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Recommended Citation
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IN THE SUPREME COURT
OF THE STATE OF UTAH

)EPARTMENT OF BUSINESS REGULATION)IVISION OF PUBLIC UTILITIES, Plaintiff and Appellant	:	
vs.	:	No. 15701
?UBLIC SERVICE COMMISSION OF JTAH: MILLY O. BERNARD, Chairman;)LOF E. ZUNDEL, Commissioner; and (ENNETH RIGTRUP, Commissioner, Defendants and Respondents	:	

BRIEF OF INTERVENOR - APPELLANT
BUSINESS TELEPHONE SYSTEMS OF UTAH, INC.

Appeal from Report and Order of
Public Service Commission of Utah

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DATED: October 27, 1978

FILED

OCT 27 1978

Clerk, Supreme Court, Utah

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BRIEF OF INTERVENOR - APPELLANT
BUSINESS TELEPHONE SYSTEMS OF UTAH, INC.

PRELIMINARY STATEMENT, DISPOSITION
BELOW, AND RELIEF SOUGHT ON APPEAL

This is an appeal from a Final Report and Order of the Public Service Commission of Utah ("Commission" or "PSC"), in PSC Case No. 76-049-01, approving several business telephone equipment service tariffs filed by Mountain States Telephone and Telegraph Company ("Mountain Bell", "MBT" or "Applicant"). Appellant Business Telephone Systems, Inc. ("BTS"), Intervenor below, challenges the lawfulness of a new Mountain Bell contract payment plan, and of a Mountain Bell costing methodology, sanctioned by the Commission for use in connection with competitive terminal telephone equipment services. Intervenor-Appellant seeks reversal of the Report and Order of the Commission, and rejection of both the two-tier lease-contract tariffs and the incremental pricing methodology approved by the PSC for use by Mountain Bell.

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STATEMENT OF FACTS

1. Procedural History

On September 1, 1976, Mountain Bell filed a Petition and accompanying tariff sheets with respect to a business telephone service, known as Dimension 400 PBX, which it proposed to offer. Though suspended initially for a brief period of time, the proposed tariffs were made effective by order dated October 1, 1976, "subject to the further modification, amendment, or suspension of said tariff by the Commission . . . ."[1/] The Dimension PBX tariffs provided the customer with the option of paying for service under one of two payment plans, a "two-tier" or "lease payment" plan, and a "conventional", or straight monthly payment plan. While the second, or "conventional", payment plan levies a traditional single rate for each month that the customer subscribes to service, as noted below, the two-tier lease payment concept is far more complex. (See Ex. 2, R. 1492; Tr. 46-47, 67-73.)

On September 22, 1976, Appellant Business Telephone Systems of Utah, Inc. ("BTS"), was officially admitted by the Commission as an intervenor in Case No. 76-049-01.

On October 15, 1976, Mountain Bell filed a proposal to restructure, along the lines proposed in the Dimension 400 PBX tariff, the manner in which other of its business telephone

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1/See Order of PSC, issued October 1, 1976, R. 1137-43.

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services are provided in the State of Utah. This proposal was consolidated for hearing with the Dimension 400 PBX petition on December 2, 1976, and the PSC indicated that the Commission would determine, following the close of hearings, the Commission would determine whether these other tariffs should be "suspended, amended or made permanent". (Tr. 315)

Finally, on November 5, 1976, Mountain Bell filed a Petition and accompanying tariff sheets by which it proposed to offer still another telephone system service, known as ComKey 2152, on the two-tier, incremental cost basis. This third set of tariffs became effective on December 4, 1976, subject to further Order after hearing. Hearings on this additional matter were consolidated with the Petition and proposal already consolidated in Case No. 76-049-01.

Hearings were held November 29 and 30, 1976, December 1 and 2, 1976, and February 1, 2, 3, 4, 7 and 8, 1977.

On December 2, 1977, the Commission entered its Final Report and Order in PSC Case No. 76-049-01, approving Mountain Bell's Dimension 400 PBX petition, its ComKey 2152 petition, and its business telephone services proposal.[2/]

2/Intervenor-Appellant BTS was not immediately served with the PSC's Final Report and Order, but, after learning about it by telephone during the second week of December, 1977, Intervenor's counsel called the Secretary of the Commission and requested a copy thereof, which was ultimately received by undersigned counsel on December 16, 1977.

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On January 4, 1978, BTS filed an Appliation for Rehearing with the Commission, which was denied on January 30, 1978. The instant proceeding was commenced by the filing of a Petition for Writ of Certiorari on March 1, 1978. By motion filed May 30, 1978, Mountain Bell moved to dismiss BTS's Petition for Writ of Certiorari and to quash the Writ issued pursuant thereto. MBT's motion was denied by this Court on June 9, 1978. Subsequently, by motion filed June 12, 1978, Mountain Bell moved for reconsideration of its Motion to Dismiss BTS's Petition for Writ of Certiorari, but said Motion for Reconsideration was, in turn, denied by this Court on June 13, 1978.

2. Two-Tier TelaLease Pricing and Mountain Bell's Incremental Costing Methodology

All of the terminal telephone equipment tariffs at issue in PSC Case No. 76-049-01 offer the customer two-tier lease rates as well as a conventional payment plan. The two-tier or lease payment plan purportedly divides the cost of terminal telephone equipment service into two components and utilizes present worth analysis. The first component, or Tier "A" portion of the rate, is paid over a predetermined initial payment contract period which is as long as, or shorter than, the full economic life of the equipment involved. As the Commission observed in its Report and Order:

> Mountain Bell proposed to make available to Utah business customers the two-tier TelaLease payment option of 3, 5, 7 or 10

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> years, as the case may be, for PBX and fixed key telephone service. Under the TelaLease option, the telephone customer's monthly payment consists principally of two portions or tiers: capital-related costs and expense-related costs. "Tier A" is payable over a fixed period of time of either 3, 5, 7 or 10 years depending upon the type of terminal equipment provided. At the end of the fixed payment period, "Tier A" payments terminate. "Tier B" payments run contemporaneously with "Tier A" but continue after "Tier A" payments end. "Tier B" is composed of a fixed portion and a variable portion, both of which are payable throughout the period a customer retains the service. (Report and Order, p. 6, R. 1139)

Under the TelaLease proposal, if a customer discontinues service pursuant to the two-tier lease plan prior to the expiration of the initial contract period, a termination charge is levied equal to the sum of the monthly charges for the unexpired portion of the initial lease period. Presumably, the Tier "A" rates are designed to recover non-recurring-capital costs. Tier "A" rates are not subject to change for any particular customer, although new vintage Tier "A" rates, for new customers, may be filed from time to time. The second component, or Tier "B" rate, is divided into a variable portion, designed to recoup recurring expenses, and a constant portion equal to 18% of the Tier "A" rate, designed to recover part of the capital costs. The Tier "B" rate continues for so long as the customer keeps his service, is not set by lease, is always subject to change, and is the same for all

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subscribers at any given time. (Ex. 2, R. 1492; Ex. 5; Tr. 46-47, 67-73, 117-18, 159-60, 215-16)

Under the TelaLease payment option, the customer allegedly makes a contractual commitment to pay a fixed monthly rate for a fixed period of years. This Tier "A" charge is designed to recover the three basic components of capital cost, *i.e.*, "depreciation, the cost of money and the income tax". (Tr. 131; *and see* Tr. 215-16) Once established for a given installation, the Tier "A" rate applicable to that customer is intended by Mountain Bell to remain unchanged and is not subject to rate increase:

> The applicable monthly Fixed rent will apply without change during the Fixed Rent Payment Period. (*See* original sheet 23, Part 11, Section 6 of the Dimension 400 PBX tariff, R. 1068; Tr. 157.)

Turning to the Mountain Bell's incremental costing methodology, utilized for competitive services only, the PSC's Report and Order states that all of the terminal telephone equipment tariffs in question filed by Mountain Bell were based upon a so-called Long Run Incremental Analysis (LRIA) "taking into account cost factors, demand elasticity, cross-elasticity, payment plans, incrementalism and contribution". (Report and Order, p. 7, R. 1140) According to Mountain Bell, the basic purposes of its LRIA:

> . . . are to estimate the future impact of a pricing decision, because all pricing de-

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> cisions are made for results that they will cause in the future. And it - the second purpose is to use a tool for selecting prices. (Tr. 63)

The salient feature of Mountain Bell's LRIA, for purposes of this appeal, is that it represents an incremental approach to costs. This incremental approach takes into account only "directly related" or additional costs of administration resulting from the particular new service (Tr. 452) and ignores or overlooks common overhead costs of the utility.

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ARGUMENT

POINT I - THE COMMISSION ERRED IN APPROVING THE TWO-TIER TELALEASE PAYMENT PLAN.

A. The Two-Tier TelaLease Payment Plan Concept Constitutes A Predatory, Anti-Competitive, Exclusionary Pricing Technique In Restraint Of Trade Which Is Designed And Intended To Maintain Mountain Bell's Monopoly In The Terminal Telephone Equipment Market In Utah.

State regulatory agencies have repeatedly been required to consider and enforce antitrust policies where public utility services are concerned. Gulf States Utilities Co. v. Federal Power Comm'n., 411 U.S. 747 (1973); Otter Tail Power Co. v. United States, 410 U.S. 366 (1973)[3/] Appellant respectfully submits that the Commission below did not properly consider or enforce these policies.

3/See also Northern California Power Agency v. California Public Utilities Comm'n., 96 Cal. Rep. 18, 46 P. 2d 1218 (1971), where the California state regulatory body was required to consider the antitrust laws, both state and federal, in the case of a public utility company seeking to construct and operate an electric power plant; Phonetele, Inc. v. Public Utilities Comm'n., 113 Cal. Rep. 16, 520 P. 2d 400 (1974), in which the Supreme Court of California, in applying the law of Northern California Power Agency to a telephone interconnection tariff, articulated principles calling upon the Commission to carefully weigh competitive factors to assure that a tariff was not being, and would not be, used for anti-competitive monopoly purposes.

In addition, several state regulatory agencies have considered and applied antitrust principles specifically to two-tier contract tariffs. For example, the Colorado Public Utilities Commission, in its decision of November 26, 1975 in Docket No. 881, rejecting a two-tier TelaLease tariff proposed by Mountain Bell for ComKey service, stated:
(footnote continued on next page)

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In a Report and Order totally devoid of citations to the transcript or exhibit evidence in this case, the Commission made only the following conclusory statements:

> 10. The TelaLease or two-tier concept of pricing is not anti-competitive in nature and will not artificially enable Mountain Bell to maintain its market position. . . .
>
> 11. The two-tier concept of pricing is a permissible offering in this jurisdiction and is a reasonable response from Mountain Bell to the competitive market in which it must offer its terminal equipment. (Report and Order of December 2, 1977, at 11-12, R. 1142)

From these summary opinions, it is absolutely impossible to determine the reasoning processes which led the Commission to reach its conclusions. The PSC's Report and Order amounts to little more than an arbitrary dismissal of Intervenor-Appellant's

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> The Commission recognizes the benefits that have accrued to the public through the introduction of competition . . . [C]ompetition in the areas of terminal telephone systems equipment has been declared to be in the public interest. Given this declaration of public policy, it is the Commission's opinion that it should consider the state antitrust laws in determining whether the proposed tariffs are just and reasonable. [citations omitted] (Decision of November 26, 1975, on reargument in Docket No. 881, at 21-22)

See also Massachusetts Department of Public Utilities Docket 18403, Decision of April 26, 1976, at 12-13, aff'd, New England Tel. & Tel. Co. v. D.P.U., 363 N.E. 2d 519 (Mass. Sup. Ct. 1977)

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allegations, without any attempt to come to grips with the issues and evidence raised and introduced below. In fact, the Commission's decision is contrary to the manifest weight of the evidence, and is erroneous in view of the reliable, probative and substantial evidence on the whole record.

The fallacious and arbitrary nature of the Commission's opinion is underscored by the fact that a third party, the Utah State Attorney General, independently scrutinized the record evidence and filed a comprehensive _amicus curiae_ brief carefully explaining to the Commission how the antitrust laws apply to the facts of this case, and why, in the opinion of the Attorney General's Antitrust, Trade Regulation and Consumer Protection Section,

> . . . this Commission is legally obligated to reject the tariff proposed by Mountain Bell in this proceeding due to the serious anti-competitive effect that its approval would have in the market for PBX systems. The two aspects of the proposal that are most objectionable from an antitrust standpoint are the long-term leasing provisions associated with the TelaLease and the underpricing of Dimension equipment and services. The record indicates that these two practices are designed to maintain, increase and prevent erosion of Mountain Bell's dominance in the PBX market by working to exclude and eliminate present and potential competition. (Brief of Attorney General, p. 26, R. 1410)4/

4/On November 30, 1977, the Assistant Attorney General, Antitrust Division, filed a brief on behalf of the Attorney General of Texas before the Public Utility Commission of (footnote continued on next page)

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It is egregious, and inexcusable, that other than a mere passing reference to the fact that the Attorney General filed a brief before the Commission (Report and Order, p. 4, R. 1138), no mention, discussion or analysis of the antitrust implications of the two-tier TelaLease concept appears anywhere in the Commission's Report and Order.[5/]

As noted by the Utah State Attorney General, the long-term two-tier TelaLease pricing concept violates well established principles of federal antitrust law. The offense of monopolization involves two elements:

> (1) possession of monopoly power in the relevant market; and
>
> (2) willful opposition or <u>maintenance of that power</u> as distinguished from growth or development as a consequence of a superior product, business acumen, or historical precedent. (<u>United States</u> v. <u>Grinnell Corp.</u>, 384 U.S. 563 at 570-71 (1966)) (emphasis added)

Monopoly power, in turn, is defined as "[t]he power to control prices or exclude competition in a relevant market". <u>Grinnell</u>, <u>supra</u>, at 571.

(footnote continued from previous page)
Texas, in Docket No. 156. At issue was a Dimension PBX tariff similar to MBT's tariff in Utah, filed by Southwestern Bell Telephone Company. That brief concurred wholeheartedly with the Utah State Attorney General's antitrust allegations.

5/Indeed, the Commission paid such little heed to the antitrust arguments that it even neglected to list in its Report and Order any appearance by the Antitrust, Trade Regulation and Consumer Protection Section of the Attorney General's office.

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The very large percentage of the PBX market in the State of Utah controlled by Mountain Bell leaves no doubt that Mountain Bell is a monpolist.[6/] Prior to 1968, Mountain Bell was the sole supplier of terminal telephone equipment in the State of Utah, and thus enjoyed an absolute monopoly over the provision of PBX and key telephone equipment throughout the area of its operation. It was only following the 1968 decision of the Federal Communications Commission, _In the Matter of the Use of Carterfone Device_, 13 FCC 2d 420 , _recon. denied_ 14 FCC 2d 571 (1968) ("_Carterfone_") - holding, _inter alia_, that AT&T tariffs prohibiting the interconnection of customer-provided telephone terminal equipment were unjust and unreasonable under the Federal Communications Act of 1934, 47 U.S.C. 151 _et seq_ - that Mountain Bell [and indeed the entire Bell Telephone System of which it is an integral part] began to experiene some slight competition in the provision of PBX and key telephone terminal equipment and services. Both the Federal Communications Commission[7/] and the Massachusetts

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6/As of the time of hearing of this case, the total number of Mountain Bell's PBX and key telephone customers in the State of Utah was 9,410. (Tr. 234) By contrast, there were only 211 interconnect PBX and key telephone systems in the State of Utah, according to Mountain Bell's own estimate. (Tr. 401) Thus, MBT's share of the total market is 98%. (Tr. 472)

7/ The present unlawfulness of the tariff also permeates its past. It has been unreasonable and unreasonably discriminatory since its inception for the reasons

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Department of Public Utilities[8/] have held that Bell's monopolization over telephone equipment was unlawfully obtained. Mountain Bell, through its two-tier TelaLease payment concept, is now striving to maintain its monopoly position through the use of an anti-competitive pricing technique.[9/]

The widely recognized decision in United States v. United Shoe Machinery Corp., 110 F.Supp. 295 (D. Mass. 1953) aff'd per curiam, 347 U.S. 521 (1954), presents a situation very analo-

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> given above. That the Telephone Company may not have known prior to the proceedings herein that the Carterfone was in fact harmless is in fact irrelevant, since they barred its use without regard to its effect upon the telephone system. Furthermore, the tariff was the carrier's own. It was not prescribed by the Commission. It has remained subject to complaint and to a finding that it had been unlawful since its inception.
>
> A Commission-prescribed rate or practice must be followed by the carrier. It becomes the lawful rate or practice. But where the carrier itself initiates the rate or practice its unlawfulness remains open, not only to a prospective finding, but also to a retrospective one. (Carterfone, supra, at 425) (emphasis added)

8/Mass. D.P.U. Docket 18403, Decision of April 21, 1976, supra, at 24)

9/As Justice Learned Hand has recognized, ". . . no monopolist monopolizes unconscious of what he is doing". United States v. Aluminum Company of America, 148 F.2d 416, 462 (2nd Cir. 1945)

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gous to the one at bar. United Shoe held, because of United Shoe's monopoly position, that United's ten-year leases for shoe manufacturing machinery 10/ constituted monopolization in violation of Section 2 of the Sherman Act. 11/ As in United Shoe, Mountain Bell refuses to sell its PBX and key telephone equipment outright to the public. As in United Shoe, Mountain Bell's Dimension PBX leases require a commitment to obtain, or at least pay for, 10 years of service. As in United Shoe, MBT's leases are designed to perpetuate Bell's monopoly status in an area which has now been opened to competition. As a practical matter, service is provided only by means of long-

---

10/Lest the similarity between the telephone and shoe machinery industry be regarded as attenuated, it must be noted that the relationship between the two industries dates back to the very early days of the telephone. As John Brooks observed in his recent book on the history of the Bell System:

> . . . [S]omewhere along the way [Gardiner] Hubbard made what would prove to be one of the key decisions in telephone's corporate history - the decision to rent telephone service rather than to sell telephones apparently based on a previous successful experience of Hubbard's in leasing shoe-making machinery. [Brooks, Telephone, the First Hundred Years, Harper & Rowe, 1975, at 55] (emphasis added)

11/Section 2 of the Sherman Act, 15 U.S.C. §2 states: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several states, or with foreign nations, shall be deemed guilty of a misdemeanor . . . ." Similarly, the Utah Code, Section 50-1-3 makes it unlawful for any corporation to enter into any agreement, or combination to "monopolize any part of trade or commerce".

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term leases, since the alternative traditional month-to-month rental rates have been set so high in relation to two-tier TelaLease rates as to be very unappealing to the vast bulk of MBT's business customers. (Tr. 570, Ex. I-8, R. 1535, p. 56)[12/]

In United Shoe, Judge Wyzanski noted:

> Much of United's market power is traceable to the magnetic policies inherent in its system of leasing.
>
> * * *
>
> Yet, they (the leasing practices) are not practices which can be properly described as the inevitable consequences of ability, natural forces, or law. They represent something more than the use of accessible resources, the processes of invention and innovation, and the employment of those techniques of employment, financing, production, and distribution, which a competitive society must foster. These are contracts, arrangements, and policies, which, instead of encouraging competition based on pure merit, further the dominance of a particular firm. In this sense they are unnatural barriers; they unnecessarily exclude the actual and potential competition; they restrict the free market. While the law allows many enterprises to use such practices, the Sherman Act is now construed by superior courts to forbid the continuance of effective market control based in part upon such practices. (110 F.Supp. at 344-45) (emphasis added)

The record evidence in this case, particularly Exhibit I-1, R. 1529, the "Two-Tier Contract Plan" made available by

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12/And see Ex. I-8, R. 1935, J.W.-19, which shows the relationship between the regular monthly rates and the two-tier TelaLease rates for Dimension PBX.

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the American Telephone and Telegraph Company ("AT&T") to MBT in 1973 (Tr. 104), overwhelmingly demonstrates that two-tier TelaLease pricing is anti-competitive, both in purpose and intent. The evidence shows that it was designed to restrain and eliminate what little competition presently exists in the terminal telephone equipment market in Utah.

By its own language the Two-Tier Plan applies only to competitive telephone products and directs MBT to use, in markets of high competitive vulnerability, contracting devices which lock customers into Bell services over a period of years, and to thereby join in AT&T's anti-competitive scheme. (*See* Ex. I-1, R. 1529, Section 4 and Section 7, p. 2)

Section 1 of the Two-Tier Contract Plan directs the attention of MBT to the necessity for market analysis, including determination of "competitive price levels". Once this first step is taken and a market price is established, Sections 2, 3, 4 and 5 of the Plan emphasize the importance "from a regulatory aspect" of cost studies designed to support or justify the selected "competitive price level". It is thus clear that, from the outset, AT&T directed MBT that the price of competitive offerings should be dictated primarily by competitive, as opposed to cost, considerations.[13/] The Two-Tier Contract Plan constitutes a master plot for im-

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13/Indeed, MBT concedes: "We price according to what the market says is - is the right price". (Tr. 54)

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plementation of a radical new two-tier pricing technique; it discusses market and rate strategies (Section 3), and presents illustrative tariffs in contract form (Section 4) complete with rates and a computer program which can be used to calculate two-tier costs.

Finally, the AT&T Two-Tier Contract Plan also outlines how telephone companies should "handle" state regulatory commissions, with specified directions and instructions relating to lobbying, in order to gain acceptance of two-tier lease pricing and to preclude or minimize intervention and hearing. Section 6 of the Plan (Ex. I-1, R. 1529) underscores the necessity for pre-tariff lobbying:

> State regulators must be made aware of the problem areas brought about by outside vendors and the realistic solutions made possible by unusual and often controversial new services. This requires direct involvement in company planning on the part of state regulatory contact people. Their knowledge of the Commission can greatly assist planning efforts . . . . [I]t pays off in a better understanding and a more permissive climate (Ex. I-1, R. 1529, Section 6) (Emphasis added)

In addition, Exhibits I-8, R. 1535, J.W.-17 and J.W.-18 demonstrate that Mountain Bell received from its parent company, AT&T, guidelines and directives designed to insure that two-tier rates would in practice provide a very strong economic inducement for MBT's customers to enter into long-term service contracts, rather than to subscribe to telephone service on a traditional monthly basis. (Ex. I-8, R. 1535, p. 56)

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The record is replete with references by several witnesses to the lock-in effect of two-tier TelaLease pricing. (See Ex. I-8, R. 1535, p. 42; Tr. 650; 1001.) Such views were voiced not only by the Intervenor-Appellant, but also by other interconnect companies (Tr. 262), by a representative of the University of Utah (Tr. 268), and by the Commission staff's own witness, Mr. Hogstrom. (Ex. D-1, R. 1526, pp. 12-13)

Mr. Hogstrom indicated:

> There is the danger that if we allow Mountain Bell to offer telalease contracts, then the market will be closed to competition.
>
> * * *
>
> . . . the possibility exists that with the adoption of these telalease tariffs, a large segment, if not all of the market, would be closed to competition . . . . [T]he competitor has most likely lost that opportunity for the life of the telalease contract. This brings up the possibility of Mountain Bell "locking up" the marketplace for a number of years by this means. (Ex. D-1, R. 1526, pp. 12-13)

Finally, the record evidence demonstrates that in view of Mountain Bell's overwhelming 98% monopoly share of the PBX and key telephone market in the State of Utah (Tr. 234, 472), its very favorable win/loss record even in the absence of two-tier TelaLease pricing (Ex. 14, R. 1522, Tr. 388, 391, 488), the marketing experience and expertise of MBT (Tr. 32, 383-85), and the stringency of MBT's lease service arrangement (Tr. 115, 151, 160, 170, 207, 731-32, 968, 922-23), that denial of two-

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tier TelaLease pricing would not unduly handicap Mountain Bell in the terminal telephone equipment market.

To all of the above evidence, the PSC turned a deaf ear.

As Intervenor-Appellant's witness, Dr. Wilson, stated: "The conduct of a firm has to be evaluated in terms of its competitive or anti-competitive impact based upon the posture, the position, the dominance that that firm holds within the market." (Tr. 923) Such an evaluation was most assuredly not performed by the Utah Public Service Commission in this case.14/ The Utah Commission did not allude at all to any of the overwhelming evidence marshalled by Intervenor-Appellant, summarized above, and set forth in detail at pages 25-37 (R. 1299-1311) of Intervenor's initial brief to the Commission.

Because Mountain Bell in the past has relied on the Tenth Circuit U.S. Court of Appeal's decision in Telex Corp. v. Internat'l. Bus. Mach. Corp., 510 F.Supp. 894 (1975), it must be noted, even before a responsive Brief is submitted, that any such reliance on Telex by Mountain Bell would be entirely misplaced. First, United Shoe was appealed to, and affirmed per curiam by, the United States Supreme Court. The validity

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14/Obviously, when a company with 98% of the market locks up customers, that company's market share begins to approach 100%, and competition is totally eliminated. When a company with less than 1% of the market ties up a customer for a period of years, the effect is pro-competitive and the continued existence of at least minimal competition is guaranteed.

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of Telex v. IBM was never passed upon by, and the case is not now pending before, the United States Supreme Court. If in fact there were any inconsistency between United Shoe and Telex, then surely the U.S. Supreme Court's opinion, rather than the opinion of the U.S. Court of Appeals, must control.

Second, in actuality the decision in Telex actually supports Intervenor-Appellant herein. The trial court in Telex found that IBM did not possess a monopoly since it enjoyed just over 35% of the market in 1970, down from 64% in 1952. (510 F.2d at 898-99) As noted earlier, in this case Mountain Bell's market share is 98%, down from 100%.

Moreover, in the Telex case, the leasing plan approved by the Appellate Court was one used by all competitors. (510 F.2d at 902-03, 906) That is not the case in this instance. The record below contains little or no support for the notion that the contract-leasing scheme inherent in Mountain Bell's two-tier TelaLease concept constitutes an ordinary and typical marketing method employed by other competitors in the market. At no place in the record is there any indication that Intervenor-Appellant, or any other interconnect supplier in Utah, utilizes "two-tier pricing".

Interconnect equipment is sold outright. Maintenance is obtained pursuant to a separate contract, or on a time and materials basis, from either the equipment seller or another entity. The purchaser need not obtain such maintenance from

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the third party leasing company, as is the case when Mountain Bell leases equipment pursuant to its TelaLease plan. (Tr. 1014-15, 1021-22) Whereas Intervenor-Appellant BTS sells equipment, title ultimately passing to the purchaser, Mountain Bell does not sell equipment. Title to the equipment never passes. Ownership is always retained by MBT, and the subscriber is not free to take his equipment anywhere within or without the State of Utah, to use it at another location, or to resell it[15/] if he so desires. (Tr. 115, 151, 160, 170, 207, 731-32, 922-23, 968) In exchange for payment of the total cost of an interconnect piece of terminal equipment, the customer obtains a tangible benefit in the form of a substantial property interest. When and if the customer elects to sell his equipment, to purchase new equipment from another supplier, or to obtain service from Mountain Bell, his property interest can be converted into cash. The Mountain Bell customer receives no such benefit of title and merely obligates himself to pay for service for a minimum period of years. Competitive suppliers are thereby "locked out" of the market, and the market is "locked up" for Mountain Bell.

In contrast to the cursory treatment rendered by the Commission below, the Public Utilities Commission of the neighboring State of Colorado, in its first two-tier opinion

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15/The evidence below establishes that there is a significant market for used terminal telephone equipment. (Tr. 1021)

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dealing with Mountain Bell (Decision No. 86791, issued May 6 1975), considered allegations virtually identical to those advanced by Intervenor-Protestant herein. At issue was a tariff for ComKey telephone service proposed by Mountain Bell. The Colorado Commission stated:

> Respondent [Mountain Bell] finds itself faced with competition in the marketplace when in the very recent past it enjoyed a virtual monopoly position . . .
>
> * * *
>
> It was in response to that competition that Respondent established the tariffs that are here under consideration. The Commission recognizes the benefits that have accrued to the public through the introduction of competition.
>
> * * *
>
> It is clear that Respondent has monopoly power within the relevant market because of its predominant share of the market which is in excess of 92% and because of Respondent's massive size and length of time as the only source of supply in the market which has just recently changed. . . . <u>The [two-tier lease] concept was developed in combination with AT&T and perhaps Western and Bell Labs to beat the competition they were facing and thus violates the anti-trust statutes of this state. There is no reason or consideration can justify this situation . . . because of the anti-trust violation involved with the tariff here under consideration . . . the tariffs here under suspension are found and concluded to be unjust and unreasonable.</u> [Decision No. 86791, May 6, 1975 at 16-18, 19] (emphasis added)

And, in its subsequent Decision and Order on Reargument

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No. 87834, issued November 26, 1975, the Colorado Public Utilities Commission concluded, in affirming its prior decision:

> The Tele-Lease could be a means to enable respondent to continue its control over the . . . market and thus to tie up the market and accomplish the market coverage objective set by AT&T of 100% . . . . (Decision No. 87834, p. 27) (emphasis added)

In sum, the Commission erred in approving a two-tier TelaLease payment plan which is exclusionary, anti-competitive, and was designed and intended to restrain trade.

In recognition of applicable antitrust laws, and in accordance with the independent judgment and opinion of the Utah State Attorney General, this Court should reject the two-tier TelaLease payment concept, and the long-term service arrangement inherent therein. Only by so doing, can this Court preserve and protect what little competition now exists in the terminal telephone equipment market in Utah.

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B. The Two-Tier TelaLease Payment Plan Concept Is Inherently And Unlawfully Discriminatory And Preferential, In That It Insulates The Rates Of Certain Select Subscribers To Competitive Services Against Increases In Capital-Related Costs, While Imposing The Burden Of Those Capital-Related Cost Increases On All Other Mountain Bell Ratepayers.

The Tier "A" portion of Mountain Bell's TelaLease rate is designed to recover such capital-related costs as depreciation, cost of money, and income taxes. (Tr. 131, 215-16) However, while the Tier "A" rate is fixed, these capital-related costs are not fixed. The evidence below demonstrates that regardless of changes over time in the cost of money, and in the federal income tax rate, the customer's Tier "A" payments "will apply without change during the Fixed Rent Payment Period". (emphasis added) (*See* original Sheet 23, Part 11, Section 6 of the Dimension PBX tariff, R. 1068; Tr. 157.) When these measurable capital-related costs change during the service or economic life of a PBX or key telephone system, the Tier "A" portion of the TelaLease subscriber's rate should change, just like all other telephone utility subscribers' rates change when these important capital costs increase. MBT, which never sells equipment but instead provides a service over time, should not be permitted to guarantee the unchangeability of any rate.

When the Utah Public Service Commission awards an increased rate of return to the Company in a general rate case,

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or when the applicable federal income tax rate increases, basic subscribers experience an increase in rates, regardless of the length of time they have subscribed to, or have agreed to subscribe to, telephone service. Under two-tier TelaLease pricing, two-tier customers, alone, are blessed with the privilege of never having to incur a rate increase to reflect an increase in capital-related costs. Two-tier contract subscribers simply do not share the burden of these increased costs. No other MBT subscribers besides certain select business customers are offered "a guarantee that a portion of their rates will not be subject to future rate increases". (Tr. 156) Residential customers who subscribe to basic telephone service cannot "obtain that same sort of insulation against changes in the authorized rate of return by promising to sign up for a certain number of years of service". (Tr. 170) As MBT's witness, Mr. Brown, stated on the record, " . . . . the benefits of lease pricing are not available to a residential customer . . . unless he does require key telephone service". (Tr. 221)

Intervenor-Appellant's witness, Dr. Wilson, criticized the application of two-tier TelaLease vintage pricing to specific services in the following terms:

> What MB has proposed in this regard is a discriminatory pricing structure available only for a certain competitive product, and available to only select cus-

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tomers located in market segments of its business which are vulnerable to competition. The attempt to recover capital investment in a PBX account via a two-tier pricing mechanism by incorporating a fixed-term payment, while denying this pricing approach for the recovery of capital investment in other terminal equipment (such as the basic single-line telephone set) is discriminatory. Thus, for example, if embedded costs continue to increase over time, vintage Dimension PBX subscribers will be immune from parallel rate increases, and general telephone subscribers will be forced to bear the entire burden.

* * *

. . . Two-tier capital costs are not fixed for MB. Interest rates on debt, return on equity, depreciation rates and income rates change over time. As these changes occur, although they may be reflected in future vintages, the company expresses no intention to reach back into prior two-tier vintage tariffs in order to adjust the old capital rates to reflect current and future conditions. Under these circumstances, if, for example, MB's capital costs rise in the future due to the maturing and refinancing of old cost debt, or if income taxes were to increase, older Dimension PBX customers will pay preferentially lower rates in relation to all other MB ratepayers. This, too, would result in a discriminatory rate structure for all Dimension PBX services. (Ex. I-8, R. 1535, pp. 43-44)16/

16/Although Dr. Wilson's comments were directed at Dimension PBX, it is clear that his criticism is directed at the entire two-tier TelaLease vintage pricing concept, and at "the pricing changes . . . for items of business terminal equipment . . . primarily . . . PBX and key services". (Tr. 39, 42; Ex. 2, R. 1492)

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The Staff of the Utah PSC concurred with Dr. Wilson's analysis. When asked whether he "saw any discrimination inherent in the two-tier lease tariff concept by virtue of the fact that those rates alone among all of Mountain Bell's rates are fixed or insulated against change", Mr. Hogstrom responded "we've got one class of customer . . . who is now going to get a different pricing option available to him that at the moment is not available to anybody else. If that's discrimination . . . I guess so". (Tr. 714-15) The PSC closed its eyes to all this evidence.

In response to the joint contention of the Commission's own Staff and Intervenor-Appellant, the Commission's Report and Order provides only the following conclusory statement:

> 10. . . . said TelaLease concept is not discriminatory in nature either to other PBX customers, to other categories of telephone customers or as between two-tier customers. (Report and Order, p. 11, R. 1142)

Once again, the basis for the Commission's decision is obscure or non-existent. The Report and Order constitutes little more than an arbitrary dismissal of Intervenor's and Staff's contention, without any attempt to come to grips with the issues raised. It remains impossible to ascertain how or why the Commission reached the "findings and conclusions" which appear in its Report and Order. Blanket generalizations and summary conclusions are not sufficient in a case of this

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magnitude and importance. Other than the unexplained statements of the Commission that the terminal telephone equipment tariffs which are the subject of the proceeding are "not discriminatory in nature" (Report and Order, p. 11, R. 1142) and are "non-discriminatory" (Report and Order, p. 12, R. 1142), no discussion, analysis or any other reference to the discrimination argument, or to the underlying evidence and MBT's failure to meaningfully refute that evidence, appear anywhere in the Commission's decision. The Commission's conclusion is thus totally naked and unsupported.

By contrast, the Massachusetts Department of Public Utilities, in its two-tier contract pricing decision, based on a record and a tariff virtually identical to the one under review here, identified and declared illegal the very discrimination described by Dr. Wilson and recognized by Mr. Hogstrom:

> Tier A prices are founded upon an assumption of fixed earnings and tax rates. Between 1970 and 1975, the Department has authorized four increases in earning rates for MBT . . . . The federal corporate income rate has fluctuated between 48 and 52 percent, while income tax rates in the Commonwealth have increased over the past decade. Under these uncertain conditions, there is no assurance what the required level of capital costs and tax rates will be five years from now, let alone for the next decade.
>
> * * *
>
> Under conditions of rising capital costs and income taxes, Plan I (two-tier) cus-

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> tomers would be insulated from any increases in these costs.
>
> In the event of an increase in such costs, NET would properly stay "whole" in that it would be entitled to recover all the taxes and a fair rate of return on its total investment. If revenue deficiencies were recouped in future years, they would be recouped from other classes of ratepayers.
>
> * * *
>
> Accordingly, the 2-tier plan can be rejected on the basis that it is unjustly discriminatory as against other classes of ratepayers. (Mass. D.P.U. Docket 18403, Decision of April 21, 1976, pp. 21-23, aff'd, New England Tel. & Tel. Co. v. D.P.U. 363 N.E. 2d 519 (Mass. Sup. Ct. 1977) (emphasis added)

On appeal, in affirming the Department's rejection of two-tier contract pricing, the Massachusetts Supreme Judicial Court held that the D.P.U.'s disapproval of "rates which are unjust, unreasonable and otherwise discriminatory" was supported by "substantial evidence". (New England Tel. & Tel. Co. v. D.P.U., 363 N.E. 2d 519 Mass. Sup. Ct. 1977)

The Massachusetts Supreme Court stated:

> From this evidence, a reasonable mind could conclude that the Plan I price structure discriminated against customers of NET's non-competitive services; that the ratemaking processes encouraged discrimination in favor of competitive services; and that Plan I, therefore, was not in the public interest. (New England Tel. & Tel. Co. v. D.P.U., 363 N.E. 2d at 524)

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The only reasonable conclusion to be drawn from the evidence submitted below in this case is the one reached by the Massachusetts regulatory body and affirmed by the Massachusetts Supreme Court.[17/]

Attempts by regulated Bell System operating telephone companies to fix terminal telephone equipment rates have been rejected by other conscientious regulatory commissions besides the Massachusetts Department of Public Utilities. For example, the Montana Public Service Commission, in Docket No. 6496, stated in its Order No. 4389d of September 29, 1978:

> Included in the Tela-Lease contract is the provision that tier A rates will remain unchanged for the duration of the lease. The Commission reserves the right

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17/Very recently, the Massachusetts D.P.U. finally did approve a modified two-tier payment plan, but only after the New England Telephone and Telegraph Company struck from its two-tier tariff all references to a fixed rate for the term of the contract. The Mass. D.P.U. required the incorporation into NET's two-tier tariff of a practical, built-in safeguard against cross-subsidization in the form of an automatic Tier "A" supplement charge whenever there is any increase in capital costs. The D.P.U. stated:

> . . . in order to address the question of future cross-subsidization, any increase in capital costs would have to apply _automatically_ to Tier "A" customers _when increased_ just as the increase would apply to other classes of ratepayers. (Mass. D.P.U. 19319, Order of March 31, 1978, pp. 7-8) (emphasis in original)

The notion of a capital cost-related rate which is guaranteed against change was thus totally and finally rejected a second time by the Massachusetts Department of Public Utilities.

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> to change this portion of the two-tier when its analysis indicates that an adjustment is warranted. To do otherwise would be to abrogate the Commission's responsibility for ongoing regulation of utility rates. The Tela-Lease contract shall inform customers that tier A payments may be changed by Commission action. (Order No. 4389d, Sept. 29, 1978, Finding 77 at p. 28)

Similarly, the Nebraska Public Service Commission, in Application No. 31287, entered June 24, 1976, although it allowed a modified form of two-tier lease pricing for Northwestern Bell Telephone Company wrote:

> First, the provisions declaring that Tier "A" rates are fixed, not subject to change should not be allowed. The tariffs should be modified in order to clearly indicate to customers that Tier "A" rates are subject to the jurisdiction of this Commission and are subject to change upon order of the Commission and all customers subscribing to two-tier rates should be so notified. (Order, p. 6)

Similarly, although the Rhode Island Public Utilities Commission approved a modified two-tier rate, it ruled:

> New England Telephone Company cannot guarantee "no change" in Tier "A" rates to potential customers, in view of this Commission's jurisdiction over said rates and our ability to change said rates on our own motion. (Docket 1207, Opinion dated September 13, 1976, p. 10)

In sum, the Commission erred in approving a payment structure which the record evidence shows unequivocally to

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be highly discriminatory.[18/]

18/In this connection, it is ironic that the one gratuitous concession in the Commission's decision to the challenge to two-tier TelaLease tariffs posed by Intervenor and the Commission staff is really no concession at all. Finding No. 13 of the Report and Order states:

> In order that customers entering into TelaLease with Mountain Bell might not be misled as to the continuing jurisdiction of this Commission, it is necessary that all tariffs relating to the TelaLease and the lease document itself contain language indicating that the Commission may at any time by proper administrative procedure change the variable portion of the "Tier B" under said leases. (Report and Order, p. 12, R. 1142) (emphasis added)

This quotation is the most glaring illustration of the Commission's failure to carefully consider the evidence in this case. The sole "revision" or "modification" to the tariffs ordered by the Commission really amounts to nothing more than a restatement of what is already contained in the proposed tariff. There never was any dispute in this case concerning the changeability of the "variable" portion of the Tier B rate, so that the Commission's order does not modify the original tariff at all. (Ex. I-6, R. 1534, Tr. 71) Had the Commission really reflected upon and considered the arguments and the evidence in this case, it would not, and it could not, in good conscience, have ordered an alleged "revision" which is really nothing more than a recapitulation of the tariff as initially proposed by MBT. It was always the fixed "Tier A" rate, and the constant portion of the "Tier B", which were the focal points of contention, and not the admittedly changeable, variable portion of the "Tier B" rate.

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C. The Methodology Utilized By Mountain Bell To Compute Net Book Investment For Two-Tier TelaLease Rate-Making Purposes Establishes The Dependency Of Two-Tier TelaLease Pricing On The Existence Of Monopoly Revenues.

The evidence before the Commission demonstrates unequivocally that the "equated cost of money" ("ECM") methodology utilized by Mountain Bell to determine net book investment for two-tier TelaLease rate-making purposes necessarily results in rates which require cross-subsidization by other Mountain Bell ratepayers. (*See* Intervenor-Appellant's Brief to the Commission, pp. 102-05, R. 1376-79.) For two-tier TelaLease tariff purposes only, Mountain Bell computes the rate of return, or cost of money, based on only 62.5% of total original investment. (Tr. 908-09) Intervenor urged below that Mountain Bell's cost of money, or rate of return, for two-tier TelaLease purposes be based upon the Company's system-wide depreciation factor in 1975, which was in excess of 85%. (Ex. I-12, R. 1540)

The record evidence below shows that, under Mountain Bell's "equated cost of money" approach, during the first half of an asset's life (a PBX or a key telephone system), before the actually declining net book investment reaches the average, or mid-way point, of net book investment for a particular asset, the difference, or defficiency, must be made up by Mountain Bell's general ratepayers. Although, admittedly, the total cost of capital may be finally realized at the very end of the last year of a particular two-tier TelaLease asset's

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life, so long as the number of two-tier TelaLease assets continues to increase over time, there will exist a perpetual deficiency which must be made up by monopoly revenues. As Intervenor-Appellant's expert witness, Dr. Wilson, stated:

> . . . We're dealing with a growing element within the Company's overall rate base. Dimension PBX systems are growing in leaps and bounds in terms of proportionate share of the rate base . . . . If you take a growing entity . . . and you apply the equated cost of money you're going to end up with a repeated deficit year after year after year. That's why when you establish rates for a regulated electric utility you make a - you make an adjustment to the gross investment and plant and equipment by subtracting out accrued depreciation, but that usually winds up with a net investment of somewhere in the 75 to 85 percent of gross investment ballpark. (Tr. 936-37)

It is essential, if two-tier rate-making is to be allowed at all,[19/] that an appropriate depreciation factor be utilized which will be applicable, "over the period of time that the

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19/Although two-tier TelaLease pricing must be rejected for several reasons, it should be noted that it is theoretically possible to offer two-tier lease payment plans without utilizing the equated cost of money concept. For example, Dr. Wilson used a much higher net or depreciated investment figure in his two-tier cost study than the 62% which results from MBT's ECM methodology. (Ex. I-8, 1535) Massachusetts has not allowed its local Bell Operating Telephone Company to utilize the ECM methodology in the modified two-tier lease payment plans which its regulatory body approved five months ago, and the California Public Utilities Commission has recognized the burden imposed on other groups of subscribers by the use, for two-tier tariff subscribers, of the equated cost of money methodology (See Ex. I-8, R. 1535, J.W.-16, p. 3.), and has rejected ECM even though it has allowed some two-tier rates.

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rates are going to be in effect". (Tr. 939)

As if none of this evidence existed, the Commission's Report and Order contains no mention whatsoever of the Company's use of the "equated cost of money" methodology for two-tier TelaLease pricing purposes. No findings, discussion or reference to any of the evidence relating to the "equated cost of money" methodology appears anywhere in the Commission's decision. Other than the Commission's glib assertion that all the business terminal telephone equipment services in question "are priced at level which will recover for Mountain Bell all of its costs associated with the provision of said products and services," (Report and Order, p. 11, R. 1142) none of the intricacies of the net investment costing methodologies proposed by Mountain Bell, on the one hand, and by Intervenor-Appellant, on the other, are even referenced, much less resolved, by the Commission.

By contrast, the very "equated cost of money" methodology problems called to this Commission's attention by Intervenor-Appellant were recognized and acknowledged by the Massachusetts Department of Public Utilities:

> A key component of the 2-Tier methodology is the ECM principle . . . under which reimbursement for capital costs would be obtained. As we see it, the ECM procedure is a completely valid procedure for preparing engineering economy studies, i.e., making investment choices when capital additions and revenues are contemplated at

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> different time intervals. We find the application of the ECM methodology, however, wholly inappropriate for utility rate-making.
>
> * * *
>
> . . . If we were dealing with a static plant, the impact on total revenues would not be perceptible. However, 2-Tier pricing is being proposed by NET for its most advanced and presumably most rapidly growing PBX offering. Under situations of market growth, we have substantially a negative flow-through effect . . . . As the gross plant investment increases year by year, the cumulative revenue deficiencies between the sum of annuity payments and a corresponding depreciation, return and taxes widens.
>
> * * *
>
> The company can contemplate the offering of 2-Tier pricing on a present worth annuity basis only because of its monopoly position. Approximately 90% of company revenues are derived from monopoly service classifications. Deficiencies in return during the early stages of Dimension PBX service can be recouped through overall state-wide rate of return adjustments. To apply ECM procedures universally to all NET services would ensure corporate insolvency. (D.P.U. 18403, Decision of April 21, 1976, pp. 17, 19, 21) (emphasis added)20/

20/Similarly, in its recent Dimension two-tier decision, the Montana Public Service Commission reasoned as follows:

> The ECM-FGR debate revolves around the question: Are Dimension . . . services provided by single units of investment or assets which are members of a pool? In Finding of Fact No. 77, the Commission

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The Utah Commission totally ignored all the record evidence dealing with the "equated cost of money" methodology, evidence which shows that its use makes two-tier TelaLease tariffs dependent, for their compensatory sufficiency, on the existence of monopoly revenues. The "equated cost of money" methodology necessitates the use of non-two-tier TelaLease revenues to cross-subsidize two-tier TelaLease subscribers in the earlier years of their service, and thus constitutes a classic transfer of monopoly power in further violation of federal antitrust law. (United States v. Griffith, 334 U.S. 100 (1948); Otter Tail Power Co. v. United States, 410 U.S. 366 (1973))

In sum, the Commission erred in approving, by its silence, the equated cost of money methodology. This is but one additional reason why the overwhelming weight of the evidence below compels the conclusion that two-tier TelaLease pricing violates the antitrust laws.

(footnote continued from previous page)

> has rejected the proposal of unchanging tier A payments which would have resulted in vintage pricing. Consistent with that earlier Finding, the equated cost of money method is rejected in favor of the forecasted growth reserve approach which computes the return requirement on average net investment in an equipment account rather than on average investment in a single piece of equipment. An undepreciated balance of 77.98% shall be used for PBX's . . . . (Order No. 4389d, Sept. 29, 1978, Finding 92 at p. 34)

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POINT II - THE COMMISSION ERRED IN APPROVING AN INCREMENTAL COSTING METHODOLOGY FOR USE BY MOUNTAIN BELL IN CONNECTION WITH COMPETITIVE SERVICE OFFERINGS.

As noted by the Commission in its Report and Order (p. 7, R. 1140), Mountain Bell asserted below that its terminal telephone equipment tariffs "covered all of its incremental costs of providing these . . . services". (emphasis added) Mountain Bell relied on a so-called Long-Run Incremental Analysis (LRIA) which proportedly takes into account "cost factors, demand elasticity, cross-elasticity, payment plans, incrementalism and contribution". (Report and Order, p. 7) In contrast to the marginal or incremental pricing approach which the Commission approved for Mountain Bell's terminal equipment services, Intervenor-Appellant, and the Commission's own staff, urged that a true fully allocated costing methodology be used. (Ex. D-1, R. 1526, pp. 4, 6-7; Tr. 397-98; Tr. 949, 951-52; Tr. 995-98, 1009)

The difference between these two costing methodologies has to do primarily with the sufficiency of Mountain Bell's allocation, in its Dimension PBX and ComKey tariffs, for an aliquot portion of common overhead Company costs. Taking only "directly related administration costs" into account, Mountain Bell utilized an administrative overhead factor of 6.5% (Tr. 452, 925), whereas Intervenor-Appellant proposed an allocation equal to 9.85% of total investment (Ex. I-8, R. 1535, p. 53, J.W.-15(a); Tr. 934-35)

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Intervenor-Petitioner submits that the Commission erroneously lent its approval to a costing methodology which does not account for an appropriate portion of common administrative overhead costs.

Mountain Bell argued below that no allowance whatsoever should be made for fixed, or common, overhead costs. (Tr. 60, 232, 830, 883) The Company's position is that rather than select a formula which might be deemed "arbitrary", it preferred to make no allocation at all. Dr. Wilson, Intervenor-Appellant's expert witness, found:

> MB's rates do not include a proper allocation of joint costs which are shared with other services. Instead, they cover only costs directly attributable to Dimension PBX service. Thus, "overhead" costs have been excluded. Overhead includes such items as headquarters buildings and general office buildings, heating and lighting costs associated with those buildings, executive salaries, lawyers' fees, etc. The assignment of all these costs to monopoly telephone services constitutes a direct subsidy of Dimension PBX. Obviously, such costs must be included in the determination of the prices of products sold in competitive markets. (Ex. I-8, R. 1535, p. 7)

The record evidence also contains testimony which indicates that, in addition to being non-compensatory, MBT's costing methodology is anti-competitive. Speaking of Mountain Bell's short-run incremental pricing methodology, Dr. Wilson stated:

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> The result is to create an unfair economic advantage for MB in the pricing of its PBX products. Competitors must recover all their costs; they simply do not have the artificial advantage of being able to arbitrarily charge off some cost elements to non-competitive lines of enterprise and thereby subsidize their competitive operations. For MB to allocate Dimension PBX overhead costs to the rate base and operating expenses of the franchised portion of its general telephone utility operations is ruinous to independent PBX competitors and unfair to MB's other telephone utility subscribers who are faced with monopoly conditions and have no choice but to pay inflated prices that are high enough to cover these unfairly allocated rate base and operating expenses in addition to their own costs of service.
>
> To allow one competitor (MB) to allocate some of its costs to other product lines that are protected from competition, and recover those costs from its monopoly lines, cannot be justified on rational economic grounds. (Ex. I-8, R. 1535, pp. 8-9)

MBT's LRIA analysis, which forms the theoretical justification for its incremental pricing methodology, purportedly makes a "contribution" to common overhead. (*See* Tr. 61, 283.) But there is no way of determining whether the alleged marginal "contribution" is sufficient to actually recover all costs. According to MBT, one purpose of the LRIA is to serve as "a tool for selecting prices". (Tr. 63) Mountain Bell's LRIA pays lip service to costs such as premature retirement, and common overhead, but makes no attempt to quantify these costs. The LRIA offered by Mountain Bell is nothing more than

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its own self-serving judgment and guesswork about possible market activity. No economic data, or quantifiable elasticity of demand, appears. The LRIA thus amounts to pure guesswork performed by Company executives whose duty it is to justify a price long-since designed not to meet costs, but to suppress competition. The guesswork is then fed into a complicated game theory which projects what old and new customers would or might do - again without any empirical data or experience whatsoever. Mountain Bell's witness even admitted that he had no idea, for example, "how much it is costing or will cost" for "the telephone company to proceed through this proceeding here in Utah". (Tr. 436)

Once again, in response to this evidence, the Commission made virtually no findings whatsoever. Once again, other than its glib assertion that all of the business terminal telephone equipment services at issue "are priced at a level which will recover for Mountain Bell all of its costs associated with the provision of said products and services" (Report and Order, p. 11, R. 1142), none of the conflict between costing methodologies which saturates the record is even referenced, much less resolved, by the Commission.

By contrast, in other jurisdictions where the same conflict in costing methodologies has arisen, state commissions have made a meaningful attempt to come to grips with the is-

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sues. Thus, based on a record virtually identical to that before the Utah Commission, the Montana Public Service Commission concluded:

> The Commission finds that Mountain Bell's long run incremental analysis is not an appropriate procedure for price setting by a regulated utility selling in both monopoly and competitive markets. Responsible regulation by this Commission is premised on its ability to compare rates with the cost of service, insuring that the proposed rates are compensatory. On relying on forecasted costs and market conditions, LRIA provides less assurance that rates will cover actual costs than does a comparison of rates with historic costs. LRIA considers only those costs the utility regards as incremental, thus creating the possibility of cross-subsidization if rates based on such analysis do not cover full costs including an allocation of common overheads. With the Company's residual pricing policy, the potential subsidy would be from basic exchange ratepayers to those using competitive services. (Montana Public Service Commission, Docket No. 6496, Order No. 4389d, Sept. 29, 1978, Finding 63 at pp. 22-23. (emphasis added)

The Montana Public Service Commission appropriately concluded, "to insure the absense of cross-subsidies, rates for telephone services should be set equal to fully-distributed costs". (Order No. 4389d, Finding 67 at p. 24)

In addition, after considering arguments in favor of incremental costs by the Pacific Telephone and Telegraph Company very similar to those advanced below by Mountain Bell, the California Public Utilities Commission, last year, cogently

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and concisely reasoned:

> Where a public utility and a non-regulated enterprise are competing for the same market and scarcity of products or service is not a factor, the proper choice becomes quite clear. The use of the incremental cost concept to justify the price of an offering by the utility in such a competitive situation would allow the utility to allocate its overhead and fixed costs to its monopoly services. Leaving the effects of such an allocation on the utility's competitors aside, incremental cost pricing would obviously be unfair to the utility's monopoly customers in that they would bear all costs except the incremental costs associated with competitive markets. The unfairness of the incremental cost approach on the utility's monopoly customers would alone be sufficient to rule its use. The requirement that we must consider the anti-competitive aspects of the utility's offering upon suppliers who have no monopoly service to bear the overhead and fixed costs further militates against incremental cost pricing. (Cal. P.U.C., Decision No. 87962, October 12, 1977, p. 47)21/

21/Similarly, the New York Public Service Commission, last year, had occasion to comment on the use of a long-run incremental analysis by the New York Telephone Company to justify its terminal telephone equipment rates. In denying a request for subpoena _duces tecum_, the New York Commission wrote:

> It is the Commission's opinion that the issue presented . . . is whether the rates chosen by New York Telephone Company are compensatory, not whether the rates chosen by the Company are superior to other rates in the sense that they will maximize the net revenue contribution from the service . . . . _[T]he Commission will give no weight to any claim by the Company that its proposed_

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So too, in this case, the Commission should have rejected the Company's so-called LRIA. The Commission should have demanded a full and complete cost study which fairly takes into account all costs associated with competitive services, including a fair portion of the common overhead of the firm.

Although the main thrust of this Point II has to do with the non-compensatory nature of Mountain Bell's incremental costing methodology, it must be noted that the use of marginal or incremental cost pricing, absent a proper allocation for fixed overheads, has been declared illegal under the federal antitrust laws. More than half a century ago, in Northern Pacific Railway v. North Dakota, 236 U.S. 585 (1915), the United States Supreme Court expressly rejected the pricing of utility services on an incremental or "out-of-pocket" cost basis:

> . . . [W]e entertain no doubt that in determing the cost of the transportation of a particular commodity, all the outlays which pertain to it must be considered. We find no basis for distinguishing in this respect between the so-called "out-of-pocket costs", or "actual" expenses and other outlays which are nonetheless actually made because they are applicable to all traffic in question. . . .

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rates will optimize the revenue contribution from the service. (N.Y.P.S.C. Case 27006, letter of S.R. Madison, Secretary, to K.J. Roland, January 25, 1977) (emphasis added)

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> It is not sufficent reason for excluding such, or other, expenses to say that they would still have been incurred had the particular commodity not been transported. That commodity has been transported; the common carrier is under a duty to carry, and the expenses of its business at a particular time are attributable to what it does carry . . . The outlays that exclusively pertain to a given class of traffic must be assigned to that class, and the other expenses must be fairly apportioned. It may be difficult to make such an apportionment, but once conclusions are based on cost, the entire cost must be taken into account. (Northern Pacific Railway, supra, at 596-97) (emphasis added)

In more recent years, the United States Supreme Court, in American Commercial Lines v. Louisville & Nashville Railway Co., 392 U.S. 571 (1968), upheld an ICC determination that inter-modal transportation competitive rates should be set on the basis of fully distributed costs, as opposed to out-of-pocket or marginal costs.[22/] Without belaboring the point further, numerous lower court and state court decisions are to the same effect. See, e.g., Inglis & Sons Baking Co. v. ITT Continental Baking Co., 1975-1 Trade Cas. Para. 60146 (D.C.N.D. Cal. 1975); Tri-Cue, Inc. v. Sta-High Corp., 45 Cal. Rptr. 878 (1965); Northern Natual Power Co. v.

22/And see AT&T Long Lines Department (Revisions of Tariff FCC No. 260 Private Line Services 5000 (TelPak), 61 FCC 2d 587, 615 (1976), where the Federal Communications Commission mandated use by carriers of fully distributed costs in the determination of rate levels.

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City of St. Paul, 99 N.W. 2d 207 (Minn. 1957); St. Michael's Utilities Comm'n. v. The Eastern Shore Public Service Co. of Maryland, 35 F.P.C. 591, aff'd, 377 F.2d 912 (4th Cir. 1967); Paine v. Washington Metropolitan Area Transit Comm'n, 415 F.2d 910 (D.C. Cir. 1968).

This is plainly not a case which falls within the ambit of the Tenth Circuit U.S. Court of Appeals' recent decision in Pacific Eng. & Prod. Co. v. Kerr-McGee, 551 F.2d 790 (10th Cir. 1977). While the Tenth Circuit Court of Appeals in that case allowed AMPOT, a multi-product firm, to utilize incremental costs, that case is plainly distinguishable from the one at bar in that all of AMPOT's operations were in competitive markets. Mountain Bell, on the other hand, is engaged in a variety of operations which fall both within the competitive and monopoly areas.

There is nothing illegal under the antitrust laws, nor should there be, about a multi-product, totally competitive, firm engaging in cross-subsidization. If the price of competitive product "A" is raised to cross-subsidize competitive product "B", then, sooner or later, competitive product "A" will be priced out of the market in which it competes. Product "A" sales will have been sacrificed for the benefit of product "B" sales. The same statement cannot be made with respect to MBT. MBT cannot be priced out of its monopoly mar-

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kets in the State of Utah. Where Mountain Bell's general telephone exchange services are concerned, it enjoys an absolute monopoly and it need not concern itself with raising prices above those of its competitors. It has no competitors in the general exchange service market. Thus, while the use of incremental pricing may have been permissible with respect to AMPOT, it is impermissible and totally unacceptable where MBT is concerned. Any reliance by Mountain Bell on the _Pacific Engineering_ decision would ignore the difference between a completely competitive, multi-product company and a multi-product company which is engaged in the provision of both competitive and monopoly services.

The Commission erred in approving Mountain Bell's incremental cost methodology.

Conclusion

For all the foregoing reasons, the Final Report and Order of the Public Service Commission of Utah in PSC Case No. 76-049-01 should be reversed; all two-tier TelaLease contracts entered into by Mountain Bell with its customers since December 2, 1977 should be set aside; and Mountain Bell should be directed not to offer any additional terminal telephone equip-

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ment services on a two-tier TelaLease payment plan or on the basis of tariffs based on an incremental costing methodology.

Respectfully submitted,

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DATED: October 27, 1978

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MAILING CERTIFICATE

This is to certify that I mailed two true and exact copies of the foregoing Brief of Intervenor-Appellant Business Telephone Systems of Utah, Inc., postage pre-paid, each, to:

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