directed verdict. In his order, setting aside that verdict and entering judgment for the defendant, the trial judge stated that defendant's motion for a directed verdict should have been granted. We agree.

During a rough sea, Jeanne Van Nieuwenhove and Victoria Van Nieuwenhove sustained injuries when a ladder came out of slots in the bulkhead of their stateroom and fell on Jeanne who was pitched with the ladder and a chair on to Victoria. Prior to this episode, Victoria had moved the same ladder from its position adjacent to the double-decker berths, where she had previously used it to reach

University Hills Beauty Academy, Inc., a Colorado corporation v. The Mountain States Telephone and Telegraph Company, a Colorado corporation

No. 75-668

Court of Appeals of Colorado, Division Two

38 Colo. App. 194; 554 P.2d 723

August 19, 1976, Decided

SUBSEQUENT HISTORY: Petition for Rehearing Granted and Prior Opinion Announced July 15, 1976, Withdrawn.

PRIOR HISTORY:
Appeal from the District Court of the City and County of Denver, Honorable Joseph N. Lilly, Judge.

DISPOSITION: Affirmed.

SYLLABUS: Action to recover damages allegedly caused by telephone company's failure to include beauty school's listing in appropriate section of yellow pages directory. From jury verdict for defendant, plaintiff appealed and defendant cross-appealed that it was entitled to summary judgment.

COUNSEL: C. Mert Reese, Steven Henry DeVito, for plaintiff-appellant and cross-appellee.

Stuart S. Gunckel, for defendant-appellee and cross-appellant.

JUDGES: Opinion by Judge Van Cise. Judge Coyte and Judge Smith concur.

OPINIONBY: VAN CISE

OPINION: [*195] [**724] Plaintiff, University Hills Beauty Academy, Inc., appeals from a judgment entered upon a jury verdict in favor of defendant Mountain States Telephone and Telegraph Company (Mountain Bell). Plaintiff sued for loss of business profits and expenses in mitigating its damages allegedly resulting from the negligent omission of its listing under the heading "Beauty Schools" in the classified directory ("yellow pages") of the Denver metropolitan telephone directory published by Mountain Bell in October 1971. Mountain Bell contends that since plaintiff did not pay the contract price for the advertisement, its damages under the terms of the contract were nil and that judgment in favor of Mountain Bell was properly granted. We affirm that judgment.

Mountain Bell admitted that a wrong computer code number had inadvertently been assigned by the account representative to plaintiff's advertising contract so that the bold type listing contracted for erroneously appeared in the yellow pages under the heading "Beauty Salons." However, [**725] it claimed that its liability was limited by paragraph 9 of the contract, which provides: "In case of error in the advertisment as published, or in case of the omission of all or any part of the advertisement from publication, the telephone

company's liability, if any, shall be limited to a pro rata abatement of the charge paid to the telephone company for such advertisement in the same proportion that the error or omission reduces, if at all, the value of the entire advertisement, but in no event shall such liability exceed the amount payable to the telephone company for said advertisement during the service life of the directory in which [*196] the error or omission occurs." (emphasis supplied)
At the trial, simple negligence was established and the facts as set forth abov were proven.

Plaintiff contends on appeal that the court should have determined that the limitation of liability clause in the contract was unconscionable as a matter c law, or, absent such a finding, it should have given plaintiff's tendered instruction directing the jury to determine whether the contract clause was unconscionable. Plaintiff argues that public policy prohibits contractual limitation of liability for negligence when, as here, there is an inequality of bargaining power. It further asserts that the provision itself is substantivel unreasonable. We do not agree.

Mountain Bell, a public utility, functions in both a public and a private capacity. Although a limitation of liability clause in a contract with reference to the services to be rendered by it in its public capacity is subjec to careful scrutiny by regulatory agencies and, on review, by the courts, that principle has no application to contracts which it enters into in its private capacity. See Barker v. Colorado Region-Sports Car Club of America, Inc., 35 Colo. App. 73, 532 P.2d 372 (1974). The publication of the yellow pages in a telephone directory is wholly a matter of private concern. Gas House, Inc. v. Southern Bell Telephone & Telegraph Co., 289 N.C. 175, 221 S.E.2d 499 (1976); McTighe v. New England Telephone & Telegraph Co., 216 F.2d 26 (2d Cir. 1954).

Where there is no duty to the public, such clauses "are valid when fairly made and may be enforced to preclude recovery caused by simple negligence." Barker v. Colorado Region-Sports Car Club of America, Inc., supra. Although the plaintiff contends otherwise,
"[M]ere disparity of bargaining strength, without more, is not enough to make out a case of unconscionability. . . . [T]here must be additional factors such as deceptive bargaining conduct. . . . [T]he doctrine of unconscionability . . . is directed against one-sided, oppressive and unfairly surprising contracts, and not against the consequences per se of uneven bargaining power or even a simple old-fashioned bad bargain." Wille v. Southwestern Bell Telephone Co., 21 Kan. 755, 549 P.2d 903 (1976).

Whether the contractual limitation for errors or omissions in telephone company yellow pages advertising is unconscionable has not been specifically decided in Colorado. Plaintiff relies on Allen v. Michigan Bell Telephone Co., 18 Mich. App. 632, 171 N.W.2d 689 (1969). There, by a two to one decision, a Division of the Michigan Court of Appeals reversed the trial court and declined to give effect to an identical limitation of liability clause because of unequa bargaining power of the parties and the absence of any reasonable alternative for the advertiser.

However, virtually all of the other courts which have considered the matter have held to the contrary and have upheld the contract provision. In both Will v. Southwestern Bell Telephone Co., supra, and Gas [*197] House, Inc. v. Southern Bell Telephone & Telegraph Co., supra, decided in 1976, the

contentions in Allen were considered [**726] and rejected. n1 As stated in Gas House:
"The inequality of bargaining power between the telephone company and the businessman desiring to advertise in the yellow pages of the directory is more apparent than real. It is not different from that which exists in any other case in which a potential seller is the only supplier of the particular article or service desired. There are many other modes of advertising to which the businessman may turn if the contract offered him by the telephone company is not attractive."

- - - - - - - - - - - - - - - - - - -Footnotes- - - - - - - - - - - - - - - - - -

n1 Additional cases upholding the limitation of liability clause in yellow pages advertising contracts include: Robinson Insurance & Real Estate, Inc. v. Southwestern Bell Telephone Co., 366 F. Supp. 307 (W.D.Ark. 1973); Cole v. Pacific Telephone & Telegraph Co., 112 Cal. App. 2d. 416, 246 P.2d 686 (1952); Advance Service, Inc. v. General Telephone Co., 187 S.2d 660 (Fla. App. 1966); Neering v. Southern Bell Telephone & Telegraph Co., 169 F. Supp. 133 (S.D. Fla. 1958); Wilson v. Southern Bell Telephone & Telegraph Co., 194 S.2d 739 (La. App 1967); Baird v. Chesapeake & Potomac Telephone Co., 117 A.2d 873 (Md. 1955); Mitchell v. Southwestern Bell Telephone Co., 298 S.W.2d 520 (Mo. App. 1957); Warner v. Southwestern Bell Telephone Co., 428 S.W.2d 596 (Mo. 1968); State ex rel. Mountain States Telephone & Telegraph Co. v. District Court, 503 P.2d 526 (Mont. 1972); Federal Building Service v. Mountain States Telephone & Telegraph Co., 76 N.M. 524, 417 P.2d 24 (1966); Correll v. Ohio Bell Telephone Co., 63 Ohio App. 491, 27 N.E.2d 173 (1939); Wheeler Stuckey Inc. v. Southwestern Bell Telephone Co., 279 F. Supp. 712 (W.D. Okla. 1967); Georges v. Pacific Telephone & Telegraph Co., 184 F. Supp. 571 (D. Ore. 1960); Smith v. Southern Bell Telephone & Telegraph Co., 364 S.W.2d 952 (Tenn. 1962); Wade v. Southwestern Bell Telephone Co., 352 S.W.2d 460 (Tex. Civ. App. 1961); Russell v. Southwestern Bell Telephone Co., 130 F. Supp. 130 (E.D. Tex. 1955); McTighe v. New England Telephone & Telegraph Co., supra (2d Cir. 1954, interpreting Vermont law). In none of these cases except Cole v. Pacific Telephone & Telegraph Co., supra, was there even a dissent.

- - - - - - - - - - - - - - - - - -End Footnotes- - - - - - - - - - - - - - - - -

The appropriate test of unconscionability of a contract provision is set forth in Carlson v. Hamilton, 8 Utah 2d 272, 332 P.2d 989 (1958), quoted with approval in Wille and Gas House:
"People should be entitled to contract on their own terms without the indulgence of paternalism by courts in the alleviation of one side or another from the effects of a bad bargain. Also, they should be permitted to enter into contracts that actually may be unreasonable or which may lead to hardship on one side. It is only where it turns out that one side or the other is to be penalized by the enforcement of the terms of a contract so unconscionable that no decent, fairminded person would view the ensuing result without being possessed of a profound sense of injustice, that equity will deny the use of its good offices in the enforcement of such unconscionability."

Here, the enforcement of the limitation of liability clause does not lead to a result so unreasonable as to shock the conscience. There are other directories and publications in which plaintiff could have chosen to and did advertise. The omission of the advertisement from the yellow pages leaves the plaintiff in the same position it would have occupied had [*198] it made no contract at all with the telephone company. On the other hand, if we were void this provision of the contract, it would make the telephone company an insurer against consequential damages by advertisers, contrary to the law whic has traditionally been applied to telephone and telegraph companies. See Hamilton Employment Service v. New York Telephone Co., 253 N.Y. 468, 171 N.E. 710 (1930). In fact, to make the telephone company such an insurer would be grossly inequitable. The "premiums," in the form of advertising billings, fo such "insurance," in the form of unlimited liability for consequential damages are disproportionately low (here $ 5.10 per month) when compared to the magnitude of the potential liability (here $ 89,500 in claimed damages by this one advertiser), and the rates are obviously based on the limited liability created by the clause in question.

Judgment affirmed.

MODERN EQUIPMENT CORP., Plaintiff,

v.

PUERTO RICO TELEPHONE CO. and ITT World Directories, Defendants.

Civ. No. 116-70.

United States District Court, D. Puerto Rico.

Jan. 13, 1977.

Subscriber brought action against telephone company to recover for damage allegedly suffered as result of company's refusal to publish subscriber's commercial advertisements in telephone directories for years 1969–70 and 1970–71. The District Court, Pesquera, J., held that telephone company was justified in refusing to publish such advertisements after subscriber had refused to pay for advertisements published in 1968–69 telephone directories on ground that telephone service rendered by the company to subscriber during 1968–69 was deficient.

Complaint dismissed.

1. Telecommunications ⟹269

Publishing advertisements in classified section, yellow pages, of telephone directory is not public service, but matter of private contract between subscriber and telephone company.

2. Telecommunications ⟹261

Rendering telephone service is public service and not matter of strictly private contract.

3. Telecommunications ⟹269

Telephone company was justified in refusing to publish subscriber's commercial advertisements in telephone directories for years 1969–70 and 1970–71 after subscriber had refused to pay for advertisements published in 1968–69 telephone directories on ground that telephone service rendered by company to subscriber during 1968–69 was deficient; thus company was not liable for any damage suffered by subscriber as result of company's refusal to publish the advertisements.

4. Telecommunications ⟹346

Deficient telephone service to subscriber did not justify subscriber's failure to pay for yellow page advertisements, in view of separateness of contracts for service and contracts for advertisements.

5. Telecommunications ⟹281

Subscriber was not precluded from claiming damages from telephone company for denial of insertion of advertisement in telephone directories, even though plaintiff had been awarded damages by Public Service Commission based on deficient telephone service.

Benito Gutiérrez Díaz, Hato Rey, P. R., for plaintiff.

Baltasar Corrada del Río, San Juan, P. R., for defendants.

OPINION AND ORDER

PESQUERA, District Judge.

Pursuant to an order filed and entered on August 26, 1974, the Court took under advisement issues numbered 1, 3 and 4 in the Statement of the Contested Issues of Fact and of Law to decide the same on the basis of the documentary evidence submitted with the proposed Pretrial Order filed and entered on July 10, 1974.

The Court has considered said issues and documentary evidence and the stipulation or Statement of Uncontested Facts ("Stipulation") and finds that defendants cannot be held liable for the damages claimed by plaintiff in the complaint. Said damages were allegedly suffered as a result of defendant's refusal to publish plaintiff's commercial advertisement in defendant's telephone directories for the years 1969–70 and 1970–71.

The question of liability and the three specific issues considered by the Court can be disposed of by deciding issue number 4 of the Statement of the Contested Issues of

Fact and of Law: Are the mutual obligations of the parties separate and distinct with respect to the contract for the rendering of telephone service and to the contract for commercial advertisement in the telephone directories?

[1, 2] The answer to this issue is yes. It has been decided that publishing advertisements in the classified section (yellow pages) of a telephone directory is not a public service but a matter of private contract between a subscriber and a telephone company. *University Hills v. Mountain States*, 554 P.2d 723 (Colo.App.1976); *Classified Directory Subscribers Ass'n. v. Public Service Commission of D.C.*, 127 U.S.App. D.C. 315, 383 F.2d 510 (1967); *McTighe v. New England Telephone & Telegraph Co.*, 216 F.2d 26 (2d Cir. 1954); *Mitchell v. Southwestern Bell Telephone Co.*, 298 S.W.2d 520 (Mo.App.1957). The rendering of telephone service is such a public service and not a matter of strictly private contract. Cf. *Rovira Palés v. Puerto Rico Telephone Company*, 96 PRR 47 (1968).

The evidence submitted by the parties confirm the separateness between the contract for rendering telephone service and the contract for commercial advertisement in the telephone directory. Exhibit 2 of the Proposed Pretrial Order is a copy of an Opinion and Order of April 28, 1970 in Case No. Q–2595 where the Puerto Rico Public Service Commission (PSC) decided that commercial advertisements in the defendant's telephone directory are not directly related nor essential to the rendering of telephone service contemplated by Puerto Rico's Public Service Act.

The parties accept, at Stipulation number 17, that telephone subscribers sign a contract with the Puerto Rico Telephone Co. for the rendering of telephone service when they become subscribers and the same does not provide for the inclusion of commercial advertisements in the telephone directory. A separate contract is signed to place said advertisements. Exhibits 12 to 15 of the Pretrial Order are such separate contracts.

Moreover, in its order in Case No. Q–2595 the PSC specifically warned the Puerto Rico Telephone Co. it could not refuse or discontinue service to plaintiff by reason of or because of problems with plaintiff's advertisements in the classified section.

The result of this order was that noncompliance by plaintiff under its contract for advertisement in the classified section of the telephone directory could not be used to justify discontinuance of telephone service to plaintiff. On the other hand, it is logical to say that noncompliance by the Puerto Rico Telephone Co. under its contract for telephone service cannot be used by plaintiff to justify noncompliance with its contract for advertisement in the directory.

Plaintiff's own actions reinforce these conclusions. On March 14, 1969 plaintiff filed a complaint before the PSC (Case No. Q–2517) alleging deficient telephone service and damages suffered because of said service. On July 10, 1969 plaintiff filed a *separate* complaint before the PSC (Case No. Q–2595) alleging refusal by the defendant Puerto Rico Telephone Co. to accept plaintiff's advertisements in the telephone directories.

The former complaint was decided in favor of plaintiff and was awarded $2,500.00 in damages, Exhibit 1 of the Proposed Pretrial Order. Thus, plaintiff has been satisfied for damages caused by deficient telephone service. However, the evidence presented by the parties shows that plaintiff also demanded that defendants deduct 50% of the invoice for advertisement in the telephone directory for the year 1968–69, Exhibit 4 of the Proposed Pretrial Order, and refused to pay for commercial advertisements published in the 1968–69 telephone directory on the grounds that telephone service rendered by defendant to plaintiff during 1968–69 was deficient—Exhibits 9, 10 and 11.

[3] This takes us to issue numbered one in the Statement of the Contested Issues of Fact and of Law: Is defendant liable for damages suffered by plaintiff as a result of defendant's refusal to publish plaintiff's commercial advertisements in the telephone directories for the years 1969–70 and 1970–

71 due to plaintiff's refusal to pay for commercial advertisements published in the 1968–69 telephone directories which plaintiff refused to pay on the grounds that telephone service rendered by defendant to plaintiff during 1968–69 was deficient?

This issue must be decided against plaintiff. The Puerto Rico Public Service Commission (PSC) authorized on September 10, 1965 a Schedule of Rates and charges together with general provisions applicable to services provided by the Puerto Rico Telephone Company. General Provisions Number 4 and 7 state that if any applicant for service is in debt to the Telephone Company because of lack of payment of a bill for services previously provided, the Company may refuse new service until said debt is paid. P.R. PSC Sheet No. D–4–2, D–7–1.

In *Denham v. Southwestern Bell Tel. Co.*, 415 F.Supp. 530 (D.C.1976), the Court stated that plaintiff had breached his contract by not paying for telephone service at a hotel he owned and defendant had the right to suspend telephone service at said hotel. Furthermore, defendant had the right to consider suspension of plaintiff's other business telephone service at his optometrist's office.

The rights of defendant in the present case to refuse advertisement service for lack of payment is even stronger because said service is a private relationship not covered by the public service law as we saw above.

Defendants were entitled to refuse to publish plaintiff's commercial advertisements in the telephone directories for the years 1969–70 and 1970–71 due to plaintiff's refusal to pay for advertisements published in the 1968–69 directory. We have already decided that advertising in the directory is merely a private contract and as such one of the parties can unilaterally refuse to enter into said contract with the other party. In this case defendants had a justified reason for the refusal: nonpayment. Furthermore, as we have seen, the General Provisions approved by the PSC authorize the Telephone Company to refuse new service until a previous debt is paid.

[4, 5] We have also seen that plaintiff's reason for nonpayment was not justified or legally binding on defendants. Deficient telephone service does not provide a justification for noncompliance with the commercial advertisements contract. The separateness of the contracts, the public nature of one and the private nature of the other have been stated above. Plaintiff's remedy for deficient service was available before the PSC, plaintiff exercised its right to such remedy and it was granted its remedy. Exhibit 1 of the Proposed Pretrial Order. This brings us to Issue Number 3: Is plaintiff enjoined from claiming damages from defendant in this case as a result of damages *already awarded* to plaintiff by the Public Service Commission in Case No. Q–2517?

Because the complaint in this case does not allege or claim damages in relation with deficient service, the decision by the PSC in Case No. Q–2517 does not enjoin plaintiff from claiming damages in this case, which damages are claimed only in relation with the denial by defendants of insertion of an advertisement in defendants' telephone directories for the years 1969–70 and 1970–71.

However, resolution of the two previous issues makes this decision irrelevant for purposes of determining defendants' liability under the allegations of the complaint. There is no liability from defendants because plaintiff had no right to its advertisement being published in the 1969–70, 1970–71 directories until plaintiff paid for amounts due under the previous 1968–69 contract for commercial advertisements in the classified section of the telephone directory.

It is therefore ORDERED, ADJUDGED and DECREED that the complaint be, and the same is hereby dismissed. The Clerk of the Court shall enter judgment accordingly.

The parties are directed expeditiously to complete discovery. Magistrate Washington is authorized to continue supervising discovery and to resolve any outstanding and future discovery disputes.

SO ORDERED.

EXECUTIVE SERVICES OF MIAMI, INC., a Florida Corporation, Plaintiff,

v.

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY et al., a foreign corporation, Defendants.

No. 81-906-CIV-EPS.

United States District Court, S.D. Florida, Miami Division.

May 13, 1981.

Florida corporation filed six-count complaint against telephone company and sought preliminary injunction requiring telephone company to publish corporation's request for advertisements under lawful trade names. The District Court, Spellman, J., held that Florida corporation which operated, under various fictitious names, a number of "escort services" in the South Florida area, was not entitled to preliminary injunction requiring telephone company to publish plaintiff's requests for advertisements under operations' lawful trade names.

Relief denied.

Injunction ⟹136(2)

Florida corporation which operated, under various fictitious names, a number of "escort services" in the South Florida area, was not entitled to preliminary injunction requiring telephone company to pub plaintiff's request for advertisements un operations' lawful trade names after te phone company had refused to list cert trade names which it deemed suggestive offensive, such as "lady," "angel," "venu "Dreams Unlimited," "Smashing Beautie and "All American." 28 U.S.C.A. § 1441(

Thomas G. Sherman, Miami, Fla., f plaintiff.

John T. Kolinski, Shutts & Bowen, Mia Fla., for defendants.

MEMORANDUM OPINION AND ORDE DENYING PLAINTIFF'S MOTIC FOR A PRELIMINARY INJUN TION

SPELLMAN, District Judge.

On April 20, 1981, Plaintiff filed a s count complaint against the Defenda Southern Bell Telephone and Telegra Company (hereinafter "Southern Bell") the Eleventh Judicial Circuit Court in a for Dade County. On April 23, 1981, Sout ern Bell petitioned this Court to remove t action from state court and, on April 2 1981, this Court granted said petition bas on the provisions of 28 U.S.C. § 1441(l The cause is presently before the Court c Plaintiff's motion for a preliminary injun tion.

Plaintiff operates, under various fic tious names, a number of "escort service in the South Florida area. The complair states, *inter alia*, that:

> for the 1981–82 yellow pages, [Souther Bell] will not accept any advertisemen with company names which include term which refers to the male or fema gender including names with the ter "lady", "playfirl" (sic), "angel", and "ve nus". In addition, the Defendant has se other arbitrary and capricious prohib tions for the Plaintiff's business, whic include on some unknown basis a refus to advertise trade names with such phra es as "Dreams Unlimited", "Star Times' "Good Times", "Sun Times", "Smashin

Beauties", "All American", "Rent-A", among others. Said policies apply only to Plaintiff, or others in the same business.

Plaintiff has requested this Court to "issue a preliminary injunction requiring Defendant to treat Plaintiff's request for advertisement in a non-discriminatory and reasonable manner forthwith, and to publish Plaintiff's requests for advertisement under their lawful trade names, in their proper category of escort services, and in accord with reasonable regulations as to content as this Court may deem appropriate."

The four prerequisites for granting a preliminary injunction are as follows:

1. A substantial likelihood that Plaintiff will prevail on the merits;

2. A substantial likelihood that Plaintiff will suffer irreparable injury if the injunction is not granted;

3. That the threatened injury to Plaintiff outweighs the threatened harm the injunction may do to the Defendant; and

4. That granting the preliminary injunction will not disserve the public interest.

Canal Authority of the State of Florida v. Callaway, 489 F.2d 567 (5th Cir. 1974). Upon review of the facts in this case, the Court is of the opinion that the weight of the aforementioned factors support denial of Plaintiff's motion.

Plaintiff seeks injunctive relief in Counts I and II of the Complaint.[1] Count I alleges that the aforementioned acts of the Defendant constitute a violation of section 364.10 of the Florida Statutes. Section 364.10 provides:

> No telephone company shall make or give any undue or unreasonable preference or advantage to any person or locale, or subject any person or locale to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.

In attempting to determine whether Plaintiff has a substantial likelihood of prevailing on the merits of Count I, this Court had to ascertain whether Plaintiff's complaint stated a claim under section 364.10.[2] Although this Court was unable to find any Florida cases that dealt with the specific issue here raised, there are two cases that shed light on this issue. The Florida Railroad and Public Utilities Commission opinion in *Re Southern Bell Telephone and Telegraph Co.*, 41 PUR3d 401 (1961) was issued following a hearing on a proposal for new exchange groupings and rates. The opinion notes that the only people who showed for the hearing were there to make protests "directed primarily at the telephone company's yellow page directory advertising policies and practices. The commission disallowed these protests on the basis of court decisions holding that yellow page advertising is not a public utility function of the telephone company, and, therefore, is not subject to control and supervision by a commission such as this." The commission's ruling is supported by a decision of the Eleventh Judicial Circuit Court in and for Dade County, Florida, wherein it was stated:

> [T]he yellow pages appendix to defendant's directory is merely an advertising media in the publication [in] which the defendant does not perform an essential public service subject to public regulation or which is within the ambit of chapter

1. Although Count VI also requests an injunction, it really amounts to nothing more that a prayer for relief based on the allegations previously set forth in the complaint. Counts III, IV, and V are claims for damages based on alleged past and present breaches of contracts, both express and implied in fact, and for tortious interference with Plaintiff's business. These counts are strictly actions at law and do not contain prayers for equitable relief.

2. The Court notes that there is a question as to whether Plaintiff's claim for declaratory relief should be brought in the courts or before the Public Service Commission. *See* Fla.Stat. 364.01; *Southern Bell Telephone and Telegraph Co. v. Mobile America Corporation, Inc.*, 291 So.2d 199 (Fla.1974). The Court finds, however, that it has the authority to rule on Plaintiff's motion for a preliminary injunction and that it is unnecessary to rule at this time on whether the request for declaratory relief would be more proper in another forum. *See generally State of Alabama v. United States*, 304 F.2d 583, 590 (5th Cir. 1962).

363, Florida Stats. *Florida ex rel. Montemarano v. Southern Bell Teleph. & Teleg. Co.*, (Fla.Cir.Ct. 1950) 87 PUR NS 87, and cases cited therein.

Horn v. Southern Bell Telephone and Telegraph Co., 43 PUR3d 239, 240 (1962).

The rationale for these decisions was neatly summarized by Judge J. Skelly Wright in *The Classified Directory Subscribers Ass'n v. Public Service Commission of the District of Columbia*, 383 F.2d 510, 513 (D.C.Cir.1967) when he stated:

> The Telephone Company certainly is in a uniquely advantageous position as a publisher of directory advertising. But its monopoly in that capacity is not so strong as the one it holds as the exclusive provider of telephone services. Even if no one else has yet found it profitable to publish a competitive directory, certainly the availability of other advertising media does exert some competitive restraining influence on Telephone Company pricing. Thus the distinction which the Commission drew between the classified listing, as an integral part of telephone service, and the directory advertising, as primarily a matter of private contract, was not without some reasonable basis.

Based on the above-cited authorities, the Court has concluded that Plaintiff does not have a substantial likelihood of prevailing on the merits of Count I.

Count II alleges, based on Defendant's status as a public utility and the "grant of monopoly and enfranchisement of the State of Florida," that the aforementioned acts of Southern Bell constitute a violation of 42 U.S.C. § 1983. It is the opinion of this Court, however, that Plaintiff has not stated a claim under section 1983. A cursory examination of Count II shows that there are no allegations that Defendant's actions were made under color of any statute, ordinance or regulation. In addition, it is the view of the Court that even if such allegations were made that Count II would fail to state a claim under section 1983 based on the Supreme Court's decision in *Jackson v. Metropolitan Edison*, 419 U.S. 345, 95 S.Ct. 449, 42 L.Ed.2d 477 (1974). Thus, there is no substantial likelihood that Plaintiff will prevail on the merits of Count II.

Plaintiff's allegations of irreparable injury appear to be similarly without merit. As Judge Wright pointed out, there are numerous means to advertise one's business other than in Southern Bell Telephone's yellow pages.[3] Moreover, Defendant has represented to the Court that, although it will not accept advertisements for any escort services, "Southern Bell has *never* refused to list the escort services of plaintiff or anyone else in its Yellow Pages. It has only refused to list certain trade names which it deems suggestive or offensive. . ." The Court is certain that Plaintiff will be able to find some trade names that will be acceptable to Defendant and does not feel compelled to require Southern Bell to provide Plaintiff with guidelines before Plaintiff submits additional names. Such a requirement is particularly inappropriate here because the names Defendant has refused to list are not Plaintiff's corporate name, that the Secretary of State has approved as being consistent with the public's standards, rather, they are merely fictitious names under which Plaintiff has elected to do business. This Court does not believe that Plaintiff is entitled to invent a name under which it desires to do business and to compel Defendant to accept that name, no matter how offensive it may be, for a publication where Plaintiff's advertisements are run, not as a matter of right, but based on a contractual relationship that has not even been established for the 1981–82 period.

In light of the foregoing, it is unnecessary to elaborate extensively on the remaining prerequisites for granting a preliminary injunction. Suffice it to say that the injury to plaintiff if the injunction is not granted

3. Although the Court recognizes that many of Plaintiff's prospective clients might want to avail themselves of its services while "walking through the Yellow Pages", the affidavit in support of Defendant's memorandum in opposition to the motion for a preliminary injunction lists a number of trade directories covering the Dade and Broward County areas that are likewise available to Plaintiff.

is speculative at best[4] and it does not appear to outweigh the harm the Defendant will incur if this Court requires them to delay publication of the yellow pages while Plaintiff comes up with acceptable trade names or to publish the trade names as they currently are. Such an injunction would, in the Court's view, be a disservice to the public interest. Accordingly, the Plaintiff's motion for a preliminary injunction is DENIED.

Charles MERIWETHER, Joseph Harris, and Victor Jackson, Plaintiffs,

v.

Wilbur K. SHERWOOD, Individually and as Sheriff of Orange County, New York, Charles Conklin, Individually, and formerly as Under Sheriff of Orange County, New York, Kenneth Davis, Individually and as Captain in the Orange County Sheriff's Department, William P. Powers, Individually, and as Under Sheriff of the Orange County Sheriff's Department, Robert Vosburgh, Individually and as Physician to the Orange County Jail, Eduard Liebel, as Nurse to the Orange County Jail, and the County of Orange, New York, Defendants.

No. 78 Civ. 6128.

United States District Court, S. D. New York.

May 14, 1981.

In action brought by prisoners against sheriff and various employees of sheriff's department in which prisoners sought $340,000 in damages for injuries allegedly suffered while they were pretrial detainees but were awarded total of only $6,500 by jury on their negligence claim, plaintiffs and defendants filed cross motions for attorney fees. The District Court, Sofaer, J., held that neither plaintiffs nor defendants were "prevailing parties" such as to be entitled to attorney fees.

So ordered.

1. Civil Rights ⟹13.17

Generally, a rule precluding attorney's fees when plaintiff has specifically lost on the civil rights claim asserted is proper, but exceptional circumstances may arise in which a court should have discretion to deem that a plaintiff has "prevailed" even though the civil rights claim asserted was decided adversely such as when the party losing the civil rights claim establishes ample justification for bringing the claim and obtains from the jury a verdict on other claims that substantially vindicate his constitutional quest. 42 U.S.C.A. §§ 1983, 1988.

2. Civil Rights ⟹13.13(1)

In order for prisoners to have prevailed on their claim under statute prohibiting the deprivation of civil rights by state action, they would have had to have proved that sheriff and other employees of sheriff's office were deliberately indifferent to their serious medical needs. 42 U.S.C.A. § 1983.

3. Civil Rights ⟹13.17

Prisoners, who sought to recover $340,000 in damages for injuries allegedly suffered when they were pretrial detainees but who were awarded total of only $6,500 by jury on negligence claim against county sheriff, were not "prevailing parties" as required to be entitled to attorney fees. 42 U.S.C.A. § 1988.

4. Civil Rights ⟹13.17

Even assuming an adequate evidentiary basis existed to justify a finding that prisoners, who sought to recover $340,000 in damages for injuries allegedly suffered while they were pretrial detainees but who were awarded a total of only $6,500 by jury on a negligence claim against county sheriff, were "prevailing parties," prisoners, who obtained a substantial victory of their constitutional objectives in previous suit which resulted in prison reform, could not claim credit for such results in the instant

4. Especially in light of Southern Bell's representation that they will list trade names for Plaintiff's businesses if they are not suggestive or offensive.

NETWORK MODERNIZATION AND INCENTIVE REGULATION

A Report to
The Missouri Public Service Commission
From
The Telecommunications Project Team

August, 1991

VI. LEGAL CONSIDERATIONS

Many of the ideas, information and options which were gathered, discussed and analyzed by the Project Team brought up questions as to whether or not the current statutory scheme would allow the implementation of new forms and methods of network modernization and incentive regulation. Additionally, there was discussion as to what would be the best way -- statutory change, rulemaking or docketed case -- to deal with those legal constraints.

Within the concept of network modernization, there are several alternatives available for implementation which need to be considered: (1) the companies could voluntarily agree to implement a network modernization plan that is mutually acceptable to the Staff, Public Counsel, company personnel, customers and other interested parties, and approved by the Commission; (2) the Commission could order, on a company by company basis, some specific network modernization plan; or (3) the Commission could establish a generic network modernization plan for implementation by a rulemaking. Each of these alternatives has different legal considerations and each will be addressed in turn.

If a company were to voluntarily agree to some network modernization plan that is mutually acceptable to the Staff, Public Counsel, company personnel, customers and other interested parties, arguably there would be no statutory problem. This is a comparable situation to the ultimate settlement of the Southwestern Bell Telephone Company complaint case, TC-89-14, et al., where the company volunteered to modernize under an incentive plan experiment and share earnings via billing credits to its customers. Billing credits are arguably not allowable under the statute if ordered by the Commission; however, the company can do so voluntarily.

The Commission could establish a docket for each and every telecommunications company within the state of Missouri to investigate the status of their portion of the overall telecommunications network within the state of Missouri. Even after going through that rather cumbersome process, there is still some concern that the Commission does not have clear authority to order network modernization for the sake of modernization. However, the Courts have stated that "[t]he Commission does have power to order a telephone company to make reasonable improvements in its facilities or to extend its lines so as to provide service or <u>better service</u> in an area which the company has undertaken or professed to serve." (Emphasis added). *State ex rel. Southwestern Bell Telephone Company vs. Public Service Commission*, 416 S.W.2d 109, 114 (Mo. banc 1967). This could be read to include any type of modernization which would result in "better service" for the consumers of the product.

Another possibility is to propose a generic rulemaking which would establish some predetermined network modernization plan for all telecommunications companies who make up the network. This would then allow each company who desired to do so the opportunity to comment on the plan and to propose alternatives. This also has the feature of eliminating any unfairness or alleged discrimination which could result from company-by-company cases and orders by the Commission. What this alternative could do, however, is unduly burden some companies who are currently further behind in modernization than the average telecommunications company. For example, if you set a predetermined goal of being 80 percent modernized by December 31, 1994 based upon specific criteria, the company who is 20 percent modernized now will have a greater burden to meet the goal than a company who is presently 75 percent modernized.

In the event the Commission were to order, by whatever method, a company to modernize its piece of the overall telecommunications network, the Commission must provide some means for the company to recover the costs associated with the purchase, installation and maintenance of the new facilities. Without providing for some recovery, there could possibly be a legal argument made regarding confiscation of telecommunications company property. However, the flip side of this coin is the savings associated with the new equipment being installed. Typically, the new facilities require less maintenance and are more cost-effective. These savings need to be considered when providing for recovery.

The Project Team also discussed the alternative of establishing service quality standards which could effectively require the replacement of existing plant with newer technologies. The Commission has the authority granted by Section 386.250(6) RSMo Supp. (1990) to "... prescribe the conditions of rendering public utility service...." Additionally, the Commission is authorized to determine the just, reasonable, adequate, efficient and proper regulation if it finds that the equipment or service of any telecommunications company is inadequate, insufficient, improper or ineffective. Section 392.240 RSMo Supp. (1990). As discussed at Chapter III.B. of this Report, many of the current quality of service standards which are set out in the current Code of State Regulations are outdated and indeed surpassed by most telecommunications companies in the state. Moreover, most companies have established internal quality of service standards that are higher than those found at 4 CSR 240-32. This option may also raise the argument of confiscation of telecommunications company property.

Another major concern in all of the discussions of the Project Team was whether or not an incentive regulation scheme can be ordered by the Commission under the current law. Certainly there is no specific statute which states that price caps or profit sharing/sliding scale plans are allowable. On the other hand, there is no specific prohibition against these types of plans.

After a close reading of Section 392.230 RSMo Supp. (1990), Subsection 3, it seems that if there is to be price cap regulation or a profit sharing/sliding scale plan in the telecommunications industry in Missouri, it will be at the sole discretion of the Commission. Subsection 3 of Section 392.230 RSMo Supp. (1990) reads:

> "Whenever there shall be filed with the commission by any telecommunications company, other than a small telephone company, any schedule stating a new individual or joint rate, rental or charge, or any new individual or joint regulation or practice affecting any rate, rental or charge, the commission shall have, and it is hereby given, authority, either upon complaint or upon its own initiative without complaint, at once, and if it so orders without answer or other formal pleading by the interested telecommunications company or companies, but upon reasonable notice, to enter upon a hearing concerning propriety of such rate, rental, charge, regulation or practice; and pending such hearing and the decision thereon the commission, upon filing with such schedule and delivering to the telecommunications company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, rental, charge, regulation or practice, but not for a longer period than one hundred and twenty days beyond the time when such rate, rental, charge, regulation or practice would otherwise go into effect; and after full hearing, whether completed before or after the rate, rental, charge, regulation or practice goes into effect, the commission may make such order in reference to such rate, rental, charge, regulation or practice as would be proper in a proceeding initiated after the rate, rental, charge, regulation or practice had become effective, however, if any such hearing cannot be concluded within the period of suspension, as above stated, the commission may, in its discretion, extend the time of suspension for a further period not exceeding six months."

The statute refers to "<u>any</u> schedule stating a new individual or joint rate, rental or charge, or <u>any</u> new individual or joint <u>regulation</u> or <u>practice</u> affecting <u>any</u> rate" (emphasis added). Thus, any schedule having a new rate or new regulation or practice affecting any rate is the key language. It specifies "any ... practice affecting any rate...." It therefore follows that there can be submitted to the Commission for approval, any practice that the company so desires to use in making its rates. A telecommunications company can submit any practice, any rate, any schedule or any "method" for approval by the Commission. Whether the Commission decides to adopt that practice, rate, schedule or method as submitted is entirely up to the Commission. The statute clearly states that any regulation or practice may be used and submitted to the Commission and the Commission alone will decide whether it is proper. The argument is, therefore, that incentive regulation schemes are a "practice" making or "affecting" a rate. Webster's Third New International Dictionary of the English Language Unabridged defines "practice," when used as a noun, as the "performance or operation of something" and as a synonym for "execution". Therefore, incentive regulation plans could be interpreted as methods of "practicing" ratemaking. That is, they are practices used in ratemaking, and are practices "affecting" ratemaking. In summary, the Public Service Commission shall decide whether or not incentive regulation plans should be used if proposed in a schedule submitted by a telecommunications company.

This analysis continues when looking at Section 392.230 RSMo Supp. (1990), Subsection 5, affecting small telephone companies. The same key words are employed in the statutory construction, and again, the same analysis would mean that the Public Service Commission shall decide whether or not price caps or a sliding scale/profit sharing plan could be used if proposed in a schedule submitted by a small telecommunications company.

In both scenarios, 392.230 RSMo Supp. (1990) Subsection 3 and Subsection 5, it seems quite clear that a telephone company could propose an incentive regulation scheme and that it would be entirely in the discretion of the Commission whether or not to allow it to be used.

When considering price caps, it is also interesting to note that Section 392.240 RSMo Supp. (1990), Subsection 1, speaks in terms of the "maximum" rates that a telephone company can charge. Price cap regulation involves just that -- "maximum" rates. What Subsection 1 of 392.240 does is allow the Commission to establish a new "maximum" rate if a current rate is found to be inadequate. As discussed in Chapter V, price caps involve setting "maximum" rates that automatically change as inflation, productivity and other factors change. It seems, therefore, that 392.240 RSMo Supp. (1990) allows price cap regulation and that price cap regulation can be accommodated in the current Missouri statutes.

Again, as was pointed out in the discussion of price cap regulation, the Commission should not be overly concerned with how funds are spent once a company earns them. The Commission's only concern should be whether or not the maximum rate allowed is fair and whether or not the quality of service is at an allowable level or an improving level.

An additional concern of those opposed to price cap regulation in the state of Missouri is that companies allowed to use price cap regulation might not improve their capital plant and equipment. They are concerned that perhaps the company will try to receive the highest return possible and not be concerned with customer service. However, 392.250 RSMo Supp. (1990) gives the Commission authority to order improvements or changes to any telecommunications facility as long as those requests are "reasonable." So, if a regulated utility is not utilizing its funds to whatever extent is necessary to maintain its facilities, the Commission has the authority to order the utility to bring its facilities to a "reasonable" level.

Part of price cap regulation also involves the idea that separate services offered by a regulated entity will be put into different service baskets. Under 392.361 RSMo Supp. (1990), the Public Service Commission of the state of Missouri is already empowered to classify different services of the telephone company into three different groups. These groups are "non-competitive services", "transitionally competitive services" and "competitive services." Under price cap regulation, the services most likely to be regulated and given price caps would be the noncompetitive services and the transitionally competitive services. If the Commission has already taken the time to identify these different services under Section 392.361 RSMo Supp. (1990), it seems quite likely that it would be a simple process to set price caps for each one of the services as well. It would be a natural extension of the classification process already in place.

Finally, one of the main worries of opponents to price cap regulation is that there would be the possibility for rampant cross-subsidization. However, 392.400 RSMo Supp. (1990) points out clearly that the Commission will have the power to investigate for cross-subsidization and will have the power to enforce the law. Subsection 5 of Section 392.400 Supp. (1990) states that:

> "It shall be unjust, unreasonable, and unlawful for a noncompetitive or transitionally competitive telecommunications company to offer or provide a competitive or transitionally competitive service below the cost of such service as determined by the commission if the commission finds that such offering or provision of service constitutes conduct which is not consistent with the promotion of full and fair competition."

In other words, if a regulated firm is not charging its competitive customers enough and is overcharging its noncompetitive customers, it will be breaking the law.

Aside from the file and suspend method as outlined in 392.230 RSMo Supp. (1990), the Missouri Public Service Commission also has the practice of the "complaint" method of ratemaking. This is outlined in 386.390 RSMo. The important language of this statute is: "any act or thing done or omitted to be done by any corporation, person or public utility, including any rule, regulation or change ..." can be brought forth as a complaint in front of the Commission. This is important for consideration of the legality of price caps. This method would still be available to all parties even under a price cap plan in the event a cap was believed to be unreasonable.

APPENDIX C

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. TA-92-145
Digital Teleport

FROM: Charles W. Brown CWB
Telecommunications Department

MISSOURI LEGAL DEPT.

SUBJECT: Staff's Report and Recommendation pertaining to Staff's Investigation of Local Exchange Private Line Services

DATE: July 30, 1992

REVIEWED BY: 7/30/92 Utility Operations Division/Date 7/31/92 General Counsel's Office/Date

The Commission's Report and Order in Case No. TA-92-145, issued on June 10, 1992, directed the Commission Staff to conduct an investigation of providers of private line services within a local exchange. The Commission's Report and Order states, "...[T]he Commission is advised that some private line certificate holders are providing, at least in part, private line services which both originate and terminate within the same local exchange...." The Commission has expressed the concern that such activity may be beyond the granted scope of authority. The Commission has therefore directed the Staff to investigate which companies are providing local exchange private line services and what Staff recommends regarding this matter. Staff has been directed to file its report by July 31, 1992.

Staff has conducted a broader investigation than perhaps contemplated by the Commission's Report and Order. Staff has investigated both the provisioning of private line services and switched services within a local exchange area. Staff has conducted a survey of all interexchange companies that operate in Missouri rather than the limited list of companies identified on Attachment B in the Commission's Report and Order. Staff's investigation has also included a review of each company's certificate and tariff.

In conducting the survey, Staff responded to questions and inquiries based on Staff's positions identified in this memorandum and directed the companies to complete the survey based on Staff's interpretations. Staff has not had adequate time to verify that all companies have followed through with these instructions. Therefore, Staff reports the results as submitted. Staff's positions as stated in this memorandum are based on information known at this time and are subject to change as the issues are examined further.

Staff has reviewed and analyzed the various types of certificates of service authority that have been granted for all of the existing interexchange companies in Missouri. The majority of companies have been granted a certificate of service authority to provide intrastate interexchange telecommunications services. However, a few companies have been granted a type of certificate that might imply they have the authority to provide telecommunications services within a local exchange area. These include the following:

(1) St. Louis Fiber Communications, Inc., in Case No. TA-91-13, has been granted a certificate of service authority to provide intrastate private line telecommunications services.

(2) Kansas City Cable Partners d/b/a KC FiberNet, in Case No. TA-88-232, was

granted a certificate of service authority to provide intrastate private line high-speed telecommunications services.

(3) Cable & Wireless Communications, Inc. in Case No. TA-87-31 was granted a certificate of service authority to provide intrastate intercity toll telecommunications services.

(4) Americall Dial O Services, Inc. in Case No. TA-89-153 and MidAmerican Long Distance in Case No. TA-88-144 were granted certificates of service authority to provide intrastate toll telecommunications services.

Staff recommends that the Commission clarify whether the scope of interexchange carriers' certificates, as summarized in Attachment I to this memorandum, includes the authority to provide telecommunications services within a local exchange area. Staff recommends that this clarification be made in the context of a broader proceeding as discussed below.

A review of interexchange company tariffs in general indicates that existing tariffs generally do not specify that the offered private line services are provided only on an interexchange or also on a local exchange basis. In many cases, tariffs only specify the type of private line services available without any mention of the interexchange or local exchange availability of services. Staff recommends that the broader proceeding also be used to address whether the tariff approval process can be used to authorize services not within the scope of a company's certificate.

Staff has also attempted to determine how many companies actually provide telecommunications services that originate and terminate within the same exchange. On June 19, 1992 Staff sent a survey letter (copy attached marked as Attachment II) to all certificated interexchange carriers. The survey letter asked whether the company has provided, is providing, and/or plans to provide, any of the following types of telecommunications services, including any incidental traffic, which transmits information that originates and terminates within the same exchange:

1) Private line services.
2) Two-way switched voice services.
3) Two-way switched data services.
4) Private telecommunications system services.
5) Other types of services.

Companies that stated that they provide any of the above telecommunications services within a local exchange were instructed to describe the service, identify the Missouri tariff reference, and identify the percentage of total Missouri revenue derived from the local exchange traffic.

Seventy-five companies were mailed the survey. The responses of twenty-two companies indicate that they currently provide, plan to provide, or provide on an incidental basis, services that originate and terminate within the same exchange. Thirty-six companies responded that they do not provide or plan to provide any type of service that originates and terminates within the same exchange. Staff did not receive a response from the remaining seventeen companies.

Survey results are shown in Attachment I. The following list provides the number of companies that provide a particular type of local exchange service based on the survey results. Staff has contacted some but not all of these companies individually to verify the accuracy of the information.

Six companies: Private line services.

Thirteen companies: Two-way switched voice services.

Three companies: Two-way switched data services.

One company: Private telecommunications system services.

Four companies: Other types of services.

All companies responding affirmatively that they provide two-way switched voice or data local exchange services identified that such traffic is handled solely on an incidental basis. For example, these companies stated that they might complete message toll, 800 and travel card service traffic that originates and terminates within the same exchange. However, these companies indicated that callers do not have an economic incentive to utilize their message toll service or travel card services to place local exchange calls; therefore, companies estimate that such local exchange traffic is minimal.

The companies responding that they provide local exchange private telecommunications system services and "other types of services" generally identified such services as incidental in nature. One company that stated it offers private telecommunications system services indicated that such traffic would be incidental for their 800 service and electronic mail offerings. Another company reported that it handled incidental local exchange traffic for service to inmate payphones.

In Staff's opinion, companies that handle incidental switched traffic that originates and terminates within the same exchange should not be required to possess a local exchange certificate or tariff unless the company specifically is offering such a service to the general public. For example, a person may dial an 800 number that terminates within their exchange. In handling switched services, it may be difficult, if not impossible, for a company to identify and route such local exchange traffic to a carrier authorized to carry such traffic. Presently, Staff is not aware of any company that is openly attempting to market switched telecommunications services that originate and terminate within the same exchange.

As previously mentioned, six companies responded that they either want to provide or are currently providing local exchange private line telecommunications services. The magnitude of local exchange services provided by these companies has not been determined since only two companies identified a percentage of revenues generated by these services.

The difficulty of determining the extent to which local exchange private line service is offered by these companies is compounded by confusion and disagreements concerning the definition of local exchange private line service. Staff's position is that connecting two customer locations within the same exchange constitutes the provisioning of local exchange private line service regardless of whether the connection is part of a larger private line network that includes interexchange links. However, many companies disagree with this interpretation. Their interpretation appears to be based on similar principles that guide the determination of whether a customer's private line service should be considered interstate versus intrastate. For example, in determining interstate versus intrastate jurisdiction, a customer's entire private line network can be classified as interstate if more than 10% of the traffic is interstate. Therefore some companies argue that connecting two points within the same exchange does not constitute the provisioning of local exchange private line service if the two points are part of a larger private line network.

Confusion and disagreement also arose over what constitutes a private telecommunications systems. Section 386.020(31) RSMo Supp. 1991 defines a private telecommunications system as "a telecommunications system controlled by a person or corporation for the sole and exclusive use of such person, corporation or legal or corporate affiliate thereof." Section 386.020(44) excludes such private telecommunications systems from telecommunications services subject to Commission jurisdiction. Staff concludes that any private line service provided by one company to another entity falls within the scope of the Commission's jurisdiction. This scope specifically includes private line services that connect various locations of the same customer. However, this scope does not include situations where a consumer owns the facilities used to provide only its own private telecommunications needs. One company has previously argued that private line arrangements connecting locations of a single customer constitute a private telecommunications system and therefore do not fall under the Commission's jurisdiction.

Confusion also surrounds whether connecting a customer premise to an interexchange telecommunications company's point of presence in the same exchange constitutes local exchange private line service. Staff is investigating whether a private line service would be a local exchange private line service if the customer's premise is connected to an interexchange company's point of presence within the same exchange even if calls are transmitted to another exchange.

The arrangement of reselling private line services is another area of disagreement. Some companies argue that they are not actually providing a telecommunications service when they resell to a customer a private line or special access service that the company obtains from the local exchange company. These companies state that they do not own any of the facilities and generally just pass through the local exchange company's charges to the customer. Therefore, these companies believe that such an arrangement does not require a special certificate or tariff. In contrast to this position, Staff believes that the company is offering a telecommunications service and therefore should possess the proper certificate and have approved tariffs to offer the service. In Staff's opinion, whether the company actually owns the facilities used in the provisioning of a particular service is immaterial. For example, many certificated companies do not own any facilities in the provisioning of their interexchange switched services but simply resell the services provided by other companies.

In Staff's opinion, further clarification is necessary to determine what constitutes local exchange private line service since not all companies are willing to accept Staff's interpretations as reflected in this memorandum. Therefore, Staff recommends that the Commission develop a proceeding that addresses these issues. The proceeding should allow all telecommunications companies to comment on the proper determination of local exchange private line service and certification and tariffing requirements.

In summary, Staff's investigation reveals that several companies currently possess a certificate of service authority that might imply that they have the authority to provide telecommunications services within a local exchange area. Existing tariffs generally do not specify whether a particular service is only offered on an interexchange basis or on a local exchange basis as well. Based on the results of Staff's survey a number of companies currently offer or plan to offer local exchange private line service. In addition, a significant number of companies handle incidental switched traffic that originates and terminates within the same exchange. Based on questions and inquiries generated from Staff's survey, it became apparent that Staff and some companies have several areas of disagreement concerning these issues.

Staff recommends that the Commission establish a proceeding to address at least the following issues:

(1) whether private line service to connect two points within the same exchange is local exchange private line service if the private line network provided by a company to a customer also connects to points in different exchanges;

(2) whether service is local exchange private line service if a particular customer is connected by a private line/special access circuit to an interexchange telecommunications company's point of presence in the same exchange.

(3) whether the Commission has jurisdiction over a private line system that a company provides to a customer to connect only that customer's locations.

(4) whether reselling a service provided from a local exchange company requires the reseller to possess a certificate and tariff.

(5) whether and how the scope of existing certificates which do not explicitly include or exclude local exchange services should be clarified; and

(6) whether the tariff approval process can be used to authorize services not explicitly within the scope of a company's certificate.

Staff further recommends that in such a proceeding the Commission also address the issues raised by Southwestern Bell and United Telephone regarding the definitions of switched and private line services.

Attachments

copies: Director - Utility Operations Division
Director - Policy & Planning Division
Assistant to the Director - Utility Services Division
Manager - Financial Analysis Department
Manager - Accounting Department
Office of the Public Counsel
Thomas A. Grimaldi - United Telephone
Darryl W. Howard - Southwestern Bell Telephone
Richard Brownlee, III
Richard Weinstein
W. R. England, III

ATTACHMENT I

CERTIFICATES AND LOCAL EXCHANGE SERVICES OF INTEREXCHANGE CARRIERS

Interexchange Company	Case Number	Applied for	R & O Granted	Local Exchange Services*
Affinity Fund Inc.	TA-92-12	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	No Reply
Allnet Comm. Services Inc	TA-84-154	Resell InterLATA & IntraLATA Toll Svc.	Consolidated to TO-84-223	None
	TO-84-223		Intrastate InterLATA & IntraLATA Toll Telecom. Svcs.	
Alternate Comm. Tech. Inc.	TA-91-384	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	Yes, 2 No, 1, 3-5
Alumni Network	TA-92-129	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
Amer-I-Net Comm. Corp.	TA-91-288	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	No Reply
Americall Dial O Ser. Inc.	TA-89-153	Intrastate Telecom. Svc.	Intrastate Toll Telecom. Svc.	Yes, 5 (Jail Calls) No, 1-4
American Comm. Inc.	TA-87-120	Intrastate InterLATA & IntraLATA Toll Telecom. Svcs.	Intrastate InterLATA & IntraLATA Toll Telecom. Svcs.	No Reply
American Network Exch. Inc.	TA-91-234	Operator Svc., Intrastate Telecom. Svc.	Intrastate Interexchange Telecom Svc. and AOS in Missouri	None
Am. Telephone Net. Inc	TA-91-378	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	No Reply
Amerifax Inc.	TA-90-354	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None

*IXC indicated that it provides the following local exchange services:

1-Private Line 2-Two-way switched voice 3-Two-way switched data 4-Private telecom. systems 5-Other

ATTACHMENT I

Interexchange Company	Case Number	Applied for	R & O Granted	Local Exchange Services*
Ameritel Long Dist. Inc.	TA-91-144	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	No Reply
Ascom Auteka Comm. Ltd.	TA-92-264	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
ATC Long Dist. (Satelco)	TA-87-44	Intrastate InterLATA & IntraLATA Toll Telecom. Svc.	Consolidated to TO-84-223	No Reply
	TO-84-223		Intrastate InterLATA & IntraLATA Toll Telecom. Svcs.	
AT&T	TR-83-253	Intrastate InterLATA Toll Authority	Intrastate InterLATA Toll Aut	Yes, 2-3
	TA-87-103	Intrastate IntraLATA Telecom. Svc.	Intrastate IntraLATA Toll Tel	No, 1,4 & 5
BSN Telecom Co.	TA-92-76	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	Yes, 2 No, 1, 3-5
Cable & Wireless Comm. Inc.	TA-87-31	Intrastate Intercity Toll Telecom. Svc.	Intrastate Intercity Toll Telecommunications	Yes, 2 No, 1, 3-5
Cellular L. D. Ser. Corp	TA-92-8	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	Yes, 5, IXC No, 1-4
Coast International Inc.	TA-90-156	Resell Telecom. Svcs.	Intrastate Toll Telecom Svcs.	Yes, 2 No, 1, 3-5
Communigroup of K.C. Inc.	TA-87-51	Intrastate InterLATA & InterLATA Toll Telecom. Svcs	Intrastate IntraLATA Toll Telecom. Svcs.	Yes, 2 No, 1, 3-5
Contact America Inc.	TA-86-47	Resell Intrastate Interexchange Toll Svc.	Consolidated to TO-84-223	None
	TO-84-223		Intrastate InterLATA & InterLATA Toll	
Corporate Telemgt. Group Inc.	TA-92-119	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None

*IXC indicated that it provides the following local exchange services:
1 Private Line   2 Two way switched voice   3 Two way switched data   4 Private telecom. systems   5 Other

ATTACHMENT I

Interexchange Company	Case Number	Applied for	R & O Granted	Local Exchange Services*
Dial U.S.	TA-84-140	Reselling WATS and Other Type Long Distance Circuits	Consolidated to TO-84-223	None
	TO-84-223		Intrastate InterLATA & IntraLATA Toll Telecom. Svcs.	
Dial U.S.A.	TA-86-50 TO-84-223	Operate as WATS Reseller	Consolidated to TO-84-223 Intrastate InterLATA & Toll Telecom. Svcs.	None
Digital Teleport Inc.	TA-92-145	Interexchange & Intraexchange Private Telecom. Svcs.	1) Private Line Intrastate Interexchange Telecom. Svcs. 2) Dedicated, Non switched Local Exch. Private Line Telecom. Svcs. 3) Switched Interexchange Telecom. Svcs.	Yes, 1 & 4 No, 2, 3 & 5
Econo-Call Inc.	TA 85-273	Reseller of Intrastate Telecom. Svc.	Intrastate Telecom. Svc.	None
	TO 84-223		Intrastate InterLATA & IntraLATA Toll Telecom. Svcs.	
Excel Telecommunications Inc.	TA 90-117	Intrastate Reseller of Telecom. Svcs.	Intrastate Interexchange Toll Telecom. Svcs.	None
Fiberline Net. Comm. L. P.	TA-90-135	Resell Telecom. Svc.	Intrastate Toll Telecom. Svc.	None
Fiberoptic Alter. Sys. Tech.	TA 91-257	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	Yes, 1-5 if PSC approves
Gateway L. D. Ser. Inc.	TA 90-235	Intrastate Reseller of Telecom. Svcs.	Intrastate Reseller of Interexchange Telecom. Svcs.	No Reply

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ATTACHMENT I

Interexchange Company	Case Number	Applied for	R & O Granted	Local Exchange Services*
Hillsboro Tel. Co. Inc.	TA 91-91	Resale of Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
Inter-Tel NetSolutions Inc.	TA-91-289	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	No Reply
International Telecharge Inc.	TA-88-12	Toll Telecom. Svc.	Intrastate IntraLATA & InterLATA Toll Telecom. Svc.	None
International Telecomm. Exch.	TA 92-69	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	Yes, 2 & 3 No, 1, 4 & 5
KC Fibernet (KCCP)	TA 88-232	Intrastate Private Line High-Speed Telecom. Svcs.	Intrastate Private Line High-Speed Telecom. Svcs.	Yes, 1 No, 2-5
Kindview Telephone Co.	TA 91-243	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	No Reply
LCI International (LiTel)	TA 89-204	WATS Reseller Providing Intrastate Long Distance Telephone Service	WATS Reseller Providing Intrastate Toll Telecom. Svcs.	None
LDCC Inc.	TA 91-188	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	No Reply
LDD Inc.	TA 86-65	Operate As Provider of Telecom. Svc.	Consolidated to TO 84-223	None
	TO 84-223		Intrastate InterLATA & IntraLATA Toll Telecom. Svcs.	
LDDS Communications (K.C.)	TA 86-15 TO 84-223	Wholesale and Retail Reseller	Consolidated to TO-84-223 Intrastate InterLATA & IntraLATA Toll Telecom. Svcs.	None
LDDS Communications (Missouri) (Com Link 21)	TA-85-26	Provide InterLATA & IntraLATA Resale Svc.	Intrastate InterLATA & IntraLATA Toll Telecom. Svcs.	None

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1 Private Line 2 Two way switched voice 3 Two way switched data 4 Private telecom. systems 5 Other

ATTACHMENT I

Interexchange Company	Case Number	Applied for	R & O Granted	Local Exchange Services*
Long Distance Network Svcs. Inc.	TA-90-304	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
Long Distance Network Inc.	TA-92-70	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	No Reply
LTS Inc.	TA 84-150	Provide InterLATA & IntraLATA Resale Svcs.	Consolidated to TO 84-223	None
	TO 84-223		Intrastate InterLATA & IntraLATA Toll Telecom. Svcs.	
Matrix Telecom	TA 91-237	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	Yes, 2 No, 1, 3-5
MCI Telecommunications Corp.	TA-84-82	Interexchange Telecom. Svcs.	Intrastate InterLATA Toll Telecom. Svcs.	Yes, 2 No, 3-5
Metromedia Communications Corp. (ITT Communication Services)	TA-87-130	Provide Intrastate Services	Intrastate InterLATA & IntraLATA Toll Telecom. Svc.	Yes, 1 & 2 No, 3-5
Mid-Com Communications Inc.	TA-91-379	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
MidAmerican Long Distance	TA 88-144	Resell Telecom. Svcs.	Intrastate Toll Telecom. Svcs.	No Reply
Midwest Fibernet Inc.	TA-88-219	Interexchange Telecom. Svcs.	Interexchange Telecom Svcs.	None
Missouri Microwave L.P.	TA 92-28	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	Yes, 1 No, 2-5
NCN Communications Inc.	TA 90-157	Intrastate Reseller of Telecom. Svc.	Intrastate Reseller of Interexchange Telecom Svcs.	No Reply
Norstan Network Services Inc.	TA 92-190	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	No Reply

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1 Private Line 2 Two way switched voice 3 Two way switched data 4 Private telecom. systems 5 Other

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Interexchange Company	Case Number	Applied for	R & O Granted	Local Exchange Services*
One Call Communications, Inc.	TA-91-293	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
Opticom	TA-91-156	Intrastate Interexchange Telecom. Svc	Intrastate Interexchange Telecom. Svc.	None
Prime Link Communications Corp.	TA-90-281	Intrastate IntraLATA & InterLATA Toll Telecom. Svc.	Intrastate Toll Telecom. Svc.	None
Quest Communications Corp	TA-92-31	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
Show-Me Long Distance, Inc.	TA-92-99	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
Southnet Communications, Inc.	TA-92-82	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
Springfield Fiber Net, Inc.	TA-92-173	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	Yes, 1 No, 2-5
Sprint Communications Co. L.P.	TA-87-45	Provide Intrastate IntraLATA Toll Telecom. Svcs.	Provide Intrastate IntraLATA Toll Telecom. Svcs.	None
Sprint Services	TA-90-127	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
St. Louis Fiber Comm. Inc.	TA-91-13	Intrastate Private Line Telecom. Svc.	Intrastate Private Line Telecom. Svc.	Yes, 1 No, 2-5
Tel-Central of Jeff City Inc.	TA-84-121	Provide InterLATA & IntraLATA Resale Svcs.	Consolidated to TO-84-223	No Reply
	TO-84-223		Intrastate IntraLATA & InterLATA Toll Telecom. Svcs.	
Teleconnect Long Dist. Svcs.	TA-86-114	Intrastate Interexchange Toll Telecom. Svc.	Intrastate Interexchange Toll Telecom. Svc.	No Reply

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Interexchange Company	Case Number	Applied for	R & O Granted	Local Exchange Services*
Telegroup Inc.	TA 92-172	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svcs.	None
Telenational Comm. L.P.	TA-91-14	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Toll Telecom Svc.	Yes, 2 No, 1, 3-5
Transcall America, Inc.	TA-84-158	Provide InterLATA & IntraLATA Resale Svcs.	Consolidated to TO-84-223	Yes, 2 & 3 No, 1, 4 & 5
	TO-84-223		Intrastate IntraLATA & InterLATA Toll Telecom. Svcs	
U.S. Long Distance, Inc.	TA 91-490	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom Svc.	None
U.S. Net, Inc.	TA-91-303	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom Svcs.	None
United Tele. Long Distance	TA 88-260	Reseller of Interexchange Telecom. Svc.		None
Valu-Line of St. Joseph Inc.	TA-84-136	Provide InterLATA & IntraLATA Services	Consolidated to TO-84-223	None
	TO-84-223		Intrastate IntraLATA & InterLATA Toll Telecom. Svcs.	
Value-Added Comm. Inc	TA 92-37	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchage Telecom. Svc.	Yes, 5 No, 1-4
VarTec Telecom Inc.	TA-92-117	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	None
WATS/800 Inc.	TA-92-26	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	Yes, 2 No, 1, 3-5
WilTel Inc.	TA-92-68	Intrastate Interexchange Telecom. Svc.	Intrastate Interexchange Telecom. Svc.	No Reply

*IXC indicated that it provides the following local exchange services:
1 Private Line 2 Two way switched voice 3 Two way switched data 4 Private telecom. systems 5 Other

June 19, 1992

TO: ALL CERTIFICATED INTEREXCHANGE COMPANIES

The Telecommunications Department of the Missouri Public Service Commission is conducting a survey of all certificated interexchange companies in Missouri to determine the extent to which companies are providing telecommunications services within exchanges. This survey is in response to Commission direction in Case No. TA-92-145.

Please complete the attached form and return it to Charles Brown no later than June 29, 1992. If you need additional time to provide some of the requested information, return the form by the deadline with the information currently available and indicate when the remainder of the information will be provided. If you have any questions, please call John Van Eschen at (314) 751-5525 or Charles Brown at (314) 751-3516.

Sincerely,

Charlotte F. TerKeurst

Charlotte F. TerKeurst
Manager
Telecommunications Department

RETURN THIS FORM TO THE FOLLOWING ADDRESS NO LATER THAN JUNE 29, 1992:

Charles Brown
Missouri Public Service Commission
Telecommunications Department
P.O. Box 360
Jefferson City, MO 65102

Company Name: ______________________________

Person Responding: ______________________________

Title: ______________________________

Telephone Number: ______________________________

Indicate whether this company has provided, is providing, and/or plans to provide the following types of telecommunications services in Missouri to any customers in a manner in which any of the transmission of information both originates and terminates within the same exchange, as defined in the local exchange telecommunications company's tariff. This includes any incidental local exchange traffic which may occur.

Yes	No	
____	____	Private line voice and/or data
____	____	Two-way switched voice
____	____	Two-way switched data
____	____	Telecommunications via a private telecommunications system
____	____	Other

If the answer is Yes to any of the above, provide the following information for each service, as an attachment to this form:

Description of the service(s).

Missouri tariff reference for the service(s), if applicable.

If the service(s) are provided now or have been provided in the past, the percentage of total Missouri revenue derived from local exchange traffic for each year provided. Indicate whether this information is proprietary.