

State of Florida



Public Service Commission

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-M-E-M-O-R-A-N-D-U-M-

DATE: August 16, 2007

TO: Office of Commission Clerk (Cole)

FROM: Division of Competitive Markets & Enforcement (Bates, Simmons) *QB SAS*
Office of the General Counsel (McKay, Wiggins) *Ysm flw*

RE: Docket No. 070390-TL – Petition for waiver of Order PSC-96-0012-FOF-TL and request to establish modified price regulation categories by Embarq Florida, Inc.

AGENDA: 08/28/07 – Regular Agenda – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Administrative

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\CMP\WP\070390.RCM.DOC

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Case Background

Per Section 364.051, Florida Statutes, incumbent local exchange companies (ILECs) have been able to elect price regulation since January 1, 1996. Section 364.051(1)(c), Florida Statutes, states in part that “[e]ach company subject to this section shall be exempt from rate base, rate of return regulation . . .” Under price regulation, rates for basic local telecommunications service and nonbasic services, which are defined by statute, are regulated by groupings and subject to different limits as explained below.

Section 364.02(1), Florida Statutes, defines basic local telecommunications service in part 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 multifrequency dialing, and access to the following: emergency

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services such as '911,' all locally available interexchange companies, directory assistance, operator services, relay services, and an alphabetical directory listing." Per Section 364.051(3), Florida Statutes, an ILEC may ". . . on 30 days' notice adjust its basic service revenues once in any 12-month period in an amount not to exceed the change in inflation¹ less 1 percent . . ."

Section 364.02(10), Florida Statutes, defines nonbasic service as "any telecommunications service provided by a local exchange telecommunications company other than a basic local telecommunications service, a local interconnection arrangement described in s. 364.16, or a network access service described in s. 364.163." Nonbasic services include custom calling features and other retail services such as message rate local service² which are not included within the definition of basic service.

Section 364.051(5)(a), Florida Statutes, limits rate increases by a price-regulated ILEC, for any nonbasic service category, but does not define the categories. This section specifies that "[t]he price increase for any nonbasic service category shall not exceed 6 percent within a 12-month period until there is another provider providing local telecommunications service in an exchange area at which time the price for any nonbasic service category may be increased in an amount not to exceed 20 percent within a 12-month period . . .". The Commission established nonbasic service categories in order to implement this statutory provision. The original ten nonbasic service categories were established by Order No. PSC-96-0012-FOF-TL (Stipulation Order), wherein the Commission approved a proposed stipulation among certain parties to Docket No. 951159-TL, Investigation to Determine Categories of Nonbasic Services Provided by Local Exchange Companies Pursuant to Section 364.051, Florida Statutes.

On June 29, 2007, Embarq Florida, Inc. (Embarq or Company) filed a petition for a waiver of the Stipulation Order to consolidate the existing ten nonbasic service categories to the same five categories approved previously for BellSouth Telecommunications Inc. (n/k/a BellSouth Telecommunications, Inc. d/b/a AT&T Florida d/b/a AT&T Southeast) and Verizon Florida Inc. (AT&T and Verizon, respectively) pursuant to waiver requests (Docket Nos. 041213-TL and 050294-TL).

¹ Inflation is ". . . measured by the changes in the Gross Domestic Product Fixed 1987 Weights Price Index, or successor fixed weight price index, published in the Survey of Current Business or a publication, by the United States Department of Commerce."

² Embarq's message rate local service (SmallTalk in Embarq's General Exchange Tariff, Section A3 D.2) is a single-party service with an allowance of 30 calls per month. Outgoing calls in excess of 30 are rated at \$.10 per call.

Discussion of Issues

Issue 1: Should the Commission grant Embarq's Petition for Waiver of Order No. PSC-06-0012-FOF-TL and reduce the number of nonbasic service categories from ten (10) to five (5)?

Recommendation: Yes. The Commission should grant Embarq's Petition for Waiver of Order No. PSC-06-0012-FOF-TL and reduce the number of nonbasic service categories from ten (10) to five (5) for Embarq. **(Bates, Simmons)**

Staff Analysis: Certain parties to Docket No. 951159-TL stipulated to the creation of ten nonbasic service categories. Based on the Stipulation Order, the statutory limitation on nonbasic rate increases does not apply to individual services within the category, but rather to the revenue change across all the services in a nonbasic category, over a 12-month period. With each tariff filing, the company submits a price-out for the affected nonbasic service category, showing beginning of period and proposed revenue, to demonstrate the overall rate change is within the statutory limit.

The following chart depicts the present categories and Embarq's proposed categories:

<u>Present</u>	<u>Embarq Proposed</u>
Residence Nonbasic Exchange Access	Residential Nonbasic Service
Residential Optional Services	
Business Nonbasic Exchange Access	Business Nonbasic Service
Business Optional Services	
Local Directory Assistance and Directory Services	Local Directory Assistance and Directory Services
Toll Services	Other Optional Services
Operator Services	
Transport Services	
Public and Semi-Public Telephone	
Miscellaneous Services	Miscellaneous Services

Embarq proposes to migrate the revenue for each existing category to the appropriate new category, at the end of the current 12-month pricing period, which is October 31, 2007. According to Embarq, and staff agrees, this approach will allow the Company to transition to the new categories, while maintaining compliance with Section 364.051(5)(a), Florida Statutes.

The size and structure of the nonbasic service categories can directly influence Embarq's flexibility to adjust prices and be compliant with the statute. With a larger number of services included in a nonbasic service category, Embarq can increase some rates significantly if market conditions favor the Company, while lowering other rates to address competitive pressures. For

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this reason, staff believes the services in a nonbasic category should be subject to similar competitive and market conditions. A system of fewer, but larger, nonbasic service categories provides more pricing flexibility, although competitive and market conditions will dictate to what extent this flexibility is actually used. Embarq takes the position that competition is increasingly limiting its ability to increase prices, which indicates that fewer nonbasic service categories are needed.

In concept, staff believes the proposed category structure reflects differences in the competitive pressures facing Embarq. Combining the existing Nonbasic Exchange Access and Optional Services categories for Residential and Business, respectively, makes sense from the standpoint that both types of services are provided by the end user's local telephone company. The state of competition in the local market likely would affect pricing of exchange access and optional local services in a similar manner. Staff also believes that Embarq's request to combine Toll Services, Operator Services, and Transport Services³ is logical since these types of services are recognized as being some of the most competitive.

Staff next considers whether Embarq's rate increase history provides any indication of how Embarq might utilize additional pricing flexibility, and how customers might be affected. In reviewing Embarq's rate increase history for the various categories, staff found only one area of concern with the proposed consolidation. In the Residence Nonbasic Exchange Access category, Embarq has increased rates to essentially the full extent permitted by statute during 2005 and 2006.

Nonbasic Service Category	Percentage Increase in Rates							
	1999	2000	2001	2002	2003	2004	2005	2006
Residence Nonbasic Exchange Access	0.00%	4.08%	5.73%	5.30%	2.06%	4.02%	19.95%	19.47%
Residential ⁴ Optional Services	5.17%	5.29%	5.96%	5.99%	6.00%	1.17%	-1.11%	2.15%

If the above two categories are combined, Embarq would have even greater latitude to increase rates for message rate local service, which is the key component of the Residence Nonbasic Exchange Access category. Currently, Embarq prices residential flat rate service \$3.20 to \$3.85 higher than message rate service, but the pricing differential has been shrinking over time.

While consolidation would give Embarq greater flexibility in theory to increase prices for message rate service, these increases would be limited by market dynamics. In order for message rate service to be a viable offering for customers, the service needs to be priced less than flat rate service (i.e., basic service). If not, there would be no demand for the service, and

³ Staff believes the Public and Semi-Public Telephone category is no longer applicable since these retail services have been deregulated.

⁴ The Stipulation Order defines this category as "[a] service or family of services offered to residential customers that provides enhanced calling features or functions complementary to residential basic or non-basic local exchange access services."

Embarq would eliminate the offering. Therefore, staff believes the price of residential basic service, which is regulated more strictly under the statute, acts as a practical limit on the price Embarq can charge for nonbasic, message rate service.

In considering AT&T and Verizon's previous petitions on this subject, staff reviewed the rate increase history for each carrier and did not find the same concerns as expressed above for Embarq. While the rate increase history for Embarq may weigh in favor of not granting the requested relief, staff is equally concerned that failure to grant Embarq's petition may place this carrier at an unreasonable disadvantage, as compared to AT&T and Verizon. An option the Commission may consider is to grant Embarq's petition in part. Staff believes Commissioners can resolve any concerns arising from the rate increase history by retaining Residence Nonbasic Exchange Access and Residential Optional Services as separate categories and granting the remainder of the requested relief. Under this option, the number of nonbasic service categories would be reduced from ten (10) to six (6) for Embarq.

The following chart depicts the present categories, Embarq's proposed categories and the aforementioned staff option:

Present	Embarq Proposed & Staff Recommended	Staff Option
Residence Nonbasic Exchange Access	Residential Nonbasic Service	Residential Nonbasic Exchange Access
Residential Optional Services		Residential Optional Services
Business Nonbasic Exchange Access	Business Nonbasic Service	Business Nonbasic Service
Business Optional Services		
Local Directory Assistance and Directory Services	Local Directory Assistance and Directory Services	Local Directory Assistance and Directory Services
Toll Services	Other Optional Services	Other Optional Services
Operator Services		
Transport Services		
Public and Semi-Public Telephone		
Miscellaneous Services	Miscellaneous Services	Miscellaneous Services

On balance, after considering the potential effects of consolidation and the previous relief granted to AT&T and Verizon, staff recommends the Commission grant Embarq's Petition for

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Waiver of Order No. PSC-96-0012-FOF-TL and reduce the number of nonbasic service categories from ten (10) to five (5). This action would be consistent with Order No. PSC-05-0278-CO-TL, issued in Docket No. 041213-TL, and Order No. PSC-05-0697-CO-TL, issued in Docket No. 050294-TL.

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Issue 2: Should this docket be closed?

Recommendation: Yes, if no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order. **(McKay)**

Staff Analysis: If no person whose substantial interests are affected by the proposed agency action files a protest within 21 days of the issuance of the order, this docket should be closed upon the issuance of a consummating order.