

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for waiver of Order PSC-96-0012-FOF-TL and request to establish modified price regulation categories by Embarq Florida, Inc.

DOCKET NO. 070390-TL
ORDER NO. PSC-07-0774-PAA-TL
ISSUED: September 24, 2007

The following Commissioners participated in the disposition of this matter:

LISA POLAK EDGAR, Chairman
MATTHEW M. CARTER II
KATRINA J. McMURRIAN
NANCY ARGENZIANO
NATHAN A. SKOP

NOTICE OF PROPOSED AGENCY ACTION
ORDER APPROVING CHANGES IN
NON-BASIC SERVICE CATEGORIES

BY THE COMMISSION:

NOTICE is hereby given by the Florida Public Service Commission that the action discussed herein is preliminary in nature but will become final unless a person whose interests are substantially affected files a petition for a formal proceeding, pursuant to Rule 25-22.029, Florida Administrative Code.

This matter is before the Commission upon the petition of Embarq Florida, Inc. (Embarq or Company) to reduce the number of its non-basic service categories from ten (10) to five (5). We have jurisdiction.

Case Background

As provided in 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

DOCUMENT NUMBER-DATE

08724 SEP 24 5

FPSC-COMMISSION CLERK

exchange area, dual tone multifrequency dialing, and access to the following: emergency 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 filed its 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).

Discussion

In Docket No. 951159-TL certain parties 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

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.

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.

Proposed Changes

As noted above, Embarq proposes to reduce the number of categories of nonbasic service from ten to five. 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, this approach will allow the Company to transition to the new categories, while maintaining compliance with Section 364.051(5)(a), Florida Statutes.

Rationality of proposed changes

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 this reason, it appears that 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, the proposed category structure appears to reflect 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. Additionally, Embarq's request to combine Toll Services, Operator Services, and Transport Services³ is reasonable since these types of services are recognized as being some of the most competitive.

Rate History

We next consider 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, we 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, in theory, would give Embarq greater flexibility 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 Embarq would eliminate the offering. Therefore, we recognize that the price of residential basic

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."

service, which is regulated more strictly under the statute, would likely act as a practical limit on the price Embarq can charge for nonbasic, message rate service.

Analysis and Decision

In considering AT&T and Verizon’s previous petitions on this subject, we 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, we are equally concerned that failure to grant Embarq’s petition may place this carrier at an unreasonable disadvantage, as compared to AT&T and Verizon. To balance these concerns, we choose to grant Embarq’s petition in part. Specifically, we resolve 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 categories as approved under this order:

| Present | Embarq Proposed | Approved |
|---|---|---|
| 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 |

Conclusion

In conclusion, after considering the potential effects of consolidation and the previous relief granted to AT&T and Verizon, we grant in part Embarq's Petition for Waiver of Order No. PSC-96-0012-FOF-TL and reduce the number of nonbasic service categories from ten (10) to six (6) as identified above. This decision is 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 in that it balances promotion of competition with protection of the customers.

Based on the foregoing, it is

ORDERED by the Florida Public Service Commission that Embarq's Petition for Waiver of Order No. PSC-96-0012-FOF-TL, and request to reduce the number of nonbasic service categories is granted in part. It is further

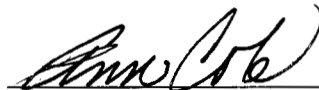
ORDERED that Embarq's proposed nonbasic service categories are approved *as modified* in the body of this order. It is further

ORDERED that the findings made in the body of this Order are hereby approved in every respect. It is further

ORDERED that the provisions of this Order, issued as proposed agency action, shall become final and effective upon the issuance of a Consummating Order unless an appropriate petition, in the form provided by Rule 28-106.201, Florida Administrative Code, is received by the Commission Clerk, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on the date set forth in the "Notice of Further Proceedings" attached hereto. It is further

ORDERED that in the event this Order becomes final, this docket shall be closed.

By ORDER of the Florida Public Service Commission this 24th day of September, 2007.



ANN COLE
Commission Clerk

(S E A L)

PWK

NOTICE OF FURTHER PROCEEDINGS OR JUDICIAL REVIEW

The Florida Public Service Commission is required by Section 120.569(1), Florida Statutes, to notify parties of any administrative hearing that is available under Section 120.57, Florida Statutes, as well as the procedures and time limits that apply. This notice should not be construed to mean all requests for an administrative hearing will be granted or result in the relief sought.

Mediation may be available on a case-by-case basis. If mediation is conducted, it does not affect a substantially interested person's right to a hearing.

The action proposed herein is preliminary in nature. Any person whose substantial interests are affected by the action proposed by this order may file a petition for a formal proceeding, in the form provided by Rule 28-106.201, Florida Administrative Code. This petition must be received by the Office of Commission Clerk, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, by the close of business on October 15, 2007.

In the absence of such a petition, this order shall become final and effective upon the issuance of a Consummating Order.

Any objection or protest filed in this/these docket(s) before the issuance date of this order is considered abandoned unless it satisfies the foregoing conditions and is renewed within the specified protest period.