

FLORIDA PUBLIC SERVICE COMMISSION
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Tallahassee, Florida 32399-0850

M E M O R A N D U M

MARCH 11, 1997

TO: DIRECTOR, DIVISION OF RECORDS AND REPORTING (DAYO)

FROM: DIVISION OF COMMUNICATIONS (WIGGINS) *JAW*
DIVISION OF LEGAL SERVICES (BROWN) *MB* *MD*

RE: DOCKET NO. 962986-TL - NOTICE OF ELECTION OF PRICE
REGULATION BY BELLSOUTH TELECOMMUNICATIONS, INC., (d/b/a
SOUTHERN BELL TELEPHONE AND TELEGRAPH)

AGENDA: MARCH 18, 1997 - REGULAR AGENDA - POST HEARING DECISION -
INFORMAL HEARING PURSUANT TO SECTION 120.57(2), FLORIDA
STATUTES - PARTIES MAY PRESENT ORAL ARGUMENT ON THE
BRIEFS FILED IN THIS PROCEEDING

CRITICAL DATES: NONE

SPECIAL INSTRUCTIONS: S:\PSC\LEG\WP\951354TL.RCM

CASE BACKGROUND

On January 10, 1996, the Commission issued Proposed Agency Action Order No. PSC-96-0036-POF-TL acknowledging BellSouth Telecommunications, Inc.'s (BellSouth) election of price regulation. The Commission also ordered BellSouth to revise the rates in the Jensen Beach, West Palm Beach, and the Holley-Navarre exchanges to eliminate rate increases stemming from the reclassification of those exchanges (rate regroupings) that became effective subsequent to July 1, 1995. The Commission determined that the rate regroupings were not permitted by Section 364.051, Florida Statutes, because BellSouth's local exchange rates are capped at the rates in effect on July 1, 1995. On January 31, 1996, BellSouth filed a protest to the portion of the Order that required it to eliminate rate increases due to reclassification, and requested a hearing.

The case was initially set for hearing, and BellSouth prefiled the Direct Testimony of Mr. A. J. Varner on May 28, 1996. Thereafter, the parties and staff agreed that since the issues in the case did not involve any contested factual matters, the parties

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would file briefs and present oral argument on the issues, in lieu of a formal evidentiary proceeding. BellSouth proposed, and the parties agreed, that the factual portions of Mr. Varner's testimony and the factual stipulations of the parties would provide the evidentiary basis for the proceeding. BellSouth acknowledged that those portions of Mr. Varner's testimony that contain statements of BellSouth's legal position need not be accepted as fact in the proceeding, and the Commission was free to draw its own legal conclusions from the evidence. In Order No. PSC-96-0981-PCO-TL, issued July 31, 1996, the Prehearing Officer approved this procedure pursuant to Section 120.57(2), Florida Statutes. The proposed stipulation of additional facts that supplements Mr. Varner's testimony, BellSouth's identification of those portions of Mr. Varner's testimony that contain legal and policy arguments, and a marked copy of Mr. Varner's testimony are attached to this recommendation as Attachment A.

BellSouth filed its brief on September 11, 1996. Sprint United/Cental (Sprint) and GTE Florida Inc. (GTE), were granted intervention in the proceeding, and filed their briefs on the issues also on September 11, 1996.

DISCUSSION OF ISSUES

ISSUE 1: Is reclassification of an exchange (rate regrouping) subsequent to election of price regulation by BellSouth, a price increase that is prohibited under Section 364.051, Florida Statutes?

PRIMARY RECOMMENDATION: Yes. Reclassification of an exchange (rate regrouping) subsequent to election of price regulation by BellSouth is a price increase that is prohibited under Section 364.051, Florida Statutes. Since BellSouth elected price regulation effective January 1, 1996, the statute precludes BellSouth from increasing local exchange rates subsequent to July 1, 1995. Therefore, BellSouth is prohibited from regrouping after this date.

ALTERNATIVE RECOMMENDATION: No. Reclassification of an exchange (rate regrouping) subsequent to election of price regulation by BellSouth, is not a price increase that is prohibited under Section 364.051, Florida Statutes. Since rate regrouping subsequent to July 1, 1995, is not a price increase in local exchange service prohibited under the statute, BellSouth should not be precluded from regrouping after this date.

POSITION OF THE PARTIES

BellSouth: No. The pricing restrictions in Section 364.051, Florida Statutes, apply to the price of service in an existing exchange rate group. When customers move to a larger rate group, the nature of their service changes. Thus, it is permissible to charge a higher price for the new service.

Sprint: No. Reclassification of an exchange (rate regrouping) subsequent to the election of price regulation is not prohibited by Section 364.051, Florida Statutes. When the access lines in the local calling area of an exchange exceed the upper limit of its assigned rate group, all the customers in that exchange move to the next rate group at the previously established rate. Moving an exchange to the next rate group does not constitute a rate increase, because rates are not increased.

GTE: No. Section 364.051 caps prices applicable to rate groups, not to individual customers who may move into different rate groups. Because customers in the same rate group category continue to pay the same rates for the same services, there is no violation of Section 364.051.

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PRIMARY ANALYSIS: Section 364.051, Florida Statutes, permits local exchange companies to elect price regulation effective January 1, 1996. Section 364.051 also provides that the rates for basic residential and single line business local telecommunications services, as well as certain protected non-basic services, will be capped at the rates in effect on July 1, 1995. Specifically, Section 364.051(2) states:

(a) Effective January 1, 1996, the rates for basic local telecommunications service of each company subject to this section shall be capped at the rates in effect on July 1, 1995, and such rates shall not be increased prior to January 1, 1999. However, the basic local telecommunications service rates of a local exchange telecommunications company with more than 3 million basic local telecommunications service access lines in service on July 1, 1995, shall not be increased prior to January 1, 2001.

(b) Upon the date of filing its election with the Commission, the rates for basic local telecommunications service of a company that elects to become subject to this section shall be capped at the rates in effect on that date and shall remain capped as stated in paragraph (a).

For protected non-basic telecommunications services, Section 364.051(6)(a) states that the prices of:

1. A voice-grade, flat-rate, multi-line business local exchange service, including multiple individual lines,

¹ Section 364.02 Florida Statutes, defines basic local telecommunications service as:

. . . voice grade, flat rate residential and flat-rate single-line business local exchange services which provide dial tone, local usage necessary to place unlimited calls within a local exchange area, dual tone multi-frequency dialing, and access to the following: emergency services such as "911", all locally available interexchange companies, direct ry assistance, operator services, relay services, and an alphabetical directory listing. For a local exchange telecommunications company, such a term shall include any extended area service routes and extended calling service in existence or ordered by the Commission on or before July 1, 1995.

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centrex lines, private branch exchange trunks, and any associated hunting services, that provides dial tone and local usage necessary to place a call within a local exchange calling area; and 2. Telecommunications services provided under contract service arrangements to the SUNCOM Network, as defined in chapter 282,

shall be capped at the rates in effect on July 1, 1995, and such rates shall not be increased prior to January 1, 1999; . . .

BellSouth elected price regulation effective January 1, 1996. GTE and Sprint have also elected price regulation pursuant to section 364.051. Under section 364.051(1)(b), their rates are capped as of the date they elected price regulation.

Prior to the effective date of BellSouth's election of price regulation, but after July 1, 1995, BellSouth filed tariffs to regroup rates for the Jensen Beach, West Palm Beach, and Holley-Navarre exchanges. The regrouping moved those exchanges to higher rate groups to reflect increases in the local calling scope of the exchanges due to increases in numbers of access lines. The regroupings increased basic rates for customers in those exchanges.

In Order No. PSC-96-0036-FOF-TL, the Commission acknowledged BellSouth's election of price regulation, but required BellSouth to reduce the rates for the Jensen Beach, West Palm Beach, and Holley-Navarre exchanges to the rate levels that were in effect prior to July 1, 1995. The Commission described rate regrouping as follows:

Rate regrouping is a rate design mechanism that has been used historically to insure that the rates for certain customer classes are equalized. Rate groups are premised on the number of access lines an end user can call on a local flat-rate basis. As the number of access lines an end-user can call increases, the rate for flat-rate local service also increases. The increase in rates is rooted in an historic value-of-service pricing philosophy; as the number of lines a person can call increases, the more valuable the person's local flat-rate service becomes. As the service becomes more valuable, customers should pay more for it. The rates for each rate group are set for each LEC. Pursuant to Rule 25-4.056, Florida Administrative Code, rate regrouping has been accomplished on an automatic basis by the LECs based on subscribership in an exchange.

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Order No. PSC-96-0036-FOF-TL, p.3.

The Commission explained that:

[T]he rate grouping plans are something that have [sic] originated from rate of return regulation. With the revisions of Chapter 364 and the encouragement of competition, current rate structures of the local exchange companies ultimately may vary greatly to respond to competitive pressures. As competition develops, particularly price competition, pricing plans such as regrouping will become an historic anachronism.

Order No. PSC-96-0036-FOF-TL, p. 4.

Disagreeing with BellSouth's contention that the rate regroupings in question were a change in service, the Commission determined that the rate regroupings were an increase in the rates for a telecommunications service, contrary to the clear statement of Section 364.051, Florida Statutes, that basic local telecommunications services and protected non-basic services are to be capped at the rates in effect on July 1, 1995.

In its brief, BellSouth contends again that the increase in price that customers pay when their local exchange is moved from one rate group to another reflects a change in the local service that they receive.

BellSouth's position is that when a customer moves from a smaller rate group to a larger one, this is not an increase in the price of that customer's service, but rather a change from one (lower priced) service to a different (higher priced, but more valuable) service. This clearly constitutes a change in the nature of the service of an affected customer. Consequently, there is no violation of Section 364.051 because the customer is not paying a higher price for the same local service.

BellSouth brief, p. 7.

BellSouth states that Commission Rule 25-04.056, Florida Administrative Code, requires BellSouth to reclassify exchanges when access lines in the exchange increase or decrease to the extent that the exchange would fall into a different rate group. If access lines in a local calling area increase enough to cause a change to a higher rate group, the rate charged for local service in that exchange would increase. If access lines in a local

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calling area decrease enough to cause a change to a lower rate group, the rate charged for local service would decrease. (Varner Direct Testimony, p. 3) BellSouth explains that each rate group is separately priced and tariffed, and monthly basic exchange rates vary by rate group, consistent, BellSouth claims, with the value of the service. The value of a customer's service increases with the number of access lines that the customer can call in the local calling area. (Varner Direct Testimony, p. 4.)

BellSouth argues that rate regrouping does not constitute a rate increase because the rates for each group are not increased. The higher price that the customer pays merely represents a "more valuable version of local service." (BellSouth BR., p. 10.) Witness Varner compares the pricing differentiation between rate groups to the pricing differentiation of other products and services, where the price difference reflects the greater value of the enhanced version of the service. (Varner Direct Testimony, p. 5.)

BellSouth claims that its position that rate regrouping is not a price increase is consistent with the rationale that the Commission used in Docket No. 820112-TP, In re: Extended Area Service between Holley-Navarre and Gulf Breeze, Pensacola and Fort Walton Beach. There the Commission authorized an increase in rates reflective of the change in rate groups brought about by extended area service. The Commission stated that since the customers in Holley-Navarre would be able to call more people, they would move into a higher rate group. BellSouth points out that the customers of the other exchanges did not receive a rate increase, because the extended calling scope was not sufficient to change their rate group. BellSouth argues that the Commission's decision in this case reflects the rationale "that a larger calling scope equals a more valuable version of local service, which justifies a higher price." (BellSouth BR., p.13.)

BellSouth also directs the Commission's attention to the Pennsylvania Public Utility Commission's approval of a local exchange company's proposal to classify certain exchanges into new rate groups with higher rates even though it had agreed to a freeze on protected service rates under an alternative regulation plan. In Re: Bell Atlantic-Pennsylvania, Inc.'s Petition and Plan for Alternative Form of Regulation under Chapter 30, Docket Nos. P-00930715; P-00930715C001; P-00930715C002, 1995 Pa. LEXIS 134, the Pennsylvania Commission recognized that service for exchanges with more density is a more valuable quality of service than service for exchanges with less density.

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GTE adopts and agrees with BellSouth's position that section 364.051, Florida Statutes, requires that the rates of rate groups must be capped, not the rates of individual customers. (GTE BR., p. 1.)

Sprint also agrees with BellSouth that Section 364.051, Florida Statutes caps the prices in effect on July 1, 1995, that apply to existing rate groups, not to individual customers. Sprint argues that moving an exchange to a higher rate group does not constitute a rate increase, because the rates are not increased. (Sprint BR., p. 3.) Sprint states that the Commission correctly described the process of rate regrouping, but incorrectly determined that the process violated the price increase proscriptions of section 364.051.

The prohibition in the statute is that existing rates may not be increased. The rates in effect on July 1, 1995, were approved by this Commission for rate groups, not individual customers. As the Commission noted in its Order, the rate regrouped customer pays more because the customer gets more benefits for the new price than he or she got for the old price. If, however, the Commission were to adopt the policy that a rate regrouping is a rate increase for individual customers, such policy would have to be premised on a belief that a local exchange customer, who receives greater benefit because of increased calling scope should, nonetheless, never pay more than he or she is currently paying for local exchange service.

Sprint Brief, p. 5.

Sprint argues that if there can be no further rate regroupings, then there should not be any further Extended Area Service for price-regulated LECs, either. Sprint contends that in time there will be many communities whose customers will be paying rates for local exchange service different from rates paid by customers in other communities of exactly the same size. Sprint argues that there can be no rational basis for this anomaly. (Sprint BR., p. 6.)

Staff recommends that the parties in this proceeding have misinterpreted the clear language of section 364.051, Florida Statutes. Section 364.051 prohibits rate increases by price regulated LECs in basic and protected non-basic telecommunications services for the time set out in the statute. Period. It does not make any exceptions to that prohibition, for rate regrouping,

extended area service after July 1, 1995, or any other price "adjustment". Staff suggests that the parties have misinterpreted section 364.051 to permit the price increases at issue here, because they have applied traditional regulatory pricing principles of rate setting and rate structure to a statutory scheme that rejects those principles and instead embraces a deliberate move to the pricing mechanisms of a competitive market for telecommunications services in Florida. The Commission's decision cited by BellSouth, as well as the Pennsylvania Public Utility Commission's recent decision, reflect the traditional philosophies of pricing that are appropriate for rate of return regulation, but are not appropriate for deregulation.

Rate grouping is a creature of the rate-of-return regulatory era, created as a value-of-service, revenue generating mechanism, where rates were not necessarily based on cost. Rate groups were premised on the number of access lines an end user could call on a local flat-rate basis. As the number of access lines an end user could call increased, the rate for flat-rate local service also increased. The increase in rates was rooted in a value-of-service pricing philosophy. It was logical to assume that customers should pay more if they could call more lines. Rule 25-4.056, Florida Administrative Code, reflects this traditional regulatory philosophy, and, as witness Varner stated, regrouping occurred fairly automatically under this rule, based on growth in subscribership in a local calling area.

Under a statutory scheme that deregulates local telecommunications service, however, it is not appropriate to provide regulated revenue streams for price-regulated LECs, unless the statute specifically contemplates, and provides for, such an aberration, which it does not. Further, staff does not believe that the statute contemplates a rate increase for price-regulated LECs under the rationale that it is appropriate to raise basic telecommunications service rates for certain customers by moving them into a different group as long as the rates of any group are not raised. The statute does not say that rate group rates will be capped. It says that rates will be capped. Staff believes that "rates" means all rates for basic local and protected non-basic telecommunications services.

While staff agrees with Sprint that if further rate regrouping is not permitted under section 366.051, some customers may be paying rates for local exchange service different from rates paid by customers in other exchanges of the same size, staff recommends that the answer to that problem is not the perpetuation of a traditional regulatory pricing system, but the development of an

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effective competitive marketplace. Staff recommends that reclassification of an exchange (rate regrouping) subsequent to July 1, 1995, by BellSouth is a price increase that is prohibited under Section 364.051, Florida Statutes.

ALTERNATIVE ANALYSIS: The Commission concluded that BellSouth should not be permitted to reclassify (rate regrouping) an exchange subsequent to July 1, 1995, because this would constitute a rate increase that is prohibited for LECs who elected to operate under Section 364.051, Florida Statutes, effective January 1, 1996. In its brief, BellSouth argues that when a customer moves from a smaller rate group to a larger one, this is not an increase in the price of that customer's service, but rather a change from a lower priced service to a higher priced, but more valuable, service. Consequently, BellSouth contends that there is no violation of Section 364.051, Florida Statutes, because the customer is not paying a higher price for the same local service. (BellSouth BR p.7)

Sprint asserts that the Commission's conclusion that rate regrouping constitutes a rate increase for basic local telecommunications service prohibited under Section 364.051, Florida Statutes, is without clear analysis. (Sprint BR p.4) Sprint contends that while a customer who is moved to a different rate group because of a change in the number of subscribers in the local calling area will pay a different rate, this does not mean that the approved rate has been changed. Essentially, the customer is being moved from one capped rate group into another capped rate group. The rates for each rate group, which were in effect on July 1, 1995, remain unchanged. (Sprint BR p.4)

BellSouth asserts that the pricing differentiation between rate groups is not unlike the pricing differentiation of other products and services. For instance, the Company offers Caller ID in Florida on a two-tier price level based on the added feature value. Customers may purchase Caller ID-Basic service for \$6.00 per month, which permits the customer to view on a display unit the directory number of incoming telephone calls. However, for \$7.50 per month, the customer may purchase Caller ID Deluxe, which permits the customer to view on a display unit the calling party's directory name and directory number on incoming calls. The price difference is commensurate with the greater value of the enhanced version of the service. The concept of a higher price for a more valuable version of a service is in no way unique to regrouping. (BellSouth BR p.11-12)

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Sprint believes that the proper interpretation of the statute is that existing rates may not be increased. In this case, the rates in effect on July 1, 1995, were approved by the Commission for rate groups, not individual customers. As noted earlier, the regrouped customer pays more because the customer gets more benefits for the new price than he got for the old price. If the Commission were to adopt the policy that rate regrouping is a rate increase for individual customers prohibited under Section 364.051, Florida Statutes, Sprint contends that such a policy would have to be based on the belief that a customer who receives greater benefit because of increased calling scope should never pay more than he is currently paying for local exchange service. (Sprint BR p. 11-12)

Staff agrees with the parties that no rate increase has taken place, even though the community is transferred from one rate group to another. Although the transferred customers will pay a higher price for service in the larger rate group, this merely reflects the fact that the nature of the service has changed, and the value of that service has increased. A price change to reflect increased value of the service does not amount to a price increase prohibited by section 364.051, Florida Statutes. Competition will bring change to the pricing structures of the telecommunications industry, but it has not done so yet, and there is no way to foresee what changes will take place or how long they will take. As competition evolves, there will be justifiable bases to distinguish between customers who are charged different prices. Until competition develops, however, there is no reasonable basis to justify a pricing system that does not recognize a distinction between the value of service available to different rate groups. At some point, rate regrouping will become a mechanism of the past, but that point has not yet been reached. While the system of rate grouping may be less useful over time, it is not appropriate to eliminate regrouping immediately. As explained in Issue 2, staff believes that terminating regrouping will result in pricing anomalies that constitute unreasonable and undue price discrimination among similarly situated customers in violation of certain sections of Chapter 364.

As set forth above, staff believes that regrouping constitutes a change in the nature of a customer's service, and is not merely a price change for the same service. Staff recommends that the statute should not be interpreted to mean that customers who have a change in service cannot also have a change in price that corresponds to the existing rate for the new service. Therefore, staff believes that reclassification of an exchange is not a rate increase prohibited under Section 364.051, Florida Statutes.

ISSUE 11 If rate regrouping by BellSouth is not allowed, does any resulting disparity in prices constitute undue discrimination in violation of Chapter 364, Florida Statutes?

PRIMARY RECOMMENDATION: No. If BellSouth is not allowed to retain regrouping procedures, this does not result in any disparity in prices which constitutes undue discrimination in violation of Chapter 364, Florida Statutes.

ALTERNATIVE RECOMMENDATION: Yes. If BellSouth is not allowed to retain regrouping procedures, this will result in disparity in prices which constitutes undue discrimination prohibited under Chapter 364, Florida Statutes.

POSITION OF THE PARTIES

BellSouth: Yes. If this Commission does not allow BellSouth to continue established regrouping procedures, this will result in prohibited undue discrimination under Florida law.

Sprint: Yes. If rate regrouping is not allowed, the resulting disparity in prices constitutes an undue discrimination in violation of Chapter 364, Florida Statutes.

GTE: Yes. If the Commission halts longstanding regrouping procedures, unreasonable discrimination will occur because customers with the same basic local calling scope will pay different rates.

PRIMARY ANALYSIS: The parties argue that if rate regrouping for LECs who elect to operate under price regulation is prohibited pursuant to Section 364.051, Florida Statutes, the rate disparity among similarly situated customers that would result amounts to undue discrimination that is prohibited under Chapter 364, Florida Statutes. (BellSouth BR., pps. 15-18; Sprint BR., pps. 7-10; GTE BR., p. 2.) The parties cite sections 364.08, 364.09, and 364.10, Florida Statutes, as support for their position.

Section 364.08(1), Florida Statutes, states:

(1) A telecommunications company may not charge, demand collect, or receive for any service rendered or to be rendered any compensation other than the charge applicable to such service as specified in its schedule on file and in effect at that time. A telecommunications company may not refund or remit, directly or indirectly, any portion of the rate or charge so specified or extend

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to any person any advantage of contract or agreement or the benefit of any rule or regulation or any privilege or facility not regularly and uniformly extended to all persons under like circumstances for like or substantially similar service.

Section 364.09, Florida Statutes, states:

A telecommunications company may not, directly or indirectly, or by any special rate, rebate, drawback, or other device or method, charge, demand, collect, or receive from any person a greater or lesser compensation for any service rendered or to be rendered with respect to communication by telephone or in connection therewith, except as authorized in this chapter, than it charges, demands, collects, or receives from any other person for doing a like and contemporaneous service with respect to communication by telephone under the same or substantially the same circumstances and conditions.

Section 364.10(1), Florida Statutes, states:

(1) A telecommunications company may not make or give any undue or unreasonable preference or advantage to any person or locality or subject any particular person or locality to any undue or unreasonable prejudice or disadvantage in any respect whatsoever.

BellSouth claims that if it is not permitted to continue "the well-established" regrouping procedures that are required by the Commission's rules, then it will be required to violate Chapter 364, because it will be subjecting customers in Florida to undue or unreasonable prejudice or disadvantage. BellSouth explains that the prices charged for the Jensen Beach, West Palm Beach, and Holley-Navarre exchanges will be different than for similarly situated customers in other exchanges. BellSouth BR., p.16. BellSouth's witness Varner gave the example of the Fort George exchange to explain BellSouth's dilemma. The Fort George exchange was reclassified from Rate Group 8 to Rate Group 9, effective June 30, 1995, the day before the rate cap of section 364.051, Florida Statutes, took effect. Witness Varner explained that if BellSouth may no longer reclassify exchanges into different rate groups and adjust prices accordingly, the West Palm Beach subscribers will pay the same rate as the Fort George subscribers, but they will have access to about \$7,000 more access lines and trunks. Witness Varner states that the distinction in treatment of these similarly

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situated customers would be based on "nothing more than a quirk of timing". (Varner Direct Testimony, p. 8-9.)

Sprint and GTE agree with BellSouth that if the Commission interprets section 364.051 to prohibit rate regrouping, the resulting disparity in prices constitutes undue discrimination against similarly situated customers. (GTE BR. p.2; Sprint BR. p.7-11.) Sprint also points out that the concept of rate regrouping was specifically designed to eliminate undue price discrimination.

BellSouth does agree that in an increasingly competitive environment there will be many more instances where differential pricing will be appropriate, but BellSouth argues that there will be a "reasonable basis" to charge customers different prices. BellSouth contends that no reasonable basis exists at this time to permit the pricing disparities that the elimination of rate regrouping would create. BellSouth BR., p. 19.

Staff recommends that price differences caused by the implementation of price caps for basic and protected non-basic services under the provisions of section 364.051, Florida Statutes, do not constitute undue discrimination pursuant to sections 364.08, 364.09, or 364.10, Florida Statutes. Staff suggests that the parties have again applied traditional regulatory principles to a statutory scheme that does not incorporate those principles and thus they reach the mistaken conclusion that the elimination of rate regrouping would be unduly discriminatory. What would have amounted to unduly discriminatory rate setting under monopoly regulation does not amount to undue discrimination under deregulation.

As BellSouth acknowledges, an increasingly competitive environment will create many instances of differential pricing where similarly situated customers will pay different prices for similar services. Under the revisions to Chapter 364, issues of undue discrimination may arise where companies themselves have acted arbitrarily or for anticompetitive purposes to favor one customer over another, but not where the statute itself prohibits a rate increase that leads to a pricing difference. While the rate caps established in section 364.051, create differences between the prices customers in different exchanges pay, customers within an exchange will still pay the same rates for the same calling privileges.

The 1995 legislation recognizes that prices can vary between exchanges for the same service within a LEC's territory. Subject

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to the caps established in section 364.051(2), section 364.051(6), Florida Statutes, allows the LECs to respond to competitive offers by altering their current rate structure in an attempt to match these offerings. As competition evolves and the companies use these options, staff believes that there will be many instances of appropriate differential pricing. For example, Section 364.051 (6), Florida Statutes, allows price increases for non-basic services up to 6¢ with no competition and up to 20¢ within a 12 month period in exchanges with another competitive provider. Multi-line business line accounts, rotary service lines, Centrex lines and PBX trunks can also be increased by 6¢ in some exchanges and 20¢ in others depending upon the level of competition, thus creating a rate differential in exchanges of the same size. Competition will create more situations in which customers that in the past may have been viewed as similarly situated, will be paying different rates for the same service.

Staff recommends that there is reasonable justification for the price difference between exchanges that arises from the implementation of section 364.051. Thus, if BellSouth is not permitted to continue rate regrouping, any resulting disparity in prices between exchanges does not constitute undue discrimination in violation of Chapter 364, Florida Statutes.

ALTERNATIVE ANALYSIS: Sections 364.08, 364.09, and 364.10, Florida Statutes, preclude a telecommunications company from charging different rates to different customers for the same service if the customers are similarly situated. Traditionally, rate regrouping eliminated this pricing disparity. (BellSouth BR p.16)

BellSouth argues that if rate regrouping is eliminated, customers whose calling scopes differ, and therefore should be in different rate groups with different prices, will be charged the same price. Also, customers with the same basic local calling scope would be charged different rates in many cases. BellSouth argues that the result in both cases is the same, undue or unreasonable prejudice in prices charged to customers. (BellSouth BR p.18-19)

Sprint asserts that in a recent proceeding, the Virginia State Corporation Commission, in a review of its incentive regulation plan which included a moratorium on basic local exchange service rate increases, determined that "rate regrouping due to growth in access lines will continue in order to avoid rate discrimination between similarly sized exchanges." Re: Incentive Regulation, 157 PUR 4th 465, at 506 (Va. S.C.C. 1994). Although this decision is not binding on this Commission, Sprint contends that this does

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provide an example of how another state dealt with this same issue.
(Sprint BR p. 10-11.)

Although each section of the statutory provisions addresses a slightly different aspect of the appropriate treatment of customers, each section stands for the general principle that a telecommunications carrier may not unduly discriminate in the rates and services that it charges customers who are similarly situated.

Staff recommends that if BellSouth is precluded from regrouping, this will result in BellSouth being required to violate Sections 364.08, 364.09, and 364.10, Florida Statutes, in that the company will be subjecting customers to unreasonable prejudice or disadvantage. We believe that customers in an exchange that is not regrouped in response to access line growth will pay less for their local service than other customers in Florida who have comparable calling scopes. Specifically, the rates charged for the Jensen Beach, West Palm Beach, and Holley-Navarre exchanges could be lower than similarly situated customers in other exchanges.

In conclusion, staff believes that prohibiting rate regroupings essentially will result in unreasonable or undue discrimination prohibited under Chapter 364, Florida Statutes. Thus, we believe the Commission should approve BellSouth's proposed regroupings and any future regroupings by price-regulated LECs.

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ISSUE 2: Should this docket be closed?

RECOMMENDATION: Yes.

STAFF ANALYSIS: With the Commission's decision on Issues 1 and 2, this docket should be closed.

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ATTACHMENT A
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APPENDIX A

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Notice of election of) Docket No. 951354-TL
price regulation by BellSouth)
Telecommunications, Inc. d/b/a)
Southern Bell Telephone and)
Telegraph Company.) Filed:

BELLSOUTH'S PROPOSED STIPULATION

The portions of the testimony of Alfonso J. Varner identified below contain the witnesses' statement of BellSouth's Legal position. Although Mr. Varner is the only witness to submit testimony in this proceeding, the parties agree that the identified portions of his testimony do not contain uncontroverted facts:

Page 2, lines 4-7

Page 3, lines 19-25

Page 4, lines 1, 2 and the first ten words of line 3

Page 6, lines 17-23

Page 7, lines 1-18

Page 7, line 23 (beginning with the second word) through line 25

Page 9, line 11 (beginning with the word "Section") through line 16

APPENDIX A

BellSouth Rate Regrouping
Additional Facts to be Stipulated

- The current prices for the various BellSouth rate groups were established prior to and were in effect on July 1, 1995.
- The process of rate regrouping, that is moving a community from one rate group to another because of a change in the number of access lines accessible by the customers in the community, does not alter the prices for the individual rate groups.
- A BellSouth residential local exchange customer on January 1, 1996, physically moving from a BellSouth-served community in rate group 3 to a BellSouth-served community in rate group 4 or higher will, on January 3, 1996, pay more for his or her basic residential local exchange service than he or she was paying while a resident of the rate group 3 community.
- The basis for different flat-rate local exchange service prices for the different rate groups is to reflect the value and benefit to the customer from the number of other customers that can be reached without having to pay a toll charge for the call.

DOCKET NO. 951354-TL
DATE: MARCH 11, 1997

J. Phillip Carver
General Attorney

PAGE 3 OF 13
BellSouth Telecommunications, Inc.
470 Nancy H. Sims
Suite 400
150 So. Monroe Street
Tallahassee, Florida 32301
Telephone 904 347-5588

May 28, 1996



Mrs. Blanca S. Bayó
Director, Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Betty Easley Conference Center, Rm. 110
Tallahassee, FL 32399-0850

Re: Docket 951354-TL
Price Regulation

Dear Mrs. Bayó:

Enclosed is an original and fifteen copies of BellSouth Telecommunications, Inc.'s Direct Testimony of A. J. Varner, which we ask that you file in the captioned matter.

A copy of this letter is enclosed. Please mark it to indicate that the original was filed and return the copy to me. Copies have been served to the parties shown on the attached Certificate of Service.

Sincerely,

J. Phillip Carver
J. Phillip Carver

Enclosures

cc: All Parties of Record
A. M. Lombardo
R. G. Beatty
R. Douglas Lackey

- 20 -

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05870 MAY 28 1996

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CERTIFICATE OF SERVICE
DOCKET NO. 951354-TL

I HEREBY CERTIFY that a true and correct copy of the foregoing was served by U.S. Mail this 22nd day of May, 1996 to the following:

Mr. Tracy Hatch
Staff Counsel
Florida Public Service Commission
2340 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

J. Phillip Carver
J. Phillip Carver

1 **BELLSOUTH TELECOMMUNICATIONS, INC.**
2 **DIRECT TESTIMONY OF A. J. VARNER**
3 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**
4 **DOCKET NO. 951354-TL**
5 **MAY 28, 1996**
6

7 Q. **Please state your name, employer, position and business address.**

8
9 A. **My name is Alphonso J. Varner. I am employed by BellSouth**
10 **Telecommunications, Inc. ("BellSouth") as Senior Director for Regulatory**
11 **Policy and Planning for the nine state BellSouth Region. My business**
12 **address is 675 West Peachtree Street, Atlanta, Georgia.**
13

14 Q. **Please summarize your background and experience.**

15
16 A. **I graduated from Florida State University in 1972 with a Bachelor of**
17 **Engineering Science degree in systems design engineering. I**
18 **immediately joined Southern Bell in the division of revenues organization**
19 **with the responsibility for preparation of all Florida investment separations**
20 **studies for division of revenues and for reviewing interstate settlements.**
21 **Subsequently, I accepted an assignment in the rates and tariffs**
22 **organization with responsibilities for administering selected rates and**
23 **tariffs including preparation of tariff filings. In January 1994, I was**
24 **appointed Senior Director of Pricing for the nine state region. I assumed**
25 **my current responsibilities in August of 1994.**

1

2 Q. What is the purpose of your testimony?

3

4 A. My testimony explains BellSouth's position that the reclassification of an
5 exchange (regrouping) does not constitute a price increase under Section
6 364.051, Florida Statutes. Moreover, if regrouping is not allowed, this will
7 result in price discrimination that violates Chapter 364.

8

9 Q. Which exchanges are at issue in this docket?

10

11 A. There are three exchanges that are subject to rate regrouping based on
12 access line growth after July 1, 1995: Jensen Beach, West Palm Beach
13 and Holly-Navarre. However, the Commission's decision on this issue will
14 affect not only these exchanges, but other exchanges that could be
15 subject to regrouping in the future.

16

17 Q. How does BellSouth determine when regrouping is warranted?

18

19 A. BellSouth is required by Rule No. 25-04.056 (1), Florida Administrative
20 Code, to reclassify exchanges (regroup) in response to access line
21 increases and decreases. The Rule states:

22

23 Whenever the number of access lines in the local calling area of an
24 exchange increases or decreases to the extent that such exchange
25 would fall into a different rate group, the company shall file a

1 revised tariff with the Commission requesting authority to reclassify
2 the exchange to its appropriate group.

3
4 The tariff change associated with the reclassification of an exchange is
5 quickly implemented and virtually automatic. The Commission has
6 routinely approved these tariffed changes in the past.

7
8 Q. Can regrouping result in a change in a subscriber's rate?

9
10 A. Yes. If there is a sufficient increase in access lines in the local calling
11 area to trigger a rate group change, subscribers in that exchange would
12 be regrouped into the next highest rate group. As a result, the rate that
13 they are charged for local service would be increased. Similarly, if there is
14 a sufficient decline in access lines to trigger a rate group change,
15 subscribers in that exchange would be regrouped into a lower rate group.
16 Consequently, the rate charged to subscribers in that exchange would be
17 reduced.

18
19 Q. Is a reclassification of an exchange that results in a particular customer's
20 paying a higher rate, an increase that is prohibited under Section 364.051,
21 Florida Statutes?

22
23 A. No. Under this Section of the Statutes, as it applies to BellSouth, the rate
24 charged for basic telecommunications and certain protected nonbasic
25 services is capped until January 1, 2001 at the levels that applied on July

1, 1995. The price cap in Section 364.051 applies to the price of service
2 in the existing exchange rate groups, not to the service of individual
3 customers who may move from one rate group to another. Each rate
4 group price is established by individual tariff. All individual customers
5 included in the same rate group category pay the same price for basic
6 exchange service. In regrouping situations, the price for a given rate
7 group does not change; instead, the customer simply moves into a
8 different rate group.

9
10 Q. How does the rate group pricing correspond to the value of the service?

11
12 A. Each exchange rate group is separately priced and tariffed, with monthly
13 basic exchange rates varying by rate group, according to the value of the
14 service provided. The service has greater value when calls can be placed
15 to a greater number of customers. For example, the value (and thus the
16 price) of the basic service in a Rate Group 10 exchange service area,
17 such as Boca Raton, is greater than that of a Rate Group 1 exchange
18 service area, such as Cedar Keys. This is because customers in the Rate
19 Group 10 area have access to up to 550,000 exchange access lines (and
20 PBX Trunks) while customers in a Rate Group 1 exchange service area
21 have access to 2000 or less exchange access lines (and PBX Trunks).
22 Thus, a rate group reclassification prompts a difference in calling scope
23 that changes both the value and extent of the service. Coincident with
24 this, a customer simply pays a higher rate that corresponds to the greater
25 calling scope.

1

2 This pricing differentiation is not unlike that of other products and services.
3 For example, Caller ID is offered in Florida on a two tier price level based
4 on the added feature value. Customers may purchase Caller ID - Basic
5 service for \$6.00 per month, which permits the customer to view on a
6 display unit the directory number on incoming telephone calls. However,
7 for \$7.50 per month, the customer may purchase Caller ID - Deluxe,
8 which permits the customer to view on a display unit the calling party
9 directory name and directory number on incoming telephone calls. The
10 price difference is commensurate with the greater value of the enhanced
11 version of the service.

12

13 Q. If regrouping by BellSouth is not allowed, is there a resulting disparity in
14 the price charged to similarly situated customers? Chapter 364.10

15

16 A. Yes. If this Commission does not allow BellSouth to continue established
17 regrouping procedures, this will result in a pricing disparity among affected
18 subscribers with the same basic local calling scope.

19

20 For example, if regrouping is not allowed, BellSouth will be required to
21 revert West Palm Beach back to a Rate Group 9 classification. Presently,
22 there are ten (10) exchanges within Florida that are classified as Rate
23 Group 9, with an average calling scope of approximately 433,000 access
24 lines and trunks. Currently, West Palm Beach has access to 485,000
25 access lines and trunks, which is 52,000 greater than the average Rate

1 Group 9 exchange, and 35,000 greater than the upper limit on Rate
2 Group 9. At the same time, there are three other existing Rate Group 10
3 exchanges which have a calling scope of between 450,001 to 550,000
4 local access lines (as does the West Palm Beach exchange).

5
6 Under the normal regrouping process, customers in the West Palm Beach
7 exchange would be charged the tariffed rate for services in Rate Group
8 10. Without regrouping, customers in the West Palm Beach exchange
9 would pay less than the customers in the three exchanges that are
10 currently in Rate Group 10, even though these exchanges have the same
11 numerical range of access lines to which they can place a local call.
12 Conversely, customers in the West Palm Beach exchange would pay the
13 same price for local service as these customers in the ten exchanges that
14 are currently in Rate Group 9, even though customers in these exchanges
15 have a smaller calling scope. This disparity is simply not fair.

16
17 Q. Is this disparity in pricing legally permissible under Florida law?

18
19 A. In my opinion, no. This disparity constitutes price discrimination that
20 violates Chapter 364. Sections 364.06, 364.09, and 364.10 generally
21 preclude a telecommunications company from charging different rates to
22 different customers for the same service if the customers are similarly
23 situated. In particular, Section 364.09 states:

24
25

1 A telecommunications company may not, directly or indirectly, or by
2 any special rate, rebate, drawback, or other device or method,
3 charge, demand, collect, or receive from any person a greater or
4 lesser compensation for any service rendered or to be rendered
5 with respect to communication by telephone or in connection
6 therewith, except as authorized in this chapter, than it charges,
7 demands, collects, or receives from any other person for doing a
8 like and contemporaneous service with respect to communication
9 by telephone under the same or substantially the same
10 circumstances and conditions. (Emphasis added.)

11
12 Likewise, Section 364.10 (1) states the following:

13
14 A telecommunications company may not make or give any undue
15 or unreasonable preference or advantage to any person or locality
16 or subject any particular person or locality to any undue or
17 unreasonable prejudice or disadvantage in any respect
18 whatsoever.

19
20 In other words, customers in an exchange that is not regrouped in
21 response to access line growth will pay less for their local service than all
22 or most of the other customers in Florida who have comparable calling
23 scopes. This is clearly unduly discriminatory pricing for a service provided
24 to similarly situated customers. Accordingly, this disparity violates Florida
25 law.

1

2 Q. Are you saying that all customers must pay the same price for the same
3 service?

4

5 A. No. There are permissible reasons to charge different prices for the same
6 service. The most obvious example of this is a single line used to provide
7 local service. In this case, the price of the line varies substantially
8 depending on whether the line is used for business or residential service.
9 In this example, the difference in usage of the line provides a reasonable
10 and statutorily permissible basis to support a price difference.

11

12 The statute does not prohibit all discrimination in pricing, only "undue" or
13 "unreasonable" discrimination. This distinction goes to the heart of the
14 reason that regrouping must continue. On June 30, 1995, the tariff
15 revision reclassifying the Fort George exchange from Rate Group 8 to
16 Rate Group 9 became effective. Presently Fort George subscribers have
17 access to approximately 398,400 access lines and trunks. If BellSouth is
18 not allowed to reclassify its exchanges, the West Palm Beach subscribers
19 will pay the same rates as Fort George subscribers, but they will have
20 access to about 87,000 more access lines and trunks (22 percent more)
21 than Fort George. There is no basis for this disparate treatment (i.e.,
22 charging the same price for different service) other than the fact that
23 regrouping of the Fort George exchange took place four months before
24 the regrouping of the West Palm Beach exchange was to occur.
25 Differently, customers in these two exchanges are similarly situated in

1 that, based on access line growth, both should be regrouped. If
2 regrouping of the West Palm Beach exchange is prohibited, then these
3 two groups of customers will be treated differently based on nothing more
4 than a quirk of timing. Any distinction in the treatment of similarly situated
5 customers based on this type of happenstance is arbitrary and
6 impermissible.

7
8 Q. Please summarize your testimony.

9
10 A. Regrouping constitutes a change in the nature of a customer's service
11 and is not merely a price change for the same service. Section 364.051
12 caps the prices that apply to existing exchange rate groups, not to
13 individual customers who may move to a different rate group because
14 their calling scope changes. In addition, to the extent that BellSouth is
15 forced to abruptly terminate regrouping, undue discriminatory pricing will
16 necessarily result.

17
18 Q. Does this conclude your testimony?

19
20 A. Yes.

21
22
23
24
25