

## Chapter 24      How Pac Bell and SBC Stole California's Digital Future.

In 1993, Pacific Bell laid out a massive Information Superhighway plan titled "California First". The company stated that they would be spending a whopping \$16 billion to rewire the state with fiber optic technologies, replacing the old, in use, copper wiring. By the year 2000, the company would have 5 million homes rewired, 1.5 million by the end of 1996! According to Pacific Telesis's 1993 Annual Report:<sup>1</sup>

*"In November 1993, Pacific Bell announced a capital investment plan totaling \$16 billion over the next seven years to upgrade core network infrastructure and to begin building California's 'Communications superhighway'. This will be an integrated telecommunications, information and entertainment network providing advanced voice, data and video services. Using a combination of fiber optics and coaxial cable, Pacific Bell expects to provide broadband services to more than 1.5 million homes by the end of 1996, 5 million homes by the end of the decade."*

And what would be offered? — Tele-medicine, tele-learning, and "unlimited programming choices", to name a few services.<sup>2</sup>

- "telemedicine, linking medical specialists across time zones for review of x-rays and medical procedures;
- learning and education programs that connect universities and school districts, whether for information access, or teacher-student and class-to-class interaction;
- unlimited programming choices at flexible times for TV watchers and unprecedented public access for TV producers; and
- multi-media, virtual-reality computer games; and voice-activated home shopping from an infinite variety of vendors."

This wonderland would not just include regular cable or online services, but would also give customers between 70 cable channels and 150 to 300 digital channels, according to Pac Bell's

video dialtone application to the FCC for permission to deploy this fiber-upgraded system. According to the FCC: <sup>3</sup>

“The Commission found that Pacific Bell's proposed platform, consisting of 70 analog channels and between 150 and 300 digital channels, would offer sufficient capacity to serve multiple programmers.”

The speeds of these services would be incredibly fast, according to the Pacific Telesis 1994 Fact Book.<sup>4</sup> Fiber optics is a glass wire and has the capacity to deliver speeds about 100 times faster than current DSL, which still travels over the original copper wiring.

### **Exhibit 53**

#### **Pac Bell's Consumer Broadband Hybrid Fiber/Coaxial Direction**

(\* The speeds are not quite the equivalent to Mbps)

750-50 MHz Forward Direction (to the customer)

5-40 MHz Reverse Direction (from the customer)

*Source: the Pacific Telesis 1994 Fact Book*

But the main reason the FCC agreed to allow Pac Bell to build this new network was because Pac Bell would be bringing in competition in both cable (video) services, as well as new interactive digital services. <sup>5</sup>

“The Commission found that Pacific's proposals will produce new investment in an advanced telecommunications infrastructure, bring additional competition in the distribution of video services, and give consumers in those areas additional choices in video programming and interactive digital services.”

And who was going to pay for this fiber optic wonderland? According to Pac Bell, the expenses would fall to customers. <sup>6</sup>

“Pacific Bell officials say the whole project will cost about \$1,000 per household. While most of the cost will be covered by telephone rates, Pacific Bell officials were adamant that phone bills would not be increased. “

Pac Bell reiterated this numerous times. In another article, Pac Bell said the fiber upgrades would benefit customers so, of course, it would be paid for by ratepayers.<sup>7</sup>

"Pacific Bell officials say most of the new network would be paid for by ratepayers because the upgrade would benefit phone customers by improving quality and reducing maintenance costs.”

There were, of course, numerous people who questioned the plan. Some complained that the Bell was creating a schism between the communities that would and would not be wired — the first signs of today’s Digital Divide.

"While hailed by many state and local officials, Pacific Bell's plan has come under fire from Sen. Steve Peace, D-Chula Vista, because South Bay communities were not included in the phone company's initial upgrade program.<sup>8</sup>

“Peace said his 720,000 constituents, who live south of Interstate 8, primarily in the South Bay, will be economically and educationally disadvantaged by the telephone company's initial deployment of the superhighway in more affluent communities to the north.<sup>9</sup>

“You're going to have two societies out there — one that's plugged in and one that's not plugged in', Peace said. 'Pacific Bell has carved out where the wealth is in the county, and it's going to give those communities a head start. The gap is going to get wider and we'll never catch up.’”

However, though there were doubters, Pac Bell decided to go forward, and in 1994, they would start replacing the older copper wiring with the newer fabled fiber optics — as one writer put it, “The Copper Age is over in California”.<sup>10</sup>

*“The Copper Age is over in California.* Hundreds of Pacific Bell technicians have begun yanking thousands of miles of twisted-pair copper telephone wire and replacing it with broadband fiber and coax. Lasers and light — that's the future for this Baby Bell's 10 million telephone customers, who will be among the first in the nation to ride on the information highway.”

Also, it was clear from Pac Bell that this was not a test or trial, but full deployment.<sup>11</sup>

“And there's one crucial difference between what is happening in the Golden State and interactive efforts elsewhere: In California, they're playing with real bullets.

“While other RBOCs and cable companies continue to test market their broadband networks with subscribers, *Pacific Bell has launched into full-scale deployment.*“

As we discuss in other sections, virtually every phone company had plans to roll out fiber optics in the states they controlled. From Bell Atlantic's 8.75 million households by 2000, or Ameritech's 6 million households by 2000, All of America was going to be rewired. As we now know, this was mostly fiber to the press release.

### **Construction Begins.**

In May of 1994, four areas were included in the initial phases of construction:<sup>12</sup>

- The San Francisco Bay Area in Northern California
- The Los Angeles area
- Orange and Riverside counties
- The San Diego area

In a Los Angeles Times article, titled “Interactive TV Will Come to Valley in '94”, specific neighborhoods were detailed:<sup>13</sup>

“Areas of Canoga Park, Reseda, Sherman Oaks, Northridge, Van Nuys, Calabasas and Hidden Hills have been targeted for Pacific Bell's Los Angeles roll-out of a high-speed fiber optic network that will bring customers everything from phone and cable television services to movies-on-demand, video catalogue shopping and video research libraries.”

Even the starting point, the Reseda area, was outlined by Pac Bell. <sup>14</sup>

“The initial Valley beachhead will be part of the Reseda area, where 45,000 households will be wired with fiber optic cable next year. By 1996, when all the targeted Valley areas are connected, 250,000 homes in the Valley will be capable of receiving the new phone and video services.”

The next page is an actual copy of the deployment plan as stated in the Pacific Telesis “Fact Book”, from 1993. It outlines in no uncertain terms, the various parts of California that should be rewired — and when.

**Exhibit 54  
Pacific Telesis' Consumer Broadband Deployment Schedule for California,  
1996-2000.**

*Consumer Broadband  
Deployment Schedule*

*Consumer Broadband*

<b>Geography for 7-year deployment</b>	<b>Regional Areas where Pacific Bell will initially break ground</b>	<b>Cities within regional areas slated for initial deployment in the 1994-1996 time frame</b>	<b>Areas slated for deployment by 2000</b>
San Francisco Bay Area	Silicon Valley and San Jose	Campbell, Cupertino, Los Altos, Los Altos Hills, Milpitas, Mountain View, San Jose, Santa Clara, Saratoga, Sunnyvale	Peninsula, San Francisco, East Bay, Contra Costa
Los Angeles	San Fernando Valley/West LA	Parts of Los Angeles (Canoga Park, Reseda, Sherman Oaks), Calabasas, Hidden Hills, Inglewood	Most of greater Los Angeles area
San Diego	San Diego	Central San Diego, (and other parts of San Diego, including La Jolla, Linda Vista, Pacific Beach and Rancho Bernardo), Del Mar, Poway	Central and eastern San Diego areas
Orange County	Anaheim	Anaheim, Buena Park, Cypress, Garden Grove, Orange, Stanton, Villa Park	Orange County and western Riverside County

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## **Other Promises: The Wiring of Schools**

Alongside these promised networks, Pac Bell made other claims that insured that even California's schools and libraries would be entering the future.<sup>15</sup>

"Pacific Bell will spend \$100 million during the next three years to hook up more than 7,400 schools, community colleges and libraries to computer and video networks, the company announced yesterday.

“By the year 2000, phone company officials predicted, *every classroom will be wired to handle voice, data and video telecommunications.*”

In fact, Pac Bell would: <sup>16</sup>

"install four digital lines, called ISDN, free in every public school, community college and public library in its service areas by end of 1996. Costs of installation and one year's usage would be waived.

"Wire two rooms at each school and library for computers and video-conferencing and donate \$5 million in seed money for wiring all classrooms."

Pac Bell said that they would be the ones footing the bill.<sup>17</sup>

“Pacific Bell President Phil Quigley said telephone rates will not be affected by the company's program because the money is coming from the corporation's regular capital-spending budget.

"in the same breath Pac Bell stated that it would 'ask the Public Utilities Commission to set special rates for educational access?'"

But the phone company didn't have to worry. The Public Service Commission slapped everyone with the bill. <sup>18</sup>

“The PUC is developing a \$150 million-per-year grant program for schools, libraries and nonprofit groups to develop telecommunications programs, train personnel and buy equipment.”

### **Video Dialtone Promises**

As in every other state, the phone company also filed with the FCC to offer "video dialtone" services. By 1993, Pac Bell California filed for four locations with 1.3 million households in the initial wave of construction.

**Exhibit 55**  
**Requested Video Dial Tone Applications by Pacific Telesis for California,**  
**Filed 1993**

Date	Telco	Location	Homes	Proposal
12/20/93	Pacific Bell	Orange Co.	210,000	permanent
12/20/93	Pacific Bell	So. San Francisco	490,000	permanent
12/20/93	Pacific Bell	Los Angeles	360,000	permanent
12/20/93	Pacific Bell	San Diego	250,000	permanent
			1,310,000	

### **Did Promises of the Highway Effect California Customer Phone Rates?**

As early as 1988, Pac Bell pushed hard to change state laws that would give them more money to build this wonderous wonderland, as well as roll out ISDN. Based on the Bell's continual assault in the press about how California needed this wonderland, laws were changed to give the Bells more money. The old "rate of return" (which capped the Bells profits, since they were still a monopoly) was replaced with a newer form known as "alternative regulations". Also, known as "price caps", the law capped the price of some services for a while, but not the profits. And considering that the costs to offer telephone service continually dropped, price caps just supplied more profits— i.e., extra billions of pennies, nickels, dimes, and quarters on customers' phonebills.<sup>19</sup> In short, Pac Bell received an additional \$600 million.<sup>20</sup>

"John Gueldner, Pacific Bell's vice president of regulatory affairs, said yesterday's decision on rates 'gives Pacific Bell the funding we need to continue building the information superhighway'.

"'With that \$600 million, we'll be able to accelerate our investment in improving telecommunications in California', said Gueldner."

Another form of monies came in the numerous concessions that the Bell was able to get from the very anxious California cities and counties that wanted their fiber optic networks — ASAP. As the San Jose Deputy City Manager put it: <sup>21</sup>

"'We want to get the on-ramps and off-ramps (to the systems) built as soon as possible.... We want it to be clear, from (city) staff to the city council, that San Jose is aggressively pursuing (the high-tech development)', said Greg Larson, deputy city manager."

Though each city and county had a long list of enticements, the major incentives offered were: (Note: It is not in the scope of this report to identify all of the agreements and their terms.)

- loosened regulations and fast-track permitting
- various fee waivers for prospective developers
- waivers for its enterprise zones
- waiver of candidate fees, charges for use of public right-of-ways

We will return to the topic of the financial impacts of these decisions later.

## **A Dark Secret: The Technology Didn't Work as Advertised.**

Unfortunately there was a very dark secret — the system couldn't be built. As discussed in other sections, the technology wasn't available — not for the price that the companies had outlaid for each home, and there were even questions if it could be built for any sum. According to a report titled "The Information Superhighway: Get a Grip", by New Networks Institute, 1994: <sup>22</sup>

“Numerous speeches given at a conference titled 'Interactive Marketing', May 1994,<sup>23</sup> discussed the technological and manufacturing hurdles required to bring to the residential subscriber full-motion, interactive video services. The consensus was simple:

- The boxes required computer chips that were not yet being mass manufactured.
- The initial boxes would cost \$2,000–\$5,000 per unit, since they are, in reality, high-speed computers and not production models.
- The mass market manufacturing price would most likely wholesale for \$1,200–\$1,500 per unit.

“In fact, in most of the interactive TV trials during 1994-1995, the price per set-top box was between \$4,000-\$5,000. The Time Warner trials in Orlando, originally scheduled for spring 1994 (and shut down in 1997) were delayed a year because even the prototypes were not fully operational and the boxes reportedly cost \$5,000. In another trial by Viacom and AT&T in Castro Valley, that was also canceled, the cost was \$4,000 per box. This \$4000-\$5000 box didn't take into account the network upgrades, or the digital switches and servers, which were believed to cost an additional \$1,000 to \$1,200 per subscriber.”

And there were obvious signs that there were problems with the Info highway build. For example, Bell Atlantic halted its video service plans in April of 1995.

“Bell Atlantic Halts Plan for Video Services”, *The New York Times*, April 26, 1995<sup>24</sup>

“Bell Atlantic Corporation called an abrupt halt to its scramble into television yesterday. Saying it wanted to rethink its strategy for upgrading its telephone network, the company asked the Federal Communications Commission to suspend its application to offer video services to as many as three million telephone customers...”

Meanwhile, an article in *The New York Times*, December 18, 1995, stated that:

"Bell Atlantic revealed that it cost \$17,000 per household to build and deliver a Full-Service network." (in Toms River, New Jersey)<sup>25</sup>

The odds that Pac Bell was aware of this at the time this law was passed was high, since Bell Atlantic and US West (two other Bell companies) both started to close down some of their info highway plans months before, citing technical difficulties.

As we discuss elsewhere, statements made by both Verizon and SBC about their new fiber optic plans, including Verizon's FIOS and SBC's Lightspeed, also indicate that it wasn't until 2004 that they were once again discussing their new fiber optic deployments, both claiming that the plans to have fiber-to-the-home was a 'first', with no mention that these identical plans were first announced in 1993!

### **Construction Expenditures for the Network Came from the Regulated Budget.**

More to the point, an examination of Pacific Bell's construction expenditures for the years in question clearly show that there weren't any major increases in network spending. The company spent more money on the telephone network in the mid-1980's.

#### **Exhibit 56**

#### **Pacific Telesis Construction & Capital Expenditures, 1984-1996**

*(In the billions)*

1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
\$2.1	\$2.3	\$2.2	\$2.2	\$1.6	\$1.9	\$2.1	\$1.7	\$1.8	\$1.9	\$1.7	\$2.1	\$1.8

*Source: Pacific Telesis Annual Reports, 1984-1996.*

From these statistics it is clear that Pac Bell's network upgrades for fiber most likely came directly from their normal annual spending, and most likely replaced the upgrades to the copper wiring plant — the same plant that handles DSL.

Also, simple math would dictate that if the company was spending \$16 billion starting in 1994 for a total of seven years, then the 1994, 1995, and 1996 expenditures would have to be at least \$2.3 billion a year above the normal average amount.

### **The SBC-Pacific Bell Merger: The Hatchet Comes Down on California's Plans**

While Pac Bell at least gave the appearance that it cared, although didn't fulfill any of these obligations, SBC simply pulled the plug on all of these plans.<sup>26</sup>

“Pacific and Southwestern Video Curtailment/Purchase Commitments — SBC also announced in 1997 that it was scaling back its limited direct investment in video services in the areas also served by Pacific Bell Telephone Company (PacBell) and Southwestern Bell Telephone Company (SWBell). As a result of this curtailment, SBC halted construction on the Advanced Communications Network (ACN) in California. As part of an agreement with the ACN vendor, SBC paid the liabilities of the ACN trust that owned and financed ACN construction, incurred costs to shut down all construction previously conducted under the trust and received certain consideration from the vendor. In the second quarter of 1997, SBC recognized net expense of \$553 (\$346 net of tax) associated with these activities. During the third quarter of 1997, SBC recorded the corresponding short-term debt of \$610 previously incurred by the ACN trust on its balance sheet.

“Additionally, SBC curtailed certain other video-related activities including discontinuing its broadband network video trials in Richardson, Texas, and San Jose, California, substantially scaling back its involvement in the TELE-TV joint venture and withdrawing its operations in territory served by SWBell from the Americast venture. During 1999, SBC negotiated a settlement with its Americast partners related to the withdrawal. The settlement did not have a material impact on SBC's financial condition or results of operations. The collective impact of these decisions and actions by SBC resulted in a charge of \$145 (\$92 net of tax) in the second quarter of 1997.”

To demonstrate the total irony of this move, SBC released a press release about Philip Quigley, Pac Bell's president, at the time of SBC-Pac Bell merger. It demonstrates how the hype continued, regardless of the reality. Even though Pacific Telesis stopped all of its major highway plans and never spent the money, the press release (April 1, 1997) stated that Quigley led Pac Tel's \$16 billion broadband Info Bahn project.<sup>27</sup>

*"During Quigley's tenure, Quigley led PacTel's comprehensive **\$16 billion network redesign program, which involved construction of a broadband information superhighway.**"*

However, as the previous quotes demonstrate, not only did SBC do a wholesale cleanout of the advanced network plans, but, more importantly, Pac Bell never spent the \$16 billion — not even a fraction of it. However, it seems they did write-off whatever was put into the ground. It also seems that customers never benefited from the network, or the write-offs. However, customers did pay for these fabled networks. In fact, some parts of California were wired — but never connected — a true highway to nowhere.

### **Show me the Money**

If the networks weren't finished, where's all the money? In other sections of the book we outline our belief— overcharging comes to approximately \$2000.00 per household. Without audits it is hard to tell exactly how much money was overcharged in the Pac Bell territories, but it is most likely close to the other phone companies.

### **Changes in State Laws**

Pac Bell stated that the additional \$600 million would be spent on the new networks. As Pac Bell stated the money was on an increasing scale from \$100 million in 1996 to \$300 million in 1998, accrued from changes in state laws.<sup>28</sup>

“Pacific Bell said the PUC's productivity formula would have required refunds of \$100 million in 1996, \$200 million in 1997 and \$300 million in 1998 — money that it needs to be competitive in the new marketplace.“

However, Toward Utility Rate Normalization (TURN) said the refunds were higher and that over \$1 billion was at stake.<sup>29</sup>

“The commission just handed Pacific Bell a billion-dollar Christmas gift’, said Regina Costa, a telecommunications analyst for TURN.”

This extra billion dollars is only a small part of the overcharging picture. The “Regulatory Audit of Pacific Bell for 1997, 1998, and 1999 by the California Public Utilities Commission”,<sup>30</sup> just examined the “regulated intrastate revenues”, found that the company made mistakes of \$1.94 billion dollars and that in 1999, the amount of monies that should have been collected, had the law not been changed in 1999, would have been an additional \$457 million.

“The audit of financial results identified 67 corrections to Pacific Bell’s regulated operating revenues, expenses and rate base. Audit corrections to bring financial results into compliance with CPUC requirements increased the regulated intrastate net operating income that Pacific Bell reported during the audit period by \$1.94 billion. This translates into recommended customer refunds under NRF earnings sharing rules of \$349 million for the years 1997 and 1998. NRF earnings sharing rules were suspended by the CPUC effective in 1999. Customer refunds for 1999 would have totaled \$457 million if the sharing rules had been effective. Following are additional key findings and conclusions from the audit.”

And these were simply corrections needed. They do not reflect how much money the phone company made from the changes in state law.

## **Did Customers Illegally Fund ADSL in California?**

As we just discussed, what was promised to Californians was a fiber optic wire, not simply using the old copper wiring.

The difference is of course speed and services. The fiber optic future was of 45 Mbps and hundreds of channels. DSL is about 45-100 times slower. ADSL, which is “Asymmetric” DSL, is only fast in one direction.

However, the Audit of Pac Bell for the years 1997-1999 found that Pac Bell had \$196 million dollars in expenses to develop ADSL and much, it not all of it, was charged to phone customers, which is known as “cross-subsidization”.

According to the Audit.<sup>31</sup>

“ADSL was introduced in 1998 but was not widely available until after the audit period. During the three year audit period Pacific Bell incurred net expenses of \$196 million to develop ADSL service and placed substantial ADSL plant investment into rate base.... At the end of 1999, at about the time the service was ready to be widely marketed, Pacific Bell transferred ADSL to SBC Advanced Solutions, Inc.. As a result, regulated customers paid a substantial amount for ADSL’s development, but never received the benefit of significant ADSL revenue.”

We need to point out that there have been many fights, legal actions, etc.. over DSL in California, as well as on the Federal level. For example, the FCC ruled that DSL is an Interstate Information service and doesn’t have to be to competitive Internet Providers. If customers funded these networks, then shouldn’t they have remained open to competition? We will come back to this issue in Volume II.

## **Cross-Subsidization of Other Expenses**

A customer is only supposed to be charged for local service when paying a local service bill. However, it seems that every phone company, including Pac Bell, has been able to move expenses to the phone company’s regulated’ side, thus raising the cost of local phone service for ‘ratepayers..

The Pac Bell audit found a host of these improperly added expenses, which can add hundreds of millions of dollars or expenses, such as with ADSL. Here are some examples. In this case, SBC charge Pac Bell customer for their political and legislative lobbying costs.

“We found other cross subsidies flowing from Pacific Bell’s customers to SBC shareholders. Examples included parent company political and legislative

influence costs and secondary cost allocations of parent company “management fees” charged to Pacific Bell’s customer (above-the-line) accounts.”

SBC extortion charges? SBC charged more money to California in the form of building the SBC Corporation.

“Pacific Bell’s operating expenses increased because of a substantial increase in corporate charges. Pacific Bell’s corporate charges increased from less than \$120 million in 1996, the year before the merger, to nearly \$300 million in 1999. *Most of the increase was due to new and higher cost levels billed by SBC’s Texas-based corporate organization, which was added to the California-based PTG organization that existed prior to the merger.* Pacific Bell’s corporate charges continued to climb in 2000. This occurred in part because cost allocations from Management Services Inc., SBC’s Texas-based parent organization, were layered on top of costs being charged by PTG’s parent organization prior to the merger”

And there are loads of areas that are impacted. Here are 9 different items totaling \$463 million. To sum up a few — the company incorrectly charged \$38 million for local number portability, (the ability to take you phone number when you go to a competitive service), \$49 million for local competition costs, \$35 million for not adding the merger savings, etc. However, the author’s personal favorite was \$41 million for the “Shut down of an Advanced Communication Network that was never placed into service,” — the fabled fiber optic deployment.

“We identified and calculated nine audit corrections to operating expenses. These include 1) removing \$138 million in local number portability (LNP) costs from intrastate operating expenses that the FCC explicitly ruled should be assigned directly to the interstate jurisdiction; 2) removing \$49 million in local competition implementation costs that should have been deferred and amortized over the period of CPUC-authorized surcharge recovery that began in 2001; 3) reducing operating expense by \$35 million to reflect the allocation of merger savings between ratepayers and shareholders ordered in the CPUC decision that approved the merger of SBC and Pacific Telesis; 4) removing \$41 million in cost associated with the shut down of an Advanced Communications Network that was never

placed into service; 5) reducing operating expenses by \$44 million to correct Pacific Bell's accounting for a December 1999 software buy-out agreement; 6) removing \$103 million of unsupported and unauditible litigation and regulatory accruals from operating expense; 7) reducing incentive compensation accruals by \$29 million to reflect the actual payout levels for the 1997, 1998 and 1999 performance years; 8) reducing 1997 and 1998 operating expense by \$42 million to remove the cost of settlements paid to contract billing customers for an increase in uncollectible amounts attributable to 1996 operations; and 9) increasing operating expense by \$19 million to correct the classification of traffic bound for internet service providers for separations purposes. In total these nine corrections reduce audit period intrastate regulated operating expense by \$463 million."

### **An Additional \$3.6 Billion in Tax Deductions Is Tied to Changes in State Law.**

In 1995, the company took a massive one-time deduction of \$3.6 billion using the excuse that they were replacing the older copper wiring with the fiber optics, which, of course, did not happen. We discuss this deduction in our construction and depreciation analysis of the Bell companies, as every other Bell also took a similar deduction tied to the changes in state regulations for their broadband announcements.

(NOTE: In 1999, New Networks Institute filed a \$3.6 billion Complaint against Pac Bell with the IRS, contending that the copper wiring was still in use and had not been removed. This saved the company over a billion dollars in Federal taxes.)

Without a full audit of the monies directly related to the changes in state law that were made for their fiber optic promises, it is impossible to tell the full extent of the costs to customers and the economy.

### **Other Business Indicators**

Because of the mergers with SBC, the various write-offs, etc., it is impossible to go into complete detail about how the fiber optic promises played out in the state. But a few things are clear — in 1992, the company's overall return on equity, a standard business measure, was then 16.1% and went to 46% in 1996, an increase of 186%. And one of the reasons for this increase

was the massive staff cuts. There were 57,000 staffers in 1992. By 1996 there were only 48,300 — a drop of 8,670, or 15%

**Exhibit 57**  
**Pacific Telesis Return on Equity, Staff, 1992-1996**

	1992	1994	1996	
Return on equity	16.1%	22.0%	46.0%	186%
Staff	57,023	51,590	48,330	-15%

Clearly, changes in regulation that allowed for massive staff cuts, and a lack of large increases to construction, as previously discussed, all added up to major increases in the companies' profits.

**Coda: So Much for California's Digital Future.**

There were some customers that did notice. The San Diego Tribune wrote what amounts to an obituary for the fabled highway.<sup>32</sup>

"San Diegans continue to shake their heads in disbelief over the sudden cancellation of a project that promised to bring meaningful competition to the local cable market — and much more.

"It was a little disappointing to hear about all these marvelous things that they were going to provide us with, and then, with no communication with us, they just came through and started yanking (the new boxes) out again.' said Gordon Buck, a Clairemont resident. 'I'm just puzzled by it,' said Lou Quayle, another Clairemont resident. 'They had an army up here for almost three years.'"

More to the point, there's a network to nowhere sitting in various California neighborhoods.<sup>33</sup>

"Late last year, the company quietly sent word out in the industry that it is willing to sell its cable operation in San Jose as well as its unfinished networks in San

Diego, Los Angeles and Orange County – a total of 2,733 miles of fiber optic and coaxial cabling.

“Since that announcement in June, Pac Bell has disconnected cable customers in San Jose and has spent months tromping through San Diego neighborhoods to disable household boxes and reconnect customers to the old copper phone network.”

In fact, the fabulous Information Superhighway is now nothing more than another version of POTS — plain old telephone network.<sup>34</sup>

“Pac Bell's video network here, begun in May 1994, had included more than 73,000 homes in Pacific Beach, Mission Beach, Clairemont, Mira Mesa and Scripps Ranch when it was canceled last year.

“Although the network never carried video service, about 3,500 local customers in the beach areas had been receiving phone service over the high-tech network. To date, all but 946 phone customers here have been reconnected to copper wires.”

The San Diego Tribune encapsulated the failed deployments in 1998 with a timeline titled “A plan that failed,” highlighted on the next page.

**Exhibit 58****San Diego Tribunes' Year by Year: A Plan that Failed****(Summary of the Pac Bell Deployment of the Information Superhighway.)**

- November 1993 — Pacific Bell unveils plans to spend \$16 billion over seven years to upgrade its California network to handle interactive services like home shopping and compete against cable companies with video channels and movies-on-demand.
- May 1994 — PacBell begins network construction in Pacific Beach and Mira Mesa in San Diego. Construction also begins in San Jose and in Orange and Los Angeles counties.
- October 1994 — City of San Diego considers proposal to require that Pacific Bell pay franchise fees and abide by other requirements imposed on cable companies if it gets into the video business.
- October 1994 — Pacific Telesis, Bell Atlantic Corp. and Nynex Corp. form TELE-TV, a joint venture to provide the companies with video programming, entertainment and information to sell to residents.
- January 1995 — PacBell and city of San Diego sign "landmark" agreement, with PacBell pledging to give the city 5 percent of gross revenues from voice, video and data services sold over new network. City agrees not to regulate PacBell as a cable company.
- April 1995 — PacBell buys Cross Country Wireless Inc. and announces plans to offer "wireless cable" service to 5 million-customer service area covering San Diego, Riverside, Los Angeles and Orange counties.
- September 1995 — PacBell slows network construction to save \$1 billion in capital costs over five years for statewide project, but accelerates network construction in San Francisco.
- January 1996 — PacBell halts fiber/coaxial network construction in Los Angeles County. Network projects continue in San Diego, San Jose and Orange County (briefly).
- April 1996 — SBC Communications of Texas signs deal to buy Pacific Telesis.
- May 1996 — Network construction halted in Orange County.
- June 1996 — San Jose City Council awards PacBell a cable franchise, giving the company official standing as cable operator.
- September 1996 — PacBell begins selling video service in San Jose over its new network.
- April 1997 — SBC's purchase of Pacific Telesis becomes final.
- April 1997 — TELE-TV, jointly owned by Bell Atlantic Corp., Nynex Corp. and Pacific Telesis Group, cuts staff in half and abandons all joint video projects in favor of individual company efforts.
- May 1997 — PacBell launches 'wireless cable' service in Los Angeles and Orange counties.
- June 1997 — SBC abandons almost all attempts to compete with cable, announcing immediate ends to Pac Bell's video network project as well as a smaller test in Texas. The decision halts construction in San Diego and pulls the plug on 8,000 PacBell cable customers in San Jose. SBC writes off \$500 million investment in both ventures.
- November 1997 — PacBell sends out requests for bids on various components of the partially built video network.

## Chapter 15      **The SBC-Pacific Telesis-SNET-Ameritech Mergers Were the Death of State Fiber Optic Deployments.**

### *Summary*

We believe that the creation of SBC, formed from a merger of Southwestern Bell, Pacific Telesis, SNET and Ameritech should be investigated and broken up. This enlarged mega-Bell harmed the fiber optic based broadband deployments that were underway in EVERY state — from California-Pac Bell and Connecticut-SNET, to Ohio-Ameritech and Texas-Southwestern Bell. SBC never fulfilled its state obligations to upgrade the networks properly.

More importantly, when one company can control 40% of America's digital future, and it decides to NOT do something, it impacts not only the 13 states the company controls (about 125 million people) but also the entire economy.

### **Exhibit 22**

#### **The SBC Hatchet of Fiber Optic Deployments**

(Sources: Bell Annual Reports)

	Money (billions)	Households	Merger	Shutdown	Cable
Pacific Telesis	\$16.0	5,500,000	1997	1997	0
Ameritech (3states)	\$6.6	6,000,000	1999	2000	304,000
SNET	\$4.5	1,000,000	1998	2000	31,000
SBC, Texas	\$1.5				0
Pronto	\$6.0				
<b>Total</b>	<b>\$33.6</b>	<b>12,500,000</b>			

By 2002, over \$33.6 billion should have been spent by the mega-Bell for fiber optic cable deployment in over 12.5 million households.

As discussed, Pacific Bell promised deployment in 5.5 million households and to spend \$16 billion by 2000; Ameritech promised 6 million households at over \$6.6 billion by 2000 (in just 3 states); SNET promised \$4.5 billion for just Connecticut. Texas was to commit \$1.5 billion to wire schools, libraries and government agencies with fiber optics, all by 2000.

We need to stress a vital point: SBC stated in every merger that the mergers were good for broadband, competition and the economy, by bringing upgrades, new services, etc. According to the SBC 1999 Annual Report, the merged SBC-Ameritech company would start a new \$6 billion dollar fiber optic broadband plan called “Project Pronto”.<sup>35</sup>

“Broadband Initiative in October 1999: As the first post-Ameritech merger initiative, SBC announced plans to offer broadband services to approximately 80 percent of SBC's United States wireline customers over the next three years (Project Pronto). ***SBC will invest an estimated \$6 billion in fiber, electronics and other technology for this broadband initiative. The build-out will include moving many customers from the existing copper network to a new fiber network.***”

As we will show, Project Pronto, as well as every other fiber optic broadband plan in the states, were stopped by the mega-Bell, SBC.

Secondly, the FCC completely failed to enforce the merger conditions when SBC-Ameritech deceptively opted to not create wireline competition outside of their regions. Besides the failure of “Project Pronto”, by 2002, SBC-Ameritech was supposed to have been competing with wireline services in 30 cities “out-of-region” or pay large fines.<sup>36</sup>

“At December 31, 2001, \$1.9 billion in remaining potential payments could be triggered if the "Out-of-Region Competition" and "Opening Local Markets to Competition" conditions discussed below are not met. The following briefly summarizes all the major conditions:

“Out-of-Region Competition: In accordance with this condition, we will offer local exchange services in 30 new markets across the country. We are required by the FCC to enter these 30 markets as a provider of local services to business and residential customers by April 2002. Failure to meet the FCC condition requirement could result in a payment of up to \$40 million for each market. Entrance into these new markets did not have a material effect on our results of operations or financial position.”

None of this competition happened out of region and the FCC never enforced this condition. In fact, SBC believed it fulfilled its obligations by having 3 customers per 22 cities — 66 customers. Is this nationwide, robust competition?

We will also discuss elsewhere that Verizon, which was formed from NYNEX, Bell Atlantic and GTE, also promised to compete out of region and had also cut virtually every fiber optic deployment in its territories.

Both companies pulled one of the largest bait-and-switches in history. Not only did they both roll out an inferior product, DSL, which used the copper wiring, but both used the mergers to consolidate their own local service positions by taking the money and using it to roll out their long distance services.

Enlarging the mega-Bell SBC (which controls the fate of 125 million customers) is ridiculous on any level, and there are NO merger conditions that will be enforceable.

Let's first focus on the fiber optic broadband deployments and closures, using data to make the case clear: the previous mergers were bad for broadband.

### **First, Who Is SBC?**

During the 1990's, Southwestern Bell became SBC, and starting in 1997, first acquired Pacific Telesis, then SNET, and then Ameritech. According to SBC's 1999 Annual Report:<sup>37</sup>

“SBC was formed as one of several regional holding companies (RHCs) created to hold AT&T Corp.'s (AT&T) local telephone companies. On January 1, 1984, SBC was spun-off from AT&T pursuant to an anti-trust consent decree, becoming an independent publicly traded telecommunications services provider. At formation, SBC primarily operated in 5 southwestern states. SBC subsidiaries merged with Ameritech Corporation (Ameritech) in 1999, Southern New England Telecommunications Corporation (SNET) in 1998 and Pacific Telesis Group (PAC) in 1997, thereby expanding SBC's wireline operations into a total of 13 states.”

This one company now controls most of the telecommunications in 13 states including:<sup>38</sup>

“...the term "SBC/Ameritech" shall mean Illinois Bell Telephone Company, Indiana Bell Telephone Company, Incorporated, Michigan Bell Telephone

Company, Nevada Bell, The Ohio Bell Telephone Company, Pacific Bell, The Southern New England Telephone Company ("SNET"), Southwestern Bell Telephone Company ("SWBT"), and Wisconsin Bell, Inc.; any successor or assign of such company that provides wireline telephone exchange service; and Ameritech Corporation, SBC Communications Inc., and any successor of either company."

The states are:

- Ameritech — Ohio, Illinois, Indiana, Wisconsin, Michigan
- Southwestern Bell — Texas, Oklahoma, Missouri, Kansas, Arkansas
- Pacific Telesis — California and Nevada
- SNET — Connecticut

In terms of market reach, SBC now controls two of the largest states in terms of population. According to the 2004 World Almanac,<sup>39</sup> quoting 2002 Census data by state, SBC controls California, which has about 35 million people, while Texas has 21 million; about 56 million people combined. When all of the states are added together, the population coverage is approximately 125 million people; about 40% of the entire United States. (We note that in each state there are other incumbents, such as Verizon (formerly GTE). However, SBC is the largest incumbent by far, and none of the companies compete with each other directly.

We need to make it clear that SBC controls 90+% of wireline phone service in most of their states. This is because even their competitors must rent the wires. Also, SBC and BellSouth own Cingular, which also gives them about 40% of the entire wireless markets. In broadband, SBC was so successful in putting most ISPs out of business that they now own 90+% of the wireline DSL market.

Besides market size, let's review the circumstances in California that we've discussed in our case studies, and also look at SNET and Ameritech. We also discuss Texas (a Southwestern Bell state) and Project Pronto.

**Pacific Bell: 'California Dreamin'.**

(Note: We suggest you read the chapter dedicated to California's failed broadband deployments.)

As discussed in previous sections, Pacific Telesis, the parent of Pacific Bell and Nevada Bell, told regulators, investors, and the public that it was going to spend \$16 billion on the fiber optic info highway in California.

According to Pacific Telesis's 1993 Annual Report:<sup>40</sup>

*"In November 1993, Pacific Bell announced a capital investment plan totaling \$16 billion over the next seven years to upgrade core network infrastructure and to begin building California's "Communications superhighway". This will be an integrated telecommunications, information and entertainment network providing advanced voice, data and video services. Using a combination of fiber optics and coaxial cable, Pacific Bell expects to provide broadband services to more than 1.5 million homes by the end of 1996, 5 million homes by the end of the decade."*

We also presented video dialtone application materials that showed that specific parts of California were scheduled to be rewired.<sup>41</sup>

**Exhibit 23**  
**Pacific Bell Video Dialtone Deployments, 1995**

Application	Phone Co.	Location	Households	Approved
12/20/93	Pacific Bell	Orange Co., CA	210,000	7/19/95
12/20/93	Pacific Bell	So. San Francisco Bay	490,000	7/19/95
12/20/93	Pacific Bell	Los Angeles, CA	360,000	7/19/95
12/20/93	Pacific Bell	San Diego, CA	250,000	7/19/95
TOTAL			1,310,000	

Like the other video dialtone applications, this was fiber to the home, replacing the old copper wiring, and it had channels galore. Also, the number of households was for immediate deployment. Pac Bell stated that by 1996 it would have 1.5 million households wired. This data shows 1.3 million.

### **SBC Does a Hatchet Job on Pac Bell's Fiber Optic Plans: Merger 1997, Shutdown 1997.**

When SBC merged with Pacific Telesis, SBC did a hatchet job on Pacific Bell's existing fiber optic deployment. While Pacific Bell at least gave the appearance that it cared, though didn't fulfill any of these obligations, SBC simply pulled the plug on all of these plans.<sup>42</sup>

“Pacific and Southwestern Video Curtailment/Purchase Commitments - SBC also announced in 1997 that it was scaling back its limited direct investment in video services in the areas also served by Pacific Bell Telephone Company (PacBell) and Southwestern Bell Telephone Company (SWBell). As a result of this curtailment, SBC halted construction on the Advanced Communications Network (ACN) in California. As part of an agreement with the ACN vendor, SBC paid the liabilities of the ACN trust that owned and financed ACN construction, incurred costs to shut down all construction previously conducted under the trust and received certain consideration from the vendor. In the second quarter of 1997, SBC recognized net expense of \$553 million (\$346 million net of tax) associated with these activities. During the third quarter of 1997, SBC recorded the corresponding short-term debt of \$610 million previously incurred by the ACN trust on its balance sheet.”

What this says is that SBC pulled the plug early and therefore had to pay off the various vendors, whether or not the work had been completed. There is no indication of the actual expenditures versus the payoffs to terminate early.

As we pointed out in the case study, and is clear from this quote, Pac Bell never came close to spending any serious money on this project, certainly not anywhere near the \$16 billion as stated in their annual reports.

According to the 1999 Annual Report, SBC also shut down the video dialtone trials in Richardson Texas and San Jose, as well as scaled back the TELE-TV work.<sup>43</sup>

“Additionally, SBC curtailed certain other video-related activities including discontinuing its broadband network video trials in Richardson, Texas, and San Jose, California, substantially scaling back its involvement in the TELE-TV joint venture and withdrawing its operations in territory served by SWBell from the Americast venture. During 1999, SBC negotiated a settlement with its Americast partners related to the withdrawal. The settlement did not have a material impact on SBC's financial condition or results of operations. The collective impact of these decisions and actions by SBC resulted in a charge of \$145 million (\$92 million net of tax) in the second quarter of 1997.”

If the incumbent closes down the entire operations for the entire state, who is left to deploy the fiber optic networks which were upgrades to the current network? As we discussed in the case study, the deployment plans of Pac Bell were in place since the early 1990's and led to the deregulation of the company's revenues and profits on the state level.

## **SNET**

SNET (Southern New England Telephone) told the state of Connecticut, investors and the public that it would be spending \$4.5 billion over 15 years.<sup>44</sup>

“On January 13, 1994, the Telephone Company announced its intention to invest \$4.5 billion over the next 15 years to build a statewide information superhighway ("I-SNET"). I-SNET will be an interactive multimedia network capable of delivering voice, video and a full range of information and interactive services. The Telephone Company expects I-SNET will reach approximately 500,000 residences and businesses through 1997.”

As previously quoted, the materials filed with the FCC showed that they would be rolling out 1 million households of video dialtone services.<sup>45</sup>

**Exhibit 24****SNET's Filed Connecticut Fiber Optic Video Dialtone Deployments, 1995**

Date of application	telco	state	homes	type
4/28/95	SNET	CT	1,000,000	permanent

**The SBC Hatchet on Connecticut: Merger 1998, Shutdown, 2000**

In comes the SBC hatchet. By 1999, the SBC 1999 Annual Report calls it a “cable” service with 31,000 customers, and by 2000, SBC decided to close down this service.

SBC 1999 Annual Report<sup>46</sup>

“Cable Television - SBC also operates a cable television system under the SNET brand in Connecticut that is currently included in the Wireline segment. SNET began offering cable television service in the first quarter of 1997. As of December 31, 1999, SNET provided cable television services to approximately 31,000 households in Connecticut.”

SBC 2000 Annual Report<sup>47</sup>

“Cable Television - We also operate a cable television system under the SNET brand in Connecticut that has been included in the wireline segment results. Our request to close this business is currently under review by the Connecticut Department of Public Utility Control and a final decision is expected in early 2001.”

The idea that SNET, which had state laws changed to accommodate the building of a fiber optic-based service would be allowed to simply “close this business”, as if this was some whim is, of course, worth investigation.

More to the point, if SBC was supposed to be serious about fiber optic services, closing down two state's programs, where the wiring alone not only had value, but also could be used

with different electronics for the fiber optic services it was claiming it was going to deploy, is, of course, illogical.

## **Ameritech**

The oddest closing of all was by Ameritech, which simultaneously closed down its fiber optic deployments in 5 states. According to the 1994 Investor Fact Book, Ameritech was building a video network that was going to extend to 6 million customers by 2000.

Ameritech Investor Fact Book, March 1994: <sup>48</sup>

“We're building a video network that will extend to six million customers within six years.”

Ameritech also filed its video dialtone applications with the FCC, which listed 1.3 million households in Detroit, Columbus, and Chicago, among other places.

### **Exhibit 25**

#### **Ameritech Video Dialtone Requested Permanent Authorizations**

- 232,000 homes in Detroit, MI
- 262,000 homes in Columbus and Cleveland, OH
- 115,000 homes in Indianapolis, IN
- 501,000 homes in Chicago, IL
- 146,000 homes in Milwaukee, WI
- **1,256,000 Total homes**

And let's be clear. This is all fiber video dialtone stuff.

Ameritech petitioned the FCC for ALL five states. <sup>49</sup>

“Ameritech Operating Companies for authority pursuant to Section 214 of the Communications Act of 1934, as amended, to construct, operate, own, and maintain *advanced fiber optic facilities* and equipment to provide video dialtone service

within geographically defined areas in Illinois, Indiana, Michigan, Ohio, and Wisconsin.”

Ameritech, in five states, would roll out 390 channels in an “economically diverse section of its service area”.

“Ameritech maintains that approval of the applications would permit its video dialtone network to reach 1.3 million homes, businesses and institutions in geographically and economically diverse sections of its service area. The proposed hybrid network would provide 310 multicast (240 digital and 70 analog) channels and 80 switched digital channels.”<sup>50</sup>

**Billions of Spending on the State Level**

Ameritech also made state-by-state commitments to update their networks and sold them as a “fiber optic future.” The Ameritech 1993 Investor Fact Book<sup>51</sup> shows that at least \$6.6 billion was to be spent in just three states, Illinois, Ohio and Michigan. These commitments were all for “alternative regulation” plans (deregulation) that gave these companies more money in the form of higher phone rates for many services and no caps on the companies profits.

**Exhibit 26**

**Ameritech Investment Commitments, 1992-1998**

*The Ameritech Investor Fact Book, 1993*

Illinois	\$3.0 billion	Investment commitment over 5 years
Ohio	\$1.6 billion	Investment commitment over 5 years
Michigan	\$2.0 billion	Investment commitment, 1992-1995
Indiana	\$150 million	<ul style="list-style-type: none"> <li>• \$120 million in “Digital Broadband Facilities” to connect schools, hospitals, and government over the next 6 years</li> <li>• \$30 million for the next six years for educational hardware, software and training</li> </ul>
Wisconsin		pending legislation

We need to make it clear that state laws were changed because of a massive press campaign with multiple promises over several years. Below is a collection of articles and their summaries from the Chicago Tribune from 1992 to 1994. To sum up, Illinois Bell would spend \$3 billion on a “massive upgrading” of its fiber optics in exchange for removing its 13.1% profit cap. This would bring fiber optics to Chicago area suburbs and 40 others. Ameritech, the holding company, would spend \$5 billion for the mid-west information superhighway and \$1 billion with two electronic equipment suppliers for hardware to supply fiber optic service to 5 million of its 16 million customers by 1995! This was supposed to be distributed over six metropolitan areas in the five states to start.

- **Ameritech Fiber Links Going to Suburbs First**, February 2, 1994<sup>52</sup> “Ameritech's plan to bring digital video services to customers through optical fiber will start by targeting nearly two dozen Chicago-area suburbs and parts of more than 40 others, but not the city itself.”
- **Ameritech's Fiber Plan**, January 27, 1994<sup>53</sup> “Ameritech will announce a plan to spend close to \$5 billion installing optical fiber to bring the information superhighway to Midwest homes, schools and businesses. The construction will center on six metropolitan areas in the five states in which Ameritech provides local telephone service, including Illinois.”
- **Bell Rate Plan Appears Right on Line**, December 2, 1992<sup>54</sup> “Illinois Bell Telephone Co. is likely to find a willing ear among state regulators for its new rate plan, which would lift the profit cap on the state's largest phone utility in exchange for \$3 billion in new fiber optic lines.”
- **Bell Seeks Rate Overhaul**, December 1, 1992<sup>55</sup> “Illinois Bell Telephone Co is expected to ask state regulators to lift the utility's 13.1% profit cap in exchange for a massive upgrading of its system, including widespread installation of fiber optic cables.”
- **Ameritech Expanding Fiber Optics to Residential Users** September 1, 1992<sup>56</sup> “Ameritech will spend almost \$1 billion with two electronic equipment suppliers for hardware to supply fiber optic service to 5 million of its 16 million customers by 1995, the company said Monday.”

We will return to this information later.

We need to note that Ameritech was proud that it was able to change the regulation in their favor. From the 1994 Investor Fact Book:

“In 1994, Ameritech proactively changed the way in which we are regulated. We have replaced rate of return regulation with price-cap plans without earnings sharing in all five states in which we are franchised as a communications carrier.

“As a result 100% of Ameritech’s \$8 billion of intrastate revenues are now regulated by prices , not earnings. The plans foster market based pricing and give Ameritech greater incentive to earn more by allowing us to keep all that we earn.”

To paraphrase — Ameritech got rid of anyone looking at their profits, even though they were still a monopoly. Some services could now be “market priced.” Ameritech could charge what customers were willing to pay, even though there was no competition in 1994. In this bucket would be “calling features”, such as Call Waiting, Call Forwarding, etc., that cost about one penny to offer, but could sell for \$5.00 per month per line. We will return to this topic in future sections.

### **Ameritech’s Profits Went Through the Roof. A Summary 10 Year Model for Ameritech, 1988-1998.**

We need to note that while Ameritech was deploying some new networks, it is clear that the real benefit was to their corporate profits. We go into overcharging and other financial information in the 20<sup>th</sup> anniversary section, and explain each of the items we discuss here in more detail. But we decided to show just how much money these companies, such as Ameritech were able to garner through the alternative regulation plans. From 1988 through 1992, Ameritech’s average was 15.6% “return on equity”, the standard measurement of business returns, the “dividend” paid to its shareholders was \$1.16, and the “net income” was about \$2.2 billion. By 1993, the numbers start climbing and by 1998 the dividend increased 187% to \$3.27, the return on equity was now 36.2%, an increase of 129%, and the net income was \$4.2 billion, an increase of 97%.<sup>57</sup>

Virtually every Bell had similar growth in profits, dividends and returns on equity.

### **SBC Next Hatchet Job: Ameritech’s Fiber Networks: Merger 1999, Shutdown 2000**

SBC, once again waiting for the ink to dry on its merger agreements, took over in 1999 and by 2000 it was getting rid of the entire Ameritech network.

SBC 2000 Annual Report — “Cable Television Services”<sup>58</sup>

“We offer enhanced cable television services in the Chicago, Cleveland, Columbus and Detroit metropolitan areas through our subsidiary Ameritech New Media, Inc. (ANM). As of December 31, 2000, ANM provided cable services to approximately 304,000 customers in approximately 100 Midwestern communities. In 2000, ANM scaled back its construction of additional cable networks and expansion plans for new cable franchises and we are currently in negotiations to sell ANM.”

Ironically, the Bell companies have been getting various federal and state Senators and Congressmen to write bills so that they can offer cable services with limited or no franchises. Curiously, Ameritech had 115 franchises that it owned and then SBC threw away.

SBC 2000 Annual Report — “Cable Television Services”<sup>59</sup>

“ANM’s cable television systems are subject to Federal, state and local regulation, including regulation by the FCC and local franchising authorities. ANM has entered into approximately 115 cable television franchise agreements with local government authorities. Generally, these franchise agreements are in effect for a period of 15 years, and are transferable with regulatory approval.”

### **The Sale of Ameritech's Cable Plant — WOW, What a Deal.**

An article in *Telephony* magazine, “Wow, What a Deal”,<sup>60</sup> told of a quite bizarre end to the fiber optic future of the entire Ameritech region. As previously discussed, Ameritech promised 6 million households by 2000. In the middle of 2001, WideOpenWest purchased the entire plant, about 300,000 customers, for about \$1000 a subscriber.

"According to an industry source, WOW agreed to pay about \$1000 per subscriber, although neither company would confirm the figure....When the deal closes in October or November, WOW will grow from 200 Denver-area subscribers to 310,000 users in Chicago, Detroit, Denver, Cleveland and Columbus, Ohio."

What is really odd is that this service was supposed to offer 390 channels and fiber to the home, as told by the video dialtone applications.

“Ameritech maintains that approval of the applications would permit its video dialtone network to reach 1.3 million homes, businesses and institutions in geographically and economically diverse sections of its service area. The proposed hybrid network would provide 310 multicast (240 digital and 70 analog) channels and 80 switched digital channels.”<sup>61</sup>

Ameritech put in the fiber! And, according to the article, it was two-way, with a “high fiber count”:

“Mark Haverkate, WOW's president and CEO.... 'It's definitely a two-way system', Haverkate said. 'It's a high fiber count, small home-per-node size [estimated at about 200 homes]. The system was extremely well built — top-of-the-line equipment across the board. It's been extremely well-maintained.'”<sup>62</sup>

And yet, while it had the capabilities to offer more, the system, as rolled out by Ameritech, was based on one-way analog services.

“The Americast system is only being used for one-way analog services but can easily support digital and Internet services', Haverkate said.”<sup>63</sup>

What is odd from any direction of analysis is that SBC stated in the article that its plan was to get fiber “into the neighborhoods” for video and broadband, and the installed fiber optic system could do this with its eyes closed. Instead, SBC decided to close down the entire system for \$300 million dollars.

“SBC has been trying to shed the cable properties it acquired with Ameritech while trying to get some return on the investment because being a cable provider 'didn't fit with our business strategy,' said a company spokesman. 'That strategy doesn't preclude video and high-speed data; it just won't be done over conventional cable networks.'”

"'We've invested \$6 billion in Project Pronto, which is to get fiber into the neighborhoods,' the spokesman said. 'Video streaming is certainly going to be part of what they'll be able to get from broadband and have it delivered by DSL.'"<sup>64</sup>

The Project Pronto quote shows the 'say anything' mentality of SBC, since it would never spend the \$6 billion it kept quoting to the press.

WOW currently offers a series of services, including digital phone at speeds of up to 6 Mbps (500 kbps upstream). See: <http://www1.wowway.com/wowStory.asp?id=1002>

### **Outcome for Pac Bell, SNET, Ameritech and SBC?**

SBC trashed all of the various plans when it bought the other phone companies.<sup>65</sup> This piece of irony from a FCC document on the topic is about what we expect.

"115. Prior to the 1997 Report, SBC acquired Pacific Telesis, and its Pacific Bell Video Services subsidiary. Subsequently, SBC ended its own in-region video efforts, sold its out-of-region systems, scaled back the video plans of Pacific Bell Video Services, and, later, sold most of its interest in Pacific Bell Video Services. SBC later acquired SNET, and proposed to acquire Ameritech. In front of the Senate's Antitrust Subcommittee, SBC Chairman Edward Whitacre would not commit to maintaining Ameritech's cable overbuild operation. SBC, however, as a condition of approval of the SBC-SNET merger, promised the Connecticut Department of Public Utility to continue cable operations for two years. The Connecticut Department of Public Utility gave SBC the right to petition for modification of the state-wide franchise agreement once SBC studies SNET's cable operations. Some have observed that since Ameritech has a well-established cable operation, one that has continued to expand even as the merger is pending, it is less likely that it will be sold or abandoned. Some analysts also have pointed out that the Ameritech cable operation could become more important, in terms of offering a complete package of telecommunications services, in light of the pending AT&T-TCI merger."

The scorecard: 3 mergers and every state retrenched or canceled its fiber optic deployments, and as the quote demonstrates, the FCC had no clue to what was really going on.

## **SBC's "Southwestern Bell" Own Fiber Plans?**

In reviewing the materials, it is obvious that Southwestern Bell's (now SBC) announcements on video dialtone/broadband services were more constrained than the other companies in the mid-1990's. However, Southwestern Bell was one of the first to discuss online services when it had touted ISDN back in 1986, almost two decades ago.

Southwestern Bell, **1986** Annual Report: <sup>66</sup>

"At the forefront of new technology is ISDN. Scheduled for commercial availability in 1988, ISDN will revolutionize day-to-day communications by allowing simultaneous transmission of voice, data and images over a single telephone line.

"With ISDN customers will have the potential to access videotex, telemetry, alarm services, sophisticated calling features, teleconferencing much more economically than they can today."

We bring this up because the company was positively destructive to the info highway projects in every state in the 1990's.

SBC, originally known as "Southwestern Bell", owned five states prior to any merger. This included Texas, Missouri, Oklahoma, Kansas, and Arkansas. However, deployment plans were shrouded in secrecy. In the chapter on Texas, we show that the company had committed to spending \$1.5 billion to rewire the schools, libraries, hospitals and government agencies with 45 Mbps services.

An SBC press release revealed that SBC, in 1996, was pro-broadband. "GTE to join Disney, Ameritech, BellSouth and SBC in Home Entertainment partnership. Increases venture reach to 68 million access lines, 32 states." July 7, 1996. <sup>67</sup>

“SBC is building a traditional cable network in Richardson, Texas that will be in service in the fourth quarter of this year. It also is constructing a broadband network that will allow the company to offer cable and interactive services to up to 47,000 Dallas area households in 1996. SBC may provide video-on-demand — as well as a host of other interactive services such as home shopping, education programs, and interactive games — to those 47,000 households. SBC, which recently won court approval to provide video programming in its telephone subsidiary's five-state territory, is working with Microsoft, Lockheed and others to develop the delivery system.”

SBC also told the San Antonio Business Journal that Americast was about to purchase \$1 billion worth of digital set top boxes:<sup>68</sup>

“Americast — the television venture between locally based SBC Communications Inc. and four other companies — last week announced the purchase of \$1 billion worth of high-tech boxes, referred to as digital set-top boxes.”

And the article surmised that, from this purchase, SBC was serious about video services and that they'd be coming out in 1997 or 1998.

“SBC officials have been tight-lipped regarding their video plans. However, telecommunications analysts say they expect the San Antonio-based firm to begin offering some type of video services in its major markets in 1997 or 1998....'You should expect to see Southwestern Bell-branded entertainment products in the near future,' says SBC spokesman Bob Ferguson. 'We're very much committed to moving forward with plans to have video offerings for our customers.'”<sup>69</sup>

It seems it was all wishful thinking. By the time of the SBC-Pacific Telesis merger in 1997, the company was pulling out of cable TV and Americast, the joint venture with Ameritech, BellSouth, and Disney. According to Telephony magazine:<sup>70</sup>

“SBC effectively ended its attempt to enter the wireline cable TV market last week, selling its 94.6% stake in two Washington-area systems for \$606 million to an investment group that includes Prime Cable.

“The company has also withdrawn from the Americast partnership and sold an option to purchase 75% of Prime Cable of Chicago to the same investment group.”

As previously quoted, the company wrote-off the Richardson, Texas, deployment along with the Pac Bell deployments in 1997.

## **Questions Remain.**

Were customers illegally charged for the SNET and Ameritech cable roll outs? In the case of Ameritech and SNET, a separate investigation needs to be considered. How did all of these video dialtone offerings become regular cable services? We discuss the federal changes to the video dialtone laws in other sections, but at issue is the fact that if the state regulators signed off on a proposed rewiring of the state for a fiber optic service with more capabilities than a collection of cable channels, then this changeover could have been a “bait-and switch”.

Two other items need mentioning: Texas and Project Pronto (though there may have also been promises in the other Southwestern Bell states, such as Oklahoma, Missouri, Arkansas and Kansas). Texas is addressed separately in a case study as it was not a merger-based fiber optic plan. However, the outcome was the same as all of the other SBC states.

## **Project Pronto Was Part of the SBC-Ameritech Merger Conditions.**

According to SBC, the company's broadband plan for the SBC-Ameritech merger was “Project Pronto”, and the company announced it would be spending \$6 billion in three years to reach 77 million customers (August 9, 2000). We believe Project Pronto was needed to show that SBC had a genuine interest in broadband, even though it had cut virtually every fiber optic plan in every state.

"The DSL deployment is part of Project Pronto, a \$6 billion initiative that will transform Ameritech's parent company, SBC Communications, Inc., into America's largest single broadband provider. Project Pronto will make SBC's DSL service available to approximately 77 million people by 2002 and will dramatically increase the speed of DSL service."

On May 9, 2001, SBC stated that the next phase would be 'direct' fiber optics to customer's homes and offices

"Direct fiber is the broadband holy grail — and bringing fiber directly to smaller businesses has always been part of the Project Pronto plan', said Ross Ireland, senior executive vice president of services. 'But we didn't envision when we announced Pronto that viable technology would be available to enable us to begin our initial direct-fiber deployments to smaller businesses a mere 18 months later and to residential customers shortly thereafter.'"

Notice that these two statements are in contradiction, since DSL goes over the old copper wiring, therefore, fiber optics is being used as a selling tool, a glimpse of the future. Of course, this is ironic, when one thinks of all of the promises made in 1992 for full state deployments by 2000 of fiber-based services.

Irony aside, it was clear in 2001 that Project Pronto was nothing but a snail yearning for fast speeds. Dave Burstein, publisher of the respected DSL Prime, did this account of the rollout of DSL by SBC in October 2001. We couldn't have said it better.

“Subject: SBC's disingenuous financials and Pronto 'cutbacks'. Sent: Monday, October 22, 2001 4:01 PM

“DSL is my speciality, so I was surprised and appalled listening to SBC's call this morning. ...I remind everyone that universal broadband service and separation to protect competitors were part of the Ameritech merger deal, voluntarily accepted by SBC. It's a repudiation of a deal they made only two years ago. SBC is now

behind BellSouth, Verizon, Bell Canada, Germany, Japan, and Korea in DSL deployment as a percent of lines, despite all the 'Pronto' hype.

“Selim Bingol has disagreements with this work, but after an hour did not have any facts to disprove it either. He did not elaborate, in particular, on how much Pronto is being cut back, and asserted the decision was made late in Q3. Other than initial startup costs of the new subsidiary, he did not offer any facts to explain why it would cost 'hundreds of millions more' - highly unlikely, because the same work needs to be done either in SBC or the subsidiary.

“1- Either SBC's claim they are now cutting Pronto to reduce capital spending is untrue, or last quarter's statement (that most of the capex is behind them) is untrue.

“This is important because delivering broadband to all Americans can jumpstart the economy. It is also a false economy, that will cost SBC over time, done presumably to pretty up the financials and/or pressure Washington into anti-consumer policies.

“They also had in the first quarter said Pronto was behind, with conclusion of the first stage, 80%, being postponed from 2002 to 2003. The one hard fact they released is that they have only installed 4,000 of the 17,000 Pronto DLCs, and only 300 since Q1, which suggests their prior quarters' statements were untrue, and/or that the Pronto build was dropped more than five months ago, despite claims to the contrary in D.C..

“Also from SBC Q2 — SBC views DSL as a strategic growth driver for the future — capable of delivering to residential and business end-users a host of entertainment, information and time-management services, as well as high-speed Internet access. In the second quarter: there is nothing in the last quarter - or year - that makes that any less true today.

“2- SBC said putting DSL in a separate subsidiary added 'hundreds of millions' to costs. Hogwash and unsupportable. SBC's DSL subsidiary is a \$500M business, and only a very small fraction of this - a tenth of what they claim at most - can be

explained by the organizational structure. Whether they are part of the parent company or not, they still have essentially the same costs - the same equipment, provisioning, customer acquisition, support, billing etc. SBC has never justified that number because they cannot.

“The only way the number could be true is if SBC's own subsidiary is getting screwed in a major way by how SBC treats independents. We're sure SBC will not make that claim.

“3- Whitacre (I believe it was his voice) said he thought 'regulation had gotten tougher'. I leave you to judge the reasonableness of this statement. Everything I know, and dozens of opinions I've read, believe that Mike Powell's FCC is a less active regulator. This is evidenced, for example, by his acquiescence in so many price increases, and I can give many other examples. What does this say about the man's judgment or veracity?”

The piece continues, but it is clear that in the 2000-2002 timeframe the company was not fulfilling its obligations under Project Pronto.

### **SBC's Lightspeed. Another Fiber Optic Scam?**

Before we leave this issue of fiber optic deployments we should once again mention SBC's newest plan, called “Lightspeed”. Though the puns are many, if history is our guide, this, too, is nothing more than window dressing for the AT&T merger and other regulatory perks the company is trying to achieve. It is NOT real today. There have been no major rollouts. Here's a sample of the fiber to the release.

### **SBC, November 11, 2004<sup>71</sup>**

“SBC Communications Inc. (NYSE:SBC) today will provide operational and financial details on its plans to deploy fiber optics closer to customers and build an advanced, IP-based (Internet Protocol) network capable of delivering a rich array of integrated next-generation television, data and voice services

substantially beyond what is available from today's telephone, cable or satellite TV providers.

“In a conference call today, the company will say network lab and field trials are under way, network construction is scheduled to begin in the first quarter of 2005 and SBC's new IP-based network is expected to be available to 18 million households by the end of 2007. The launch of IP-based TV services over the new network is planned for the fourth quarter of 2005.”

However, the real issue is — who's paying for it. Well, according to SBC, what ever they build, the money is coming out of the budgets for local phone service.

“SBC now expects that three-year deployment costs for Project Lightspeed will be approximately \$4 billion, at the low end of its previously announced range of \$4 billion to \$6 billion. In addition, there will be customer-activation capital expenditures of approximately \$1 billion spread over 2006 and 2007. ***Because a significant portion of capital expenditures for Project Lightspeed will replace and refocus ongoing spending for its current network, SBC expects incremental capital investment for this project to be relatively small.***”

## Chapter 16 Failure to Compete, Failure of the FCC to Enforce Merger Conditions.

Part two of this merger quagmire involves the FCC. The FCC is virtually useless in enforcing any merger conditions, especially pertaining to competition and broadband. For example, the SBC 2001 Annual Report claims that they could be liable for \$1.9 billion if the company was not competing in 30 cities outside their own territories by 2002.<sup>72</sup>

“At December 31, 2001, \$1.9 billion in remaining potential payments could be triggered if the 'Out-of-Region Competition' and 'Opening Local Markets to Competition' conditions discussed below are not met. The following briefly summarizes all the major conditions:

“Out-of-Region Competition: “In accordance with this condition, we will offer local exchange services in 30 new markets across the country. We are required by the FCC to enter these 30 markets as a provider of local services to business and residential customers by April 2002. Failure to meet the FCC condition requirement could result in a payment of up to \$40 million for each market. Entrance into these new markets did not have a material effect on our results of operations or financial position.”

### Exhibit 27

#### SBC “Out-of Region” Cities, National-Local Strategy

1. New York	2 Philadelphia	3. Boston	4. Washington DC	5. Miami-Ft. Lauderdale
6. Atlanta	7. Minneapolis-St. Paul	8. Phoenix	9. Baltimore	10. Seattle-Everett.
11. Denver-Boulder	12. Pittsburgh	13. Tampa-St. Petersburg	14. Portland	15. Cincinnati
16. Salt Lake City-Ogden	17. Orlando	18. Buffalo	19 New Orleans	20. Nashville-Davidson
21. Memphis	22. Las Vegas	23. Norfolk - Virginia Beach	24. Rochester	25. Greensboro Winston-Salem
26. Louisville	27. Birmingham	28. Honolulu	29. Providence - Warwick	30. Albany-Troy Schenectady

The FCC agreed to this merger because the Bell company committed to competing outside its regions in 30 of the largest US cities, offering both business and residential customers local phone service. The claim was that this would stimulate nationwide competition as well. The FCC writes.<sup>73</sup>

"This will ensure that residential consumers and business customers outside of SBC/Ameritech's territory benefit from facilities-based competitive service by a major incumbent LEC. This condition effectively requires SBC and Ameritech to redeem their promise that their merger will form the basis for a new, powerful, truly nationwide multi-purpose competitive telecommunications carrier. We also anticipate that this condition will stimulate competitive entry into the SBC/Ameritech region by the affected incumbent LECs."

This was wireline competition that was supposed to be deployed using their own facilities as well as "Unbundled Network Elements" (UNE-P) that were wholesale services sold by the incumbent to a competitive company.

Phone calls by the author and others over the last few years to purchase SBC wireline residential service were in vain and anyone else reading this knows that SBC wireline service is not available in virtually any city in the United states, especially for local residential phone service. Yet, the FCC agreed that SBC had fulfilled its obligations.

What should be obvious is that SBC gamed the regulatory system on multiple levels. SBC claimed that the entire reason for the merger with Ameritech was to give it the size it needed to compete. SBC lied. Numerous documents go on for hundreds of pages about this point. (From testimony by James S. Kahan, Senior VP SBC)

"SBC/Ameritech would not undertake this merger without National-Local strategy.

"In the absence of the merger with Ameritech, the National-Local strategy will not work. The problem is not primarily that SDB on a stand alone basis, is incapable of raising the capital necessary to fund the national a-local strategy. The more important constraints are a) customer base, b) personnel and earnings dilution and market reactions."

Make no mistake about it; this merger was touted as having many benefits for the public. SBC claimed that it would facilitate more competition in the 30 markets they entered.

“By implementing the National-local strategy, SBC believes that its actions will accelerate the development of competition in all market segments. There should be no question that the national-local strategy will have pro-competitive effects in the 30 new markets SBC will enter.”

We also need to make it clear that SBC wasn't simply gaming the regulatory system, but was papering the country with promises of competition. Just look at the headlines highlighting states/cities that SBC would be competing in, as well as touting the benefits of the merger in states that the company already served.

- **New Jersey** Customers to Have New Telecom Choice  
San Antonio, Texas — October 11, 1999.
- **Baltimore** Will Have New Telecom Choice  
San Antonio, Texas — October 11, 1999.
- **Philadelphia** to Have New Telecom Choice  
San Antonio, Texas — October 11, 1999
- **Orlando** Will Have New Telecom Choice  
San Antonio, Texas — October 11, 1999
- **Atlanta** Will Have New Telecom Choice  
San Antonio, Texas — October 11, 1999
- SBC Files To Provide Local Exchange Service In **Florida, Massachusetts, Washington,**  
San Antonio, Texas — April 16, 1999
- **Ameritech** Chief Says Merger Will Speed Competition; Criticizes AT&T for  
Hypocritical Anti-Merger Efforts Detroit, Michigan — March 16, 1999
- **Illinois** Consumers and Business Customers Will Benefit from SBC-Ameritech Merger,  
Chicago, Illinois — March 11, 1999.
- SBC-Ameritech to Compete in **Boston, Miami and Seattle** First -San Antonio, Texas —  
February 4, 1999.
- **SBC-PacTel** Merger Brought Job Growth, Improved Service and Increased Giving  
Chicago, Illinois — January 26, 1999

- SBC-Ameritech Merger Will Offer Consumers More Choices; Vital to Midwest Growth and Jobs Chicago, Illinois — January 25, 1999

Expectations, at least those being told to the public, were very high. By 2003 the company was to have a positive cashflow of \$2 billion and it would have 5-10% of the business and residential customers. Within a 10 years the company would have 30 million households and 10 million small businesses.<sup>74</sup>

“Revenues and customer penetration is targeted to grow quickly under the National-Local strategy. We are aiming for \$2 billion in revenue by 2003 and more than \$7 billion in revenues by 2008. Earnings are estimated to turn positive in 2003. SBC expects to capture between 5-10% of addressable business and residential customers by the end of the plan.”

***“Within the next 10 years, the 30 out-of-region markets will have 30 million households and 10 million small businesses.”***

NOTE: In doing these calculations we discovered that if SBC-Ameritech had garnered 30 million households outside their own regions by 2010, if the company already has 35-40% of phone customers, at about 35 million households, SBC was claiming it would have an additional 1/3 of all American households or 70% all by itself. This, of course, would assume that they did not lose market share within their own territories, something that they did not comment on in any testimony about competing with the other Bell companies.

Timing? SBC was supposed to start serving residential customers within one year of the closing and by 2003, the majority of customers in every city should have been offered service. SBC also stated that it would be spending approximately \$1.4 billion (approximately \$500 per customer) for customer acquisition.

“SBC will begin offering service to residential customers within one year of closing with Ameritech and plans to offer service to a majority of households in the 30 out-of-region markets within four years of closing. We will achieve an

overall penetration rate of 4% of the residential customers in all of these 30 markets.” (page 23).

“To achieve these results SBC anticipates spending approximately \$500 per line ultimately served on customer acquisition, product development and marketing expenses related to residential and small business — a total of \$1.4 billion.”

SBC’s 2001 Annual Report states that it introduced service in 22 new markets outside their region and therefore has fulfilled its obligations, even though the company “scaled back” the service offerings.

"As of December 31, 2001 we had introduced service in 22 new markets (Boston, Fort Lauderdale, Miami, New York, Seattle, Atlanta, Denver, Minneapolis, Philadelphia, Phoenix, Baltimore, Bergen-Passaic, Middlesex, Nassau, Newark, Orlando, Salt Lake City, Tampa, Washington D.C., West Palm Beach, Louisville and Charlotte), and plan to enter at least eight more by April 2002. In March of 2001, we scaled back our service offerings in these areas in response to certain economic environment and regulatory factors, while still fulfilling our FCC merger condition requirements."

Since we could not find any competitive SBC Local wireline residential services being offered in any state, we went back to the original merger conditions, and found that the FCC’s conditions were essentially useless; a bad joke on what was promised versus what would actually be delivered.

### **The Fine Print?**

SBC claims it is in compliance because it had “**at least three customers” in 22 states** or at least 66 customers.

- On March 28, 2001, the Company notified the Commission that it had installed local telephone exchange switching capacity and was providing facilities-based local exchange

service to **at least three** unaffiliated customers in the **following seven markets : Atlanta, Denver, Ft. Lauderdale, Minneapolis, New York, Philadelphia and Phoenix.**

- On April 9, 2002, the Company notified the Commissioner that it had installed by April 8, 2001 local exchange switching capacity and was providing local exchange service to **at least three unaffiliated customers** in the following **10 markets: Baltimore Bergen-Passaic, Middlesex, Nassau, Newark, Orlando, Salt Lake City, Tampa, Washington DC and West Palm Beach.**
- In total, SBC notified the FCC that it had installed in 2001 a local telephone exchange switching capacity and was providing facilities-based local exchange service to **at least three unaffiliated customers** in the above listed seventeen markets, **five more than the required additional twelve markets** to be deployed by April 8, 2001. **Additionally SBC started operations in the Charlotte and Louisville markets in November 2001, making a total of nineteen new markets that SBC entered in 2001.**

Meanwhile, the FCC also believed that SBC was in compliance. According to an article in XChange magazine.<sup>75</sup>

“‘In fact, SBC had met the terms of its commitment to launch facilities-based local voice services in 30 markets by the second quarter of this year’, says John Winston, assistant bureau chief at the FCC's Enforcement Bureau. ‘They have complied,’ Winston says. ‘That's all I have to say on the matter.’”

Unfortunately, the FCC has failed to read its own rulings because SBC’s obligation was to also have offered competitive services to **ALL** residential and business customers through resale and UNE-p services.

“...collocating in each of ten wire centers; offering facilities-based service to all business and all residential customers served by each of those ten wire centers; **and offering service, whether by resale, unbundled elements or facilities, to all business and all residential customers within the entire service area of the incumbent RBOC** or Tier 1 incumbent LEC in the market or make voluntary incentive payments to a state-designated fund (or as governed by state law) in the

amount of \$110,000 per day for each missed entry requirement, for a total of \$1.1 million per entry requirement per market.”

There was never any advertising to entire cities that we could find. They gamed the regulatory system and got away with not having to pay \$1.9 billion in damages.

In an interview with a reporter for a major Boston daily newspaper in 2003, when asked if there was SBC wireline competition in Boston, the reporter responded:<sup>76</sup>

“No sign of SBC here in Boston, plenty of signs of Cingular. I thought it was a fairly open dirty secret that SBC did nothing more than barely live up to the letter of the FCC decrees, ‘offering’ service within xx months of the merger in these markets, then shutting it down six months later. Haven't they sort of all but said publicly they have done the bare minimum needed to meet the FCC regs???”

Three customers in twenty-two markets are NOT robust competition. The FCC should never have set a threshold for the merger that could be met with three friends out for a late night beer who are talked into getting some SBC service. America depended on the FCC to make sure that the mergers were in the public interest and both SBC and the FCC failed to do this.

### **The SBC-Ameritech-SNET-Pac Bell Punchline**

By the end of 2002 there is no mention of the “National-Local” strategy in the SBC 2002 Annual Report. There is also no mention of any other city or state outside of their original territories with any significant wireline services being offered.

### **The Largest Bait and Switch in History: SBC Enters Long Distance.**

In his book *The Billionaire Shell Game*<sup>77</sup>, published by Doubleday in October 1998, award-winning, former *New York Times* reporter L. J. Davis describes the Bell operating companies’ bait and switch tactics employed in every state and at the federal level in Washington. Based on independent interviews and a survey of the documentary evidence, we came to many of the same conclusions as described here. Further, Davis posits that the tactics for selling broadband

were part of the RBOC plans to win approval to enter the long distance markets earlier than they would have otherwise been allowed to under normal market movement. They never really cared about broadband.

"Like the other six regional telephone companies that had come into independent existence with the break up of AT&T in 1984, Bell Atlantic had a single great goal in the autumn of 1993. Bell Atlantic and the other six baby bells were determined to enter the lucrative long distance business before the march of science rendered their existing equipment vulnerable, obsolete, or both, but getting there was no simple task. Before Bell Atlantic could offer a long distance service — even within its own part of the country, using its own lines and switches — sixty years of federal law and judicial decisions had to be overthrown, and there was only one certain, reliable, and simple way to do it: persuade Congress to pass bold new legislation that would remake Bell Atlantic's world.

"Unfortunately, there was no great public outcry for such a new law. There was, in fact, not a peep from the public, whose indifference on the subject of telecommunications law was as large as the public's very considerable ignorance of it, and it was extremely difficult to explain why Bell Atlantic, a company with annual profits of over a billion dollars, felt a compelling need to overturn more than half a century of lawmaking in order to make more money. The easy part had already been done; influential congressman had been provided with large sums of money and more would be forthcoming, but encouraging the legislators to think correct thoughts was only part of the task. It was also essential to provide Congress with a plausible and, above all, a popular and easily understood reason for writing the new law. The secret of the trick, Bell Atlantic and other regional television companies had correctly come to believe, was cable television.

"With great fanfare, the telephone companies announced that, if only one small condition was met, they would provide cheap, friendly, and reliable cable television service, using their existing networks. The cable companies would no longer hold the country in the iron grip of monopoly, and the viewing public would soon be happy. All it took was a small change in the existing laws— and, while the

legislators were at it, they might as well make a few additional and long-overdue modifications of the statutes in the interest of tidiness and for the benefit of all. To the regional telephone companies, God — long distance service — would be found in the modifications. Television was the cover story.

"The regional telephone companies had never been interested in television, and most of them weren't interested now. The goal had always been the long distance business, and the goal never changed. Once the new telecommunications bill was passed and signed, the telephone companies could run a few inexpensive tests in places like Omaha, El Cerrito and Richardson, Texas. If the tests succeeded, well and good, the telephone companies could make some extra money. If the test failed, no great harm was done; the telephone companies could claim technical difficulties and public indifference and quietly abandon the undertaking. In the meantime, it was important to feign enthusiasm until the law changed..."

We could not have said this better. What happened was a bait and switch of massive proportions. Let us put some facts into this equation. We have just proved that the fiber optic deployments that were being conducted were all closed down as soon as the ink was dry on the mergers. Whether or not each Bell company would have actually rolled out anything looking like what they had promised is, of course, an additional question, requiring additional investigations.

### **What Is Long Distance and Why Is It Important?**

- A **"Long Distance"** call is a call between states, also known as "interstate"; i.e., a call from New York to New Jersey is interstate, or from New York to California.

When AT&T was broken up in 1984 the Bell phone companies were restricted from entering long distance because their monopoly power would allow them to gain too much market share just from being able to bundle their local service with long distance.

This is too complex to explain here, but needless to say, if you own the local phone customer and you can sell them long distance for another \$20-\$30 a month and use the existing advertising, etc. to sell it (commonly known today as a "package of local and long distance

service”), the local phone company generates almost double the amount of revenue from the same customer.

The reason they were not allowed into long distance is now clear; they would easily be able to out-muscle the long distance companies, AT&T, MCI and Sprint. Verizon, who now has control over the “PSTN” (that’s “Public” Switched Telephone Network), was able to get over 50% of its customers to buy both local and long distance as a package by 2004. With the current restrictions that block AT&T and MCI from selling local service (another long story), these companies were essentially taken apart. It is a primary reason they were sold off. The Bell companies were allowed into long distance before there was sustainable residential local phone competition.

Teletruth’s survey work on phone bills found that the majority of customers pay more for a package than they would if they purchased the service ala carte. This is because the advertised price of a package does not include all of the required taxes and surcharges, many of which, such as the “FCC Line Charge”, are, in actuality, more direct revenues to the phone companies. We will return to this topic at a later point.

We will now show that SBC not only did not compete for local phone service out-of-region and dumped their fiber optic promises, they instead took the money and entered long distance.

### **Long Distance Promise Versus the Fiber Optic and Competing Out-Of-Region Promises.**

Let’s follow the money. First, we find in the SBC 2001 Annual Report that SBC had spent virtually no money in 2001 or even 2000 to fulfill its obligations of the merger conditions. SBC states that they “decreased approximately \$90 million in 2001”.<sup>78</sup>

“Costs associated with our national expansion initiative decreased approximately \$90 (million) in 2001, reflecting the initiative’s scaleback, compared to an increase of \$300 (million) in 2000.”

However, long distance spending was way up. In total contrast, SBC spent \$320 million in 2001 and \$260 million in 2000 for entry into just four states to offer long distance.

"InterLATA long distance service expenses increased by approximately \$320 million in 2001 compared to \$260 million in 2000 primarily reflecting our entry into four new states."

As we previously mentioned, the 2001 plan for the company (as told by press releases) was to focus on long distance, and forget about their commitments to compete.<sup>79</sup>

"SBC said that delays in regulatory approvals for its entry into in-region long-distance markets, primarily in California and its Ameritech states, have shifted the timing of expected revenues from, and investments in, wireline growth initiatives. SBC continues to work aggressively to accelerate approvals in all of its states.

"Our mission in 2001 is to build on our strengths and move SBC's transformation to the next level,' Whitacre said. 'That requires financial discipline, and it requires timely access to new markets - beginning with long distance. The freedom to compete in interLATA long distance throughout our markets is an important revenue driver and a key component in our wireline growth strategies.'

"In 2001, we will place additional emphasis on accelerating long-distance approvals,' Whitacre said. 'At the same time, we will pursue growth opportunities with intensity, balanced with a determined focus on enhanced financial strength and flexibility. We are confident that this balanced approach strongly positions SBC for sustained growth and value creation.'"

Here is a list of the status and approvals to enter long distance as written in the SBC 2001 Annual Report.

**Exhibit 28**  
**SBC Long Distance Applications and Status as of 2001**

	<b>Alternative Regulation</b>	<b>Long Distance Application Status</b>
Arkansas	Yes	November 2001
California	Yes, review pending	Decision expected in 2002
Connecticut	Yes	Long distance service provided
Illinois	Yes, pending state approval	Decision expected in 2002
Indiana	Yes, through 12/2003	Filing planned in 2002
Kansas	Yes	March 2001
Michigan	Yes	Decision expected in 2002
Missouri	Yes	December 2001
Nevada	Yes	Decision expected in 2002
Ohio	Yes, through 1/2003	Decision expected in 2002
Oklahoma	Yes	March 2001
Texas	Yes	Long distance service provided
Wisconsin	Yes	Filing planned in 2002

The exhibit also highlights the fact that EVERY state had some form of alternative regulation plan, meaning more money than the previous "rate of return". This new alternative regulation was granted, for the most part, based on the fiber optic deployment plans.

By the end of 2002, SBC was able to offer long distance in 6 of the 13 states.<sup>80</sup>

“Federal regulation prohibits us from providing interLATA wireline long-distance services in six of our 13 in-region states. We provide interLATA wireline long-distance to our customers in Texas, Kansas, Oklahoma, Arkansas, Missouri, California and Connecticut.”

And by the end of 2003, SBC was able to offer long distance service in ALL of the states.<sup>81</sup>

“Long-distance voice — Long-distance voice consists of all interLATA (traditional long-distance) and intraLATA (local toll) wireline revenues, including calling card and 1-800 services. Prior to 2003, Federal regulations prohibited us from offering interLATA wireline long-distance services in six of our 13 states. During 2003, we received regulatory approval to offer these services to customers in these remaining six states.”

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**ENDNOTES**

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- <sup>1</sup> Pacific Telesis 1993 Annual Report
- <sup>2</sup> Pac Bell Press Release December 21, 1993
- <sup>3</sup> "Commission Authorizes Pacific Bell Video Dialtone Systems In California," FCC press release, Report No. DC 95-40, Common Carrier Action, July 19, 1995
- <sup>4</sup> Pacific Telesis 1994 Fact Book, page 13
- <sup>5</sup> "Commission Authorizes Pacific Bell Video Dialtone Systems In California," FCC press release, Report No. DC 95-40, Common Carrier Action, July 19, 1995
- <sup>6</sup> San Diego Union Tribune, January 16, 1994, page I-1
- <sup>7</sup> San Diego Union Tribune February 11, 1994, page C-1
- <sup>8</sup> Ibid.
- <sup>9</sup> San Diego Tribune, January 19, 1994, C-I
- <sup>10</sup> PC Week , October 3, 1994 , No. 39, Vol. 11; Pg. A1
- <sup>11</sup> Ibid.
- <sup>12</sup> "Pipeline & Utilities Construction," December 1, 1995, Pg. 21
- <sup>13</sup> "Interactive TV Will Come to Valley in '94," November 16, 1993, Valley Edition, Business; Page 8
- <sup>14</sup> Ibid.
- <sup>15</sup> San Diego Union Tribune, February 15, 1994, page C-1
- <sup>16</sup> Ibid.
- <sup>17</sup> Ibid.
- <sup>18</sup> Ibid.
- <sup>19</sup> California had a number of changes to their regulations. According to Pac Bell's 1995 Annual Report, "The CPUC adopted a new regulatory framework ("NRF"), which is a form of "price cap" regulation, for Pacific Bell in October 1989. In June 1994, the CPUC reduced Pacific Bell's benchmark rate of return from 13.0 percent to 11.5 percent. Earnings between 11.5 percent and 15.0 percent will be shared equally between Pacific Bell and its customers. Earnings above 15.0 percent will be shared 70.0 percent and 30.0 percent between Pacific Bell and its customers, respectively. Under "price cap" regulation, the CPUC requires Pacific Bell to submit an annual price cap filing to determine prices for categories of services for each new year. Price adjustments reflect the effects of any change in inflation less a productivity factor as well as adjustments for certain exogenous cost changes."

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However, the specific change in question happened in December 1995. According to the 1995 Annual Report “In December 1995, the CPUC issued an order in Phase I of its second review of the NRF. The order suspended use of the "inflation minus productivity" component of the price cap formula for 1996 through 1998. This action freezes the price caps on most of Pacific Bell's regulated services for three years except for adjustments due to exogenous cost changes or price changes approved through the CPUC's application process.” This one change gave \$600 million to \$1 billion in extra, tied directly to the broadband promises.

20 Bloomberg Business News and Associated Press, December 21, 1995

21 The Business Journal-San Jose November 1, 1993, Vol 11; No 29; Sec 1; pg 3

22 “The Information Superhighway: Get A Grip,” published by New Networks Institute, 1994

23 “Interactive Marketing Conference”, Orlando Florida, May 11, 1994; now part of Soft Bank Conferences, as of 1999.

24 “Bell Atlantic Halts Plan for Video Services,” The New York Times, April 26, 1995

25 “Dwindling Expectations; Two Providers Reduced Expectations on Interactive TV,” Mark Landler, The New York Times, December 18, 1995

26 SBC 1999 Annual Report

27 SBC Press Release, April 1, 1997

28 Bloomberg Business News and Associate Press, December 21, 1995

29 Ibid.

30 “The Regulatory Audit of Pacific Bell for 1997, 1998, and 1999,” California Public Utilities Commission, 2002

31 ”Regulatory Audit of Pacific Bell for the Years 1997, 1998, 1999”. California Public Service Commission, 2002, Volume 1

32 San Diego Tribune, February 1, 1998, page I-1

33 Ibid.

34 Ibid.

35 SBC 1999 Annual Report

36 SBC 2001 Annual Report

37 SBC 1999 Annual Report

38 Ibid.

39 “The World Almanac and Books of Facts”, 2004, published by World Almanac Books,

- 
- 2004
- 40 Pacific Telesis 1993 Annual Report
- 41 “In the Matter of Implementation of Section 19 of the Cable Television Consumer  
Protection and Competition Act of Annual Assessment of the Status of Competition in the  
Market for the Delivery of Video Programming,” FCC, CS Docket No. 94-48, First Report  
Released: September 28, 1994
- 42 SBC 1999 Annual Report
- 43 Ibid.
- 44 SNET 1993 Annual Report
- 45 “Annual Assessment of the Status of Competition in the Market for the Delivery of Video  
Programming,” FCC, Second Annual Report, CS Docket No. 95-61, FCC Released:  
December 11, 1995
- 46 SBC 1999 Annual Report
- 47 SBC 2000 Annual Report
- 48 Ameritech Investor Fact Book, March 1994
- 49 “Ameritech Operating Companies for Authority Pursuant to Section 214 of the  
Communications Act of 1934, as amended, to construct, operate, own, and maintain  
advanced fiber optic facilities and equipment to provide video dialtone service within  
geographically defined areas in Illinois, Indiana, Michigan, Ohio, and Wisconsin,” FCC,  
Order And Authorization, W-P-C-6926, W-P-C-6927, W-P-C-6928, W-P-C-6929, W-P-C-  
6930, Adopted: December 23, 1994 Released: January 4, 1995
- 50 Ibid.
- 51 Ameritech 1993 Investor Fact Book
- 52 Chicago Tribune, February 2, 1994. pg. 33
- 53 Chicago Tribune, January 27, 1994. pg. 31
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