BOOK IV
The Regulators and the Laws

Subtitled:
A Swiss Cheese Landscape on Stale Bread Rhetoric

Chapter 19 The World of Telecom Regulation — Nationwide Swiss Cheese

"Isn't phone service regulated?" My Aunt Ethel asked.

"I thought they were protecting me!" She exclaimed, while shaking her cane.

The use of federal and state regulation for controlling Bell profits and prices must have had many redeeming values for local telephone subscribers. Why else have the Bells constantly tried to have it removed?

As we have seen, from the beginning, the Bells have advocated the removal of all regulation. From US West's 1984 Annual Report stating "we advocate continued deregulation of our industry at state as well as federal levels, (306) to Ameritech's 1985 Annual Report exclaiming that their goal was no regulation —"Our goal remains unchanged: To have the marketplace, not regulation, determine what we offer, the prices we charge.", (307) the Bells have all proclaimed that any regulation is evil, unless of course it works in their favor.

More importantly, one should ask *Why regulate at all?* — Regulation defined as a set of state and federal laws that govern the actions of a company, service or industry.

Judge Harrison, in his decision for a rate moratorium on New York Telephone in 1985, stated simply that regulation is applied when there is no competition. There is no tug of a competitor's lower prices to keep monopoly, the sole provider of local telephone prices, in check.(308)

> "Regulation will fill the void of competition. . . . The predicate for relaxed regulation is based on a generalized argument that the company is conducting its business in an increasingly competitive arena, and that earnings regulation has somehow become inappropriate. What should be remembered, however, the company is still operating in areas where large portions of which, fundamentally, are not competitive at all."

Unfortunately, current regulation, or the lack there-of, has allowed the Bells to make unprecedented amounts of profits for a company that has been and is still a monopoly. In fact, according to Ameritech, there are no longer regulatory safeguards in place to limit its profits. How else can Ameritech state: (309)

> **"Federal and state regulators no longer limit the company's profits."**
> (Source: Ameritech: Investor Alert 1/95)

The wholesale removal of regulation that has slowly occurred over the last 13 years was largely based on Info-Bahn promises — remove regulation and profit limitations, and we will build the Fiber-optic highway or deliver on ISDN. While the promises were never kept, the money has been accruing.

But these promises and failures to deliver are only part of the problem. Today's' regulation fabric is threadbare at best. The most recent effort to effect change in telecommunications, "The Telecommunications Act of 1996", promised wondrous new services offered at cheaper prices through competition. The Act specifically states in its opening: (310)

> "An act to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumer and encourage the rapid deployment of new telecommunication technologies."

Patricia Horn's article "Report Card on Telecom Act of '96", for the Sun-Sentinel, (2/9/97), found that the new bill just increased prices for telephone and cable services. (311)

> "A year ago, in a Library of Congress ceremony steeped in grand themes, President Clinton signed what he called "truly revolutionary legislation that will bring the future to our doorstep".
>
> "Still waiting for the revolution? You could say you've been put on hold...Virtually the only pocketbook difference the average consumer has seen in the first year is higher cable and phonebills, the reverse of what the

act was supposed to achieve. It's unclear whether consumers will see much difference in Year Two either. "

Just the title of an article in the New York Times, "Rising Phone Bills are Likely to Result from Deregulation," 3/30/97, tells the tale of the Telecom Act's impact. (312)

But if you want a sense of deja vu, just read the following quote from a press release by Consumer Federation of America dated December, 1985, over a decade ago. Notice that the question "Where are the promised benefits of the Bell Break-up?" is hauntingly similar to the quote from the Sun Sentinel reporter's take for the Communications Act of 1996. (313)

"The Consumer Federation of America (CFA) today, (12/10/85) released a report entitled "Divestiture: Two Years Later", shows that the average consumer must now pay between 35 and 52 percent more to get the same local service available on December 31, 1983, just prior to the breakup of AT&T. '

"Where are the promised benefits from the Bell Breakup? Consumers are paying more and getting less fore their phone-service dollars since Divestiture", charged Gene Kimmelman, Director CFA.

"The Bell system break-up was supposed to produce consumer benefits through increased competition. Instead, pressure from local phone companies for dramatic price increases, coupled with regulatory mismanagement, threaten the affordability of basic phone service. "

Simply put, the problems of regulation require an overhaul of the entire system — the patient needs a heart transplant while the politicians and regulators are applying a band-aid and giving the patient two aspirins.

Defining the Playing Regulatory Field

Let's start with the major regulators and their functions. The first, and most obvious of regulators is Congress, the creators of the Telecommunications Act of 1996, the national law pertaining to all telecommunications. This bill was created over several years of accumulated bill proposals, accompanied by House and Senate hearings and

future chapters will discuss the history of the Act. Eventually a bill was created that the House and Senate could agree on, or should I say the republicans and democrats, and one that the President would sign.

The other Federal regulators and law makers are The Federal Communications Commission (FCC), and sometimes included, The Department of Justice (DOJ). They are then responsible for implementing the bill, writing specific laws, including laws on Access fees, and the Interconnection of competitors, among others.

However, there is a serious flaw in the FCC 's ability to accomplish its tasks. For example, the most recent Order by the FCC on the price of interconnection of competitors has been overturned by the 8th Circuit Court of Appeals — a case brought by the Bells and State Public Utility Commissions, who did not want to let go of control to the FCC.

Finally, there are the local regulators which include the State Assemblies, and the Public Utility Commissions (PUC) (sometimes called "Public Service Commissions" (PSC)). These organizations are responsible to make and implement the laws that govern the local telephone companies activities by state. And the state regulators are the ones who were responsible for accepting the Info Bahn plans.

State Consumer Advocates and State Attorneys General Offices are also part of the state telecom picture. The State consumer advocates, sometimes a separate office, sometimes part of the Attorneys General Office or the PUC, also try to balance out the arguments by the Bells. At best they are outfunded and outflanked. Some states do not even have a separate consumer advocate's office.

And behind all of these regulators are the Courts of the US, state and federal, that help shape the laws, or sometimes even replace laws. For example, the break-up of AT&T was not done by regulators but through a civil court case.

The Problems with Regulation — Swiss Cheese Landscape, Stale Bread Rhetoric.

It can be argued, and almost justifiably so, that the Bells were not responsible for failure to build the I-Way or for overcharging local customers. It was the failure of the regulators and politicians to do anything about it.

And in some ways it is the regulators and politicians faults for not fixing intrinsic holes in the regulatory fabric, some larger than Texas, for passing laws that were more

rhetoric and hype than good planning, and for removing the constraints from the monopoly that should never be removed.

Also, we want to make it clear. We are not interested in regulation for the sake of regulation. Just the opposite, we are for fully-competitive open markets.

Today, the Baby Bells are neither open nor competitive.

Let's go through some of the problems with regulation today.

- **First and Foremost, No One is Watching Anymore:** Since the 1990's, the implementation of Alternate Regulation has stripped-mined the regulators' ability to examine RBOC profits from a subscriber's telephone charges. In many cases the state regulators no longer look at the profits for many items, from Inside wiring to Call Waiting. Once again, Ameritech's quote "Federal and state regulators no longer limit the company's profits." (314) says it all.

This is one reason why the Bells are showing profits that are double of what a monopoly is supposed to be earning. Later we will argue that the removal of these limits were done for a highway that was never built, and therefore, the states that no longer examine profits should start again.

- **Phone Bill is a Regulatory Mess:** With all of these various state and federal government agencies, the most surprising fact is that no agency actually looks at all of the charges and therefore profits of your telephone bill. For example, a typical telephone bill has some charges, such as the Subscriber Line Charge, that is controlled by the FCC, while some services, such as inside wiring, have no regulator examining the charges to customers.

  - **Basic Service** is now only a few line items on the Bill regulated anymore. It is controlled by the **State PUCs**.
  - **Toll Call** Revenues are regulated by the **state PUCs.**
  - **FCC Line Charge**, on all business and residential bills, is an **FCC controlled** service.

- **Calling Features,** included Call Waiting to Caller ID have varying rules per state but most services are **no longer examined** by any state regulator for profits.
- **Inside wiring** is deregulated and **no longer examined** for profits.
- **Long Distance Access Charges,** which are not considered charges to subscribers, and are examined **by the FCC.**
- **State & Local Taxes and Surcharges:** Various government agencies, have added a wide variety of surcharges — including everything from a 911 to Deaf Relay.

• **This Jurisdictional Morass Allows For A Serious Revenue And Profits Shell Game To Have Take Place:** Because each regulator only examines specific charges on the phone bill, the Bells have been able to state that they are "losing money" on "basic service" and even today, are requesting rate increases. How can this be when they are so profitable?

• **50 States and a Telecom Patchwork Quilt or Rules:** No two states have the same alternate regulation laws, and no two telephone services have the same price, even though the services offered are identical. This has caused three major problems—

- 50 states require 50 regulatory battles — at millions of dollars each.
- Fifty consumer fights for protection- In order to protect subscribers, a group has to fight 50 separate PUC battles, instead of aggregating them.
- Total customer confusion about the price of any service. — 0% of the population are able to answer basic questions about the price of any service.

• **Bad Data at the FCC, and Its Ability to Regulate is in Question.** The FCC relies on data from telephone companies and over the last year has not completed even 7% of the audits they deemed most critical. According to the General Accounting Office (GAO) report titled "FCC's Oversight Efforts to Control Cross-Subsidization," February 1993: (315)

> "At the present staffing level, the FCC could cover each area once every 18 years [there are 297 audit areas]. If the FCC confined its efforts to the

183 areas that it has designated most critical, it could audit each area about once every 11 years."

Without good data, how can the agency hope to make good laws? In fact, as we will see, the FCC's ability to regulate has been into question by its own commissioners for decades.

- **State and Federal Regulators are Seriously Out-flanked:** Where alternate regulation plans have been presented, the phone company has out-spent the advocates and PSC staff by approximately 30-1. This includes everything from hiring high-paid consultants to using the Bell's endless legal staff. This has left few safeguards for customer protections.
- **Telecom Act of 96 is Seriously Flawed:** The Telecom Act was really a band-aid, when, what was needed, was a complete overhaul. The problems mentioned, from the patchwork quilt of regulation, the missing "total bill analysis" of profits to inaccurate FCC data, was never addressed by the Telecommunications Act.
- **Justice Against the Bells — Fat Chance Today.** Besides the fact that a battle against the Bells requires a 50 state run, there is something called "the Rate Doctrine" which protects the rates set by a local Bell company, so they can not be legally sued over the rates. Most cases must be funneled through the PUC, which does not normally allow companies to be reimbursed legal fees, and therefore can't take a suit on a contingency basis.

Before we go forward explaining the details and failings of the regulatory landscape or how the Info-Bahn was pitched and sold to the regulators, I think it might be more appropriate to explain some fundamental concepts represented by words including "Monopoly" and "Competition". As we will see, the definitions in some cases have been corrupted to mean almost the opposite of their common sense meaning.

A Discussion of the Terms "Competition", "Deregulation", and "Monopoly"

In a perfect world, the "market forces", a loosely defined term of business factors, takes care of all business problems. Competition forces prices lower and keeps the competitors developing new products and services. Ah, the perfect world.

And sometimes these forces do work. For example, in the late 1970's AT&T was a monopoly that controlled all long distance calls in America. Then some upstarts, such as MCI, decided to go head-on with the monopoly, offering services at somewhat discounted rates.

Through the series of court decisions, known as 'Divestiture", the Bell networks were opened to long distance competitors. This case changed the market forces and the effect has been that long distance competitors dramatically decreased AT&T total control. According to the FCC's statistics, as of second quarter 1997, AT&T only had 47.9% of the long distance market, with MCI at 20% and Sprint at 9.7%. Other companies garnered over 19%, accounting for almost $15 billion dollars. (316)

EXHIBIT 56
% of Market by Long Distance Carriers, 1997

AT&T	47.9%
MCI	20.0%
Sprint	9.7%
Other	19.4%

Source: FCC, 6/97

In an article tilted "Watch 800 Companies Stuff Themselves into One Phone Booth" that appeared in the New York Times (8/4/97) there are over 800 companies competing for long distance customers, including Excel Communications, Worldcom and Frontier (formerly Rochester Telephone) (317)

And from the customer prospective, these new competitors have successfully reduced prices as well. Regardless of the bull being spread around by the Bells, that there is no competition in the long distance markets and that prices never came down over the decade, the truth of the matter is that the overall retail prices have dropped an average of 28%. And discount plans during 1996-1997 have dropped the price of service almost 50%. (318)

EXHIBIT 57
Long Distance Prices 1984-1996

No Discount	28% Drop
Discount plan	49.6% Drop

The other part of the equation is that the former market leader, AT&T, over the last few years has been trying to keep up with its competition in terms of new innovative plans. For example, the Sprint Candice Bergen advertising spots feature 10¢ a minute for calls made between 7PM and 7AM. Not to be undone, AT&T returned with a price of 15¢ anytime of the day or evening, and in 1998 customers are being offered a 10¢ rate (with some caveats) (319)

New Long Distance Infrastructure An additional benefit to these competitive wars has been the creation of competitive, separate long distance networks. Both Sprint and MCI now have their calls travel over their own, proprietary, fully-digital networks, and the companies are constantly upgrading their networks for more efficiencies. Why is it good? Because each company can develop new services without worrying or getting permission from a group.

There is also a new trend that has become a large topic for discussion in 1998 — the use of the Internet to handle long distance calls. Internet Telephony, as it has come to be called uses separate data networks, instead of the traditional long distance networks.

Local Competition Ain't the Same Thing

But here's the rub with local competition. Try to pick up this line.

The fundamental problem is that unless there is a totally separate second wired network, and few companies have announced any plans to rewire America's homes, then ALL Competitors must deal with the local telephone company and must resell part or all of the Bell's services, at inflated prices.

Unfortunately, many laws, including the Telecommunications Act of 1996 were written based on the idea that competition, using a second network i.e., a cable company or electric company using their separate wire into the home, would lower **local** rates.

As we will see, to date, April, 1998, there is no significant competition, especially for residential customers. Even the laws for allowing competitors to resell the networks are still missing in many states.

But even the term "competition" is in the eye of the beholder and many laws are very vague about what constitutes Competition. Take, for example a story in the Wall Street Journal back in 1994, discussing the status of NYNEX's competition. According to the Wall Street Journal, on August 26th, 1994, NYNEX asked the Justice Department to allow them into the long distance market, arguing "that competition in the state is robust enough to warrant letting them loose." (320)

> "We recognize that competition in the local exchange market is developing in many parts of the country, but in New York, we've got it. It's here," said Frank Gumper, NYNEX's managing director of Federal regulatory affairs. [emphasis added]

Elsewhere the article states:

> "NYNEX's Mr. Gumper concedes that the "Bell firm still has almost 100% of the local telephone market, but he said NYNEX shouldn't have to wait around for full-fledged competition to materialize."

So, though NYNEX controlled "almost 100%" of local telephone subscribers, they had stated that the company had robust competition, but it was not "full-fledged" competition. Even today, NYNEX is still yelling it is no monopoly. Take, for example, the statement by Donald Reed, President of NYNEX Manhattan. in the NY Post, 3/5/97 (321)

> "NYNEX is No Monopoly... In the real world, New York is the most competitive communications marketplace in the country.

> "Today, 15 separate companies are offering local telephone service in New York, processing thousands of orders a week by reselling NYNEX services."

The definition of competition is not simply a mute point. For example, Ameritech, SBC Communications, NYNEX and others have asked the FCC for waivers to allow them into Long Distance services. The Telecom Act states that they can offer long distance services upon proving that they completed a specific "Competitive Checklist". Outlined in the Telecom Act. this involves completing network upgrades to handle local competitors, and there must be "facilities based" competition as well, meaning that the competitors own their own network switch, not just resell local service.

The law is vague in numerous ways. USTA ran numerous full page advertisements stating that there are hundreds of agreements already in place. (322)

> "Over 680 agreements to open local service to new competitors as of February 1997."

However, there is no mention of whether there are actual customers. If there's only .001% of the population using another service, is that competition?

Competition has also been a issue in the I-Way proposals, especially the proposed congressional bills of the 1990's. Everything would be solved, including new network infrastructure development, if regulation would only help bring in competition. Senators Danforth and Inouye introduced a bill, the "Telecommunications Infrastructure Act of 1993" to do just that: (323)

> "A bill to foster the further development of the Nation's telecommunication infrastructure through the enhancement of competition, and for other purposes."

In this model, competition was envisioned as a market controller, where it lowers prices and gives incentives for the incumbent to build a better network as a principle way to keep its market share.

"Competitive" Services and "Deregulation"

Probably the most irksome use of the word competition has been when applied to describe specific services, known as **"Competitive Services",** sometimes called "Enhanced services", "Discretionary services" or "Value Added services". These include Call Waiting, Call Forwarding or Inside wire maintenance. The phone companies' arguments for calling these services competitive are:

- The customer has a option to use the service
- The customer can supply their own service.

For example, one of the first services to be labeled competitive was inside wiring. (also called Wire maintenance) As previously stated, this service, which was once regulated was **deregulated** in 1982, allowing customers to provide their own wiring or add extensions to the monopolies' service. Deregulation means that these services have some competition, i.e., the customer puts in their own wiring, or another company does it, and so regulation controlling the price of the service has been removed and the prices are whatever the market may bear, known as "market prices". ERGO, they are no longer regulated.

And in a large part, competitive services became deregulated so that this excess profit would help create the Info Bahn. We argue that most of these services were never competitive and no one came to offer another service, therefore the term should be used synonymous with overcharging customers.

And finally, there is **Alternate Regulation** which was the deregulation of the original Rate-Of-Return regulation. Simply put, the old method of calculating profits, the Rate-of-Return, was a simple model that took the phone company revenues in a state, and deducted its expenses, and with some fudging, came to a number of how much profits the phone company made from its monopoly.

Alternate Regulation, then, removed the profit model, and like a big erasure, removed safeguards for the profits the company can make. NNI contends that most of the Alternate Regulation did nothing more than allow the monopoly to make more money, instead of either building new infrastructure or the company having actual competition.

Price Caps — Smooth Sounding Three-Card Monty.

Probably one of the most insidious parts of Alternate regulation and deregulation is a term called **"Price Caps"** where the companies promise to keep the price of a specific service at the same level for 3 to 5 years.

Sounds too good to be true? Well, the catch is simple. The cost of operating the network has been plummeting, so keeping the price the same just increases the profits. Arthur C. Clark, science fiction writer and the inventor of the "communications satellite" once said that the cost of a phonecall should go to almost zero after the equipment has all been paid-off because it is only electrons.

Price Caps reminds the author of the controversy surrounding breakfast cereals, which was exposed by Congressmen Schumer and the television program on ABC, Primetime TV. While the box remained the same size, many companies were cutting the amount of breakfast cereal in the box.(324)

"Price Caps" is now basis of almost all Alternate regulation plans!

Working Definitions of Monopoly, Competition, "Price Caps", and "Deregulation"

While others might be wishy-washy on the meanings of these terms, for subscribers, there are specific definitions that we consider imperative and should be basis for future discussions.

NNI Definitions:

Monopoly According to Judge Harold Greene, the Supreme Court has defined monopoly as "the control of prices or the stifling of competition." (325) NNI uses two other postulates to define monopoly based on the following question.

Is there another company offering the same or better local service/ connection to the network?

- If the subscriber has no other option, then there is a monopoly.

- If the subscriber must buy from the sole supplier or not get the specific service, then there is a monopoly.

For example, today, almost every residential subscriber in America does not have a choice of another local telephone company. Prior to 1996, in many states, the law specifically stated that there would be no other local provider.

However, the second part of the NNI monopoly example states that the subscriber must buy from a sole supplier, or not get the specific service. For example, Call Waiting, Call Forwarding, Touchtone, and almost all calling features would fall into the category of monopoly services, because while they may be considered optional by the telephone company (i.e., the subscriber has the option not to purchase the service), the subscriber has no choice but to buy from the sole supplier.

This definition is contrary to most Alternate Regulation state laws, which have decided that "optional " services are competitive services. If they don't want Touchtone, why should they pay for it, is the usual retort.

Competition

- Another company(s) can and does supply the exact same service for comparable or less money.
- The company must have approached the subscriber, with the service being available, in their area, today.
- Anything with a "conditional" or "future" adjective, verb, or adverb, or contains the words "test", "coming", "arriving", "announced", is not competition. It is hype.

NYNEX's Donald Reed, stated that NYNEX is "No monopoly" and is "the most competitive marketplace in the United States". But later, he shows that its mostly hand-waving because while companies "announced plans", they were not currently offering service. (326)

> "Competition is arriving from all directions — from the global conglomerates to small start-ups. AT&T and MCI have announced major plans to offer local services this year."

In many annual reports, telephone companies expound on the competitive threats, both real, imagined or expected. we believe that competition must not only be real, i.e., that there are other companies who can sell the exact same service (or better) but who are also currently selling it today. Competition is not "Tomorrow Time Warner will be offering telephone services".

Deregulation

Deregulation, the removal of regulation, was the buzz word of the 1980's in the telephone industry, and with little exception, it has just raised prices. Why? Because any product or service that is deregulated i.e., no control, over prices, without adequate competition to lower prices, just raises prices. For future reference, whenever you see deregulation think "price increase by bogus politicians".

Price Caps

Price Caps should be considered the "Cereal Box of Telecom". There can never be a justification for price caps from the customer perspective, especially when the costs of the network keep going down, not up.

Competition Resell Vs Second Network:

One other aspect of competition that needs to be addressed is the difference between a "Reseller" as a competitor vs a company with a second network.

- **A Reseller** is a company that does not have its own local network to offer telephone services, but purchases the service in bulk. For example, companies can purchase AT&T's long distance service in bulk and then resell it with their brand name.

A local phone service reseller, is a company that offers local service over a Bell company's network. If MCI is a Bell Atlantic reseller, then MCI must pay Bell Atlantic its bulk prices or not offer service.

Please note: A local reseller is totally dependent on the base price of service, including "local access fees", which are set by the states and sometimes the FCC.

- **Second Network:** In contrast to a reseller is a competitor with their own, separate network such as a cable company, who uses its own network, not the telephone company, to offer local telephone services. i.e., Time Warner Cable in New York offers telephone service over its cable network.

As we will see, these two types of competition, second network vs resellers, have totally different outcomes for both lowering prices and building new infrastructure.

With all of these definitions in mind, let's first discuss the FCC's ability to regulate, followed by State regulations, including the I'Way Plans and then an analysis of the Telecommunications Act of 1996.

Chapter 20 The FCC's Regulation Has Never Worked Well

http://www.fcc.gov. The FCC web site welcomes you, and in November 1998, you can hear an audio recording from the Chairman William Kinnard (327).

> "Welcome to the FCC. We are an independent government agency charged with regulating interstate and international communications by radio, television, wire, satellite, and cable."

The group within the FCC that develops and delivers its telephone regulation is the "The Common Carrier Bureau", Its mission is to ensure all consumers have nationwide access as well as reasonable rates: (328)

> "The Common Carrier Bureau (CCB) is responsible for administering the FCC's policies concerning telephone companies that provide long distance and local service to consumers. These companies, called "common carriers" provide services such as voice, data and other telecommunication transmission services to consumers. The Common Carrier Bureau ensures that all consumers have rapid, efficient, nationwide and worldwide access to these services at reasonable rates. As competition grows and new technologies are introduced into the marketplace, the CCB seeks to eliminate unnecessary regulatory burdens on carriers while protecting the interests of consumers."

The Process of FCC Regulation

The FCC usually creates large exploratory "dockets", which are essentially a topic, such as "Access Fees". Legal briefs are then filed by the various companies, wishing to show that there statistics and legalese should be used to create new laws, not its competitors. Eventually an "Order" is created that establishes specific regulations.

There are hundreds of topics a year and they are each worth multiple billions of dollars. For example, most "Access Fees" are controlled by the FCC, and Access fees are

worth over $20 billion dollars annually. A movement of a few percentage points in either direction can be billions.

Other services, such as "Universal Services", a pool of billions of dollars, which will be discussed in future chapters, to opening the local phone companies to competition, known as "Interconnection", have major consequences, for all those concerned, whether it is a phone company or the subscriber who pays the access fees.

Unfortunately, the past five years of research has convinced the author that the FCC statistics, which they are basing these billions of dollars of charges on, is in many cases inaccurate, and that the FCC's ability to monitor and implement the laws, once they have been made, is also seriously flawed.

Some History About the FCC's Ability to Regulate

While the FCC started out with lofty goals, attempting to audit Ma Bell, one must ask: Has regulation ever been effective in monitoring the behavior of the telephone companies, much less controlling them? According to Judge Harold Greene's 1987 Opinion denying the Regional Bells access to information services, he states that over the last fifty years, the FCC has never been able to adequately police the telephone industry, much less regulate it. (329)

> "After drawnout proceedings (in the 1950s-1970s) it became apparent to everyone, including those in charge of regulation at the Commission, that the FCC, with its relatively small staff and resources, and its limited authority, would never be able to cope successfully with the Bell System's powerful monopoly position and its ever-changing strategies.
>
> "....testimony was heard and documents were introduced demonstrating the inability of regulators to penetrate and evaluate the Bell Systems' accounting system and its cost and pricing strategies... to reach conclusions concerning other methods employed to disadvantage Bell's competitors. "

One expert witness, William Melody, stated that cross-subsidization between the Bell System's regulated and unregulated activities was almost non-existent. (330)

> "Over the last 15 years, the FCC has both recognized and attempted to come to grips with this problem . . . but its experience has not been a satisfactory one and it has not been able to establish standards and implement them."

Even more to the point about the FCC's effectiveness to monitor and regulate the Bell System comes from Walter Hinchman, Chief of the FCC's Common Carrier Bureau from 1974 to 1978: (331)

> "I didn't feel that we were at all effective in controlling competitive practices or creating an environment for really full and fair competition."

And one of the reasons has been that the FCC relied on telephone company supplied to make its rules. For example, Bernard Straussburg, FCC Bureau Chief from 1963 to 1973, stated that: (332)

> "Given the limited budget, the FCC had to rely to a large extent upon the Bell System to supply it with technical information, and that our expertise to go behind the Bell System's representations was also extremely limited."

From Bad Data to Good Regulation— I Don't Think So.

Over the last seven years of publishing research reports, we have had to rely on a great deal of data from the FCC. And at each turn, whether the information was about the price of local service, to the revenues from telephone subscribers in America, the numbers were off by billions of dollars.

In 1994, we filed a complaint with the FCC, Congress and the Department of Justice stating that (333)

> "much of the information from the FCC is inaccurate because of serious understaffing, lack of important audits, inaccurate scope and methodology of collecting and analyzing data, lack of accurate primary data from the telephone companies, and simply missing analyses and cross-checking of

state and federal information, causing jurisdictional loopholes in regulation."

In short, the FCC's ability to properly examine overcharging is, at best, a guesstimate, not based on accurate, complete, factual data. The only public official to respond to our complaint was Vice President Al Gore's Office, who requested we meet with FCC staff to discuss my problems. At the meeting we learned that, like the other FCC's of past administrations, this FCC did not have available staff to do comprehensive analysis of even the most basic telephone numbers and relied on numbers supplied by the telephone companies. In fact, based on recent visits to their web site, the problems we found in 1993 are still here in 1997.

The primary problems:

- Statistics from different government agencies do not match, and are off by $10 billion dollars.
- The FCC's own statistics as compared to other research firm's findings are way out of sync.
- Primary audits have not been done,
- The FCC's data vs other published RBOC company data doesn't match.
- No one is monitoring state Alternate Regulations or total profits from subscribers.

Here's some of NNI's findings:

- **Major Mismatches Between Government Information— Bureau of Labor Statistics, FCC, and Bureau of Economic Analysis** The FCC's Telephone Rate Report, May 1993, presented an exhibit titled "1990 Estimates of Residential Expenditures for Telephone Service", which showed the three different government statistics presented below: (334)

EXHIBIT 58
Government Estimates of Residential Expenditures for Telephone Service, 1990

Consumer Expenditure Survey	Personal Consumption Expenditures	Survey of Communications Firms
$57.4 Billion	$53.4 Billion	$47.9 Billion

Source: The FCC and Government Agencies, 1993

According to the FCC:

> "The Consumer Expenditure survey (Bureau of Labor Statistics) data for 1990... estimates that households spent $57.4 billion for telephone service."
>
> "The Bureau of Economic Development Analysis (BEA) which produces estimates of personal consumption ... was $53.4 billion for telephone services in 1990."
>
> "Census estimated that in 1990 telephone companies received $47.9 billion from residential customers for local, toll, and access services."
>
> "Much of the difference can be attributed to differences in scope and methodology "

Even with varying definitions, the numbers are purely "guesstimates". There is no actual information supplied by primary data, such as telephone bills. $10 billion dollars is a very large variance and it brings doubt about the veracity of most of the household data.

In the latest FCC Rate Report, dated March 97, (335) which carried updated statistics for 1994, had a $13.3 billion dollar difference between the Personal Consumption Expenditures and the Survey of Communications Firms, $79.8 billion and $66.5 billion respectively.

• **The FCC's Own Statistics as Compared to Other Research Firm's Findings Reveal Major Flaws.** According to the FCC's statistics on RBOC customer services, the

Bell's are doing exemplary jobs. In fact, the FCC's statistics shows that 94% of Bells' customers are satisfied with service. In fact, Ameritech and Bell South have 99% of customers satisfied. (336)

EXHIBIT 59
FCC's % of Residential Customers Who are Satisfied With Their Phone Service (First Half, 1995)

	Satisfaction Level
Ameritech	99.0%
Bell Atlantic	92.5%
Bell South	98.7%
NYNEX	84.3%
Pacific Telesis	91.6%
SBC Communications	93.7%
US West	96.0%
Average Satisfaction level.	93.7%

No company in America ever had 99% of its customers satisfied. NONE. NADA. It's just a fact of customer service life. The fact the FCC can publish the number is remarkable in and of itself.

However, when the statistics are compared with other reputable studies, the numbers show just how poor the FCC data is. For example, according to a JD Powers and Associates study, Southwestern Bell had 33% of the customers being dissatisfied, as opposed to the 94% who the FCC stated were satisfied, a difference of 23 percentage points. (337) the New York Times, 11/11/96.

EXHIBIT 60
JD Powers RBOC Customer Complaints, 1996

	% of dissatisfied customers
Bell Atlantic	22%
NYNEX	29%
SBC	33%
Avg.	26%

Source: JD Powers and Associates

Our consumer studies, which surveyed 2,000 consumers nationwide, was much closer to JD Powers findings. We found that overall, 39% of the households give the Bells a failing grade in one of seven customer service areas, such as answering the telephone promptly or arriving at appointments in a timely fashion. We will revisit these statistics In "Chapter 43: Customers & Telephone Service — What They Don't Know Hurts Them".

But none of this matters compared to the hard data. At the end of 1994, Ohio Bell, one of the Ameritech states was hit with fines by the PUC because it couldn't answer 30% of its calls in a timely fashion. (338)

> "In order to resolve all previous alleged violations of the Business office answer time standard through December 31, 1994, the company agrees to submit a civil forfeiture totaling $60,000.
>
> "The business office answer time milestones are 70% for the month of January, 1995, and 80% for February, 1995

Maybe the customers in Ohio weren't asked if they were 99% satisfied.

• **The FCC Has Not Adequately Audited the Telephone Companies, Especially for Cross-Subsidization.** Audits pertaining to a deregulated service paying its fair share have not been widely done. According to the General Accounting Office (GAO) report titled "FCC's Oversight Efforts to Control Cross-Subsidization," February 1993: (339)

> "At the present staffing level, the FCC could cover each area once every 18 years [there are 297 audit areas]. If the FCC confined its efforts to the 183 areas that it has designated most critical, it could audit each area about once every 11 years.
>
> "Given the current staffing level, the FCC's on-site audits of company books and records continue to be infrequent. On average, the FCC audits about 16 of the 297 audit areas that it has designated for routine auditing to assess major carriers' compliance with FCC standards."

• **The FCC is taking only information provided by the telephone companies and has not independently investigated to ascertain if the information is accurate in relationship to actual subscriber usage.** (340) The FCC's statistics of "Installation fees" listed for a business line in New York City in 1992 was $138.70. However, when NNI contacted New York Telephone, the local telephone provider, for verification, the price quoted was $598 for initiating service and a required deposit, a 331% difference. This did not include surcharges, taxes or other fees, and no service can be connected without paying these fees. In examining other installation fees on telephone bills from across America, NNI found no one paying the FCC's cited charges for installation fees, or almost any other charge.

In fact, the FCC only uses the lowest cost of an installation as stated by the telephone company and does not count deposits, initiating service fees, or average time of the installation by the telephone company (regulated and deregulated) staff. Also, the telephone company does not supply, nor is required to supply, actual average charges of installation fees, including deposits, initiating service or average installation work fees per hour. While the information supplied is double-checked, according to an FCC analyst, the FCC dropped examining deposits because the amount quoted from a telephone company representative varied widely, depending on the specific representative or even the callers' tone of voice, regardless of the ability to pay.

• **The FCC's Data vs Other Published RBOC Company Data Doesn't Match.** When comparing FCC data with other data sources, including an RBOC Investor Fact Book, everything can vary, from the number of lines to the revenues per line. For example, the information supplied for US West in the FCC report compared to the US West supplied information in the Investor Fact books didn't match at all. (341)

EXHIBIT 61

US West Communications Data vs FCC Data, for 1991

	FCC Supplied	US West
Lines	12,412,818	12,935,000
Basic Network rev. Per line	$50.25	$53.37
TOTAL DIFFERENCE	$845 MILLION	

Sources: FCC, US West, NNI, 1992-94

In this case, NNI found a $3.12 difference per month, per line, which amounts to approximately half a billion dollars. Also, NNI found a half a million (522,182) line difference shown above, which is an additional $345 million difference, for a total of approximately $845 million.

• **No One is Monitoring State "Alternate Regulation" Policies and there is no Total Bill Analysis.** When NNI met with the FCC, we specifically asked about two separate, but troubling facts of telecom life. The first was who, if anybody, was monitoring the Alternate Regulations being implemented by the phone companies in various states and whether the FCC was maintaining its own calculation about phone company profitability based on an analysis of all telephone charges.

The findings were that the FCC did not have the authority, much less the staff time and budget to do any monitoring of either local regulations or telephone company profits based on an analysis of the entire charges paid by a subscriber. As it was pointed out, some charges are no longer being examined by any regulator such as wire maintenance, and the phone companies were no longer obligated to give the FCC almost all information about "Calling Feature" charges and profits.

In short, the FCC has its own specific agenda and does not have the authority or staff to do any further analysis of state regulation or telephone company profits.

The FCC's Ability to Effect Change is Questionable

The other serious problem? The FCC's ability to effect change is, at best, limited and at most, non-existent. Here are two examples, but hundreds exist. The first example shows that cable regulation, enforced by the FCC, did not work to control prices to consumers, while the second example highlights the current fiasco with getting competition in the local phone markets.

• **Cable Enforcement of Laws and monitoring is up for grabs.** One of the simplest examples of the FCC's inability to actually effect change has been their implementation of the Cable Act of 1994 which mandated a 7-15% reduction of a person's cable bill. This bill is now defunct, being replaced by the Telecommunications Act.

Unfortunately, the reduction never happened for most subscribers, as seen in the next exhibit. The only finding is that cable rates had a very steady increase, with no drop in customer prices evident. There was a flattening in price in 1993, but the overall outcome was just to make larger increases the next year.

In fact, since 1990, cable bills have gone up about 75%, approximately $150. a year.

EXHIBIT 62
Average of Cable Rates from 1990-1996

1990	1991	1992	1993	1994	1995	1996	1997	% Change
$17.72	$19.06	$20.06	$23.60	$23.84	$26.70	$29.37	$30.83	74%
	7%	5%	15%	1%	12%	10%	5%	

While the reasons for this lack of discount is very complex, the ultimate impact was actually higher rates.

• **Competition Today? The FCC Tried.** There are numerous other ways FCC's Orders have been sideswiped. Take for example, the recent Order by the FCC about local competition, which was overturned.

The Telecommunications Act of 1996 specifically calls for the FCC to come up with a plan to create local competition which was announced on August 8th, 1996. According to Interactive Week, (August 30, 1996), the Order was designed to give new competitors discounts so they could re-sell local services, and still make some money. (343)

> "Under rules announced Aug. 8, the FCC ordered incumbent local telephone companies to resell their local services to new competitors at a discount of 17 percent to 25 percent, vs. the 5 percent to 10 percent the seven regional Bell operating companies had requested. The commission, moreover, suggested the Baby Bells charge no more than four-tenths of one cent a call to connect traffic from competitors' networks to their own, a price GTE and SNET claimed is well below their cost."

The RBOCs, however, took a suit and have effectively stopped almost all competition. Richard D. McCormick, chairman and CEO of U S WEST Inc, as keynote speaker at the annual convention of the USTA, stated that the FCC just creates "potholes" and is asking companies to sell below costs, calling it "confiscation". Citing the Telecommunications Act of 1996, McCormick said that (344)

> "Where Congress paved the way, the FCC has blasted some unbelievable potholes. The FCC's proposed rules on interconnection, unbundling and resale are not competition; they're confiscation.
>
> "It's as if the government said 'OK, McDonald's: sell your hamburgers to Burger King, below your cost; watch them undercut your price and call it competition.'"
>
> "The proposed FCC rules are the biggest threat, ever, to our industry's ability to improve our facilities, our products and services, and our contribution to society. But we are confident that the courts will continue to affirm what Congress intended and what America needs."

Some analysts believe the reason the FCC failed was because it had taken into account the local PSC concerns, and without their support, the law could be challenged more easily.

We believe that the entire playing field is filled with landmines, especially when the FCC does not have its own data, has not done the critical audits, and therefore must rely on second hand arguments. Issues of competition, especially its future, will return in later chapters.

Chapter 21 State Regulation — 50 of Everything

If the FCC is under siege, the state regulators are not only outfunded and outflanked, but many times their decisions seem only to favor the Baby Bells. And with 50 of everything, it gives telecommunications a patchwork quilt of regulation, some places threadbare, instead of comprehensive, logical, homogeneous governance.

And in later chapters we will question the need for 50 of everything because customers' use of telecom seems to be seamless, with few regional or geographic differences in the consumer research.

The Public Utility Commissions and Attorney General Offices are the front line for monitoring and regulating utilities in each state, including gas, electric, water and sewer; transportation, highways and railroads, and telephone. In many cases they have been responsible for keeping rates at the level they are today. Unfortunately, each state has to be treated on its own merits, because there are some states that have been exemplary for fair-handed and intelligent regulation, while others seem to think of telecommunications as little as possible.

However, when you add the states together as a gestalt, the analysis of the situation brings up questions as to the ability of the local regulatory bodies to effectively monitor and regulate the activities of the telephone companies or their ability to create coherent national policy.

In interviews with Public Utility Commission staff, it is clear that while some states are active in monitoring telecom activities in their states, there are others that have little, if any, staff, budget or ability in this area. The next exhibit gives a glimpse at the problem. Every year, NARUC, the National Association of Regulation Utility Commissions, publishes a survey of the states' PUC workings, laws and regulations. In 1995, they found that 54% percent of the PUCs have created a separate division for telecommunications, while 40% do not have a separate division, and 6% combine telecom with other utilities, such as gas or electric. (345)

EXHIBIT 63
Percentage of PUCs With Separate Telecom Divisions, 1995

54%	PUC has a separate division for telecommunications
40%	PUC does not have a separate division for telecom
6%	Combines telecom with gas or electric in a utilities division

Source: 1995 Annual Report on Utility and Carrier Regulation, NARUC

These statistics do not reveal the specifics. For example, in one state, 186 staff members were dedicated to transportation issues, while only 2 are dedicated to telecom. However, in the same state, approximately 1,500 complaints were telecom related, but only 448 concerned transportation, including railroads and motor vehicles. (346) For the most part, telecom is simply viewed as another utility to be regulated. Conversely, some states have general categories, such as Safety, Consumer, Environmental and Utilities, and telecom is part of the utilities mix.

On the other side of this issue are the demands put on the local regulators. NNI found that the PUCs do not have the budget or staff to adequately and continually monitor and defend the current markets, much less new telecom offerings. For example, in the case of monitoring RBOC business activity, an article in Communications Week by Kathleen Killette (March 23, 1992) stated: (347)

> "State regulators last week expressed concern that they and their federal counterparts cannot adequately monitor attempts by the Bell Companies to use their local exchange monopolies to competitive advantage in information services and manufacturing."

The article continues by stating that according to William Cowan, General Council for the New York Public Utilities Commission: (348)

> "The states are hard pressed to monitor the Regional Bells increasingly complicated businesses," and that "It would be egotistical to believe that regulators can do the job through rigorous oversight alone."

And then there is the politics of the local regulators. Some Commissioners are elected while others are politically appointed. Some get excited by telecommunications while other just see it as one more Utility. And some even question their motivations. Senator Metzenbaum, during a telecommunication committee hearing, stated that the PUC's historically have been too friendly to the telephone companies. Considering the findings of this report, NNI has to concur. Metzenbaum's comment: (349)

> **"Isn't it a fact that the Utility Commissions are way too close to those they are supposed to be regulating?"**

And there have been cases of scandal throughout the Bell system's history of Commissioners on the take. For example, an article titled "Southwestern Denies Oklahoma Corruption, Texas Sabotage", that appeared in the newsletter "State Telephone Regulation Report", (10/22/92) (350) stated:

> "The Chairman of the Oklahoma Corporation Commission has accused Southwestern Bell and unnamed commission member of corrupt misconduct.
>
> "Chairman Robert Anthony announced he has been cooperating since 1989 with an FBI investigation into alleged corruption at the commission. "

In 1997, another article titled "$2.2. Billion Bell Bonanza, Ransacking Ratepayers" in the Oklahoma Observer (9/25/97) (351) stated that while a Commissioner and a Bell attorney both ended up in jail, and one commissioner, Bob Anthony won an award from the FBI for helping, the state legislature just passed a law that stopped the PUC from analyzing Bell profits until 2001. However, the new commissioners recently found about $100 million annually in overcharging.

We consider the main problems with State Regulation not to be fraud and corruption, but due to the way state regulation has progressed, creating a patchwork quilt of commissions, many of whom are not staffed or funded to adequately address telecom issues. Also, we consider the current problems inspired by the Bell's ability to promise on technology and have regulators believe them.

Demonstrating the Patchwork Quilt of Regulation

While each state has a different approach to staff requirements, budgets, and examining telecommunications, the states also dramatically differ in their law making, the components of their rate cases (i.e., what is included in the rate-making models) and in the regulated charges for services.

In fact, there are as many price differences for a service as there are states. One has only to look at some services, such as directory assistance, to realize just how out of whack regulation uniformity has become.

50 Different Prices for Directory Assistance

During the creation of a database of all telephone charges, from directory assistance to the price of toll calls, we made a startling finding.

> **Every price of every service, in almost every city of every state, has a different charge.**

Take, for example the price of a directory assistance (DA) call. There are numerous forms of directory, but, for the moment, let's just look at the service that uses the telephone number "411" or the local "555-1212", and gives the caller the ability to find out a specific business or residential telephone number.

The service is almost identical in every state, and while the costs to offer the service depends on labor contracts and directory assistance technology, the expenses should have only a small variance.

However, this is just not the case. Directory assistance prices, for the exact same call, **can vary 4,200%,** with some states giving 12 free calls, known as an "allowance" with service, while others, such as New York Telephone, charge 45¢, with no free calls. In fact, there is almost as much variance in the price of directory-assistance calls as there are states.

The exhibit below highlights just a few state's directory call prices in 1996. Notice that even when the price is the same, such as Utah, New Jersey or and Arizona, the amount of free calls can vary. (352)

EXHIBIT 64
The Varying Cost of Directory Assistance, 1996

	Cost per call	Number of Free
New York City	45¢ each	No Free
Arizona	20¢	2 Free
Utah	20¢	No Free
New Jersey	20¢	10 Free
Pennsylvania	50¢	2 Free

Worse, some states have different prices for business vs residential customers. The other problem with the price of directory is more historical in perspective. Before 1984, all directory across America was included with service and therefore, no charge, or the customer had substantial amounts of free calls, 10 to 20 free calls per line was common. Over the last decade, the number of free calls in all states either diminished in number or eliminated, and the price per call also went up.

And the impact of this variance in pricing is straightforward. Based on "Consumer Attitudes Toward Telephone and Cable Companies," NNI found that: (353)

> **"0% of the population can answer basic questions about the price of services, such as directory assistance, on their telephone bills.** "

Lack of consumer education can also have an impact on a person's phone bill. For example, we found that over 45% of the population believe that directory-assistance service is free or they receive a substantial number of calls, and in some cases, we found subscribers making 15+ calls a month, at 35¢ per call. (354)

Other Examples of State Regulatory Coverage

From the business perspective, there is little rhyme or reason of PUC examinations and control over services offered by the Bells to long-distance companies, and in the future, to competitors. The following exhibit highlights billing and collections services provided by the local telephone company to other telephone companies.

While the FCC's Interconnection order attempts to modify some of the current billing problems, today, a company who wishes to do business in 50 states must file 50 times, and sometimes more per state, depending on local ordinances.

As of 1995, the NARUC survey of 50 states reported that billing and collection regulation, and therefore services, had a wide diversity across the United States. NARUC's survey information showed that in 54% of the states, billing and collections were "tariffed", 14% were "deregulated", 20% were "detarriffed but not deregulated", 6% were "partially tariffed", and 6% were "partially detarriffed". Regardless of the intricacies of the terms, the outcome is that few states regulate billing the same way. (355)

EXHIBIT 65
Billing and Collections as a % of States, 1995

54%	Tariffed
14%	Deregulated
20%	Detarriffed, not deregulated
6%	Partially tariffed
6%	Partially detarriffed
50%	**Have not analyzed billing practices**

Source: NARUC, 1995 NNI, 1995

Also, the NARUC survey data showed that **50% had not analyzed the telephone company billing practices to make their decisions.**

The Telephone Bill — 50 Responses

And how evenly applied are consumer protections across America? Well, using the same 1995 survey, NARUC found that the majority of states have not required a Customer Bill of Rights or have studied plain-language bills, while 12% of the states didn't not even require itemized telephone bills. (356) The states that have instituted these laws have come up with them separately, instead of an agenda that gave a national blanket of protections, affecting all consumers.

EXHIBIT 66
Various Findings of State PUC Examinations

74%	have not issued a Bill of Customer Rights
68%	have not studied or put into effect plain-language bills
12%	do not require itemized bills

Source: NARUC, 1995

We will return to the lack of consumer education later.

State Regulatory Models — Where's the Beef?

Within this telecom bio-diversity, there is no homogeniousness — not even in the types of regulatory mechanisms the PUC use. The original form of state regulation, the primary one that had been used since the flood, is usually known as **rate of return,** while the newer forms have come to be known as **alternate regulation,** but each state has it's own flavors and rules.

However, regardless of the specific regulations, the question readers should be asking: Where's The Beef? Where are the protections and safeguards to keep prices in check? Let's start with some basic terms and definitions.

- **Rate-of-Return Regulation** This traditional model allowed the phone company to receive a specific amount of profits from the services offered to the customer. These profits, sometimes defined as "return-on-equity", or "return-on-Capital", was a fixed amount — If the return falls above a specific amount, usually 11% to 13%, the company returns revenues in the form of refunds or rate reductions. If the earnings are below the stated amount, price increases are granted to give the RBOC more revenue
- **Alternate Regulation** This catch-all term refers to an alternative form of regulation. The primary variations include:
  - **Nonregulation** (or partial nonregulation) removal of regulation on some or all services
  - **Incentive Regulation** (or earnings sharing) When earnings for a particular product is reached, additional revenues are usually shared with the ratepayer.

- **Price Indexing** Earnings are based on some indexes, such as inflation or productivity.
- **Price CAP Regulation** The price of a product is fixed, but there is no cap on the company's earnings .

All of these forms of Alternate Regulation are really "deregulation" in disguise. Most services which were once regulated under rate-of-return for profits, are no longer constrained. Alternate Regulation has become the equivalent of no one examining the books.

And the Baby Bells freely admit that much of their revenues are no longer examined by state regulators, or that are under some form of alternate regulation. And this trend has been accelerating since the 1980's.

For example, BellSouth states: (357)

> "By 1992, 80% of all access lines in BellSouth were under alternate regulation." (Source: BellSouth 1993 10 K)

Bell Atlantic, in 1990, states: (358)

> "Overall, Bell Atlantic enjoys one of the most favorable regulatory climates in the nation. With federal price caps and its progressive state plans, the major portion of its revenues are now free from traditional regulation. [emphasis added]

Remember, the removal of regulation was the Baby Bell's goal since they were born. Let's first start with a better understanding of Rate-of-Return regulation. It has been the regulation that the Bell's insisted they wanted removed at all costs. Therefore, it must have had some virtues.

Rate of Return — A Horse-trade From the Start

The concept of the rate-of-return model is simple. A telephone company's revenues are X, their operating expenses are Y, and so, in the simplest sense, a rate-of-

return model should examine X minus Y—the amount of profit. Unfortunately, like everything else in telecommunications, the caveats and variety of states applying these models can be completely different — what they examine, what the Bells can include as expenses, and even which services contribute to the regulated pool of funds to calculate the rate-of return, are all up for grabs.

Rate-of-Return models traditionally accounted for most revenue paid to the local telephone company, since most services were regulated. This included all local service charges, such as basic service, installation, toll calls, directory assistance, and even Touchtone service. In 1980, even the wire in the home and the telephone handset were part of the rate-of-return calculation.

However, the treatment of each charge has gone through major changes, and how it was, and is now accounted for in the rate base, has great variability. Even the simplest of service, such as Touchtone, is treated differently by each state and each state's regulatory model.

Horse-Trade Philosophy of Regulation

Rate-of-Return guaranteed the Bells a specific return-on-equity, and this amount had some variables based on which service was being examined. But in a lot of ways, the prices of services was a virtual-construct, created not by what it cost to run the network or the actual price of a service, but by hundreds of calculations.

It was a horse-trade from start to finish. How much they should charge for a directory call, how many free calls came with basic service, and even charging for Touchtone service, were all thrown into a basket, and stirred.

And what revenue is even included in this potash is also up for grabs. According to a joint report issued in 1990 by Public Communications Associates and the Michigan State University Department of Telecommunications, found that the treatment of telephone Yellow and White pages revenues and expenses varied based on the state. (359)

> "Some states, such as Iowa and North Dakota, permit agency consideration of directory revenue and expenses associated with the sale of classified advertising or listing by a telecommunications firm in determining rates, while Missouri prohibits agency Yellow Pages

jurisdiction unless it finds these directory revenues are being associated with telecommunication revenues by way of direct or indirect subsidy."

Allowable RBOC Spending on Advertising, Contributions and Dues

In examining advertising expenditures as part of the rate-of-return models, we find that each state applies different laws and reasoning to what they will and will not allow under this category. While the words *reasonable* and *limits* appear everywhere, telephone companies can charge ratepayers for the advertising they do. (360)

EXHIBIT 67
Allowable Advertising Expenses by PUCs, 1995

100%	Advertising
92%	Special-service ads
50%	Institutional advertising
42%	Goodwill advertising
52%	Sales-promotion expenses

Source: NARUC, 1995, NNI 1995

NARUC's 1995 study found that almost 50% of the states allow for most types of advertising, from goodwill to sales promotions.

On the topic of contributions and dues we find, once again, that many different types of expenses are allowable, with trade and professional dues leading the list. NARUC's 1994–1995 survey asked: "In the cost of service, does the agency allow contributions/dues payments to these types of organizations?" The exhibit below summarizes the findings. (361)

EXHIBIT 68

States' Rate-of-Return Policies on Contributions and Dues

16%	Religious
30%	Charitable
40%	Educational
20%	Patriotic
0%	Political
8%	Fraternal
54%	Economic development
50%	Service
92%	Trade
86%	Professional
26%	Promotional
20%	State/local fund-raising drives

Source: NARUC, 1994-1995 and New Networks Institute, 1995

Though few states allow for all charges, 30% allow telephone companies to include charitable contributions as a deductible item, 16% allow religious contributions, 54% allow economic development, while 20% allow state/local fund-raising drives.

While some states such as Florida, Indiana, or Maine allow for very few specific contributions and dues, others such as Massachusetts or Mississippi allow for most charges, albeit on a case-by-case basis.

And loading advertising costs happened in all states. For example, according to the New York Citizens Utility Board, New York Telephone charged $24 million to ratepayers for changing the name of New York Telephone to NYNEX. (362) Considering every RBOC has changed their name, from Bell Atlantic to Ameritech, this advertising expense could be $350 million or more.

However, each state treats all of their charges separately, and so, many of the complaints filed and acted on in any specific state may not have been considered or acted on across America. In fact, NNI found that the converse is true in dealing with wire maintenance charges. While almost all telephone companies have used the same practices for selling wire maintenance, only a few states have had court cases or had done any investigation.

Rate-Of Return "Subsidies"?

There are also something called subsidies that were part of this mis-mash. According to Robert Anderson, Vice President of Regulatory Affairs for New York Telephone: (363)

> "For New York Telephone, the average cost of providing basic residence access is $23.25 for message rate service and $39.50 for flat rate service, (which include local usage) These prices include the $3.50 FCC Line Charge. The gap between cost and price totals about 1.3 billion a year and is closed with subsidies from other services." [emphasis added]

Contrary to this statistical presentation,. MCI filed in New York State court that the subsidies in 1996 were inflated by $400 million dollars annually. (364)

In fact, there is this myth that has been perpetrated, that local services are not profitable, and continues even in 1997, Case in point is an article by Bill Gates, which appeared in the New York Post titled "Bill Gates predicts what's ahead in '97" (1/2/97) (365) He writes that current regulation has caused local telephone service to be undercharged while long distance service is overcharged. The exact same argument that NYNEX uses when it talks about subsidies.

> "The rate scheme used to pay for telecommunications in the United States will change dramatically. Regulators will end the current practice that forces phone companies to undercharge for local service and overcharge for long-distance service. As a result, heavy user of the local telephone network -including people who keep computer modems connected hour after hour - will see the bill rise."

NNI contends that subsidies are a shell game. The non-regulated and de-regulated products have not been paying their fair share to the regulated side, thus the phone companies can claim local service loses money.

In our discussion of Universal Service as well as Access fees, the issue of subsidies will appear again.

The easiest way of understanding the transition from Rate-of-Return to Alternate Regulation, as well as the subsidy shell game, is to examine what happened to the charges on the telephone bill. Though it is quite complicated in detail, let's use a simple metaphor, going out to dinner, to explain how the Bells can say they lose money on local service, and how the rate-of return model was displaced slowly but surely over a decade.

Redefining the term "Basic, Local Service": 1980–1996

Book VI is dedicated to the charges on your telephone bill. And here is a glimpse of the ultimate redefinition of simple, common sense terms —"Basic Service".

Let's go out for dinner.

You walk into a restaurant in 1982 and order a steak dinner. The dinner costs $10, and includes everything from the soup and choice of appetizer to coffee and dessert. In 1996, you go back to the same restaurant and order the same steak dinner. This time, the dinner costs $20, but no longer includes an appetizer, dessert, or coffee, and all of the portions are a bit smaller, and everything is ala carte.

Like the 1982 dinner, basic local service as defined in 1982 was simple. A subscriber received unlimited local calling, almost unlimited Directory Assistance, the wire in the home and even a telephone, besides connection to the network.

.By 1996, every service feature, from a directory call to even local calling, is now ala carte, and at super retail prices. And like the dinner, basic service redefinition is analogous to the extra charges for the appetizer, dessert and coffee. In fact, in 1982 there used to be 9 different bill charges, while in 1996 the average is 21 items, including new fees, such as a $3.50 per month FCC Line Charge, (which is not paid to the FCC but to the Bell companies). Some states, such as New Jersey or Pennsylvania, even have the gall to still charge extra for Touchtone service, a charge that has no costs to offer. (It is more expensive to offer rotary than Touchtone service).

Add the new additional state and local taxes, and the average telephone bill, as configured in 1982, went up 275%. This analysis is based, not on FCC documents or Regional Bells' supplied information, but to actual collections of telephone bills. Conversely, long distance charges have decreased an average of 35% off, 55% with discount plans.(366)

And the increases to many services have been outrageous. A simple example is Directory Assistance. In New York City, in 1984 a subscriber received 6 free calls with

local service, then charged 10¢ per additional call. By 1994, there were no free calls and the price of a directory call went to 50¢ each, counting tax, For 10 calls, the increase is $4.60 each month, a 1150% increase. Nationwide, Directory Assistance went up 1326% since divestiture in 1984.

Returning to our Dinner metaphor, the definition of "local service" as used by the telephone companies, and unfortunately by Bill Gates, is the cost of just "entree" in 1996, and for the most part does not include almost all charges the customer actually uses and pays for in its definition, nor all the profits these services accrue.

And almost all of these other charges through Alternate Regulations became deregulated over the decade, meaning that the company could charge almost whatever it wanted, and the fee was no longer part of the 'rate-of-return. For example, wire maintenance, a fee for maintaining the wire in a home or office, is deregulated and highly profitable. The telephone company neglects to tell subscribers that the wire breaks on the average once every 16 years.

What did this mean in the calculation of "Rate-of-Return"? it means that highly profitable services were removed and hidden from the regulators. New York Telephone stated that in 1991, revenues of $367 million switched from regulated to deregulated for inside wiring. (368) This number included both residential subscribers, as well as businesses, who, in New York paid $6 a month in 1991. Based on the number of NYT lines, the nationwide average would be a total of $4 billion for 1991.

EXHIBIT 69

Wire Maintenance Fees, Nationwide, 1991

New York Telephone Revenues	$367,000,000
New York Telephone Lines	$ 9,807,000
Per line	$37.42
Estimated Nationwide total	$4,025,700,000

Source: New York Telephone, NNI 1994

In fact, because of Alternate Regulations, almost all local services never pay adequate reimbursements and fees back to the regulated side. According to the New York Times 1/1/4/97 (369)

> "Ameritech has been promoting services including Caller ID and voicemail, which can carry profit margins greater than 50%".

And there are other problems with the term local service - long distance Access Fees are not included in the model either. Access Fees are fees that the long distance companies, such as AT&T or MCI, pass through to customers. MCI has stated that in 1997, Access Fees accounted for 40% of their long distance revenues. (370) We argue that Access Fees, as well as every other fees paid by the subscriber, are part of local service because the customer must use their local monopoly telephone company or nothing.

This change over the decade was slow, affecting every American. To show a more formal analysis of the deconstruction of '"basic service", NNI analyzed the Ohio Consumer Council's analysis of telephone rates and found "basic service" redefined numerous and subtle ways over the decade.

Ohio Consumer Council Definitions of Basic Service

Every year since 1976, the Ohio Consumer Council, the state consumer advocate's office, created the "Telephone Rate Surveys" (1976-1993) to show how the price of service changed in that state. (371)

To start, in 1980 the definition of "basic service" included the telephone, the wire in the home, flat-rate service, and taxes, which only cost $8.21. Directory assistance calls, which were unlimited and at no charge, were never included in any analysis.

By 1988, the definition of basic service was the "cost of individual line including flat rate service, plus FCC access charges, 911 emergency service and applicable taxes.", and the average price of $19.44. This new definition no longer included the phone rental, the wire in the home, but added FCC access charges, a fee that started in 1984.

However, in reworking the definition of Basic Service, there was no reworking of the of the "value" received. All other items, from telephone to taxes and inside wire, were now excluded and obviously cost extra, just like the dinner in 1996, where every item is extra - and the math to recalculate the actual cost of a "dinner" is never done.

Unfortunately, if the subscriber kept their exact same service in Ohio throughout 1980 to 1993, they ended up paying a 237% increase. Some charges, such as inside

wiring, went up 375% to 1,150%, depending on the specific wire maintenance fee selected.

And it was Alternate Regulation that allowed this devolution to occur.

Chapter 22 Alternate Regulations: The I-Way Sleight of Hand

Almost at birth, the Baby Bells pitched a series of new regulations, called **Alternate Regulation**, to the Public Utility Commissions. By 1997, the Bells have convinced every state regulator to grant some form of alternate regulation.

From the telephone company perspective, alternate regulation has been the buzzword for giving incentives for the telephone company to give new technology to the masses sooner. For example, Ohio Bell, in its alternate regulation proposal, Advantage Ohio stated: (372)

> "The purpose of alternate regulation is to maintain responsible prices and high-quality service for telephone customers while providing incentives for telephone companies to deploy advanced telecommunications throughout the state. The purpose of alternate regulation is to address the state's public policy goals:
>
> - "ensure the availability of adequate basic local exchange service to citizens throughout the state.
> - "maintain just and reasonable rates, rentals, toll, and charges for public telecommunications service.
> - "encourage innovation in the telecommunications industry
> - "promote diversity and options in the supply of telecommunications services."

Also, Alternate Regulation was supposed to help the local phone companies compete with "unregulated competitors". According to Robert Harris Berkeley, in testimony for Indiana's alternate regulation case, Opportunity Indiana, regulation is used so that companies can be more flexible in pricing, and that this increases companies' incentive to reduce costs and stimulates competition: (373)

> "Although each state has adopted a somewhat different form of alternative regulation, they have certain important features in common. They are more flexible in enabling LECs to compete with unregulated competitors;

> they incorporate adjustment or indexing factors that are more adaptive to changing economic conditions than traditional rate-of-return regulation; they eliminate strict "cost-plus" features of rate-of-return regulation to increase the company's incentive to reduce costs; they tend to stimulate competition and they promote efficiency, innovation, service quality and customer responsiveness."

And these two reasons, flexibility to deal with unregulated competitors and building infrastructure drove almost all state plans. .

The Pitch for ISDN — Alternate Regulation, Round 1

The early Alternate Regulation Plans were basically created as a trial plan, with specific sunshine expiration dates of 3 to 5 years. These simplistic plans were usually pitched as **"incentive plans"**, where the company could garner more profits if they would guarantee a modernization of the plant, usually from analog to digital switches, as well as try for "productivity gains", where the local company becomes more efficient.

The technology that Southwestern Bell was selling for its Alternate Regulation was Fiber-optics and ISDN. In 1986, Southwestern Bell stated that ISDN would "revolutionize day- to-day communications".

Southwestern Bell, **1986** Annual Report (374)

> "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."

And by 1988, Zane E Barnes, Chairman and CEO, stated:.(375)

> "Southwestern Bell company, the subsidiary that provides telephone network service, <u>is bringing high tech home to millions of people.</u>

> "In 1988, Southwestern Bell telephone company tested new services that ultimately could bring the Information Age to everyone in the company's five-state area. One of the links will be fiber-optic cable which has more capabilities than standard telephone line.
>
> "Our regional telephone operation continues in leadership in development of Integrated Services Digital Network (ISDN). With more than 17,000 lines under contract, we're the nation's number one producer of this advanced technology capable of simultaneously transmitting voice, data, video services over the telephone line."

(It is Ironic that according to the FCC, Southwestern Bell's total ISDN lines in 1995 was only a total of 38,000 ISDN lines, with Texas having 32,000, approximately 85% of the total. (376)

And these early plans were a form of incentive regulation. Telefuture 2000, the plan for Missouri, froze rates of local service, and required a $180 million dollar investment in advanced technology. This five year plan was approved October 1989. (377)

EXHIBIT 70
Southwestern Bell's TeleFuture 2000, 1989

- freeze on the rates for local telephone service
- Local exchange prices would be tied to the Consumer Price index
- an investment in Missouri of $180 million **in advanced technology for its customers.**

Source: Southwestern Bell Telephone Company 10-K, 1991

TeleKansas

TeleKansas was another five year incentive plan and was approved by the Kansas Corporation Commission on February 1990. This plan also froze rates, reduced some rates, required networks upgrades, but also allowed for flexible pricing for some, not all "discretionary" products. (378)

EXHIBIT 71
Southwestern Bell's TeleKansas, 1989

- Freeze basic local rates for five years,
- a reduction of other annual rates approximately $22 million,
- a network modernization plan at an estimated cost of $160,
- a flexible pricing for a specific list of discretionary services.

Source: Southwestern Bell Telephone Company 10-K, 1991

However, there were caveats. The companies' profits were still capped for profits with a schedule of earnings based on Return-on-Equity. Make too much money and you give some back. (379)

> "The Missouri Public Service Commission require that certain ratemaking adjustments be made to the telephone company's reported earnings in order to compute earning subject to sharing. "

And the schedule of earnings: (380)

EXHIBIT 72
Southwestern Bell's TeleFuture 2000 Return On Equity Splits, 1989

ROE	14.1% to 14.5 shared 60% with customer
ROE	14% - 17% shared 50-50
ROE	anything above 17% returned to customer

Source: Southwestern Bell Telephone Company 10-K, 1991

Anything under 14.1% Return-on-equity was the phone company's profits. From 14.1% to 14.5% the company shared the revenues with the customers on a 60%-40% split, from 14% to 17% the company split it 50-50, and anything over 17% was supposed to be returned to the customer.

We will come back to a discussion of the lack of ISDN rollouts later.

Info-Scandal Alternate Regulation, Round 2

The series of Alternate Regulation plans before the 1990's were almost dress rehearsals for the "Opportunity plans", Like our case study, Opportunity New Jersey, these plans were much more grandiose, and focused more on the Info-bahn, a full-multimedia fiber-optic future, not the relatively low tech, ISDN. And as such the promises were more pronounced:

For example, Advantage Ohio stated that regulatory changes would benefit for jobs, education, and healthcare. (381)

> "What does Ohio stand to benefit from regulatory reform and a broadband telephone network?
>
> **"Creation of Jobs:** Ohio's strongest performers in business growth and job creation are in telecommunications-intensive industries. According to a Case Western Reserve University study completed in 1991, these industries generated 250,000 jobs for Ohio during 1980 to 1987 and are expected to generate 88% (497,000) of Ohio's new jobs by the year 2000.
>
> **"Education:** New telecommunications technology has the potential to produce quantum leaps in providing high-quality education for all students throughout Ohio. The broadband network could transport two-way interactive video and link all of Ohio's primary and secondary schools. Distance-learning applications would support teachers, benefit students, and provide more equitable education by carrying universal and special educational programs to every school, including those that are economically disadvantaged in both urban and distant rural areas.
>
> **"Health Care:** Telecommunications technology holds great promise for delivering health-care services to the public. A broadband network would free health care providers and patients from the confines of buildings separated by time and distance. A broadband network would be capable of transmitting high-resolution, full-color, full-motion video images which would facilitate improvements in medical diagnostics, X-ray lithography, and medical training. For example, surgeons at the Cleveland Clinic could guide a surgical procedure at a hospital in Ironton.

> Such technology could be used to produce high-quality health care while containing health-care costs."

And the companies didn't want any revenues under any surveillance, except one line item, basic service. Earlier plans, still required profit monitoring, and had forms of revenue-sharing when profits exceeded specific limits.

Indiana Bell's proposal put it succinctly. According to Testimony by Norman L. Cubellis, Vice president-Regulatory and External Affairs, Indiana Bell Telephone Company: (382)

> "Indiana Bell now presents Opportunity Indiana, a progressive plan which is designed to protect the price of Basic Local service through a rate stability index, provide equal freedom to Indiana Bell to respond to competitive actions and as a consequence of reform eliminate the outmoded and costly rate-of-return regulatory process. In response to approval of the total package of these forward looking initiative by this Commission, Indiana Bell commits to accelerate and increase its infrastructure investment, thereby accelerating the benefits of technology to its customer." [emphasis added]

Another way of saying this, emphasized below, is that in exchange for the removal of rate-of-return regulation, Basic service prices and carrier access would be stable, and everything else would be priced at "Market Prices", meaning whatever the company deemed they could get away with. (383)

> "As a result of this proposal (Opportunity Indiana), rate base/rate-of-return regulation would be replaced by price regulation for Basic local service and Carrier Access services. (384)
>
> "Market prices would apply to the balance of the Company's services. The Commission would decline its jurisdiction and allow the marketplace to determine the prices of these services which are already competitive in nature." [emphasis added]

And we want to re-emphasize one crucial point — the company would commit funds to build the I-Way. (385)

> "Finally. the Opportunity Indiana Plan recognizes the need for Indiana Bell to provide a high level of new investment to achieve and maintain a state-of-the-art telecommunication infrastructure."

Many of the other Ameritech states, Illinois and Michigan for example, had similar packages, though each state had different wording and amounts of monies. According to Ameritech's 1993 Investor Handbook, by 1993, both Michigan and Illinois had plans which freed Ameritech from earnings' limits, and required a commitment of construction. (386) (387)

EXHIBIT 73
Alternate Regulation in Illinois, Ameritech, 1993

- no limit on earnings or depreciation
- basic service (residence access lines capped for three years, then indexed to inflation, productivity, and service quality
- competing services not included
- $3 billion investment commitment
- currently authorized 13.1% on equity

Source: Ameritech's 1993 Investor Handbook

EXHIBIT 74
Alternate Regulation in Michigan, Ameritech, 1993

- no limit on earnings or depreciation
- basic service (residence/business access lines and local usage) expedited rate adjustments subject to inflation and productivity
- toll rates capped at 12/31/91 level
- prices of other competitive services not regulated
- $2 billion investment commitment 1993–1995

Source: Ameritech's 1993 Investor Handbook

So, with the pitch in place, the wonderous promises being made, the Opportunity plans went forward. However, what was happening under the surface, from the subscriber perspective, was much more revealing. Some of the state commission members were examining the impact of the studies, and of the Bell activities.

Chapter 23 Catching the Bells — State and Federal Audits Reveal Wrong-Doing

Alternate Reality is More Like It

While most alternate regulations were veiled as a device for the common good, the reality of alternate regulation has been that the Baby Bells gained weight, while obscuring the facts. As we have seen in Show me the Money, the Bells' became over the last five years some of the most profitable companies in America. We also saw that there was no serious increase in network construction, only decreased staff. Most of the Bells' profits, especially from deregulated products, no longer have anyone monitoring or analyzing earnings. And the subscriber has seen little, if any, benefits such as cheaper prices, or the promised wonders of the Information Age.

While Opportunity New Jersey highlighted the situation in one state, other regulators, such as the Michigan PSC's study of their Alternate Regulation plan, shows that the problems were not just in one place.

Also, audits of Pacific Telesis and Ohio & Wisconsin show that the cracks in regulation are letting the Bells "cross-subsidize" easily, meaning allowing the telephone subscriber to be charged for expenses that should have been paid for by the shareholder's profits.

First, Alternate Reality in Michigan.

Alternate Regulation: The Michigan Experience

In 1992, "The Michigan Telecommunications Act" was established, which was intended to foster "new developments in Michigan's infrastructure". A year later, the Michigan Public Service Commission (PSC), released a report card on their first year's experiences with alternate regulation. (388)

And the conclusion was that Michigan Bell, an Ameritech company, made more money, the promised new services never arrived, and the phone company was now able to hide information because the act eliminated any ability to review the phone companies' working. (389)

- "The deregulation of nonbasic service coupled with the pricing freedom gained for toll and access service has permitted Michigan Bell to prosper financially.
- The act has not increased the number of new services. New services under the Act could have been introduced under previous statutes and the act has eliminated any regulatory review process to prior introduction."

And the Public Service Commission wasn't receiving enough information to properly monitor the Bells. (390)

> "Unfortunately, due to a lack of data from some of the state's major telecommunications providers, the Commission has been hampered in its efforts to gauge how extensively modern telecommunications services are available, or to identify where growth has occurred and where progress is stagnant."

In compiling its report, the PSC found three primary problems:

- The telephone companies did not supply adequate information to be able to assess the new act.
- Telephone companies were hiding behind the Freedom of Information Act and were not forthcoming with even basic information about the installed base of products, their earnings, or their profits
- The telephone company unregulated and deregulated services were not being properly monitored, but were now making more money and hampering competitors.

In order to complete its obligation, the Michigan PSC sent out a survey. The PSC stated: (391)

> "Seven local exchange carriers exempted themselves from submitting data for this report. ...Among the seven are the state's four largest telephone

> companies, representing 4.9 million, or almost 98%, of Michigan's telephone lines."

Even worse, the data received was incredibly incomplete. For example:

> "Of the 141 items of information requested [in the survey] Michigan Bell claimed exemption from providing answers to 81. Michigan Bell also asked for FOIA protection on 26 other items, thus limiting their usefulness for the report."

NOTE: Freedom of Information Act (FIOA) protection allows telecommunications companies basically not to disclose information it feels is proprietary or competitive. The exempted and FIOA services includes everything from Call Waiting and Speed Dialing to ISDN.

Another disturbing finding from this report was the incredibly poor information details, even when they were supplied. For example, while Michigan Bell stated that they had 1,008 switches in use, the Michigan Bell information supplied to the FCC's report of installed switches (ARMIS Report 4305), stated that it had only 452 switches statewide. Meanwhile, GTE reported 195 switches in Michigan in 1992. though in the report survey they stated that they had 219 switches at the end of year 1992. (392)

Quality-of-service complaints faired no better. The PSC had 4,029 complaints and inquiries in 1992 involving telephone companies and 46% (1,866), were Michigan Bell customers. However, Michigan Bell reported only 136 complaints to the FCC in 1992, regarding complaints filed at the state level about its quality of service. (393)

Like we said before, no two statistics in telecom matches. And the FCC's information is supplied by the phone companies...

Assessment of the Michigan Alternate Regulation Act

Besides the comments pertaining to the incomplete data supplied by telephone companies, the Michigan PSC made these observations about the impact of the alternate regulation act. As the partial list demonstrates, the telephone companies profited, while the telephone subscriber received no new value, only increased costs. (394)

- "The act appears to have had minimal impact on the deployment of educational systems [which was one of the primary reasons for the act in the first place].
- "Construction programs for Michigan Bell have been reduced since the enactment of the act.
- "The workforce of Michigan Bell has been appreciably reduced.
- "Monopolistic power is being exerted in nonregulated, noncompetitive markets more than permitted under prior statutes.
- "Parties want entry and competition in markets they wish to enter. When in a dominant market position, the same parties attempt to erect barriers and stifle competition.
- "The formal complaint process is too expensive for small-business and individual customers, costing $10,000–$20,000 and these companies and individuals also have limited expertise and financial resources. This diminishes the Commission's ability to rely on the complaint process to identify violations of the act. Therefore, the system of checks and balances inherent in the act fails.
- "The deaf-relay system is being provided free from competition with other vendors and providers (i.e., all of the money paid for these services, as mandated by the 1990 federal act, is simply direct revenues for the company).
- "Requests for Freedom of Information disclosure exemptions have been excessive. Many requests have been without reasonable justification.

In short, the Michigan PSC found that:

- "Important data was no longer available, even for monopoly subscribers.
- "Prices increased, construction decreased, employees were dropped, and competitors have been road-blocked.

But this is only part of the problem. Audits of other phone companies reveal that other forms of hanky-panky

Cross Subsidization: The NARUC Audits of Pacific Telesis and Ameritech

The other part of the state regulatory puzzle has been the inability of the state Public Service Commissions to successfully examine and monitor excessive Bell profits from various Bell improper cross-subsidization practices, i.e., subscribers paying for items they should not be paying for.

The findings of a few audits, some of the only ones ever done on the Bells, shows that the Bell companies are able to play a serious shell game with its revenues and therefore profits. The losers are subscribers.

A partial audit of Pacific Bell showed that customers had improperly paid for the development of many new products, who's cost of development should have squarely fallen on the holding company. (395)

> "A situation exists where ratepayers in essence provide the seed money and bear the risks with the potential rewards accruing for the shareholders from electronic directory and personal communications to Information Age products and services."

Let's discuss two disturbing partial audits conducted in part by the FCC and NARUC members in 1994 and 1995 — one of Pacific Telesis and the other, of Ameritech. The findings of each of the audits were so similar, and yet so anti-subscriber, that one has to wonder if anyone is still in control.

There are however, two much more disturbing parts. First, as you will see, the outcome of these audits was just a slap on the wrists, instead of refunds, rebates and better monitoring.

Secondly, these are only partial audits for only a few states. These audits DID NOT happen in almost all states. They DID NOT look at most expenses, only a few. And they DID NOT have access to most data.

However, both audits clearly found gross cross-subsidization of regulated revenues used to pay for non and deregulated services. A simple example of this is the monies spent for the research and development of a products like PCS, Personal Communications Services. The development of services were supposed to be paid for by the shareholders because the PCS services are not regulated and therefore should not be

expensed to regular phone customers. Also the product is supposed to be sold, not through the monopoly company, but through a separate subsidiary.

However, according to the Pacific Telesis audit, the current safeguards: "may be creating the perverse effect of encouraging cross subsidization".

Background of NARUC Audits

In 1991, the NARUC passed a resolution to audit the Baby Bells because of numerous concerns. The Pacific Telesis audit stated that the audit should answer specific questions. (396) Are there:

- "Improprieties
- non-compliance
- resource draining
- Cross-subsidies
- improper sharing of resources
- cost shifting
- monopoly profit siphoning
- anti-competitive behaviors"

However, the audits were plagued by numerous obstacles. Many state Public Utility Commissions were unable to participate because of the lack of staff, some RBOCs refused to give any "information of value", while BellSouth sued to stop the Florida audits.

According to NARUC Staff Audit Oversight Committee, presented in July 1992, the Maryland audit of Chesapeake & Potomac's (now Bell Atlantic) "affiliate interests", (other non-regulated companies that Bell Atlantic owns), found that the expenses had been charged to the regulated side improperly. However, "much of the information with value was deleted as proprietary", and "the issues as laid out by NARUC were not specifically addressed". (397)

The problem is complicated by the fact that state audits were not allowed to see important holding company data nor able to combine and examine other state information, even for the same RBOC.

> **Today, no Regional Bell has ever been audited for the majority of its revenues. nor has any Bell been seriously effected by the outcome of any audit, even when it showed massive improprieties.**

Let's start with the Pacific Telesis audit, followed by the Ameritech audit and then cross reference the similarities of between these two reports.

Pacific Telesis Audit

Background: Pacific Telesis is the Regional Bell Operating Company (RBOC) that controlled Pacific Bell (local telephone company of California) and Nevada Bell, and both companies are regulated by the state Public Utility Commissions.

In 1992, NARUC's Committee on Finance & Technology started a series of audits of Pacific Telesis's regulated and non-regulated business activities. A report of their findings and conclusions was released in August, 1994. The audits were designed to examine: (398)

1) "The potential for cross subsidization between regulated and non-regulated RBOC businesses.
2) "The relative economy and efficiency with which products and service are provided between the operating companies and their parent companies and/or unregulated affiliates.
3) "The effectiveness and adequacy of present non-structural safeguards.
4) "The need for a good understanding of current holding company structures, parent-subsidiary relationships and the affiliated inter-company relationships.
5) "The lengths of time since RBOC business direction and activities have been reviewed."

Six audit areas were selected, but, because of a lack of staff, only three of the six audit areas were executed. Also, "The FCC staff was not able to participate in this region's audit effort. The Nevada PSC staff were not able to join in the audit."

The agency examined three distinct areas:

- Yellow Pages, Including Electronic Publishing
- Research And Development
- Enhanced Services Include PCS And Broadband Services

Areas not examined:

- Billing And Collection
- Service/Central Management Operations
- Costing Methodologies And Practices

According to NARUC, "Each of the six audit areas has had a history of being subject to potential cost shifting, cross subsidizations and anti-competitive behavior". (399)

To insure that repetitive audits were not done, NARUC surveyed the states for audits performed from 1989 to 1991 and the finding was that no state had done all of the 6 audits and that only 9% of the audits had been done. For example, Bell Atlantic had no audits for any of its seven states in any category.

Findings:

The primary finding is that billions of ratepayer dollars have been used to develop almost all enhanced services, from PCS (Personal Communications Services, including wireless) to Electronic Publishing. And once the area became profit making, Pacific Telesis spun off the area into a separate unregulated division.

Also, the trail to examine exactly what happened is "not a bright line between what should be chargeable to shareholders vis-a-vis the ratepayers." In fact, it is totally obscured because, as the report highlights, almost all expenses went to the ratepayer, while all profits went to the shareholder, instead of lowering prices.

Here's' some of the details, quoted directly from the report. (400)

Research and Development

- "The present regulatory scheme provides the utilities with the incentive and the means to charge the ratepayers with the costs of developing information age products and services.
- "Pacific Bell has not developed a clear audit trail for research and development project expenditures.
- "Pacific Bell's subject matter experts working for both competitive and non-competitive projects have not been correctly segregating their time between the two business sectors."

Enhanced Services:

- "Because the enhanced services related expenditures are co-mingled with other operating expenses that are funded from baseline budgets, the pre-captured costs are borne by the ratepayer".
- **"Personal Communication Services (PCS)** was developed using ratepayer funding.... Under Pacific Bell's Plan, the potential profits for PCS would flow to the shareholders even though most if not all expenditures and development costs were borne by the ratepayers."
- **New Infrastructure: "**Pacific Bell made network infrastructure modification, with ratepayers' funding, that were mainly to accommodate the development of its competitive enhanced services".
- **Pay Phones:** "Pacific Bell spent millions of dollars to modify its pay phones to accommodate its Pacific Bell Information Service Group. The benefits to ratepayers from retrofitting pay phones have not been quantified by Pacific Bell."

Yellow Pages

- "The price of Directory advertising has increased 250% since 1984."
- "Pacific Bell Directory's research and development and associated activities in electronic publishing and other emerging technology in the directory field were funded by the general body of ratepayers. As best as can be determined, the ratepayers' funding of these potential new electronic publishing services and products began in the mid-1980s, a period of over 8 years.
- **Electronic Yellow Pages: "**There has been no compensation for the ratepayers' multi-million dollars risk. Pacific Telesis' Electronic Publishing ventures have been removed to a newly formed company that is not part of the Pacific Bell Corporate structure, another step away from the reaches of the regulatory agency. Pacific Telesis' electronic publishing ventures have been cross-subsidized by the ratepayers,. estimated at $1billion dollars." [emphasis added]

The Ameritech Audit

Outcome: Though the audit found that subscribers had been overcharged by an estimated $110,000,000 dollars, the FCC only made Ameritech pay $675,000 dollars. (401)

The Ameritech audit, "Review of Affiliate Transactions at Ameritech Services Inc.", May 95, (402) was only a partial audit of Ameritech Services Inc. (ASI), a fully owned subsidiary with a budget of over $1 billion dollars which acted as the central purchasing agent for the local telephone companies. Only two of the five Ameritech states participated, Ohio and Wisconsin Public Utility Commissions, and only a third of the revenues were examined.

However, the Commissions found serious improprieties, clearly demonstrating that Ameritech was able to charge ratepayers for expenses that the shareholders should be paying for. The list includes: (403)

- "Ameritech charged ratepayers for developing new products, from non regulated data services and personal communications, to video conferencing development".
- "The regulated company leased excess office space, at a cost of $30 million dollars a year, to be used by non-regulated companies".
- "Ameritech charged ratepayers for non-regulated expenses".

Worse, according to an article in Washington Telecom Week, the FCC did not endorsed the audit, while Ameritech stated they did nothing wrong. However, the report states: (404)

> "Ameritech Services established a classification system that is clearly biased against assigning costs to the non-regulated activity."

One example from the study found that because of staff reductions, savings of $236 million should have accrued from 1990 to 1992. However, the expenses grew at a rate much faster than inflation, with no savings, due to questionable staff shifting. The exhibit below highlights the estimates of questionable charges outlined in the report. (405)

EXHIBIT 75

Questionable Expenses Charged to Ratepayers by Ameritech

Rent.	$ 30,000,000.
Directory	$ 142,838.
New products	$ 21,000,000.
Saving from staff* @25%	$ 58,750,000.
Overbill to subscribers	$109,892,838.
Charges for Bellcore	$150,000,000.

The report states that Ameritech "erroneously charged Directory expenses of $142,000 to ratepayers", "charged ratepayers over $30 million for office space for non-regulated businesses", "charged ratepayers for non-regulated new product development" (NNI estimates at $21 million), and "never transferred savings based on staff reductions" (NNI estimates $59 million).(406)

As stated elsewhere, we also question why ratepayers are paying for the running of BellCore, the RBOC research organization. (BellCore has an annual budget of $1 billion dollars and examines regulated and non-regulated services. Ameritech's portion for one year, 1992, came to $150 million.)

The following exhibit highlights quotes from the Ameritech Audit. (407)

(ASI = Ameritech Services Inc., the purchasing company

AOC = Ameritech Operating Cos. (local Bell telcos))

EXHIBIT 76
Quotes Directly from The Ameritech Audit Report

- ASI failed to provide sufficient written documentation to allow the audit team to analyze and substantiate, to the audit team's satisfaction, ASI's rationale for the apportionment of its costs between regulated and non-regulated service.
- ASI allocated all costs of developing new products and services to regulated operations. Examples of activities directly assigned include "New Applications Development", "New Products", "Video", "Speech Technologies", "Video Conferencing Prototype", and "Human Factors Development".
- ASI billed the AOC's for overhead costs that ASI should have allocated between the regulated and non-regulated services. includes Mobile and Corp.
- ASI failed to bill the non-regulated affiliates, Ameritech Advanced Data Services Inc. for development costs.
- The auditors found that ASI incorrectly charged the Personal Communications Services (PCS) trial... The auditors also found that ASI failed to directly assign the PCS to the non-regulated affiliate.
- ASI failed to bill Ameritech Publishing for $142,838 worth of services.
- ASI has leased excess space in its new headquarters in which ASI plans to house nonregulated affiliates.

Comparing Ameritech and Pacific Telesis Audits

If you needed proof that the Bell system policies extend throughout the Bell system, just compare the findings in the Ameritech audit and the almost identical problems found in the Pacific Telesis audit. These included lack of proper recording keeping and charging ratepayers for development of non-regulated new technologies, including everything from Personal Communications (PCS) to Electronic Directory. Compare the following quotes, taken directly from the audits. (408)

EXHIBIT 77
Similarities of Ameritech and Pacific Telesis Audits

Foggy Audit Trail

- **Pacific Telesis:** "Pacific Bell has not developed a clear audit trail for research and development project expenditures."
- **Ameritech:** "ASI failed to provide sufficient written documentation to analyze and substantiate the apportionment of Ameritech's costs between regulated and non-regulate services."

New Product Development

- **Pacific Telesis:** "The present regulatory scheme provides the utilities with the incentive and the means to charge the ratepayers with the costs of developing Information Age products and services."
- **Ameritech:** "Ameritech allocated costs....of developing new products and services to regulated operations."

Personal Communications (PCS)

- **Pacific Telesis:** "Personal Communication Services (PCS) was developed using ratepayer funding."
- **Ameritech:** "Ameritech Services failed to directly assign the PCS trial to non-regulated activity".

Source: NARUC Audits, 1993-1995 New Networks, 1995

With almost identical problems in three separate states, one would think that there would have been an outcry to not only examine all of the other parts of the business, but also conduct these audits in every state.- We are calling for the other 45 states regulators to do their jobs.

However, If the state regulation is sorely in need of fixing, the Federal regulation, specifically the Telecom Act of 1996 only exasperated the problems,

Chapter 24 The Telecommunications Act of 1996 — Two Aspirins Instead of Open Heart Surgery

Starting in the early 1990's, a host of bills were put before Congress that were all supposed to cause sweeping changes to the telecommunications and cable industries. The new law would replace The Communications Act of 1934, which ruled telephone regulation for over 60 years. These new laws were also designed to supersede Judge Greene's decisions.

All of these bills focused on our same basic dance, but each had differing amounts of push and pull. The dance card:

- Encourage Competition
- Bring New Infrastructure
- Public Interest in the Form of Lower Prices and Universal Service

And at the time, the early 1990's, there was a belief that competition was coming "tomorrow". Donaldson, Lufkin & Jenrette's report, "Competition is Reemerging in the US Telephone Market", (6/7/1991), stated that competition was only a few years away. (409)

> "We believe that the monopoly position currently enjoyed by the local exchange telephone companies, will erode over the next few years as new competitors, such as the fiber optic bypass vendors, (known as CAPS, competitive Access Providers), cable TV companies, and long distance companies invade the local telephone monopoly franchise."

Add the massive announced combinations of the cable and phone companies of 1993, as well as the massive I-Way hype and massive lobbying, and what you have is Alternate Regulation on a national basis — Remove regulation so the nation will be a better Information Age place to live.

Some Telecom Act History

The early versions of the Telecom Act, presented by a Democratic Congress, focused on infrastructure and the protection of Universal Service. In 1993 there was H.R 3636 by Ed Markey "National Communications Competition and Information Infrastructure Act of 1993".(410)

> "To promote a national communications infrastructure to encourage the deployment of advanced communication services through competition."

In 1994, Senator Fritz Hollings presented "The Communications Act of 1994": (411)

> "The purpose of this bill is to protect the public interest encourage private investment in the telecommunication infrastructure, encourage competition in all sectors of the communication industry, ensure the preservation and advancement of universal service and grant the FCC more regulatory flexibility."

This bill died in late 1994, blocked from passage by the Regional Bells and the Republicans, specifically Bob Dole.

Starting in 1995, with a Republican packed Senate and House, the next two iterations of the communication bill were suddenly just deregulation bills — Competition, not regulation, will fix everything. In 1995, Senator Pressler introduced the "Telecommunications and Deregulation Act of 1995". (412)

> "This legislation contains pro-competitive, deregulatory national policy framework for telecommunication reform legislation.
>
> "It will spur economic growth, job creation and gains in productivity.

Notice the difference in presentation between the pre and post 1995 bills. The Hollings dill specifically called for "public interest" and universal service in its definition, Pressler's 1995 bill only wanted pro-competitive deregulation. What this meant, big business was more important than customers in this version.

And finally, "The Telecommunication Act of 1996" states that its purpose is to promote competition and reduce regulation, which in turn will bring lower prices and deployment of advanced technologies. (413)

> "An act to promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies."

What America ended up with is a series of band-aid regulations, none of which has worked yet, two years later. In fact, there has only been price increases, and no serious competition to date. And the future for the next few years is far from encouraging.

Let's go through some of the details of The Telecommunications Act of 1996, and what it specifically addresses, followed by our own interpretation.

The bill's market drivers uses our basic dance steps — local competition will fix everything, lowering prices, and creating new infrastructure. In exchange, the Bells are free to enter all other businesses.

Bring Competition to the Local Telephone Company

The bill specifically lays out, in detail, the requirements of the local phone companies to enable competition. Known as the "Competitive Checklist", it is a list of 14 items that the Bells must provide in order to be allowed into any new business. (414)

Just think through what a local phone company must provide to enable a competitor to offer service, and the checklist should make some sense. For example, here's two of the check list items:

- **Portability** is the ability for the customer to keep their telephone number when they go to a competitor. Without this, a customer would have to switch their phone number to use another company's competitive local service.
- **Directory Listing** allows the customer to have their number in the central directory assistance database, even if they are a competitor to the

Bell company. Without this feature, someone trying to find the customer would have to keep calling different local phone companies in the hopes of finding the number.

With all 14 items, the premise is that the competitor should have an equal footing with the incumbent Bell company, and therefore, every item from directory to telephone number portability should look transparent to the user.

Other items include:

- Equal access to the basic network wiring including even the poles and conduits in the street,
- Equal access to the local phone companies switching and information from its network switches,
- Equal use of 911 and E911.

Completing the "Checklist" allows the Bells' Restrictions to be Removed, Letting Them into Long Distance.

In exchange for completing this checklist, the Bells will be allowed into all other businesses they have been restricted from, including long distance.

And the process for these new freedoms? Once the Checklist is completed, the Bells must also have agreements with competitors who have "facilities based" services, meaning an installed network switch, and then go for a review in front of the FCC and the Department of Justice. Almost all of the phone companies have already, or will apply to enter long distance. We believe the Bells should never be allowed into long distance services until there are other, actual residential competitors. We will address this topic later.

The FCC, State Regulators, and the Department of Justice's Role

There are literally thousands of caveats to this simplistic model we are presenting, and it is the role of the FCC, and then to the state regulators and the

Department of Justice, to work out the details. In the Bill, the FCC is supposed to create a series of examinations and eventually orders.

As the FCC states that there is a "trilogy" of rules. (415)

- Interconnection: The price and scope of inter-connection between the local competitors and the Bells. Competitors are supposed to be able to purchase services at reasonable rates.
- Access Fee Reform
- Universal Service fund.

Before we delve into the murky world of Universal Service funding, let's continue to define why the telecom act is seriously flawed.

Telecommunications Act of 1996: Why It's Broken.

After years of Congress attempting to develop a new series of Regulations or lack thereof, the Telecommunication Act of 1996 is more about what happens when special interests, i.e., the telephone companies writes laws.

In fact, Senator John Mc Cain, in a luncheon speech, March 26th, 1997, designed to rally support for finance and campaign reform stated (416)

> "We have a system awash in money dominated by special interests, a system that cries out for repairs."

Common Cause, in a clear, concise analysis of campaign finance payoffs by the Bells and other phone companies, found that millions of dollars reshaped the bill to fit the needs of the Bells. (417)

> "In 1995, the seven local Baby Bell telephone companies gave a total $941,590 in soft money donations, favoring Republican political party committees by more than 2-to-1, according to the study. By early August, the Republican-controlled House and Senate had passed versions of the telecommunications bill which allowed local Bells into the lucrative long

> distance telephone market on favorable terms." (the bill was passed in February 1996)

In fact, Common Cause's President, Ann McBribe, believes that campaign financing, not subscriber needs, determined the outcome of the Telecom Act. (418)

> "The integrity of the legislative process is destroyed by huge telecommunications companies which carefully target millions in campaign dollars to win favorable and lucrative results on Capitol Hill," Common Cause President Ann McBride said. "The voices left out of this process are those of the average citizens. The telecommunications battle of 1995 is an example of why the corrupt campaign finance system must be cleaned up now."

We believe that the final version of the Act was nothing more than fixing a bad, cholesterol filled heart with an external band-aid, instead of a triple by-pass.

The hard questions, those that needed to be answered, were simply washed under the rug, instead of making this law a pro-subscriber investigation into the problems. This bill is business as usual in Washington DC.

The major flaws are straightforward.

1) NO Second Network, Just Bad Assumptions.

As we pointed out earlier, by 1995 there were no other major 'second network' providers, meaning that there was no one planning to re-wire homes, nor were other competitors, such as the cable companies, rushing to offer local service. However, this was one of the primary assumptions by regulators.

This also means that every other competitor must purchase and resell the local company's networks, at almost retail prices, making it impossible to offer heavy customer discounts, or even having enough of a profit margin to make money.

2) The Telecommunications Act Didn't Fix State Regulation

Though there are some specific areas where federal law is supposed to overrule local/state rules, such as requiring that competition is allowed in local jurisdictions, the Act didn't fix any of the previously mentioned problems with state laws. This includes the intrinsic problem of 50 different laws still governing telecom, as well as the fact the many commissions have proven time and again that they are not able to handle or care about telecommunications.

Also, there is no provisions which would allow an examine the entire RBOC business practices vis-a-vis the state's within the RBOC. And this is the very problem that faced NARUC in its previous audits attempts of the Bells.

3) The Telecommunications Act Requires More Work from the States.

The FCC order on interconnection specifically allows the states, and NOT the FCC to continue to govern, 8/1/96 (419):

> "The Commission Order relies heavily on the states to develop the specific rates and procedures, consistent with the Commission's general rules.
>
> "The 1996 Act's pricing standard for wholesale rates requires state commissions to identify marketing, billing and competition, and other costs will be avoided or that are avoidable by incumbent LEC's. To define clearly a wholesale service, the commission identified certain avoided costs. The application of this definition is left to the states."

And the statement by Commission James Quello (420)

> "To our state commission counterparts, I would say: with today's action, we effectively pass you the pen. It is now your responsibility to write the rules and set the prices and terms that will make Congress's vision of competition a reality."

4) No Mention of an Examination of RBOC Profits

As we pointed out numerous times, the Bell's profitability is hidden through a myriad of state and federal regulations or in some cases, no regulation. There has never been an independent assessment of revenues and profits by the FCC or any other government regulatory body. This bill never addresses the issue of current RBOC profits, or fixes the problem of exploring the deregulated revenues and therefore, profits. There is no provision of the bill to ascertain how much profit is derived from a subscriber's bill, nor any revenues derived from any service for that matter.

5) No Mention of Obtaining Accurate Statistics

The Bill never provides for the collection of accurate and independent data, from the revenues and profits of the Bells to even the allocation of charges, such as access fees and universal services.

There are no new analyses to create an accurate assessment of access charges or even universal service fees.

6) Price to Competitors: FCC's Order Overturned by the Courts

Immediately after the FCC's first major order, the Interconnection order, which was supposed to set the price for competitors to enter the market to resell local services, the RBOCs sued in Court and eventually won.

Before we mentioned that US West believed that the FCC's Order was not competition, it was Confiscation of property, and the prices that the FCC recommended were below costs. The exact same sentiment was also echoed in an interview by the Kansas City Business Journal, 2/16/97. with David Cole, president of Southwestern Bell, Texas: (421)

> "Southwestern Bell contends that the deep wholesale discount rates being ordered by the FCC are tantamount to "confiscating our property."
>
> "Southwestern Bell is moving aggressively to meet the federal guidelines for competition in spite of our concern that regulators are asking us to offer new competitors extremely low discounts, which give

> them access to our network at rates below our cost," said David Cole, president of Southwestern Bell in Texas."

According to Interactive Week, August 30, 1996 the FCC's order would have set the price to competitors at 17-25% of retail vs 5%-10% as the Bells have requested. (422)

> "Under rules announced Aug. 8, the FCC ordered incumbent local telephone companies to resell their local services to new competitors at a discount of 17 percent to 25 percent, vs. the 5 percent to 10 percent the seven regional Bell operating companies had requested. The commission, moreover, suggested the Baby Bells charge no more than four-tenths of one cent a call to connect traffic from competitors' networks to their own, a price GTE and SNET claimed is well below their cost."

The numbers being discussed are for resale of the local telephone company's services, and the percentages are the percentage of discounts from the current retail price of the service. Therefore, a company who wishes to compete will pay 10-20% off the current price and this does not take into account the costs of the competitor's marketing and sales efforts. No company can offer services 10-20% below the Bells and also show any profit. In fact, the discounts do not allow for companies to make back their marketing costs.

Also, the total revenues and therefore profits of the Bells from the subscribers are not measured in any of these statistics. These figures only account for specific portions of the connection charges and not the profits from inside wiring, Call Waiting or any other network service. The arguments are all hand-waving, and not geared to either bringing in competition or cheaper prices to customers.

7) The Bill Allows the Bells to Enter into Long distance and Other Services, without Having <u>Actual Competition.</u>

Many of the early congressional drafts required the Bells to not only complete the competitive checklist but also to have "actual and demonstrable competition" before the companies could be allowed into long distance. The reason for this is simple, the Bells

own the local customer, and are paid access fees to handle long distance calls. Without competition for access fees and other services, the Bells are simply subsidizing their long distance business being bundled with other regulated revenues.

According to a press release by Ameritech, released Monday, October 21,1996, declaring the completion of the checklist in Indiana. The company can now just file for offering long distance service and bundling the long distance service with their local service. Also, there is no need of real competitors. (423)

> "This filing will also be part of the implementation of the Telecommunications Act. It will show that Ameritech is in compliance with the act's 14 point checklist which ensures that an environment exists in Indiana which permits local competition. Meeting the checklist is a requirement before Ameritech is allowed to offer long distance service.
>
> "The IURC (Indiana Utility Regulatory Commission) will have 60 days within which to verify that Ameritech is in compliance with the checklist. After that, the company can apply to the Federal Communications Commission (FCC) for authorization to provide long distance, and the FCC has 90 days within which to act. On that schedule, Ameritech could be able to offer customers in Indiana the full package of local and long distance service they say they want by the end of the first quarter of 1997.
>
> "The Telecommunications Act allows Ameritech to apply to provide long distance once it shows it has removed all barriers to competition by meeting the checklist, **even if no other company has yet taken advantage of the opportunity to begin offering local service.** [emphasis added]

Chapter 25 — Universal Service: It Ain't Universal

There are two major issues surrounding Universal Service: No one has a clue how much it cost to run the network, and secondly, it ain't universal today.

The Costs of Universal Service

The costs of Universal Service has been constantly being argued since the 1990s. For example, the positions presented by MFS and MCI in 1994 are still an accurate assessment of today's Universal Service arguments. In a nutshell:

> **Today, no one has the slightest idea what it cost to provide Universal Service and the number presented by the Regional Bells, $20 billion annually, is totally unfounded.**

To quote MCI's position paper, "From a Single Line to the SuperHighway: Rethinking Universal Service Policy for the 21st Century Consumer, 1994": (424)

> "The Local Exchange Companies, (LEC) claim that the Universal Service subsidy now flowing to residential local service is $20 billion and that Universal Service can only be maintained if that revenue stream remains intact. In reality, even a cursory examination of LEC profit levels in recent years—and their ability to generate enormous amounts of cash to invest in ventures domestically and abroad that have nothing to do with their local service responsibilities—would be enough to create strong suspicion that this subsidy requirement is vastly overstated. The above-cost pricing of certain local telephone services, among them the access charges paid by the current long-distance providers, would appear to far exceed what's truly needed to subsidize Universal Service.
>
> "This overinflated number—a by-product of the LEC shell game of internal revenue shifting—really reflects the cost of their inefficient monopoly operations. By delinking the notion of LEC revenue requirements from the funding of the Universal Service subsidy, public

policy makers will ensure equal access to and fair distribution of the Universal subsidy."

MCI further goes on to state that the LEC's costs as a company, which include inefficient operations, over-valued plant, and excessive profits, are also included in the Universal Service subsidy requirement.

Components of Universal Service

The following exhibit highlights MCI's "Components of Universal Service". We believe that the list is the minimum series of services, and as defined in other sections of the report, some proponents of Universal Service believe that it should be full service, fully digital, broadband. (425)

EXHIBIT 78
MCI's Components of Universal Services, 1994

- dial one access to the first point of switching
- local usage
- touchtone service
- 911 service
- White Pages listing
- access to directory and operator assistance
- single-party service

MCI believes that Basic Universal Service should be provided "at a rate no higher than the existing nationwide average of approximately $18 a month."

MFS takes a different approach to Universal Service. In fact, the company, now owned by Worldcom, filed a Notice of Inquiry into the policies and programs to assure universal telephone service in a competitive market place.

The company states "the big myth" propagated by some local exchange carriers is that Universal Service inherently requires local service be provided by subsidized and protected monopolies. They ask:

Which services or users require subsidization?
How much subsidy is actually required?
Who should administer subsidy programs?
How should the subsidy funds be raised?

MFS, in its document, also questioned the $20 billion subsidies, and suggests the use of the "Net Trans Account System" proposed by Eli Noam, Professor of Finance and Economics and Director of Columbia Institute of Tele-information: (426)

> "At their most basic, Net-Trans Accounts are not primarily a new form of transferring money. They are rather a way of keeping score that all carriers pay a proportionally similar share to the maintenance of that type of Universal Service. It would be an independently administered Universal Service account, carriers would be debited a flat percentage of their transmission path revenues, net of transmission charges paid to other carriers, and given credit for Universal Service contributions made and for subsidized users."

Professor Noam does point out that the system is politically driven, besides the economics, with some companies paying more based on competitive models. For example, if it was deemed necessary, the monopoly provider today may pay more or less depending on the number of competitors, etc.

In 1995, the interstate carriers were charged fees for the Universal Service Fund, which total approximately $700 million, in addition to the $20 billion collected as access fees and is administered by the National Exchange Carriers Association (NECA). This $700 million annually "provides explicit assistance to LECs with high cost loops." All LEC costs that are 15% above the national average are subsidized by the Universal Service Fund. (427)

There are limits, however, on larger companies (above 200,000 lines receiving such revenues). Also, the IXCs have to pay in proportion to the presubscriber line share in payments. In consequence, AT&T's share in the fund is larger than its market share measured by revenues.

How Much Do Things Really Cost?

If you want to get even more confused about this fund, the next series of quotes gives the Regional Bell side. In a rebuttal to an article by the author that appeared in Telecommunications Magazine, NYNEX Vice President Robert Anderson's response was "LEC Pricing for Basic Telephone Service: Why Rates are so Low." It states: (428)

> There's a one-word answer for why basic telephone service rates are so low—subsidies. . . . For New York Telephone, for example, the cost of providing basic residence access is $23.25 for message-rate service and $39.50 for flat-rate service, which includes local usage. The monthly price for message-rate service is $10.10 and for flat-rate service $20.60. [These prices include the FCC line charge of $3.50.] The gap between cost and price totals $1.3 billion a year and is closed with subsidies from other services. Local, toll, and regional calls provide about 45% of the total subsidies necessary to maintain residence access rates below cost.

Is There Really Universal Service Today?

Regardless of how much it currently costs, findings by the Commerce Department in 1995, and the FCC bring up a more serious side, which questions whether Universal Service even exists today across America. Larry Irving, of the National Telecommunications and Information Agency, stated at a Senate Judiciary Committee hearing about the proposed bills: (429)

> "The Commerce Committee along with Commissioner Andrew Barrett of the FCC have done five hearings around the country. We've gone to South Central LA, Indianapolis, North Carolina, New Mexico, and we've looked at the issue of Universal Service and who's being left out.
>
> Mr. Chairman, there are some really troubling problems out there. We found that 20% of some communities don't have telephone service. I grew up in Brooklyn. In Bushwick Brooklyn, 28% don't have telephone service. Ten communities in New York City alone... one-fifth don't have

telephone service. Even worse, 65% of some Navajo reservations don't have telephone service.

We have a very, very, serious problem. If you are poor in this country you are less likely to have telephone service...If you are poor and a minority, you are even less likely to have telephone service....If you are poor, a minority, and a single woman you have a 43% chance of having telephone service in this nation.

"You talk about the SuperHighway, we have people without a foot path and we have to do something about that."

Our belief about Universal Service is straight forward.

Universal Services expenses should be audited using the telephone companies' total revenues, expenses and profits from subscribers.

Chapter 26 Competition in Residential Local Telecommunications — NOT

Regardless of the hype, it is save to say that in 1998 "local residential telephone competition" is still an oxymoron. There is virtually no competition for local residential telephone services today and there are few prospects for robust competition in the next few years.

According to numerous sources, before 1996, the total amount of local competition, almost all business customers, hovered around 2% of business lines. And before the Communications Act of 96, many states outlawed direct local residential competition.

Where competition has occurred in some states to portions of the telephone bill's charges, such as Toll Call competition, the usual result has been that only 5% of customers switched to competitors. However, California Toll call competition allowed the local companies to plead poverty, and massive price increases of 30%-60% were granted for local telephone subscribers. (430) :

In fact, the RBOCs have applied for and received various increases to local phone service based solely on the threat of competition, not the reality.

In the case of Rochester New York, one of the first cities to allow competition, only a few customers had switched carriers, and according to AT&T, who pulled out of the market, the price to resell service did not allow for profits. And this has not changed.

In many cases, the early attempts at competition have ended in lawsuits against the Bells for obstructionist actions towards new competitors entering the markets, further slowing competitive changes.

In some areas of competitive offerings, such as offering voicemail services, the RBOCs have even been accused of stealing customers, using regulated services to sell non-regulated products and even supplying the deregulated services with telephone features that were not offered to competitors. Over the last few years hundreds of complaints were lodged against US West, BellSouth, Pac Bell and the other RBOCs for their anticompetitive behavior, according to ATSI, Association of TeleMessaging Services International. (432)

Though there is so much talk about the Communication's Act ability to fix these past problems, to offer competitive local service, the scorecard for the current wave of

local competition does not seem to be much more than a continuation of the previous problems.

Besides the FCC's Interconnection actions being stalled, according to numerous sources, the Bells are still making it extremely difficult for competition to occur in any specific state. Many state agreements are on hold, while the Bells have been accused of numerous wrongdoings, including inaccurate filed statistics and 'feet dragging".

But there is also another side of the competition issue that puts into question any competitive offerings, regardless of the supplier — Lack of Consumer interest. Based on NNI's proprietary study, cross-referenced with other research firms" findings, there seems to be little interest in having a competitor offer service. Most customers just want cheaper prices today. And almost no customer is interested in having to change telephone numbers to use a competitor's service.

So, let's first walk through a brief history of competition over the last few years, demonstrate how the RBOCs have been able to get price increase just over the threat of losing marketshare, examine the current status of competition in 1997, examining the RBOC threat to other competitive businesses including Voice mail and Internet access, and ponder the findings from the consumer research about customer interest in competitive offerings.

- a brief history of competition over the last few years,
- demonstrate how the RBOCs have been able to get price increase just over the threat of losing marketshare,
- examine the current status of competition in 1997,
- examining the RBOC threat to other competitive businesses including Voice mail and Internet access
- ponder the findings from the consumer research about customer interest in competitive offerings.

The Last Five Years of Competition — Regional Bell Impairment to Local Competition

The history of competition can be summed up as one hand clapping — The Bells. The primary impediments to competition has been and will continue to be the local telephone companies themselves. NNI's position is straight forward.

> "The competitors entering the local service market believe that they have a right to use and interface with the network. The Bells feel that someone is taking over their jobs and businesses, while they sit there watching...
>
> "Since the Bells are in control, basic human behavior is going to take over. The Bells will protect their turf, believing it is theirs, and this will cause all actions by the competitors to take years, not months, to complete. And even small areas of competitor needs, like the use of bathrooms, will be the new battle-grounds.

In fact, articles over the last five years shows that before the communications Act, the Bells obstructionist behavior. The Wall Street Journal (October 24, 1995) highlighted a litany of problems for competitors throughout the Bell System. (435)

> "NYNEX last year touted itself as the first bell to sign a contract letting its competitor hook up directly to its network. Last week the rival, Teleport Communications Group asked the New York regulators to "Investigate NYNEX's attempt to stifle local telephone competition"
>
> "US WEST: LCI International filed a suit with the justice department stating that US West shut off service to 4,000 LCI customers in the Denver area, prompting 24% of them to cancel. It states that US West failed to provide services as promised. When customers called US West to complain, they were told that LCI had gone belly up, the complaint says.
>
> "SBS Communications charges huge markups when selling network equipment to rivals, contends MFS communications... It charges $137,000 for a pair of multiplexors, that usually cost $67,000 and $21,000 for running a cable that costs $900, MFS claims.
>
> "AT&T states that Ameritech won't disclose where "conduit space" is available for AT&T to install new lines, thereby hindering AT&T in designing its network. The long distance company has resorted to having its engineers walk the streets peeking under manhole covers to find the space. "

The article also points to a great deal of smaller problems, from Ameritech wanting to charge over $20 a month if the customer wants the same telephone number moved to a competitor, or worse, Bell Atlantic workers in Philadelphia wouldn't let MFS workers into the bathrooms, because "It wasn't required by the FCC".

The Battle for Rochester: A Sign of Things Not to Come.

In the beginning of 1995 all eyes were on Rochester New York, a bustling up-state town, to watch one of the first areas in America to have residential competition for local telephone service.

However, according to Mark Landler's New York Times Article October 23rd, 1995 "The Big Boys Come Calling ---Rochester is Courted by AT&T and Time Warner", progress after 10 months has been slow at best. (433)

The new hopeful local carriers, AT&T and Time Warner are "hearing a lot of busy signals". The incumbent is the well liked Frontier Telephone (formerly Rochester Telephone).

The article states that AT&T only garnered 2% of the market share while Time Warner had only 50 customers. In fact, Time Warner had been giving new customers three months of free service, a "sporty telephone with their logo on it" and then a 10% discount, but customers are still switching back.

In "Washington Telecom Week", AT&T was quoted as saying that they could not make profits reselling local telephone service from Frontier because AT&T's price was 95% of retail. (434)

Landler's findings, highlighted below, show that Competition is not going to come soon or easy. (435)

> "For now, though, the Rochester laboratory seems to have yielded a few early conclusions and casts doubt on the future of competition here and elsewhere.
>
> • The long distance carriers like AT&T that plan to offer local service by leasing capacity on the local telephone network may find it difficult to offer competitive service and still make money

- The cable operators, like Time Warner that plan to woo consumers by packaging phone services with cable channels must face the reality that most people will only switch to a new service if it is cheaper
- Though the existing monopoly many not win raves from customers, many fear that a new provider will not be able to match the incumbent in quality, reliability or customer service

A Model of Competition: California Toll Call Wars and Raising Prices.

FINDING: NNI believes that the changes that have occurred in California's telecommunications in 1995, is the model for future competition...massive price increases for local service, combined with total consumer confusion. (437)

- Only 5% accepted competitive offerings.
- "Competition" for Toll calls in California only caused massive local telephone price increases, averaging 60% for GTE, 30% for Pac Bell. The average telephone GTE subscriber in California will pay approximately $100 more per telephone line.
- The four primary reasons for competitive failure has been:
  - Bad decisions by the local Public Utilities Commission
  - Unfair roll-out for competitors
  - Total subscriber confusion about all telephone services
  - Little subscriber interest in competition

Background of California Toll Call Price Changes

In January, 1995, the California Public Utilities Commission allowed competition to be implemented for toll calls throughout the state, stating that this would be a boon for California telephone subscribers by lowering prices and giving customers a choice. In exchange, the local telephone company was allowed to raise local rates to balance the projected losses to competition. (438)

Just to show that GTE and the other local phone companies also benefit from changes to the Bell's services, we're going to highlight GTE's massive local service increases, which were done on a statewide basis to all local companies.

According to GTE telephone bill, January 1995. (439)

> "A California Public Utilities Commission decision rebalanced local telephone company rates and introduced competition in the regional long distance market effective January 1995. The decision moves GTE California's local service prices closer to cost but provides customer with an approximate 42% reduction in Regional long distance rates. The dramatic decrease in regional long distance rates will be reflected on calls made since January 1, 1995."

In fact, Toll calls have always been overpriced. In the next chapters we will show that local telephone companies were charging $6 billion dollars more than long distance companies would charge for the same service.

In California, after the first two years, one thing was clear — the balancing act hadn't worked. The only thing that happened was that local telephone bills went up. Customers didn't flock to competitive services. There are four primary reasons were:

1) Total Consumer confusion about price and services: While some consumers are outraged at the telephone prices, the overwhelming majority have no idea about Local, toll, and long distance distinctions, don't care who offers them telephone services and they have no idea about the prices of services.

2) Unfair rules for competition. The California rules are strongly in favor of the local telephone company. First, anyone using a competitive service for Toll calls in California had to dial a string of 5 extra digits before the telephone number.

For the monopoly service, there are no extra digits... service is identical to the way it has been for decades. Numerous studies in consumer behavior have shown that when there is any change from a routine, such as adding digits, the consumer will simply forget or not want to be bothered.

3) Subscribers don't care about competition. In our 1995 consumer survey we found that only 11% of consumers really cared about competitive offerings from their

telephone or cable company. With a high confusion level, consumers just want to be left alone and not have to worry about their telephone service.

4) The fundamental flaw in the new California law's application is that Toll calls only accounted for 9% of total bill charges, while local increases effected 85% of the bill.

California Telephone Price Increases and Problems

In order to appreciate the changes that happened to California, NNI sampled a series of actual telephone subscriber's bills. (NNI has been tracking charges for 12 separate GTE subscriber lines in Los Angeles, some dating back to 1982.)

NNI found that the overall savings averaged only $2.25 on Toll Calls, while the additional cost averaged $108 a line, $9 dollars a month more. (includes surcharges and taxes)

EXHIBIT 79
GTE Subscribers--Telephone Bill Increases, 1994-1995
(36 lines averaged)

	Monthly	Total
Toll Call savings over 12 months	$ 2.25	$ 27.00
Additional Charges	$11.25	$135.00
Difference	$ 9.00	$108.00

Source: GTE Telephone bills, NNI, 1994-1995

Clearly, customers are now paying substantial increases with little, if any, savings...

Toll Call Price Decreases vs Total Bill

The fundamental flaw in the new law's application is that Toll calls only accounted for 9% of total bill charges, while local increases effected 85% of the bill. The exhibit below gives a break-out. (Based on an average for 12 lines, using three different months per line.)

EXHIBIT 80
Breakout of Local Telephone Bill Charges, 1995-1996

Access	66%
Fees and Taxes	16%
Toll Calls	9%
local calls	6%
Late Fees	2%
Directory Calls	1%

Toll charges on telephone bills vary based on different calling patterns, and even different times of the year. However, when averaged, the overall toll call prices savings was nominal.

The Status of Competition Today

According to MCI's President and Chief Operating Officer Timothy F. Price, February 6, 1997, the Bells have been making it extremely hard for competitors to enter the marketplace. (440)

> "Today the promise of the Act remains largely unfulfilled, primarily because of resistance by the local telephone monopolies. At every turn, the regional Bell companies, GTE and the other local monopolies are opposing FCC rules intended to open local markets. They're dragging out negotiations on interconnection agreements at the state level and resisting the steps needed to resell local service."
>
> "We didn't expect the local monopolies to be cooperative. On the other hand, we didn't expect that, after four months, they'd have fulfilled only seven out of our 72 requests for co-location.
>
> "Having a local telephone monopoly is like having a license to print money. And asking a monopoly to open up its market is like trying to take away that printing press. It's a very tough proposition.

In Michigan (Source: MCI, 2/6/97) (441)

> * Only four companies offer local exchange service in Michigan -- Brooks Fiber, MCI, MFS and TCG. Together, they operate four switches and serve principally business customers. Ameritech Michigan has 442 switches.
> * In its Michigan territory, Ameritech controls 99.6% of local telephone customers. Under federal antitrust law, this level of market share constitutes a monopoly. There are approximately 4.9 million access lines in Ameritech's territory in Michigan. Only 15,000 to 20,000 access lines are served by a local exchange provider other than Ameritech.

This situation seems to be playing around the country. According to the Kansas City Business Journal, February 10, 1997, there has been little progress in the Southwestern States of Kansas and Missouri. (442)

> "Some competitors waiting in the wings are becoming increasingly frustrated with what they say is slow implementation of the law and a move by the Baby Bells to make it harder for challengers to storm their markets.

According to the article, AT&T states that Southwestern Bell and the other local companies in the state of Missouri still have a 99.9% monopoly hold on the marketplace and that's not going to change soon. (443)

> "While AT&T welcomes the opening of a monopoly market in Springfield, 99.9 percent of Missouri consumers still do not have a choice," said Steve Weber, director of government affairs for AT&T in Missouri. "Except for a handful of customers in Missouri, it is impossible to switch local telephone companies, and only a few customers have done so."

In fact, Missouri has 25 companies that have applied for service, but even the rates haven't been set yet for competitive offerings.

Sprint is already in the local service business with its United companies throughout America. However, it has yet to go into other markets, even those in Kansas and Missouri, where Sprint is headquartered. According to the Kansas City Business Journal, (2/17/97) (444)

> "For long-distance companies like Sprint, questions about rate structure have made the prospect of tapping local markets largely unsuccessful. Sprint officials have 29 agreements to provide local phone service in 29 states, but not one market has been served, said Leon Kestenbaum, vice president of federal regulatory affairs for Sprint in Washington. "

Tally of Competitive Residential Offerings:

RBOC Tally: According to the USTA there are over 680 interconnection agreements or in arbitration. (445)

> **"Over 680 agreements to open local service to competitors as of February 1997"**

Long Distance Company Tally

The exhibit below gives a summary of the local interconnections agreements by the Big Three long distance companies. As is clearly shown, while there are 112 agreements among AT&T, MCI and Sprint across America, there were less than 30,000 actual customers, with MCI have 25,000 in California, and Sprint having 0, as of April 1997.(446) However, there has been little changes to these statistics in 1998.

EXHIBIT 81

Status Of Residential Local Service Competition, April 1997

	Agreements	Number of Customers
MCI	31 pacts , 26 states	25,000 in California
Sprint	29 pacts, 29 states	None
AT&T	52 pacts, 38 states,	few thousand in Sacramento, CA
Total	112 Agreements	

Sources: Kansas City Business Journal, the New York Times.

AT&T's rollout has been mostly in the business community. According to the New York Times (2/28/97): (447)

> "Starting February 3rd, 1997, AT&T said it would offer local phone service to small and medium-size business customers in California. The long distance company will not build its own local operations but will lease lines on the existing local network of Pacific Telesis Group.
>
> "AT&T said it would also offer local service to large business customers that have dedicated lines connecting their offices to AT&T's long distance network. This service, called Digital Link is available in 35 states. But for now, it will only handle outgoing local calls.

The scorecard as of April 1997, with approximately 80 million RBOC lines and only 30,000 competitive users, the total residential lines using competitive services from the big three is .00036

EXHIBIT 82

Total Residential Lines In America Using Competitive Local Service, April 97

.00036%

The Tempo of Competition ---Slightly Faster than a Standstill in 1998. (added during the edit of this book)

Other, recent 1998 statistics also show that competition is still a mirage. In 1998, some new entrants, including RCN, have started to market services, but as of 1998, the two major hopefuls, AT&T and MCI, have all but pulled out of residential local service offerings. AT&T stated "they were losing $3 per customer", and have "stopped marketing local service" (448a) while MCI's President, Timothy F. Price stated that they "would not offer resale service to any new residential customers because... the Bells have managed to ensure that the business is not a profitable one for new entrants, who don't have government protected territories". (448b)

More recent information from the summer of 1998 clearly shows that competition is not prevalent, nor is continuing at great speed. In a Enbanc Hearing on Competition at the FCC, (448c) numerous companies and business groups testified about competition in local services. According to ALTS, the Association of Local Telecommunications Services, the association of the competitive local companies, today, only 1% of the lines are held by competitors, and the Bell's second line growth is causing the overall Bell companies to grow faster than competitors. Heather Gold, president of ALTS put it this way in her testimony before the FCC. (448d)

> "Compared to our $2.7 billion in 1997, the incumbents (the monopoly local phone company) last year had revenues of $101 billion. The C-LECS (competitive local phone companies) clawed their way to an enterprise value of 26 billion while the I-LECS (the incumbent phone companies, including the Bells and GTE) posted to a nice 400 billion enterprise value and our 1 million -- 1.4 million access lines are dwarfed compared to the incumbents 161 million access lines. And though our lines will double in 1998 or should, the incumbents are forecast to gain 7 million lines, twice -- three times as much."

Roy Neel, President of the USTA, a lobbying association for the local phone companies, including the Bells, stated that competition in "the local market is highly competitive", but, still almost 100% (448e)

> "I want to spend a few minutes talking about the diversification at the local industry because there are some stereo types that come into play, particularly when we hear terms like monopolies or incumbents or controlling a hundred percent of the market. The fact is, we don't control 100 percent of the local telephone market. We don't. We'll talk a few minutes about the business market and it's truly local and it has eroded dramatically for the incumbents. So, 100 percent of residential customers -- it's not even 100 percent anymore and that number is dropping quickly.
>
> "So, it's not 100 percent. It may be 100 percent of residential consumers that perhaps some entrants have low down on their priority list. But, the fact is, the local market is highly competitive, especially in the business market place.

And state and federal regulators haven't fixed the major problems. New Jersey's Consumer Advocate stated that there were major blocks to actual competition in that state. Not surprisingly, the testimony on why competition in the local exchange marketplace has failed to materialize in New Jersey focused on one issue — pricing. The Advocate points out that testimony by Bell Atlantic own witness that anyone reselling local service would lose money. (448 f)

> "Entry through resale has been deemed an unviable option by most major CLECs and will not be the path to gain market entry to any significant extent. Witnesses from AT&T, MCI, and Sprint testified that competitive entry through resale would not provide CLECs with a reasonable return on their investment, and that these carriers would not offer service via resale in New Jersey. BA-NJ's own witness, Mr. Deatherage, from the securities firm Bear Sterns testified that CLECs would lose some $3 per customer per month, should they choose to compete under the pricing structure as it presently stands."

And the charges to the phone companies effects every aspect of bringing in new local residential competition. All of this material from 1998 points to only one thing — Competition is not here and is not coming anytime soon.

Competition Brings Price Increases

Like Toll Call Competition, or rather the threat of competition, over the last three years has only raised prices. Since no regulator is examining the entire profitability of the company, basic local service keeps being accused of "losing money". Therefore, any change in the fabric, such as the threat of competition, (not actual competition, just the threat) has allowed the Bells to apply for and receive increases.

Sick as it may sound, the idea was for competition to lower prices, but instead, the RBOCs are claiming they should be reimbursed for any losses they incur, just the opposite of what competition was supposed to accomplish.

Here's two different examples from US West, pitched over the last two years. But this is happening across America . In the first example, US West applied for a $2.85 a month increase and extra $34.20 a year to align the prices closer to costs. (448)

> **U S WEST Communications Asks For Changes to Encourage Competition, Align Prices With Costs**
>
> U S WEST Communications will ask the Iowa Utilities Board to change its prices to align them more closely with costs and encourage more competition for local and long-distance telephone service in Iowa. — The company will ask to: Raise the price of local residential phone service by $2.85 per month, more accurately reflecting the cost of providing local residential service. By reducing the traditional subsidies for local service, the change will help encourage competition in the local-phone-service business." [Emphasis added]

Once again, there is this concept of rebalancing, this time not in the toll call arena but to the price of local service. The rational escapes the author. As we have seen, rebalancing is just another word for price increases. Here's more from US West on how rebalancing brings competition. (449)

> "The company is recommending some rate adjustments as part of the revenue increase request. It also wants to bring prices for particular services more in line with costs. This "rebalancing" of rates is needed to

> reduce a general subsidy of residential service by other customers. The traditional pricing system which subsidizes basic residential service by setting other rates well above cost has worked well in a purely monopolistic environment. But given the rapid changes and growing competition in the telecommunications industry, the current pricing structure cannot be sustained in a competitive environment and must be changed. The long-term potential benefit of competition will be an increase in options available to customers."

In the second example, US West , filed a complaint that they shouldn't have to pay for the costs associated with portability. According to Interactive Week, November 22, 1996: (450)

U S West Seeks Relief From Portability Costs

> "U S West Inc. last week filed a complaint with the U.S. Court of Federal Claims that said the Federal Communications Commission's requirement that the company offer interim number portability without providing for recovery of those costs violated the Fifth Amendment.
>
> "Number portability lets customers change local telephone companies without having to change their telephone numbers.
>
> "The carrier, which operates local networks in the Great Plains region, noted the Fifth Amendment prohibits private property from being taken "without just compensation." It claimed the temporary changes to its network to support number portability until a final solution is set up will cost the company $20 million.
>
> "In a statement, U S West Communications President Sol Trujillo said, "We can't ask U S West Communications customers and stockholders to pay our competitors' business expenses."

And there are many other new charges and surcharges being proposed. Here are just a few.

Ameritech, Common Carrier Charge According to :Washington Telecom Week, 09/13/96 (451)

> "The FCC agreed to allow Ameritech to raise its Common Carrier Line Charge, (CCL) which is a charge the long distance companies pay for part of access. These additional fees are of course passed on to the subscriber. Ameritech is planning " to increase the CCL charge by almost 30 percent, while Wisconsin is proposing to increase the CCL charge by 21%. "

Pacific Telesis, Pay For Universal Service (452)

> "In order to ensure revenue neutrality, Pacific Bell must offset its rates dollar for dollar for any funds it receives from the newly created universal service fund. This offset will initially be accomplished by means of an across-the-board surcredit on all of Pacific Bell's products and services except for residential basic exchange services." [Emphasis added] (Pacific Telesis, 1996 3rd Q report.)

Pacific Telesis, Pay For Schools, etc

> "The final decision also establishes a discount program for schools, libraries, certain community-based organizations and municipal- and county-owned hospitals and clinics. Carriers providing services at a discounted price will be reimbursed from a newly created California Teleconnect Fund. This discount program will be funded by a separate surcharge of 0.41 percent on the bills of customers of all telecommunications carriers in California. [Emphasis added] (Pacific Telesis, 1996 3rd quarter report.)

And this is just a start. According to US West, the company will continue to file until "prices more closely reflect the cost of providing the service". (454)

> "The change in prices that U S WEST Communications is currently seeking is a first step. Changes in the way U S WEST Communications

> prices services will ultimately enhance the quality of life for Iowans by bringing more choices and services to all sectors of the marketplace. Until prices more closely reflect the cost of providing the service, U S WEST Communications will continue to pursue changes."

What's going on? How can these companies apply for and receive massive increases, a great deal of them, when they are so profitable?

Remember The Primary Bell Tactic — Plead Poverty, and call for a "rebalance" or claim the "confiscation of property".

Telecom Turf Wars? Little Consumer Interest in Competition

The phone companies can beat their chests all they want about competition, but the truth of the matter is that consumer research indicates that most people couldn't care less about a competitive offering — they just want cheaper prices. Also, they have little interest which company is their local phone provider, and little interest in new services. (455)

> **NNI has found that only 3% of the population wants unbridled competition, and only 11% wants the local telephone company to offer long distance and cable services.**
>
> **The only thing consumers care about is cheaper prices now.**

In the 1993 and 1995 consumer interviews, we asked specific questions pertaining to consumer attitudes toward telephone and cable companies. In the 1995 study specific questions were asked pertaining to having the local, long distance or cable companies offered competitive services. The next exhibit clearly shows that the overwhelming majority of subscribers don't really want to migrate to another service.

These findings mimic the general patterning of ranking of telephone and cable companies, with the long distance companies getting the highest rating and therefore

more interest, while cable gets a cool response, with only 7% choosing the company to offer long distance. The next exhibit highlights the answer to the question: (456)

> *"There is a lot of competition to provide long-distance telephone services, and there are bills in congress to open up competition for local telephone service. As I read the following possible telephone-service options, please tell me how your household would react.*
>
> *If your Local telephone company also offered long distance service would you switch?*
>
> *If your long distance company offer local service would your switch.?*
>
> *would you switch if..."*

EXHIBIT 83
Consumer Interest in Switching Local Providers, 1995

21%	the local phone company offered long distance
32%	the long distance company offered local.
7%	the cable company offered long distance
9%	the cable company offered local
28%	if the local phone company offered cable.

Source: New Networks, 1995

These numbers mimic the 1993 study, which found that only 17% of the population "really wants competition".

While these responses might seem somewhat encouraging, the numbers must be put into context. The exhibit below highlights a cross-referencing of the responses. Only 3% wanted everyone to compete with everyone else, while only 11% wanted the local telephone companies to offer both long distance and cable. (457)

The reason for this is simple: certain customers may like the long distance companies, but not like the local telephone company, and visa versa.

EXHIBIT 84
Overall Consumer Interest in Competitive Local Provider, 1995

3% want total competition between parties.
11% want local companies into both cable and long distance.
5% want cable to offer local and long distance services
Source: New Networks, 1995

Also, at first we thought that those interested in interactive services would be the largest potential group for wanting competition. Unfortunately, when cross-referenced with preferences, it turns out that those most interested in competition are those who had complaints against the carrier... so a person who dislikes the cable companies would want other companies to compete, and at the same time not be interested in the company offering them new services.

Also, there were two other trends to the data that were important, which include the fact that the older the customer is, the less they want competition, and secondly, there are virtually no differences in consumer responses based on geography. We will come back to these issues in Chapter 48, highlighting Consumers and their telephone services.

The Yankee Group's Competition Findings

The Yankee Group, a Boston based research firm also found almost identical findings in 1996. The exhibit below answers two basic questions. The number of households that: (458) (FOOT:SOURCE: the Wall Street Journal, January 27, 1997)

- Households who call service from their providers, cable, local phone, long distance and power utility "excellent".
- Households that are very or somewhat like to switch local service if a cable, power utility, or long distance company offered local service.

The research firm found that while 38.3% of long distance company customers give the company an excellent grade, only 9.3% of local phone subscribers were "very or somewhat likely" to switch if the long distance company offered them local service.

Conversely, only 17.7% give their cable company a grade of excellent, while a dismal 1.7% are likely to give their cable company the local phone company's business. (459)

EXHIBIT 85
Yankee Group's Interest in Competition for Local Service, 1996

	Excellent Grade	Likely to switch
Long Distance Company	38.3%	9.3%
Local Service	36.7%	7.5%
Power Company	27.3%	2.8%
Cable TV	17.7%	3.1%
Cellular Phone	16.3%	1.7%

These findings are even more pessimistic than our findings from 1995. The bottom line seems to be that consumers couldn't care less about competition.

Consumer Attitudes Toward Telephone Number "Portability"

FINDING: The overwhelming majority of consumers and businesses will not switch carriers if they can't keep their telephone number.

The consumer research to date, from numerous sources, shows that if a consumer can't take their telephone number when they change carriers, the overwhelming majority will do nothing.

While the Act in Congress specifically calls for portability, the Bells, such as US West, have actually applied for surcharges to cover these costs, as if the need for portability should be put on the backs of subscribers.

And portability isn't a mute point. For example, if a customer won't use a competitor because they have to change their telephone number, then, ergo, there won't be robust competition, no matter how hard companies try.

To explore just how important portability is, the FCC asked for comments about portability. (460) The findings were very straight forward. The first study, from MFS Communications, found that 92% of consumers would not consider the company for local telephone service if they couldn't take their telephone number. Only 2% didn't care.

EXHIBIT 86
MFS Study of Importance to Customers of Number Portability, 1995

92% wouldn't consider MFS without portability
98% stated that their telephone number was important
2% didn't care.
Source: MFS Communications

In another study, this time by Gallup for MCI, the findings show that 80% of business customers were very unlikely or somewhat unlikely to switch to MCI if they had to change numbers. (461)

EXHIBIT 87
MCI Study of Importance of Portability to Business Customers, 1995

83% of biz customers-- retaining phone number was important
5% was not important
80% very or somewhat unlikely to switch
Source: MCI

Another Version of Portability: Extra Digits

In the example of Toll Call Competition in California, the Law passed requiring anyone using a competitive service to dial five extra digits. While specific consumer studies, about adding additional digits are scarce, for almost all telephone services, anything that requires a change in consumer behavior spells death to competitors. In this case, the consumer has to remember to use these extra numbers — and predictably, data, such as the toll call data, indicates that competitors lose.

According to MCI, toll call portability, which one would have expected would have already been available in the states, is still being fought over in numerous states. For example, Jay Young, regional director of public policy for MCI, stated on February 24th, 1997, that they had filed a suit against Bell Atlantic to open up New Jersey's Toll

Call market, which has some of the highest prices in the US. And the battle has been going on for over three years. (462)

> "Bell Atlantic's federal lawsuit attempting to delay competition in New Jersey's local toll call market is a serious blow to New Jersey's residential and business telephone customers.
>
> "MCI and other carriers are eager to bring competition to the local toll market by ending the need for customers to dial a burdensome five digit access code when choosing an alternative to Bell Atlantic.
>
> "Unfortunately, with Bell Atlantic once again trying to use the courts to delay competition, that day may be pushed back. And, the local phone monopoly will continue its chokehold on the local toll call market -- denying the benefits of choice and savings to New Jersey phone users.
>
> "Attempting to delay the benefit of choice and savings is nothing new for Bell Atlantic in New Jersey. Friday's lawsuit marks nearly the third year that the local monopoly has stalled full and fair competition in New Jersey's local toll market.

RBOC Abuses of Competition in The Voicemail Industry — The Internet Next?

A report titled "Incidents of Telco Abuse", (463) published by the ATSI, Association of TeleMessaging Services International, in June of 1992 painted a very grim picture of the future of voicemail companies, (companies that independently supply voicemail to residential and business customers) and their ability to stop the Bells from taking over their industry The organization found that the rules for competition, known as "FCC Computer III and ONA Requirements", were inadequate.

> "The FCC's safeguards Have not prevented the RBOCs from abusing their monopoly power to impede competition in the Voice messaging marketplace. "

In fact, by 1997, many of these companies no longer exist.

Unfortunately, these are the same rules that govern the Internet Industry, and our finding is that the RBOCs are currently engaged in a de facto, grab for the entire Internet industry's business. Because of cross-subsidization, which was highlighted earlier, the ease in which the Bells can inter-mingle and co-mingle activities that are supposed to be strictly separated, give them an unfair advantage over the small ISP (Internet Service Provider) and other Internet concerns. Also, their market power can keep out competitors who offer Internet and services to schools, libraries, etc.

The Voicemail Industry: A Clear Model of a Murky Future.

The ATSI quotes a finding by the Georgia PSC which had hundreds of complaints by Voice Messaging companies. (464)

> The Georgia Public Service commission concluded that Southern Bell (BellSouth) has actually used its monopoly position to deter competition in the Voice messaging industry, causing inevitable and likely irreparable harm... It found abuse in three areas.
>
> 1) **Cross Subsidization and Predatory Pricing** The company undercharged for services below the cost of even the network.
> 2) **Marketing** The regulated monopoly was actually selling the deregulated product.
> 3) **Discrimination of Network Services** The company received better network services than did its competitors.

The ATSI also found the exact same problems in US West's territories. (465)

- Regulated service personnel had solicited customers of competing messaging services who call US West for Call Forwarding services.

- US West regulated services has offered extensive free trials of voice messaging.

These same charges were leveled at almost all other Bell companies from Bell of PA, and Pac Bell, to Southern Bell of Florida and New York Telephone

Service Problems: The ATSI recorded hundreds of complaints by its members over failure to deliver on specific product, such as Call Forwarding or fixing an non-operative line.

The Internet Industry - A Case of Deja Vue.

One has only to visit NYNEXSUCKS.com or USWorst.com to realize that the Internet service providers are going through an identical period that voice messaging service providers. For example, we found that:

- ISPs across the country, from Maine and US West Territories to New York City, have had to file complaints to get even basic business services, such as ISDN running.
- Pac Bell and other RBOCs are offering free internet services when a second line is ordered, thus illegally combining regulated and non-regulated businesses, as well as under-pricing its services to competitors.

According to a Pittsburgh Business Times article, "Bell may toll for Internet competitors" (March 17, 1997), (466) the Bell companies, specifically Bell of Pennsylvania, raised its rates 100-200%, an act that numerous Internet providers see as the first step in a Bell takeover of their businesses.

> "Bell Atlantic Corp. isn't just a player in the local Internet service game, it's setting the rules by which all others in the business compete.
>
> "And Bell, the region's dominant local phone company, may ultimately determine who wins and loses.

> "They have an ultimate agenda here," one of the Internet providers stated "They are changing their services to make it very hard for their competitors to provide services at a reasonable price and survive."

As of November 1998, the situation between the Internet Providers and the Bells, including GTE has worsened. According to numerous ISP interviews, NNI estimates that the majority of the Internet providers have either taken law suits, filed complaints with the Public Service Commissions or, are now contemplating actions. Go to www.newnetworks.com for updates of these problems.