BOOK V

Overcharging by the Numbers: Do the Math

Chapter 27 Overcharging is in the Eye of the Beholder — or Just Better Lawyers.

By now the reader must realize that the cost of any telephone service has virtually nothing to do with actual cost of offering that service. The price is based more on manipulation by the forces of local, state and federal politicians and the lobbying efforts of the Bells.

And while the Bells I'Way promises caused the removal of limits on Bell profits, it was only part of an existing process to increase excessive profits. For the Bell's ability to "milk its monopoly" started at the RBOC's inception, when they pleaded poverty during and after the breakup of AT&T — and continued on from there.

We estimate that by the end of 1997, approximately $30 billion had been overcharged based on Info Bahn promises, while an additional $90 billion has been excessive, garnered since the creation of the Bells. These two figures do not include the "Write-Off Bonanza" of $21 billion in excess depreciation expenses mentioned earlier. And almost all of this money has been pennies, nickels, dimes and quarters paid by subscribers.

Before we detail all this overcharging, looking more closely at the costs of telephone services, we need to define the term "unreasonable", a term who's definition, and therefore legal implementation, is as slippery as the proverbial banana peel.

Why unreasonable? Because all of telecom's primary laws, from the Communications Act of 1934, or the more recent Telecommunications Act of 1996, to even the state Alternate Regulation plans, such as Opportunity New Jersey, emphatically state that prices should be reasonable.

The Communications Act of 1934 specifically stated that services were supposed to be both universal as well as reasonably priced. (467)

> "The purpose of this Act is for regulating interstate and foreign commerce in communication by wire and radio so as to make it available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities **at reasonable charges."**

Also, the act specifically gives the FCC the right to investigate any overcharging or unreasonable increases. (468)

> "Section 47 U.S.C. 215 The Commission shall report to Congress... any undue or unreasonable increase in charges or in the maintenance of undue or unreasonable charges."

Continuing, the Telecommunications Act of 1996 clearly states: (469)

> "CONSUMER PROTECTION — The Commission and the States should ensure that universal service is available at rates that are just, reasonable, and affordable."

Opportunity New Jersey's final decision also uses the term "reasonable" throughout the Order. (470)

> "In the New Jersey Telecommunication Act of 1992, the Legislature declared that it is the policy of the State to, among other things "ensure that customers pay only reasonable charges for local exchange telecommunications service". To this end the Act permits the board to approve a plan for an alternate form of regulation if it finds that the plan, among other things "will produce just and reasonable rate for telecommunications services." [emphasis added]

And so we are left with a dilemma. In earlier sections we clearly showed that:

- The Bells are still monopolies and utilities, but are now making more money than some of the best corporations in America, who have competition. Shouldn't they be making less money and isn't everything else unreasonable?
- Most of the promises to build the I-Way were never met, making the companies excess profits. Yet state laws were never repealed nor monies returned. Isn't that unreasonable?
- State audits of the Bells clearly demonstrated cross-subsidizing of shareholder expenses, adding expenses to the rate base and therefore inflating prices.

Shouldn't that have been investigated nationwide and aren't the inflated prices unreasonable?

- And telephone charges themselves — the costs for Directory Assistance has increased 1326%, while Touchtone service, a service that has no expense, is still being charged in some states. Aren't those unreasonable charges?

Our position is straight forward about what is reasonable and represents the subscriber perspective, not the Bells, and unfortunately not the regulators.

- The Bells never completed their obligation for building the Info Highway. All monies garnered under false pretenses should not only be refunded, but prices should be lowered immediately.

- Secondly, there are literally a hundred different questionable charges and practices that should be stopped, and monies returned or refunded. For example, NO ONE SHOULD PAY FOR TOUCHTONE, a charge that is 100% profit.

- Finally, as of 1998 the Bell are still utilities and still monopolies. Their earnings throughout the decade should have reflected this fact in terms of profits, dividends etc. The laws that should have been applied in the Public Interest were stripped away through faulty decisions, some caused by lack of funds, other because of political, not public interest reasons. As previously mentioned, Ameritech stated that "Federal and state regulators no longer limit the company's profits." (471) The regulators as well as the phone companies need to be examined.

Why Should You Care? Simple:

- **You're Owed Money and You're Paying Too Much** Prices should be cut and refunds should be immediately investigated. We'll discuss how much at the end of this chapter.
- **You're Paying for Their New Businesses** The Bells can afford to go into new business such as long distance, purchase cable networks, and build out the Wireless networks, all paid for through overcharging. Therefore, the customers are defacto investors, except they do not own it.

- **They're Stopping Competitors** Not only can the Bells use its monopoly to outmarket competitors because it owns the telephone customers, but it also owns the networks that the competitors needs to connect to — and competitors are not welcome.

To be thorough, we have broken up the Overcharging into two books:

- **BOOK V,** this book highlights other Bell critics' claims, and then compares the Bells to other companies, using standard business indicators.
- **Book VI** takes a different approach and goes through overcharging looking at the details of charges in your telephone bill.

Chapter 28 Other Bell Critics: CFA, Judge Greene, MCI, and "The Rape of Ma Bell"

Over the last decade there have been numerous Bell critics who believe there's been massive overcharging, from Consumer Federation of America, who believes there has been approximately $40 billion dollars, to Probe Research, who has found $60 billion in excess charges, just for access fees.

Though mapping the critics' findings is hard because each examined different timeframes, used different methodologies, and examined different parts of the Bells profits and revenues, we believe that the critics' analyses all tells a similar story — there's been massive overcharging through numerous means and the profits have not gone into new network construction but dividends and non-subscriber investments.. Before we summarize and cross-reference the various perspectives, let's start with the specific findings.

Consumer Federation of America's Claims of Overcharging

Probably one of the strongest critics of the telephone company earnings, expenditures, and profits has been Consumer Federation of America, (CFA) a non-profit consumer advocacy group. Over the last decade they have published seven reports including "Excess Profits and the Impact of Competition on the Baby Bells" published September 96" and "Milking the Monopoly: Excess Earnings and Diversification of the Baby Bell Since Divestiture," published in February 1994.

Their position: The Bells are monopolies with guaranteed earnings and therefore, since there is less risk, the companies should enjoy solid, yet lower earnings than companies at risk through actual competition. (472)

> "One can reasonably argue that the Bells return-on-equity should be lower than other firms which do not enjoy the monopoly power of the telephone companies. Historically the Bells earned two percentage points less than was earned in the manufacturing sector."

However, CFA found that the Baby Bells have been overcharging approximately $4 billion annually, and this problem is continuing today. In a report released in 1994, CFA estimated that since the break-up, $30 billion had been overcharged. (473)

> "This report estimates that since the break-up of the AT&T monopoly, the RBOCs have overcharged customers by approximately $30 billion in the form of excessive earnings and inappropriate expenses."

With $4 billion dollar a year in excess, the Bell's overcharging through 1996 would be almost $40 billion dollars. This number is "pre-taxes" and "pre-interest", which would add an additional billions to the total.

And a very large part of this excess was from excessive write-offs. In 1992 Consumer Federation of America (CFA) stated that the Bells were overcharging $3 billion dollars annually in just depreciation fees, up from a billion in 1986.(474)

> "In 1986 CFA estimated excessive rates resulting from accelerated depreciation of approximately $1 billion per year. Assuming that depreciation rates should have remained constant after divestiture, we estimate current excessive depreciation expenses of $3 billion per year."

CFA also found that the Regional Bells have not invested in capital expenditures, but have a "take-the-money-and-run attitude", (which was something clearly shown from the Opportunity New Jersey outcome). (475)

> "One of the major claims by the RBOCs to support their campaign for higher earnings, alternate regulation and entry into other businesses is the assertion that incentive would encourage the companies to seek greater efficiencies in the delivery of service and more rapid deployment of infrastructure. However, it should be recognized that rather than pursue efficiencies though investment, companies might choose to take their money and run, diverting it into unregulated activities. An analysis of the use of cash flow by the RBOCs gives strong indication that this is what they have done... Capital expenditures as a percent of cash flow have declined."

> "The numbers are quite large. The BOCs have enjoyed an increase in cash flow of more than seven billion, yet have increased capital expenditures by a little more than $1 billion."

Consumer Federation also points to the fact that the Bell earnings are not being put back into the telephone company but are instead funding all of the non-bell businesses. (476)

> "Excess earnings have not been plowed back into the network by the telephone subsidiaries of the Baby Bells. Instead, these economic resources have been funneled out of the industry in the form of excessive dividend and the acquisition of everything from foreign telephone and cable companies, to domestic cellular companies, to real estate business."

And by 1994 CFA estimated that almost $40 billion has been spent in the acquisition of unregulated assets. (477)

> "Many of the RHCs have thrown cash off into very bad non-telco investments, which have already been written off. Including those losses would push the total assets acquired close to $40 billion."

As we continue to review the other critics, it will become obvious that many of the overcharging claims will be echoed by the other independent findings.

Judge Greene's Opinions About The Bells' Profits & Spending

Probably the most specific information about the Bell profitability was highlighted in Judge Greene's 1987 Opinion which blocked the Regional Bells early entry into Information Services. He found excessive profits from rate increases which have been put into non-bell activities. (478)

> "Following the divestiture, the telephone operating companies, controlled by the Regional Companies, requested and were awarded large rate

> increases almost everywhere in the nation, even though their profits substantially exceeded those of comparable corporations. Regional Bell return on equity amounts to 14% compared to an all-industry composite of 10.9%. At the same time, in addition to their twenty-two telephone operating companies, the Regional Companies have created some one hundred fifty corporations, partnerships, subsidiaries, and other entities having sometime but a remote relationship to telephone operations. Business Week has estimated that the Regional Companies spent $1.2 billion in 1985 acquiring real estate, financial services, software, publishing companies and the like."

Judge Greene wrote:

> "Thus, during the period in question, the Regional Companies had a total operating income from their telephone operations, paid for by the ratepayers, of almost $13 billion, and a loss from their competitive enterprises amounting to close to one-half billion dollars. These figures suggest that the rise in local telephone rates during the past several years may be due in some significant part to cross-subsidization, that is, the diversion of ratepayers' monies to finance regional Companies ambitions to become full-fledged players in conglomerate America." (479)

EXHIBIT 88
Income From Telephone Operations vs. Competitive Services
(in the Millions)

	Income Telco Operations	Loss From Competitive Subs.
Ameritech	$1,820	-65
Bell Atlantic	$1,828	-59
BellSouth	$2,535	-4
NYNEX	$1,776	-70
Southwestern Bell	$1,630	-36
Pacific Telesis	$1,799	-47
US West	$1,684	-180
TOTALS	$13,072	$461

Source: 1987 Judge Greene Opinion

Judge Greene denied entry into any other business, stating as one of the reasons: the Bells excess profits would subsidize their competitive services. (480)

> "One likely consequence, then, of Regional Company entry into the Interexchange, manufacturing, and information services markets would be to give these companies the ability to undersell their rival in these markets because they would have at their disposal an ever-replenishing fund with which to subsidize their competitive operations --- the monies contributed pursuant to regulatory compulsion by the nation's local ratepayers."

The Judge further pointed out that these other businesses were distracting the Bells from giving their local telephone subscribers the companies' undivided attention. (481)

> "An observer might well be justified in concluding that the participation of the Regional companies in these far-flung enterprises is bound to diminish their managements' interest in and attention to the local telephone

business... and under present conditions, if the Regional Companies do not attend to local telephone service, no one will or can."

MCI's Overcharging Claims

"ACCESS CHARGES: $14 BILLION MONOPOLY RIP-OFF"

Probably the most vocal company to take on the Bells has been MCI. In February 1997, MCI released an attack on the current Access Charges, which are fees paid to the local phone company, representing $23 billion dollars in 1996. MCI's claim is that the Bell's, and the other local phone companies have overcharged the long distance carriers, and therefore customers, by $14 billion dollars annually, costing each customer $110 a year. And that's just from Access fees, not the rest of the telephone bill. Here's some details from MCI's press release. (482)

"MCI has asked the FCC to slash these (access fees) billions in overcharges and return the money to customers where it belongs.

"Why are access charges so excessive?

- "According to the Federal Communications Commission, access charges account for more than 40 cents out of every dollar a consumer pays for a long distance call.
- "The real cost for the local phone company to connect the call is about 5 cents out of the dollar.
- "Long distance companies and their customers are forced to pay these monopoly overcharges as part of every long distance call.
- "As a result, MCI estimates that an average customer is overpaying for access by about $110 a year.
- "$14 Billion Excess: After Universal Service Subsidies, the access charge subsidy serves no legitimate purpose whatsoever. This money is simply lining the pockets of the local monopoly telephone companies at the expense of their captive customers.

"Where does the excess go? Last year, long distance customers paid some $22 billion to local telephone monopolies in access charges. The actual cost of connecting those customers' calls was about $3 billion. An additional $5 billion went to support so-called "universal service," a government-mandated effort to keep residential telephone rates affordable. The rest is excess."

EXHIBIT 89

MCI Estimate of 1996 RBOC Access Fee Overcharges

(in the billions)

Ameritech	$1.0
Bell Atlantic	$1.3
BellSouth	$1.9
NYNEX	$1.8
Pacific Bell	$ .9
SBC	$1.4
U S WEST	$1.5
All RBOCs	$9.7
GTE & other local telcos	$3.6
TOTAL `	$13.7

Source: MCI, 1996

Probe Research's Overcharging Claims

Probe Research, a respected market research and consulting firm, has found massive overcharging by the Regional Bells, or as they put it, "Give-aways to the Bells." According to "The End of the Local Monopoly" and "Taking Over the Telephone Companies," two Probe reports, Probe estimates a $50 billion giveaway from 1969 to 1991. The largesse includes an FCC ruling allowing approximately $13 billion of accelerated depreciation, as well as much as $17 billion of savings based in incentive (alternate) regulation by the states and the FCC. These findings also fit with the Consumer Federation model, for much of the alternate regulation savings appear as telephone company profitability.

Probe also examined Access Fees separately in 1995 and concluded that the Bells have overcharged $60 billion in access fees from 1984 through 1994. Based on their extensive statistical series of data about the local exchange companies, known as "The Telephone Book", Probe found that Access Fee revenues, which was supposed to pay for only a portion of the local telephone network, paid more than the entire network cost. (483) Probe states:

> "Since divestiture on January 1, 1984 through the end of 1994, the seven regional bell operating companies (RBOCs) have collected $218.7 billion in network access charges from long distance carriers. These charges are intended to cover the cost of only a portion of the local plant, specifically a portion of the cost of the local loop and a portion of the switching and transmission gear needed to carry traffic over the long distances companies' points of presence in each LATA.
>
> "The total gross plant investment on the books of the seven RBOCs' at year end 1994 was $213.9 billion, less than $218.7 billion in network access charges collected since 1984. Since divestiture through 1994, the seven RBOC's collectively spent $157.8 billion in new construction, which is $60.0 billion less than the access charges collected in the same period. Furthermore, the "old" plant still carried in the balance sheets, i.e., total plant less the new construction, is only $56.1 billion. These numbers refer to local telephone operations of the seven RBOCs, and not their cellular or equipment business or other ventures."

EXHIBIT 90
Probe's Access Charges Revenues and Their Roll in Financing Plant Construction, 1984-1994
(in the billions)

Total RBOC Revenues	$729.4
Access Charges	$218/7
Gross Plant investment	$213.9
Net Plant Investment	$154.1
Plant Construction	$157.8
Old Plant	$ 56.0
Excess Access Charges	**$ 60.9**

Source: The Telephone Book Series, Probe Research, 1995

"Thus the nation's long distance carriers have already paid for a complete local network in the seven RBOC regions including switches, copper and fiber plant, loop carrier systems, transmission systems pay phones, T1 and DS3 carrier systems operations, support systems, buildings, telephone poles, conduit space, trucks and so on. Before the RBOC's began equipment write downs, access charges were more than double net income of the seven RBOCs: 1994 access charges are almost four times the net income of the seven RBOCs."

The Rape of Ma Bell

One of the most eye-opening tales of overcharging came from two Bell lifers, Constantine Kraus and Alfred Duerig. Their book titled "The Rape of Ma Bell" argued that the Bell system should never have been dis-assembled and that it cost the country $25 billion in one time costs by 1987, with an additional $45 billion of on-going expenses. (484)

> "The country was robbed in one of the greatest rip-offs and dirty deals in modern industrial history...
>
> "Think of this $25 billion (of overcharging) in terms of $100 for each man woman and child."

Their argument is that the country had to replace an efficient working network with a piece-meal system that required redundant networks. Also, there were major price increases, including residential and business rates that the book pegs at $13.5 billion annually alone. (485)

> - "The average telephone line rate has increased 50% from $180 annually to $270. This included FCC mandated access charges. Increased Residential Line rates totaled $9 billion."
> - "There are 20 million business telephone lines in service and the rate has increased about $150 per line annually. This includes the FCC mandated access fee charges. Increased business rates total $4.5 billion annually."

While the authors' passion can not be denied, probably the most disturbing finding in the book is their contention that if the Bell system had been left alone, we all would have had better services and at cheaper prices. All of these claims were based on original Bell system planning, way back in the 1970's. Take the case for free Touchtone service. It not only cost nothing to offer, but touchtone also aides in making the entire telephone network more efficient. (486)

> One way to make the present communications system more efficient would be to provide universal touchtone dialing. It would be an easy change since all electronic switching systems have tone capability, and by 1990 more than 98 % of US telephones would be served by electronic switching in electronic offices.
>
> "The premium charge (for touchtone) make no sense... If a unified Bell system still existed, and still owned all the terminal equipment (phones), there would be a gradual programmed phase-out of dial phones.

> In fact, just such a plan was proposed by Bell Laboratories more than a decade ago, with a projected completed date of 1990." [emphasis added]

Notice, not only is the author talking about free touchtone service, but he also states that current network switches have "tone capability", meaning that it cost nothing to offer touchtone service today. This is also true of Call Waiting and Call Forwarding! (487)

> "Another step should be taken for a more efficient system would be to provide **call waiting** on a universal basis. Again <u>no new technology is needed here. Electronic central offices are already offering this service for an additional monthly charge. But there is no need for that charge. The cost of providing the service is quite small and is actually outweighed by the potential benefits to the telephone company."</u> [emphasis added]

Considering that Call Waiting costs $5-$8 a month, (and when this was written almost every state was charging for touchtone) the claims of overcharging and the failure of the Bells to deliver new technology makes the author consider this analysis valid. We will return to the costs of calling features again, in Book VI.

Unity Coalition's Catalog of Bell Abuses

We end this section with a study released in 1993 presented by the Unity Coalition titled "Anticompetitive and Anticonsumer Practices of the Regional Bell Operating Companies Since the Break-Up of the Bell System." This document highlights, state by state: (488)

> . . . abuses of ratepayers, competitors and consumers including:
>
> 1) overcharging by the RBOCs,
> 2) inappropriate cross subsidies
> 3) fraud and misrepresentation.

The Unity Coalition presented a collection of past cases against the Bells as well as current cases dealing with overcharging and other illegal activities. The compilation was done by RBOC and highlights most states. Please note that in some states there were multiple complaints and refunds. Here are some highlights, representing different Regional Bells. (489)

- **Ameritech — Wisconsin** In a 1990 audit of Ameritech corporate expenses, the Wisconsin Public Service Commission found that over 30% of these corporate costs were improperly included in consumers' rates, including lobbying expenses, the cost of the Ameritech Senior Golf Tournament, advertising directed at shareholders, etc. Neither Ameritech nor Wisconsin Bell formally challenged the Wisconsin Commission Findings. Prorated over the five state Ameritech Service Area, the total expenditures improperly allocated to the rate base would be $33.6 million.
- **Bell Atlantic — Pennsylvania** Bell of Pennsylvania agreed in 1990 to pay $42 million in refunds and $5 million for consumer education to settle charges in two 1988 challenges before the Pennsylvania Public Utilities Commission that it used deceptive marketing techniques in selling optional services. (such as Call Waiting or Call Forwarding)
- **BellSouth — Florida** Fraud and Deceit — In October 1992, Southern Bell entered into an agreement with the state of Florida to settle Grand Jury charges that customers paid $15.2 million for calls that were never made and services they never received.
- **BellSouth — South Carolina** In 1991, the company was ordered by the South Carolina Supreme Court to refund between $10 million and $12 million to customers for touchtone service overcharges.
- **NYNEX — New York** In 1990, NYNEX was charged with buying equipment at inflated prices from an unregulated NYNEX subsidiary, MECO, and siphoning profits from its regulated to its unregulated subsidiaries. It found that between 1984 and 1989, NYNEX drained revenues from the operating exchange companies into MECO, then asked for a rate increase to cover the revenue shortfall. MECO allegedly overcharged New York Telephone and New England Telephone $118.5 million, and the subsidies passed these inflated costs to ratepayers.
- **Pacific Telesis — California** In 1988, the CPUC investigated Pacific Bell's investment in plant modernization and ordered a $144 million customer rate reduction to compensate for the company's "deficient and unacceptable decision making...inadequate

levels of performance in its investment justifications and inability or failure to provide data required to justify such decision."

- **Southwestern Bell — Oklahoma** The Oklahoma Commission has ordered Southwestern Bell to refund $140 million in overcharges to its customers. In addition, Southwestern Bell will have to lower rates by $90 million a year and make $84 million in improvements to the phone network.
- **US West — Oregon** In January 1992, the Oregon Public Service Commission ordered US West to refund to its customers $56 million in overearnings from directory publishing. Residential customers received $20 per line and businesses received $50 per line.

Chapter 29 Follow the Money — How Much We, the Subscribers of America, are Owed.

Making Sense of Overcharging With all of these assorted claims, how do they all line up, if at all. First, here's a summary of some of the overcharging claims. (490)

EXHIBIT 91

Overcharging Claims by Various Bell Critics, 1984-1996

Overcharging

- $40 Billion Overcharging, From 1984 To 1992. CFA
- $48 Billion In Overcharging, From 1984 To 1987, Kraus & Duerig
- $25 Billion In One-Time Expenses, From 1984 To 1987, Kraus & Duerig
- $50 Billion Giveaway From 1969 To 1991, Probe Research

Annual Expenses

- $1 Billion **Dividends** And Expenses, 1992 CFA
- $3 Billion **Depreciation** Expenses, 1992 CFA

Access Fees

- $60.0 Billion, 1984-1994, Probe
- $14 Billion Annually, MCI

Return On Equity Increases Based On Rate Increases, 1983-1986

- "Regional Bell **Return On Equity** Amounts To 14% Compared To An All-Industry Composite Of 10.9%." Judge Greene

Price Increases —35%-52% From 1983 To 1985.

- 35-50% Increase In The Price Of Local Service —CFA
- 50% Increase In The Price Of Local Service From $180 Annually To $270. Krause & Duerig

Revenue Increases From 1983 To 1986, Kraus & Duerig

- Increased Residential Line Rates Totaled $9.0 Billion
- Increased Business Rates Totaled $4.5 Billion

Non-Telco Spending CFA, 1992

- $40 Billion Spent In The Acquisition Of Unregulated Assets

Misc. Charges By State

NNI's Analysis: Putting the Critics into Perspective

To try and summarize the various examinations, all of the critic's findings should be viewed in terms of four basic phases of overcharging, and unfortunately they are all tied to specific regulatory changes in telecom's history. As far as the critics and NNI are concerned, these changes have, for the most part, have not always been in the best interests of the public, regardless of the hype. The phases are:

- **<u>Phase One</u> was created by the Break-up of AT&T,** 1983-1985. CFA and Kraus & Duerig document massive telephone rate increases of 35-50% during this period, while Judge Green pointed out that these increases caused the return on Equity profits to go from 10.9% to 14%. Deregulation of the wire and the telephone also added to this excess revenue.

- **<u>Phase Two</u>** was the **implementation of early Alternate Regulation Plans**, circa, 1986-1990, such as TeleKansas. At this time, CFA found that Bell dividends, depreciation expenses, among other expenses were costing customers $4 billion annually.

  Also, According to CFA, spent $40 billion dollars on new assets, almost all of it losses. According to Judge Greene, in 1986 the companies had already lost 1/2 billion dollars, while we found over $7 billion in losses from Real Estate.

- **<u>Phase Three</u>** was created by the **removal of rate-of return regulation based on I-Way Alternate Regulation plans, such as Opportunity New Jersey,** starting in 1991 and going through 1996.

- **<u>Phase Four</u>** is currently in play and it has been created by the **implementation of the Telecommunications Act of 1996 and local state competition laws —** the Bells, of course, are complaining that they must be compensated to let competition in, or to "rebalance their costs and subsidies".

A clear model of the first three phases can be seen in the RBOC return on equity from 1980 through 1996. In Phase One, the return on equity jumped from 10.8% to an average of almost 13.9% in 1984. During Phase two, from 1985-1991 the Bell's ROE hovered around 13.8%. Then from 1992 through 1996, ROE skyrocketed from 14.8% to 29.3%, and increase of 171%! (491)

EXHIBIT 92

RBOC Return On Equity 1990-1996

	Phase One		Phase Two	Phase Three		
	1980-1983	1984	1985-1991	1992	—	1996
ROE	10.8 %	13.9%	13.8%	14.8%	=	29.3%

Let's give some detail to the Bells largesse.

Phase One — Pleading Poverty Pays Off Big.

Phase One of overcharging started when the Bell system was still intact. The local phone companies requested and received massive increases in local telephone rates, complaining that the break-up would cause the Babies serious financial risk. We will take a few pages to demonstrate that Phase One, based on pleading poverty, is the same strategy being repeated today, with the Bells requesting, and in many cases receiving, rate increases by complaining of threats of competition.

Previously we quoted the FCC, who chronicled the Bells receiving an additional $10 billion dollars annually. Most of this was in the form of annual telephone rate increases for various services.

And there was a direct relationship between these increases and total new revenue as well as increased Bell profits. Before the break-up of AT&T, the Bell System, (including AT&T's kick-back for access fees), accounted for a total revenue of $51 billion dollars. By 1986, an additional $17 billion dollars was accrued, over $10 billion from 1984 to 1986. (492)

EXHIBIT 93
RBOC Revenues, 1980-1986
(in the millions)

		1982	1984	1985	1986
RBOC Total	Revenues	$50,988*	$57,996	$63,366	$68,733

* includes AT&T Long Distance contribution of $3,544

Sources: AT&T Annual reports, RBOC Annual Report

It doesn't take a rocket scientist to see that the $10 billion in new annual revenues helped to dramatically increase the RBOC revenues, which increased— $10.7 billion from 1984 to 1986.

And All Profit Indicators had Increased

Besides the increased in Return-on-Equity mentioned earlier by Judge Greene, "Earnings-per-share", a standard business analysis of corporate earnings, showed that the Bell's were making 191% more than the Business Week 1000, 174% more than the Business Week ScoreBoard for Utilities. (493)

EXHIBIT 94
1984-1985 Bell Earnings-Per-Share Compared to Other Utilities

	Earnings Per Share	% of overcharging
RBOC	$9.12	
All Industries	$3.13	191%
All Utilities	$3.33	174%

Source: Business Week Corporate ScoreBoard, 1984, 1985

Higher Prices:

Unfortunately, while the break-up was supposed to lower prices and competition, it only caused price increases, up 35-52%, in just two years. A press release by Consumer Federation of America, dated December, 1985: (494)

> "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? The Bell system break-up was supposed to produce consumer benefits through increased competition.
>
> "The local phone companies are earning tremendous profits from rate increases. Regulators have helped the phone company out perform all other industries.

To make it more specific, let's explore the impacts on two Bell companies' revenues. Southwestern Bell and Bell Atlantic. First, Southwestern Bell Telephone requested almost five billion in increases in its various states. While only a portion of these requests were granted, the total additional revenues for four years was a whopping $2 billion dollars. Texas alone received a whopping $1.3 billion in new found, mostly annual, monies from 1982 to 1985. Below is the summary showing Southwestern's requested vs granted rate increases, by state. (495)

EXHIBIT 95

Southwestern Bell Rate Increases, by State, 1982-1985

(in the millions)

	Requested	Granted
Kansas	$ 367	$ 176
Missouri	$ 528	$ 270
Texas	$2,965	$1,340
Oklahoma	$ 412	$ 215
Arkansas	$ 224	$ 85
Total	$4,495	$2,086

Source: NARUC Annual Reports, 1982-1986

And make no mistake about it. It was these increases, not performance, that lead major revenue increases. According to the 1986 Southwestern Bell Annual Report, all services were increased substantially due to rate increases, known as "rate relief". (496)

EXHIBIT 96

Quotes From Southwestern Bell About Rate Increases, 1986

Local Service
"During 1985 local service increased $198.8 million compared to 1984. This increase was due to realized rate relief"
Network Access
"Network access Revenues in 1985 increased $418.4 million, compared to 1984 interstate revenues increased primarily due to the implementation of certain access service tariffs".
Long Distance service
"Long Distance service increased in 1986 due primarily to realized rate relief".

Bell Atlantic also grew by leaps and bounds from 1984 to 1985 with an increase of over $1 billion dollars annually. And the quotes indicate that the majority of this new found booty stemmed from rate increases. Notice the similarities with Southwestern's quotes. (497)

Exhibit 97

Quotes From Bell Atlantic About Increased Revenues, 1986

Local Service
"Local Service increases (of $227 million) are attributable to a combination of higher rates authorized in certain jurisdictions".
Network Access
"Intrastate rate awards totaled approximately $268 million in 1985.
Toll Calls
"The increase in toll call revenues in 1985 ($50 million) resulted from growth in Toll call messages and higher rates"

We will return to this strategy to obtain new revenues and profit when we examine Phase Four, the current problems.

Phase Two of Overcharging, 1986-1991

Phase Two, from 1986-1991, was a period where some of the Bell's constraints on earnings were removed through new Alternate Regulation Incentive plans. However, while the profits from the telephone companies was accruing, the companies' overall profits were tied down by billions of dollars of unprofitable non-bell companies.

For example US West wrote off over a half billion dollars in 1991 for its real estate business. (498)

> "The portion of the change related to a valuation allowance for real estate operations was $500 million and was intended to cover both carrying costs and losses on disposal of the properties."

Meanwhile, Pacific Telesis's 1991 Annual Report revealed $317 million in write-offs for Pac Bell Business Systems and Pac Tel Properties, its real estate business. And it wasn't over yet for Pac Bell. In 1993 the company took a $400+ million dollar loss for more real estate losses (499)

We estimate that over $11 billion was lost in Real Estate, and another $27 billion spent on International services. (500)

Phase Two also saw the rise of a new, corporate holding company infrastructure and culture, costing billions of dollars. For example, by 1986 US West had 15 companies besides the telephone subsidiaries, and its corporate staff had doubled, while the telephone company staff (the staff that handles customers) had dropped by 7,300 people. (501)

EXHIBIT 98

US West Corporate Staff Increases 1984-1986

	1984	1985	1986
Total US West	70,765	70,202	69,375
Telephone Co Employees	66,538	64,868	59,221
Increase In Corporate	4,227	5,334	10,154

Source: US West 1986 Annual Report

Finally, the new incentive plans all had the lure of new technology. As mentioned earlier, TeleKansas, and TeleFuture 2000 in Missouri were both early incentive plans promising technology. These plans also quickened depreciation schedules, meaning more cash through write-offs.

Phase Three Overcharging — The I-Way Plans

It is clear that the first two phases were just practice to Phase Three, the I-Way plans of the 1990's. As far as we can tell, all sensibilities of protecting the subscriber from overcharging were thrown to the wind, based on the promises of the fields of gold, the Fiber Optic future.

We previously highlighted Opportunity New Jersey, a plan based on the belief that Bell Atlantic was delivering wonderous new technology so, why not charge regular telecom users more. (502)

> "Staff (State Board of Utilities) submits that the view that POTS (Plain Old Telephone Service) is static and should be examined in terms of existing uses does not properly consider the benefits of advanced technology, which including possibilities of Telecommuting technology, distance learning applications, video transport and high speed transport of computer data."

And the testimony of State Senator Menendez, a sponsor of the New Jersey Telecommunication Act of 1992, stated: (503)

> "The information technologies, including fiber optics, would allow New Jersey, in general, and urban areas such as Union City in particular to move to the front of the pact in competing for a piece of the 21St century economy....The economic boon driven by an information based economy and the new and better jobs it would create, will positively affect a wide range of revenue areas."

The New Jersey Consumer Advocate found almost $1 billion in excess dividends, and a rate of return of 21%, among other problems: (504)

> "The gains captured by BA-NJ, involve earnings, dividends, return on equity, cost of debt and additional benefits."

- "BA-NJ paid out an additional $954.8 million in dividends* over what was projected in 1992" (1992-1995)
- "the Company is earning a return on equity in excess of 21%, well above the average New Jersey State utility rate of return (11.25%) and substantially higher than any rate of return authorized by the Board in recent memory."
- "net earnings have increased by $85 million. Its cost of debt has declined substantially resulting in an annual savings of $22 million in interest expense.

If you compare these issues with those brought up by Consumer Federation, who found overall excess dividends of $1 billion in 1992, or the $3 billion in depreciation CFA found as a total in 1992, these newer Alternate regulations from 1992-1996 removed almost all previous safeguards.

Judge Greene had pointed out in 1987 that 14% was excessive profits for the Bells, and here, in New Jersey, the Advocate found a 21% return, almost double the return of 10.9% which Judge Greene stated was a traditional Utility return.

By almost all indicators, as of Phase Three, the Bells as a group were the most profitable companies America. By 1996, profits were 147% higher than the Business Week ScoreBoard for Utilities, 68% from all other industries, while the profit margins are 78% and 102% over Utilities and all Business Week ScoreBoard. (505)

EXHIBIT 99

Comparing RBOCs Profits to Business Week ScoreBoard, 1996

	ROE	Dividend	Profit Margin
RBOC Total	28.1%	$3.18	11.9%
All Industries	16.8%	$2.44	5.9%
Utilities	11.4%	$2.10	6.7%
All Industries	68%	30%	102%
Utilities	147%	51%	78%

And with the removal of regulations, Phase Three Net Profits for the five years, 1992-1996 went from an average of $7.8 billion from 1984-1991 to almost $14 billion in 1996. (506)

EXHIBIT 100

RBOC Net Profits 1984-1996

	1984-1991	**1992**	**1993**	**1994**	**1995**	**1996**
Net Profits	$7,843	$9,218	$8,063	$10,349	$11,637	$13,700

Sources: RBOC Annual Reports, 1984-1996

Phase Four Overcharging—Failure of The 1996 Telecom Act

There are today, and will continually be numerous increases to the local phone bill based on the Bell's stating that they need to be compensated for allowing competition. As we pointed out earlier, when Toll call competition was permitted in California, the phone companies, Pac Bell and GTE, both received massive increases 35-50% respectively. Meanwhile, US West and other companies have applied for extra payments for providing competitors with services.

However, this is just the start. Probably the most recent and ridiculous change to date has been the implementation of the FCC increases on the subscriber line charges for second or multi-line business as well as residential lines. Calling it a 'balancing of access fees".

We will return to these new charges in future sections since Phase Four effects are expected to continue over the next five years.

DO THE MATH — Summing up Overcharging, 1984-1996

The most telling examination of the Bell's excess profits is simply to hold them up to the other companies that are also regulated by the Public Utility Commissions, or compare them to the rest of America's companies.

Taking into account all of the various phases, the overall Bell overcharging when compared to other companies, such as other utilities or the Business Week 1000, showed a total of over $121 billion from 1984 through 1997, $30 billion of that accumulating since 1991 from the Info-Bahn. (507)

That's an incredible amount of excess monies. In terms of telephone lines in America, the total comes to over $1,000 per phone line in toto!

So let's start with a top down approach for the last 12 years, examining standard business indicators, using the Business Week ScoreBoard 1000 and the Business Week Utilities, as our source for comparison.

Bell's Return on Equity

While the other Utilities' maintained an average of only 10.8%, the Bells, especially in the last five years, have had a 20% average return, approximately 100% higher than their utility brethren. (508)

EXHIBIT 101

RBOC's Compared to Business Week Utilities, 1992-1996

	1992	1993	1994	1995	1996
Utilities	11.3%	9.8%	11.3%	11.5%	11.4%
Bells	14.9%	15.7%	19.8%	29.1%	28.1%
% of Diff.	32%	60%	75%	153%	147%

Earnings, Dividends, Net Profits, and Depreciation

If Return-on-Equity don't thrill you, by 1997 (using 2nd quarter results), the Bells had: (509)

- paid out a whopping $35 billion in excess dividends,
- had $41 billion in excess net income,
- changes in depreciation expenses added an additional $45 billion

EXHIBIT 102

Bell Overcharging, 1984-1997

(In the millions)

	1996	1997	Total 1984-1997
Dividends	$ 2,060	$ 2,266	$ 35,217
Depreciation	$ 4,271	$ 4,698	$ 45,357
Net Profits	$ 6,718	$ 7,390	$ 40,670
Per year Total	$13,049	$14,354	$121,244
Highway Portion	$ 6,485	$ 7,133	$30,055

Source: Business Week, Bell Annual Report, 1983-1996

A whopping $121 billion dollar difference. About $30 billion of which can be attributed to promises for the info-bahn. Make it $50 billion if you take into account the "$21 billion dollar Write-Off".

The total for 1997 will be around $14 billion of overcharging, with $7 billion of that directly attributable to the Info-bahn's excesses.

And the growth of this excess started from a low of about $4.8 billion in 1984 and has been continually growing year by year. However, the primary growth in excess, from $9 billion in 1990 to $14 billion in 1997 was almost all pennies, nickels, dimes and quarters. (510)

EXHIBIT 102a
Bell Overcharging, 1984-1997
(In the Billions)

1984	1990	1996	1997
$4.8	$9	$13	$14

In November 1998, we expect that the total for the year will be higher than 1997 totals, though with the mergers and their costs /write-offs, make the profits harder to track.

Other Bell Overcharges

And this is not the end of the story, because there are multiple billions of overcharging still in question. Lack of room spares us all the detail, but there are a host of other charges that are not only questionable, but should be investigated. We will highlight just some of the other charges.

• **$21 Billion Write-Off Bonanza** — As previously mentioned, the Bells as a group recorded almost $21 billion dollars in extra depreciation charges. Their claim was that because they were constructing new fiber-optic networks, and had serious competition, they could change their accounting practices, from a monopoly to a free market enterprise.

As we found in the outcome of Opportunity New Jersey, Bell Atlantic New Jersey was never competitive nor had they fulfilled their obligations to wire the state. And this happened throughout the Bell System. Therefore, this incredibly large sum should be returned to ratepayers since no Bell has rolled out the fabled fiber-optic highway.

• **$13 Billion Dollars of BellCore Expenses** BellCore has served as the research arm of the Bells since 1984, with its original goal to mimic Bell Labs, (now Lucent technologies) the old Bell system's research laboratories.

BellCore's expenses comes to approximately $1 billion dollar, annually. And It is a little known fact that the Bell's divide up these expenses by Bell, who in turn, divided up the expenses by state. This was originally allowed because BellCore was supposed to be doing work specifically for the local telephone subscribers.

For example, the New Jersey Bell 1994 Annual Report showed Bellcore expenses ranging from $27 million in 1994 to $55 million in 1992. Remember that this represents only one state and there are 47 others that pay these fees. (Hawaii and Alaska do not have Bell companies) (511)

EXHIBIT 103
New Jersey Bellcore Expenses, 1992-1994
(in millions)

1994	1993	1992
$27	$40	$55

Source: New Jersey Bell, 1994 Annual Report

Unfortunately, the problem is that BellCore's billion dollar budget has shifted, mostly dedicated now to non-phone subscriber services, or advanced technologies that have nothing to do with basic service.

In a civil case where the author was a consultant, the Court found that BellCore's expenses were not related to ratepayer needs. However, the Public Service Commission was the organization to define the refunds, not the courts. And the New Jersey Board Of Commissioners had not examined BellCore expenses since 1985, even though the composition of BellCore had dramatically changed. (512)

Also, BellCore has products and services it sells hundreds of millions of dollars annually. However, though the subscriber is the defacto investor, funding BellCore's existence, the Bell shareholders keep all profits!

Estimated BellCore expense to each subscriber is about $100.

During the editing of this book, Bell Atlantic was charged $20 million dollars in refunds for New York's share of Bellcore pay-ins. Unfortunately, that is only one state and many dollars shy. However, at least one regulator has actually studied the issue and made a decision.

• **Billions in Cross-Subsidization Between Affiliates?** In a previous section we highlighted the findings of a series of partial audits of the Bells. This included 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 Ameritech 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 Commission found serious improprieties, clearly demonstrating that Ameritech was able to charge ratepayers for expenses that the shareholders should be paying for. The list included: (514)

> • "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".

Considering that the audit just mentioned showed serious problems between the purchasing company and its affiliates, in Ohio and Wisconsin, one would expect that every other state would have instituted similar investigations.

Let's return to New Jersey and Bell Atlantic. New Jersey Bell is a $3+ billion dollar company which has numerous relationships with other Bell Atlantic companies, including Bell Atlantic Network Services, Inc. (NSI), and Bell Atlantic Network Funding Corporation (BANFC). To our knowledge, there has never been an audit similar to Ameritech's affiliate transactions. However these arrangements are almost identical in scope. (515)

> "The Company has contractual arrangements with NSI for the provision of various centralized corporate, administrative, planning, financial and other services. These arrangements serve to fulfill the common needs of Bell Atlantic's telephone subsidiaries on a centralized basis.

> "The Company has a contractual agreement with an affiliated company, Bell Atlantic Network Funding Corporation (BANFC), for the provision of short-term financing and cash management services. BANFC issues commercial paper and secures bank loans to fund the working capital requirements of Bell Atlantic's network services subsidiaries, including the Company, and invests funds in temporary investments on their behalf.
>
> "Operating revenues and expenses also include miscellaneous items of income and expense resulting from transactions with other affiliates, primarily rental of facilities and equipment. The Company also paid cash dividends to its parent, Bell Atlantic."

And we are not talking about a small amount of money changing hands. The New Jersey portion of NSI is almost $1/2 billion dollars annually, and its dividend to Bell Atlantic, the parent, was almost an additional $1/2 billion. New Jersey Bell also borrowed hundreds of millions of dollars from the financing company. (516)

EXHIBIT 104

NJ Bell's Bell Atlantic Affiliation—Operating Expenses, 1993-1994

(in the millions)

	1993	1994
NSI	$459	$500
Dividends paid to Bell Atlantic	$440	$435
Note payable to affiliate (BANFC)	$ ---	$117
Long-term debt maturing within one year	$104	$ 29

The author does not know of any state of FCC audit of any of these transactions, yet considering that Ohio and Wisconsin found serious problems one would think that these areas are rife with problems.

Worse, the Ameritech purchasing company actually has its own profit centers, and in many cases is charging retail for its services, increasing Ameritech's total profits. The NSI and the financing companies are separate entities as well. Are they charging retail to New Jersey customers? Is there cross-subsidization?

And what about dividend payments of almost $1/2 billion dollars to the holding company? Is that reasonable? Considering the track record of the Bells, it is clear that these items should have been investigated long ago, determining if these arrangement were the best for New Jersey subscribers. Also, this problem is not just for New Jersey to figure out, but for all of the states as well.

• **Adding Corporate Expenses to Ratepayers** According to the Unity Coalition, Wisconsin PSC found improper expenses were being charged to subscribers. (517)

> "In a 1990 audit of Ameritech corporate expenses, the Wisconsin Public Service Commission found that over 30% of these corporate costs were improperly included in consumers' rates, including lobbying expenses, the cost of the Ameritech Senior Golf Tournament, advertising directed at shareholders, etc."

Meanwhile, when New York Telephone changed its name to NYNEX, NYNEX filed to charge customers $25 million dollars. And how much will Bell Atlantic charge its various states for the new name? The list of expenses that are charged to subscribers, from donations to charities, varies by states and as we have pointed out, in some states, the local phone bill charges can be almost anything the Bells decides is appropriate. In most states, audits have not been done, but some audits revealed that the ratepayers were dumping grounds for almost any expense.

• **Charging Ratepayers for Non-Regulated Activities —** The regulated side of the Bell system, the side that handles the local telephone subscribers is not supposed to pay for the development of non-regulated services, services that the customer didn't order and may never use. However, according to the audits of Ameritech and Pacific mentioned earlier, the company has been improperly charging customers. (518)

EXHIBIT 105
NARUC AUDIT Highlighting Ratepayers Paying for Non-Regulated Personal Communications (PCS) Services, 1992

- **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

This problem is common in many activities from purchasing research to hiring consultants and lawyers, all of which were highlighted in the Audit of Pacific Telesis.

- **Deregulated Local Charges Not Paying Their Fair Share.** Many of the items included on the phone bill, such as wire maintenance, are deregulated and there are supposed to be separate records kept, including all expenses. And this is done so that basic local service charges are separate, and customers are not paying the deregulated products expenses. Even phonecalls made to customer service centers are supposed to highlight what the customer asked about, so that accurate records are keep between the regulated calls and the calls handling deregulated products.

In a letter from the FCC dated Nov. 9th, 1992 which was a "time report audit" of Ameritech's Michigan and Ohio Bell, the FCC audit found that the company was improperly charging Inside wiring costs to the regulated side of the business, when the expenses should have been paid for by the non-regulated product. This increased the company's profits on inside wiring. The audit found: (519)

- "Direct Marketing (Telemarketing) Groups Expenses are not Being Properly Allocated.
- "Travel time allocation was not in compliance with FCC's requirements.
- "Improper Charging of Non-Regulated activities to a Sale Function"

In fact, an earlier audit of Wisconsin Bell, summarized in an FCC letter dated 5/2/1990, found similar problems. (520) And all of this goes to show that the Bells are not keeping accurate records and are ignoring basic laws that separate the regulated and non-regulated business dealings. Besides the obvious, that the customer is helping to pay for services they might not have ordered, it also brings up a more serious question — with the addition of new services, such as Bell Internet Services, are customers funding these new actions?

Let's bring overcharging home by examining the telephone charges you pay — and how much it really cost to offer... The pennies, nickels, dimes and quarters on your phonebill.