

The Unauthorized Biography of
the Baby Bells
&
Info-Scandal

by

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With Foreword by:

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To all my telecom friends, my Aunt Ethel,
Vice President Al Gore,
and anyone else who uses a phone.

The Unauthorized Biography of the Baby Bells & Info-Scandal

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Foreword
by
Dr. Robert M. ("Bob") Metcalfe
(1/26/98)

Bruce Kushnick just spent seven years writing his "unauthorized biography" of the Bell telephone monopolies. His unpublished 475-page manuscript exposes how the Baby Bells have been ripping us off since they were born out of AT&T in 1984.

Kushnick has been living off credit-card debt in Brooklyn, New York. He wears black, vibrates with nervous energy, and jokes about his Bell paranoia.

After a letter from NYNEX saying a "mysterious third-party" is after him, Kushnick also wrote a semi-autobiographical novel, now a screenplay in development at Warner Brothers. "Touchtone" is about the Bells conspiring to kill a telecom analyst with an unpublished manuscript.

Reliable sources do confirm Kushnick is credible. He's been a telecom analyst for 15 years, associating at times with Link Resources, Probe Research, and Phillips Business Information. He lists former clients including AT&T, MCI, Sprint, Nortel, British Telecom, PacBell, and BellSouth. And the manuscript is heavily footnoted, so (not that I have) his findings can be checked.

Kushnick's main finding is that Ameritech, Bell Atlantic, BellSouth, NYNEX (now within Bell Atlantic), Pacific Bell, SBC (now including PacBell), and US West -- are annually overcharging us \$14 billion.

But wait, aren't profits on the Bells' \$100 billion in revenues regulated by our Federal Communications Commission (FCC) and 51 state public utilities commissions (PUCs)? Well, actually, no.

Kushnick finds that understaffed regulators must rely on information provided by the Bells. Independent audits are rare, often find gross overcharging, and only get the Bells slapped on their thick wrists.

And worse, since the Telecommunications Act of 1996, the most heavily lobbied bill in legislative history, the Bells have been "deregulated," which just means more gouging of their choiceless customers.

And the Bells' gouging is not evident on phone bills. Kushnick finds zero percent of telephone customers understand their bills. Bells overcharge for calls -- like 75% more for intrastate than coast-to-coast. They overcharge for unordered services -- like

home wiring maintenance. They overcharge the unwary -- like Kushnick's legally-blind 87-year-old Aunt Ethel, who has paid \$1,100 since divestiture for the rental of an old rotary telephone. And then there's "digital spew" -- like the posting of bogus charges on phone bills.

Kushnick finds -- get this -- it's a myth the Bells lose money on local telephone lines. They've been shoveling expenses into their regulated local services while shifting revenues out into unregulated subsidiaries. With line numbers growing, the Bells are lowering per-line headcounts, deinvesting per line, and increasing actual prices.

The FCC and PUCs do already report Bell prices are up, and that's scandal enough, but reported prices are for reduced services, for the rare least-expensive installation, without deposits and substantial charges for initiating services. Reported prices are gross understatements of total prices actually paid. Kushnick finds telephone bill charges up an average of 275 percent since 1983.

Kushnick finds at the bottom line the Bells financially outperform other regulated utilities, 28 versus 11 percent. Bell shareholders have enjoyed guaranteed returns 55% higher than those by investors in the S&P 500.

The part of Kushnick's expose that angers me most is how the Bells have used the Information Superhighway to win concessions on how much money they can extract from their monopolies. Kushnick recounts extravagant Iway promises, shows them to be just a Bell ploy, and documents how they've not been kept. He tracks billions intended for Iway deployment to Bell executives, to their shareholders, and, of course, to almost all of your elected representatives in government.

Kushnick sees his book as a manifesto for a coordinated effort against the Bells in the jurisdictions of all 51 PUCs. He's looking for a bold and fast publisher. Interested parties, but not Bell assassins, should contact Kushnick not by phone but by e-mail at internet@interport.net or soon on the Web at www.newnetworks.com.

Kushnick worries the Bells will sue him into oblivion once they catch wind of his manuscript. I've tried to reassure him. First, InfoWorld readers can keep a secret. Second, there's The First Amendment. Third, Kushnick is already in oblivion. And fourth, nothing would advance his cause more than the publicity of defending against the legions of Bell stormlawyers. Many of you, I'm sure, would join in the Kushnick Legal Defense and Publicity Offense Fund.

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Preface

Almost everyone in America knows how to use a telephone and almost everyone picks up a phone every day to make or answer a call. Unfortunately, almost no one understands their telephone bill. Worse: almost no one knows that they have been paying, for years, for services that they never ordered and that will probably never be delivered anytime soon.

And we believe **you're owed money** — hundreds of dollars per-line.

The Information Superhighway was supposed to be America's shining, high-technology future. With millions of miles of super-special glass wires, known as fiber-optics, attached to ultra-modern, all digital telephone network switches, every home in America would be connected to a dazzling array of new products and services — 500 channels of movies, shopping, and games, all coming soon to the TV.

And, of course, there was supposed to be Tele-Learning, Tele-Medicine, Tele-Anything; things so wonderful that even science fiction couldn't predict them.

The primary finding of this tale is that instead of building this wonderful highway, the Baby Bells, the progeny of AT&T in the form of seven, very large holding companies that were created in 1984, most likely pocketed the money. We estimate that it comes to about \$30 billion dollars to date (1991-1997) and another \$7.5 billion in 1998. And they left America with POTS: Plain Old Telephone Service.

And that \$30 billion dollars is really billions of extra pennies, nickels, dimes, and quarters that you, your company, your family, friends, cousins, relatives, neighbors, and acquaintances are paying through overcharges on their telephone bills. You paid for and did not receive the new fiber-optic future.

This largesse is based on a fact: in exchange for the removal of state regulations that controlled profits, known as "deregulation", the Bells promised to build the fiber-optic Info Highway. By 1998 there was supposed to be almost 27 million Info Highway fiber-optic homes. Almost half of America, 45 million, would be wired by the year 2000. Today virtually none exist. Also, large consulting firms, including Deloitte & Touche, charged millions of dollars for studies to corroborate the Bells' story.

In a complaint filed with the New Jersey Public Service Commission by the New Jersey Public Advocate, March, 1997, the fiber-optic future is definitely being paid for, but not delivered. In April 97, the Advocate told The New York Times. (1)

"...low-income and residential customers have paid for the fiber-optic wire lines every month but had not yet benefited. "

What's worse, **Info-Scandal** overcharging for the I-Way is only part of a long tale of abuse, which started right at their birth in 1984. It adds an additional \$85-\$100 billion of questionable overcharges by the Bells, bringing the total to about \$14.5 billion annually. In fact, we believe you're owed a lot of money, about \$500-\$1,500 per line, but without proper audits it's hard to be exact.

What's \$14 billion a year between friends, right? And we need to stress one point: most of the money in question is not from the long distance companies, such as AT&T, MCI and Sprint, but from the local phone companies affectionately called the Baby Bells. They are arguably the fattest babies in history.

How I came to write this Book - See "CODA", at the end of the book.

What's In the Book: The Info-Scandal Roadmap

The book in front of you is the culmination of the last seven years of research. Though it focuses on the Info Bahn's no-show, it was written with the hope of effecting change, by explaining what's broken in telecom and poising some long term solutions. Right now what's broken costs you money in the form of higher and unjustified prices. Fixing it, however, is another story.

And what's broken? Well almost everything. There's no Info Bahn, prices have risen over 275% since 1984, the Bells are still monopolies, there is no immediate local competition to drive down prices, and the laws do not work to adequately protect subscribers.

And there are scandals galore, which we will present, from "Digital Spew", "The Measured Service Scam — The Pelican Brief of Telecom", the "\$20 Billion Dollar Write-Off Scandal" or simple things, such as charging for services, such as Touchtone or Call Waiting, which cost virtually nothing to deliver.

To detail the problems and scandals, we've divided the book into seven sections, representing the seven original Bells, covering 48 chapters, representing the 48 states the Bells control. (Alaska and Hawaii were non-Bell)

We've also dedicated portions of the book to explain basic terms and concepts for the telecom-uninitiated. The sections include:

Book I — Info-Scandal: Highway to Nowhere, lays out the hype and the failure of the Bells to live up to their Info Bahn promises. The conclusion: the Bells either conspired with research firms to pull off a scam to remove protective state and federal regulations, or else they are the worst marketers in history, totally overestimating the market and underestimating the costs. Either way, the money for this rollout, estimated at \$30 billion to date, should be refunded.

We also show that there never was any consumer interest, that the technology cost thousands more than stated, and that earlier technologies, specifically ISDN, which was promised in the mid-1980's, was also never adequately delivered.

Book II — Bell History and Strategies: Shareholders First, Customers Last demonstrates how the Bells' have shifted priorities, placing the shareholder and profits before local customer needs. From the excessive lobbying and a concentration on removal of all regulation, the massive staff cuts and lack of new construction, or the moving of funds for international and non-Bell investments, the Holding company has put the customer in the back seat.

In a special chapter titled "Liar, Liar: Baby Bell's Pants on Fire", we focus on the Bell statements and actions that were "deceitful", or "misleading". For example, while Bell Atlantic and NYNEX stated publicly that they were a "merger of equals", the fine print shows that it was not at all equal. Bell Atlantic purchased NYNEX for 75¢ on the dollar, thus avoiding Congressional scrutiny. SBC also used this tactic to purchase Pacific Telesis.

Book III — Show Me The Money focuses on these \$14 billion dollar babies, collectively about \$100 billion annually. We show how the Bells have flourished with the removal of regulation. Profits are more than double most of the best companies in America, outperforming the S&P 500 and other business indicators. And this money was

not from the new businesses and investments, but the increases in the pennies, nickels, dimes and quarters of phone subscribers.

In fact, prices should have dropped continually over the last 10 years because two major expenses, employees and construction, are continually dropping. For example, over 235,000 people have been laid-off from the local Bells (a 57% reduction in employees per-line). These massive staff cuts have lead to missed appointments and clogged customer services, causing an increase in customer dissatisfaction, not to mention state legal actions and fines.

Book IV — Regulation and Regulators shows that the telecommunications laws of the land have been built more through campaign financing than the Public Interest. For example, the Telecommunications Act of 1996 was supposed to lower telephone prices and pave the way for development of new network services, by bringing in competitors. But, according to Senator Pressler, it was "The most lobbied bill in history". It was a band-aid act which did not fix the basic problems.

How perverse is the situation? Well, we show how competition is now being used as a new means to raise local service prices. What's more, the Bells and State commissions have successfully sued the FCC, effectively stopping mass competition at lower prices.

There are also numerous questions about the ability of the FCC or the states to properly monitor and control telecommunications. In some states there has been a blatant disregard for the Public Interest, and collusion with the monopoly seems apparent. Other states are out-classed, out-flanked and out-funded and with 50 of everything, Swiss cheese coverage comes to mind. Meanwhile, the FCC's statistics for some areas are so far off track that they can not possibly make good laws, regardless of their intentions.

The Bells have also filed state and federal briefs asking for surcharges on Internet local use or Internet Telephony. And in many states, they have hindered school wiring by either not delivering on promises or by putting caveats on available funds, making them only usable with the local companies' internet services, at unreasonable prices, or not at all.

Book V — Overcharging by the Numbers. According to Probe Research, customers have paid over \$60 billion dollars in excess Access fees, while Consumer Federation of America believes that over \$50 billion has been overcharged. By comparing the Bells

dividends and a host of other business indicators to other companies, we find that about \$80-120 billion is in question. We detail the shell game, examining terms like "subsidies" and "Price Caps" that have allowed the Bells to plead poverty while beating almost all of America's leading corporations in profits. The largest subsidies are the ones paid by subscribers to run the holding companies.

Book VI — Overcharging on Your Phonebill and How to Save Money. Believe it or not, no regulator looks at the profits of the entire telephone bill. How else can Ameritech state "State and Federal Regulators no longer limit Ameritech's Profits." In fact, in the book "the Rape of Ma Bell", the authors, two former Bell lifers, state that Touchtone Service, as well as Call Waiting and Call Forwarding, cost pennies to offer.

From my Aunt Ethel's \$1,100 rotary phone charges, to taxes and surcharges that are nothing more Bell company revenue and profits, we expose the phonebill for what it is: an unreadable profit machine.

And we'll explain how you can save money on your phonebill through simple things the phone company doesn't want you to know. We also present an internal Bell-AT&T Memo, which we dubbed "the Pelican Brief of Telecom". It discusses why paying per-minute for local service was instituted. It wasn't done to save you money.

Book VII Customers and Conclusions. After 13 years, all that customers have to show for the Bells control has been a 275% increase in local service charges and a rollout of Caller ID and Voicemail, which were all designed before the break-up. Meanwhile, customers are totally in the dark about what has transpired — so they can't complain.

Our conviction, stated in this book, is that there should be immediate investigations and audits, and that prices should be lowered immediately. The basic questions:

- Where is that 500 Channel Highway?
- Why have the States and other regulators not monitored the Bells' failure to deliver on its promises of products and services?
- Why haven't there been refunds?
- Why are there charges for Touchtone and other no-expense services?
- How did the Bells become some of the most profitable companies and still be regulated monopolies?

- Were the Bell Mergers misrepresented to the General Public and are they in the public Interest? Should siblings marry?

And these questions should be asked, not just of the Bells, but all local phone companies, including GTE.

Also, it is time to pursue other alternatives. Numerous companies and individuals have proposed that the local phone companies be separated from the Holding companies. They have consistently blocked competition, not deployed advanced technologies, have drained the local bells of assets and staff, and have taken large dividends with little benefit to the subscribers. Also, the Bells should not be allowed into other businesses including long distance, until there is real, not imagined competition, and they have paid back their Info Bahn promises.

Can it Be Fixed?

The Bells have been in control of local phone service for over 100 years, and they have, in many cases, hard-wired politicians, state public utility commissions and even the press. Why has there never been a full audit of a Bell, or a major investigation by the FCC or Congress? Why has there never been a major investigative story by a television network or newspaper? And why has there never been a book on the Bells?

It can't just be that most people look at the Babies as poor defenseless companies. Or is it that they have avoided public scrutiny by a slow conscious shaping of ideas, many times using millions of dollars of advertising, paid by subscribers, to fund customer and political complacency?

Another fundamental problem is that large, legal and regulatory walls have been put up which protect the Bells, blocking individuals from receiving adequate compensation or groups trying to accomplish change. For example, the Bells' prices are protected by something called a "Rate Doctrine", which states that "a rate is a rate", and even if there was fraud in creating that rate, it stands. And the rate is the published price that was set, most times by the PUC. Also, most Bells have to be challenged in front of Public Utility Commissions, which in and of itself is a stumbling block. And most commissions historically do not allow lawyers to recover fees, which can be millions of dollars, so taking Class Action suits facing the commission cannot be done on

contingency. To create change in America it is going to require a rethinking of these fundamental stumbling blocks.

The irony, of course, is that the advertisements used to make the customer feel "warm and fuzzy", and the lawyers and lobbyists paid to keep the status quo to block customer initiatives benefiting subscribers, are almost all paid for by the very subscribers they are overcharging.

Finally, there is another fundamental problem — having a conscience. While this tale might seem to be a discussion of money, power and deceit, it is really about corporate conscience, or in this case the lack thereof. The Bells were given a 'natural' monopoly, who's primary responsibility was the Public Interest, a loosely defined term — until you see it corrupted. In almost every part of this tale there is a lack of regard for the customer, meaning telephone subscriber. This permeates almost all corporate Bell actions. The large shareholders, meaning those who run these companies, have put their interests over and above those they were supposed to take care of, and this has got to change.

And it was NOT the actions of the local telephone staff — who answer the phones or who keep the network alive, that is the problem. With only 50% of the original staff left who now have to do almost double the work, downsizing should never have been so severe. Staff should be added to let the workers, who are conscientious, deliver better service.

I am for open markets that is full of competitive choices. The Bells are monopolists, and like the Communists, want to maintain control. May this book help to shift the balance of power — to disconnect the Bells.

Want your money back? Keep reading and join us. To receive updates of the information of this book or to get involved, please visit the New Networks Institute web site at: [HTTP://www.newnetworks.com](http://www.newnetworks.com).

Who are the Baby Bells?

For over 100 years, **Ma Bell**, sometimes called the "Bell System", sometimes called "AT&T", controlled almost all telecommunications in the US. Once the largest company in the world with over one million employees, the company consisted of 22 local Bell companies, (including New York Telephone and Ohio Bell), AT&T Long Lines, (the long distance division) as well as Western Electric, (the subsidiary that manufactured telephone equipment) and Bell Labs, one of the premier research organizations.

Then in 1984, because of the monopoly control the company had over phone service, the company was broken-up and the local Bell phone companies were divided up among seven, artificially created, very large companies called "Regional Bell Operating Companies" (RBOCs, pronounced "R-BOKS") or sometimes the "Regional Bell Holding Companies" (RHC) and sometimes "**The Baby Bells**".

Please note: AT&T no longer has any ownership relationship with the Bell companies. However, in our 1993 consumer survey, we found that about 1/4 of the population thought that AT&T still owned the Bell companies. Meanwhile 5% still call the companies "Ma Bell", or the "Bell Company". The original seven RBOCs are:

- Ameritech
- Bell Atlantic
- Bell South
- Southwestern Bell
- NYNEX
- Pacific Telesis
- US West

Each company controls specific geographic regions of the US. For example, Ameritech controls a five-state region — Illinois, Indiana, Michigan, Ohio and Wisconsin. The exhibit on the next page gives the original Baby Bells, the phone company(s) it controlled, and the state(s).

EXHIBIT 1
Regional Bells by State

Ameritech

<i>Illinois Bell</i>	Illinois
<i>Indiana Bell</i>	Indiana
<i>Ohio Bell</i>	Ohio
<i>Michigan Bell</i>	Michigan
<i>Wisconsin Bell</i>	Wisconsin

Bell Atlantic

<i>New Jersey Bell</i>	New Jersey	
<i>Bell of Pennsylvania</i>	Pennsylvania	
<i>Chesapeake and Potomac</i>	West Virginia	Delaware
	Virginia	Maryland
	District of Columbia	

BellSouth

<i>Southern Bell</i>	North Carolina	Florida
	South Carolina	Georgia
<i>South Central Bell</i>	Kentucky	Louisiana
	Mississippi	Tennessee
	Alabama	

NYNEX

<i>New York Telephone</i>	New York	
<i>New England Telephone</i>	Massachusetts	Rhode Island
	Vermont	New Hampshire
	Maine	

Pacific Telesis

<i>Pacific Bell</i>	California
<i>Nevada Bell</i>	Nevada

Southwestern Bell Corporation (now SBC Communications)

<i>Southwestern Bell</i>	Iowa	Arkansas
	Missouri	Texas
	Kansas	Oklahoma

US West

<i>Mountain Bell</i>	Arizona	Colorado	Idaho
	Montana	New Mexico	Utah
	Wyoming		
<i>Northwestern Bell</i>	Minnesota	North Dakota	Nebraska
	Iowa	South Dakota	
<i>Pacific Northwest</i>	Idaho	Washington	Oregon

Two Bell Companies Escaped: Cincinnati Bell and Southern New England Telephone (SNET) were both spun off after the break-up.

What's in a Name? Renaming the Local Phone Companies: Over the last five years, all of the Holding companies removed the local Bell name for the name of the holding company.

- New Jersey Bell became Bell Atlantic
- Ohio Bell, Indiana Bell, Wisconsin Bell, Michigan Bell and Illinois Bell were all renamed "Ameritech"

Hundreds of Companies with RBOC Name: The holding companies own literally hundreds of other companies, each with their name-brand. For example, here are just a few of the NYNEX companies: NYNEX Entertainment & Information Services Company, NYNEX Asset Management Company, NYNEX Credit Company, NYNEX Capital Funding Company, and NYNEX Trade Finance Company. (source: NYNEX 3rd Q, 1996)

Mergers and More Renaming: In 1997, two Bells purchased two other Bells, making a new total of five companies.

- Bell Atlantic & NYNEX —All NYNEX states were renamed Bell Atlantic.
- SBC Communications, (formerly Southwestern Bell) & Pacific Telesis.

Other Local Companies: There are over 1,400 other local phone companies, including United/Sprint, SNET, Lincoln Telephone or Rochester Telephone (renamed Frontier). GTE is the largest and is larger than most Bell companies. It is also a holding company, owning numerous local telephone properties throughout the US, from California to Virginia. Also, **GTE** is not a Bell company and does not own US West or any other Bell company, a common misconception.

Thousands of Other Telephone Companies

Though this book focuses on the Baby Bells, there are literally thousands of communications companies, and their relationships and services they offer are at best, fuzzy to the general public. Here's the basics

Big Difference --- Local Vs Long Distance Companies

A "Long Distance" phone call crosses state Lines. A call from New York to New Jersey or Texas to Arkansas are long distance. Every other call is either a local call, which is usually 10 miles near your home or office or a Toll call.

AT&T and MCI today are mostly long distance companies, offering long distance calling, while the Bells are local phone companies, still prohibited from offering long distance services. We argue later that the Bells should never be allowed into long distance services, for a good deal of reasons.

Two Other Important Distinctions

- **Long Distance Resellers:** Hundreds of companies 'resell' long distance services; i.e., the company purchases services from AT&T or MCI in bulk and then "Resells" the service, usually nationally, with their own name brand on it..
- **CAPS (Competitive Access Providers):** There is another growing group of companies referred to as CAPs, who also offer local telephone. Some companies have their own installations, including MFS Communications, (recently merged with Worldcom), and Teleport, while other resell the local phone companies. Most companies only offer local business services in selected area codes in America.

All other types of companies, such as "Wireless", "Cellular", "pay phones", etc, will be highlighted when necessary.

BOOK I

Info-Scandal: Highway to Nowhere

Chapter 1 Promises, Promises: The Future is Always.

It's the spring of 1993 and the fiber-optic Info Bahn is just a few months away... The April 12th, 1993 Cover of Time Magazine proclaims: "The Info Highway: Bringing a Revolution in Entertainment, News and Communication: Coming Soon to your TV Screen...". (6) The story continues:

"It's not here yet, but it's arriving sooner than you think...Suddenly the brave new world of videophone and smart TVs that futurists have been predicting for decades is not years away but a few months... We won't have to wait long. By this time next year, vast new video services will be available at a price to millions of Americans." [emphasis added]

Welcome to the Information Age: Again and again... and again.

The Information Age has always been 'just around the corner' with words, such as "soon", "next year", and "tomorrow" describing when this miraculous use of technologies and networks will change the world for the better. As best as we can tell, the term "**Information Age**" was coined in the 1960's by AT&T's public relations department, and it is a polyglot phrase that can mean almost anything you can think of. The author is reminded of meetings in the 1980's that used the term "**Information Products**" to describe everything from 900 number sex lines to home shopping.

"**Information Theory**", the basis for terms using Information-Anything, was developed at Bell Labs in 1948 almost 50 years ago. One of Information Theory's principles is that digitizing something turns it into all ones and zeros — and to a computer, well, that's all just information.

The Information Superhighway, sometimes called everything from the "Info Bahn" to the "I-Way", like the Information Age, is another polyglot term. Coined by Vice President Al Gore in the 1970's. It has come to describe the future communications network and applications, from the fiber-optic conduit to the Information Age products and services carried over the wires and through the air.

As Vice President Gore put it: (7)

"When I first introduced the concept back in the 1970's, the only company that showed any interest at all was Corning Glass, which, for some mysterious reason saw the potential in a nationwide fiber-optic network. (National Journal, 3/20/93)

Superhighway Feeding Frenzy Fuel: (The I-Way Go-Go Years)

By the early 1990's a confluence of events brought what can only be described as a techno-crescendo of I-Way dreams. It was fueled, in part, by an aggressive administrative policy lead by Vice President Gore to get business to build the I-Way. The telecom and cable giants saw this as the something that would make them barrels of new money, but also give them leverage to remove regulation on the federal, as well as the state level.

The other parts that would supposedly make the I-Way dreams real was the proposed mega-deals of 1992-1994, such as Bell Atlantic and TCI for \$33 billion, or Southwestern Bell and Cox, and US West and Time Warner. They were all "a sure thing". Who could have doubted that \$90 billion dollars of new marriages and partnerships wouldn't bring the future that much faster. Even after the TCI deal was history, Ray Smith, CEO of Bell Atlantic, was still in bravura mode. Interviewed in Wired Magazine, 2/95, he said: (8)

"I would say that by the year 2000, we'll have 50% of the cable business. No doubt about it. Which is why the cable companies are in a panic. Meanwhile, the cable companies won't have even 5% of the telephone revenues in their best markets."

There were a few people with a bit more reality in their assessments of the Info Highway. Sumner Redstone, Chairman of Viacom, (a conglomerate which now owns Paramount, Blockbuster, cable channels and Viacom Productions) spoke at the National Press Club in October, 1993. (9) He said:

"It seems to me not to be a 500 channel information Superhighway but rather a road to Fantasy Land. The assumption that individuals will

suddenly transform themselves into renaissance men and women with the potential of information and entertainment is an understatement.

"While we may anxiously await that fully-interactive, individually tailored, all encompassing home entertainment and information appliance with the greatest anticipation, the truth of the matter is that plain old television is going to be around for a long time.

"It's gonna cost a lot more, It's gonna take a lot longer, if we ever get there, and there is no guarantee that the customer is willing to pick up the price tag."

But Redstone's concerns were all drowned out by the roar of the politicians and pundits' noise.

And the Promises?

According to Baby Bell annual reports and press announcements from 1993-94, by 1997 there would be almost 20 million households wired to the all digital, 500 channel, full-motion video network, 45 million by the year 2000. For example:

US West, 1993 Annual Report (10)

"In 1993 the company announced its intentions to build a 'broadband', interactive telecommunications network... US West anticipates converting 100,000 access lines to this technology by the end of 1994, and 500,000 access lines annually beginning in 1995." [emphasis added]

Ameritech Investor Fact Book, March 1994 (11)

We're building a video network that will extend to six million customers within six years. [emphasis added]

NYNEX, 1993 Annual Report (12)

We're prepared to install between 1.5 and 2 million fiber-optic lines through 1996 to begin building our portion of the Information Superhighway. [emphasis added]

And we are not talking about the Internet or World Wide Web. The Superhighway, based on fiber-optics, is "broadband", able to supply hundreds of times more information for enhanced interactive services, while the Net is 'narrowband', based on available phone wiring. It's the difference between a Ferrari and a skateboard.

And the promises were that the Info Highway would fix everything — Tele-Medicine, Tele-Learning, even new jobs. For example, Deloitte & Touche's "New Jersey Telecommunications Infrastructure Study, 1991", dubbed "Opportunity New Jersey" (a Bell Atlantic state) proclaimed that the Info Highway was: (13)

- "essential for New Jersey to achieve the level of employment and job creation in that state"
- "advance the public agenda for excellence in education"
- "improve quality of care and cost reduction in the healthcare industry".

Meanwhile, in 1993, Ray Smith, CEO of Bell Atlantic, exclaimed at the "Electronic Summit" conference: (14)

"Imagine a button on your TV that you push to get your pizza, without the fuss and problems.

"Bell Atlantic will have the first virtual VCR, and 100,000 people by the end of the year (1993) buying things over transactional services. We will never get into the car and jump down to the store once we get used to the idea of any kind of network offering."

In fact, in Bell Atlantic's 1993 Annual Report, the company announced they were the "leaders" of the Info Bahn, and that they would be spending \$11 billion dollars. (15)

"First, we announced our intention to lead the country in the deployment of the information highway... We will spend \$11 billion over the next five years to rapidly build full-service networks capable of providing these services within the Bell Atlantic Region." [emphasis added]

Another Bell's 1994 annual report was even more bullish than Ray Smith. Pacific Telesis' President Philip Quigley boldly announced that they were going to spend a whopping \$16 billion dollars. (16)

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

Unfortunately, almost nothing was ever built and promises were never kept.

Today there are no full-motion-video, fiber-optic homes, except for tests, and the telephone companies cannot even supply two telephone calls over the same wire.

US West told the New York Times (9/26/1995), it can't be built today. (17)

"US West said it had ended its experiment into interactive television shopping because it cost too much and the technology was out of reach... John O'Farrell, president of US West Interactive Services Group said the technology to create two-way television and sophisticated programming production was years away and more expensive than originally thought.

But the hype continues, regardless of the reality. For example, even though Pacific Telesis stopped all of its major highway plans and never spent the money, a press release from SBC Communications, April 1st, 1997, touting their purchase of Pacific Telesis, stated that Quigley led Pac Tel's \$16 billion broadband Info Bahn project. (18)

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

A History of the Techno-No-Shows

Unfortunately, almost all wonderous techno-color visions of the future rarely comes into focus, much less shows up when they're supposed to. Take a look at the next quote which discusses the first round of Information Superhighway rollouts, the cable rollout of the 1970's. Here, the writer bemoans the fact that the two-way interactive world, promised in the 1970's, still hadn't arrived by the mid-1980's..

"March 4, 1984 "Ten years ago, when cable was young, it was envisioned as a technological wonderland, a purveyor—through an "ultimate box" of 108 channels atop the television set—of a lavish menu of two-way services, home banking, and tele-shopping, home security and energy monitoring, video games, polling, news and sports scores on demand. Some telecommunications experts predicted that the revenues of such services would eventually dwarf the sums realized from cable's more conventional home-entertainment fare." (19) The New York Times, Sandra Salmans, 3/4/84

But hype is a timeless thing. For example, the next quote, this time about John Malone, president of TCI Cable, echoes almost the same promises, almost 10 years later.

"October 14, 1993 "In announcing the \$33 billion deal with Bell Atlantic, the cable industry entrepreneur John Malone held out the vision of a single powerful box on top of each home television set that would combine the diverse streams of information that now flow separately into the home: telephone calls, television shows, video rentals, newspapers, and even books." (20) (New York Times, John Markoff, 10/14/93)

I've always been amazed that hype, I mean history, keeps repeating itself, rewriting itself to be current. I remember as a teenager going to the 1964 World's Fair and visiting an AT&T videophone booth, seeing and talking to friends in other enclaves and listening to the words of the telephone company stating videophones would be available by the 1970s. Personal vision aside, the Information Age and its associated products, services, and "dramatic" changes have always been driven more by hype than by a sense of *deja vu*. And the hype keeps changing, modifying itself to fit the product that is being hyped for the year.

In fact, the original Bell vision of the I-Way has been around since the 1980's. Here's some of the RBOCs on Integrated Service Digital Network's, (ISDN) potential from the 1980's. Notice that the words "Information Superhighway" can be almost substituted for ISDN without missing a beat.

Southwestern Bell, **1986** Annual Report (21)

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

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

Pacific Telesis's **1988** Annual Report states that ISDN will help California compete in the 21st. century's global economy. (22)

"To accommodate growing voice and data traffic we've nearly completed digitization of Pacific Bell's interoffice circuits. By testing and implementing advanced technologies like ISDN — which will allow customers to transmit digitized voice, text, video and graphics simultaneously over ordinary Pacific Bell lines — we're preparing California to compete in the 21st Century global economy."

It is interesting to point out that ISDN, a technology that could have been rolled out in the 1980's, waited until the 1990's before any actual implementation ever occurred— and today it's still broken, according to many in the New Media/computer/internet businesses. (We will address ISDN's roll-out problems in Chapter 6 subtitled, "It Still Does Nothing")

Sometimes, the hype and reality do meet, but the time and capital it takes to fulfill a vision can be decades, not years. Take, for example, this quote from a Scientific American Book titled "Information" 1966. Even in the early 1960's, computers connected by public telephone networks were already being envisioned by John Mc Carthy. (23)

"By 1961 John McCarthy, then Professor of Computers at Stamford University, envisioned the 'Public Utility Information System' which would interact with consoles in homes, schoolrooms, and offices. 'Everyone will have better access to the Library of Congress than the librarian himself has. Any page will be immediately accessible. Because all payment will depend upon usage, all levels and kinds of tastes can be accounted for'."

Sound Familiar? It's almost today's online services, though the billing issues, being able to bill for usage, still has not been adequately addressed or solved with the World Wide Web, three decades later.

Evolution, not Revolution

Evolution, not Revolution is the way most technologies work. In fact, it could be argued that data has been traveling through the networks long before the 60's. For example, "tickertapes", "telexes", "teletypes", and a host of other systems have been delivering information to the business markets since the 1920s. And one can argue that the "telegraph", from the 1800's, was one of the first systems to send a kind of digital data, dots and dashes, in the form of Morse Code, over an analog wire.

And now, of course, the Internet has superseded the "Information Superhighway's" domination of the press's infatuation with the "new", which started around 1994. A chart featured in Interactive Age called the "Superhighway Hypemeter" found that the number of newspaper stories (tracking 54 national and regional newspapers)

carrying the term "Information Superhighway" and similar metaphors, dropped almost 50% from a high of 1,200 stories in January 1994, down to about 650 stories by September, 1994.

Also, articles proclaiming Internet's victory over the Info Bahn started to appear regularly. For example, one article "How the Propeller Heads Stole the Electronic Future" by Steven Levy (New York Times, 9/24/95) stated that "The silver haired media monopolists follow their 500 channel dream. They haven't reckoned with the 500 million channels of Netscape and the Internet."(24) In exclaiming the demise of the 500 channel universe, Levy states that the real new Information Highway is the Internet.

"It (the Internet) is based on unlimited channels of communication, community building, electronic commerce and full-blown version of interactivity that blurs the line between provider and consumer. In short the Information Superhighway, font of a thousand bad metaphors, is already here."

And the same hype that clouded the fiber-optic rollout has been in vogue when it comes to Internet prognostications. An article in the New York Times summarized two meetings of industry pundits showing that the revolution was in full swing, at least in the mind of the cognoscenti. Peter Lewis of the New York Times, 8/28/95. stated: (25)

"The revolution will be televised. And if some of the deepest thinkers in cyberspace are to be believed, the revolution will also be e-mailed, faxed, uploaded to a World Wide Web site, catalogued in computer databases, routed on phone lines, encoded on CD-ROM disk and tattooed on billions of digital identification cards.

"According to many of the digital revolutionaries, the information age will transform the political, social and economic foundations of the planet just as surely as the agricultural and industrial revolutions did, only much faster."

One telecommunications lawyer, Peter Huber, stated that the Internet will completely change commerce. (26)

"We'll see a revolution in the infrastructure of the marketplace by eliminating the middleman sector of the economy, the Internet will enable global markets to be more efficient than ever before and we should see markets accelerating and improving beyond recognition."

At another conference, sponsored by the Aspen Institute, the idea that the world is about to dramatically change was reinforced by numerous speakers. For example, Jeffrey Eisenach, an economist who founded the Progress and Freedom Foundation stated: (27)

"What we are headed for now is a world in which a very small percentage of workers work in manufacturing, some proportion of the population works in knowledge work and the rest are in service."

Nathan Myhrvold, chief technologist for Microsoft, said even communities will change. (28)

"In the short run, we're talking about communities online. The long term effect of all this is to restructure our physical communities."

Unfortunately, most of these soothsayers don't mention the fact that numerous failures of online services in the mid-1980's were in large part, part of the developmental life of the current online markets, both in terms of initial customers, as well as the backbone of the new media community. Called "Videotex", or "Videotel", or 'Gateways", and based on the successful French "Minitel", a national rollout of online services used home terminals supplied for free by the phone company as the connection, instead of a computer; these services supplied everything from chat services to the ordering of products.

It should be remembered that it was this community of US users, a techno-savvy group, that was using e-mail and data/text services, such as "Dialog", that was the basis of all of the original online customers — "Before you were born".

Whether the current Internet and the Web will reach their full potential, or just be more fade & fashion than money maker, is still too early to tell. But this fiber-optic fairy tale and its related customer overcharging doesn't start in the present, but back to the

early 1990s, when Al Gore was finally laying out his vision of the future to a very eager group of listeners.

Chapter 2 What Was the Information Superhighway, Anyway?

Let's start with the words of the inventor, Vice President Gore. His definition from 1993 described a series of specific applications and combinations of technologies and regulations, which, taken as a whole, was perceived as both innovative and the right path to take, over the next two decades. (29)

Our definition of the I-Way is the Gore vision — a broadband, fiber-optic, fully interactive, fully digital, fully competitive, full-motion video, communications network. Let's define and explain some of these terms.

Definition: Broadband: To understand "broadband", think of a water hose with the width of a pencil, compared to a hose with a width of a large sewer pipe. Copper wire is the equivalent of the pencil, while the sewer-pipe width is compared to fiber. A great deal more water can go through the sewer-sized hose and at much higher speeds. Similarly, a great deal more data, such as full-length movies, or Internet information can travel over fiber at higher speeds.

Definition: "Bandwidth" describes the size of the pipe, or the speed that the data is flowing. More bandwidth, more information.

Definition: Digital vs Analog: Forget the science. Digital is always considered the better technology. Analog should be thought of as "older".

Definition: Full-Motion Video The term "full-motion video" refers to the network being able to deliver a picture analogous to current television, which delivers a clear, smooth motion picture. with a full spectrum of colors. This is in contrast to most videophones today, (i.e. a system that delivers a picture of the person you are taking to) where the picture may be jerky, or the voice is out of sync, and delivered usually, in black and white. Full-motion video requires a massive bandwidth and therefore can not be done over copper wire without a great deal of expensive technology.

Definition: "Interactive" A service that allow the customer to interact with the content— play a game, select a camera angle in a sports event, or participate in a class. It also is a "transactional" service, meaning that the customer can order a product or service.

The Bottom Line - The I-Way Wiring Plan

The foundation of the Info Highway was its wiring plan: to upgrade the existing, mainly copper wiring and reciprocal network switches to glass fiber wire. This would be ubiquitous throughout America, connecting every home, and every health facility, school, business, etc.

Today, almost all households in America still use copper wires.

Interim wiring strategies can also be used, such as using both "coaxial cable", which is the wiring most common in cable systems, or enhanced copper wire (using smarter technology over the same current telephone wiring, such as ISDN, or ADSL). (In 1998, the pragmatic realities are that while fiber-optics will always be able to deliver more bandwidth, copper wiring and cable coax are now being revisited to expand their capabilities.)

Wireless, Cordless plan: Numerous companies have talked about "bypassing" the wire based services altogether, using everything from satellite technologies or Cellular and Personal Communications Services (wireless PCS) to other "spectrum" services, such digital FM radio services.

As we will see, wiring America is a nightmare because it requires actually replacing everything that already is installed with new wires. And even Cable systems, using Coaxial wiring needs to be redone. We'll return to this problem later.

Technologies Merging

In the Gore vision, as well as most visions of the future, there are basic streams of technologies and industries merging: (30)

- **The Networks**, which include Telephone networks, cable networks, wireless (satellite, microwave, radio, PCS), "other carriers" electric companies
- **The Equipment**, which include computers and modems, televisions, TV boxes, telephones, fax, videophones.
- **Other Technologies**, which can include cameras, security and monitoring equipment

All, or some of these, in various combinations, would play a role in the evolution and deployment of the I-Way.. For example, a movie would appear on your computer or television, depending on the room you were in.

I-Way Regulation

According to Gore, the driving regulatory forces would need to include:

- **Investment:** Create incentives for investments in the private sector.
- **Competition:** Create an environment of competition on all levels of communications.
- **Access:** Allow equal access to all competing companies to the network, and all network services have "interoperability"—the ability of all competitors to use the same standards and protocols.
- **Universal Access:** Preserve the basic tenets of Universal Service for all subscribers. Also, the Gore vision gives the rural subscriber the same service offerings as the urban subscriber.

It should be stressed that the Info Bahn's federal life was tied, in a large part, to the Telecommunications bills that Congress was trying to make into law since the early 1990's, culminating in the Telecommunications Act of 1996. Earlier versions of the bill, such as the 1993 "National Communications Competition and Information Infrastructure Act of 1993", which didn't pass Congress, was specifically focused on "promoting a national communication infrastructure to encourage the deployment of advanced communication services". (31)

There was also two other large regulatory pieces that were needed. First, changes in all fifty states to Alternate Regulations would be required. Also, the FCC enacted the "Video-dialtone" (32) ruling, allowing the Bells to go forward. To make matters even more complicated, the I-Way plans also needed to fulfill the "politicians needs" and therefore, all fifty state legislatures had to have their piece of the I-Way action. We will discuss these regulatory changes later in Book 4: "Regulators and the Laws"

And Who Would Build it?

Though there were moments that the government threatened that this would become a public works project, the RBOCs assured the government that if the right regulation passed, the RBOCs would step up to the plate and create the Info Bahn. Also, the cable companies, the long distance companies and even other utilities all made hand-waving motions that they would be building the Info Bahn as well.

Why Do It?: Benefits of the Superhighway—The 1990's

Today, the Information Superhighway is an oxymoron but seven years ago the world was aflame with excitement.

Besides the "chicken in every pot" similarities, what the Highway was and who would use it, much less pay for it, had hundreds of groups issuing thousands of studies all trying to prove their specific point. Almost every state, federal government agency, and of course lobbyists, associations, consumer groups, and the phone companies, spent hundreds of millions of dollars on research, and almost all of it self-serving.

To start, one of the most quoted reports was by the Economic Strategy Institute. Called "The Impact of Broadband Communications on the U.S. Economy and on Competitiveness" (1993), this study stated that \$321 billion dollars in new growth could be expected over the next 16 years from the I-Way. (33)

"Economic growth in the United States would be greatly accelerated by increased private sectors' investment into broadband communications. Creating a more favorable environment for such investment could enable U.S. industries to create as much as \$321 billion new GNP growth and 0.4

percent to annual U.S. productivity growth over the next 16 years—about the time currently needed for two cycles of investment in new telecommunication infrastructure. The gains would come on top of the gain of \$191 billion in U.S. output that is already expected if present trends in broadband investment continue."

Bear Stearns, the brokerage house, was also quite bullish on the future of the Information Highway. In a report, "New Age Media" released in 1993: (34)

"In our opinion, we are on the threshold of a technological revolution that will sweep through all modern societies across the globe, dramatically changing the way we communicate, educate our children, access our entertainment and train our workers... The creation of a fully interactive nationwide communications network could open up the largest opportunity in history."

In fact, each group in America probably had visions that the Information SuperHighway would eventually fulfill some new, unexplored potential for their specific citizenry. However, almost all visions could be summed up by three specific models.

- **Government & State Justification Superhighway**
- **The Home "Wonderland" Model**
- **Internet Expansion Model**

The next section gives a brief explanation of each model.

Government & State Justification Superhighway

Let's start with what we call the "Government & State Justification Model" of the Information SuperHighway. This approach stated that the primary reasons to build the highway was to directly benefit Public Interest and special needs. The wiring was supposed to connect America's hospitals, schools, libraries, jails, and other government and nonprofit organizations to the American public.

Sold as a boon to education, healthcare and the creation of thousands of new jobs, this approach was carried out at both the state and federal levels — on the state level it was pitched as "bringing the state into the 21st Century" while on the federal level, it was used by the Bells and their supporters, as a major pusher of the passage of the Telecommunications Act of 1996. In fact, Senator Pressler, then chairman of the Senate Telecommunications Committee, stated repeatedly that "This is a jobs bill". (35)

To highlight how the State Justification approach was sold on the state level, we present a small portion of testimony from Lawton C. "Mitch" Mitchell, a partner at Deloitte & Touche. discussing their Opportunity Indiana study, which was done for Indiana Bell-Ameritech. He focuses on: "The benefits that arise from an advanced telecommunications infrastructure...and the implications of technological innovation on the telecommunications infrastructure of Indiana and various initiatives under way to respond to the demand for an advanced telecommunications network." (36)

The exhibit below highlights Mitchell's testimony topics and is followed by a description of some of the important areas where this Information Highway model would be the most useful — everything from education and healthcare to the economic development.

EXHIBIT 2

Deloitte & Touche Benefits of Information Highway for Indiana Bell, 1993

- The Emerging Role of Telecommunications in Economic Development
- Health Care: The Impact of Telecom on Quality and Cost Effectiveness
- Opportunities to Leverage Telecom to Benefit Other Public Interests
 - Education
 - Public Safety
 - Telecommuting
 - The Criminal Justice System
 - Special-Needs Groups
 - Libraries and Info Services

Here's Deloitte's analysis of telephone's role in building the economy: (37)

The Emerging Role of Telecom in Economic Development

"As the overall economy in the United States continues its transition from a traditional foundation in manufacturing toward the service-based sectors of the economy, access to information has become a major factor in the determination of competitive advantage and commercial success. More than half of the jobs in the U.S. economy are now in the service-producing sectors rather than the goods-producing sectors."

In fact, according to Mitchell, Indiana had "Almost one-half of its current employment base in industries which can be defined as telecommunications intensive." i.e. companies that supposedly spend twice the amount on their telecommunications usage. These include communications, finance and insurance, while Mitchell also adds education services, and print and publishing markets as "telecom intensive".

But it is the fixing of problems that is supposed to be the major reason to implement the I-Way. Have a problem in your school? No problem. Roll out technology. Mitchell states:(38)

"Major problems facing the U.S. educational system today include unsatisfactory educational performance, potential teacher shortages, and budgetary pressures.

"Especially within the K–12 community, educational institutions often lack the financial resources or purchase dedicated facilities to accomplish highly effective two-way interactive distance learning and other advanced educational applications that require broadband facilities.

"Distance learning is the provision of live, interactive video instruction from a remote source. Often employing interactive video, fax machines, electronic blackboards, and other forms of media, distance learning enables teachers and students in one classroom to discuss lessons with students and teachers in distant as well as multiple locations.

"Distance learning applications, which leverage advanced telecommunication services and capabilities, can help improve educational quality by eliminating the geographic constraints which have traditionally

prevented teachers in specific fields from reaching a student audience outside their classrooms. Advanced telecommunications can be used to expand the breadth of instruction in schools, not only increasing the value and diversity of education, but also increasing student interest and participation in school.

And let's not forget healthcare. According to Deloitte, everything from reduction of costs to delivering healthcare to "less mobile citizens" will be facilitated with the Info Bahn. (39)

EXHIBIT 3

Opportunity Indiana's Impact on Health Care

The Information Highway will:

- "Reduce the cost of health care through technology applications that improve hospital, clinical, administrative, and related insurance operations.
- Expand limited availability of medical knowledge and expertise.
- Improve health care quality.
- Increase health care access for rural and less mobile citizens.
- Improve and increase home health care opportunities.
- Improve the quality and availability of health care education for practitioners.
- Send X-rays to experts realtime via broadband technology.
- Give improved health care for limited resources with telemedicine projects."

Before debating the issues at hand of using the Information Highway for healthcare or education, let's first examine the other two "Information Highways" models:

- The Home "Wonderland" Model
- Internet Expansion Model

The Home "Wonderland" Information Superhighway Model

Forget the Public Interest perspective. The Information Age is everything from home shopping to movies-on-demand (the ability to watch a movie or any program at the customers convenience). These mainly consumer services make every household into a "wonderland" of technological advances, making our lives easier. This sales pitch of the Info Highway can be summed up by a series of quotes by Bell Atlantic, Pacific Telesis, and Time Warner from the Electronic Summit, sponsored by the Academy of Arts and Sciences, 1993.

Bernard Shaw, newscaster from CNN, was the moderator. He wondered how the SuperHighway was going to be paid for: "What I'm struck by is there seems to be an unspoken assumption that peoples' discretionary income is going to be there to buy your products." (40)

Ray Smith, CEO Bell Atlantic stated: (41)

"It already is there. If you look at the early (Info Highway) applications, those markets already exist. Already making those purchases. Home video is \$17 or \$18 billion, catalogs is gigantic, that is really home shopping. Games and gaming is also huge. You're talking about taking market share from other businesses, not inventing new services. They won't have to spend a single dollar more than they had to before...It's a rather sweet deal."

In another place, Smith stated: (42)

"Bell Atlantic will have the first virtual VCR, and 100,000 people by the end of the year (1993) will be buying things over transactional services. We will never get into the car and jump down to the store once we get used to the idea of any kind of network offering."

Pacific Bell's President Philip Quigley agreed that the money was already being spent in other areas wastefully, especially in education: (43)

"In the field of education, there is potentially significant waste and inefficiency today, and there are millions and billions of dollars that can be spent on educating our children to the modern technologies. And we can shift a lot of the hard dollars that can be redirected."

Also, the applications are quite similar for either cable to telephone companies. For example, the list of Time Warner's proposed services, from games to shopping, is straightforward, with some creativity added.

Gerald Levin, Chairman of Time Warner, stated: (44)

"There are great opportunities for video information. Going into an auto showroom can be an intimidating experience for some. You can call up some four-wheel-drive videos, interact a little bit, then set a time to take a test drive. So there's an auto concept. There are four major areas:

- video-on-demand movies
- games
- shopping
- news, sports, on demand, Videotex with a printer."

In fact, Levin continued:

"The conviction that started with our test in Queens, (named) Quantum, consumers really want choice. Starting in 1994, we will need to take one step further, which is true video-on-demand. In our case we think it's going to take about five years and one billion a year—five billion dollars.

"In the short term it makes a lot of sense, so we put in an impulse-purchase box in peoples' homes."

Other sources, such as Bell South's Annual Report, 1993, begins with the phrase "The Excitement is Now." (45)

"Interactively — What you want, when you want it. Many of these new services will be interactive. This means you'll have the option of controlling a network to make transactions. Select camera angles and replays. Ask a teacher a question. And compete with other viewers in tests of skill and knowledge. . .

"Need to buy a present? Call up the choices on your TV, select your gift, pay for it electronically, and it arrives the next day. Want to see a movie? Order one of thousands of titles and it will be piped directly to your set. Watch it when you want. Start it, stop it, rewind, and fast forward at your command."

In another paragraph entitled "Linking the Value Chain," BellSouth makes it clear that besides transmission, the company is also going to supply the content.

"Content, Packaging, Delivery: These are the links in the value chain of convergence for customers and investors.

- **"Content** includes TV shows, movies, games, and a limitless array of services—shopping, education, communications, advertising, financial transactions, and information.
- **"Packaging** means being in contact with you so it is convenient to access, simple to use, and affordable.
- **Delivery:** Telecommunication networks, cable TV systems, and computers are the infrastructure of delivery."

So, in the "Wonderland" Model, as stated by Time Warner, Bell Atlantic, and Bell South, we are looking at gaming, home shopping, movies-on-demand, and sports and news, mainly paid for by redirecting monies already being spent.

The Internet Expansion Info Highway Model

(NOTE: NNI published a research report titled "Inter-NOT: Reality Check on Online & Internet Services", which discussed the current market and future growth and trends, 1995-1997.) (46)

There are numerous people and companies who believe that the Information Highway is really here and growing, called Internet or World Wide Web. This international, data communications network, has 10-45 million users in the US, depending on who's statistics you believe. Starting as a government project in the late 1960s, and for decades remaining mostly a network for colleges and government agencies, in 1992 it was "discovered" by the business community at large, and literally overnight thousands of companies and organizations sprung up to offer everything from cooking recipes to the latest in advanced mathematics.

This model is the poor man's Information Highway, depending on existing computers, modems, servers, and telephone and data networks. However, some believe that it will be the computer and modem that will be the new Information Highway. According to Nicholas Negroponte, Director of MIT's Media Lab: (47)

"For interactive applications, the personal computer is going to win the battle over cable and the television box. "

While the Internet will continue to grow, and delivers many of the I-Way's original applications, it is not the Information Highway. Or at least, it is not the Fiber-optic highway — the highway you paid for.

The Info Highway — What and When

To sum up, the exhibit below highlights the original bravura of the RBOCs Info Highway rollouts, as declared in their annual reports. Ameritech stated that they were planning 1 million a year starting in 1995, while Bell Atlantic stated it would have 8.75 million households wired by the year 2000. The numbers for Bell South and SBC

communications are averages of the five companies because they never officially released their roll-out plans

EXHIBIT 4

Announced RBOC Upgraded Residential Subscribers, 1994-2000*

	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>Total by 2000</u>
Ameritech	800,000	1,000,000	1,000,000	1,000,000	6,000,000
Bell Atlantic	100,000	1,750,000	1,750,000	1,750,000	8,750,000
Bell South			1,106,000	1,106,000	4,324,000
NYNEX			2,000,000	1,500,000	6,500,000
Pacific Telesis	780,000	780,000	780,000	780,000	5,500,000
SouthWestern			1,006,000	1,106,000	4,324,000
US West	100,000	500,000	500,000	500,000	2,600,000
PER YEAR:	1,780,000	4,030,000	8,042,000	7,742,000	
RUNNING TOTAL*:					
	1,780,000	5,810,000	11,840,000	19,582,000	45,740,000

(48) Sources: *Bell Annual Reports*.

What Happened Over the Last Five Years with the Info Bahn.

Today, there are no full blown, interactive, full-motion video rollouts besides "tests", and the companies have all retrenched. In fact, according to the FCC, at the beginning of 1996 there were only 4,202 residential digital lines in America— 1 Full-motion digital line in 1996 according to Interactive Age.

Here's some RBOC quotes from the last two years:

"Bell Atlantic Delays Home Video Service", Washington Post, 4/26/95 (49)

"Bell Atlantic Corporation yesterday delayed indefinitely the home video service it had promised to introduce here and elsewhere in its mid-Atlantic service region this year."

"US West Ends Interactive Trials", The New York Times, 9/26/95 (50)

"US West, said it had ended its experiment into interactive television shopping because it cost too much and the technology was out of reach... "

"Pac Tel Cuts \$1 Billion Interactive Plan", NY Post, 9/28/95 (51)

"Pacific Telesis Group said it will cut \$1 billion over 5 years from proposed spending on its Information Superhighway amid concerns about costs, competition and regulations... The company's revamped strategy calls for it to substitute old fashion roof top antennae for cable in some areas."

According to an article in "New Media Strategist" titled "Interactive switched networks dumped in favor of plain digital", the current Info Highway rollout is now just another analog cable supplier. 11/16/95. (52)

"Over the last few months the long awaited results from a host of interactive-digital trials have started trickling in. What these trials have in common is that their video services are neither digital nor interactive... The move is away from complex interactive service toward simpler, cable-like networks." [emphasis added]

"Interactive Week", another publication that has been tracking the Info Highway progress ran a summary in August, 96. (8/26/96). (53) Exhibit five shows that only one digital test line and a host of cable rollouts, with a total of only 32,000 at best. Notice that Pacific Telesis's clients were non-paying, while Bell South's service number is only 'passed homes', i.e., a wire passes the home and the person could subscribe if they cared to.

EXHIBIT 5**Rollout of Telephone Companies and Interactive TV, 9/96**

	<u>Full- motion</u>	<u>Hybrid/Cable</u>	
Ameritech	0	0	20 cable franchises, 8-90 basic channels with PPV, Int. Programming guide
Bell Atlantic	0	1,000	Virginia: Video-on-Demand <u>trial</u>
		7,000	NJ Basic cable and Texted based.
Bell South	0	8,000	<u>passed</u> with cable Near-video-on-Demand, and online access
NYNEX	0	0	No announced activities
Pacific Telesis	1	1,300	<u>Non-paying customers</u> with basic cable one digital line
SBC	0	1,800	test with paying customers for cable
US West		12,800	Basic cable and Pay-Per View—dropped digital trials.
<u>TOTAL</u>	1	31,900	<i>Source: Interactive Week, NNI 1996</i>

Meanwhile the New York Time's article 12/18/95, by Mark Landler summed up the 1996 reality of the Info Highway in an article titled "Dwindling Expectations; Two Providers Reduced Expectations on Interactive TV" which discussed Bell Atlantic and Time Warner's recent announcements about their Interactive TV services. (54)

"Within a year Bell Atlantic plans to offer 385 channels to 38,000 residents of Dover township—compared to its full-motion announcements in 1993, which predicted 3.6 million households by 1996. "

In fact, there is approximately a 300,000% difference between the amount of rollout promised and the actual lines delivered, and a 20 million percent difference in the number of fully digital lines.

Chapter 3 The Doomed I'Way — Consumers Never Cared and It Cost Too Much Money

After watching the Info Highway events unfold and then fall apart, we can look back at our research report which predicted the I-Way's demise, "Information SuperHighway: Get A Grip", (published in 1994) and say "we told you so". However, it was only later, in 1996, after everything had died down and the Internet had taken hold of the title "the new kid on the block", did we suddenly realize that it all might have been one of the most elaborate scams in telecom history. And that was something even this jaded telecom analyst didn't predict.

We now contend that there are four major reasons why the Info Highway was never built by the Baby Bells.. The first two reasons are easy to prove:

- Consumers never really cared.
- The technology didn't work and it was way too expensive.

The next two reasons are also compelling, but the trail to prove them is much more difficult.

- It was a ruse to build cable networks.
- It was never going to be built. It was a ruse to remove regulation and raise prices.

Before entering the realm of conjecture, let's first focus on some facts about consumer interest and those surrounding Info Bahn technology. We present our consumer research from the time when the Info Highway plans were still "a sure thing", 1993 and 1994. Then we'll cross-reference our findings with other market research firms' conclusions, followed by a cost and technology analysis of the I-Way. It clearly shows that it could never be built for the money the Bells had stated. Not even close.

Consumer Interest in Interactive Phone and Cable Services

During 1993 and 1994 we launched two consecutive nationwide surveys, representing 2,000 consumers (55) And the research revealed a startling finding:

The primary reason the Information Superhighway would fail in the 1990's was that the consumers, those who actually were expected to use these new interactive services and technology, were never really interested.

And we weren't alone in discovering that consumers were luke warm, at best, to Interactive Services. A study by Advertising Age came to the same conclusion. (56)

"A disappointing 66% of the total, and more than 70% of people over age 45, said they were **not interested at all** in new media services."
Advertising Age Survey, October 1993

Using the primary applications we laid out in our previous "Wonderland" model, such as movies-on-demand, let's look more closely at the consumers' attitudes toward the new technology as revealed in our proprietary studies, circa 1993-1995 We will also cross-reference other research from Advertising Age, and a Times/CBS poll, to Fairfield Research, Inc. and Link Resources.

NNI Consumer Research — Where's the Beef?

Let's start with the first two questions about interest in videophone and movies-on-demand. (57)

- On a scale of 1 to 10, where 10 is extremely interested, how interested would you be in having a videophone service (where you can see the person you are talking to) from your telephone company?

- On a scale of 1 to 10, where 10 is extremely interested, how interested would you be in having movies sent over telephone lines to your television from the telephone company?

NOTE: NNI selected the telephone company as the primary distributor of the services because in preliminary surveys, we discovered that consumers felt more proactive toward their telephone company than to their cable company.

As the exhibit below demonstrates, it would not be disingenuous to ask at this point, "Where's the Beef?" Only 16% to 20% of the population were very excited by the prospects of these services, while 44% and 41% were not at all interested in either videophone or movies-on-demand, respectively.

EXHIBIT 6

Consumer Interest in Interactive Services, 1993

	<u>Videophone</u>	<u>Movies-on-Demand</u>
Extremely interested	16%	20%
Not at all interested	44%	41%

Source: New Networks Institute, 1993

More importantly, there is a dramatic difference in the acceptance of these new technologies by age groups, with the younger and older groups representing extreme positions. Clearly, the older the respondent, the less they want new technologies, to the point that 70% of the 65+ age group was not interested in these new services. Other criteria, such as income or the geographic location of the respondent, showed only marginal differences.

EXHIBIT 7

Interest vs. No Interest in Interactive TV Services, By Age, 1993

	<u>Avg</u>	<u>18-24</u>	<u>25-34</u>	<u>35-44</u>	<u>45-54</u>	<u>55-64</u>	<u>65+</u>
Extremely interested	17%	29%	22%	21%	15%	10%	4%
Not interested	42%	18%	29%	34%	44%	54%	70%

Source: New Networks Institute, 1993

While these statistics clearly reveal that the consumer was lukewarm to new technological services, the findings become much more startling when you ask if they would rather pay higher prices for the development of new technology or just get cheaper prices.

EXHIBIT 8
Higher Prices for New Technology?

	<u>Avg</u>	<u>18-24</u>	<u>25-34</u>	<u>35-44</u>	<u>45-54</u>	<u>55-64</u>	<u>65+</u>
Pay for new tech	19%	39%	18%	23%	17%	10%	6%
Want cheaper prices	71%	49%	73%	63%	76%	80%	85%
Don't know	10%	12%	9%	14%	7%	10%	9%

Source: New Networks Institute, 1993

In fact, only 19% of the population actually is willing to pay for new technology, while the overwhelming majority, 71%, want cheaper prices. As seen from the age breakouts, even the majority of 18 to 24 year olds would rather have cheaper services, while 85% of seniors (65+), want cheaper prices and do not want to pay for new technology.

More to the point, according to Fairfield Research, Inc.'s extensive historical tracking of purchases from computers and video games to ordering pay per view, only 65% of consumers who rate their interest level as "extremely interested", i.e., a 10 on a 10-point scale, would actually purchase a service.

Therefore, in 1993-1995, our belief was that only 11% of households would actually take the option to purchase new videophone services or movies-on-demand services. The overwhelming majority would not care, but would still be required to pay for development of these services.

It is interesting to note that at the end of 1996, we found only 10% of households were online. Also, the online demographics show that the majority of users are younger than the general population, as well as more affluent.

Other Consumer Research on Interactive Services

Advertising Age's Interactive TV Consumer Research

In October, 1993, Advertising Age conducted its own survey of 1,000 consumers and concluded: "A disappointing 66% of the total said they were not interested at all in new interactive services." (58)

Advertising Age however, believes that it was an educational problem and that consumers simply didn't know about the service. "So far, consumers don't have a clue what interactive media services are."

According to Advertising Age: (59)

"What the study shows is the purveyors of interactive media service will have to heavily educate the consumer before the concept is embraced by any age group... The study also found that when asked which services they would be interested in getting (but not necessarily paying for it) 55% chose on-demand movies or TV programs, with home shopping getting only 22%."

EXHIBIT 9

Advertising Age's Consumer Study of Interactive Media, 1993

On-demand movies or TV programs	55%
Educational children's shows	48%
Travel reservations/information	40%
TV game shows	33%
Electronic mail	27%
On-line service, like Prodigy, on TV set	25%
Home shopping	22%

However, it also turns out that about 50% were not willing to pay for either new technology or monthly fees.

EXHIBIT 10

Willingness to Pay for Interactive Services

52%	Not willing to pay anything for new hardware
48%	Not willing to pay anything for monthly fees

The similarities to our study are straightforward. We found that 44% don't care at all, while the Advertising Age study found that 50% would not pay for anything.

The CBS/New York Times Consumer Poll

Some other polls conducted at the time were more optimistic. A CBS/New York Times poll conducted June 1993 with 1,347 respondents titled, "Americans want more from TV." found that 38% would be very interested in watching reruns, 35% in making videophone calls, and 22% in playing along with a game show. (60)

However, the Times also found that, on the average, a household would spend a maximum of about \$10 a month more for these services, with only 26% stating they would pay more than \$15 a month. Below is an exhibit of the percentage of the maximum amount that people were will to pay a month.

EXHIBIT 11

Maximum Willingness to Pay a Month

Nothing	4%
Less than \$5	20%
\$5 to \$10	23%
\$10 to \$15	19%
\$15 to \$25	18%
More than \$25	8%

Source: CBS/New York Times Poll, 1993

Unfortunately, if the average payment was really only \$10 a month, then the phone companies would have lost billions of dollars on these new services. For example, at \$120 a year, it would take approximately 10-30 years to pay for the new box on top of the TV.

To summarize, the overall findings from these studies and others too numerous to mention, was that there never was any interest, especially if the customer actually had to pay for the service. Also, the customer only wanted cheaper prices today, not the Info Bahn tomorrow.

There was another model that needs to be considered before we talk about the technology. Would customers migrate to these new systems, from other businesses? Ray Smith, of Bell Atlantic, claimed that customers of home video and home shopping would simply move over — "They won't have to spend a single dollar more than they had to before." In fact: (61)

"Bell Atlantic will have the first virtual VCR, and 100,000 people by the end of the year buying things over transactional services. We will never get into the car and jump down to the store once we get used to the idea of any kind of network offering."

Unfortunately, none of the research about "Pay-Per-View", which is the Precursor to Movies-on-Demand, bear out this statement.

"Pay-Per-View": The Precursor to Movies-on-Demand.

According to a number of sources, Pay-Per-View, the precursor to (movies on demand), has never been an exciting service, and consumer research and statistics of transactions to back this statement are plentiful. Though there has been successful events, especially boxing matches and other similar sports events, or adult entertainment, Pay-Per-view has never lived up to what people projected it would attain.

First some definitions:

Pay-Per-View (PPV): A cable viewer can select a specific movie, usually running on its

own cable channel, and airing at specific times. For example, the customer can see the Jim Carrey movie, "Liar, Liar", starting at 8:00, 12:00 and 4:00 on Channel 61. Some cable systems require a specific telephone call to activate the programming, while others can be done from the TV-cable box.

Movies-on-Demand (MOD): Sometimes called "Video-On-Demand". The customer can choose a movie, past TV programming, educational specials, etc., at their discretion, any time, and have all the control features of a normal television VCR, such as "fast forward" or "pause".

Near-Video-On-Demand (NMOD): A system that has some, but not all of the features of Movies-on-Demand. For example, in one RBOC test, humans loaded specific movies for customers. In another test, once a selection was made, there were no controls, such as pause.

Though many argue that comparing pay-per-view to movies-on-demand, is wrong because MOD is interactive — movies on a rotating schedule vs movies when you want them. However, MOD tests around the country demonstrated that a person's free time is limited and therefore viewing time, regardless of the technology, whether it be a VCR rental, a Pay-Per-View or even Movie-On-Demand, are all vying for the customer's time, which makes them comparable. Just the delivery vehicle is different.

VCR Penetration and Video Rental Market

Let's start with video rentals. The exhibit below reveals that in 1993, the majority of American households, 85%, had VCRs and that these households rented approximately 7 tapes a month (1.6 tapes a week, about 83 movies a year) in 1993 — which brought in about \$13.5 billion dollars. (62)

EXHIBIT 12

Fairfield Research on VCR Penetration and Usage, 1993

Number of households with VCRs	85%
Average rental cost	\$2.60 per rental
Average per month	7 movies a month

To update to 1996, an article in the Wall Street Journal "Video Buying Is Surprise Hit With Viewers" (63) 1/17/97, quotes Adams Media Research, who found that video rentals and purchases in 1996 came to a total of \$16.5 billion. Also, an entirely new phenomena has been occurring in the video stores — customers are now purchasing videos as well as renting them. In fact, according to Adams Media research, Disney's video sales alone hit \$2.6 billion during 1996.

While this \$16.5 billion dollar industry is thriving, historically, pay-per view has been, comparatively, almost dead in the water.

Consumer Pay-Per-View Statistics

Link Resources Annual Consumer study from 1993, based on surveying over 1,400 consumers, showed that there just wasn't any interest in pay-per-view services. Only 7% of households said they were very interested, while the overwhelming majority, **72%, stated they were not interested in pay-per-view**, even if it was "possible to order pay-per-view programs like boxing matches, hit movies, or concerts to watch over cable TV, not prerecorded cassettes, and pay for them on a per-program basis." (64)

EXHIBIT 13

Link Resources Survey of Interest in Pay Per View, 1993

Very interested	7%
Interested	20%
Not interested	72%

Source: Link Resources, 1993

But that is not the bad part of the story. Link's examination of households that DO order pay-per-view revealed that 50% of households ordered less than once a month, 21% ordered about once a month, and 21% ordered two or three times a month. Heavy users, customers that used Pay-Per-View at least once a week, were less than 2% of the users, equating to approximately .4% of the population.

EXHIBIT 14
Frequency of Ordering Pay Per View, 1992

Less than once a month	50%
About once a month	22%
2-3 times a month	21%
4 or more times a month	2%
Don't know	5%

Source: Link Resources, 1993

In another research study, Paul Kagan Associates estimated that approximately \$361 million was spent on pay-per-view in 1993, and that the average price was \$4.35, which comes out to less than one pay-per-view order per household per year. (65)

If the findings about the lack of public interest isn't enough, a more disturbing consideration is just how profitable the area was expected to be.

Bob Alexander, president of Alexander & Associates, discussed the cost structure of the pay-per-view markets and stated that the RBOC video-on-demand services had to generate billions, while in 1993, pay-per-view was lucky to break even. In a New York Times article, 2/17/93 he states: (66)

"Everyone is talking about video-on-demand as the "killer application" for interactive television. But I don't think it stands up."

According to the New York Times:

"Mr. Alexander estimated that it would cost \$100 billion to deploy advanced electronic network to most American homes [to offer the service]. That works out to almost \$1,000 a home. He then assumed that the price per movie in the interactive television trials would be \$1 to \$4, generating an hourly rate of 50¢ to \$2 per hour, of which the cable operator would clear 25¢ to \$1.

"Then he estimated that the cable industry would require a 15% to 20% return on investment. If that is true, it would require 20 to 80 billion hours

of movies-on-demand. If the figure were 50 billion hours, that would work out to 500 hours per household—10 hours per week, or 5 movies a week for every household in the country. It is not disloyal to say that this kind of activity is simply not in the cards. Something besides movies-on-demand will have to pay for the new networks."

Shifting back to the current state of affairs, Video Magazine, in an article titled "Video-On-Demand Tests, and Hype Continue Despite Telco Shift to Wireless Communications", 4/14/97, (67) the phone company roll-outs are all but stillborn.

"Despite the lofty predictions and continued tests, the major phone giants are still displaying little eagerness to jump into the video business."

The article also found that while Bell Atlantic stated that most customers in their northern Virginia 18 month, 1,000 household test of near-video-on-demand "quit renting videos", this was still only a test and deployment is years away, if ever. Notice that it is "near-video-on-demand", not the real thing. And it is 1,000 people instead of 100,000. (68).

Bell Atlantic doesn't plan to roll out 'true' video-on-demand service until 1998 at the earliest, and then only in Philadelphia." (69)

Using the Alexander statistics, the company would have to dramatically increase usage, not simply have customers "quit renting videos." Also, there was no mention of whether Bell Atlantic charged customers for movies they viewed in the test.

Meanwhile, Video Magazine, (70) stated that Pay-per-view services only garnered \$500 million dollars in 1996. Not a great deal more than in 1993.

Technology Doesn't Work And It Is Too Expensive: Original Cost Models.

During the 1990's, numerous sources provided information about the costs of outfitting the network and the consumer with the proper Info Bahn technologies. While the phone companies insisted that the average cost per household was \$750-\$1,000, our

finding was that it would cost over \$2,500 per customer. And that was just for the required new TV/cable set-top box in the house.

In fact, both numbers were way low. The technology never worked as advertised. As previously mentioned, US West stated that the technology to create interactive television was "years away and more expensive than originally thought".

Meanwhile, an article in the New York Times, 12/18/95, quoted Bell Atlantic, which stated that the price to deliver the "Wonderland" applications was about 17 times the original costs. (71)

"Bell Atlantic revealed that it cost \$17,000 per household to build and deliver a Full-Service network."

The Info Bahn Technology Made Simple

Simply put, there are a series of costs associated with delivering full-motion video to the home. (We will discuss networks and services, including ISDN in future sections) These include: (72)

- **Rewiring the Street:** The entire street wiring, either on the poles or below the ground, as well as all of the "drop-lines, lines that connect a house to the street's main wiring, must be redone.
- **All New Network Components, Including "Switches":** Fiber-optic cable requires all different network switches, which are advanced computers connected to the fiber-optic lines that control and distribute the massive amounts of video and audio over the network.
- **A New TV Set-Top Box:** Like the cable set-top box that usually sits on top of the TV or VCR, the Info Highway design requires a new, very powerful computer, today costing thousands of dollars per home.
- **Rewiring the Entire House:** A house has to be entirely re-wired with fiber-optic cable, replacing the copper wire.

- **Besides all of these charges there are hundreds of other detailed charges that are not important for this discussion.**

The rest of this section looks at the costs for the I-Way as presented over the last five years.

Other Info Bahn Technology Models: Bear Stearns

Bear Stearns released a report in 1994 titled "New Age Media," which estimated technology charges would range from \$650—\$1,100, using information supplied by Bell Atlantic and other companies. There are two models: the telephone Broadband system (BBT FLX) should cost \$650-\$900 per household, while a hybrid cable version (TVHFC) would cost \$950-\$1,100. (73)

"For offering interactive applications, systems such as those being installed by Bell Atlantic and using technology from broadband technologies are less expensive than the cable TV hybrid fiber-coax (TVHFC) network solution. Total costs for installing the BBT FLX System (Broadband) would range from \$650 to \$900 per home, while the typical cable TV HFC system should range between \$950 and \$1,100."

Technological issues aside, their price for the various components gave the expense of the set-top box at only \$225 for a "telephone digital video terminal" to \$450 per home for a "cable TV hybrid fiber-coax set top." Other expenses were outlined, such as the "Telephone Optical Network Unit" at \$60 to \$180, or the telephone's "Host Terminal" at \$200 per-home passed, excluding inside wiring costs.

A Few Techno-Naysayers

There were some who didn't believe the hype. For example, numerous speeches given at a conference titled "Interactive Marketing," May 1994, (74) discussed the technological and manufacturing hurdles required to bring to the residential subscriber full-motion, interactive video services. The consensus was simple:

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

In fact, in most of the Interactive TV trials during 1994-1995, the price per set-top box was between \$4,000-\$5,000. The Time Warner trials in Orlando, originally scheduled for spring 1994 (and shut down in 1997) were delayed a year because even the prototypes were not fully operational and the boxes reportedly cost \$5,000. In another trial by Viacom and AT&T in Castro Valley, that was also canceled, the cost was \$4,000 per box.

While the hope was to have the mass production unit cost only \$300 per set-top, based on computer pricing and increases of computing power, it will most likely be 2005 before this threshold is reached, possibly longer.

This \$4000-\$5000 box didn't take into account the network upgrades, or the digital switches and servers, which were believed to cost an additional \$1,000 to \$1,200 per subscriber.

Last, but not least, is the required last mile of rewiring from the street to the customers' premises and through the house. In 1996, the nationwide average for an installation was about \$82.58 (75) for the first hour and \$63.15 for each additional hour. Rewiring would take, on the average, 1.5 hours or \$115, not counting initiating service fees, deposits, etc., which can be an additional \$250. This also would not include "drop-lines," and a host of other specific installation services.

Adding up all these variables, in 1995, we expected the average new customer to cost at least \$2,500, after a production model was finally deliverable.

Cable and Phone Company Techno-Wiring Hodgepodge

Some plans called for the cable companies to use their existing wiring, or the phone company to use the copper more effectively. But like a Rube Goldberg

contraption, where every turn is turmoil, there is an entire mismatch when using the existing wires—especially for the final mile and the customers' residence. For example, just look at the household placement of telephone and television/cable. The most obvious problem is that the wiring is not in the same room. The phone is almost always in the kitchen or bedroom, while the TV is in the living room, den, or bedroom (not necessarily the same bedroom as the telephone).

Rewiring, either for cable companies offering telephone or visa versa would also require rewiring homes. Would the RBOCs waive the installation charges? Would people pay them?

The 1996 Punchline: Average cost per household was \$17,000

Chapter 4 Case Study: Opportunity New Jersey—An I-Way Failure

Opportunity New Jersey, the first of the Opportunity alternate regulation plans, turned out to be nothing more than an opportunity for Bell Atlantic to make more money. Using this as a case study, we would like to demonstrate how the broken regulatory fabric and the massive Bell lobbying efforts, specifically Bell Atlantic, all worked in conjunction to overcharge customers without serious retribution from the state commission, the Advocate's office, or even the state legislature.

Though we will return to all of these topics in future chapters, what happened in New Jersey pretty much sums up the process of regulation nationwide — a failure of the regulators to control Bell profits or monitor Bell's technology deployment promises.

What Happened to the Info Bahn in New Jersey?

According to a brief filed by the New Jersey's consumer advocate (Division of the Ratepayer Advocate) with the New Jersey Board of Regulatory Commissioners (BRC), NJ's state utility commission, on March 21, 1997: (76)

"Bell Atlantic-New Jersey (BA-NJ) has over-earned, underspent and inequitably deployed advanced telecommunications technology to business customers, while largely neglecting schools and libraries, low-income and residential ratepayers and consumers in Urban Enterprise Zones as well as urban and rural areas."

So much for the promise of the Info Bahn. Before delving into the telecom muck and how the Bell has prospered by not fulfilling promises and thus overcharging customers, let's go back to 1991, when New Jersey Bell presented a new plan created by Deloitte & Touche to move New Jersey into the future.

Background

In March of 1991, the findings of a report written by Deloitte & Touche on behalf of New Jersey Bell were presented to politicians and government regulators, from the

Governor on down. Dubbed "Opportunity New Jersey", it stated that New Jersey needed to implement "policies that encourage development of an advanced telecommunication infrastructure." In fact, the study stated, this was essential for New Jersey's future. (77)

"(fiber optics is) essential for New Jersey to achieve the level of employment and job creation in that state", would "advance the public agenda for excellence in education", and "improve quality of care and cost reduction in the healthcare industry".

And this rhetoric was also repeated by the phone company. For example, Alfred C. Koepee, Vice President of New Jersey Bell, said the plan was New Jersey's future, building new networks to create jobs. (78)

"You have a choice as a regulator. You can move into the future, or you can put through a 10-cent reduction in somebody's bill. It makes a lot of sense to build the new technology to create new jobs."

According to an article by Rick Linsk titled "All the Right Connections, — New Jersey Bell and the Wiring of a Regulatory Bonanza", from The New Jersey Reporter, the entire series of events that led up to the passage of Opportunity New Jersey by the state legislature and endorsed by the state utility commission, was one of the most masterful lobbying jobs in the state's history. According to Rick Linsk:

"Above all, though, credit goes to a combination of muscle and merit and to one of the savviest, most complete and aggressive lobbying efforts ever to accompany a public issue in New Jersey. For nearly a year, Bell missionaries had swarmed over the state spreading the gospel of fiber-optics to doctors, teachers, labor leaders, the (Governor) Florio Administration and the Legislature. It is now clear, in retrospect, that the hard-sell worked so well, and the connections forged by top-flight influence-peddling ran so deep, that Bell had won long before the first vote was cast.

"When the dust had settled, the Bell had spent \$640,000 on lobbying, a huge sum by New Jersey standards. For comparisons sake, Bell spent \$79,079 the year before." (Note: This figure does not include the Deloitte & Touche study.)

Others, such as Nancy Becker of the New Jersey Cable Association, believed that even the Deloitte & Touche study, at a cost of \$1.2 million dollars, was nothing more than a lobbying document. (80)

"It was basically a lobbying document with the imprimatur of the board (Utility board) on it... It was a million-dollar lobbying document. "

According to Linsk, other critics made it clear that the Board of Regulatory Commissioners, (BRC), specifically Edward Salmon, Chairman, was perceived as "too tight" with the Bell company. (81)

"Arthur Cooper, president of a pay-phone company that competes with the Bell: This is my opinion, but if everybody in the room was blindfolded, and without being introduced he (Salmon) read his testimony, they would have thought he was not from the BRC; they would've thought he was from Bell."

In May of 1993, the New Jersey Commission officially implemented Opportunity New Jersey.

The Outcome — Opportunity for the Bell

According to the NJ Advocate, the original rate-of-return regulation was replaced by Opportunity New Jersey, an alternate regulation plan based primarily on the promise of "greatly accelerated deployment of advanced technologies...approximately \$1.5 billion dollars above current expenditures." (82)

"The ONJ (Opportunity New Jersey) Plan replaced traditional rate-base/rate of return regulation with an incentive ratemaking system in

exchange for a commitment from BA-NJ to greatly accelerate deployment of advanced technologies in its communications network to the entire State by the year 2010 at an estimated additional capital expenditure of approximately \$1.5 billion above "business as usual" from 1992 through 1999. Through the incentive of alternative regulation under the ONJ Plan, BA-NJ was given the financial flexibility to operate in the new competitive telecommunications market in exchange for commitments to upgrade the network in order to realize "positive benefits" to the New Jersey economy."

In fact, according to the Advocate, the Bell company only spent \$79 million dollars, not the \$1.5 billion promised. (83)

"Although BA-NJ projected that it would expend approximately \$1.5 billion in network investment above "business as usual" by the end of 1999...However, the Ratepayer Advocate has calculated that BA-NJ has spent a total of \$79 million above "business as usual" over these years."(1992-1995)

More to the point, the actual dollars spent on construction dropped below normal levels. (84)

"BA-NJ can hardly be characterized as having made capital expenditures beyond "business as usual" during the first three years of ONJ. (1992-1995) Indeed, in constant 1987 dollars, the company's capital expenditures have actually decreased. "

And how has Bell Atlantic prospered from the plan? — Almost one billion dollars of excess profits, and a return on equity almost twice what a regulated monopoly should be making. (85)

"Since the time of the adoption of the ONJ Plan, BA-NJ has received enormous financial benefits, greatly in excess of the Company's original projections. The gains captured by BA-NJ, which probably would not

have been achievable but for the Plan, as set forth immediately below, involve earnings, dividends, return on equity, cost of debt and additional benefits."

During this period:

- "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."

NOTE: *Dividends, in this case, are the monies that New Jersey Bell paid to Bell Atlantic, the holding company.

The Other Dark Secrets to Opportunity New Jersey

Besides the obvious overcharging of customers, the Advocate in two other documents, one discussing the Bell Atlantic/NYNEX merger, and the second being the Advocate's annual report, (86) clearly showed that Bell Atlantic/New Jersey business practices were filled with problems. They ranged from the company's customer service provisioning, or the price of ISDN service, to low-telephone subscribership due to non-existent low income options.

- **Customer Service Provisioning:** According to the Advocate, numerous customer services, from meeting appointments to even properly answering directory assistance calls, have all had a decrease in the standard measurements of good service. (87)

"BA-NJ's performance in the following categories was lower in the year ending September 1996 than in 1993, 1994 and 1995:

- (1) percentage of service order provisioning completed within 5 working days;
- (2) percentage of service order provisioning appointments met; and
- (3) percentage of directory assistance calls answered within 10 seconds."

"In addition, the service standards regarding the percentage of BA-NJ customers having no difficulty reaching repair were below the targeted levels in July and September 1996. These standards also dropped from 1995 to the year ending 1996 by approximately 450 to 500 basis points. In addition, the service standard regarding the percentage of service trouble reports cleared within 48 hours experienced a percentage decrease of approximately 480 basis points from 1995 to the year ending September 1996 and this service standard was below the exception and surveillance levels in July 1996 and August 1996. "

- **Lack of Low-Income Options:** New Jersey has had a steady decline in the number of telephone subscribing households, and the Advocate believes that this can be attributed, in part, to the fact that the state had not implemented proper low income options. (88)

"The Ratepayer Advocate has continually pointed to the fact that BA-NJ fails to provide adequate measures to ensure the availability of affordable telephone service for the state's low income consumers.

"In 1995, New Jersey was identified as the only state that experienced a statistically significant decrease in residential penetration, and in 1996, New Jersey was only one of three states (plus the District of Columbia) to have experienced a decrease in subscribership.

"Although New Jersey's annual average penetration rate rose slightly from 92.3% in 1995 to 93.6% in 1996, the fact still remains that New Jersey has experienced a declining subscribership for the past several

years, and that, despite the increase reflected in the most recent monitoring report, we continue to fall below the national average."

- **ISDN Rates:** According to the Advocate, BA-NJ's ISDN rates are "excessive" and this is stifling deployment of ISDN. (89)

"The Advocate argues that Bell's proposed residential ISDN rates are excessive and will stifle deployment and expansion of this valuable technology...Bell's proposed revised tariff submitted to the Board on April 19, 1996, offers residential ISDN service in New Jersey for prices ranging from \$23.50 to \$249 per month, with full bandwidth usage charges of \$0.04/minute from 7 a.m. to 7 p.m. and \$0.02/minute from 7 p.m. to 7 a.m. Over the ensuing four months, the Ratepayer Advocate and Bell attempted to negotiate a settlement to set mutually acceptable rates, but Bell did not propose an ISDN pricing structure which the Ratepayer Advocate could support. "

"Fatally Flawed" New Research —Another Deloitte & Touche Study

The Advocate also discussed a new survey prepared for Bell Atlantic by Deloitte & Touche, stating that it was "fatally flawed". The survey attempted to "demonstrate the importance of telecommunications to business in terms of their operations, efficiency and competitiveness and how their usage of advanced technologies has dramatically increased.". (90)

"Deloitte & Touche Consulting Group conducted a survey of 45 businesses in the State of New Jersey. The survey indicated that 97% of the businesses surveyed believe that telecommunications is critical to their business' ability to compete. The survey also showed that business usage of telecommunications increased by 80% over the last three years. Among all the businesses surveyed, 75% used ISDN, 60% used frame relay, 41% had dedicated lines, and 30% used SONET rings. The survey of small business showed that 100% used ISDN, 75%, used frame relay service, 41% had dedicated lines, and 30% used SONET rings." (91)

Reviewing the methodology and findings clearly shows just how flawed this self-serving study is. First, probably only 2-5% of business users use ISDN services today, not 75%-100%. Worse, Bell Atlantic created the list to be surveyed, knowing full well these were heavy users of new technologies. According to the Advocate: (92)

"The study presented to the Board cannot be relied upon because it is fatally flawed. The study is of only 45 businesses in the State, which is not a representative sample of the businesses in the this State. Furthermore, the 45 business selected by Deloitte & Touche were drawn from a list supplied by BA-NJ, which was comprised of BA-NJ customers."

Advocate Solutions — A slap on the wrist would have been nice.

While the Advocate has tried to help subscribers, a recent agreement between the phone company and the regulators pertaining to Opportunity New Jersey clearly demonstrates just how broken the regulatory system is.

As just outlined, the Advocate found that Bell Atlantic had not delivered on the Opportunity New Jersey Plan. There was no interactive services nor any massive fiber-optic deployment. More to the point, almost \$1 billion dollars of excess dividend profits was accrued by the Bell company from 1992-1995.

Yet the agreement made between the Bell company and the state clearly shows that the regulators are either unwilling or unable to step up to the plate. Here's the details.

A press release from the New Jersey Advocate titled "New Jersey Consumer to See \$176 Million in Benefits from Bell Atlantic Agreement with Ratepayer Advocate and BPU" was released on April 21, 1997. (93) And though the rhetoric says that schools will be wired and low income residents can receive discounted rates for phone service...

"As a result of the modification of ONJ, Bell Atlantic will accelerate its schedule to provide New Jersey's 3,557 public and not-for-profit schools and public libraries with broadband service by the end of 2001, offer up to 225,000 low-income residents a discounted rate for phone service, accelerate its schedule to provide Urban Enterprise Zones with access to

high-speed telecommunications services, and create up to 800 new jobs in New Jersey by the end of 1997."

...the details reveal that the rewards are mostly handwaving. There are virtually no guarantees of any monies returning to subscribers. The release states: (94)

- "establish a "Lifeline" fund for eligible low-income New Jersey residents, which will provide a **credit of up to** \$7.00 per month/customer, with an estimated total value of \$18 million";
- "forego seeking rate increases through 1999 that **could have totaled** \$28 million; and",
- "use **best faith efforts to** achieve a net job gain of 800 full-time employees in New Jersey by the end of 1997."

What's wrong with this picture? All of the savings and new service promises are based on 'conditional' phrases: "use its best efforts to get jobs", "offer a credit up to", and forego rate increases that "could have totaled \$28 million". There is not one concrete dollar. From a legal standpoint, if the company spends only \$2 dollars it qualifies as an "up to" amount.

Meanwhile, customers are paying hard money, by having to pay excessive prices, and therefore Bell profits, while all that's been agreed upon is soft money — there is no cash, no refunds, and even no legal promises.

More to the point, in 1997, New Jersey Bell still charged for Touchtone Service, and its Toll call prices were still some of the highest in the country. Also, the company's returns were 100% higher than a utility should be earning.

And then there's the amount of excess — almost \$1 billion dollars of excess profits. This means that customers paid over \$300+ million a year in excess dividends, and yet this agreement calls for nothing more than a 'value of \$176 million in benefits' with no payback for over \$1 billion dollars and no reductions of \$300 million annually!.

To put this into perspective: New Jersey had approximately 5.4 million phonelines at the end of 1995, so the overcharging comes to approximately \$175 per line (counting interest) for just those three years.

The author's position is that the Bell company should have been re-regulated, all of the monies accrued that were not spent on the fiber-optic service provision should have been returned, penalties should have been imposed, including interest, and prices should have been slashed to the appropriate level of a company who's regulated rate-of-return should be 11%; i.e., a utility rate , not the current 21%+.

In this case we fault, not the Advocate, though they may have been able to get more concessions from the Bells, but the New Jersey Board of Regulatory Commissioners for not adequately protecting the public interests.

Oh-Oh, Another Billion Owed? What About Massive Network Write-offs?

The Advocate found that Bell Atlantic-NJ dividends were excessive and that the return on equity had doubled, but there was another billion dollars of extra profits that they didn't include. It was accrued from a massive network write-off, based on a change in accounting, a change that was implemented because of Opportunity New Jersey.

In Chapter 18 we detail "depreciation", a business accounting term that describes how a company writes-off its construction expenses, and we explain that by accelerating the write-offs the Bell companies were garnering billions in basically free cash. This cash was supposed to be used specifically to build the fiber-optic highway, but virtually nothing was ever built.

More to the point of our story, in examining the 1994 Bell Atlantic-New Jersey Annual Report, we find that with the implementation of Opportunity New Jersey, the telephone company changed its accounting principles and took additional write-offs, adding over \$1 billion in free money. This accounting's obscure name is "FAS 71", for Financial Accounting Standard 71. (95)

EXHIBIT 15

Bell Atlantic New Jersey, Write Bonanza, 1994

(in the millions)

Increase in Plant and equipment depreciation reserve	\$ 946
Other regulatory assets and liability elimination	\$ 67
Total	\$1,013

Source: New Jersey -Bell Atlantic Annual Report 1994

This billion dollars was applied to income tax and so the company showed the charges, as a savings of \$423 million in taxes and a charge of \$589.7 million in extra cash. (96)

"In connection with the decision to discontinue regulatory accounting principles under Statement No. 71, the Company recorded a noncash, after-tax extraordinary charge of \$589.7 million, which is net of an income tax benefit of \$423.2 million." [emphasis added]

There were also a host of other savings not mentioned by the Advocate, from a \$7 million "extinguishment of debt", and a \$67 million dollar "Regulatory Asset and Liability elimination", to a \$36 million dollar annual increase in depreciation expenses.

And make no doubt about it. These savings were accrued because of Opportunity New Jersey. (97)

"The Company's determination that it was no longer eligible for continued application of the accounting required by Statement No. 71. It was based on the belief that the convergence of competition, technological change (including the Company's technology deployment plans), actual and potential regulatory, legislative and judicial actions, and other factors are creating fully open and competitive markets." [emphasis added]

When we consider that Bell Atlantic never built the highway, nor was there competition in 1994, can these accounting changes be justified, or are these additional monies that should be returned to subscribers? We will return to this question in later sections.

Chapter 5 ISDN (The Info Bahn, Take 1): "It Still Does Nothing"

Non-Technical Definition: ISDN, Integrated Service Digital Networks, is a digital access line, that should give the customer more information, faster, over a single copper telephone line. An ISDN line should deliver 3-5 times more speed for Internet connections, or deliver larger graphics files faster. The service can also be used as two separate telephone 'channels' over one wire, meaning that the customer may have two telephone calls simultaneously, without bringing an additional second wire into the home.

Technical Definition (See footnote 98)

The Promise:

ISDN was the original promised technology for the first Information Superhighway, circa, the mid-1980's. In 1986, over 12 years ago, Southwestern Bell's Annual Report said ISDN would "revolutionize day-to-day communications". (99) Pacific Telesis promised that ISDN "will enable everyone with phone service to take part in the information revolution over fiber cable or the now-common single copper pair of wires."(100)

Sound familiar? Well for the next decade, ISDN has been little more than 10 years of smoke and mirrors. It is the original "Failure to deliver on promises of new network enhancements".

This lack of deployment should also trigger in the reader's mind the need for audits and investigations on a state and federal level. Why? Because state alternate regulations gave the Bells more profits to be used for ISDN technology deployment...which never occurred.

The ISDN Reality, 1997-1998

According to many in the new media industry, ISDN is still not a fully functional service. It is very expensive, it can't be easily delivered if the person lives 3 miles from a

network switch, and some areas can't receive ISDN at all, including major parts of NYC. And horror stories of people trying to use it are legendary. A recent article by Al Perlman, a web/technology writer for Interactive Week, titled "Fear and Loathing With ISDN" (October 6th, 1997), defined ISDN as "It Still Does Nothing". He summed up the various horror stories he had heard. (101)

"The problems ran the gauntlet of bureaucratic foul-ups. inexperienced technicians, telephone personnel who never heard of ISDN, incompatibilities with ISDN lines of other carriers and on and on."

Perlman's own experience with ISDN service: It never worked as advertised and the phone company "doesn't know when this will be fixed". As he put it, even after a decade, the telephone companies still don't have the kinks worked out. (102)

"I had heard all the horror stories but tried to defy the odds. I remember writing about ISDN for the first time in the mid-1980's. I'd had thought, by now, the telephone companies would have figured out a way to deal with this technology. But in my experience, No dice."

Ironically, almost two years ago, Kate Maddox, senior editor of now defunct Interactive Age, called it "A Consumer Nightmare." (July, 1995). (103)

"Despite all the hoopla about advances in ISDN (just about every Regional Bell is touting it as the next frontier), I had heard horror stories about getting one hooked up and working in your home.... I wouldn't recommend ISDN for consumers unless they have plenty of time and their own private tech support team.

Ms. Maddox goes on to say that it took "a veritable army of support technicians in four states", cost over \$900 dollars including hardware and telephone installation, none of the equipment worked with each other and the entire package took over three months to be almost functional. In fact, Ms. Maddox had to put in a network "repeater" because she was more than 14,000 feet from the Central office...at an expense of an additional \$21.50 a month.

Jerry Michalski, industry analyst and Managing Editor of the respected Release 1.0 newsletter, said even the telecom resellers are telling their clients not to use ISDN. According to Michalski: (104)

"Our system integrator talked us out of it. He said it wasn't dependable enough to use on a day-to-day basis. And we're located in the middle of Manhattan's Silicon Alley."

Others can't even get the service. Daniel Dern, former editor of Internet World and author of two books on the Internet (MC Graw Hill, Prentice Hall) states: (105)

"ISDN is a joke. After a bunch of calls they told me I couldn't get it because I lived over three miles from the central office. Worse, my friend in Boston got his installed and it keeps having problems. When he calls NYNEX they tell him that they don't offer anything called ISDN."

So what if ISDN was advertised in the mid-1980s as a technological wonder that would change the world.

ISDN — The First Information Superhighway — That Never Was

Using the Bell's own words, we want to make it clear that the Bells promised ISDN deployment in the 1980's and they even stated that it was available by the early 1990's. Let's go back over 10 years. Here's some of the RBOCs on ISDN. Notice that the words "Information Superhighway" can be almost substituted without missing a beat.

Southwestern Bell, **1986** Annual Report: (106)

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

"With ISDN customers will have the potential to access videotex, telemetry, alarm services, sophisticated calling features, teleconferencing much more economically than they can today. The company is responding to requests for ISDN services by custom -fitting it's ESSX central office based communications services already in place. "

Pacific Telesis **1987** Annual Report: (107)

"Pacific Telesis's Group's vision of the future is universal access to information — Thanks to ISDN.

"In 1987 Pacific Bell began the first in a series of three tests, to be completed by 1988, of a new technology for ISDN. I'm not going to launch into a highly technical discussion of ISDN here, but I would like to point out why it's so important. Developing a universal, international standard ISDN will insure the compatibility of communications equipment which will enable everyone with phone service to take part in the information revolution over fiber cable or the now-common single copper pair of wires."

Pacific Telesis **1988** Annual Report: (108)

"To accommodate growing voice and data traffic we've nearly completed digitization of Pacific Bell's interoffice circuits. By testing and implementing advanced technologies like ISDN — which will allow customers to transmit digitized voice, text, video and graphics simultaneously over ordinary Pacific Bell lines — we're preparing California to compete in the 21st Century global economy."

Bell Atlantic's Annual Report **1990**: (109)

"Bell Atlantic's investment in new technology also includes deployment of Integrated Services Digital Network (ISDN) features. ISDN combines telephone and computer transmissions on a single line and makes creation of computer networks relatively simple and efficient. Users include major

customers such as the John Hopkins Medical Institution in Baltimore and several federal agencies in and around Washington. Bell Atlantic has successfully tested ISDN for residential users, as well, in anticipation of the growing demand of home data services. "

Ameritech **1991** Annual Report: (110)

"ISDN Speeds Information. 'The ISDN link multiplies, by more than 40, the speed with which information can be transmitted', says Illinois Bell's Bill Kallmyer, senior marketing operations manager. 'This results in higher productivity and lower on-line charges for consumers'. Kallmyer says ISDN is available to single-line customers as well as larger firms." [emphasis added]

And the promise of ISDN continued into the 1990's. For example, Pac Bell's "Education First" program was to spend \$100 million in connecting all schools to the superhighway by 1996. (111)

"Pacific Bell Helps Bring Schools On-line. As part of a continuing commitment to education in California, Pacific Bell has launched Education First, a \$100 million program to connect the state's schools to the communications superhighway. By the end of 1996, all of the nearly 7,400 public K-12 schools, libraries, and community colleges in Pacific Bell territory will have access to the company's Integrated Services Digital Network (ISDN), which enables simultaneous transmission of voice, data and video signal over a simple telephone line." [Emphasis added]

According to CNN, (8/17/97) in 1997, only 60% of California schools had computers and less than half were online. (112)

To show the disparity between these Bell quotes of bravura, and the actual deployment, the next exhibit highlights a survey of the Bells by Interactive Age, July 1995, clearly showing that all of the Bells, with the exception of Pacific Telesis, never rolled out ISDN to residential customers. Meanwhile, Pacific Telesis only had 53,000 total ISDN lines installed at the end of 1995. (113)

EXHIBIT 16**Regional Bell Residential ISDN Offerings, July, '95**

Ameritech	Has only a trial running for ISDN Service
Bell Atlantic	Beginning residential trial
BellSouth	Has only a trial running
NYNEX	Has only a trial running
Pacific Telesis	Goal of 1 million lines by 1998
SBC	Installing software in switches, few "Market probes"
US West-	Still installing software in switches

Source: Interactive Age, 95

More to the point, there have been two pictures that are painted about ISDN deployment: One picture is supplied by the people who are selling ISDN and related products while the other is represented by those who actually want to purchase it. This split-brain market representation has been going on for years.

Take the following example. The first quote is taken directly from the NYNEX 1993 Annual Report. Here, NYNEX is discussing their wonderful new telecommunications services. This is followed by the user perspective, highlighted by an article in The New York Times titled "The Information Future Out of Control: Hello, Anybody Home?" written by a NYNEX user, James Gleick, who helped start the online service called Pipeline.

As you will see, the reality vs. the company's myth collides when customers actually try getting the advertised technology.

NYNEX 1993 Annual Report: (114)

"Private-line service as quick as a click: bandwidth where a business wants it, when a business wants it, as much as it wants, for as long as it wants. That's the value of NYNEX Enterprise Services, a set of new networking tools that bring unprecedented flexibility to private-line voice data and video systems"

From: The New York Times article by James Gleick (115)

"I have visited the advanced telecommunication research laboratories and have seen what technology can bring, ISDN, which promises to turn ordinary phone lines into high-bandwidth carriers of pictures and videos. I've also visited the local telephone company and seen what technology can't bring. I've tried to order this very service. I have a 14-page, four-color brochure! "NYNEX ISDN Primary Service. For more efficient voice, data, image and video... " The Pipeline's [author's company] order has been floating about for months. Our sales representative says he wrote it up three times, and each time the system bounced it back. I have a phone number for an ISDN specialist inside NYNEX, but he doesn't seem to have voice mail. The Pipeline is not alone. The large, private on-line services, too, rely on more or less the same graying telephone technology, not ISDN. "

After the article appeared, NNI contacted five other online providers, all located in the New York City, we found that none of the five companies could get adequate ISDN services. Two out of the five companies had filed complaints with the New York PSC, while the other three were transferring all business to Metropolitan Fiber, (MFS), another NY local phone provider. (116)

The Skinny on ISDN Rollout — Waiting for the Godot, the Info Bahn, or just making more money from doing nothing.

The history of ISDN should be understood in relationship to "telecom buzz", i.e., what's hot every two years or so. In the early/mid-1980's, ISDN was the next generation of telecommunications, to be rolled out as fast as possible. And though there was a great deal of handwaving, there is little proof that the Bells ever had any intentions for mass deployment in the mid-1980's.

By 1993, ISDN was all but forgotten. The fiber-optic Information Super-Highway, that nationwide, 500 channel, full-motion video, network, was being touted as the new, bigger, better, next generation telephone network coming soon... and to a TV set too. This perceptual change was not something imagined. One has only to look at the

number of articles that disappeared as ISDN topics in 1992, only to be supplanted by Info Highway topics.

For example, a Bell Atlantic sponsored study presented by the "National Economic Research Associates", pooh-poohed ISDN rollout. It suggested that industry groups such as Electronic Frontier Foundation, (117) who were calling for ISDN deployment was "old world" thinking, while broadband, fiber-optics was "new world".

The Bell sponsored research stated (118)

"It would be unfortunate if the public policy focus were to be on implementing only ISDN rather than on taking the necessary steps to facilitate the transition to a broadband network. While it is important to use existing technology fully during the transition, the danger of the emphasis is that policymakers may take away from it a view of the "Old New World", rather than the "New New World" of Broadband. "

By the summer of 1995 the "500 channel universe" was no longer the buzzword. The Internet had been proclaimed the new winner and ISDN, the telephone network that can make the Internet more successful, at least in the minds of the media, has once again been crowned as the next future, albeit, interim hot product.

However, massive staff cuts and lack of network upgrades caught the Bells' understaffed and unable to deliver the technology with any speed. In fact, based on interviews with Bell staffers, we now believe that staff cuts throughout the Bell system have been so severe, that the remaining staff made promises which they could not keep, either because of a lack of expertise, or simply because there weren't enough warm bodies to fulfill orders.

And the exact promises? Mass-deployment at cheap prices.

In February 1993, Ameritech's Russ Ruebensall, Marketing Operations, Data/ISDN Product made a presentation to the Ohio Consumer Council, the Ohio Consumer Advocate, which outlined the Bell's ISDN deployment schedule. There was supposed to have been approximately 340,000 customer lines by 1992, (which did not

exist according to the FCC and other statistics), while the company would have almost 2.5 million subscribers by 1996. (119)

Exhibit 17

"Ameritech ISDN Deployment, (Customer Lines), 1993"

<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
339,000	1,278,000	1,925,000	2,318,000	2,447,000

Below is the FCC's statistics for ISDN deployment for 1994 and 1995, representing three RBOCs. According to the FCC, Ameritech only had a total of about 50,000 lines in 1995, about 2% of the projected amount, while Pacific Telesis had only 34,000, and SBC not much more than that. (120)

EXHIBIT 18

ISDN Deployment for Specific RBOCs

(Year ending 12/95)

	<u>1994</u>	<u>1995</u>
Ameritech	41,744	48,622
Pacific Telesis	7,324	34,064
Southwestern Bell	1,595	34,628

Sources: FCC, 1995, NNI 1995

However, according to the FCC, some Southwestern Bell states, such as Kansas and Missouri had no single-line customers (known in the industry as "BRI") in 1994 or 1995. (121)

EXHIBIT 19**FCC Statistics: ISDN Lines, Kansas and Missouri 1994-1995**

(for year ending December, 1995)

	<u>1994</u>	<u>1995</u>
Kansas	0	0
Missouri	0	0

NOTE: The FCC ISDN information never matches any of the information supplied by telephone companies in their annual reports .

Then there are the costs. Originally, ISDN was pitched as two telephone lines for the price of one. The next exhibit, also part of the Ameritech presentation, shows that the price of ISDN was supposed to be only \$34, as compared to two residential lines, costing \$41, actually saving 20%. (122)

EXHIBIT 20**Ameritech's ISDN Direct Cost Comparisons****Residence/Work At Home Application, 2/93**

<u>\$41</u>	<u>\$34</u>
2 Residence Lines*	One Ameritech ISDN Direct Line*
(Voice and Data)	(Voice and Data)
* Usage charges apply	

The Rub: The Costs of ISDN — 1997

Though ISDN may be sold with a low cost figure for "basic service", no one pays this price, and the total per month can be prohibitive, hundreds of extra dollars per month.

- **First, there's the equipment:** This must include, besides a well-equipped computer, a special ISDN modem, costing \$300-700 dollars.

- **Then there's the instillation:** Many times the house or office requires a total rewiring, and installation fees are not cheap. New York charges \$234 for residential customers, \$325 for businesses, not counting the actual rewiring. (123)

- **Next come the monthly charges:** On paper this can look reasonable. NYNEX New York charges only \$24 a month for residential service, \$35.23 for business. Ohio, on paper, charges \$32.20 and \$42.42 for business. However, there are caveats, meaning other charges. These can include: (124)
 - "Residential monthly rates include a \$6.70 recurring charge for the local loop",
 - "Message rate service is \$2.63 per b channel" (there are 2)
 - "Distance Extension/XTN" may be applied when necessary at \$26 a month." (125)

This means that besides the basic charge there are a host of other charges, which may apply, and they add an additional \$30 a month. Also, the phone company considers this service to be two or more telephone lines and may charge the customer two or more times.

- **Then there's the actual calls:** Called "usage", these charges can add hundreds of dollars. Below is NYNEX's model for a five minute ISDN call. (126)

EXHIBIT 21**NYNEX's Typical 5 Minute Call In NYC Using ISDN, 1997**

"This example demonstrates the charges for a five minute 128-Kbps data call within New York City, New York."

First three minutes	\$0.080
Additional two minutes	\$0.026
Time charge (five minutes)	\$0.106
Circuit switched data charge (five minutes @ \$0.01)	\$0.050
Subtotal	\$0.156
128-Kbps call uses 2 channels	(x2)
Total	\$0.312

The example shows that a five minute call using ISDN costs the customer 32¢. Since the charges are for "Measured Service", the charges are per minute, plus something called a "circuit switched data charge" and then everything is multiplied by two — for the two B channels. Also, all of the charges are 'rounded up', even though they are fractions of a cent.

For 40 hours that's **\$143.60 a month in just usage charges, not counting taxes, which adds 18%**. Remember, anyone who is getting ISDN must be, by definition, a heavy user of telecom services, including online services.

To add insult to injury, NYNEX goes on to show its total misunderstanding of the product with the following quote. It compares ISDN to a 1200 bps, (bits per second) baud modem, which was slow in 1992. Today's current standard speeds are 38,000-BPS or the faster 56,000-BPS for regular phone lines. (127)

128,000 bps ISDN service transmits data approximately 100 times faster than a 1200-bps modem, so a five minute ISDN data transfer would take approximately 50 minutes using a modem and analog service. Transmission costs: 31.2 cents for ISDN, \$1.302 for analog. (Not to

mention an additional 45 minutes of your time waiting for the data to arrive.)

Other pricing information from other states are not only prohibitive but the regulatory solutions seem to be equally bad. For example, the New Jersey Advocate states that Bell Atlantic's ISDN charges are "excessive", with prices from \$23.50 to \$249. a month. However, the Advocate's solution is for a \$10 charge then a 25¢ a minute peak and 12.5¢ off peak. Considering that the average heavy online user uses 25-40 hours a week, (128) their pricing could cost over \$300.

Scandal: ISDN Is Distance Sensitive. They Charge The Customer Extra For Their Inability To Deliver A Service Over Three Miles!

We mentioned it before, but it is an important point. Many customers have to spend extra on ISDN because they live three miles or more away from the company switch. This can add \$25 a month or more for a "repeater, which boosts the signal. Other customers must pay for special "virtual" services in some states. Worse, some customers simply can't get ISDN at all because of the distance.

We believe that it has been and should be the phone companies' responsibilities to cover the distance sensitive costs. It is their failure to upgrade the network that results in additional costs.

And the Future of ISDN and Digital Services?

ISDN still has a lot of fans. For example, the New Jersey Rate Advocate, states that ISDN is still a 'vital' technology. (129)

"According to the Advocate, ISDN will most likely play a vital role in the development of the 21st Century's telecommunications infrastructure. Since ISDN is the first end-to-end digital service offered to the residential customer by the exchange network, the Advocate believes it should be viewed as the "POTS" -plain old telephone service -- of the Information Age. ISDN is perhaps the only technology that can now be installed to allow every home in New Jersey to become part of a digital network. With

its high-speed digital connections, ISDN will provide New Jersey residents with high-speed Internet access, CD-quality sound, video-conference and data transfer at speeds that are more than five times faster than that available with state-of-the-art modems. ISDN will allow computers to manage network connections and pave the way for a new generation of information services. ISDN will also allow a single line to support two telephone numbers and two simultaneous telephone calls."

First, and foremost, we believe that ISDN promises should be investigated both on a state and federal level for a massive failure to deploy promised advanced technologies, as well answering the basic question: State laws were modified to give the Bells funds to roll-out ISDN. It never occurred. Where's all the money?

Secondly, we are left with a technological dilemma. If ISDN still isn't working and the fiber-optic highway is doomed, what's next? Bob Metcalfe, inventor of the Ethernet and a founder of 3Com, believes that ISDN was too little too late, and while there are other technologies that are more advanced, he puts little hope in any of these visions of the future in the near term, primarily because the phone companies, "Telopolies", will fight to stop them from being deployed. Competition of advanced technologies is the only way to go. (130)

"ISDN, from the telopolies, would have been a great advance in the 1980s. Today, ISDN at 128kbs is looking too little too late. Worse, ISDN goes through voice switching systems, which makes it too expensive.

"DSL, digital subscriber lines, are a way of moving more data (mbps) over installed telephone wiring. This is our best hope for the near term, but the telopolies are not deploying XDSL, except to provide old-fashion technology (1.544mbps T1 service) for which without competition they charge us through the nose. And the telopolies are viciously fighting to keep competitors from installing XDSL around them. It's not a pretty sight. Not nice.

"Cable TV modems are another alternative, but they don't work, or not yet in scale anyway. And the cable TV companies seem to lack the cash flow to invest in the cable upgrades required. Let's keep rooting them on.

"And then there's other: terrestrial wireless, geostationary, middle earth orbiting, and low earth orbiting satellite constellations, powerline data transmission, and the long-term winner, fiber optics everywhere.

"Too bad that on all of these we can't really hold our breaths. The most important thing that we should not do about all these alternatives is let Washington conduct a study of which one to go with as a national priority, you know, like committing to have, say, cable modems in every school, library, and video arcade by 2002.

"The most important thing that we should do, as we've learned in Silicon Valley over the last several decades, is encourage these bandwidth alternatives to compete on a level playing field. Through such competition, I expect, we'll see the very gradual convergence of telephone, television, and Internet into a diverse and evolving digital infrastructure for the information age."

BOOK II

Bell History and Strategies: Shareholders First, Customers Last

**What does the Star Wars' Evil Empire and Bell Atlantic
Have in Common?**

**James Earl Jones was the Voice of Darth Vader and is the
Voice Of Bell Atlantic—**

Are There Other Commonalties?

"Food For Thought" Interlude— Conspiracy or Miscalculation?

Book 1 leaves us with a serious dilemma, especially about the I-Way. First, we know straightforwardly that the plans were all scrapped and the announced services were never delivered. But we are left with wondering how both the telephone companies as well as their consultants, were so wrong. Let's look at the options:

There were three massive errors in judgment:

- Mistakes in the costs of rolling out the network
- Mistakes in overestimating demand
- Mistakes by the research/consulting suppliers

Let's walk through each one:

- **Mistakes in the Costs of Rolling Out the Network:** The original cost model for the I-Way was estimated at around \$1,200 per household. However, Bell Atlantic stated that the cost of their trials came to \$16,000 per line. This includes the cost of the various Info Highway components in the home, described earlier, as well as the cost of the fiber-optic networks.

But, that's a difference per line of 1233%. Of course there are caveats. Most importantly, that the trickle of a rollout was only a "test" of advanced services, and with larger volumes of users, the costs would decline.

In fact, Bell Atlantic's original plans may have actually called for a great deal less spending than \$1,200 a line. Bell Atlantic stated it was spending \$11 billion dollars and since the company had 18.6 million lines in 1993 — That comes to approximately \$591 per line if the company were converting all of its lines, or \$917 per line, if the company was only upgrading the residential lines.

Either way you cut it, the cost differential of what it was supposed to cost per line vs the actual costs, is enormous.

There are also numerous hidden technical problems that were revealed with recent ISDN rollouts that also cause the author wonder whether the plans were ever even tested before they were announced. ISDN, a supposedly simpler product that was designed

almost a decade before the I-Way is distance sensitive — the farther away the customer is from the "local central office", the worse the service gets to the point that customers over 3 miles away can't get ISDN at all. There are some kludges, where the company can install "amplifiers", which boosts the power, but they are all extra charges.

Unfortunately, various I-Way trials found that amplifiers had to be included also, costing a great deal more than anticipated. But how the phone company didn't know this beforehand is a mystery.

- **Mistakes in Overestimating Demand:** As we demonstrated before, the research from a number of firms showed weak consumer interest.
- **Mistakes by Research/consulting Suppliers:** Then there is the mystery of the consultants. How is it that a major consulting firm, Deloitte & Touche, and numerous other companies who gave testimony at the various state Public Service Commissions, were not accurate? How could they not have been able to examine the data and say "This plan should not be put forward because of numerous problems?"

Plan 2: The Removal of Regulation was a Primary Reason to Announce the I-Way.

From a phone company perspective, the I-Way plans were a win-win situation because while the I-Way doesn't exist, the regulation was still removed. Just look at it from an economics point of view. The removal of regulation has caused massive increases in Bell profits. It also allowed the Bells to hide the actual costs of the networks to competitors, since both the costs and the profits are no longer examined by any regulator..

The removal of regulation on the Federal level over these years has given the Bell's almost all the freedoms they were originally restricted from. Only the prohibition to offer long distance services remains, and that is poised to be removed in the very near future for most of the Bells.

Also, the odds that there would be retributions by the various state regulatory agencies who were supposed to be monitoring the company's deployment plans were nominal, as demonstrated by our New Jersey case study. So it was an obvious choice to take a chance, because the consequences would never be anything but a slap on the wrist.

While the reader may be doubtful, in a follow-the-money scenario, the data will speak for itself. And the data all points to one thing — a disregard by the RBOCs of their primary customers, and a serious shift of focus and purpose since they were created in 1984, to the shareholder.

In order to prove this hypothesis, that the I-Way announcements were done, in a large part, to remove regulation, we need to walk through some necessary background about the Bells, and their notorious mother, Ma Bell, and then present a picture of corporate Bell-Head mentality, revealing a dark side to a group of supposed babies.

Chapter 6 **A Brief History of Ma Bell and the Creation of the Baby Bells.**

FOR THE TELECOM COGNOSANTI: This chapter is a primer section about the history of the Bell System. If you like, please skip to Chapter 7.

In order to understand the formation and the first decade of the Regional Bells, we need to explore the events leading up to and surrounding the break-up of AT&T, commonly known as "Divestiture."

And believe it or not, the history of divestiture has its roots over a half century ago, in the late 1920s. At the time, complaints about the Bell Systems' monopolistic practices were so rampant that a major piece of legislation, the Communications Act of 1934, was created to set out the parameters for all interstate telecommunications regulation. It also established the FCC with the Commission's initial goal to audit and investigate AT&T.

By this time, "Ma Bell" had just about taken control of everything that was telephone — from the local service and long distance calls, to even the telephone handset itself. AT&T's monopoly consisted of:

- **Local Bell Companies** — which covered 80% of all local telecommunications in the United States through 22 Bell telephone companies, from New York Telephone to Pacific Bell.
- **Long Lines** — which controlled 100% of long distance services.
- **Western Electric** — the division that manufactured all telephone equipment, from the telephone handset to the telephone switches.
- **Bell Labs** — one of the premier research laboratories in the history of the world.

After years of struggle with a non-cooperative AT&T, in 1938 the FCC finally issued the "Walker Report", which found that AT&T had overcharged customers by about \$50 million dollars (about \$500 million today):

According to "Telephone", by John Brooks (1975 Harper & Row): (131)

"Western Electric, (the equipment subsidiary of AT&T) through overcharges of various sorts, had been inflating the rate base from which telephone rates were derived, thereby bringing about unwarranted extra costs to telephone subscribers of about \$51 million per year. It further contended that Western could cut prices by about 37%."

This report was then rewritten, toned down considerably, and all but forgotten, being overshadowed by world events, including World War II.

It should be emphasized that the concept of regulation was based on a simple assumption — AT&T was a monopoly. Therefore, AT&T had captive customers and had guaranteed, rock-solid income, without risk associated with companies that had competition. People wouldn't just stop using their telephones. Hence, safeguards were needed so that AT&T didn't overcharge its subscribers.

And this same issue still resonates today when discussing the Baby Bell monopoly and the lack of actual Bell competition. (The topic of monopoly power and competition will be detailed in future discussions.)

Then in 1949, the government filed an action in the District Court of New Jersey, stating that AT&T and its division, Western Electric, had:

"...monopolized and conspired to restrain trade in the manufacture, distribution, sales and installation of telephone, telephone apparatus, equipment, materials, and supplies in violation of the Sherman Act," (the major piece of anti-trust legislation". (132)

According to Judge Harold Greene, the Civil Court Judge that would eventually preside over the break-up:

"The government requested the divestiture of Western Electric, termination of exclusive relationships between AT&T and Western Electric, divestiture by Western Electric of its 50% interest in the Bell Telephone Laboratories, separation of telephone manufacturing from the provision of telephone service, and the compulsory licensing of patents owned by AT&T on a non-discriminatory basis." (133)

Over the next 7 years (1949-1956) and after various legal movements, a "Consent Decree" was finally issued — a totally watered down slap on the wrist for AT&T. The decree only prohibited Western Electric from engaging in any businesses other than the provision of common carrier communications services, restricted Western Electric from manufacturing any other equipment except that used by the Bell System, and required AT&T to license the patents for royalties.

Along the way there were other various cases, sometimes against AT&T, and sometimes even against the FCC. One short summary appeared in "Telecommunications Deregulation: (134)

In the **Above 890 decision**, 1959, the FCC opened microwave frequencies above 890 megacycles to private line service by companies other than AT&T. In the **Carterfone decision**, 1968, the FCC ordered AT&T to allow interconnecting devices so that non-AT&T equipment could be connected to AT&T lines. In **MCI Telecommunications Corp v FCC**, 1977, the U.S. Court of Appeals authorized competing uses of microwave systems to service business and data communications markets. The court also concluded that the FCC had no general authority to insist on approval of new services without a finding of "public convenience and necessity". In a part proceeding in the MCI case, 1978, the same court held that the previous decision's mandate required AT&T and the FCC to provide interconnection to MCI.

However, in 1974, the Divestiture ball started rolling seriously. The government filed a separate anti-trust suit against Western Electric, AT&T, and the Bell Telephone companies, which basically stated that AT&T et. al., monopolized a broad variety of telecommunications service and equipment in violation of the Sherman Act.

The government sought "The divestiture from AT&T of the Bell Operating companies and the divestiture and dissolution of Western Electric." (135) This led to a series of legal arguments which were divided into 82 separate segments, each segment with major specific disputes and court proceedings on different aspects of the trial, from the issues of anti-trust of the local telephone companies' monopoly on local service to AT&T's antitrust toward competitive services.

And in the late 1970s, Ma Bell had grown by leaps and bounds. She was the world's largest company, with over 1,000,000 employees and revenues almost reaching \$70 billion.

However, throughout the 1970's AT&T continued to be an obstructionist, not allowing upstarts like MCI to easily connect to the AT&T network, regardless of the MCI decision. But after thousands of documents, accounting for multiple thousands of pages of information, depositions, and almost 10 years, the final legal decision, known sometimes as "The MFJ" for "Modified Final Judgment", and sometimes as "Divestiture", was done surprisingly, not by Congress or the FCC, but by Judge Harold Greene, as a civil case in a District Court in the District of Columbia.

And so, on January 1, 1984, the telecom world that had lasted for almost a century, had ended. The judgment defined the new world as follows: (136)

- **AT&T:** would remain a long distance company, and it would own the equipment business, Western Electric, and Bell Labs.
Restrictions: AT&T was restricted from offering electronic publishing/information services.

- **Regional Bells:** There would be seven new companies, known as the "Regional Holding Companies" (RHCs), which would own the 22 local Bell Operating Companies (BOCs). These companies would also be permitted to provide Directory services, including the highly profitable Yellow Pages, and Cellular Services.
Restrictions: The Regional Bells would initially be restricted to supplying local telephone service and was prohibited from supplying *"any product or service that is not a natural monopoly service actually regulated by tariff."* The companies were restricted from providing:
 - Long-distance service
 - Manufacturing telecommunications products or customer premises equipment (equipment that was on a subscriber's premises, such as a telephone)
 - Information services
 - Cable services

These restrictions were created because of one concern, that the company could use its monopoly advantage to keep out competitors or win customers because of a predetermined, "natural monopoly" market leader position.

However, with the Telecommunications Act of 1996, Long Distance Service is the only restriction left on the Bells, and the Bells have or will all file to offer long distance services.

The Removal of Restrictions

According to Judge Greene, restrictions were supposed to be lifted when the RBOCs could no longer use their monopoly powers to block competitors or unfairly leverage their powers unfairly: (137)

"It is probable that over time, the Operating companies will lose the ability to leverage their monopoly power into the competitive markets from which they must now be barred. This change could occur as a result of technological developments which eliminate the Operating Companies' local exchange monopoly or from changes in the structures of the competitive markets. In either event, the need for the restrictions upheld will disappear, and the decree should therefore contain a mechanism by which they may be removed."

The legal mechanism allowed the RBOCs to petition the court for "Waivers" to allow them into services when they could justify that their behavior would not be anti-competitive.

AT&T & RBOC Investors and Shares

At the time, AT&T also had more shareholders than any other corporation in America, and the shareholder received one share of each Regional Bell for every 10 shares of AT&T stock. Also, AT&T kept stock ownership of the equipment and manufacturing businesses, in the form of Western Electric and American Bell, as well as the ownership of the telephone rental set in America's homes.

AT&T would also retain Bell Labs, which in 1997 became a separate company called "Lucent Technologies". And finally, it would retain its largest business, "Long Lines", offering Long Distance services. The exhibit below gives the assets of AT&T as told by the FCC's 1983 Bell System Reorganization Plan. (138)

EXHIBIT 22

AT&T's Assets at Divestiture, 1984

100% of Western Electric

100% of American Bell

100% of 22 CPE subsidiaries

100% of Bell Labs

100% of 22 InterLATA Subsidiaries

100% of Long Lines InterLATA Service

Source: FCC Reorganization Plan, 1983

The Regional Bell's cache of businesses, however, was much larger as a group. The Bells not only received the local Bell phone companies, but also received 100% of the Cellular licenses, as well as 100% of the Directory Publishing businesses, meaning the Yellow Pages revenues as well as Directory Assistance services.

EXHIBIT 23

Regional Bell Assets at Divestiture, 1984

100% of appropriate local operating companies

100% of cellular radio system subsidiary

100% of appropriate directory publishing

Each Bell—One-seventh of the Central Staff

Each Bell—One-seventh of cellular radio system central staff

Source: FCC Reorganization Plan, 1983

RBOC Companies Formed, States Covered

Over the last decade, each Bell has combined their separate telephone companies under one name. Please refer to the Introductory section "Who are the Bells" for states served and the original phone company names.

Division of Assets

AT&T was required to give the new companies "...sufficient facilities, personnel, systems and rights to technical information to permit the Operating companies to perform independently of AT&T". (139)

It was a monumental task by any standard. For example, in 1983 AT&T stated that of the 1,000,000 current employees, 830,000 would remain in their current jobs and their current companies, while 90% would change companies but not change locations or job functions. AT&T would retain only 30% to 40% of the total employees.

In fact, this division of assets also pertained to liabilities and formulas for everything from allocation of debt; reassignment of staff; division of local and long-distance ownership of property; and a wide array of specifics that had to be delineated. The FCC. had the task of overseeing the process.

Equal Access was Mandated

One of the primary reasons for divestiture was because an upstart company named MCI, had serious problems in being able to connect its services to the AT&T network. And in many cases, MCI was supplied inferior connectivity compared to the service provided to AT&T Long Lines.

And the term for connecting MCI or other competitors to the local Bells is different types of "**Access**". Judge Greene wrote: (140)

"The Decree requires the Operating Companies to provide all Long Distance (interexchange) carriers and information service providers exchange access, information access and exchange services for such access ... that is equal in type, quality, and price to that provided by AT&T and its affiliates."

However, "**equal**" access, meaning equal to AT&T, was also tied to numerous specific problems. AT&T and the local telephone companies were more tied together than a plate of spaghetti. Everything was all-in-one from facilities, including network management, to ownership of the buildings. Therefore, accommodations had to be arranged to try to bridge the gap between the letter of the law and not simply the dismantling of all telecommunications in the United States, and then starting from scratch.

The task of providing equal access to all information and long-distance providers was supposed to be accomplished by September 1, 1986. This time frame was, of course, never met, and as late as 1995 there were still equal access 'holes' in deployment, meaning that competing companies couldn't offer services because the network switches were not adequately upgraded.

And once again, in 1997, **Local Equal Access**, opening the local phone company' networks to offer competitive services, is one of the largest sore points in the current telecom landscape. Though the Telecommunications Act of 1996 has mandated local equal access, the Bells have, like their mother before, put up roadblocks to competitors.

Establishment of Access Fees

Someone would have to pay for the Break-up and letting competitors connect equally. And the costs were not cheap. In 1983, AT&T and the FCC estimated that it would cost the Operating Companies \$2.5 billion to provide equal access and reconfigure the network. (141)

At the time, there were a number of proposals on the table for how these new costs should be paid. Over the next decade there would be a series of new charges labeled "**Access fees.**"

The primary concept of **Access fees** is straightforward. The local telephone company would charge a fee to a long-distance company for giving them access to the network and the local subscriber, while the local subscriber would also be incurring an access fee for connection to the local telephone network, usually called an **FCC Subscriber Line Charge.**

The original AT&T model had no access fees. Pre-divestiture, AT&T was a holding company, which had the local telephone companies give their entire incomes

directly to the parent, who in turn, would "kick back" some of its long-distance revenues to make the companies stay profitable.

In the new era of access fees, everyone from the local consumers and business users to the long-distance companies pays a series of fees to allow their connection to the network. Currently, all consumers pay a \$3.50 FCC Subscriber Line Charge (sometimes called "End User Common Line"), while the long-distance companies pay approximately over 40% of their entire long-distance revenue back to the local operating companies in access fees and related charges.

In 1997, the FCC instituted new, additional access charges on residential second lines and business customers, which will be discussed later.

With the Bells receiving over \$23 billion in Access fees from businesses and consumers, and estimates by MCI of \$14 billion being unjustified, we will return to these charges again. (142)

Division of the World into LATAs

Another problem that the break-up created was one of jurisdiction over a phone call. Was it a long distance call ? Was it local call? Was it a Toll call? So the government created small geographic areas and dubbed them **LATAs** for **Local Access Transport Areas**. About the size of the historical area codes, a LATA boundary, then, determined who owned the call.

And it just created a very large mess. For example, a Toll call, a call within a LATA, but not in the "local calling area," had a different price and was handled differently from the point of view of everything from staffing and pricing to technological access. The Baby Bells were only allowed to handle calls that were "IntraLATA", calls that started and terminating within a specific boundary, while a long distance call was one that crossed LATA lines, even within a specific state. Long distance calls are also known as "InterLATA" and "Interstate" calls, because they cross both LATA lines as well as state lines.

And because of these artificial creations, a call from New York to Montauk, which is only 75 miles away but within the same LATA, only handled by NYNEX in 1992, cost 90% more than a call to California, 3,000 miles away, handled by AT&T.

Forget the geography. We will come back to Toll Calls later.

Computer Inquiry II — Phone Rental Fiasco.

In a separate, but very related case, the FCC issued another decision titled "Computer Inquiry II" in 1982 which *deregulated* the telephone handset and rental, known in the technical jargon as "CPE" (Customer Premises Equipment.). The ruling was summed up by the FCC: (143)

"The commission would forbore from traditional regulation under Title II of the Communications Act of 1934 in the case of customer premises equipment (CPE) offering of common carriers under the jurisdiction of the Commission."

Divestiture also transferred all equipment that was originally rented to customers by the local telephone company, known as "embedded CPE" to AT&T. A person who was renting a phone through the local telephone company, (and everyone in 1982 rented a telephone) would now either have the choice of purchasing the equipment or continue renting, now from AT&T.

While this law allowed customers to attach other, non-AT&T telephones to the telephone network, deregulation also removed the regulation which allowed the price of the service or product to reach "market value." We found deregulation was also to become a euphemism for simply raising prices without any safeguards for those who still kept the same service they had prior to deregulation.

Aunt Ethel's \$1119 rotary phone rental is testament to the success of this endeavor, and this cash cow will be addressed in subsequent chapters.

Deregulation of Inside Wire — More Bad News

Another telecommunication product, "**Inside Wiring**", sometimes referred to as "**Wire Maintenance**" or other regional names such as US West's "Line Backer", was also deregulated in 1982. This federal law basically left each state to postulate its own laws, but all states followed the FCC's lead. (144)

The ruling basically stated that the wire inside a person's residence could either be maintained by the subscriber or rented or maintained from the local telephone company.

We found identical problems to the telephone rental, major increases for anyone who kept this telecommunications product.

State Regulation Remained

Prior to divestiture and continuing today, the states have had the responsibility to monitor and regulate the business done in that state by all local telephone companies. Therefore, all local service offerings have been and continue to be state controlled. The Public Utilities Commissions (PUCs) across the United States have had the primary task of evaluating the costs and quality of service provided, and in most states have the legal power to impose fines and price reductions based on PUC court hearings.

The forms of regulation that each state uses, are all unique, and will be demonstrated later, many times contradictory, leaving America with a Swiss cheese, full of holes, regulatory environment. And the Telecom Act of 1996 didn't fix any of the regulatory problems state regulation has created.

Chapter 7 The Break-up: Opinions About the Future

The breaking up of the world's largest company was one of mass confusion and even the usually opinionated analysts and reporters were unsure of how the Bells would fare, much less the impacts the breakup would have on the consumer or business user.

For example, even the FCC's Reorganization Plan stated that the Bells would have financial risks because they weren't as big as AT&T. (145)

"The effect of the reduction of size and the regional concentration is likely to increase somewhat the inherent investment risk of each RHC (Regional Holding Company or RBOC) to the present Bell systems. The national diversification of the Bell system combined with its size, has produced earnings stability and low investment risks. Earnings of the RHCs is not likely to be as stable as the earnings of the present Bell systems and the new RHCs are likely to have more investment risk than the Bell system currently exhibits. Investors may require somewhat higher rates of return to compensate for this risk, with these somewhat higher costs ultimately being passed to the ratepayers. "

According to most articles, the majority of sources said that AT&T's break-up would provide a competitive local and national telecommunications environment, which in turn would keep prices low. According to Charlie Brown, then president of AT&T, long-distance prices would decrease about 10% to 15% over five years, while local prices would increase no more than 8% to 10% for the next few years and then level out. (146)

Even the most fundamental issue, who divestiture was supposed to first serve, or more specifically, who the Regional Bells were supposed to first serve, was never fully understood at the time, nor is it at all clear today. Everyone had then, and has now, different viewpoints on this topic. The three primary viewpoints are that divestiture was supposed to first serve:

- A) The Ratepayers
- B) The Shareholders
- C) Business Users

Based on surveying of consumers, business users, and telephone company staff over the last seven years, we found strict conformity to each group believing it was supposed to have helped their own needs.

- **Consumer View** - The overwhelming majority of consumer telephone subscribers believe that the breakup was supposed to bring better services, and that these new companies would be responsive to their needs. Lower prices would come because of direct competition. The RBOCs were supposed to first serve them by providing the best quality at the lowest, regulated price.
- **Business Users** - Business users felt that divestiture was supposed to serve them first, by lowering local and long-distance business rates, which were "subsidizing local consumer services" and that the RBOCs were going to be working to fulfill their supposed manifest destiny, deployment of advanced technologies.
- **RBOCs** - Meanwhile, the RBOCs believed, and still do believe, that these new companies were created to be "market driven," and that therefore the company should select their own priorities. This viewpoint is one which the shareholders obviously feel benefits them the most, since it is their company.

There is a fourth group, which includes a diverse range of interested parties of telecommunication's future, including technology vendors or the cable and newspaper industries, who are on a continuum of opinions, hovering somewhere in between any of the above three responses. Unfortunately, a good deal of all of these beliefs were also based on some serious misconceptions or mistaken premises.

Probably the largest misconception was that the local operating companies weren't profitable in 1983. The reason local rates were going to increase was supposedly because AT&T Long Lines, the long-distance part of the company was, as one writer stated: (147)

"AT&T was plowing back 37¢ on the dollar to bolster up local telephone charges [operative phrase: 'plowing back']. When this money goes away, the local operating companies will have to raise rates to pick up the slack."

It turns out that this viewpoint was completely a matter of accounting practices and political maneuverings. Under the accounting methods used by AT&T prior to divestiture, long-distance services were highly profitable because there were no major expenses, especially no fees paid back to the local company. Therefore, an artificial delineation between the local operating company and Long Lines existed. This "plowing back" was, in actuality, caused because there were no access fees—the post-divestiture fees paid by the long-distance companies to the Bells.

As mentioned earlier, under the post-divestiture picture, the long-distance companies pay the Regional Bells very high fees, over 40%, which include the access for local customers and additional monies paid in separate fees for "Billing and Collection" services. Using this enlightened accounting procedure, the RBOCs were quite profitable in 1983.

And this myth, that local service is unprofitable, has been very pervasive, even though the annual reports tell a much different story. For example, in two different articles quoting NNI research, both Pac Bell and Bell Atlantic stated that local service loses money. Here's Bell Atlantic: (148)

"Kenneth Pitt, a Bell Atlantic spokesman, said that basic phone service is a money-loser for his company." [emphasis added]

Worse, Bill Gates, CEO of Microsoft, thinks that local telephone service is being 'undercharged'. In his article titled "Bill Gates predicts what's ahead in '97" (1/2/97) appearing in the New York Post, he stated that current regulation has caused local telephone service to be undercharged while long distance service is overcharged. He also predicts that anyone online will be paying more for local service in the future. (149)

"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 bill rise."

This misconception is based totally on the way the Bells have been able to redefine terms such as "Local Service" or "Basic Service", and then convince regulators and even Bill Gates, that they lose money on local service. We will show that local service is one of the most profitable businesses in America.

Finally, another misconception was that competition would come to all aspects of the RBOC business. In 1984, all RBOCs and long-distance companies were expecting competition, which was expected to keep prices down and create an environment to offer better services. US West states in its 1984 Annual Report: (150)

"Our philosophy is 'Bring on the Competition.' In all of our companies we focus on serving the market as competitors."

Ironically, IBM was supposed to be AT&T's biggest competitor and vice versa.

Chapter 8 Regional Bell Strategies Since 1984

To the outside world, the Baby Bells' birth was one of confusion mixed with a degree of enthusiasm. However, to those who would take up the reins of these new fiefdoms, the Bell executives that were to become top management in these new companies, the focus was to become mini-AT&Ts, their model of the future. And armed with a great deal of cash, and an intimate workings of their "Ma Bell", the seven would start immediately reshaping their image of the sleepy local Bell system companies.

To this end, over the decade there has been a consistent, specific set of strategies that **all** Baby Bells have in common —The Bell System is still alive.

We will demonstrate that all the Bell's have followed the original Bell System policies, from the removal of regulation, or using lobbying to effectively stop adversaries, whether it be other potential competitors, such as AT&T, or state consumer advocates. Corporately, the Holding Company over the decade redesigned their corporate mission, which does not put the telephone subscribers first. Finally, most of the far-flung new businesses, such as Real Estate and computer leasing lost billions.

In future chapters we track down the money, going through the revenues, expenses and profits of the Bells, demonstrating that the shift of corporate purpose — corporate profits, not subscriber needs, are the first order of business.

While some of these Bell directives were not made public, almost all strategies center around the maximization of the local subscriber revenues, the cash cow, to feed the projects that potentially bring more return on equity for the shareholder.

Follow the Bell System's Edicts: The "Bell-Heads"

From 1984 to this day, all of the Regional Bell company presidents and chairmen have come directly from the Bell System ranks. They have been all male, all white, and all middle aged men.

The Bell System was over 100 years old by 1984, and it was known as a closed group, known as Bell heads, as well as a breeding ground for its own successors. For example, before the break-up, the local Bell presidents would meet regularly to discuss

problems and be given the Company's political agenda(s) for the year. This included even the roll-out of products and services.

According to "The Fall of the Bell System", Peter Temin, Cambridge University Press, 1987, after it was finally decided to divide the Bell System up into seven units, all seven presidents were chosen by AT&T, and all were or had been presidents of the local Bell companies. (151)

"Charlie Brown, (president of AT&T) announced his appointment of the CEOs of the seven regional holding companies at the May President's conference. He chose seven of the existing Bell Operating presidents. The seven presidents were Zane Barnes (Southwestern Bell), Thomas Bolger, (C&P Telephone Company) Wallace Bunn, (Southern Bell), Donald Guinn (Pacific Telephone), Jack MacAllister (Northwestern Bell), Delbert Staley (New York Telephone) and William Weiss, (Illinois Bell). "

And even the later transition, from these original RBOC presidents to their successors, was a very smooth transition, because the inheritors were also from the Bell System. For example in Bell Atlantic's 1985 Annual Report, Thomas Bolger, CEO, is pictured alone, while by the 1988 Annual Report, there is Ray Smith, the current CEO, splitting the page in a glossy color photo.

This same, relatively smooth transition happened with all of the other Bells as well — Weiss of Ameritech begot Richard Notebaert, Pac Bell's Guinn begot Philip Quigley, and NYNEX's Staley begot Ferguson who begot Seidenberg.

It is and remains an inbred, old boy's network, groomed for succession.

And from the beginning the presidents inherited massive amounts of an embedded system of everything — from the way a call is handled with customer service to even the political clout of the Bell system. The primary continuity of the RBOC's actions, almost regardless of which RBOC is discussed, is this Bell mentality. and as we will see, the behavior among RBOC corporate staff has been strikingly the same.

Therefore,

- if one company applies for "Long Distance Service Provision", sooner or later they will all follow suit,
- if one RBOC has increased number of second lines or increases in Call Waiting, you can expect that it is happening in all of the other RBOCs.
- Or if some law suit occurs in one state, such as the improper charging of inside wiring, you can almost bet that the same behavior is happening throughout the Bell system.

The rest of this section demonstrates that the Bell system is still alive and that the RBOC's business strategies and plans over the last decade have been virtually identical.

Chapter 9 Remove ALL Regulation—How? Plead Poverty and Constantly Lobby

From the very beginning, the RBOCs have shouted their belief that all regulation is evil, and it has been stopping the companies from creating a new world of telecommunications. This fundamental point, like a mantra repeated day after day, month after month, year after year, eventually wore down regulators into believing that the Bells were overburdened by laws and they would bring the Info Bahn faster if these laws were removed.

From the earliest Bell annual reports, such as Ameritech's 1985 Annual Report, the investors are informed that regulation controls everything from the service offered to financial success. According to William Weiss, Ameritech's Chairman: (152)

"Our goal remains unchanged: To have the marketplace, not regulation, determine what we offer, the prices we charge and our financial success. "

US West states in its 1984 Annual Report: (153)

"Our philosophy is 'Bring on the Competition.' In all of our companies we focus on serving the market as competitors. We welcome competition and ask only that we be permitted to compete on an equal footing. Nothing more. Nothing Less. For that reason, we advocate continued deregulation of our industry at state as well as federal levels." (emphasis added)

Ironically, **in 1997**, 13 years later, Sol Trujillo, president and CEO of US WEST Communications Group declared almost the exact same sentiment about bringing in competition. (154)

"We're ready, willing and eager to compete. My pledge from U S WEST and my challenge to competitors is simply this - let's make 1997 the year we deliver on the full promise of competition to the American public."

Southwestern Bell in its 1988 Annual Report stated: (155)

"Steps to take to make this network of the future a reality: Southwestern Bell needs assistance of those state and federal bodies that regulate our business. We are convinced the current system of regulation doesn't service the best interests of our customers, our owners or the country itself. A new regulatory framework is needed, and we've proposed what we believe are workable alternatives to federal and state regulators."

Southwestern Bell continues in its 1990 Annual Report: (156)

"Instead of designing public policies that simply protect the consumer from higher monthly bills, regulators need to broaden their view of consumer's interests. They should recognize that telephone consumers are also wage earners, whose paychecks might very well increase if their employers are made more productive by the availability of state of the art network. And regulators should see telephone customers as consumers of community services, too, who stand to benefit a great deal from services that can enrich lives and can be provided efficiently over advanced communication system. "

BellSouth, in its 1993 Annual Report stated that they were "taking aggressive actions to tear down the unfair barriers." (157)

"With laws and regulation lagging badly behind competitive realities and customer demand, we are turning up the heat in our steady battle to level the playing field. We are mounting a two-pronged legal challenge in the federal courts to the out-dated ban on providing video programming over BellSouth's local telephone network.

"We are taking aggressive actions to tear down unfair barriers in our states, as well. We serve working with progressive legislatures and regulators throughout our region to put pro-competitive rules in effect. The states should play a constructive role in the Information Age by allowing a free and open marketplace to set prices for many telecommunications services."

And there were even threats by the Bells that if regulation wasn't removed, they wouldn't even bother to invest in the network. For example, in 1989, Ameritech's Chairman, Weiss stated that if regulation removal didn't occur, Ameritech would not invest in its own phone companies.

"If we see constant progress, the company will stick with the phone business. **If regulations are tighter in the next three to five years, we will question plowing money into this business.**" [emphasis added]
(158)

And the Babies' constant attacks have been very successful, especially in manipulating state controls. For example, in 1994, Ameritech's Investment Alert, stated that the company no longer had any regulatory controls by the states in terms of earnings.
(159)

"Ameritech has led the industry in achieving regulation that removes regulatory earnings caps. . . . All of Ameritech's intrastate operations are off of return-on-asset regulation resulting in freedom from regulatory caps on earnings and no earnings sharing."

By 1995 the company added: (160)

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

As we will see, these regulatory changes were all based on the premise that the Info Bahn was going to be financed by these new found profits.

Plead Poverty

Even before the ink was dry on the Divestiture Consent Decree, Southwestern Bell applied to its regulators for a \$1.2 billion, 26% rate increase to make up for revenues lost because of the impending break-up. And every other telephone company would apply for massive increases. (161)

By 1986, over \$10 billion dollars of increases was granted. Many of these increases were permanent, and therefore NNI estimates that over \$60 billion dollars was eventually collected from 1982-1996. These increases are clearly shown in the exhibit below, which give's the FCC's summary of telephone rate cases, 1982-1986. The data was a compilation of state public utility information, and covers not only the amount of money that was granted, but also gives the amount that was requested.

The exhibit reveals that over the five-year period, the Regional Bells were granted \$10 billion. This is compared to the \$21 billion dollars the Bells requested— a 114% difference. (162)

EXHIBIT 24

FCC Compilation of State Completed Rate Cases, 1982-1986

(In the Millions)

	<u>1982</u>	<u>1983*</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>5 Year</u>
Requested	\$5250	\$4511	\$7321	\$2640	\$1758	\$21,480
Granted	\$2882	\$1811	\$3875	\$1155	\$ 290	\$10,013
	55%	40%	53%	44%	16%	114%

* data for the last three months of 1983 not available

Source: The FCC, 1993, NNI 1994

As we will see later, almost none of these increases were justified, for the companies did not use it to either increase construction expenditures or staff.

Pleading poverty continued through the next decade, and is still prevalent today. For example, all of the Bell have requested price increases in 1996, claiming that competition has been or will erode their profits. For example, Pacific Bell received a 35% increase in the price of local service when Toll call competition was introduced, (163) while US West has been requesting increases in numerous states, declaring subsidies exist and reducing them will actually encourage competition. (164)

"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]

A form of Pleading Poverty in 1996 actually reached new heights when the Bells were able to halt the FCC competition Order by taking the FCC to court. This new round of pleading — that the FCC's order is below the companies' costs and is basically a confiscation of their property. Richard D. McCormick, chairman and CEO of U S WEST Inc., put it this way at the 1996 annual convention of the United States Telephone Association, an organization that lobbies for the Bells. (165)

"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 would allow competitors to buy local telephone companies' services below the cost of providing them.

"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."

As we will see in the Revenues and Profits section, US West is one of the most profitable of the Bells today. Its profits are almost 150% more than other major American corporations with competition. And 95+% of it's profits are from local telephone customers.

Constantly Lobby and Spend More Than Adversaries

NYNEX had breakfast at the White House, according to the New York Times. (166) Meanwhile, the lobbyists for the Bells includes a former governor, former State Majority leader, and even a former Secretary of Defense.

Welcome to a glimpse at how the rich and powerful have kept telecommunications in their hands, not the subscribers.

Soft money, hard money, PACs, contributions, research funding — the Bells, the "Campaign Finance Kings", do it all. In fact, it could be argued that the Regional Bells have shown that their best business skill is lobbying. Their efforts throughout the last decade to keep their local monopoly, avoid critical audits, never have a major media investigation, and have the federal, state and local principalities grant alternate regulations has been a monumental, well-coordinated, and costly job.

In order to keep their control, the Bells have outflanked and outspent any other group opposing them to make sure it gets what it wants, both singularly and collectively. Based on case studies, we estimate that the Bells outspend the consumer advocate side 30 to 1, with overall federal and local lobbying estimated at \$225 million annually.

(Also, their mother, MA Bell, had taught her children well. It should be remembered that the RBOC's powers was just an extension of Bell System's original powers.)

The primary methodology has been both a close grass-roots approach, from supporting political candidates, as well as massive local lobbying. This includes everything from specific local and civic groups to massive expenditures on high-paid lobbyists, many with blue-chip credentials.

On the Hill, they have bought control through a series of politicians and others that reflect power and connections. The list goes from Former Defense Secretary Dick Cheney, now a director for US West, to former governors (167)

In some cases the Bells just hired well known state politicians and used their skills and influence to help move through legislation—with their own agenda. Case in point, Stanley Fink, former New York State Senator and State Assembly Speaker, who went to work for NYNEX. A NYNEX press release about his death shows that he helped obtain NYNEX's approval for both a major state Alternate Regulation Case, and influenced people for the Telecommunications Act as well as the NYNEX—Bell Atlantic merger.

The irony is that Fink used to be considered a politician on the side of the consumer.
(168)

"Mr. Fink served as a member of the New York State Assembly for 18 years, the last eight as Speaker.

"As (NYNEX) senior vice president, Mr. Fink developed the corporation's positions on public policy matters and coordinated NYNEX's regulatory and legislative functions in New York. In 1995, he oversaw the approval of a landmark agreement with New York State regulators that dramatically changed decades of monopoly-era telecommunications regulation in the state and froze basic phone rates through the year 2002.

"Last year he led efforts to implement the Telecommunications Act of 1996 in New York, including the continued opening of local telephone markets to competition. For the past year, he also orchestrated the statewide public education and information campaign and the regulatory review process on NYNEX's \$23 billion merger with Bell Atlantic.

"In a little over two and a half years, Stanley Fink has had an enormous impact on this business. It didn't take him long to master a new and complex area of regulation. Drawing on his renowned leadership skills, he influenced the making of important telecommunications public policy here in New York, a legacy that will have an impact for decades to come."

And it's on the local level, that the Bell's impact has been so dramatic. According to the Wall Street Journal: (3/15/93) (169)

"The Bells just don't work Washington - They had some \$95 million to bestow on grass-roots causes in 1992 alone, according to FCC records - they had wired the systems from top to bottom.

"Each year the Bells hand out tens of millions of dollars to chambers of commerce, rotary clubs and the like. In turn the phone companies often find support for their legislative agenda in the form of resolutions, letters and phone calls to Capitol Hill. They nurture the grass

roots one blade at a time, says an admiring AT&T lobbyist, Mike Baudhuin.

"The Bells reach...an influential alliance with the 450,000 employees spread across the country and on the ground presence in virtually every congressional district.

This money was atop an additional \$40 million in lobbying for 1992, according to the FCC.

But these figures don't begin to cover the law firms that create filed documents. The consulting firms that work on alternate regulation policies/information highway studies or the series of "contributions" made to make the phone company's good will extend into the communities.

In fact, lobbying expenses may not even be paid for by the Bells. According to an audit by the FCC, released in 1995, the Bells improperly charged \$116 million dollars of lobbying fees to telephone subscribers, between 1988 to 1991. (170)

EXHIBIT 25

FCC Audit Results of Improper RBOC Lobbying Expenses, 1988-1991

(In the millions)

Ameritech	\$18 million
Bell Atlantic	\$21
Bell South	\$27
NYNEX	\$14
Pacific Telesis	\$12
Southwestern	\$14
US West	\$10
Total	\$116

Source: FCC, 1995, Washington Telecom Week.

Washington Telecom Week, 12/1/95, reported that the FCC decided to do nothing about these improprieties. MCI's filed complaint urging the FCC to have the companies make retributions, had little impact. (171)

Then there's something called "Soft Money", where companies donate money to various Democratic and Republican causes. Common Cause, a non-profit organization who monitors campaign financing, found that millions of dollars were spent by both the RBOCs and long distance companies during the 18 month 1996 election cycle—especially geared toward securing their own favors in the Telecommunications Act of 1996.

The two exhibits (172) (173) below highlights the long distance companies' soft money donations, followed by the RBOCs soft money expenditures for both the Republican and Democratic parties. Leading the pack is AT&T followed by MCI. However, as a group the Bells out spent the three major long distance companies by over \$400,000.

EXHIBIT 26

Common Cause's Long Distance Soft Money Donations, 1996

<u>Donor</u>	<u>Democrat</u>	<u>Republican</u>	<u>Total</u>
AT&T	\$326,680	\$417,590	\$ 744,270
MCI Corp	\$479,303	\$270,000	\$ 749,303
Sprint Corp	\$137,450	\$101,400	\$ 238,850
	\$943,433	\$788,990	\$1,732,423
Total Long Distance			\$1,732,423

EXHIBIT 27
Common Cause's RBOC Soft Money Donations, 1996

<u>Donor</u>	<u>Democrat</u>	<u>Republican</u>	<u>Total</u>
Ameritech Corp	===	\$ 131,500	\$ 131,500
Bell Atlantic Corp	\$ 128,000	\$ 224,000	\$ 352,000
BellSouth Corp	\$ 71,750	\$ 243,514	\$ 315,264
NYNEX Corp	\$ 127,500	\$ 313,505	\$ 441,005
Pacific Telesis Group	\$ 117,250	\$ 213,100	\$ 330,350
SBC Communications	\$ 130,500	\$ 172,400	\$ 302,900
US West Inc.	\$ 145,500	\$ 172,400	\$ 317,900
	\$ 720,500	\$1,440,019	\$2,160,519
Total RBOC			\$2,160,519

Please note: According to Common Cause, the chart only represents companies that spent over \$50,000. Therefore, Ameritech did not spend over \$50,000.

In short, in the future sections when the Bell's profits and regulation are discussed, keep in mind that influence and politics can account for much of the Bell's overcharging of customers.

Chapter 10 The New Bells: Shareholders First, Customers Last

GOAL: Redefine the Company to be Global, Entertainment & Information Services Group, Instead of the Local Phone Company.

The clearest indication that the Bells have shifted focus is their own definition of themselves — The Corporate Mission Statements. From their inception, the Baby Bells started to slowly redefine themselves from a telephone utility to be reborn as a global information services and entertainment conglomerate. Notice the change in the definition and corporate mission of Ameritech, first from the 1985 Annual Report then to their corporate profile in 1996. In 1985, Ameritech was still a communications company first serving its monopoly market. By 1996, there is now longer any discussion of its monopoly subscribers. Now they serve 50 states and 40 countries.

1985 Ameritech Annual Report: (174)

"The Ameritech companies are the leading supplier of advanced communications products and services in Illinois, Indiana, Michigan, Ohio and Wisconsin."

1996 Ameritech (175)

"A worldwide leader in making communications easy, Ameritech serves millions of customers in 50 states and more than 40 countries. Ameritech provides a full range of communications services, including local and long distance telephone, cellular, paging, security monitoring, cable TV, electronic commerce, on-line services and more. One of the world's 100 largest companies, Ameritech (www.ameritech.com) has 65,000 employees, 1 million shareowners and \$23 billion in assets."

US West's definition of themselves in **1984** was as a diversified telecommunications holding company in the Information Industry.(176)

"US West is a diversified telecommunications holding company, with a growing base of information industry companies. "

By 1993 US West's Annual Report states that it serves "local markets worldwide", the telephone and their regional monopoly all but forgotten. (177)

"US West is in the connections business, helping customers share information, entertainment, and communications services in local markets worldwide."

BellSouth's quote in its 1993 Annual Report shows the path the RBOCs have taken in their own redefinition of themselves — from a regional telephone company, to now covering 14 countries on five continents. (178)

"In 1984 BellSouth was a regional telephone company. From our base of 9 states in 1984 in the Southeast, we expanded overseas to serve cellular, paging, wireline, and mobile communications in 14 countries on five continents."

They continue with:

"Convergence, interactive multi-media, on-demand services. New words, new opportunities for investors."

By 1996 BellSouth doesn't even hint that they are beholden to any local monopoly customers. (179)

"BellSouth is a \$19 billion communications services company. It provides telecommunications, wireless communications, directory advertising and publishing, video, Internet and information services to more than 27 million customers in 18 countries worldwide."

Bell Atlantic, by 1990, was a global communications and information management company: (180)

"The watchwords of the Bell Atlantic Way are teamwork, accountability, and empowerment, the characteristics we believe will be the key to success in a global marketplace. . . . The objective we have set for ourselves is our vision of being a leading international communications and information management company. "

Bell Atlantic believed that in 1994 their mission was clear-cut — and it included everything from video entertainment to cable television. (181)

"Our business opportunity and beyond is straightforward — enhance the value of our core businesses by expanding our customer and service base, and develop high-growth businesses in the video entertainment, cable transport, cable television, and information services markets. "

By 1996, Bell Atlantic, as the company, had moved to the "forefront of communications, entertainment and information" and owns a "substantial interest" in the telephone company of New Zealand. (Author's note: The population of New Zealand is three million people and multiple millions of sheep.) (182)

"Bell Atlantic Corporation (NYSE: BEL) is at the forefront of the new communications, entertainment and information industry. In the mid-Atlantic region, the company is the premier provider of local telecommunications and advanced services. Globally, it is one of the largest investors in the high-growth wireless communication marketplace. Bell Atlantic also owns a substantial interest in Telecom Corporation of New Zealand and is actively developing high-growth national and international business opportunities in all phases of the industry."

The next two quotes, from SBC Communications and NYNEX are simply used to round out NNI's primary finding — that the telephone monopolies have all but hidden the fact that they should be local phone companies dedicated to subscriber interests first and foremost.

NYNEX is also a global communications and now even a media corporation. (183)

NYNEX is a global communications and media corporation that provides a full range of services in the northeastern United States and high-growth markets around the world, including the United Kingdom, Thailand, Gibraltar, Greece, Indonesia, the Philippines, Poland, Slovakia and the Czech Republic. NYNEX has expertise in telecommunications, wireless communications, directory publishing, and video entertainment and information services.

Meanwhile SBC Communications Inc., is now one of the "world leaders in communications.". (184)

"SBC Communications Inc. is one of the world's leading diversified telecommunications companies and the second largest wireless communications company based in the U.S. SBC's subsidiaries provide innovative telecommunications products and services under the Southwestern Bell and Cellular One brands. Its businesses include wireline and wireless services and equipment in the U.S. and interests in telecommunications businesses in Europe, Latin America, South Africa and Asia; business and consumer telecommunications equipment; messaging services; cable television in both domestic and international markets; and directory advertising and publishing. SBC Communications Inc. reported 1996 revenues of \$13.9 billion."

In all of these definitions, there is only one thing missing—the local phone company's primary customers, in their original mandated geographic areas. As we show in future chapters, even with all this hype, it is still the local customer who supplies the overwhelming majority of both current cash and current profits.

From the subscriber perspective, these corporate mission statements should have added the phrase "**Deliver Quality Services to our monopoly subscribers at the best prices possible.**". The lack of consideration in their definitions is also demonstrated by their performance in terms of quality of service and the price to subscriber, which will be addressed in later sections.

Shift Strategy- From Customers First to Shareholders First.

The obvious definitional changes in the Bell's Corporate mission statements over the last 13 years are just a road-sign of a larger corporate shift — to serve the customers last, shareholders first. The signs of this shift are many and obvious. One major change occurred when all of the Bells replaced the local phone company name, such as Ohio Bell or New York Telephone, to with that of the holding company — i.e., Ohio Bell became Ameritech. Ashley Brown, former Ohio Public Utilities Commissioner put it this way. (185)

"When Ohio Bell became part of the Ameritech Corp., the company executives became less and less trustworthy. They began to use power in ugly ways. They became less and less concerned with local concerns and more and more interested in corporate mucky-mucks in Chicago. Sometimes they were just flat-out dishonest." Ashley Brown, former Ohio Public Utilities Commissioner.

In fact, the removal of the local identity, with changes shown in the Bell's shift in corporate mission, are all just road-signs for the customer to beware.

Or Take the Case for Customer Service Declines.

Regardless of all of its detractors, the Bell system prior to the break-up was a well functioning behemoth, that not only kept prices somewhat reasonable, but more to the point, had a sense of integrity in the work. The Bell System jobs were in high demand, because they were not only well paying and stable, but because of the company's determination to deliver high quality services. In fact, workers considered to be a personal insult if the phones weren't answered promptly.

For example, in "The Rape of Ma Bell", by Constantine Raymond Kraus and Alfred W Duerig, (Lyle Stuart, Inc. 1988), these two former long-time Bell employees bemoaned the break-up of AT&T, and discussed the work ethic of the original Bell system. (186)

"Service was the goal whether it was in long-term planning or short term programming and installation of plant additions or day-to-day operations and maintenance of the network. The highest quality service and performance were uppermost in the minds of all Bell managers and craftspeople. Whenever a choice had to be made between cost and service, or between revenues and service, quality invariably won out."

Also, jobs at the Bell system were coveted. (187)

"They were good jobs, coveted ones. When you worked for Bell you worked for life. On the average a manager stayed with the company thirty-two years resulting in a lowest management turnover of any large American company. Longevity was the norm, It was expected. Recognition awards usually weren't given until 25 to 30 years of service."

The largest shift away from customer needs has been the massive local phone company staff cuts that has effected all customer services. Since 1984, the Bells corporate arm has sheared off over 235,000 of the original workforce. Almost all of these layoffs were from the local telephone companies, and almost all of it done with an eye for corporate profits.

Without proper staffing, this has left the customer taking a back seat. It shows in the number of complaints, missed appointments and lack of keeping-up service standards that were all the heart and soul of the original Bell system. According to an LA Times article, (6/18/95) (188) the Ohio's PUC received 10 times the number of complaints in 1994 than the previous year, while NYNEX missed 142,000 appointments in the last three months of 1994 alone. In fact, according to NYNEX's 1996 3rd quarter report, (189) "New York Telephone will be required to issue rebates to customers of at least \$102 million for not maintaining adequate service standards. As a New York Post columnist, Irwin Stelzer, recently put it:, 2/26/97 **"NYNEX fails to show up at about 1,000 repair appointments every business day."** (190)

Compare this to the original Bell system philosophy from "The Rape of Ma Bell" and the change is obvious,. In fact, during interviews with some of the remaining staff, the new Bell philosophy is to worry much more about job security and waiting for pensions to be made available. In one interview we found that the staffing of some offices

were cut in half, but the work load has been increasing— the staff being forced to deliver services "as best as we can with the limitations". (191)

Chapter 11 Buy Companies, Lose Money: RBOC Investments

Almost from the beginning, the Bells started a process of purchasing companies and entering into new business arenas. This was a no brainer since the companies were secure in the fact that their primary business, local telecommunications services, was protected from direct competition. Before the Telecom Act of 1996, most states restricted other companies from offering any local telephone services. This security also led to a complacency to their local customers, with little new innovation.

And like the siblings that they were, the progeny of Ma Bell, their actions all mimicked each other. In fact, a 1985 report by Link Resources, surveying the Regional Bells' lines of business, stated that the companies' purchases were mostly the same, and there was little differentiation in actions— and little innovation. (192)

"From the viewpoint of the telephone company customer, the seven RBOCs have done very little in the way of innovations and diversification, and even less in differentiating themselves since divestiture. In addition to the local exchange carriage business, a standard list of new business enterprises across the seven RBOCs include:

Customer premises	Office automation equipment sales
Mobile communications	Directory publishing and advertising
International business	Equipment leasing and financing
Venture capital development	Property management and real estate"

The next exhibit summarizes a Department of Justice's analysis of new Bell businesses. (193) It should be remembered that the Bells were required to file for "waivers" to allow them into new areas, and the list below are from business waivers granted from 1984 to 1985.

EXHIBIT 28**RBOC Line of Business Waivers Granted from 1984-1985****Non-Tariffed Billing Services**

Ameritech
US West

Office Equipment

BellSouth
NYNEX
Pacific Telesis
Southwestern Bell

Real Estate

Pacific Telesis
US West
BellSouth
NYNEX
Southwestern Bell
Bell Atlantic

Software

Ameritech
BellSouth
Bell Atlantic
NYNEX

Print Media/Directory

Pacific Telesis
Southwestern Bell
Ameritech
BellSouth

Foreign Business Ventures

Ameritech — Cellular
Ameritech — Consulting
NYNEX
Pacific Telesis
BellSouth — Cellular
Southwestern — Cellular
US West

Source: Department of Justice, 1986, Link Resources

Considering the outcome of many of these ventures, especially real estate and computer leasing, the approach of purchasing companies has been a continual loss leader --- Some might say a dismal loss. The next exhibit highlights the spending, (mostly losses) from Foreign Investment, Real Estate, Financial Services, Computer leasing.
(194)

Exhibit 29

Bell Spending for International and Real Estate, 1984-1996

- \$27 Billion Overseas Operations
- \$11 Billion Real Estate, Financial Services, Computer Leasing.

Here's some of the details:

RBOC Real Estate and Business Leasing

Probably the largest financial losses by the Regional Bells have been in one of their early investment areas, financial leasing and real estate, as well as other non-telecommunications markets, such as computer services.

Below are the words of the Bells as stated in the annual reports. Across the board, the Regional Bells have lost billions in these areas, and by the early 1990's have all exited the markets, or were on their way.

Each quote shows hundreds of millions of dollars in losses.

US West (195)

"Weakness in the commercial real estate market persists and disposition of the real estate assets has proceeded at a slower pace than originally planned. The company's current plan is to dispose of its real estate portfolio over the next several years. The Company may hold real estate assets longer than originally anticipated in order to realize book values. 1992

"The company's 1991 operating results reflect a pretax restructuring charge of **\$915 [million]** due to workforce reductions, **projected losses associated with exiting the real estate business and the write-off of certain intangible assets.** 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. Real estate revenues of \$214.2 [million] less operating costs of \$212.8 [million] and interest of \$98.9 [million] were charged to the valuation allowance during 1992. The balance of the real estate valuation allowance at December 31, 1992 approximates \$402 [million]."

The US West 1993 Annual Report showed an additional \$120 million shown as Real Estate charge in the companies restructuring charges.

Bell Atlantic: (196)

Dealing with computer leasing business, Bell Atlantic states in its 1991 Annual Report:

"These write downs, which totaled \$164 million, were made primarily to recognize competitive changes in both the lease financing and computer maintenance industries."

NYNEX: (197)

NYNEX took big hits on both its real estate and computer businesses. For example, the 1990 results include a pretax charge of approximately \$305 million for organizational restructuring in NYNEX's software and systems business, reported in "Other Diversified Operating Expenses." In their 1991 annual report we find that exiting the real estate business, the company took an additional \$278 million dollar charge.

"An additional pretax charge of approximately \$278 million was recorded in 1991 primarily for business restructuring. NYNEX has commenced its plans to exit the real estate development and management business and streamline other operating primarily related to Other Diversified operations."

Pacific Telesis 1991 Annual Report (198)

"Discontinued Operations: Revenues as well as expenses were affected by our decisions in 1990 to discontinue certain operations. Pact Tel Business systems, a wholly owned subsidiary of Pac Tel, ceased operations when we sold most of its assets in first quarter 1991. Additionally, we now charge the results of our real estate subsidiary, Pac Tel Properties, to a reserve set up in 1990. These two events combined to decrease 1991 revenues and expenses by \$110 million and \$207 million respectively, when compared to 1990, the effect of various one time customer refunds totaling \$279 million in 1989."

Pacific Telesis Third Quarter Results, 1993: (199)

"During first quarter 1993, the corporation recorded pre-tax restructuring charges totaling \$418 million. These charges primarily reflect an additional reserve of \$347 to **cover potential future losses on sales and estimated operating losses resulting from the corporation's decision to dispose of the real estate portfolio of its real estate subsidiary over the next three to five years**. During 1992, the corporation decided to defer disposing of these properties pending a reevaluation of investment alternatives resulting to its 1990 decision to dispose of these assets. The reevaluation was completed during the first quarter 1993."

The Bell's International Holdings

- NNI estimates that by 1997 the Regional Bells had spent \$27 billion overseas and will continue to spend approximately \$4.5 billion annually. To date, counting expenditures on acquisitions, foreign investment has been and will remain for the next few years, mostly unprofitable.

Examining annual reports we find that one of the primary uses for the Local Operating Company profits has been the purchasing of a percentage of foreign telecommunications, such as telephone, cable, or cellular firms from Czechoslovakia and Russia to New Zealand and the Pacific Rim. NYNEX, for example, has offices in Hong Kong, Singapore, Geneva, Frankfurt, and London; BellSouth has over 2,000 employees overseas; and Bell Atlantic has over 700 employees in 51 offices, representing 10 nations, while Ameritech states it offers services in 40 countries. (200)

In examining international investments, the only useful analysis is to examine expenditures, the money the companies paid for their overseas holdings. This is because overall, there have been spotty, if any, revenues and many of the deals are partnerships and joint ventures, obscuring the actual details. Also, while some quick profits have been made when the foreign government telephone system goes public, most of these investments are quite risky, especially in areas where the economy is slow and current telecommunications is non-existent. For example, the RBOCs have entered cellular businesses in many eastern European and Russian areas, such as St. Petersburg and Czech Republics, Hungary and Poland, where the basic infrastructure isn't in place to deliver service.

Some examples, while profitable, make NNI wonder why the companies have been allowed to spend more on their foreign customers instead of the core business. For example, Bell Atlantic and Ameritech spent \$2.4 billion in 1991 for a percentage of the telephone company in New Zealand. New Zealand has a population of 3.4 million, with approximately 1.5 million business and consumer subscribers total (and multiple-millions of sheep). The average expenditure comes to \$1,850 per subscriber. (201)

Foreign investments also bring up another sore point from the consumer perspective. Why have the Regional Bells been allowed to spend overseas, when they did not complete their info highway plans? This point will be restated in detail in future sections.

Internationally, the amounts spent and the amounts returned are both hard to track. For example Air Touch, a spin-off from Pacific Telesis's of cellular and overseas properties, has a very varied collection of properties around the world, with varying percentages of ownership.

The next exhibit highlight's some of AirTouch's holdings, (202) highlighted the first column, followed by the number of total service users, as well as total potential subscribers. So, in Germany, AirTouch has operation(s) which represents about a third,

34.8%, of some company. This service has 2.3 million subscribers with a potential of 81 million. Then there is Poland, where AirTouch owns 19% of some entity and it had, to date, 50 subscribers, but a potential of 38.9 million users.

(From the subscriber perspective, the main concern to all Californians should be that Air Touch's properties were funded through the local monopoly, Pac Bell — and even though subscribers were given \$60 million dollars when the company was spun off, the assets alone were worth \$7 billion in investments.)

Exhibit 30

Air Touch International Cellular Businesses, 1996

	<u>AirTouch Interest</u> (percentage)	<u>Subscribers</u> (in thousands)	<u>Population</u> (in millions)
<u>European Operations:</u>			
Germany	34.8%	2,313	81.5
Portugal	50.9%	331	10.5
Sweden	51.1%	281	8.9
Belgium	25.0%	410	10.1
Spain	16.7%	652	39.3
Italy	15.5%	713	57.5
Poland	19.3%	50	38.9
Romania*	10.0%	-	22.7
<u>Asian Operations:</u>			
Tokyo	15.0%		42.2
Kansai	13.0%		20.6
Tokai	13.0%		14.4
Digital TU-KA Co	4.5%	532.0	46.3
South Korea	10.7%	290.0	45.3
<u>India</u> Madras	20.0%	11.0	6.7
Madhya Pradesh	49.0%	**	72.7

But these are just a few of the Air Touch holdings. Air Touch also has domestic paging in 178 markets, satellite services around the world with Globalstar, A partnership equally owned by the AirTouch/U S WEST venture and Bell Atlantic/NYNEX Mobile

titled **Primco Personal Communications** and even **CMT PARTNERS** an equal cellular partnership with AT&T in San Francisco and Kansas City. (203)

- **Domestic Paging:** 178 markets throughout the U.S., including 48 of the top 50 MSAs. Markets include Atlanta, Boston, Chicago, Dallas, Denver, Detroit, Houston, Los Angeles, Miami, New York, Philadelphia, Phoenix, San Diego, San Francisco, Seattle, St. Louis, Tampa/St. Petersburg, and Washington, D.C.
- **Satellite Services:** A partner in Globalstar, with service provider rights in Austria, Belgium, Canada, the Caribbean, Indonesia, Japan, Malaysia, Mexico, the Netherlands, Portugal, Switzerland, and the U.S.
- **AirTouch/US West Joint Venture:** A joint venture that will combine AirTouch's and U S West's domestic cellular assets.
- **Primco Personal Communications** A partnership equally owned by the AirTouch/U S WEST venture and Bell Atlantic/NYNEX Mobile. PrimeCo owns licenses covering nearly 60 million people in 11 markets: Chicago, Dallas, Tampa, Houston, Miami, New Orleans, Milwaukee, Richmond, San Antonio, Jacksonville, and Honolulu.
- **Tomcom:** A partnership owned by AirTouch/U S WEST and Bell Atlantic/NYNEX Mobile formed to develop technical standards for the partners' cellular and PCS services, create a joint marketing and distribution strategy, and implement joint purchasing agreements.
- **CMT PARTNERS:** Equal cellular partnership with AT&T in the San Francisco Bay Area, Dallas and Kansas City.

Here's some of the other RBOC's International holdings.

Bell Atlantic 1995 Annual Report (204)

- "Omnitel Pronto Italia, Bell Atlantic's consortium operating the second wireless license in Italy, achieved world-record subscriber growth in its first 10 months of commercial operations, signing up more than 560,000 customers to its digital GSM (global system for mobile) service.
- "EuroTel, Bell Atlantic's partnership currently serving more than 100,000 customers in the Czech Republic and Slovakia, has acquired

30,000 customers since the inauguration of its digital GSM service in the Czech Republic."

SBC International Operations, 4th Quarter, 1996, Press Release (205)

"In addition to its United States businesses, SBC has international investments in Mexico, France, South Africa, Chile, South Korea, the United Kingdom and Australia, and is involved in every part of the industry: local service, domestic and international long distance, wireless, video and directory publishing.

- "During 1996, our international ventures made significant progress," Whitacre said. "In France, after building a high quality, nationwide cellular network last year, SFR focused on customer growth and expansion of its distribution channels.
- "The Chilean telecommunications market continues to be dynamic. VTR is now poised to roll-out telephone service through its cable operations, and the VTR/CTC wireless partnership achieved strong growth, with subscribers up 21.8 percent since the merger in June 1996.
- "We remain quite positive about the telecommunications opportunities for Telmex in Mexico, and we believe Telmex is well prepared, both operationally and financially, for increased competition in that growing marketplace," he said. "We are also encouraged by the signs of economic recovery in Mexico."

Even with glowing reports, it is hard to examine International investments for profitability, at least based on information supplied in Annual Reports. For example, NYNEX included its discussion of a new International company which shows numerous operators, each with varying amount of investment.

NYNEX 10Q, 3rd Quarter, 1996 (206)

"On October 22, 1996 Cable & Wireless plc, NYNEX and Bell Canada International Inc. announced an agreement, to form a new company, Cable & Wireless Communications ("C&W Communications"), to merge the

operations, and ultimately hold 100 percent ownership, of their United Kingdom subsidiaries and affiliates: Mercury Communications Limited, NYNEX Cablecomms Group PLC and NYNEX Cablecomms Group, Inc., Bell Cablemedia plc and Videotron Holdings Plc. Upon completion of all transactions, which are subject to certain pre-conditions, NYNEX will own 18.5 percent of the fully diluted share capital of C&W Communications."

Sometimes profitability is discussed somewhat obtusely. For example BellSouth states that it lost approximately \$100 million dollars over two years based on different losses, some of them in Germany and Denmark.

Bell South 1995 Annual Report (207)

"The amounts of equity in losses of unconsolidated affiliates were (\$65 million) for the nine-month periods ending September 30, 1996 compared to (\$46 million) for the same period in 1995. The increased equity in losses of unconsolidated affiliates in the nine-month period was attributable to certain international businesses, principally operations in Germany and Denmark, partially offset by improved results from unconsolidated domestic cellular operations."

One other important point about RBOC purchases, especially in international dealings — most of these new announced ventures are not geared to increasing the core businesses, but are 'sexy investments' allowing the company to offer service overseas, with no care to their local customers.

Chapter 12 Hollywood Calling

In the movie "My Fellow Americans", Jack Lemmon and James Garner portray two former presidents. Lemmon asks Garner "Who did you like meeting the most as president?" James Garner answers "Gorbachev". Lemmon says "I mean really like?" and Garner answers "Ella Fitzgerald".

In truth, while the Bells sold the Highway as a justification for schools and government needs, in the 1990's the Bell's became "Star Struck", trying desperately to change their personas from a stodgy old utility to flashy Entertainment and Information companies, even offering cable services.

With the promises of the laying fiber-optics, all of the companies also pursued becoming a major provider of interactive content on their new networks, competing with the likes of Time Warner. However, the Bells have had dismal failures in almost all of their Interactive investments.

Simba Research, in its 1996 report "Telco's in Interactive Services", put it this way: (208)

"The telcos have had virtually no success with the interactive information, transaction and entertainment services that have developed and been brought to market. Through their failures they have shown that they are not in tune with the information and entertainment needs of their customers.

"Part of the reason the telcos have so many problems with interactive TV services is that they are reaching beyond their technological expertise and local advertiser relationships. They are trying to develop services that use extremely costly technology and court national advertisers and merchants. The telcos, in particular the RBOCs, simply lack the experience in these areas. As a result, they're had difficulty creating effective broadband transaction services

"Another obstacle for the interactive television has been a lack of consumer acceptance. Consumers have not shown an interest in using interactive TV shopping services, much less paying for these services."

Depending on how you count, the Interactive/media investments have been numerous. They fall into two major areas: Entertainment Programming companies, and purchasing cable services.

Entertainment Failures — Tele-TV and Americast

Two primary new companies created by the Bells, Tele-TV and Americast, were formed to supply new interactive content. With investments of almost \$1 billion dollars, their failures to produce have been a clear sign of the Bell's inability to deliver on interactive services. (209)

These two companies' partners include 6 of the seven Bells. Tele-TV was announced in October 94 and consists of three partners: Bell Atlantic, NYNEX and Pacific Telesis. Americast, created to rival Tele-TV, was created in April 95, and consists of Ameritech, Bell South and SBC Communications. as well as Disney and GTE.

EXHIBIT 31

The RBOC's Tele-TV and Americast Partners

Tele-TV	<ul style="list-style-type: none">• Bell Atlantic• NYNEX• Pacific Telesis
Americast	<ul style="list-style-type: none">• Ameritech• Bell South• Walt Disney• GTE• SBC Communication

And these companies started just like a Hollywood movie. According to "Ovitz", the biography of super-agent Michael Ovitz, (210) it was a meeting in early 1993, between Ivan Seidenberg, CEO of NYNEX and Ovitz that got the ball rolling. At the time Ovitz was president of CAA, one of the premier talent agencies. Soon he was flashing movie stars and personalities at the Bellhead, from Michael Crichton and Ivan Reitman, to Aaron Spelling and Warren Beatty. According to "Ovitz", the book: (211)

"Planning came to a peak in October 1994 when Ovitz and the Baby Bells announced that CAA and the phone companies would be entering into a joint venture with the NYNEX Corporation,. Bell Atlantic and Pacific Telesis to buy or invest in programs that the existing Hollywood studio would turn out.

"We'll bring technology to the home, but you'll have a twenty five inch pipe instead of a two inch pipe," stated Mike Ovitz.

Only months after the deal went through, Ovitz left CAA for a brief stint as the president of Walt Disney, which was the beginning of the end for TELE-TV. However, Ovitz walked away with a reported \$50 million dollars. (211)

TELE-TV, now defunct, also employed a number of people from the broadcast industry with impressive credentials including Howard Stringer, a former president of CBS Broadcasting and Sandy Grushow, former president of Fox Broadcasting. At its peak in 1996, Tele-TV had 200 employees

Americast, is still alive, though limping. Headed by non-Bell Steve Weisswasser as president, a former president of a multimedia division at Capital Cities/ABC, and even the fact that this group had Disney Televentures, a unit within Walt Disney Television and Telecommunications, as one of the partners, it wasn't enough to make the company work.

According to a New York Times article, (213) Americast plans have been severely scaled back from its heyday in 1996, when the company had about 100 employees.

"Americast has shut down two divisions, laid off more than a dozen of its 100 employees, and throttled back its ambitions to develop futuristic television service for its five telephone company backers. "

According to an article in Electronic Media, (214) the company has closed its programming business because interactive programming is unobtainable today.

"The move is seen as a realization of the fact that true interactive programming is still but a gleam in the eye of modern pioneers."

Some believe that these investments were actually just a strategy to keep the cable industry in its place. (215) The New York Times stated:

"Americast and Tele-TV were deterrents to keep the cable industry out of the phone business, said Michael J Wolf, a partner in the media practice at Booz, Allen & Hamilton. "When the cable companies decided not to get into that business, the phone companies didn't care anymore. "

Others believe that it was a shifting priorities that was the downfall of these companies. (216)

"Problems crept into the venture from the start. One of Americast's phone company backers, SBC, announced it was no longer interested in the television business. And some of the other phone companies delayed their plans to offer video services so they could concentrate on other businesses, like long distance. "

Whatever the reason it is clear that the Bells no longer have intentions of delivering the full-motion interactive video that they had promised.

Cable and Entertainment Investments

Other Bell investments in the entertainment business have also been huge, with over \$16 billion dollars in the last five years. Below is just a sample of the larger investments.(217)

EXHIBIT 32

Bell Cable and Entertainment Investments

NYNEX	Viacom International	\$ 1.2 billion (1993)
US West Cable	Continental	\$10.8 billion (3/96)
	Time Warner	\$ 2.5 billion (5/93)
	Wometo Cable/ Georgia	\$ 1.2 billion (12/94)
SBC	Hauser Cable Properties	\$.6 billion (1/94)

Chapter 13 Liar, Liar — Baby Bell's Pants on Fire

"The story began like a thriller novel. On October 17th, 1974, T. O. Gravitt, fifty-one year old vice-president of Southwestern Bell Telephone Company, with responsibility for all operations in Texas—a swashbuckling, private-plane-piloting executive who, at the time, was under investigation by Southwestern Bell on suspicion of having misappropriated company funds for his private use—committed suicide by inhaling automobile exhaust fumes in the garage of his home in Dallas. He left a suicide note and various memoranda accusing the company of a litany of mis-deeds, among them the making of political payoffs from a slush fund maintained for that purpose, the illegal tapping of telephone wires, the misuse of company funds, and—most serious of all from the public point of view—the securing of high telephone rates in Texas by providing regulators with false or misleading information.

The suicide note ended, "Watergate is a gnat compared to the Bell System". (218)

Isn't it a shame we can't simply make a wish, like in the Jim Carey movie, "Liar, Liar", and know if the Bells' statements are truthful? One of the primary reasons we are requesting Congressional investigations into many of the Bell activities, including the Bell mergers, the roll-out of the fiber-optic I-Way, and more recently ISDN, is because there has been a documented pattern of misleading, if not down-right deceitful behavior by the Bells, in everything from their promises of technology deployment to their state and federal filings.

But don't take our word for it. Let's start with three quotes — one from Senator Hollings, former Senate Commerce Committee Chairman, one from Judge Frank Robinson, NY State Administrative Law Judge, and Ashley Brown, former Ohio Public Utilities Commissioner.

Quote 1:

"The Bell Companies engage in a political onslaught of misrepresentation and outright fraud". From Senate Commerce Committee Chairman Ernest Holling's letter to Senate Majority Leader George Michell. (219)

Quote 2:

"...the Information Providers (IPs) (companies that provide content on the local, mass-announcement 976 Services) were harmed by the improper, deceitful and grossly negligent way in which New York Telephone provided service to them." Administrative Law Judge Frank Robinson 2/96. (220)

Quote 3:

"When Ohio Bell became part of the Ameritech Corporation, the company executives became less and less trustworthy. They began to use power in ugly ways. They became less and less concerned with local concerns and more and more interested in corporate mucky-mucks in Chicago. Sometimes they were just flat-out dishonest." Ashley Brown, former Ohio Public Utilities Commissioner. (221)

Technology Spending and Deployment

Throughout this book we have shown over and over again that the Bells announced technology deployment plans were virtually never implemented, and statements made in Bell annual reports have been closer to campaign promises than promised business initiatives.

Remember these promises of InfoHighway deployment, none of which were ever rolled out?:

US West, 1993 Annual Report (222)

In 1993 the company announced its intentions to build a 'broadband', interactive telecommunications network...US West anticipates converting 100,000 access lines to this technology by the end of 1994, and 500,000 access lines annually beginning in 1995. [Emphasis added]

NYNEX, 1993 Annual Report (223)

We're prepared to install between 1.5 and 2 million fiber-optic lines through 1996 to begin building our portion of the Information Superhighway. [Emphasis added]

Truth in advertising? Jonathan L. Petersen, a former government financial analyst, says it's all in the fine print when discussing corporate plans. (224)

"It's all in the fine print. In reading Ameritech's "Opportunity Indiana", their fiber-optic deployment plan, it is obvious that the company is playing with the meaning of the words. For example, the company states it will spend up to \$180 million in network upgrades — "up to" is the top limit and the company can spend whatever it likes below that figure— \$2 bucks if it likes. Similarly, the promises of the I-Way construction had numerous "conditional" words, such as "prepared to install" (NYNEX quote), which means that if plans change... "we were prepared, we just didn't do it."

"Is it lying? Well it is misleading in terms of meaning, but it's probably legal. "

And this pattern of misleading the public by rewriting the news hasn't stopped one bit. For example, a press release from SBC Communications, 4/1/97, touting their purchase of Pacific Telesis, stated that Philip Quigley "...led Pac Tel's comprehensive \$16 billion network design program". (225) So what if that program was never implemented and the \$16 billion dollar figure was only window dressing, not actual spending.

And the promises of ISDN deployment go back even farther — and were also never delivered upon.

Ameritech 1991 Annual Report (226)

(Illinois Bell's Bill Kallmyer, senior marketing operations manager) says ISDN is available to single-line customers as well as larger firms.

In short, a large amount of technology "promises", have been nothing more than words without any basis in fact.

The Mergers

NYNEX and Bell Atlantic promoted their merger as a 'merger of equals', but instead, Bell Atlantic purchased NYNEX, just like SBC purchased Pac Bell. And NYNEX shareholders got only 77¢ on the dollar — so much for equals. (227)

"On July 2, 1996, NYNEX and Bell Atlantic Corporation ("Bell Atlantic") executed an amendment to their definitive merger agreement (the "Merger"), effecting a technical change in the transaction structure of the merger of equals announced on April 22, 1996. As amended, the agreement provides that a newly formed subsidiary of Bell Atlantic will merge with and into NYNEX, thereby making NYNEX a wholly owned subsidiary of Bell Atlantic. There is no change in the fundamental elements of the proposed Merger. The exchange ratio for shares is restated to reflect the difference in the transaction. Each NYNEX shareholder will receive 0.768 shares of Bell Atlantic common stock in exchange for one share of NYNEX common stock." [emphasis added] (

The reason for this purchase agreement is simple. This tactic side-stepped required Congressional hearings and approval, as well as placed limits on the states' regulatory involvement.

Pacific Telesis also called it's arrangement a "merger". "Pacific Telesis announced a plan on April 1, 1996 to merge with SBC Communications Inc.." However, the fine print shows that it was a buy-out agreement with Pac Bell shareholders receiving only 73¢ a share. (228)

"On April 1, 1996, SBC Communications Inc. ("SBC") and the Corporation jointly announced a definitive agreement whereby the Corporation will become a wholly-owned subsidiary of SBC. Under terms of the merger agreement, each share of Pacific Telesis common stock will be exchanged for 0.733 shares of SBC common stock, subject to

adjustment. On July 31, 1996, the shareowners of the Corporation and SBC approved the transaction, which previously had been approved by the respective Board of Directors of each company. Pursuant to the merger agreement, the Corporation's quarterly dividend per share cannot exceed 0.733 of SBC's quarterly dividend per share."

And just how often do the Bell's make statements that are either misleading or untruthful? Well, other 1997 events would make it appear that it is business as usual. For example, New York State Attorneys General Office asked the New York State Public Service Commission to stop the merger between NYNEX and Bell Atlantic because of untruthful statements. According to the Wall Street Journal, (2/6/97) (229)

"Attorney General Dennis Vacco said in the brief (to the PSC) that evidence obtained during his office's investigation indicated that Bell Atlantic had 'considered' entering the New York City market as a competitor to NYNEX. That conclusion directly contradicted repeated assertions by Bell Atlantic to federal and state regulators that it never intended to enter the New York market." [emphasis added]

In another case, the FCC rejected Ameritech's bid to enter the long distance market anytime soon because they submitted false documents. According to the Wall Street Journal, 2/10/97 (230)

"On two separate occasions in the past month, the Chicago-based Bell asserted in its service application to the FCC that it had reached a state-approved pacts to allow AT&T Corp. access to Ameritech's local network in Michigan—assertions the agency later deemed untrue." [emphasis added]

However, there are actual scandals today, especially dealing with Information Providers (IP) and Internet Service Providers (ISP). Because the phone companies have drastically cut staff, those few remaining are having to do more and more work. Unfortunately, these employees are left with a serious problem: How do you service the

customers when there aren't enough people, or in some cases deploy technology to actually fulfill the required service provision?

Here's a recent, yet dramatic story which has taken seven years to unfold. It involves NYNEX staff stealing documents, fudging numbers, a whistle blower who was fired, and even out and out deceit on the part of NYNEX, and even its lawyers — a very dark side of NYNEX's business practices. We also found that the rollout and implementation of ISDN and Internet provision to service providers have hauntingly similar problems, from inadequate staff and expertise, to the company not being able to deliver on advertised products and promises made.

The NYNEX Information Provider Info-Scandal

NOTE: The source for this story is from direct court testimony and findings. (231)

On February 17, 1997, Administrative Law Judge Frank Robinson found that:

"New York Telephone Company has been guilty of gross negligence and willful misconduct.

"...the Information Providers (IPs) (companies that provide content on the local, mass-announcement 976 Services) were harmed by the improper, deceitful and grossly negligent way in which New York Telephone provided service to them."

"Furthermore, the company engaged in willful misconduct in striving to cover up its negligence and to defeat efforts to call it to account. This extended to willful misconduct in the company's litigation of this proceeding."

Judge Robinson recommended that the Public Service Commission award the companies over \$25 million dollars.

Background

Numerous Information Providers (IP) provide content on the NYNEX local Mass Announcement 976 Services. This includes everything from weather forecasts, such as 976-1212, to sports information and lottery results. These services garner millions of calls

annually, and the billing is performed by NYNEX, who has a total monopoly on these local services.

During September 1990, NYNEX replaced their old, faulty network switch, which gave false accounts of the amount of calls, among other problems, and 'cutover' a newer model designed by Ericsson, an equipment manufacturer. Unfortunately, the Court found that the company did not have adequate expertise nor staff to use this equipment properly, and the new equipment greatly undercounted and even blocked calls.

The Court wrote of testimony from one of the Information Providers: (232)

"Witness Fogel, president of Phone Programs Inc., summed up the picture of alleged gross negligence in connection with the cutover thusly: haphazard planning without managerial oversight; insufficient attention to detail as to differences between Autrax (the old switch) and Ericsson (the new equipment); sloppy field work at end-offices; little or no training for the technicians and field personnel as to quality control or troubleshooting; and misleading and infrequent communication with IPs, the customers. "

The IPs initiated a court case and one conscientious employee, Mr. Lobsco, complained to superiors and even kept a log of the problems, titled "Memo to Self". In September, 1995 he wrote: (233)

"I have come to believe that the Company and Ericsson are aware, and have always been aware, of systematic problems, either in the network or the IMAS [Ericsson Switch] itself. Every opportunity I had to articulate my concerns fell on deaf ears. As far as Ericsson goes, they have been aware of the software problems plaguing the statistical package and the broadcast feature, from the outset, and have been unable to resolve them to this day. "

He was summarily fired during the case because he would testify against the lawyers and upper management, who told him to not reveal the full problems to his customers, the IPs. In fact the Court wrote: (234)

"In contrast to the odor of dishonesty in the previous company testimony in which he participated, Mr. Lobosco's September testimony has the ring of candor."

Others at the company also knew of these problems long ago. For example, the Court wrote: (235)

"As evidence of the company's alleged duplicity and cover-up, the IPs also quote extensively from a December 28, 1990 memorandum from Kingsley Nelson (a mid-level company executive with supervisory responsibility for 976). The IPs say that while the company was publicly telling them that all was well with Ericsson, and minor problems had been corrected, the Nelson memorandum indicates that significant call volume data problems were still being experienced, with the software in question prone to failure fairly frequently. The memo labels these problems 'intolerable', and notes that the company cannot withstand an audit given its lack of actual call counts. "

One employee, a Mr. Cerar, even took home incriminating files, memos and letters so that the company's records couldn't be adequately investigated. The Court wrote: (236)

"The company, even while producing great volumes of material, to which it can point as supposedly proving its good faith, has hidden, lost, and destroyed reams of evidence, and doggedly deflected legitimate information requests." [emphasis added]

"The IPs assert that Mr. Cerar lied when testifying that he never took home documents... They add that Mr. Lobosco also made reference to a "cache" of documents which Mr. Cerar allegedly said he took home and would not bring forth if they were adverse to the company. The IPs urge a finding that Mr. Cesar purposely secreted or destroyed relevant documents. "

In short, NYNEX was not only unable to provide a working service, but then tried to cover-up the problems by losing files and data and firing the star witness. As Judge Robinson concluded: (237)

"Furthermore, the company engaged in willful misconduct in striving to cover up its negligence and to defeat efforts to call it to account. This extended to willful misconduct in the company's litigation of this proceeding.

"I also conclude that the IPs were in fact harmed by the improper, deceitful and grossly negligent way in which New York Telephone provided service to them."

Conclusion:

As previously mentioned, we believe that all of the filed Info Highway plans should be re-examined for failure to deliver on promised products and service deployment, i.e., the rollout of the I-Way. Also, based on interviews with various ISPs and other 'new media' experts around the country who have had long battles with the local telco in trying to obtain and maintain ISDN, the states should also investigate the promises made for the deployment of ISDN, and whether the phone companies ever spent the monies required for implementation of these services, including everything from adequate facilities to staff with the proper expertise. Finally, Congress should also investigate the Mergers of the Bells.

Coda: How common are these actual cases of deceit? The Wall Street Journal ran an article, 3/15/97, with the headline "GTE Studied for Alleged Destroying or Withholding Data in Billing Probe". The article goes on to say that: (238)

"GTE Management instructed employees to shred documents that were subject to a prior investigation into fraudulent billing practices at the company."

Therefore, all investigation of the Bells should also include all local telcos, especially GTE.

BOOK III

Show Me the Money: RBOC Revenues, Expenses and Profits

Billions of Pennies, Nickels, Dimes, and Quarters

Chapter 14 RBOC Revenues, Expenses and Profits

Throughout the book we have claimed that the Bells have seriously overcharged customers — first, taking advantage of large holes in regulations, then as a swap promising to build the Info Bahn if regulators removed limits on our profits.

And the premise is simple. If you only add a few pennies, nickels, dimes and quarters to the price of services — since there are over 125 million Bell phone lines across America, the amount, billions of dollars, accrues very quickly.

Following the money trail requires us to give you the financial landscape of the Bells — how much money they make and how much profits they keep.

After the realization sets in, that these Bell utilities are more profitable than almost every other company in America, from the S&P 500 to the Business Week 1000, we will then show that almost all of the profits, 90+% are coming directly from telephone subscribers, not the hundreds of new businesses. (239)

For example, BellSouth, in its 1993 Annual Report shows that the company's entire profitability is not in international, wireless, or any other company initiative into new ventures, but almost all, over 95% of all PROFITS, were from the 'wireline services', i.e., the local subscriber. (240)

"Approximately 95%, 97%, and 97% of net income for the years ended December 31, 1993, 1992, and 1991, respectively, were from wireline telecommunications services which were provided by BellSouth Telecommunications."

And we will make the case:

- that the Bell's profitability is excessive, out-performing almost all other companies in America.
- that almost all of it comes almost exclusively from the pennies, nickels, dimes and quarters on America's telephone bills.
- that all of the other businesses, are in essence funded through this excess profits.

Later, in Book IV we will travel down the Regulatory dirt road, showing that almost all of this money have been garnered because of faulty regulations and unkept promises of an Info Bahn future.

However, in order to make the case for overcharging, and the details to prove our points, we will first use Book III to discuss the basic revenues, while:

- **Book V** focuses on overcharging based on other analysts and comparing the Bells to other large market indicators
- **Book VI** takes a different approach and examines the specifics about overcharging by examining the charges on telephone bills — and how to save money.

First, the Facts:

The Bells are cash cows, short and simple. This is because of some simple business items.

- **They have a Captive Audience.** The Bells are still monopolies and have almost no competition. Customers must use their service, including all calling features, such as Touchtone service and Call Forwarding, or not have these phone services.
- **The Bells have Guaranteed Earnings** The Babies never had an unprofitable quarter or lost money from their phone services. Never. NADA. NOT ONCE.
- **The Bells Generated About \$100 Billion Dollars** in revenues in 1996. Subscribers generated 80%+ of this revenues and 90%+ of all RBOC profits. The profits from the local services pays for all other business ventures, most of which have not been profitable.
- **The Bells Collectively Made \$26 billion in Cash**, \$14 billion in net profits in 1996.
- **In 1996, Bell Profits were about 150% Higher** than the Business Week ScoreBoard for Utilities (241), while profit margins were over 100% for the Business Week 1000. They out-perform companies as diverse as GM and Ford, or Sears & Roebuck and PepsiCo.

Road Map for this Section

So, let's follow the money. First, we're going to explore the Bells' revenues, — how much money they make each year. Then we'll ascertain how much money and profits came from telephone subscribers vs all of the other Bell ventures, clearly showing that their wealth has been created from just Plain Old Telephone services.

Some Very Basic Definitions Before We Start

This simplified model will be expanded upon during our discussions, but for the general reader, with little financial or telecom background, we hope this helps you keep track of following the money trail.

- **Revenues** are the monies a company makes when it sells a product or service. So, when you pay the phone company your monthly telephone bill, that's revenues.
- **Expenses** are all of the costs associated with the sale of a product. For example, printing the phonebill is an expense and so is keeping the staff necessary to make sure the network keeps running without problems.
- **Profits** are the money that's left over. **Net profits** are the remaining money, after everything, from taxes to dividends, has been paid.

RBOC Revenues, 1984-1996

Anyway you cut it, since 1984 the Baby Bells have grown by leaps and bounds. In 1996 they collectively made approximately \$100 billion dollars, an increase of over \$40 billion since the break-up — a hefty 72% increase in revenues.

And it is hard to imagine a fatter set of babies, considering that the average Bell Holding company made \$14 billion dollars in 1996. The exhibit below highlights the revenues of the Bells from 1984 to 1996, showing BellSouth leading the pack with \$19 billion annually, having grown 98% since 1984. (242)

EXHIBIT 33
RBOC Revenues, 1984-1996
(in the millions)

	1984	1996	Change
Ameritech	\$8,378	\$14,917	78%
Bell Atlantic	\$8,090	\$13,081	62%
BellSouth	\$9,631	\$19,040	98%
NYNEX	\$9,573	\$13,509	41%
Pacific Telesis	\$7,830	\$11,840	51%
SBC Communications	\$7,191	\$13,898	93%
US West	\$7,284	\$12,786	76%
Total Revenues	\$57,977	\$99,337	72%
Average Per RBOC	\$8,282	\$14,191	

Source: RBOC Annual Reports, 1984-1997

And the growth even between 1995 and 1996 has been huge — 1995 revenues were approximately \$92.5 billion, increasing to almost \$100 billion a year later — an average growth per-RBOC in one year of almost ONE billion dollars of revenue, each.

EXHIBIT 34
RBOC Revenue Growth 1995 to 1996
(in the millions)

	1995	1996	Growth
RBOC Total Revenues	\$92,537	\$99,337	\$6,800

Sources: RBOC Annual Reports, 1995-1996

Chapter 15 **The Money Details —Local Service, Toll Calls, Access Charges**

When the RBOCs were created, they were each given specific local Bell telephone companies, which included the assets as well as the customers. These assets included not only the local telephone networks, but also the White and Yellow Telephone Directories businesses, as well as cellular licenses covering their entire regional fiefdom.

Baby Bell annual reports divide cash flows into five primary categories: These include (243)

- Local Service
- Toll Calls
- Access Fees
- Calling Features and Ancillary Services
- Other, including Directory, Wireless

These categories map loosely to your telephone bill charges, but they are not quite the same.

- **Local Service Revenues** are derived from a customer signing up for phone service, and it covers installation fees and deposits. It also covers the local monthly service, which connects the customer to the telephone network as well as local telephone calls.
- **Toll Calls**, (sometimes called "Intra-LATA", or "RBOC Long Distance") are calls that do not cross state or LATA boundaries. Revenues can also include corporate 800 service charges.
- **Access Fees** There are at least five different types of Access Charges. However, there are only three primary types of Access Charges that are included in a person's telephone bills. These Include:
 - **"Long Distance Access Charges"** which are fees paid by the Long Distance Company to the local telephone company for handling a local customer's long distance service. However, over 40% of the cost of every telephone long distance call made by a customer is paid back to the local company for access fees. We consider Access fees as 'pass-throughs'

- i.e., the customer making the call is paying the fee, which is added to the cost of every telephone call.
- **Subscriber Line Charge** sometimes called an "FCC Line Charge" is a separate access fee charge usually costing \$3.50 per month per line for residential subscribers, and \$6 per line for business subscribers. This fee is directly collected and paid to the local telephone company.
 - **Intra-state and Local Access Charges** Like long distance access charges, companies offering competitive Toll Call and Local competitors pay other form of access fees — Intra-state-Access Charges for Toll and Interconnection fees for Local service.
 - **Calling Features and Ancillary Services** are almost everything else you as a customer pays for. This includes Touchtone Services, and basic Calling features such as Call Waiting, Call Forwarding, Caller ID, Other Services. Unlisted Numbers can also be included.
 - **The "Other" Category** In RBOC Annual Reports, the Other Category is the garbage pail of line items, allowing everything and anything to be added. Ameritech's definition of this line item includes Cellular, Directory, and wire maintenance, among other services. (244)

"Cellular, directory and other revenues include revenues derived from cellular communications, paging services, telephone directory publishing, lease financing, billing and collection services, telephone equipment sales and installation and security monitoring services....inside wire installation and maintenance and advanced data services. "

Note: Some companies include Calling Features/Voice Mail and Wire Maintenance in their "other" category in their annual reports, while some companies break out these statistics or place them in different financial "buckets", for their own reasons.

The most common list of items can or does include:

Directory	Billing and Collections
Financial Services/ Real Estate	Cellular
Equipment Leasing/Software	Foreign Investments

For example, as we have seen in the Real Estate and Overseas Investment discussions, these services can have billions of dollars tied up, sometimes making money, but many times being a loss leader. There are exceptions, however. Parts of this category, specifically services that were part of the original Bell System, such as telephone directories, are incredibly profitable. As we will discuss later, the Other category is used as a way to obfuscate the profitability of specific items, and it is a telecom shell game.

Also, some RBOCs have created separate subsidiaries, some break-out the revenues, while others still combine most information.

- **"Directory** — The publication of the Yellow and White Pages, (the original Bell Telephone books), accounts for most of the profits of this "other" revenue category. And Directory can produce very substantial revenues. BellSouth, in its 1996 year end quarterly report showed \$1.7 billion in its directory Advertising and Publishing category. In their 1993 Annual Report they state: (245)

"Ten years ago, we had no Yellow and White Pages directories outside nine-state region. Today we publish nearly 1,000 directories in 39 states and in six overseas markets."

Considering that each Bell company automatically received hundreds of directory markets, with standard profit margins of 50%, Directory has been a great source of profits.

- **Thousands of "Others"** — Over the decade the Bells have had thousands of other companies using the distinction of this category, from overseas operations, to even real estate and furniture manufacturers.

As we will see, though the Bells have ventured into hundreds of other businesses, after a decade, the local customer still supplies 80% of the revenues and approximately 90% of profits.

RBOC Revenues by Lines of Business, 1984-1996

In 1984, the Bells philosophy, as well as their earnings and expenditures were still mainly utility-customer-o-centric. The business mix consisted of the telephone companies as well as the other, primary, grandfathered-in businesses; the yellow and white pages, as well as the cellular licenses.

So, the question remains, how has the business mix of these revenues and profits changed over 12 years? Back in 1991 Ray Smith, President of Bell Atlantic, stated that by 1996 about half of the "net income" would be from Wireless, International, and business systems — net meaning profits after everything, from taxes to dividends, are paid off. (246)

"We believe that, together, our international, wireless, and business systems lines of business will produce about 20% of our revenue stream in five years and will account for about half of our net income growth."

Unfortunately, like the Info Highway plans, the findings indicate that the profits almost all come from the basic telephone business services and over the last 12 years there has not been any major shift in the way the company makes money.

Below are the five major categories for the Bells combined revenue in 1984, compared to the current 1996 revenues. In 1984, the Bells had 44% of their revenues come from "Local Service", and almost 30% came from "Access Fees", 14% came from Toll fees. Meanwhile, only 13% accounted for other non-telephone services. This should not surprise the reader. In 1984, the Regional Bells were essentially just the telephone companies, which included the directory revenues, and the nascent cellular services. The companies had not expanded into hundreds of companies as they would do in the late 1980's. Nor was there a large number of customers for specialized. services. For example, according to Link Resources' "1985 Home Media Consumer Survey—Residential Telecommunications", based on 4,275 telephone surveyed households, only 7.7% of the population had Call Waiting, only 3.3% had Call Forwarding and only 7% even had an answering machine. (247) Therefore, the "Telecom Other" revenues most likely were included in the Local service statistics.

Exhibit 35
RBOC Business Revenue Breakout, 1984-1996
(In the Billions)

	1984	% of biz	1996	% of biz
Local Service	\$25,550	44%	\$40,967	41%
Network Access	\$16,755	29%	\$23,200	23%
Toll	\$ 8,319	14%	\$ 7,897	8%
Calling Features &			\$ 9,361	9%
Directory & other	\$ 7,372	13%	\$18,985	19%
Total Revenues	\$57,996	100%	\$99, 919	100%

Remarkably, while revenue has increased over 70% since 1984, the bottom line is that the telephone companies, or rather, the telephone customers, still provide the overwhelming amount of revenue to the company.

Since the Regional Bells were worth almost \$100 billion dollars in 1996, it is easy to calculate the amount of money and where it came from. For example, Local Service still commands over 41% of Baby Bell revenues and that equates to whopping \$41 billion dollars in revenues. Similarly, Access charges is 23% of revenues, or approximately \$23 billion dollars in the percentage of overall RBOC revenues — not a major change from the 29% of the business access fees accounted for in 1984.

Exhibit 35 shows that the non-bell revenues in 1996, here called "Directory & Other", as only 19% of revenues and this includes the wireless entities throughout the world, while all 'other' revenues in 1984 only accounted for 13%. (248)

Subscriber Based vs Non-Subscriber Based RBOC Revenues and Profits

Forget about real estate purchases, computer leasing, overseas operations or the billion lost from Tele-TV and Americast. When every line item in every RBOC annual report for the decade is cross-referenced, we find that approximately 80%+ of all revenues comes from the local telephone subscriber, and 90% of all profits. And this model has not changed dramatically over the last decade.

If you examine, in detail, the other Bell Holdings, which include US cellular RBOC holdings and their US directory holdings, almost all of which were grandfathered to the Bell Companies, only 6-10% of revenues is based on non-Bell products.

The trail to find this data can be daunting, since the Bells no longer have to reveal the details of most transactions. (without exact breakouts from the Bells, it is impossible to get the exact amount) However, there are other indications by the Bells themselves that the majority of money is from telephone products. For example, NYNEX's 1995 Annual Report stated that 88% of revenues were from the telephone companies. (249)

"The Telephone Companies mainly provide two types of telecommunications services, exchange telecommunications and exchange access, in their respective territories. The Telephone Companies revenues comprise 88.1% of NYNEX's operating revenues in 1995." [emphasis added]

NYNEX used to publish a more detailed different analysis of wire (meaning local phone customer) vs. non-wire business profits in their annual reports. As demonstrated in the exhibit below, taken directly from NYNEX Annual Reports, from 1989 to 1993. Telecommunications generated an average of 85% of the revenues, compared to cellular services which generated only 3% of the revenues. However, on the profits side, telecommunications generated 103% of the profits. (250)

EXHIBIT 36

NYNEX Revenues and Profits, by Lines of Business 1989-1993

(In the millions)

	<u>Revenues</u>	<u>Profits</u>	<u>% of Rev.</u>	<u>% of Total Profits</u>
Telecom	\$11,303	\$2,439	85%	103%
Cellular	\$ 360	\$ 38	3%	2%
Publishing	\$ 858	\$ 67	6%	3%
Financial	\$ 83	\$ 51	1%	2%
Other Revs.	\$ 703	\$(225)	5%	-9%
Total	\$13,308	\$2,371	100%	100%

Source: NYNEX Annual Reports, NNI 1994

To summarize, NYNEX's telecommunications (which is mainly local telephone customers) accounted for 103% of profits over the five year period, while all other businesses combined lost 3%. (NOTE: NYNEX no longer provides this information in this format.)

BellSouth also gave information showing that the telephone company revenues, BellSouth Telecommunications, accounted for varying amounts during the 1990's, from 73%-76% of the total business. (251)

"Approximately 73%, 74%, and 76% of BellSouth's operating revenues for the years ended December 31, 1993, 1992, and 1991, respectively, were from wireline telecommunications services which were provided by BellSouth Telecommunications."

And more recently, Bell South's 1995 Annual report stated that 71% of Revenues were from BellSouth Telecommunications. However, the fine print showed that Telecom accounted for at least 77% of the total in 1996. (252) Wireless and Directory accounted for 23% (15%+8% respectively.) This shell game did not count the profitable "Access Fees" as part of local service.

"Approximately 71% of BellSouth's total operating revenues for each of the nine-month periods ended September 30, 1996 and 1995 were from wireline services provided by BellSouth Telecommunications. Charges for local, access and toll services for the nine-month period ended September 30, 1996 accounted for approximately 61%, 33% and 6%, respectively, of the wireline revenues discussed above. Revenues from wireless communications services and directory advertising and publishing services accounted for approximately 15% and 8%, respectively, of Total Operating Revenues for the nine months ended September 30, 1996. The remainder of such revenues was derived principally from other nonregulated services provided by BellSouth Telecommunications." [emphasis added]

Therefore, taking this into account, NNI estimates that BellSouth had at least 77%+ revenues from subscribers — However, BellSouth's 1993 Annual Report shows that the company's entire profitability is not in international, wireless, or any other

company initiative into new ventures, but approximately 95% of all PROFITS, were from the local subscriber. (253)

"Approximately 95%, 97%, and 97% of its net income respectively, were from wireline telecommunications services which were provided by BellSouth Telecommunications. "

Probably the clearest example exposing which parts of the RBOC businesses are providing the revenues and profits comes from examining the US West. The company split itself into two companies, US West Communications Group, the telephone company, and US West Media Group, a media company representing all other businesses including Directory, Wireless, and Multi-media.

Exhibit 37, taken from US West 10Ks from 1995 and 1996, shows a simple model of the two companies combined. The entire company had \$12.2 billion dollars, the media company consisting of only 22% of these revenues, including its directory, wireless, cable services, information services, international, etc. — telecommunications was 78%. However, in the grand scale of things, the media company only represented 3% of the total net profits (% of Net), while the phone company made \$1.2 billion and accounted for 97% of the total profits. (254)

Exhibit 37
US West Communications Group and US West Media Group,
Revenues and Net Profits, 1995-1996
(in the millions)

	<u>Revenues</u>	<u>% of Rev</u>	<u>Net</u>	<u>% of Net</u>
Telephone Company	\$ 9,558	78%	\$1,233	97%
Media Company	\$ 2,665	22%	\$ 35	3%
Total	\$12,222		\$1,268	

The reason for this disparity is simple. The Media company is heavily involved in developing new cable and wireless services worldwide, and therefore, spends more than it makes. And it will continue to do so for years. However, many of the assets from the original Bell system, especially directory and the cellular services which are bringing in

cash, are offset by the other non- bell businesses, and these companies are not profitable, at least in the short term.

Where Has the RBOC Revenue Growth Been Over the Last 10 Years? Local Telephone Subscriber Services.

The significant growth in revenues of the Bells can only be attributed to local telephone subscriber services, specifically:

- Growth in the number of phone lines, specifically second lines.
- Growth in the number of calling features.

First, an examination of the number of Bell phonelines reveals a steady growth since 1984, with an overall increase of over 40%. In 1996, the Bells had 126 million lines, up from 89 million in 1984. (255)

Exhibit 38 RBOC Access Lines, by RBOC, 1984-1996

	<u>1984</u>	<u>1996</u>	<u>% of Change</u>
Ameritech	14,337	19,704	37%
Bell Atlantic	14,677	20,566	40%
BellSouth	14,000	22,135	58%
NYNEX	13,225	17,824	35%
Pacific Telesis*	11,310	16,485	46%
SBC Comm	10,650	14,955	40%
US West	10,871	15,424	42%
Change	89,070	126,446	42%

(Also, the Bell residential lines outnumber business lines, with approximately 65% of all lines dedicated to residential customers. Business customers, at least by lines, hold only approximately one-third of lines. However, Business customers are charged

more for most services, so the two groups, business and residential customers spend approximately the same.)

Over the last few years, much of the growth has not been from new business or residential customers, but in the massive increases in second lines, dedicated to the Boomer households (with kids), the Internet and fax machines.

For example, BellSouth stated that 1996 was a banner year, spurred on by the addition of new lines, especially for work-at-home, fax machines and children's numbers. (256)

"Capping a year of record customer growth, BellSouth Corporation became the first telecommunications company to grow by more than one million access lines in a single year.

"New retail distribution channels and marketing promotions of phone lines for Internet access, work-at-home, fax machines and children's numbers spurred record fourth quarter sales of 82,000 additional residential lines."

That's approximately 300,000 second lines in 1996!

As discussed in previous sections, what happens with one Bell is most assuredly happening with all other Bells. For example, Southwestern Bell's 1996 Summary stated that additional lines went up 14% in 1996 alone, almost 1/3 of all new lines added. (257)

"Southwestern Bell added 732,000 access lines during 1996, compared with 611,000 during 1995, for a total of 15.0 million access lines at the end of the year. Additional line penetration increased to 14.5 percent, reflecting the sale of 214,000 additional lines during the year."

Meanwhile, Bell Atlantic stated that additional lines in their region grew 24 percent, accounting for 2.1 million lines. (258)

"Total additional lines in service grew almost 24 percent during 1996, approximately 2.1 million. "

Massive Growth in Calling Features

But it has been Calling Features, products including Call Waiting, Call Forwarding, Caller ID and Voice mail that have all been big revenue winners. For example, Bell Atlantic stated that sales of "Value-Added" products, like Caller ID have all jumped in revenues. According to Bell Atlantic (259)

- "Revenues from Home Voice Mail (formerly Answer Call) and central-office-based services such as Caller ID, Return Call and Call Waiting were up more than 23 percent compared with 1995.
- "Caller ID revenues nearly doubled as subscribers grew to about 2.3 million.
- "Revenues from Return Call, in some markets now featuring a voice-recorded readout of the calling party's number, jumped more than 40 percent, with a 50 percent increase in activations in the business markets."

BellSouth's 1996 summary states that Calling Features "surpassed \$1 billion" in revenues in 1996, with over 29 million features sold. (260)

"Sales of BellSouth's calling features and convenience services, such as Caller ID, Call Waiting and MemoryCall® service voice messaging, continued to grow rapidly. With more than 29 million features currently activated, revenues from these services surpassed \$1 billion for the first time in 1996."

NOTE: BellSouth had 22 million lines and 29 million features currently activated, which means that on the average, each line had 1.3 calling features in 1996, a fact that we will address later in profitability models.

Meanwhile, Ameritech showed an almost 25% increase in calling features in 1996. (261)

"23.5% annual growth in sales of call management services such as Caller ID, call waiting and voice messaging."

The bottom line is that the overwhelming majority of Regional Bell revenues comes directly from the telephone subscribers, not new businesses as Ray Smith had hoped in 1991.

With \$100 billion dollars of revenues by the Bells, and 80% of the revenues and approximately 90-95% of the profits accruing in from the local telephone subscribers — How much profit is there?

How Much Profits Are There?

In 1996 the Bells had **\$26 billion dollars in Cash**, 23% higher than in 1995. Also, there was almost **\$14 billion in NET INCOME**, 74% higher than the year before! (262)

Some Very Basic Definitions:

- **Operating Revenues** are the money the company makes doing business.
- **Operating Expenses**, are the costs of doing business.
- **Cash or Operating Income**, is essentially the company's revenues, minus the working expenses.
- **Net Income** is the companies final income after paying off everything from the shareholder dividends to income taxes.

This next exhibit summarizes the **Operating Revenues**, and three other very important statistics from 1995 and 1996

EXHIBIT 39

Summary of RBOC Revenues, Expenses and Profits, 1995-1996

(in the millions)

All Seven RBOCs	<u>1995</u>	<u>1996</u>	<u>CHANGE</u>
Operating revenues	\$92,537	\$99,337	8%
Operating expenses	\$71,469	\$73,946	3%
Cash	\$21,068	\$25,973	23%
Net Income	\$ 7,881	\$13,700	74%
% of cash to revenues	23%	26%	

No matter how you slice it, \$26 billion is a lot of cash. However, these statistics account for the entire Bell's businesses, included losses. Therefore, other more detailed statistics are needed to demonstrate the profits from subscribers' services. A clear example are Calling Features or even Touchtone service.

Profits from Calling Features

The profitability of most calling features is, for a lack of a better term, extreme. According to the New York Times (1/1/4/97) Ameritech's Caller ID and Voicemail have profit margins greater than 50%. (263)

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

And some services, from Touchtone, to Unlisted Numbers are almost entirely profits. We will visit more detailed discussion of profits in the Book VI, Overcharging on Your Phonebill.

Chapter 16 Cash Cows: Comparing the Bells To Other Companies

Let's put the RBOC's massive profits in perspective by comparing the Bells profits to other free-market businesses and other Utilities.

According to SBC Communications, if an investor invested \$100 dollars in SBC in 1984, their return by 1995 was \$1095, almost 100% higher than the Standard & Poor 500, which represents some of America's largest companies. (264)

EXHIBIT 40

SBC Communications Cumulative Total Return, 1983-1996

YEAR	SBC	S&P 500	All Bells
83	\$100.00	\$100.00	\$100.00
84	\$128.92	\$106.22	\$133.92
85	\$167.53	\$139.83	\$190.87
86	\$233.47	\$165.86	\$250.04
87	\$227.35	\$174.45	\$255.85
88	\$284.08	\$203.23	\$299.34
89	\$471.46	\$267.43	\$462.48
90	\$434.31	\$259.10	\$449.73
91	\$526.34	\$337.71	\$461.43
92	\$630.18	\$363.40	\$504.60
93	\$733.29	\$399.86	\$594.22
94	\$740.54	\$405.28	\$569.86
95	\$1085.03	\$557.05	\$861.61

Meanwhile, the Bells as a group made approximately 55% more than the Standard & Poor 500.

Ameritech has also had returns that far exceed the Standard and Poor 500. According to Ameritech's 1995 Annual Report, they had a 965% cumulative total return, 111% higher than the S&P 500. (265)

"Since our stock began trading in November 1983, Ameritech investors have earned a cumulative total return of 965%-- more than double the total return of 457% for the S&P 500."

And 1996 was a banner year according to US West. US West stated in its 1996 4th Quarter Report, that including dividends, they had a "total return for the year was 61.2 percent." (266)

"By year end, the new U S WEST stocks combined were up 53.3 percent for the year. Including dividends, total return for the year was 61.2 percent. The market value of your company increased \$8.9 billion during the year."

"An investment in U S WEST was up more than the average of regional "Bell company" stocks for the year, and more than the average of 500 stocks measured by the commonly used Standard & Poor's index"

Out performing the S&P 500 is just one of the indicators that the monopolies' profits are way out of line with a company who is supposed to have controlled earnings. Another simple example of the Bell's performance is to compare it to other companies, which have active competition.

The Wall Street Journal, 2/27/97, (267) ran an article discussing 8 major US companies revenues and profits. The companies are General Motors, Ford Motor, Boeing, Eastman Kodak, Sears Roebuck, JP Morgan, Caterpillar, and Kellogg. Combined, the companies had \$435 billion in sales with net profits of only \$16.2 billion. The RBOCs, on the other hand, had a whopping \$14.3 billion in profits on only \$100 billion, the RBOCs out profiting our big 8 by 275%.

EXHIBIT 41**Big 8 Company Revenues and Profits vs RBOCs, 1996**

(in the billions)

	<u>Revenues,</u>	<u>Profits,</u>	<u>% of Profits</u>
Big Eight Total	\$425	\$16.2	4%
RBOCs	\$100	\$14.3	14%
Difference		275%	

Just to hammer in the point the Bell's profits are excessive, let's compare one other major business indicator, the Business Week ScoreBoard, which has been tracking company performance for decades. Business Week ScoreBoard not only uses standard business measurements such as "Return-on-Common Equity", "Earnings-Per-Share" and "Profit Margins", but also gives the information by industry, for Utilities or chemical companies.

Business Week Definitions: (268)

- **Return on Common Equity:** Rate of Net Income available for common stockholders (most recent 12 months) to latest available common equity, which includes common stock capital surplus and retained earnings.
- **Earnings Per Share:** For the most recent 12 months period Includes all common-stock equivalents.
- **Profit Margins:** Net income from continuing operations before extraordinary items as percent of sales

Let's start with the Bell's 1996 stats for these three indicators. Notice that the Bells averaged 28% return on equity, with Pacific Telesis topping the pack at 40%. Meanwhile the Bells averaged a 12% profit margin. (269)

EXHIBIT 42
RBOC Return on Equity, Earnings and Profit Margins, 1996

	<u>Return-On-Equity</u>	<u>Earnings-per-Share</u>	<u>Profit Margin</u>
Ameritech	28.8%	\$3.87	14.7%
Bell Atlantic	23.9%	\$3.96	10.3%
Bell South	21.6%	\$2.88	12.5%
NYNEX	19.9%	\$3.08	11.4%
Pacific Telesis	40.3%	\$2.47	7.8%
Southwestern	30.7%	\$3.46	14.4%
US West	31.8%	\$2.55	12.0%
RBOC Total	28.1%	\$3.18	11.9%

Source: Business Week ScoreBoard, 1996

But the kicker is in the Business Week comparisons, among other businesses as well as other Utilities. Featured in the exhibit below, the Utilities averaged only 11% return-on-equity, making the Bell's returns almost 150% higher. Meanwhile, the average for American Business profit margin is only 5.9%. The Bells, profitability was over 100% higher than the average Business Week 1000. The Bells even pay out 50% more than utilities in Earnings Per share. That's a whole lot of enchiladas. (270)

EXHIBIT 43
Comparing RBOCs 1996 Profits to Other Businesses

	<u>ROE</u>	<u>Earnings Per Share</u>	<u>Profit Margin</u>
RBOC Total	28.14%	\$3.18	11.9%
All Industries	16.80%	\$2.44	5.9%
Utilities	11.40%	\$2.10	6.7%
All Industries	68%	30%	102%
Utilities	147%	51%	78%

Source: Business Week ScoreBoard, 1996

It can be argued that since the Bells are still considered utilities, and are therefore governed by the state Public Utility Commissions, the Bells return-on-equity should have stayed at 11%, instead of the current 28%.

Of course the reader should ask: "If the company has no real competition today, and its revenues are guaranteed and therefore have virtually no risk, shouldn't they be making less money than companies with serious risks?"

Before we explain just how much money the Bells have been able to pocket, and the regulation that allowed them to do it, let's look at two other important facts. There has been massive decreases in two major expenses, the number of employees and lack of new construction. Therefore, prices should have plummeted, and profits should have remained lower.

Let's examine the employee cuts and explain how construction has been stillborn, even though the promises have been sky-high.

Chapter 17 Employee Cuts and Poor Customer Services

Throughout the last decade, the Baby Bells have been aggressively been reducing staff, sometimes referring to it as "new productivity efficiencies" or at other times "getting ready for competition". Either way, staff cuts have been deep, — over 235,000 people to date, and almost all cuts have come from the local telephone company employees who work for local customers. The irony is that almost all telco filings related to the information Superhighway stated that the Info Bahn would create new jobs. (271)

Employee cuts have yielded continuing cost-of-doing-business decreases, and ever increasing profit margins. For example, NYNEX's 3rd Quarter 1996 report shows massive savings of \$650 million dollars from staff layoffs and restructuring of the company. In fact, when the final restructuring is finished and 16,200 NYNEX employees have been laid-off, the company expects a whopping \$1.7 billion dollars savings, annually. (272)

"Since the inception of process re-engineering and the special pension enhancement program in 1994, approximately 11,900 employees have accepted the retirement incentives. On an annualized basis, this will equate to an average reduction in wages and benefits of approximately \$650 million.

"It is anticipated that the restructuring will result in reduced costs during the period of restructuring and reduced annual operating expenses of approximately \$1.7 billion beginning in 1997. These savings include approximately \$1.1 billion in reduced wage and benefit expenses due to lower work force levels, and approximately \$600 million in non-wage savings including reduced rent expense for fewer work locations and lower purchasing costs. Partially offsetting these savings are higher costs due to inflation and growth in the business." [emphasis added]

Staff cuts have also led to serious fallout. — Customer complaints. Numerous states' Public Utility Commission have levied fines on the Bells for not being able to answer their telephones. We will return to the customer dissatisfaction shortly. But first, let's explore the cause, massive employee cuts.

Bell Employees: Walking Through the Numbers

In order to help the reader understand employee lay offs, we will walk through this section in steps.

Step One: Staff at the Baby Bells— How it Works

The Regional Bell Operating Company is a holding company which controls a number of smaller local telephone companies. For example, Ameritech owns five local state phone companies: Ohio Bell, Michigan Bell, Illinois Bell, Indiana Bell and Wisconsin Bell. Therefore, the Regional Bell, tells the local telephone companies to cut staff. Meanwhile, the parent holding company, Ameritech, added staff for it's various projects and services.

Step Two: Total Bell Employees

In 1984, the RBOCs had a total of 577,000 employees. By the end of 1996 there was 387,900 total workers, a -33% decrease. The next exhibit highlights just the RBOC staff cuts. The first exhibit shows the total Regional Bell reductions of staff, including the holding companies and its subsidiaries, from 1984 throughout 1996. (273)

EXHIBIT 44

Total RBOC Employees Cuts, 1984-1996

	<u># of employees</u>	<u>% laid off</u>
Number of Employees in 1984	577,398	
Total RBOC, 1996	387,900	-33
Cuts from Regional Bells	190,498	

Sources, RBOCs, NY Times, 1996, Washington Post, 1995, NNI, 1992-1996

Step Three: The Lay-offs 1994-1997 Most of the staff reductions were announced in late 1993 and early 1994 and have effected the last three years. These cuts, including a whopping 21,500 at Bell South or NYNEX's 16,800, were all designed as "cost efficiencies". (274)

EXHIBIT 45
Announced RBOC Staff Reductions for 1994-1996

Ameritech	7,500
Bell Atlantic	5,600
Bell South	21,500
NYNEX	16,800
Pacific Telesis	20,500
Southwestern	1,500
US West	9,000
Total RBOC	82,400

Sources: NY Times, 96 Wash. Post, 95, NNI, 1995, Telephone cos.

However, the overall numbers presented do not reveal the real changes that occurred over the decade. The primary change, and not for the better, has been a serious reduction of staff from the local telephone companies. While the holding companies had staff increases, the local telephone companies had massive decreases.

Step Four: Holding Company vs Local Phone Company: The next exhibit shows that the local telephone companies, specifically the staff that handles the telephone subscriber, has had much deeper cuts. The phone companies lost 235,000 while the parent company, added 45,000 staffers.

In fact, based on announced cuts, by 1997 there will be 236,000 local telephone company staff reductions. (275)

EXHIBIT 46
Summary of Data for Local Telephone Company RBOC
Employees, 1984-1997

Telephone Company Staff Cuts

Increase of Parent company	45,056	142%
Total Reductions, 1984-1996	235,550	-31%

Sources: NY Times, 96 Wash. Post, 95, NNI, 1995, Telephone cos.

Step Five: The largest cuts have been to telephone company staff that handles the local subscriber.

Since the flood, "Employees-per-line", the standard benchmark for the number of employees working for subscribers, dropped an average of 57% from 1984-1997. (276) That's half the staff required to cover more work.

EXHIBIT 47

RBOC Employees-Per-Line Cuts, 1984-1997

Employee-per-line reductions -57%

Source: New Networks, 1995, Telephone company reports.

Step Six AT&T Break-up cut staff too: It is a little known fact that 75,000 other local telephone company staffers were cut between 1983 to 1984, during the AT&T break-up, bringing the total of cut local telephone company workers to 310,000. (277)

EXHIBIT 48

Local RBOC Phone Company Staff Cuts in 1983 to 1997

AT&T Local total From 1983 to 1984	75,000
Total RBOC Reductions, 1983-1996	310,550

Sources: AT&T & RBOC annual reports., NNI 1992-1996

Staff Cuts Lead to Customer Dissatisfaction and Fines.

One has only to go to web sites such as nynexsucks.com or USWorst.com to know that customers are having problems with their service. In fact, from the subscriber perspective, the massive staff cuts have had a detrimental impact on telephone subscribers, revealed in both the rising number of complaints as well as consumer surveys which found a growing resentment to the Bells.

For example, JD Powers Consumer Study of phone service found that for at least three RBOCs, an average of 26% of customers were not satisfied with their phone

company's services. Also, the exhibit below shows that only 75% of complaints were resolved in a timely manner, with NYNEX having only 70% of complaints actually dealt with promptly. (278)

EXHIBIT 49

Customer Complaints and RBOC Dissatisfaction, 1996

	<u>% of dissatisfied customers</u>	<u>Resolved in a timely manner</u>
Bell Atlantic	22%	71%
NYNEX	29%	70%
SBC	33%	82%
Avg.	26%	75%

Source: JD Powers and Associates

Our consumer surveys from 1993 and 1995 show a dramatic increase in Bell customer dissatisfaction. In 1995, almost 39% of the population gave the Bells a failing grade in one of seven customer service areas, more than double the number of dissatisfied customers in 1993. (279)

EXHIBIT 50

Consumer Grades for Local and Long Distance Cos., 1993-1995

<u>1993</u>	<u>1995</u>	
15%	39%	gave the local telephone company a failing grade in one of the seven customer service questions

Source: NNI Proprietary research, 1993-1995

Also, complaints are up across America. Court cases and Public Utility Commissions (PUC) actions have occurred in numerous states in the Ameritech, US West, Pacific Telesis, and NYNEX regions.

According to an LA Times article, (6/18/95) the Ohio's PUC received 10 times the number of complaints in 1994 than the previous year, while NYNEX missed 142,000 appointments in the last three months of 1994. (280)

And the problem continue. According to NYNEX's 1996 3rd quarter report, "New York Telephone will be required to issue rebates to customers of at least \$102 million for not maintaining adequate service standards. (281) As a New York Post columnist, Irwin Stelzer, put it:, (2/26/97) (282)

"NYNEX fails to show up at about 1,000 repair appointments every business day."

The New Jersey Ratepayer Advocate, in their review of Opportunity New Jersey and the Bell Atlantic NYNEX Merger stated that NYNEX's states, including New York, Massachusetts and Maine all had monetary penalties, while New Jersey has also had a declines in service. First about NYNEX: (283)

"NYNEX has had an abysmal track record with regard to quality of service. In the last three years, NYNEX has been punished for its failure to meet telephone service quality standards and, consequently, subject to monetary penalties in at least three of the jurisdictions in which it operates: New York, Massachusetts and Maine. In New York alone, in November 1996, the Commission found that NYNEX's performance warranted \$72.9 million in penalties, and after granting certain waivers, ordered \$62.3 million in rebates. "

Bell Atlantic/New Jersey: (284)

"BA-NJ's quality of service has also declined since the adoption of the Plan. Although the decline has been from a high level of service, any decline should however be of major concern to the Board, especially when quality of service should be increasing under the Plan, since the company is deploying cutting edge technology. For example, BA-NJ's performance in the following service categories was lower in the year ending September 1996 than in 1993, 1994, and 1995: (1) percentage of service

order provisioning completed within 5 working days; (2) percentage of service order provisioning appointments met; and (3) percentage of directory assistance calls answered within 10 seconds. "

NNI's position on staff reductions is simple. The ratepayer is the one who is being impacted by the staff reductions because services are not getting better. In fact, in some areas, such as customer services, the reductions have meant more time on hold and more complaints to the PUCs about service.

While the Baby Bells state that productivity is really a goal, the reader should ask: In a non-competitive environment, are staff cuts productivity driven or shareholder-profits driven?

Secondly, we contend that staff reductions have decreased the ability for the remaining staff to provide adequate subscriber coverage, including their installation and implementation of ISDN. Based on the data presented, we expect the problems to get worse, not better.

Other customer service issues also should also be examined. For example, most Bell companies only offer live customer services from 9 AM to 5 PM, and few companies have hours on Sunday. In future sections we will argue that the utility has an obligation to expand its customer operations, including adequate staffing of customer services.

Finally, why haven't prices decreased dramatically if the cuts in staff have been saving so much money?

Chapter 18 New Construction by the Bells? —NOT

According to the United States Telephone Association, USTA, there's a great deal of investment in the telecommunications network — a whopping \$20 billion dollars annually. (285) USTA, January 22, 1997)

"Local telephone companies continue to invest more than \$20 billion annually in maintaining and upgrading this network. All other users must pay their fair share or the problems we are facing now will indeed perpetuate." [emphasis added]

In fact, since the companies are putting up so much money, the USTA believes that the Internet users are not paying their fair share: (286)

"Someone has to pay for that usage, the subsequent wear and tear on the network and the new equipment additions necessitated by this rapid growth.

"The bottom line is that all companies, whether they provide long distance, Internet access or local telephone service, must pay for use of the world's most advanced telecommunications network."

\$20 billion sounds like a great deal of money, right? (this figure represents all local companies, including the Regional Bells, as well as the independents, including GTE.)

Unfortunately, the Bells spending on new construction has been decreasing annually and the expenditures for the I-Way is simply corporate myth. In fact, the Bells spent more in the early 1980's than the have over the last decade.

Before we go into the details of why construction expenditures have been steadily decreasing over the last 13 years, (even though the companies' revenues have soared) let's first understand the basics. What are capital expenditures and construction expenditures anyway?

What are Construction Expenditures?

Construction/Capital Expenditure Definitions

Construction expenditures, sometimes called "Capital expenditures", are an assortment of costs, with the bulk of these charges applied to maintaining the current telephone networks, and the replacing of older technology with newer equipment. In terms of your telephone service, the wire that connects your home or apartment to the street's main wiring, the wiring that criss-crosses America on poles and underground conduit, as well as the big network equipment that routes calls across America, are all part of construction expenditures.

The specific items include:

- **Cabling and wiring**, including underground cable, buried cable, aerial cable poles, to deep-sea cable and submarine cable.
- **Central Office switches**, is basically an aggregator of phone calls for a specific geographic area and connects all telephone lines in a specific location.
- **Network Switches and Databases**, are other large computers attached to equipment that routes phonecalls across the neighborhood, city, state, or to long distance companies.
- **General Plant support**, which is the land, buildings, and general purpose computers.

There are two primary types of switches: analog and digital.

- **An analog switch** is based on older technology, and in most cases, it cannot deliver many of the newer enhanced calling features, such as Caller ID, etc.
- **A digital switch**, is a more enhanced model, which gives enhanced calling features, and provides "equal Access".

Some construction expenditures are used to upgrade the switch, sometimes with new software, other times replacing older analog switches with newer digital ones.

Now back to our story.

In truth, while \$20 billion does sound like a lot of money, the actual spending by the Bells, as a percentage of their revenues, has been in continual decline — and worse, there is little to show that the companies ever put their money where their mouth was when it came to building the Info Bahn.

First, the \$20 billion dollar figure quoted by USTA is the total including all of the independent phone companies, including GTE and Sprint. Combined with the Bells, local service providers accounted for a whopping \$125 billion, the RBOCs \$100 billion, and the independents \$25 billion.

However, when the independent companies are removed, the Bell construction expenditures, as revealed in annual reports and filings, averaged about \$16 billion from 1984-1996. (287)

Under Construction — or maybe Lack of Construction.

And the money spent on work that is "under Construction", has been virtually flat the last 13 years. Below is an aggregate of Ameritech, SBC Communications, Pacific Telesis and Bell Atlantic. With an overall 13 year average of \$448 million a company. This group of Bells, which was supposed to be spending over \$30 billion in new monies, had more construction occurring in 1984 and 1989 than they did in 1995 or 1996. (288)

EXHIBIT 51

RBOC, Under Construction, 1984-1996

(in the millions)

1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996
\$498	\$481	\$444	\$382	\$358	\$491	\$480	\$412	\$467	\$493	\$429	\$458	\$433

The bottom line is that these companies did not spend money on the Info Bahn. In fact, they are spending about the same amount as they did 13 years ago even though revenues from local services, toll calls and access fees increased 52% from 1984-1995.

Let's put it another way. In 1984, the RBOCs' revenue was approximately \$60 billion dollars and they were spending \$16 billion. Today, they are bringing in \$100 billion and still spending \$16 billion. What this means is that their expenses for construction has decreased from 27% of revenues to only 16%, a drop of 60% relatively.

In fact, when the Consumer Price Index (CPI) is applied, the actual dollars spent on construction expenditures has gone down an astounding 74%. (289) (We bring up this index analysis because all telephone statistics presented by the FCC and the Bureau of Labor Statistics are based on the CPI, and according to these government analyses, telephone charges haven't gone up, it has simply followed the CPI's path.)

Construction Promises Unkept

In fact, the obviously massive expenditures that would be required to build the I-Way were never allocated or spent. For example, Pacific Bell specifically states in its 1993 Annual Report: (290)

"In November 1993 Pacific Bell Announced plans to invest about \$16 billion over the next seven years to upgrade its core infrastructure and to begin building an integrated telecommunications, information and entertainment network providing advanced voice, data, and video services." [emphasis added]

Unfortunately, NNI found that Pacific Telesis has not had any major increases in "Capital Expenditures", and the company spent more money on the telephone network in the mid-1980's than they do today. (291)

EXHIBIT 52 **Pacific Telesis Construction & Capital Expenditures, 1984-1996** (In the Billions)

1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	95*	96'
2.1	2.3	2.2.	2.2	1.6	1.9	2.1	1.7	1.8	1.9	1.7	2.1	1.8

The only new construction seems to be promises more than anything else. According to their 1996 annual report, PacTel promised to spend \$2 billion for new equipment in 1998, but even that commitment was never firm. (292)

"In December 1994, Pacific Bell contracted for the purchase of up to \$2 billion of Advanced Communications Network facilities, which will incorporate emerging technologies. Pacific Bell is committed to purchase these facilities in 1998 if they meet certain quality and performance criteria. Management now expects the actual amount of these facilities purchased in 1998 will be less than \$700 million. "

More to the point, SBC, who purchased Pacific Telesis, wrote-off its Info Bahn expenses and the total was a mere \$438 million for both companies. Ergo, there never was any major Info Bahn construction push. According to SBC Communications, July 1997. (293)

"Curtailement of Video and Hybrid Fiber-Coaxial Initiatives: Discontinuance of broadband video trial in Richardson, halt construction of hybrid fiber-coaxial network in San Jose and San Diego, scale back Tele-TV, and redefine Americast joint venture \$438 million."

Or take the case of Bell Atlantic, who was supposed to spend \$11 billion dollars. Once again we quote the New Jersey Consumer Advocate on New Jersey Bell's failure to put its money where its promises are. (294)

"Although Bell Atlantic-New Jersey (BA-NJ) projected that it would expend approximately \$1.5 billion in network investment above "business as usual" by the end of 1999...From 1992 to 1996, BA-NJ has spent \$545 million less than it forecasted in 1992...For the years 1993 through 1996, the Company's own projections stated that BA-NJ would spend \$632 million above "business as usual" under Opportunity New Jersey ...However, the Ratepayer Advocate has calculated that BA-NJ has spent a total of \$79 million above "business as usual" over these years."

Ameritech has also been spending less and less on new construction. (295)

"Investment in technologies that will enable the company to provide customers with new products and services represent a high priority. Capital spending in the core landline telephone business declined by \$265 million in 1993 and further declined by \$100 million in 1994 as capital was deployed more cost effectively and with greater focus on the requirement of customers."

Source: Ameritech 1994 Annual Report [emphasis added]

Is it no surprise then when the Michigan PSC's assessment of the implementation of Michigan Bell's (Ameritech) Alternate regulation, which will discussed in Book III, the Regulators and the Laws., found none of the promised spending for new construction (296)

- "Construction programs for Michigan Bell have been reduced since the enactment of the act."
- "The act has not increased the number of new services."

Massive Network Write-Offs: Depreciation = FREE CASH?

Construction expenditures are the outlays of Cash for the network and its ancillary needs, while Depreciation is method the company uses to slowly write off the costs.

And for a non-accountant, **Depreciation rates** are hard to understand, mainly because it serves as both an expense, as well as Cash the company can spend. However, billions of dollars are being overcharged using this basic accounting principle.

For example, 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. (297)

"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. "

How Depreciation Works: A company purchases a few computers for say \$10,000 in 1990 and every year the value of the computers goes down — the value is said to "depreciate". In business accounting, though a company may purchase the computers in a specific year and pay for it in that year, i.e. you purchase a computer for \$10,000 dollars and you pay all of the money at the time of purchase. The company can break up the expense over a period of years, commonly known as the "life of the product". So, instead of deducting the entire amount for the computers, the company "depreciates the expense", i.e., divides the expense up over a number of years. So if the company assigns the computers' useful life as 5 years, the company deducted \$2,000 for each year.

In the case of the Bells, the telephone company network and equipment each year depreciates, and the company takes a specific expense per year as the network gets older.

And there's a very lucrative catch to this entire story. According to "How to Profit from Reading Annual Reports" by Richard B. Loth, 1993 (298) depreciation deductions are really "cash" — cash the company can spend or purchase items with. It's in the formula:

$$\text{Net Income and Depreciation} = \text{Cash Flow}$$

According to author Richard Loth

"For many financial commentators and investment information/advisory services, the sum of net income and depreciation represents *cash flow*."

And it's free cash because the expense of the item was long paid for. For example, most of the existing telephone network was paid for decades ago, and a 30 year write-off was common —i.e., the life of the network part, such as the copper wiring, was estimated to last 30 years, and therefore, the cost, which was paid for 30 years ago, was still being deducted, little by little, over three decades.

Accelerated Depreciation = More Cash Today

When you '**accelerate**' the depreciation, it means the depreciation expense that is deducted per year is increased, while the number of years is lessened.

For all those non-financial readers who may have serious cognitive problems with this rather odd phenomena of accounting — that an expense is also equal to cash, think of it is as — the faster the depreciation, the more cash there is, and you'll be fine.

And "**Accelerating Depreciation**" is the name of the game when it comes to telephone networks for it generates great amounts of, more or less, free cash. By speeding up the write off of the networks, the company not only gets a large expense that can be used to shelter profits in rate-of-return models, but also it gives the company more cash to purchase items. And, as an expense, it also lowers the amount of taxable income, and therefore, income taxes.

We are talking about a very large sum of money since the major expense of offering telephone services depends entirely on owning and maintaining a network. In 1984, the Bells had \$9 billion dollars of depreciation expenses, \$1.3 billion per RBOC. And since 1984, the Bells have all sped up their depreciation schedules, In 1996 the expense came to a whopping \$17 billion dollars annually, \$2.4 billion per RBOC — that \$2.4 billion dollars per RBOC to spend above and beyond Net Income. (299)

EXHIBIT 53
RBOC Accelerated Depreciation 1984-1996
(in the millions)

	<u>1984</u>	<u>1996</u>	<u>Change</u>
Ameritech	\$1,347	\$2,400	78%
Bell Atlantic	\$1,194	\$2,576	116%
BellSouth	\$1,755	\$3,719	112%
NYNEX	\$1,420	\$2,601	83%
Pac Bell	\$1,089	\$1,870	72%
SBC	\$1,141	\$1,795	57%
US West	\$1,106	\$2,122	92%
Total Depreciation	\$9,052	\$17,083	89%
Per RBOC	\$1,293	\$2,440	

Sources: RBOC Annual Reports, 1984-1996

The I-Way Plans — Free Money on Fast Forward

While there has been a series of reasons to accelerate depreciation over the last 12 years, the largest changes have occurred with the implementation of the Alternate Regulation plans, because the excess monies were supposed to be used to build the fiber-optic highway. In fact, most states have removed controls on how much the Bells can deduct per year.

What does all this mean?

Well first, the most surprising part of this tale is that: (300)

"By 1992 the entire original Bell system network, including the old, copper wiring that still makes up most of the phone network infrastructure and is still the wiring in your house, was totally written off."

Remember, the Bell system's copper wires and network switches that were already in place in 1984, were paid for during the 1960's and 1970's and 1980's.

This also means that the price of service should have plummeted, since the value of the original network, at least on paper, was literally "\$0". (Of course, fully depreciated equipment can still be used and is still in service.)

But more importantly, none of these savings were being given back to the subscriber — the cash was not being used to build new networks. Think of it this way — In the construction section we showed that the construction expenses were about the same over the last 12 years. However, the deductions have gone up 90%!

An Extra \$21 Billion Dollars — The "Write-OFF" Scandal

With the removal of state regulations, the Bells decided to go all out and from 1993 through 1995, they all changed their accounting to reflect what they called a "competitive marketplace". This change, known as Statement of Financial Accounting Standards 71 (FAS 71) states that rate-of-return and Utility regulations were now replaced and the company was now a 'free market' company. Ameritech 11/28/94, Investor Alert states: (301)

"Such accounting is consistent with the regulatory actions that foster marketplace pricing of competitive service and remove regulatory caps in earnings without sharing. "

"Without sharing", means that there is no limit to the profits and Ameritech doesn't have to return anything if they make too much money. Also, there were no longer any restraints on writing off the networks.

And changing their regulations allowed the Bells to collectively write-off, in bulk, additional monies — very large Christmas presents of approximately \$21 billion dollars. The exhibit below shows the massive depreciation bonus by the RBOCs as well as the year the money was garnered. Remember, though considered an expense, this is really \$21 billion of extra cash the companies could spend. (302)

EXHIBIT 54
RBOC Accelerated Depreciation, FAS Bonus 1993-1995
(In the millions)

	<u>Amount</u>	<u>Year</u>
Ameritech	\$3,785	1994
Bell Atlantic	\$2,156	1994
BellSouth	\$2,718	1995
NYNEX	\$2,919	1995
Pac Bell	\$3,361	1995
SBC	\$2,819	1995
US West	\$3,123	1993
TOTAL	\$20,881	

Source: RBOC Annual Reports, 1993-1995

All of these changes were made primarily because the states all applied Alternate Regulation to build the Info Bahn. For example, Ameritech Investor Alert stated: (303)

"Ameritech successfully achieved this form of advanced regulation in all five states in which it operates, with the adoption of the Advantage Ohio stipulation agreement on November 23, 1994. Similar plans were implemented in Michigan in 1992, and Illinois, Indiana and Wisconsin earlier in 1994."

We will return to this free cash in examining overcharging. However, all this leads us into our next question — Where were the regulators in all of this? For example, as we will see there was no competition in the Ameritech region in 1994, nor in any other region of the USA! And all the Bells used the same excuse to make the accounting changes. Our case study of Opportunity New Jersey showed Bell Atlantic had no competition, did not build the highway, and took the FAS 71 accounting change, saving about \$1 billion just in that state.

How could the companies make claims that they are competitive? The Alternate Regulation plans have not fostered competition nor built the Info Bahn. So why hasn't there been a major drop in local telephone prices from the excess cash?

Let's start slowly and explore the varied, potholed landscape of regulation, trying to make sense out of words like competition, that are more defined by the eye of the beholder than by any dictionary.

"The Dark Fiber " Scandal— A Real Highway to Nowhere.

Believe it or not, though some fiber-optic wiring has been deployed, there is a very dark secret — the wiring isn't being used. Known as "Dark Fiber" or "Un-Lit Fiber", according to the FCC, of the 15 million kilometers of fiber-optic wiring in America, the majority of wiring, over 70%, is not being used. (304) It's like a highway with no on or off ramps, no traffic, just a big boondoggle.

EXHIBIT 55

FCC RBOC "Lit Fiber" vs "Dark Fiber", 1996

1995-1996 edition, in KM

Fiber Lit	4,287,303	29%
Dark	10,735,184	71%
Total Fiber	15,022,487	

Source: FCC 1995-1996

Are there at least Interactive Services going over the Lit fiber? According to the New Jersey Ratepayer Advocate, (3/21/97) (305) the fiber that was deployed is now just being used for regular voice calls, not interactive services. Also, the fiber that is being deployed has only been appearing in the affluent suburbs.

"From our review of broadband deployment to date, it appears that broadband has not been equitably deployed to rural and urban areas of the State. The first area of the State to receive widespread deployment of broadband is in the northern New Jersey towns of Clifton and Passaic. Right now 100,000 residential customers in Clifton and Passaic are receiving voice-grade service over broadband. BA-NJ plans to provide voice-grade service over broadband technology to an additional 400,000 households in Northern New Jersey by the year 2000, though there appears

to be no intention to provide any broadband services over the high speed network."

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 for 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 titled "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 their 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)

	<u>Satisfaction Level</u>
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

	<u>% of dissatisfied customers</u>
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

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

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

<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>	<u>1997</u>	<u>% Change</u>
\$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 Killete (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

	<u>Cost per call</u>	<u>Number of Free</u>
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 "detariffed but not deregulated", 6% were "partially tariffed", and 6% were "partially detariffed". 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%	Detariffed, not deregulated
6%	Partially tariffed
6%	Partially detariffed
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 homogenousness — 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 its 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, is bringing high tech home to millions of people.

"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 wondrous 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)

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- "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)

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- "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 \$1 billion 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 endorse 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 bill 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 McBride, 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 Actual Competition.

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)

	<u>Monthly</u>	<u>Total</u>
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**

	<u>Agreements</u>	<u>Number of Customers</u>
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

	<u>Excellent Grade</u>	<u>Likely to switch</u>
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.

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 through 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)

	<u>Income Telco Operations</u>	<u>Loss From Competitive Subs.</u>
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 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." [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:

- **Phase One** 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.
- **Phase Two** 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.
- **Phase Three** 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.
- **Phase Four** 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

	<u>Phase One</u>		<u>Phase Two</u>		<u>Phase Three</u>	
	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

	<u>Earnings Per Share</u>	<u>% of overcharging</u>
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)

	<u>Requested</u>	<u>Granted</u>
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

	<u>1984</u>	<u>1985</u>	<u>1986</u>
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 wonderful 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 pack 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**

	<u>ROE</u>	<u>Dividend</u>	<u>Profit Margin</u>
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**

	<u>1984-1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
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

	<u>1992</u>	<u>1993</u>	<u>1994</u>	<u>1995</u>	<u>1996</u>
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)

	<u>1996</u>	<u>1997</u>	<u>Total 1984-1997</u>
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)

<u>1984</u>	<u>1990</u>	<u>1996</u>	<u>1997</u>
\$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)

	<u>1993</u>	<u>1994</u>
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 kept 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.

BOOK VI

Overcharging on Your Phonebill & How to Save Money

Chapter 30 Overcharging on Your Phonebill

Forget about everything you just read. Returns on equity and Depreciation schedules are the stuff accountants are made of. The truth of the matter is that many of the charges on your telephone bill, that you pay every month, that have never been reasonable since the Era of the Baby Bells.

Let's talk Scandal.

As we have just witnessed, when comparing the profits of Bells to other US companies and other utilities, the Bells overcharged approximately \$120+ billion from 1984 through 1997. This averages to approximately \$1,000 per phonenumber, and refunds of \$500-\$2,000 dollars. A more exacting analysis is required and it depends on the different state's laws, as well as the services the person has ordered.

By now the reader must realize that this money was easy to accrue, since many regulators have abandoned their monitoring of profits, based primarily on the Bell's promises of new technology deployment. According to our Ameritech mantra: "Federal and state regulators no longer limit the company's profits." (521)

Also we pointed out that no regulator examines the entire bill for profits. The state Public Utilities commissions control a portion of the bill, the FCC controls a part, and state and federal regulators, from Congress to state legislatures, levy taxes and surcharges.

A total shell game. And it's your pennies, nickels, dimes and quarters on the bill they are playing with.

So, once again we have to ask the question "What is reasonable?", this time examining the charges on telephone bills, because almost all of the profits are from subscriber charges. And the issue of "reasonable" when it comes to telephone charges is simple.

- How much does the service actually cost to offer?
- How much profit is accrued from that service?

- What did the service, such as inside wiring, cost before the break-up and how much did the costs rise?

Of course the charges need to be put into context of the companies total profits, not simply the regulatory shell than the money hides under. Our arguments then:

- If a service cost nothing to offer, such as Touchtone service, but the customer is charged \$2.40 a month — is that charge reasonable?
- If a service, such as directory assistance has risen over 1800% since 1982, is that reasonable?

My realization of Bell overcharging came from an epiphany of a 37¢ Toll call. I was examining my company's telephone bills and noticed a one minute call from New York to Montauk, only 75 miles away. I had just completed a large study on long distance prices and found that a call across America the price averaged only 21¢. I also knew that a toll call is nothing more than electrons over wires and the costs were a fraction of a penny per minute. When I recalculated the long distance pricing for the toll calls, **I found a \$5.9 billion dollar difference annually.** (522)

Startled, I then went back to older home phonebills, (I had saved every bill and keyed all the charges into a large computer spreadsheet. Over the ten year 1982-1992, my phone service, for the exact same "basic service", had cost an additional \$1821 dollars, a 266% increase! I then went over to my Aunt Ethel's apartment, who has lived in the same place for almost three decades. Unfortunately, she had two lines as well as two old rotary telephones. Her bills showed that she had paid an additional \$2,609 since 1982. By 1996, she had paid \$1,119 for the use of just one rotary telephone (1982-1996) (523)

Previously we addressed the regulatory changes that have effected the charges on the telephone bill and now let's update the picture, using the overcharging phases to describe exactly what happened to the charges on the average telephone bill, with the caveat that there are 50 states and each state has different laws and different prices for every service.

The Break-up and Deregulation — More Money for the Same Telephone Services.

The break-up of AT&T and the associated deregulation of the telephone wire the telephone was one of the largest bad deals ever perpetrated on the American Public. And for all of those reading this who are interested in other utility or cable policies, the deregulation of the cable box and associated wire, or the deregulation of the electric wiring in the home, is going to go through the same bad logic.

Why? Because the price of every service escalated dramatically due to these deregulatory events. If you kept the exact same service you were severely penalized. And as we will show, it was the seniors and minorities who paid the most for this regulatory horror story.

In pre-divestiture, 1981, telephone service was simple. A residential customer received Unlimited calling, a telephone, the wire in their home, and unlimited directory assistance, or at least a large number of free Directory calls. By 1987, just 6 years later, every charge had gone up 100-400%, and every charge was now ala carte. There was also a host of other changes. For example, many states removed Flat rate service for the more expensive measured service, while the number of free Directory calls was dropped and each DA call cost more. Worse, the FCC added a new charge, known as the "Subscriber Line Charge" or "FCC Line Charge", costing \$3.50 a month, \$42. dollar a year. The exhibit below shows how basic service changed from 1982 to 1987. (524)

EXHIBIT 106

Redefinition of Basic Service from 1982-1987

<u>Basic Service 1982</u>	<u>Basic Service 1987</u>
Flat Rate	Measured Service
	ADDED CHARGE: FCC Line Charge
Free Directory Assistance	Charge for Directory
Telephone	Extra
Inside Wire	Extra
Installation included	Instillation Extra

And to make matters worse, the regulators, from the FCC, to the states, never bothered to change their calculations for the changes in "value" that the customer received. Take the case of Directory Assistance prices. In New York City, in 1982 a subscriber received 6 free directory calls and every other call was 10¢. By 1992, a

directory call cost 50¢, counting tax, and there are no free calls. For seven calls, a customer paid 10¢ in 1982, or \$3.50 in 1992, a 3500% increase for the exact same service. No regulator bothered to calculate these changes to explain the actual cost of residential services, even though what comprised local service had dramatically changed.

And the overall changes based on national averages? Though each state has a different price and regulation for every telephone charge, the overall telephone bill charges went up an average of 275% (from 1983-1996), but each line item went up varying amounts. Below are the basic findings. (525)

EXHIBIT 107

Nationwide Telephone Charge Increases 1983-1996,

Sources: NNI's "Telephone Charges In America," updated 11/97

Installation Fees	956%
Directory Assistance	1800%
Inside Wiring	375%
Telephone Rental	437%
FCC Subscriber Line Charge	\$42 EXTRA Annual \$72 Annual (Business)
FCC Second Line charge	\$60 Annual

Let's go through the changes that occurred to the different parts of the bill. It will allow the reader to see just how much deregulation cost the average consumer, meaning you. We will also make suggestions on how you can save money on your current bill.

- Telephone
- Inside Wire
- FCC Line Charge
- FCC New Charges
- Calling Features and "competitive Services— Touchtone, Call Waiting Call Forwarding, Unlisted Numbers.
- Flat Rate vs Measured Services
- Directory Assistance
- Toll Calls

- Installation Fees
- Taxes and surcharges-E911, Deaf Relay Teleconnect charge

Chapter 31 Aunt Ethel's \$1,119 Rotary Telephone: The Most Expensive And Profitable Piece Of Telephone Equipment In History.

The consumer had no clue what deregulation meant, much less did they care. And so in 1985, three years after deregulation, the majority of the population was still renting a telephone. AARP's 1985 study showed that approximately 70% of seniors were still renting. (526)

The exhibit below highlights how a product that cost \$22 to manufacture, and was written off, Depreciated, in 1983, made the phone companies \$1,119 — local phone companies \$217 per phone (plus tax), and \$902 per phone for AT&T — 5100% profit! Of course the phone companies argue that it was a rental, which not only included the telephone but also the ability to replace it.

How often do they break? Aunt Ethel's phone was installed in 1964 and was never replaced. Also, the companies never supplied information about the average breakage rates.

The profits were garnered through a shocking series of rate increases. The prices jumped from \$1.30 a month, \$15 bucks a year, to a high of almost \$7 dollars a month, \$84 dollars a year by 1988 — for the same rotary phone. Also, an additional charge, the **Investment Recovery Charge**, which was not itemized on most bills nor even mentioned in the rental literature, added \$1.90 a month. (\$2.26 with tax) (527)

"Investment Recovery Charge "This charge is associated with leased equipment that AT&T Information Systems is billing you for. This charge enables the company to recover costs associated with equipment transferred in 1983 to AT&T'."

EXHIBIT 108
The Price of a Rotary Telephone Rental, in NYC, 1980-1997

	1980	1983	1988	1997	Total
Telephone 1	\$1.18	\$2.85	\$4.25	\$4.45*	
Tax	\$0.12	\$0.31	\$0.48	\$0.50	
Total	\$1.30	\$3.16	\$4.73	\$4.95	\$915.54
Investment Recovery		\$2.26	\$2.26		\$216.64
Annual	\$15.60	\$65.04	\$83.82	\$59.50	\$1,132.18*
% of Change		317%	437%		

Source: New Networks Institute, Phonebills.

*In 1997 AT&T instituted a discount of 25% for Aunt Ethel, per phone. Her total was \$1,118.98 (528)

But these changes didn't just effect Aunt Ethel. With the majority of the elderly population still renting a telephone in 1985, customers had price increases from \$16 to \$65 for the exact same product. Also, according to an AARP study of those over 65+. the average number of rented phones per household was approximately 2 phone (1.9) Aunt Ethel has two rotary phones.

In time many people would eventually purchase a telephone, but in our Consumer survey of 1993 we found that 25% of the elderly were still renting, as well as 12% of all households — that's about 35 million people. And almost all of those interviewed thought the price of service was regulated. (529)

Selling Used Equipment at Retail Prices As stated earlier, the purpose of this deregulation was supposed to allow customers to purchase their own telephone equipment. However the easiest thing to do was to purchase the telephone in their home. And the cost of the telephone was super-retail, as shown below. Why? Because all of the installed phones were used equipment, many times refurbished. And some equipment was three decades old, not to mention that the companies also wrote down all of the telephones (530)

Exhibit 109
Average Purchase Price for Telephone Company Supplied Telephone

	<u>As is</u>	<u>Refurbished</u>
Average Price for Touchtone	\$56.00	\$66.00
Average price for Rotary	\$42.50	\$52.50

Source: AT&T, New Networks Institute, 1993

To make the matter worse, there were no 'rebates' or other cash reimbursements based on the age of the telephone. Imagine purchasing a used car, or a computer with no consideration of condition, or age.

Even more surprising, if the subscriber didn't want the telephone, it was their responsibility to remove it. If it was hard-wired directly into the wall, the telephone company would come to remove it, but at the subscriber's expense.

Reasonable? What happened to the telephone handset is simple. It was forgotten as soon as it was deregulated, and became *persona no grata* for any regulatory body to concern themselves with. How else then could a device that cost about \$20 to manufacture in 1980 be worth more than \$1132 by 1997, and in many years 440% above the pre-divestiture price. In fact, the rental telephone became the most expensive piece of equipment in telecommunications history.

A 440% increase in the price of a service is unreasonable. In 1992 NNI calculated that \$23 billion dollars in total has been collected unreasonably, and \$5.7 billion dollars was collected just by the Bells, that could be considered to be unreasonable, the rest paid to AT&T. And the problem continues even today.

SAVE MONEY: If someone you know is renting a telephone tell them to immediately consider purchasing a different phone. Then join us as we ask for an investigation and refunds. (See back for details)

Chapter 32 Inside Wiring Charges — A Faulty Insurance Policy

Definition: "Inside Wiring", also called "**Wire Maintenance**", or specific names including "Line-Backer", is the phone wire that is located inside a home or office, including all of the extensions.

When the wire in homes and offices was deregulated, it was thought that this would start a new business of competitors, or at least allow people to do their own extensions. While there are customers who watch Tim Allen's TV show "Home Improvement", or Bob Vila's "Home Again", the fact is that most people were left holding the bag.

Let's start off in 1982. The wiring is deregulated and people get some phone company message that they can now wire their own homes or the company will manage it. However, in 1982 every home was already wired, so, not surprisingly, most people had no idea what the company was talking about.

Though the changes played out differently state by state, the price of inside wiring service went up dramatically over a very short time. Below is an exhibit from the Office of Ohio Consumer Counsel from 1992, showing that the price for inside wiring went from no charge, the price included as part of local service, to becoming deregulated. First costing 20¢ in 1987, then to \$1.25 a month, by 1992, a 500+% increase. According to their annual survey of telephone prices, this model was typical of the rest of the USA. (532)

EXHIBIT 110

Ohio Bell's Inside Wire Pricing, 1982-1997

	<u>1982</u>	<u>1987</u>	<u>1992</u>	<u>1997</u>
Part of local service	—	.20	\$1.25	(\$1.50 Avg.)
Increase Since 1982			525%	

Source: Ohio Consumer Council, 1992, Telephone Bills, FCC

According to the FCC's Rate Report released March 1997, in October 1995, (the most recent data) the "least expensive" wiring charge in America averaged \$1.50, an increase of approximately 80% since 1987. However, the FCC only uses "lowest cost" and doesn't analyze actual charges.

"The average monthly charge for the least expensive wiring maintenance option was \$1.50, plus tax. These unregulated charges have increased 79% since October 1987."

And inside wiring generates a great deal of money. The quote below shows that when NYNEX deregulated inside wiring from the regulated part of the company, NYNEX moved \$367 million dollars. (534)

"On January 1, 1990 as part of the rate moratorium plan, NY Telephone eliminated inside wire related rates of approximately \$367 million and began to offer wire-maintenance services on a deregulated basis".

And that's just one state, New York. In fact, our estimate for inside wire maintenance contracts in 1996, was approximately \$5 billion dollars annually and is growing. This takes into various plans, some costing \$3.50. (Since this service has been deregulated and is not included in the profits for local service, nor broken out for profits in annual reports, this is an estimate.)

Do You Own the Wiring?

In New York City in 1996, anyone wishing to change their service from an installed wire plan to their own wiring was required to purchase a network interface costing about \$15 dollars. And there can be installation charges, at \$93.44 for the first hour of work performed. (535) This added technology is obviously used to deter the customer from doing their own wiring, since the service is already working without this new interface.

A Faulty Insurance Policy? Maintaining A Wire that Doesn't Break

One Attorney General we interviewed called inside wiring a faulty insurance policy. Why? Because the customer is paying for a service that has very little, if any problems. According to a New York Telephone statement in 1980, (536) the wires break once every 16 years. However, the companies today do not provide any facts on this topic.

SCANDAL: Charging Customers who never ordered Inside wiring.

During NNI's telephone surveys, including personal interviews where telephone bills were provided, we found that approximately **70% of all customers were paying inside maintenance charges. However, half of those stated that they never ordered it.** That's right. almost half of those who are paying the charge stated that they never ordered the service. (537) It's now called "cramming", but this practice has been common nationwide.

For example, in the case of Linsky vs NYNEX, Mr. Linsky had found that he had been charged \$3.21 a month, for the most expensive inside wire maintenance service NYNEX had to offer. Unfortunately, he never ordered it. (538)

"This action involves the routine practice of NYNEX of charging their customers, including plaintiff and the members of the Class, for one of three Option Wire Maintenance Plans, when, in fact these customers had not ordered such service and were unaware that they were being assessed such charges.

Unfortunately the court decided that if it is on your bill, regardless of how it got there, it's too bad.

However, during the edit of this book, the New York Times ran a story, 11/13/97, stating that Ameritech was hit with a \$225 million dollar settlement for their method of selling inside wire maintenance charges. (539)

SAVE MONEY: Check you phonebill and see if you are paying for wire maintenance service. (NOTE: In some cases, the service is not listed separately, so you have to study the front of the White pages telephone directory or call the local phone company) If you are paying for it and didn't order it, call the phone company and demand a full refund,

including all taxes, installation fees and interest. Also if you did order it, check to see if the service is the 'lowest cost' or the one you wanted. Then join us as we ask for an investigation and refunds. (See back for details)

Chapter 33 FCC's "Subscriber Line Charge" — WHY?

\$8 Billion is Collected By the Bells, Annually, From Telephone Subscribers for the FCC Subscriber Line Charge.

"Watch out for the Info highway" is the name of a chapter in "The Tax Bracket", a book by Martin L. Gross. (541) In it he states that the FCC Subscriber Line Charge is a government tax that takes billions of dollars out of the pockets of tax payers, "us suckers". (542)

"There's a hidden tax. This one outside of the purview of the IRS and virtually unknown to us suckers. It's a \$3.50 a month Subscriber Line Charge, put on everyone's phone bill by the FCC.

"It started with a \$1 charge for phone users in 1985. Then it was raised to \$3.50 for home subscribers (\$6.00 for business.) That's \$42. a year for each telephone number. A tax that takes \$3 billion a year out of our fiscal pockets. If you have two numbers and perhaps an fax, that's \$126 a year FCC tax just for using the lines."

And Gross warns us about the future: (543)

"As the information superhighway leaps from Al Gore's imagination into a working road with an exit ramp to our homes, Uncle Sam will be looking carefully at the \$500 billion a year industry.

"Just a warning fellow citizens. Watch the next time you sit down to use your modem. The tax man may be watching."

While his analysis is somewhat off, since it is not a tax per se, and the money does not go to the FCC or the government but to the local telephone companies, he is correct in two areas. First, it is costing America billions of dollars annually. Second, based on the Telecom Act of 96', the FCC increased the FCC line charges for second lines starting in 1998. Considering the profits of the Bells, we must all wonder if there is any justification for any of these charges.

What Exactly is the FCC Subscriber Line Charge? (544)

According to the FCC: "The federal Subscriber Line Charge (SLC) defrays a portion of local exchange costs that have been allocated to interstate toll (long distance) services." FCC, 1993

However, you would never know it from the vague definitions used by the phone companies on their telephone bills or in their directories, highlighted in the exhibit below. (545) Notice how none of these definitions match either the FCC's definition or each other's. Also notice that the charges are "mandated", or "ordered" by the FCC. There is no mention that this charge is revenue that goes directly to the Bells. In fact, during consumer interviews, when asked about the charge, most customers thought it went to the FCC. (545)

EXHIBIT 111**"FCC Line Charge" Descriptions by Telephone Companies, 1993**

Source :Telephone Bills & Directories, New Networks Institute., 1993

- "Line charge ordered by the Federal Communications Commission" New York Telephone bill 1993
- "Mandated Charge Interstate Subscriber Line Charge" GTE bill, 1993
- " A monthly charge required by the FCC rules, for costs to connect your phone to the network" Detail NY Telephone bill, 1992
- "Charges for Network Access For Interstate Calling, Imposed by Federal Communications Commission" Pacific Bell telephone bill, 1993,
- "Access Charge Per FCC Order" Ohio Bell telephone bill 1993,
- "The Federal Subscriber Line Charge" is an access charge authorized by the Federal Communications Commission. This charge defrays a portion of the fixed cost of providing your access to the local network" C&P Virginia Telephone Directory, 1993

The FCC Line Charge's Steady Climb

The only thing that is not vague about the Subscriber Line Charge is the expense. Before the break-up of AT&T there was no FCC Charge. It started in 1985 at one dollar, then climbed to \$3.50 per month, \$6 for businesses by 1990, where it has remained, costing the average consumer about \$42, \$72 for businesses, not counting taxes. (546)

EXHIBIT 112

FCC Line Charge for Specific Years, 1980-1996

1980	1985	1986	1987	1990	1996
\$0	\$1.00	\$2.00	\$2.60	\$3.50	\$3.50

Source: FCC, New Networks Institute, 1993

According to the FCC, the total expenditures were \$7.8 billion annually in 1995. We estimate that it was \$8 billion in 1996. (547)

An FCC Increase for Second Lines in 1998: "The Internet and Small Business Tax"

But it gets worse. As of January 1998, the FCC has implemented an increase in the SLC for all second lines, including residential and business customers. We call these new charges the "Internet and Small Business Tax", primarily because second lines have become the basis of Internet home use and small/home business fax lines. Therefore, increasing the charges on second lines is the same as adding a tax to these households and small businesses.

And the increases are not small. Residential customers with a second line can expect their cost to go from \$3.50 a month to \$5 in 1998 then "Up to \$9. a month" by 2001, with the price eventually leveling off at \$7.60. (548)

EXHIBIT 113

FCC Second Line "Internet & Small Business Tax", 1998

1988	1999	2001	PHASE IN
\$5 a month	\$6 a month	Up to \$9 a month	\$7.60

Source: FCC, 1997

Multi-line business customers currently paying \$6 a month will have to pay \$9 a month in 1998.

These additions are supposed to offset other changes in various Access fees. The FCC Order uses phrases like "The reforms are designed to move the charges for those services to more cost-based" and "these changes will promote competition for interstate transport services". (549)

It has yet to be seen whether these charges do anything more than increase Bell profits.

ISDN prices may increase as well

The FCC's Access Charges Order states that the phone companies can add an additional charge to ISDN users. (550)

"Price cap LECs may also assess a monthly flat-rated charge directly on end users that are subscribing to ISDN, digital subscriber line or other services that have higher line port costs than basic, analog service. "

But why are there fees at all? The Bell's profits are almost double other companies and every indicator shows that they are making substantially more than regulated utilities. The FCC's lack of investigation or questioning of this charge needs to be reviewed.

SAVE MONEY: Join us to repeal the FCC Subscriber Line Charges and the Internet and Small Business Tax.

Chapter 34 "Competitive" Services Do Not Pay Their Fair Share and Cost Virtually Nothing.

- **Touchtone** service is considered an "enhanced" service.
- **Call Waiting, and Call Forwarding** are called "competitive" yet no other phone company offers these services.
- **Caller ID, CLASS Services, Unlisted Numbers and VoiceMail** are also considered "competitive".

As previously quoted, in the "Rape of Ma Bell" the authors state that the costs of offering Touchtone service is virtually \$0 when the networks were upgraded for equal access. Well, it turns out that almost all basic network services, besides Touchtone, including Call Waiting and Call Forwarding, are also virtually expense free. In fact, according to the authors, the implementation of these services makes the network more efficient by reducing uncompleted calls and busy signals. (551)

"Another step to be taken for a more efficient system would be to provide Call Waiting on a universal basis. Again 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. Call Waiting would eliminate a large portion of the annual 90 billion busy signals. When a customer gets a busy signal, it ties up the network without providing revenues to the telephone company. The telephone industry should consider providing this service without extra charge." [emphasis added].

Virtually all "competitive" services are nothing more than cash machines and almost none of these services were ever competitive. No company ever said "I can give you Call Forwarding for 50% off."

The use of the word "competitive" refers more to the fact that many state Alternate Regulations "deregulated" the services, and therefore, the regulator is no longer looking at the profits from these services. And in almost all cases, these changes were based on the promise to build the fiber-optic highway!

In the previously presented Alternate Regulation plans, Illinois Bell's plan states "competing services are not included" in any regulatory profit control, (552) while the Indiana Opportunity Plan specifically states that the prices of these services would become "Market Prices", with no one looking.

"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."

Ironies abound. Besides the failure to deliver the Info bahn, it has been the telephone subscriber that has paid for all of the research and development on all of the products, first through AT&T Bell Lab's and then as part of BellCore. The subscriber also paid for the upgrading of the network switching system that supplied Touchtone, Call Waiting and Call Forwarding. It comes with the upgraded network software for little, if any, cost.

But the ultimate joke is that the telephone company is allowed to charge super-retail prices, with expansive profit margins and keep all of the profits based on the fiber-optic interactive promises that were never met.

Charges For Calling Features

Below is a sample of the prices for Call Waiting, Call Forwarding, and Touchtone Service for Flint Michigan and Augusta GA. Notice first that there are no similarities in any of the service prices, and that business services almost always costs more. (553) (554)

EXHIBIT 114**Selected Monthly Prices of Calling Features, 1996-1997**

Flint, Michigan, Ameritech	<u>Residential</u>	<u>Business</u>
Call Waiting	\$4.00	\$5.91
Call Forwarding	\$2.74	\$4.90
Touchtone	\$2.43	\$2.50
Augusta, GA Bell South	<u>Residential</u>	<u>Business</u>
Call Waiting	\$3.25	\$5.50
Call Forwarding	\$2.10	\$3.20
Touchtone	\$1.30	\$2.36

Source: Telephone Directories, 1996-1997

In New York, NYNEX offers a bundled five-year service contract for Touchtone, Call Waiting and Call Forwarding at \$6.95 a month. That's almost \$500 counting taxes, for a series of services that probably cost 10¢ a month, \$6 for five years, to offer. And penalties exist if the customer cancels early. Also, this doesn't account for any initiating service fees, or other charges tacked onto the bill. (555)

There are other services that have little or no actual costs, including Unlisted numbers. It is one of the few times you must pay not to be listed in something. Below are some of the prices for having an unlisted number. (556)

EXHIBIT 115**Various Unlisted Number Charges, 1996-1997**

Ameritech, Flint Michigan	\$1.25
Bell Atlantic, Sommerville NJ	\$1.45
Bell Atlantic, Monroe County PA	\$1.25
Bell Atlantic, Newark, NJ	\$1.44
NYNEX, Brooklyn, NY	\$1.95

Source: Bell Telephone Directories, 1996-1997

Even more gauling is the fact that many of these services had a one-time charge that must be paid. Bell Atlantic, PA charges \$15 to initiate an unlisted number, NYNEX, in its 1996-1997 Brooklyn, NY Telephone Directory puts it this way (557)

"With most Optional Services, there is a monthly charge plus a one-time connection or service charge."

And How Many People are Paying These Charges?

First, according to the FCC, almost half of all states had separate charges for Touchtone at the end of 1995 and many states have supposedly dropped the charge for Touchtone. (558)

"In most cities customers must still pay a separate monthly charge for touch-tone service. However, the number of cities with separate monthly charges for touch-tone is decreasing along with the average amount. In October 1987, 91 cities charged separately for touch-tone; by October 1995 this number was down to 42. "

We believe these numbers are flawed for a number of reasons, including the fact that "most cities" does not represent 42 of 95 cities. (559)

More to the point, the FCC's statistics do not reveal the number of subscribers who are actually using Touchtone or Calling Features. According to BellSouth's 1996 Annual Report, the company had "29 million features currently activated", (560) which included their voice mail and Caller ID products. Since BellSouth had 22 million lines, that means that the average subscriber had 1.3 features. (561)

Our 1993 Consumer survey found that approximately, 77% had Touchtone, 45% had Call Waiting and 9% had Call Forwarding. (562) With the increases over the last five years, we expect the calling products to have increased 25-40% each.

Calling Features — Revenues and Pure Profits

One thing is clear. Calling features are big business. As discussed earlier, we believe that Calling Features made over \$9 billion dollars in revenues for 1996. For example, Bell Atlantic's 1996 Annual Report shows \$1.5 billion in "Value Added"

products. (563) Considering the profits of these services, the "value" seems to have been the Bell companies.

Though state laws vary and the amounts of service for business and residential services vary greatly, one thing is true. None of these services are paying their fair share. Remember, after the software to offer these services is installed, and the number of users increases, the price per user plummets. There are, of course, marketing dollars spent on these services, and Public Utility Commissions to contend with, but inside industry estimates are that these services have profits over 50% or more. (564)

EXHIBIT 116

Estimates of Telephone Competitive Service Profit Margins, 1997

Touchtone	100%	Profit margins
Unlisted Numbers	100%	Profit margins
Inside Wiring	75%	Profit margins
Call Waiting/Call Forwarding	85%	Profit margins
Voice Mail	65%	Profit margins
Caller ID	60%	Profit margins

As previously mentioned according to the New York Times 1/1/4/97, profit margins for Caller ID and voice have profit margins over 50%. (565)

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

Unreasonable?

Many of the optional service profits were supposed to be used for the fiber-optic highway. Since this didn't happen, then these services should have had regulated returns, closer to 11%, not 50% or 100%. Since the Bells have been asking in virtually every state to "rebalance the services to costs", then all of these services should be included in the rebalance, therefore dropping the price of all of these services to a few pennies a month each, or free.

SAVE MONEY: There is little a subscriber can do to lower the prices on these service. Join us to demand a rebalance of these services to cost.

Chapter 35 Installation Fees

Installation Fees are those costs associated with the set-up and receiving of telephone service in a particular residence or business. These fees can include the service connection to the telephone network, the installation of a telephone jack or wire, or other set-up fees, such as a visit to the customer's premises.

Installation Fees have increased an average of 956% since 1983. (566) The dramatic increases are attributed to a shift in policy. Before the break-up, the telephone companies charged one low, flat-fee for each installation item, but afterward, the policy changed to a per-hour series of charges. Installation Fees for any given item can range from a 294% increase in service minimums to over 1,600% for Jack or Wire Installations. Below is a charge showing the different installation charges from 1982, then 1996. (567)

EXHIBIT 117

Residential Installation Fees, National Averages, 1982-1996

	<u>1982</u>	<u>1996</u>	<u>% Change Since 1986</u>
Connection	\$10.87	\$40.69	274%
Premises Visit	\$ 5.67	\$33.88	498%
Jack Install	\$ 4.86	\$82.58	1598%
Wire Install	\$ 6.79	\$98.37	1348%
			930%

Source: NNI, Telephone Directories, 1980, 1996

The services and names include:

- **Connection to the Network** Sometimes referred to as the "Minimum Connection Charge."
- **Jack Installation** The installation of a telephone connection jack.
- **Wire Installation** The installation of a wire on the customer's premises.
- **Repair Services, Premises Visit.** These are services provided as they are required.

There are also other charges that of course are added. These include:

Deposit and Initiating Service Fees A deposit, as well as an Initiating Service Fee, are often required to start service and these fees can be hundreds of dollars. For example, to establish a New York business account on an existing residential line (which had been in service for 35 years), NYNEX required two charges, a \$300 deposit and a \$298 charge for initiating service, \$598 dollars up front before service would start. (568)

Other companies do it somewhat differently. Ohio Bell's Telephone Directory states for starting residential service:(569)

"You may pay a deposit not to exceed 230% of the amount estimated to be the charge for regulated service provided by Ohio Bell plus Long-Distance charges provided by other companies but billed to us."

Using this calculation, Ohio Bell may require over \$125.

Meanwhile, the FCC's statistics on Installation does not take into account either deposits of start-up costs. Their analysis is based on a "Minimum Connection Charge." and has no bearing on what a consumer actually pays.(570)

Installation Impacts — Second Lines and a Moveable Society.

According to the Census Bureau, approximately 18% of the population move annually, while Link Resources found that 37% of the population moved in the five year period, 1990-1995. (571) (572) With the increases in second line installations, now accounting for 15% of households, the obvious questions are:

- Why are there any basic initiating service fees or other charges? The customer does not have a choice, and must get phone service from the Bell or local monopoly, therefore making the companies hundreds of dollars, with more than adequate returns. In almost all cases, the initiation of a service is nothing more than updating an existing telephone site, and therefore, has little if any costs.

- Secondly, the phone company should by now have been able to deliver on the basic service — two phone calls over the same wire. Then there would be no second

line installation required, just an update of the account. We contend that this service was never rolled out because it would prevent the collection of the current massive installation fee charges. Also, no regulator provides statistics which gives the actual installation fees, nor has regulators brought up the question why installation fees have been allowed to rise, especially when the monopoly utility is still in control.

Save Money: Until there is competition for installation fees there can never be lower prices. Then join us as we ask for an investigation for the removal of most installation charges. (See back for details)

Chapter 36 Directory Assistance — Count Your Calls

DEFINITION: Directory Assistance, (DA) is the service that allows a caller to find out the telephone number, and sometimes address of a person or business. There are four forms of Directory Assistance: Local, Long-Distance, IntraLATA and Intrastate. The two most common are:

- "**411**" — **Local DA** is accessed with the three-digit telephone number 411, and is constrained by a subscriber's "Local Calling Area", about a 10-15 mile area. In the US there are over 6,000 Local Calling Areas, and each state's definition of a calling area is different.
- "**212-555-1212**" — **Long-Distance DA** is carried over Long-Distance lines, and accessed by dialing a specific geographic location using the appropriate area code, then such as 212-555-1212 for New York City.

There are also two important parts of local directory services.

"Allowance" The number of free directory calls per month that is included with basic service.

"Requests" The number of phone numbers the person call ask for on one telephone call.

And there are four things you should know about local directory prices: (573)

- The price of Directory Services for the local subscriber has gone up 1830% since 1983.
- There are 50 states and at least 50 different charges.
- The FCC has never examined directory charges and its impact on local service rates.
- 0% of customers have any idea how much directory costs, or whether they receive free calls with local service. Lack of knowledge has cost them money.

DA: The Poster-child for the Patchwork Quilt State Laws

There are few products in America where the price can vary a few thousand percent. In fact, no two states have the same combination of price and allowances. Also, many states have different prices and allowances for business or residential services. Meanwhile, the independent companies and the long distance companies all charge varying amounts as well.

How Screwy is Directory Pricing?

The next exhibit compares the price for 7 calls in two adjacent NYNEX states: New York (NY) and Massachusetts (MA). In New York, there are no free calls, while the Massachusetts customer receives 10 free calls. And if the New England customer doesn't use all the calls, they receive a 20¢ credit. Also, the Mass. customer can make two different requests per phonecall, while NY customer is limited to one request per call. (574)

Comparing seven calls, the New York subscriber pays about \$3.70 a month, while the Massachusetts user receives a \$0.20 credit. On an annual basis, the NY subscriber is paying an additional \$44.40 a year, while the MA subscriber will actually have \$2.40 credited to their account.

EXHIBIT 118

New York and Massachusetts, Seven Directory Calls, 1997

	<u>New York City, NY</u>	<u>Boston, MA</u>
Allowance	NO Free Calls	10 Free Calls
Credits	No credits	\$.20
Price per call	\$.45	\$.34
Total including tax	\$ 3.70	(\$.20)
Annual	\$44.40	(\$2.40)
E911	\$ 5.28	
Total Costs	\$49.68	(\$2.40)

Source: NNI 1997

2,170% Difference

Even more surprising, the Boston DA plan actually pays for the subscriber's E911 charges, which, in New York City was 44¢ per month, counting taxes. If this is included, an additional \$5.28 would be added to the total, thus bringing the New Yorker's total to almost \$50 (\$49.68) more per year, just for Directory. That's a 2,170% difference! Finally, Boston users get two "requests" per call, in New York it's only one. (We didn't include this in these statistics.)

If you consider that both local telcos are NYNEX companies, (New York's local company was New York Telephone, while Massachusetts's was New England Telephone), one has to stand in disbelief that two companies could charge such disparate prices, considering that the costs associated with offering DA should be similar for these two companies.

Just to show that there is no logic to either the price per call or the number of free calls across America, here are some directory prices from other states. The number of free calls ("free") is given, followed by the price per call. (575)

EXHIBIT 119

Sample RBOC Directory Assistance Pricing, 1983-96

	<u>1983</u>	<u>1991</u>	<u>1997</u>
Michigan	Free	20 free, 22¢ per	5 free, 45¢ per
New York	6 free, 10¢ per	No free, 45¢ per	No free, 45¢ per
Illinois	8 free, 20¢ per	No free, 15¢ per	No free, 30¢ per
Virginia	6 free, 10¢ per	3 free, 29¢ per	3 free, 29¢ per
Mass.	Free	10 free, 34¢ per	10 free, 34¢ per

Source: NNI, NARUC, 1992, Telephone Directories, 1996-1997

Massive Decreases of "Value" of Directory Services Since 1984

The exhibit also highlights the changes from 1983. The most common features are that allowance calls were slashed in most states, while the cost per call also went up. And the changes happened in almost all states. Notice that in Michigan and Massachusetts, Directory charges were free in 1983, and that New York's price went

from 6 free calls, then a dime per call in 1983, to no free calls and 45¢ each, not counting tax.

In fact, before the break-up of AT&T, about 1/3 of the states had free directory assistance, and almost all the other states provided healthily amounts of free calls. (576) The original logic of adding free directory calls was that it generated revenue. After finding the right number, the customer would keep calling and use the network. It was also simply better customer services. But as progress of the Alternate regulations continued over the decade, the price of directory calls continued to rise, while the number of free calls continued to be cut.

The change has been dramatic. In 1983, the average household had 9 free calls per line, and the cost afterward averaged 11¢ nationwide. By 1997, the average cost per call is 38¢ and the average household gets only one free call, with many states no longer having any free calls. (577) Also, the number of requests per phonecalls has been reduced, usually to only one request per call. When you add up the changes, from the number of calls, the increase in price, or the number of requests, Directory charges have increased a whopping 1830% from 1983 to 1997, with each state having different changes.

EXHIBIT 120

The Changing Price of Directory Assistance, Nationwide 1983-1997*

1983	1997	Extra Cost—10 calls	Increase
11¢ per call 9 free	38¢ per call 1 free	\$3.70 a month	1830%

Also, the calculation for the directory "Increase" has a number of caveats. (578) However, the average household is spending about \$45 a year more for 10 directory calls, (not counting tax).

We would also like to point out the drop in "value" to Basic service. In 1997, now has to spend about \$3.70 extra a month, for the exact same "Basic Service" that they had in 1983. Unfortunately, none of this drop in "value" is accounted for in the telephone rates published by the FCC or even most state Public Service Commissions.

The Other Sleight of Hand — Customers' Confusion Adds Money

With the continued price changes and the fact that all 50 states have different prices, it should come as no surprise that in the our consumer survey we found that only 2 out of 1,000 knew the price of a call or whether their service included any allowance. In fact, almost 50% of customers (8+38%) believe that directory is still free or that they get free calls, while 30% thought directory cost 50¢, which was also incorrect (579)

EXHIBIT 121

Consumer Perception of Directory Assistance Pricing, 1993

Directory Assistance Is Free	8%
I Get a Certain Number of Calls	38%
Directory Assistance Cost 50¢	30%
I Don't Know	21%
None of the Above	3%

Source: New Networks Institute, 1993

To be blunt, most consumers guessed at the answers. Why does it matter? Because of those interviewed, almost half thought that directory was free or they received free calls. This has led many customers to use the service unknowingly, racking up \$2-\$7 dollars a month in directory charges.. For example one older customer we interviewed thought Directory was free and she averaged 13 calls a month. Unfortunately, this customer was paying an extra \$3.50 a month, and was annoyed to find out the truth.

SAVE MONEY: Start by trying to guess the price or a call and the allowance. We bet you got it wrong. Then go to your telephone directory and look up the price and whether you get free calls. Then join us as we call for an investigation into Directory prices and customer education.

Chapter 37 Taxes and Surcharges — Expensive Ghosts, Goblins and RBOC Revenues

Probably the hardest information to track in telecommunications is the collection of taxes and surcharges applied to the subscriber's bill. These phantoms, ghosts, and goblins can strike without the person ever knowing the truth about what has happened. They can also add an additional 10% or more to the total bill above and beyond federal, state and local taxes applied to normal consumer goods.

And there's a dark secret hiding. Many surcharges are either misnamed or redefined by the telephone companies, so that the truth, that the charge is really direct revenue to the company, is completely obscured. This obscurity is many times helped by the regulatory groups who have either tacked on charges for their own needs, or have allowed the telephone companies to collect fees without proper identification or notification.

Death, Taxes and Telco Surcharges

When a subscriber pays a telephone bill, it is likely that they are paying some surcharge besides the FCC Line Charge, which is imposed on everyone. Some of these have been around for over 10 years, such as E911, while the reader should expect a host of new Info Bahn charges, like the "California Teleconnect Fund" for wiring schools. Future taxes and surcharges are coming in 1998 as a bad result of the Telecommunications Act.

The two most common charges are:

- **Deaf Relay & Telecommunication Devices for the Deaf (TDD) Service** The "Americans with Disabilities Act of 1990" mandated that the disabled were entitled to accessibility of telecommunications services and the FCC was directed to oversee the implementation of "relay services" which enabled Telecommunication Devices for the Deaf (TDD) service users to communicate with non-deaf subscribers. There are numerous parts to this work including statewide "Dual Party Relay" services, and a lease

or sale on SCPE, "Specialized Customer-Premises equipment". The law required these services to be installed in three years, which started 7/26/90.

- **E911** Enhanced/Emergency 911 services, is a fee to upgrade police emergency equipment and network enhancements.

Hundreds of "Other" charges

And there are hundreds of other local state and federal taxes, some appear with names like "Other", "Occupation", or the author's personal favorite, the "NYS/MTA" tax. (580)

EXHIBIT 122

Taxes and Surcharges Found on Telephone Bills, 1995

Non-basic Charge(PA)	\$0.85
Other	\$1.25
Municipal	\$0.41
NYS/MTA	\$0.66
Occupation	\$3.13
PUC Surcharge	\$.06
Universal Lifeline	\$.33
Surcharge (PA)(11.02)	\$0.11

How Many People are Effected?

Though there are federal and state taxes to contend with, each state has a different series of taxes it imposes. For example, according to the FCC, E911 was on almost 90% of all phonebills, and the amount collected was over 40¢ a month. That's about \$600 million collected from the Bells annually. In fact, according to the FCC, E911 charges accounted for 1% of the Consumer Price Index increases. (581)

"An increasing number of cities are using a tax to fund emergency 911 service. In some cities a fixed amount of tax is levied on each access line. Other cities use a percentage tax. Eighty-five of the 95 sample cities had

emergency 911 charges as of October 1995, compared with 25 in October 1987. The average emergency 911 charge for a residential line with unlimited calling in these cities was \$0.47. On a nationwide average basis, \$0.42 of the average of \$2.34 in taxes was collected for emergency 911 service. The implementation of emergency 911 taxes accounted for about a one percent increase in the CPI local service index in recent years. "

The FCC doesn't give a breakout of the Disabilities surcharges, but according to the FCC, the costs are 3-20¢ a month. (582)

"An increasing number of jurisdictions are also using a tax to fund equipment for the hearing disabled. These taxes typically add 3 cents to 20 cents per month to the cost of telephone service."

How bizarre do surcharges get? Probably the saddest bill we found was from GTE California with 11 surcharges and fees. (583)

EXHIBIT 123

California (GTE) Surcharges, 1995*

	<u>May 95</u>	<u>April 95</u>
GTE Communications Devices Fund For Deaf & Disabled	\$.10	\$.11
Funding To Support The Public Utilities Commission	\$.05	\$.06
AT&T Universal Lifeline Telephone Service Surcharge	\$.58	\$.56
AT&T Communications Devices For The Deaf & Disabled	\$.06	\$.06
Universal Lifeline Telephone Service Surcharge	\$.33	\$.58
Temporary Surcharge Allowed By The PUC	\$3.39	\$2.94
911 State Tax	\$.36	\$.43
Taxes	\$.63	\$.59
Total	\$5.50	\$5.33
Number of Surcharges	11	

Source: GTE Telephone Bill, New Networks Institute, 1995

Taken directly from telephone bills, this person is paying about \$5.40 (for the two month average) in charges. When one considers that the price for the calling plan is \$11.50 one must wonder how the regulators would allow for these charges to add almost 50% more to Basic Service. Also, try tracking the charges and you'll go blind. If you examine all taxes paid for two months, this particular subscriber had only two charges remain constant, while all 8 others changed over just the period of one month.

But the real problem with these charges is not just the fees, and how they are paid for, but where all the money goes.

Taxes and Surcharges as Revenues and Profits

Imagine seeing the quote below on your telephone bill. It explains that there is a surcharge called the "NYS/MTA", which allows the Bell to have the customer pay the company's taxes — a tax that adds 7% to the entire bill. (584)

"New York Telephone pays taxes too. The company must pay a New York State Gross Income Earnings tax, which we are permitted to recover as a surcharge to consumers and appears on your bill as a 6.5% New York Surcharge. This surcharge applies to monthly and one time charges and to most calls made within the state". [emphasis added]

In fact, the NYS/MTA surcharge is actually a 2 part charge, the majority, 6.5% going directly to pay New York Telephone taxes. However, there is also an "MTA" surcharge, about 1%, which goes to the Metropolitan Transit Authority, the organization that runs the buses and subways. (585)

"A fee the company collects for New York State and the Metropolitan Transportation Authority. It helps pay State utility taxes and supports subway, bus and commuter rail lines. The MTA portion applies only if you have phone service in a county served by the MTA."

The bottom line is simple. New York subscriber's are paying New York Telephone's taxes, and therefore it is both a cost to the consumer and business as well as revenues to the company. And they have been collecting this charge since 1982!

E911 and Deaf Relay as Revenues

Most consumers obviously want the best emergency services. So, in a sense, E911 is an important charge. However, it is also profitable for the telephone companies. For example, in 1991 **New Jersey Bell showed revenues of \$17 million dollars from E911 services.** (586)

In fact, all mandated services collected by the telephone companies can be revenues, including Lifeline, or TDD services. For example, the Michigan Public Utilities' Audit of Michigan Bell' Alt Reg. plan found that the Deaf Relay services were just company revenues with no competitive bids. (587)

"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)".

Reimbursed for Community Discounts

And even the discounts of costs to schools, hospitals, and libraries that the Bells tout as being community oriented service will just be reimbursed through some extra tax. For example, Pac Bell states about the "the Teleconnect fund" (588)

"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."

How much has been made over the decade still needs to be determined, but when we consider that E911 has been collected since the mid-1980's in some areas, the amount of money can be hundreds of dollars in fees, hundreds of millions in Bell revenues.

Are These Charges Reasonable?

Probably the oddest part of this tale is that some states have found that services such as directory assistance are so profitable that its profits can be used to pay for both E911 and Deaf Relay. For example, Massachusetts has set up its directory assistance to give 10 free calls, pays for E911 and Deaf Relay, and even gives a phone credit to subscribers because of its profitability. The question remains "Where did all the money go?"

SAVE MONEY: Unfortunately, taxes and surcharges are added directly to the bill and everyone must pay these charges. Join us in helping revoke the charges that are unreasonable, require that the phone company identify the charges as revenues, and require all surcharges to be put up for competitive bidding or even replaced when total phone company profits are examined.

Chapter 38 Long Distance Charges: The Bells Get 40% of Every Dollar You Spend.

The average customer spends about \$30 dollars a month on long distance calls, and according to the FCC and MCI, 40% of that goes back to the Bells for Long Distance Access fees. As we pointed out earlier, MCI claim's that Access fees are a \$14 billion dollar rip-off, and that it costs the average household \$110 extra a year. (589)

Probe Research also found that access charges have been overcharged by a whopping \$60 billion from 1984 through 1994. Their argument, based on extensive research and databases, is that Access fees was only supposed to pay part of the cost of running the network, but instead, Access fees paid for the entire network, with \$60 billion dollars left over. (590)

While the Bells continue to state that Access fees are expenses for the Long distance companies, the truth is that these are pass-throughs, paid for by the customer, i.e., residential and business subscribers.

Also, as stated previously, competition has greatly reduced the cost of long distance calls. 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%, while the current discount plans have dropped the price of service 50% (49.6%).

And the long distance plans, from Sprints' offering a dime per minute on evenings and weekends to the other long distance plans, have all both lowered prices as well as give the customers numerous cost saving options.

While the new FCC Access Order is supposed to lower access fees and therefore prices, we believe the Bells are still in control and the prices will still be inflated, no matter have the new math is applied.

There are no White Hats in Telecom

Another book could be dedicated to many of the questionable exploits by the long distance companies.

SAVE MONEY: It is not in the scope of this book to highlight all of the long distance plans. However, the most important next step is to get a more accurate accounting of the access charges and then their removal. Join us in calling for an analysis for accurate statistics of the overall bill, including long distance fees and their related access fees.

Chapter 39 **Why We Pay a Per-Minute For a Local Call— The Measured Service Scam & The "Pelican Brief of Telecom"**

In the 1970's almost all of America's business and residential customers were charged a flat rate for an unlimited amount of local calls. But over the next two decades, the Bells would try state by state, and many times succeed, to migrate the customer to "measured service", which charges the customer on a per-minute or per-call basis. While the Baby Bells have pronounced measured service to be cheaper for most customers, we believe these statements are based on self-fulfilling data, not accurate accounting.

But let's backtrack. In the 1970's, AT&T devised a plan to implement measured service throughout the Bell system, replacing all flat rate service options. The following internal, **confidential**, AT&T memo, dated 1979, (Appendix X), an updated version of a document from 1977, clearly shows that the Bell system's original intent. The memo states: (591)

"By 1985, nearly all business customers and a preponderance of residence customers will be charged for (local) exchange service on a measured basis.

And the strategy: ..."enlighten" all subscribers to the benefits of Measured service. (592)

"The path must be paved toward the System Goal by careful evaluation of strategies. Ratemaking and Rate Case Planning philosophy must be in tune with requirements of Measured Service Pricing. . . . Subscribers will expect to be enlightened on this pricing change and every effort must be made to assure them of the equability of Measured Service."

The plan laid out all of the specifics necessary to implement measured services, from "Public Relations" and "Tariff" issues, but also "Marketing" and even the details of "Network Engineering". (see Appendix X)

And it worked in many jurisdictions. Like fingers from the grave, Ameritech's Investor News, dated November 1993, 14 years later, states that their measured service push was working well. (593)

"Our progress to date — 93% of our business customers and 73% of our residential customers pay for their local calls on a usage-sensitive basis

"Our progress to date" is presented in the exhibit below. As you can see, Illinois and Wisconsin had made measured service mandatory for residential customer, while Indiana's legislature had banned it until 1995. However, all business subscribers in four states no longer have a choice to select flat rate services. (594)

EXHIBIT 124

Ameritech Flat-Rate and Measured Service Status by State, 1993

	<u>Residential</u>	<u>Business</u>
Illinois	99% residential non-optional	100%
Indiana	Banned in legislature until 1995	
Michigan	Above 400 calls per month	100%
Ohio	Residence optional	100%
Wisconsin	100% residence	100%

Source: Ameritech Investors Handbook, 1992, NNI

Considering that this 1979 memo was the working plan for all local Bell companies at the time, and that all Bell company presidents and therefore all future Holding company presidents were at meetings held specifically to discuss current and future business, the Bell system is not only alive and kicking but pursuing the plans of measured service objectives, even years later.

So is Measured Service Better for Customers?

Simply put: The Baby Bells' definition of "progress" is more profits, and according to Ameritech, Measured service was "progress". To understand our contention — that the migration off of Flat Rate Service was not in the best interest of many

consumers or most businesses, a few specifics pertaining to pricing and customer usage need to be examined.

First, almost unanimously, when consumers are given a choice for migrating to measured service from flat rate service, there is little excitement. Only 8% of the population opt for measured service when there is a choice and in some states there have been actual revolts to the idea. This was documented clearly by NARUC in their 1994 Annual Survey of Public Service Commissions. Some states were 'very negative' about switching. Maine even had a referendum in 1986 to abolish LMS (local measured service) (595)

EXHIBIT 137

Some of NARUC Findings About Flat-Rate Service, 1994

- Arizona: Customer response was very negative in 1980; however, there are no surveys more recent.
- Maine: A group opposed to Local Measured Service (LMS) gathered enough signatures to force a referendum question to be placed on the November 1986 Ballot—LMS was abolished.
- Texas: Customer take-rates have been low, political opposition high. A moratorium on measured service is currently in place.
- Virginia: Consumers generally opposed to timed-message rates as proposed by C&P Telephone.

Source: NARUC 1993-1994 Annual Survey of Commissions

If this is the case, then how can could Ameritech and the other Bells move customers off of Flat rate service? The reality, (based on our consumer data, and cross referenced with US Census information) is that the data presented was self-serving to prove the point.

For example, Illinois found that 60% of the residential population will save money with measured service (596)

"According to the Illinois PUC, when asked about consumer response to measured service — 60% had monthly savings."

In fact, NNI found the exact same conclusion, 60% of households have a savings when choosing a measured service plan over a flat rate plan. However, there is a serious caveat, focused on the exhibit below and taken from NNI's consumer research:(597)

Approximately 40% of the population spend 70% of all communications dollars, including calls.

In all telecommunications use there are "active" and "inactive" users. In the exhibit below we find that while almost 60% of the population spent under \$50 a month in 1995, approximately 40% spent over \$50, but generated almost 70% of all the money. (598)

EXHIBIT 126

Spending Power of Telecom Active Vs Inactives, 1995

	<u>Under \$50</u>	<u>Over \$50</u>
% of respondents	59%	41%
Spending Power	32%	68%

Source: New Networks Institute, 1995

Using nationwide averages of telephone services for flat rate vs measured service, we also found in 1995 there was only a \$4.20 difference between flat rate and measured services nationwide. However, when the measured service calls are calculated for heavy and light users, Active users spent on the average \$17 more with measured service.

Therefore, while 60% of the population saves \$4 per month, while 40% of the population paid \$17+ more.

And don't depend on the FCC's statistics on Measured and Flat rate services. They are seriously flawed because the agency uses "the lowest recurring charge." We found a 269% difference in the statistics compared to actual telephone bills. (And the FCC has not changed its methodology in its most recent telephone rate report, dated March 1997.)

The bottom line is that there is serious evidence to show that measured service was nothing but a ploy to make more money for the local Bells, and that the data supplied

was skewed toward proving the point at the cost of large increases to active users, 40% of the population.

However, there are much bigger questions that Measured Service vs Flat rate service bring up — Internet usage, which will be addressed later.

SAVE MONEY: In most regions there are different local service plans. Without getting nauseous, look at your local service plan information in the telephone directory and see if there is another plan that might save you money. Unfortunately, since every state has different plans, a discussion of proper examination might take another book. Join us in requiring investigation of customer charges based on examining flat rate vs measured services.

Also, we believe that the utility should be responsible to tell the subscriber which service will save them the most amount of money and that plans should be required to be designed to save money for customers.

Chapter 40 Toll Calls: "A Big Rip-off"

DEFINITION: "Toll Calls", sometimes called "**RBOC Long Distance**", or "**IntraLATA Toll**", are calls made within a state, and within a LATA, (see definition page) and are between 10 to 250+ miles away from the subscriber's home. The calls do not cross state lines and therefore are not "Inter-state" or "Long Distance" calls.

In 1992, we found that the local telephone company charges for Toll calls were approximately **\$5.9 billion dollars annually** more than if the long distance companies had offered the same service. (599) That number also included the long distance access paid to the Bells.

When we mentioned this fact to a telecom analyst from a respected consulting firm, his reply was "Where have you been? Toll Calls are a big rip-off". (600) By 1996, while some Toll call prices have dropped, mainly due to mandated state reductions, not competition, there are so many caveats to the price decreases that we should explain to the reader just how broken the situation is.

First, Toll Calls still bring in the bucks, about \$8 billion in revenue in 1996. When associated Access fees paid by competitors (of intra-state and Intra-lata) are counted, an additional \$7 billion was also collected in 1996 — approximately \$15 billion in revenues. (601)

We estimate that Toll Call revenues are still being overcharged, and when associated access fees are combined, Toll Call excess comes to \$5 to 8 billion annually. A more accurate number requires audits of costs. In fact, our original study in 1992 can no longer be repeated because the Bells are no longer required to supply detailed Toll call information.

And Toll Calls are still expensive. Some calls, for the first minute, are over 40¢. For example, below are the Toll Call rates for New Jersey-Bell Atlantic, from their 1996-1997 Telephone Directory. It shows that for a one minute call, just 65 miles away from the subscriber's home, the cost was 42¢. While the second minute is less, about half of all calls in America were less than one minute long. (602)

EXHIBIT 127
New Jersey-Bell Atlantic Toll Call Charges, 1996-1997

<u>Miles</u>	<u>First minute</u>	<u>Second</u>
33—48	33¢	11¢
49—64	37¢	11¢
65+	42¢	12¢

Source: Bell Atlantic Telephone Directory 1996-1997

Actual Cost to Offer a Toll Call — Well, "Access" Cost About a Penny.

MCI and others have testified that the costs of Toll Call access fees, fees paid by competitors to offer Toll calls, are exorbitant. MCI also claims that Bell Atlantic-New Jersey charges 7 to 17 times the actual costs, with the cost of Access less than 1¢. (603)

"Bell Atlantic-New Jersey charges up to 7-times the actual cost to connect a local toll call when its actual cost to provide access service is less than a penny. For in-state long distance calling, the overcharge is 17-times the actual cost, money that comes right out of it's customers' pocketbooks."
[emphasis added]

The next exhibit highlight's some of MCI's claims about overcharging on Toll Calls. According to MCI, various states, including Missouri, Texas, Ohio, and New Jersey, are charging excessive toll call and in-state access fees, costing hundreds of millions of dollars to customers. (604, 605, 606, 607)

EXHIBIT 128**MCI's Findings Of Toll Calls Access Fee Overcharging, 1997**

<u>State</u>	<u>Telco</u>	<u>Annual Overcharge</u>	<u>Cost</u>
Missouri	SBC Com	\$ 52 million dollars	
Texas	GTE	\$178 million dollars	>2¢
Ohio	Ameritech	\$ 64 million dollars	
New Jersey	Bell Atlantic	\$108 million dollars	>1¢

SOURCES: MCI press releases, September 16, 18, 1996

MCI blames the State Public Service Commissions, in part, for these overcharges. About Missouri's Access fees MCI states: (608)

"MCI is appalled by today's decision by the Missouri Public Service Commission (MPSC) to dismiss -- without hearing any evidence -- a joint petition from over 30 long distance industry representatives to lower Southwestern Bell's (SWBT) excessive access charges to their actual cost. This decision is a disservice to the great majority of businesses and consumers of Missouri, and constitutes an abdication by the MPSC of its responsibility to protect the public interest and the ratepayers of Missouri."

Toll Call Shell Game — Shifting Toll Call Revenues

Toll Call access charges doesn't tell the true tale of Toll Call overcharging because, more recently, there has been a shell game with other parts of your telephone bill. The original reasoning behind Toll Calls' high prices is that the excess monies are used to subsidize other services. But MCI put it this way:(609)

"In the past Bell Atlantic-New Jersey has made the misleading claim that the access overcharge is needed to subsidize Universal Service. That is an old, tired scare tactic used by the monopoly phone companies to keep this profit center intact at the expense of their captive customers."

In fact, almost all local phone company Toll call reductions have been lowered due to PUC actions, many times just shifting portions of the charges by making a deal to "rebalance" their earnings. Ironically, many of these deals are shrouded with the promise of allowing competition.

In the case of Toll Call competition in California we presented earlier, while there was a drop by GTE and Pac Bell in their Toll Call prices using competition as an excuse...

According to a GTE Telephone Bill, January 1995. (610)

"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."

...the real story was that Basic Service was raised 60% and 35% respectively, and these increases effected 65% of the bill, while Toil call price deductions had little impact. In fact, the average residential subscriber was paying over \$100 dollars more per year, just so that toll call prices would decrease, or they could choose a competitor. Meanwhile only 5% switched to someone else.

Toll Call Marketing Problems: 66 Different Prices Per City

If you examine your local telephone company directory to examine Toll Call prices, you might feel a bit nauseous. When prices are given, they are usually accompanied by endless lists of prices and telephone exchanges, telling the customer which "zone" is in their calling area, etc. For the most part, Toll Call prices are still charged by mileage, known as "zones", and nationwide the average is 11 Zones for toll calls per city, with 11 prices. Worse, most Toll Calls still use a different price for the first and second minute, a throw back to pre-divestiture long distance prices. And there is also

a different price for day, evening, and night rates, with different schedules when each rate is used. Competition has been changing this model, but it is a hit or miss situation, depending on the state.

Extra Digits Stop Competitors

As we discussed earlier, the Bell's have been resisting any competition, especially "dial 1 competition". Dial 1 is the ability for a competitor's service to not require additional five digits to use the service, but have the customer simply pick up and dial the phone. To date the requirement for extra digits is still a state by state battle.

Non-Urban Internet Users Should Really Hate Toll Calls

Probably the worst problem with Toll Call pricing are those it hits the most — Internet and Online users. If you live in a less than urban area, the odds of having an Internet provider within your local telephone calling area, is small. And for those in that situation, the subscriber usually has to use a much more expensive means of connecting. Sometimes it is an expensive 800 service call — expensive because the subscriber will pay for the call with added charges, or they can pay toll call prices, which can add \$20-\$50 a month just in telephone charges. (611)

Dirty Secret: Phone Companies are ROUNDING UP to the Next Minute.

It is a little known fact that almost all Toll calls are rounded up to the next minute. If the call is 2 minutes, 1 second, you pay for three minutes. Or if the call is 5 seconds, the caller realizing that an answering machine has answered, the caller is charged the full minute. (612) Also, on the average, almost 50% of all calls in America are under one minute. This is one reason why most states' Toll Calls have a higher charge for the first minute. (613)

SAVE MONEY: Check you telephone directory to see if the phone company offers packaged discounts on Toll Calls. Also, notice when your discounts start. Some start at 5 PM some start at 8PM. Look for competitors if you want to compare. Then join us as we ask for an investigation and refunds for all Toll Calls charges. (See back for details).

Chapter 41 Digital Spew?

Imagine for a second that you were able to put a charge on the telephone bills. Nothing big. Maybe a few extra calls, or even extra services that the customer never ordered, such as inside wiring. It is something right out of a Superman IV movie where the Richard Pryor character figures out how to program a bank's computer to pay his account excess fractions of a cent from other accounts.

Whether it is done intentionally, just part of the lack of proper bureaucratic examination, total customer confusion, or actual flaws in network design, the truth is that Digital Spew is no only real but quite commonplace.

Forget about B.S. — In the world of telecom, it's D.S.

DEFINITION: Digital Spew (DS) is when the network, (or the telephone company) 'spews' bad data onto the telephone bill, resulting in extra charges to the customer. These can be temporary, as in the case of a few directory calls, or permanent, as is the case with inside wire.

There seem to be two types of Digital Spew:

- "Phantom Charges"
- "Added" Charges"

More recently called "Cramming", this problem is not something new in local telecom. It has just been found by the media, spurred on by a flurry of activity from the Long distance companies, who sometimes switch a person with permission or add bogus charges for unmade calls.

Digital Spew's "Phantom Charges": Charges that Come and Go

Phantom Charges appear to be random and show up on telephone bills sporadically and they are virtually impossible to track. The author's own experience was finding two directory assistance "direct-connect" calls which he did not make. i.e.; "If you wish for us to connect you to that party, we will do it for an additional 35¢".

Though it was only 70¢, the obvious question is "How many other people had these charges attached to their bill that month? Was it just a small technology glitch or did it effect hundreds, if not thousands of people?"

More comical was the 1,057 calls that appeared on Jonathan Berman's telephone bill. According to a New York Times article titled "1057 Calls: A Telephone Bill Is on Hold", (10/19/97) Mr. Berman's bill of over \$220 dollars was the result of over 800 calls that NYNEX could not account for, and that Mr. Berman didn't make. (614)

Digital Spew's "Added Charges": Charges That Were Never Ordered

Previously we mentioned the finding's from our 1993 consumer survey interviews, as well as collections of actual telephone bills. We found that at least half of the consumers who were paying inside wiring charges stated they never ordered the product.

That incredibly high number can be attributed in part to the lack of customer education. For example, many customers see various charges with words such as FCC Subscriber Line Charge, or inside wire charges and have no idea what the fee is for — How can they complain?

How much Digital Spew is produced by the network or through phone company additions? It is impossible to judge the actual depth of this problem without further investigation, and considering that unless there are red flags, such as a subscriber phonebill doubling, the average customer can not defend themselves from the problem.

Save Money: Start reading your telephone bill, especially if the charges are higher than usual. Then join us for an investigation into Digital Spew.

Chapter 42 **Other Services, Other Scandals: Cellular/PCS, Directory and Payphones**

An additional book could be written highlighting what's wrong with the other services including Cellular, Directory Services and Payphones. We'll just highlight what we consider to be some of the most outrageous. Also, we will briefly discuss the differences between Consumer and Business prices. The rule of thumb is that Businesses pay about twice as much for the exact same service.

Cellular and PCS

- **Cellular Services** are the original wireless phone services, that allows the caller to leave their home and use their "cell" phone in their car, or other outside places.
- **PCS, Personal Communications Services**, are the more modern "digital" services, starting to be sold in major cities.

It is a little known fact that the Bells were grandfathered the original Cellular licenses, which are the radio frequencies reserved just for cellular services. These licenses are worth multiple billions of dollars, as evidenced by the billions brought in for the more recent the PCS licenses sales. Yet the Bells received these valuable properties for free.

The obvious question is "How has the Public Interest been served by giving these companies such valuable assets?" We believe that it has never been served and that the Bells should have been required to pay for them, especially since cellular service prices are unregulated.

Also, the licenses, as well as many of the cellular properties themselves, were just pocketed when the Bells spun off their cellular properties or merged. For example, when Pac Bell spun off its cellular activities to form Air Touch, the company's assets were worth over \$7 billion dollars and they only paid California subscribers about \$60 million. (615)

Worse, as mentioned in the regulation section, the audit of Pacific Telesis, found that the Bell had inappropriately charged customers for development of PCS. (616) This identical problem was found in the Ameritech audit by Ohio and Wisconsin. (617)

- **"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

These audits were not repeated in almost every other state, even though the Bell's actions are usually similar if not identical.

Also, Cellular markets were for years a "duopoly", where the Bells owned one company and the others were competitors. For the most part, since the Bells controlled the charges to competitors for connecting to the local network, the price of service never fell very far, the Bells setting the bottom line.

Cellular or PCS Charges — Get Out Your Magnifying Glass.

Then, of course there is the issue of charges. Take out the magnifying glass and you notice that what seems to be a reasonable offer suddenly includes numerous, very odious charges. For example, the Bell Atlantic Mobile advertisement in the New York Post, 11/11/97, gives "100 bonus minutes" if you purchase the "plus 40" at \$29.99. In the fine print (we weren't kidding about the magnifying glass) we find that (618)

- early disconnection of the service plan costs \$175.
- Deposit is required
- all of the minutes **are rounded up** and therefore "the actual number of allowance minutes will vary".
- "Landline, toll, or cellular long distance charges apply" making almost any bonus call cost money. Landline calls are 5¢ a minute, in New Jersey 12¢ a call.

The Bells are not alone in their ridiculous rates, or misleading advertising. AT&T Cellular bills collected in New York City shows that some calls cost almost \$1 per minute, and all of the charges are rounded up. Some other charges and amounts include "Roaming Charges", "Local calls", "Local Cellular Company Long Distance", and

"AT&T Long Distance". And on top of this there are taxes, such as "Home Usage Taxes" or E911. (619)

And the amounts — a two minute call can cost \$1.62, while 27 minutes of Roaming charges came to over \$1 a minute. (actual NYC phonebill charges) (620)

EXHIBIT 129

Selected AT&T Cellular Charges, New York City, 10/97

2 minute call		\$ 1.62
Roaming Charges	27 minutes	\$28.96
Total 46 minutes		\$68.20 Total Bill
Average per phonecall		\$ 1.50 per minute

Rounding up also can add large numbers. For example, according to the customer's bill, the local cellular company long distance calls showed 4.65 minutes of service but 7 minutes of charges, while 8.55 minutes was 13 minutes of charges. In these examples, that's about 50% more costs just for rounding up.

In fact, when the bills were added up, these typical bills showed 46 rounded-up minutes, and the total bill of \$68.20. That's about \$1.50 a minute, counting tax, over \$2.00 a minute when actual calls, not rounded up, are counted.

Is This Reasonable?

Finally, there is the issue of the new "PCS services" the digital wireless services. The Bells purchased billions of dollars worth of PCS licenses. One of the biggest purchase was for almost \$1 billion in licenses to **Primco Personal Communications**, a partnership equally owned by the AirTouch, US WEST venture and Bell Atlantic/NYNEX Mobile. (621)

Obviously, the question of the Bells' ganging together is troubling, but the big question is whether the funds for the licenses were from excess profits derived from I-Way promises, and whether the Bells drove up the bidding to stop other less funded entrepreneurs from entering the markets.

Directory Yellow Pages

It is an industry secret: According to industry analysts, Telephone Directories' profits margins are almost 50% and it has been like that for most of the Bell's life. Most of the money was supposed to go back to pay for other ratepayer services, including Universal Service. However, over the last five years, many of the Bells have been applying for and receiving permission not to give these revenues back. And it varies greatly by state. As previously stated: (622) From the "Joint report issued in 1990 by Public Communications Associates and the Michigan State University Department of Telecommunications")

"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.

Also, the price of Directory Advertisements, according to the Pacific Telesis Audit (623) has risen 250% since 1984, while the development of most new directory products was funded through cross-subsidizing of customers.

Therefore, when the Bells no longer contribute to ratepayers, should the Bells be allowed to continue overcharging customers? And since it is still a most monopoly business, should the Bells be allowed to simply keep the customer base?

Pay Phones — The Telecom "One Armed Bandits" (624)

Probably the most frustrating part of telecom today is Pay Phones. These are the telephones located on street corners and gas stations to stores, and restaurants. And just the name, PAY PHONE, should indicate that this is costing customers money.

Unfortunately, the pay phone market was deregulated years ago and so many of the problems are not simply the fault of the Bells. There are two major complaints:

- **The Phones Just Don't Work.** In this case, both non-Bell phones as well as Bell phones just don't work, or just keep the money. In the case of NYNEX, an independent study by the New York Times (April 19th, 1997) found that over 30% of all phones were not working properly. However, other carriers have been also tied for this honor. (625)
- **Exorbitant Charges** Pay phone charges have always been expensive with many "Operator Assisted", "Collect Calls", or "Long Distance" starting at \$1.50 or more for the first minute. However, many other firms have simply jacked up the prices to dollars per minute. There is virtually little regulation on the pay phone charges.

Business vs Residential Charges

There is little you can say about the disparity of Business prices vs residential prices that makes sense. Below are two customers' bills for the same month, and in the same building. On the average, the business phonenumber cost 125% more, with some services, such as Inside Wiring, costing over 500% more. (626)

EXHIBIT 130

Comparing NY Business to Residential Charges, for 1992

	<u>Residential</u>	<u>Business</u>	<u>% Difference</u>
Basic Service	\$6.60	\$16.56	151%
FCC Line Charge	\$3.50	\$ 4.71	35%
Inside Wire	\$0.99	\$ 6.20	526%
NY Gross Income	\$0.20	\$ 0.22	10%
Call Waiting	\$5.19	\$11.68	125%
Touchtone	\$1.53	\$ 3.08	101%
Municipal	\$0.32	\$ 0.57	78%
NYS/MTA	\$1.07	\$ 1.52	42%
NY FCC Surcharge	\$0.20	\$ 0.31	55%
Enhanced 911	\$0.35	\$ 0.35	0%
State tax	\$1.77	\$ 3.81	115%
Federal	\$0.64	\$ 1.22	91%
Total	\$22.36	\$50.23	125%

Source: NNI, Telephone Bills

And in every state, almost every price for business and residential customers will NOT have the same differences between business and residential services — some higher, some lower. (In a previous exhibit, exhibit 122, featuring Flint, Michigan (Ameritech) and Augusta, Georgia (BellSouth), not one price for Call Waiting, Call Forwarding or Touchtone for either business or residential customers matched in any comparison.)

There are a host of questions this residential and business price differential brings up.

First, there is the entire work-at-home and small business argument, which is that these customers should not have to be paying business rates, especially when using residential lines, and most states do not have a work-at-home rate.

Secondly, one can argue that businesses should not be paying any difference because they use the network more and therefore supply additional revenues with their usage. They also purchase more lines and therefore pay more money — at higher prices.

Also, there is the question of charges for schools, non-profits, etc. While some states have discounts, these are usually discounts off business rates and therefore are usually still more expensive than residential rates.

SAVE MONEY: What's fair and reasonable? We believe that based on the Bell's excessive earnings, the cost of services for the various groups, business and residential, as well as the sub-groups, such as work-at-home and non-profits/schools needs to be examined.

BOOK VII

Customers and Conclusions

Chapter 43 **Consumers And Telephone Service — What They Don't Know Can Hurt Them.**

In order to complete the picture of the Bell's impacts on customers, and what needs to be fixed, we'll like to summarize the NNI consumer data presented and add some new details. We're going to focus on:

- Customer confusion is universal.
- Consumer data supports replacing many state rules, with new federal guidelines, saving on the costs of 50 legal battles..
- State and federal laws are diametrically opposed to customer needs.
- Some groups, such as Seniors, to small businesses users were adversely impacted by Deregulation.
- Since most customers Never wanted the Info Bahn, or really care about competitors, what should happen next?

So let's add some more facts, focusing on NNI's consumer surveys.

Consumers Have No Idea What Anything Costs and Phonebills are Unreadable. (627)

Most people believe that a root canal is more pleasant than reading a telephone bill. Of course it could be because the bill was not meant to be read. Take for example, the next quote from an early Candice Bergen Sprint advertisement, circa, February 1993.

"This is the Structure of DNA. (*Shows Picture of DNA*)

This is a Schematic for the B1 Bomber. (*Shows Picture of B1 Bomber*)

This is a Long-Distance Calling Plan. (*Shows Picture of Long-Distance Plan*)

What do they have in common?

You can't read them."

Sprint Ad, February 1993

The Bells constantly advertise their companies on continual basis. However, the adds focus more on image advertising to extol their virtue — "We're all Together", (628) or the "Heart of Communications" (629). But when it comes to customer education, the companies have been either totally ineffective or totally missing. Why? It could be that an educated consumer is their worst enemy. And just how much the customer doesn't know, allows the company to use this lack of knowledge to their advantage.

What does the customer knows about their charges? Nothing. Nada. Zip. Not a thing. In fact: (630)

0% of the population can answer basic questions about the cost of the telephone services. This includes people who do or do not read their entire bill or the "bill stuffers" i.e.; the accompanying information.

For example, some charges are total ciphers. We found only 28% believe they are paying the FCC Subscriber Line Charge, even though everyone in America pays the charge. Meanwhile, 70% either don't know or think there is no charge. (631)

EXHIBIT 131

Are you Paying an FCC or Subscriber Line Charge?

	<u>Paying the Charge</u>	<u>No Charge</u>	<u>Don't Know</u>
FCC Line Charge	28%	23%	49%

Source: NNI, 1993

While the guesstimates for FCC Line Charges show that it's closer to a flip of the coin than actually knowing the price, the cost of directory assistance faired worse. As we mentioned previously only 2 out of 1000 people were accurate in their answer. Almost half, 46%, thought that directory was free or they received free calls.

Reading the Bill or Bill Stuffer — No Better Answers

You'd think that if someone stated they read the entire telephone bill or the Bill Stuffer, the material that comes with the bill, that they would get more correct answers. Most people believe that the bill is too difficult to read. And only 6% of the population

reads the entire thing. In fact, virtually no one reads the Bill stuffer. And when they do, it doesn't matter. (632)

EXHIBIT 132

What People Read on a Telephone Bill*

Long Distance Calls	31%
Amount Due	27%
Call When and where	15%
Check for Errors	8%
Read it all	6%
Taxes Charges	4%
Other	4%
Local Call	3%
Bill stuffer	1%
Due Date	1%
Total	100%

Source: New Networks Institute, 1993

These findings bring up a specific point. Regulators have failed to make sure that the Bells used some of their ad dollars to educate the customer.

And besides education, the telephone bill and all of its charges are too complicated. In some cases, the definitions of the services such as the FCC Line charges, are so obtuse as to be almost non-sense. And we believe it stops the customer from realizing there's a problem. and then complaining.

No Major Geographic Differences or RBOC Differences — Yet 50 Different State Laws (633)

Regardless of where a respondent lived, in question after question there were virtually no differences in consumer responses. Whether the question was "Are you paying an FCC Subscriber Line Charge?", or whether the customer wasn't interested in new technologies, from Des Moines to Atlanta, there was little, if any, state or regional differences. In the exhibit below, an average of 28% thought they were paying an FCC

line charge, with little regional variation, while an average of 16% of America were 'very interested in videophone", no matter where they lived. (634)

EXHIBIT 134

No Regional Differences for Consumer Responses, 1993

	<u>Northeast</u>	<u>South</u>	<u>MidW</u>	<u>West</u>	<u>Avg.</u>
I am paying an FCC...	27%	31%	25%	29%	28%
Very Interested in Videophone	13%	17%	15%	19%	16%

Source: New Networks Institute, 1993

And there were very few state differences to any answer. The customer in New York or the customer in California had no idea what a directory assistance call cost. In short, while the Bells and regulators yell that their specific fiefdom is different, there were virtually no differences in consumer responses based solely on geography, either by region, RBOC, or by state.

These findings seriously question the need for 50 different state laws, with 50 different legal proceedings. While there are some differences between Rural vs Urban needs, and there are pockets of different group needs, such as Silicon Alley, or more seniors, such as Florida, there is nothing to suggest that there is a need for 50 of everything.

In the most recent challenge of the FCC's interconnection rules, the states complained that federal regulation is improper. We believe that since the customer's desires are quite similar throughout America, then Federal rules makes the most sense, cutting back on fifty costly examinations, and fifty different fiefdoms controls, which has traditionally only helped the Bells.

Age Is One Of The Major Determinants To Consumer Attitudes And Perceptions (635)

Almost all responses to questions pertaining to attitudes show that age, not geography, is the most important criteria for analysis. For example, the younger you are, the more likely you want new technology, cheaper prices, or give lower ratings for telephone and cable companies. The younger the respondent:

- the more "telephone active" they are.
- the more they want new technology, i.e., videophone or movies on demand. This includes everything from the use of answering machines and owning VCRs to custom calling features.
- the less loyal toward their telephone company and more willing to leave for cheaper prices.
- the more they spend on telephone services.

Conversely, the older the respondent:

- the less likely they are to use the telephone a lot. ("telephone inactives").
- the less they want new technology.
- the more loyal they are to their current telephone services.

As we discussed earlier, when consumers were asked if they were interested in Interactive Services, only 82% of 18 to 24 year olds were interested in new services, as compared to only 30% of Seniors. The overall average of non-interested customers was 42%.

The Active vs. Inactive Distinctions

Some customers and families are heavy users of telecom services, while others use it infrequently. And while age is a major criteria for determining attitudes, within the overall population, and therefore each age category, there are two primary distinctions between telephone users: **Actives** and **Inactives**. (636)

The active profile shows:

- 40% of the population are Actives, and they spend about twice as much Inactives, and make 2/3rds of all phonecalls.
- Actives are somewhat younger, but each age group has active and inactive users.

- Actives use many services, such as touchtone and other calling features unlisted numbers, answering machines, make more long-distance calls.

Conversely, Inactives:

- 60% of the population only makes 1/3 of the calls
- The customers only have a few calling features
- Makes much fewer long distance calls.
- Inactives spend almost 1/2 the amount of an Active family.

These distinctions are found for almost all human endeavors, and is commonly known in marketing as the 80-20 rule—20% of the population making or purchasing 80% of all items. For example, an active Mc Donald's customer might eat there 3 times a week, while an Inactive might eat there every two months or less. Therefore, the active customer would eat there 150 times a year compared to the inactive who eats there 6 times. If they each ordered the same meal, the first customer would bring in 140 meals more.

Nothing Matters When it Comes to Consumer Education — Every Group, Everywhere, Doesn't have a Clue. (637)

One very clear point is that nothing matters when it the customer's telephone bill education. From knowing the price of service, such as the cost of directory assistance, to whether the customer is paying an FCC line charge or E911 charges:

NOTHING Matters when it comes to consumer awareness of their Phone Services. NOT Age. NOT Geography. NOT User Groups. NOT Actives of Inactives. No One has a clue.

Notice there is little change between the 6 age groups. Every answer is virtually a "guesstimate". (18-24 years old is the first group) (638)

EXHIBIT 135**Stated they were Paying an FCC Line Charge or E911, by Age**

FCC Line Charge

Average	18-24	25-34	35-44	45-54	55-64	65+
28%	22%	33%	33%	27%	26%	25%

E911

Average	18-24	25-34	35-44	45-54	55-64	65+
37	31%	39%	37%	39%	38%	38%

Source: New Networks Institute, 1993

Consumer Needs Clash with Regulation

Besides the failure of the politicians and phone companies to convince the populace that they should want the Info-Bahn, and besides the fact that Congress and the phone companies keep yelling that competition is good for customers, even if they don't want it and it raises prices, regulation has been anti-customer.

- State Regulations that promised new services were doomed. — there never was consumer interest.
- The Telecom Act of 96 is a bust to date — few care about competition.

Using our findings about Consumer behavior and knowledge, what how has it played out.

How Does Telecom Regulation Impact the Differences in the Customer's "Age" or the "Active" or "Inactive" Distinction?**The Hosing of Seniors: Deregulation and the Break-up**

From the Bell's beginning, the regulations stacked the cards against. Seniors. Historically Seniors, including my Aunt Ethel, tend to be more phone inactive, and so the deregulation of the telephone and wire was nothing more than a dramatic raising of

prices. Seniors didn't know, understand, or care about the changes in these products. They just kept what they had and were severely penalized for their inaction.

As we pointed out, most Seniors were still renting phones even after the price had increased 400%. Also they were not going to rewire their homes, so inside wiring charges mounted up. And when it came to the cost of directory, the Seniors weren't educated to the fact that these services were no longer free. Remember, they had been brought up in an era when Directory was free.

This group has had low usage of Long distance, having been brought up in a time when long distance calls were expensive. Therefore, flat-per month charges such as the FCC line charge, which was to defray long distance charges, as well as the fact that this group rarely qualifies for discount plans, and therefore paid retail, were all new extras that cost Seniors money.

Finally, many state laws required that customers be charged more to pay for the info-bahn, something this group never wanted or would rarely, if ever, use.

Considering that this group lives on pensions, savings and social security, what happened to Seniors ranks as a major scandal. However, the real irony is that many of the regulators mistakenly thought that these were the very people they were protecting, never realizing, or never applying careful analysis to examine the effects their laws had.

"Actives" and Small Home Businesses are also on Hold.

State laws, including the info Bahn Alternate Regulations, have cost this group money in numerous ways.

First, the technology wasn't deployed and this group would been heavy users of advanced services--- so and so they would have had dramatic savings if the promises of the future had actually arrived.

But other costs hit their wallets. To start, the implementation of Measured service, many times mandatory, was just one of the first monetary increases that hit Actives and Small home businesses. As we have shown, the removal of flat-rate service to a per minute charge disproportionately cost more to those who use the phone the most. But this group also pays through the nose for all added features, from Call Waiting to Caller ID. On the home business side, Actives are also strapped with the charges for a second line and installation fees used primarily for fax or the Internet. We have argued that second

installations should never been required because a second channel on the same one wire should have been made available a decade ago.

Topping it off, the FCC has just imposed a new second line tax, which went into effect in 1998.

Universal Service Ain't Universal: Who Has Phone Service?

Probably the most impacted by the high costs of telephone service is a group never discussed: the low income and minority households. Because of the costs of installation and start-up fees, as well as a host of other charges, this group has had the most serious problem — just being able to pay for and maintain service. For example, According to the FCC and Census, only 85% of black households in the US had phone service in 1994. (639)

"Census data show that a smaller percentage of black households have telephone service than other households. In November 1994, about 85.5% of black households subscribed to telephone service."

But a much more revealing statement about the problem came from Larry Irving of the National Telecommunications and Information Agency. (NTIA) Testifying in front of Senate Judiciary Committee hearing about the proposed bills in Congress in 1995, he gave a startling glimpse into the other side of the mass marketplace, that whole areas of America are not as universal as we are led to believe. (640)

"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."

While the overall FCC estimate of households with phone service is 94%, (641) we believe that it is closer to 90-92%, mainly due to the fact that the FCC's statistics are based on census information, and this information has been found to consistently undercount low income/minorities.

And the question of households without phones effects almost all telephone research — especially because it make the picture seem rosier than it really is. For example, NNI has found that many Internet studies done through polling refuse to recalculate their numbers for households without phone service. According to Dr. Donna Hoffman, of Vanderbilt U, the AC Nielsen /Commercenet Internet study did not take into account households that do not have telephones. This problem runs through almost all major studies including the study done by Intelliquest. According to Intelliquest: (643)

"The process begins with the random selection of households using a random digit dial (RDD) approach that creates an equal probability of household selection and prevents non-coverage as much as possible (Waksberg 1978). This eliminates all non-coverage bias except the minor amount introduced by households without telephones." (Rich 1977, Tull and Albaum 1977, Wolfe 1979, Weaver, Holmes and Glenn 1975)
[Emphasis added]

In 1997 there were almost as many people who reside in households without a telephone than there were people using online services!

Chapter 44 Info-Scandal: A CALL TO ACTION

As I stare at my Aunt Ethel's rotary telephone, having cost over \$1,100 dollars or think about the additional charge my parents would have to pay if they wanted Touchtone service (\$1.33 monthly), to put it bluntly, the Bells have not fulfilled their promises of the Information Age. There are no fiber-optic, full-motion, interactive 500 channel services. Yet telephone subscribers paid for it. As Blossom Peretz, New Jersey Ratepayer Advocate told The New York Times about New Jersey/Bell Atlantic's fiber-optic deployment : (644)

"Low income and residential customers had paid for fiber optic lines every month, but had not yet benefited?

In fact, we contend the Bells have cost the average customer hundreds, if not thousands of extra dollars per phonenumber — and it's time to get it back.

The Bells, however, think otherwise. Bell Atlantic, in its "1996 Year in Review" states that they have delivered on their Information Age promises. Headlined "Consumers Use Technology to Prosper in the Information Age", their review states: (645)

"One year ago, Bell Atlantic promised to find more ways to meet the needs of customers who wanted more than "plain old telephone service," and to move them closer to the wonders of the information age.

"Assisted by the growth of computer technology, the Internet and historic changes in telecommunications law, Bell Atlantic delivered on its promise in 1996 by introducing a wide array of services to make life easier for its customers." [emphasis added]

In fact, Bell Atlantic highlights its info age rollout, not with the glitz of full-motion video-on-demand, distance learning, fiber-optic something, or even the extra \$11 billion they had promised to spend, but with an easy-to-use Internet service, ISDN, Caller ID, and of course, voice mail — almost all services developed before the Baby Bells were born. (646)

"In 1996, Bell Atlantic introduced affordable packages for residential ISDN (integrated services digital network) lines to give consumers high-speed connections from home to cyberspace. It launched an easy-to-use Internet access service, enhanced and expanded its own World Wide Web home page and introduced a home page for vendors to sell their products. The company added value to its Caller ID service by expanding the ability of customers to get name information on long distance calls, and the company added new features to its voice mail services to give its customers more flexibility.

"Throughout 1996, Bell Atlantic led the way in ensuring people had the tools they needed to prosper in the information age."

Ameritech's CEO Richard C. Notebaert even scoffed at the idea of bringing new technologies to the customer. At the company's 1997 Annual Meeting, April 16, 1997, he mocked Info Age products, such as videophone. (647)

"Actually, it is still very tempting for members of our industry to let technology drive their strategies. If something is technically feasible, that's what they pursue. Remember Picturephone? Never mind that it didn't meet the perceived needs of customers... or that its' quality level was not in sync with customer demands... or that its' price point was beyond what customers were willing to pay. It was technically possible! So it was trotted out as a brilliant strategic move. But it wasn't.

"Does this mean that Ameritech ignores futuristic ideas -- or that we shy away from technological breakthroughs? Of course not. But we always let customers set our priorities. Because in the end, customers are the ones who are best able to help us build value for Ameritech's shareowners."

This is a far cry from the cover of Ameritech's 1992 Annual Report, promising "Your link to a better life", with a picture of a blonde-haired boy seeing his ethnic, dark-haired friend via a videophone surrounded by various TV screens displaying The Taj Mahal, Rome Coliseum and the Sphinx. The caption reads: "Dear Jason. How's my English? Your Spanish is better since we've been studying geography together." (648)

In fact, Ameritech isn't focusing on anything like fiber optics. The company now has three basic strategies: 1) roll-out voice mail and other calling features, 2) roll out cable services and 3) focus on international business. (649)

"The best place to start is with Strategy One -- to achieve significant growth in our core business. When Heather Kiernan of Glen Ellyn lets Voice Mail pick up the calls she can't get to, she is taking advantage of Ameritech's bedrock capabilities.

"... Actually, Strategy Two is already teeming with success. Take cable TV, for instance. Our Americast cable service is now up and running in more than 20 communities in or around Detroit, Cleveland, Columbus - - and right here in suburban Chicago, where young Jordan Kramer has obviously mastered his Red Jr. remote control!

"Despite some fairly desperate attempts by the incumbent cable providers to stop us, we've already been awarded 34 franchises -- and negotiations with additional communities are going forward full throttle.

"That brings us to Strategy Three -- expanding geographically across America and into countries around the world. And here, too, we are making real progress -- in fact, our international activities contributed more than one-third of Ameritech's earnings growth in 1996." (AUTHOR NOTE: Not profits.)

So much for the promise of the Information Age, huh? No full motion this, no fiber optic that, just plain old voice mail, Caller ID and cable services. Of course three years ago, Ameritech's original "Strategy Two", as stated in its 1993 Annual Report, was all interactive services: (650)

"We will deliver interactive services to homes and business through our new video network. We've stated our position in interactive services for health care administration, education, government, libraries, travel and commerce, as well as entertainment, games and home shopping."

A CALL TO ACTION: We believe there are a series of actions that should be taken immediately.

**Chapter 45 The Problems: Let's Review What's Broken in
Telecom — Well Everything**

- **No Fiber Optic Highway — Just the Same Dirt Road.** To date, there are no plans for any full-blown fiber-optic rollouts, and based on RBOC statements, all the plans have gone decidedly low tech, or no tech.

Where are our 500 Channels? Where are the Interactive Services? When will the monies be returned? It can be argued that telephone subscribers have paid an extra \$120+ billion and received nothing more than Voice Mail and Caller ID at super-retail prices.

- **The Bells Still Can't Deliver Some Basic Services.** From the ability to have two phone calls over the same wire, (so that a second wire, installation and therefore new fees is not required), or the ability to allow customers to keep their phone number when they move, there are numerous things that the Bells should have done, but didn't. Worse, many states still charge for Touchtone Service, the ultimate bad joke of the Information Age.

- **The Bell Have Become Some Of The Most Profitable Companies In America— From Not Deploying New Technology.** An example: The New Jersey consumer advocate in her analysis of Opportunity New Jersey (ONJ) found that Bell dividends were one billion above projections from 1983-1996. Meanwhile, the Bell's fiber deployment was approximately \$1.3 billion short. (651)

- **The Telecommunications Act Of 1996 Was Supposed To Fix Everything, But It Is Seriously Flawed.** The Act was written to bring in local competition and stimulate new technology deployment. Unfortunately, it was based on a series of bad assumptions, and manipulated by a great deal of phone company lobbying —"The most lobbied bill in history", according to Senator Pressler. No wonder there is still no competition almost two years after the fact.

- **NO Second Networks Being Rolled Out.** The basic bad assumption which started in 1991 and was no longer valid by 1996, was that there would be a separate second competing network, such as the cable company or even the electric utility. who would offer local phone service. However, there are no new networks so everything will

still be controlled by the incumbents, the Bells. While wireless may become price competitive in five years, there are no plans for anyone to build a new telephone network, especially rewiring homes. Unless the laws are radically changed, the Bells are still in control.

There are a host of other problems that the bill didn't fix:

On the regulatory side, the Telecom Act kept the Public Utilities commissions in power.

- **State Laws are Many Times Lawless** The Public Utility Commissions have created a patchwork quilt of laws, with fifty different states producing fifty different regulations, many of which seem to only favor the Bells. And many of the commissions have allowed flawed state Alternate Regulations that promised, but did not deliver on, technology or competition. They just only raised prices. How else can Ameritech state: "Federal and State Regulators no longer examine the company's profits." (652)

In fact, state laws are now driving up prices. In California, Pac Tel was barely scratched from competition of toll calls, yet the PUC allowed for a "rebalancing" of the charges on the telephone bill, adding 35% to local service. In fact, in many states, any new funds the Bells lose through a competitor reselling their network will be made up from by new surcharges and additional access fees, thus raising prices.

- **Competitors Have No Room to Move.** Most of the state laws are charging competitors inflated network charges, with very small, 20%, margins to make money. According to competitors, they can not make a profit or charge less than the incumbent when they are paying high fees. MCI states that BellSouth's costs to competitors in Florida totals \$33.83 per line, while the same phonenumber retails for residential customers at only \$14.15 a month. (653) So where are the massive savings to the customers going to come from?

Meanwhile, the state PUC's successfully sued the FCC alongside the Bell companies to stop the FCC's interconnection order, that gave the FCC, not the 50 different states, the right to determine the costs to competitors!

Worse, the pragmatic reality is that massive Bell staff cuts of over 50% (employees-per-line) have left the remaining staff to handle an ever increasing work-load,

and competitor's needs will always be last. Also, the Bells believe the other companies are interlopers and, to date, have done almost everything to impede competitors.

- **Ten Thousand other problems that need fixing** From Digital Spew, the addition of charges on telephone bills that were not ordered, to the erosion of customer service provisioning, the list of what is broken would take up an entire book.

- **Telecom Subsidies are Corporate Welfare Subsidies: A Shell Game with Your Money.** Arguments abound that local service must fund a host of subsidies, such as Universal Service. Meanwhile, there are those that argue that Business customers subsidize residential subscribers and that Urban users subsidize Rural and suburban subscribers.

Unfortunately, after all of the revenues and profits are totaled the only real subsidy is that telephone subscribers are subsidizing the Bell shareholders' excessive profits and entry into other businesses. Without audits and actual costs being analyzed, and to date no total audits exist by any government regulator, all other arguments of subsidy are mute.

- **Consumers Won't Complain— How Can They?** Consumer research shows that the customer is starting to be more concerned about customer phone company services, but there is virtually no concern of who is the utility phone provider. Secondly, customers have no idea about the charges on their telephone bill. They think that rates are protected. Finally, there is no effective voice for change, and so there is no expectation that a revolution is at hand.

Chapter 46 Refunds, Rebates and Lower Prices! — Audits And investigations

The Solution? Start at the Beginning

FIRST QUESTION: Every regulator and local phone company should be forced to answer a basic question — Where is the 500 channel universe and how have the supposedly regulated local phone monopolies become some of the richest companies in America?

Failure to deliver on High Tech Deployment. We believe that \$30-\$50 billion dollars should be refunded for failure to deliver on promised fiber-optic products and services and prices should be immediately lowered. The Bells will argue that their plans changed. That's fine. Just pay back the extra money collected, because the customer never received the items that they were paying for.

\$70-\$90 Billion in Questionable Charges — From excessive profits made from "competitive" services that are not competitive, to cross-subsidization between regulated and non-regulated companies, we've outlined hundreds of problems that should be examined for excessive profiteering and use of the monopoly position to garner profits.

Ameritech stated that "state and federal regulators no longer examine the companies profits" — What are they waiting for?

Step 1:Audits and Investigations

States should investigate all Alternate regulation that have promised technology roll-outs, from early ISDN, to I-Way construction and refund the approximately \$30 billion that was granted due the removal of profit regulations.

In some cases, such as Ameritech, who rollout out cable services instead of full-service network, the monies for these new networks should be refunded to the subscribers, or the subscribers should become de-facto owners, since almost all of the funds came from overcharging.

Congress and the FCC should set-up its own separate investigations, focusing on:

- Fiber-optic technology deployments,
- state PUCs' ability to adequately monitor the Bells, both for company profits and delivering technology.

The Department of Justice should answer the question — "When did the Bells and their consultants know that they wouldn't roll-out the technology deployments and were the documents submitted by the consultants biased or were there "cooked books?"

The IRS, FCC, the SEC and the Department of Justice should investigate the "\$21 billion dollar 'give-away"— which was excess depreciation charges garnered from the Bell's changing their accounting principles prematurely, from a utility to a free market company — and all based on their deployment of fiber-optic technology.

The FCC should be required to get accurate statistics. In 1993, NNI filed a formal complaint with the FCC because the statistics presented had serious flaws. For example, NNI found that the prices listed for items such as installations, could be over 370% from actual costs, or the fact that directory charges were not accounted for in basic telephone service statistics. These numbers hide many of the problems. Also, the FCC does not examine the actual telephone charges someone pays nor do they calculate the profits. In fact, according to a 1992 GAO study, the FCC only completes 17% of the audits it has declared "most critical."

The PhoneBill Audit

Today, No Regulator looks at the entire profits of the telephone subscribers bills, and we believe that an independent analysis will show that the profits are 100% higher than a regulated monopoly should be making.

As we have demonstrated, almost all deregulated product revenues, from Caller ID to Call Waiting were declared "competitive" primarily to fund the I-Way projects. Therefore, all charges should be rebalanced and calculated in the return-on-equity. As pointed out, while Call Waiting may cost the customer \$5, it only cost a few pennies to

provide— and the company pockets the remainder. Instead, all products should be required to fund the basis for the cost of the network.

The FCC and each state should be required to do a cost analysis for all residential and business customers and all services. And all Access fees should be considered pass-throughs paid by customers. This analysis should not include items that are not germane to offering services, from Bellcore Expenses to lawyers and lobbyists, and corporate staff.

Remove all charges for services that have no costs, such as Touchtone Service, or Unlisted numbers, to mention a few.

Repeal all Surcharges and taxes. From the NYS/MTA tax in New York that pays the phone company taxes and gives money to the Transit Authority, to the hard-wired revenues from Deaf Relay to E911, all charges should be a)germane to phone service, and b) all revenues for mandated services should be put up for bid and not direct revenue to the phone companies, c) all services should be examined for profitability to the Bell.

Remove FCC Line Charge and all new FCC additions The Bells are some of the most profitable companies in America. It isn't rocket science to show that an additional charge of \$3.50 per residential line, plus \$6.00 per business lines is one of the ways the Bells are so profitable.

Cross-Subsidization is rampant and unchecked — fix it. Almost every partial audit done to date has shown that the Bell's have charged subscribers for items that should have been paid for by shareholders. And these partial audits should have been repeated by every state, since many of the audits found identical problems.

Step II — Partition the Bells.

Chapter 47 The Holding Companies Were A Bad Idea — It's Time To Separate, Partition, Break-Up, Or Just Get Rid Of Them.

The seven, (now five) artificially created Bell Holding companies have, in almost every way, put shareholders before subscribers. They have drained the local companies of profits, assets, and staff, and used the monies to purchase everything from furniture leasing companies and real estate, to ownership of telephone companies from New Zealand to Czechoslovakia.

In fact, from the start, the Holding Companies have pleaded poverty, but rarely returned the money to the local subscribers in the form of new services. After 13 years we never received the promise of the Information Age, from delivering ISDN to delivery the Info Bahn.

And telephone rates, the money that customers paid, just keeps going up even though every year the telephone network gets cheaper and cheaper to supply basic services. — It's only electrons traveling through wires, controlled by large computers.

In 1992, we proposed "Divestiture II", a plan that would dismantle the holding companies and allow for the local phone companies to be made into local open access companies to all competitors — and have the network costs be 'regulated'. (654) This would allow prices to remain as low as feasible, provide the customer with great service, and allow competition to drive new enhanced services — all over the primary telephone wire — copper. The cost to customers would fall dramatically because the holding companies dividends and markups would be eliminated.

There are others who have said quite similar things, before and after us. For example, Carol Wilson, a columnist for Interactive Week, 7/2/97, wrote an article titled "It's Time to Break Up the Bells", after hearing about the most recent slew of new combinations. She stated: (655)

"If there is going to be true competition for all aspects of communication services right down to basic telephone, however, then we need to talk about breaking up the local telephone companies, not growing them."

She also cites one of the original plans from 1990 by Probe Research. According to Wilson, in their ground-breaking report "Taking Over the Telephone Companies",

Probe "advised the Bell companies to voluntarily divide themselves into wholes and retain units as a way of gaining access to the long distance markets". (655)

More recently, Bob Metcalfe, the inventor of Ethernet, a founder of 3Com, and more recently a columnist appearing in Infoworld, believes that the Number One problem of the Information Age is the phone monopolies and he has proposed what he calls the "Coppertone Decision" to break up the Bells. Using the metaphor of the movie "Star Wars", where the phone companies are the "Evil Empire" in control of "Death Stars", he states: (657)

"It is now clear that to destroy the Death Stars we must split the Telopoly Death Star's wiring plant off into regulated monopolies, separate from their voice services, which can then be opened up to competition."

Another version of this separation is "Loop-Co", proposed by of Roy Morris of US One, a company that tried to be a competitor of the Bells, only to find that in 1997 it was impossible.

"The Loop-co proposal is based on US One's extensive experience. US One has found that ubiquitous entry in local service to be an impossible task with no economic solutions in sight."

Like other proposals, US ONE recommends a separate, unaffiliated local company that would give all competitors a fair chance to use all services. Though the details in all of these proposals might be somewhat different, the main tenets are a separation of the holding company, and the creation of a separate non affiliated local company.

During the editing of this book, LCI proposed their own version of breaking up the Bells, which would separate the wholesale and retail parts of the company. (659) Meanwhile, MCI stated that the LCI proposal didn't go far enough and their sentiments echoes the NNI proposal of 1992 --- full separation of the holding companies from the local phone companies (660)

Far Fetched? Well, remember, the Bells were artificially created and they have just cost customers money. These proposals would remove the Bell's steep dividends,

cross-subsidizations and other problems, and return the local companies to a regulated, read lower cost network for everyone.

Step III

Other Provisions

No Bell Entry into Long Distance The Bell's are currently suing the FCC and parts of the Telecommunications Act, in an attempt to enter the long distance markets. Since there is no other second network being built, and therefore no competition for Access fees, the Bells are still in control and can keep prices inflated. Therefore, the Bells should never be allowed into long distance market because they can and will cross-subsidize these markets with excess profits.

Secondly, their failure to deliver on their promises of fiber-optic and technology deployment should be a trigger that allows them into Long Distance. Until these commitments are met, or until the monies have been refunded, the Bell's should not be allowed into Long Distance.

Bell Mergers Were Never "Merger of Equals" and Congress Should Investigate the Misrepresentation. While the Bells billed their mergers as "a merger of equals", the truth is that they were buyouts purchases, and their statements were misleading. In fact, the companies used this business arrangement so that Congressional approval would not be required. Also, making the companies larger was not in the Public Interest. It has not lowered prices. It just made the monopoly stronger.

Examine the Bell's Impacts on Other "Competitive" Industries. The Bells are currently moving into other industries, from Internet access and Alarm services to the cable industry. Since many of these services are being developed with customer overcharging, all of these competitive areas should be examined.

For example, some of the Bells are including Internet access for free when a customer gets a second line, thus using its regulated monopoly to help sell its non-regulated products.

Bell's Complaint that Internet Usage Costs Money is Bogus. Conversely, any business the Bells' can't conquer they try to squash, such as the Bell's filings with the FCC that they companies are losing money from Internet Use, the onliners tying up their networks with congestion.

The truth is if the Bell's had fulfilled their Fiber optic rollout and upgraded their network as promised, then there would be excess capacity. Ironically, the Bell customers would have spent hours watching movies, which would have created much higher congestion since movies require more network usage.

Also, numerous groups, included the Internet Access Coalition have shown that the revenues from Internet users who have second lines more than adequately compensates the Bells.

Investigate The School Wiring Scandal

Pac Bell promised that all of California schools would be wired with ISDN by 1995. (661) Yet according to CNN (662) only 60% of schools even had computers and only half of those were wired, almost all to POTS. Also, schools that try to get supposed discount rates, are finding that these funds are either tied to specific phone companies, and problems abound from there.

With billions of dollars tied to the new Universal Service fund, or state funding for school wiring, (which is adding new charges on telephone bills,) this entire process is more than another way for the phone companies to make more revenues

Step IV — Next steps

Chapter 48 Fiber-optics Was a Lie. Copper Lives. So Where Do we go From Here?

An entire volume could be added on the various 'future technologies, from XDSL, or to HDTV, etc. (663) However, there is a simple answer — if we wait for fiber we will be very old. So instead, advances in computer technologies increasing bandwidth over the regular copper phone network, will most likely be the theme.

More importantly, the basic services that were not deployed, including two telephone calls over the same wire, or the ability for a customer to take their telephone number when they move, should have already been put in place. But obviously, these simple details were overlooked.

So where do we go from here? It is not technological. It is much more basic...

Enforce the Laws on the Books... Duh?

As stated throughout this book, the Bells have not complied with many laws. They have not fulfilled their "competitive checklist" which would have allowed competitors equal access to the networks, and according to many Internet providers and C-LECs, they are supplying sub-standard customer services.

Also, because of federal and state budgets and politics, important audits have not been done, and billions of dollars are in question. The FCC and state regulators should address these issues immediately, because as more competitors try to enter the market, the worse, not better, the situation will become.

Tear Down the Walls— Remove and Repeal the Rate Doctrine.

Ma Bell, and then her children, the Baby Bells, had over 100 years to build walls around their revenues, using lobbyists and lawyers to carefully create legal and regulatory structures that protect their interests.

For example, the author acted as consultant to a series of court cases that tried to get refunds for telephone subscribers. In one case, the plan was to get refunds for Bellcore expenses that were being charged to all Bell customers but were not related to telephone subscribers. (664)

Even though Bellcore is owned by the Holding companies, the Bells apply the fees to each state, which in turn is charged to customers. However, because of the laws protecting the utility, the cases had to be taken by the PUCs. In the case of New Jersey, it was the PUC that had caused the problems by allowing the charges in the first place and then not examining them since 1985. In fact, any rate the PUC sets can not be sued for, unless one want to sue the PUC, which to date, is incredibly hard and expensive.

Similarly, there is something called the "Rate Doctrine", which essentially states that any rate set by the PUCs is unquestionable, unless there is fraud, even if the data used to set that rate was seriously flawed! — A Rate is a rate.

Like the stone walls of a medieval castle, trying to attack the ramparts is virtually impossible because it is so time consuming and expensive, and the laws for rate on the side of the monopoly, not on the side of the customer.

It's Time for Utilities and Regulators to Get a Conscience

The Bell's threw away their Utility image long ago, and since the 1980's have proven time and again that their first and foremost responsibility was their shareholder, not their subscriber. Downsizing made more profits and helped their bottom line, but also caused many customer service problems. And Lobbying and Lawyers were designed to only remove regulation to make more profits, not deliver better services. From cuts in construction expenses to cross-subsidizing expenses whenever convenient, the Bells all the while used their excess profits to double spending overseas, rarely remembering that their first and foremost obligation was to the public interest.

The copper wire lays there, paid off years ago, and until there is another wire or other technology that replaces it, phone service is destined to remain a utility and a monopoly, with all newcomers simply renting existing lines.

A new test, the test of public interest should once again be applied to everything the monopoly does, this time using fact and not lobbying monies to make laws.

Info-Scandal's Conclusion

It's time to get your money back and break up the Bells — so do something. This book was written with the intention of supplying enough information and hard facts to show that it is time to make serious changes in telecommunications. And by now it must be obvious that those in charge may never get up off their collective butts to do the right thing. Therefore, we are asking every reader:

- who wants to help us get their money back, between \$500 and \$2000 per-line,
- whose school is not wired,
- who is paying for Touchtone, Call Waiting or Call Forwarding charges,
- who has Digital Spew on their telephone bills, that they did not order,
- who is paying an FCC Subscriber line,
- who wants to revoke the "Internet and Small Business Tax",
- who's tired of paying 40% of their long distance bill to the local company,
- Who is paying for a second line (instead of the phone company supplying one line with two channels),
- who is waiting for their 500 Channel Interactive Services,
- who wanted ISDN but it was too expensive or didn't work in their region.
- who had bad phone company customer service,
- who believes the PUCs are not serving the public,
- who believes that Congress should get off its butt and fix the laws,
- who believes that the FCC should supply accurate statistics,
- who believes that the artificial Bell Holding Companies were a bad Idea,

...to join us. The specifics of how you can help can be found on the net:
[HTTP://WWW.newnetworks.com](http://WWW.newnetworks.com) to get more information.

Acknowledgements

First and foremost, I'd like to thank two friends, business associates and allies, Jerry Michalski and Peter Brennan, who helped me battle the demons. Sometimes they created them, acting too well as the Devil's Advocate. But if it wasn't for them, this book would have come out after the next millennium.

And, of course, it goes without saying, that the rest of the telecom mafia must be acknowledged and appeased, for they are the ones who made it clear that the path I had taken would be biting the hand that fed me. To Plakman, Harris, Sieck, Reynolds, Seigal, Rosen, Miller, Haines, Berland and Krasilovsky — all friends and almost all Linksters to the end.

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Let's not forget my Washington "deep-throat" and friend, Cullen McCorry, the crew at Probe, from Victor Schnee to Bernstein and Rita, Gail Koff and Emily Madoff et al, Kiki Ramirez, Southern Man McKnight, Savage, Santa's Banker Jonathan Petersen, my 10th grade English Teacher, the J-Girl, Bruce "phantom" Fancher, and my data babe, Leslie Contini, who supplied me with 12 feet of stuff and counting. And we must throw in Warneldo, Shirley, Leo, Aunt Ethel and Ralph for their support, not to mention Bauer, Serino, Toadman, Angel, Gottenberg, Dern, Ulmann, Cattaneo, Young, Young, Blake-Smith, Gehrie, The Ladies at Bay Ridge Mail, Gehrie, Marcus, Sleeper, Mullis, Berse, Rob, and Rivette, Tonic, Ballan, Contessa, Isenberg, Sue-the-Bells, and Fair Telecom.

There are hundreds of others who were significant along the way, most of whom I would think would rather not be reminded, or at least not mentioned by name. Finally, I'd like to acknowledge my friends who still work for the Bells: Bell Atlantic, NYNEX, Pac Bell, Ameritech, SBC, etc.. They are the ones who climb the poles, go down the manholes and answer the phones. And a lot of them were left holding the bag by the corporate need for staff cuts. I hope you realize that I am doing this for all of us.

Coda: How I Came to Write this Book

I never believed any of the hype of the last seven years, but then again, the story for me started on a cold day in 1992. At the time I was a telecom insider — a respected, high-paid telecommunications analyst, having started as a Senior Analyst for Link Resources, in 1985, and then served as President of Strategic Telemedia since 1987. I was traveling around the world discussing the wonderful new interactive telephone technologies, from Interactive 800 and 900 Services, Caller ID and voicemail, to interactive fax and online services. My clients were all of the Baby Bells, including BellSouth and Pacific Telesis, and the long distance companies, including AT&T, MCI, and Sprint, as well as numerous other non-phone companies, from American Express to The Weather Channel.

Then on a cold day in January 1992, I had a small epiphany over a 37¢ call, of all things. I was examining my company's telephone bills and found a one minute call for 37¢, a call from New York City to Montauk NY, approximately 75 miles away. We had just completed a large study for a long distance company and I knew that a call across America only cost 21¢, and this was almost 75% higher. And when long distance company prices were applied to the same calls, nationally, there was a whopping \$6 billion dollars of overcharging, annually.

But it was a few weeks later, when I examined the telephone bills of my Aunt Ethel, an elderly, legally blind 87 year old woman who walks, painfully, using a walker, that I realized that one of the largest scams in history had been perpetrated on the American public. And it had effected the elderly, and those who can least afford it, the hardest. And it was continuing unabated.

For example, from 1982-1996 my aunt paid over \$1,100 for rental of one rotary telephone (she has two), including \$360 to the local telephone company per phone, and she had paid over \$625 for two "wire maintenance" charges, a service she stated emphatically she never ordered. For the record, in 1993, 25% of the elderly still rented telephones, and almost half of all US households that are paying wire maintenance fees never ordered it. (2)

"Isn't phone service regulated?" She asked. *"I thought they were protecting me!"* my Aunt exclaimed, while shaking her cane.

So, in 1992, feeling deceived by my former clients, and guilty that I had helped them make billions of excess pennies, nickels, dimes and quarters, I left Strategic Telemedia and created New Networks Institute (NNI) to reveal what I had found. Over the next seven years we published the most comprehensive series of reports ever compiled about how the break-up of AT&T and the creation of the Baby Bells impacted subscribers. It is 14 volumes, over 1,900 pages, 910 exhibits, 2,100 consumer interviews, 6,000+ documents examined, two computer databases — and seven years of my life. (3)

And I was summarily ignored by most of the state and federal regulators, Senators, Congressman, and even the press. The first report, "Telephone Charges in America", was published by Probe Research, a respected telecommunications research/publishing firm. It documented that local telephone prices had climbed 275% since 1982, and that information pertaining to telephone prices or revenues provided by government agencies, including the Federal Communications Commission (FCC), was not only inaccurate, but off by billions of dollars.

Probe's own published findings indicated that there had been at least \$35 billion in overcharging from 1984 through 1991. Other groups, including Consumer Federation of America, estimated that there had been \$50 billion in overcharging, including taxes, since 1984.

And overcharging claims continue today. For example, in April 1997, MCI stated that the Bells and other local phone companies were overcharging \$14 billion dollars just for Access fees, fees paid to the Bells to connect your long distance calls.

After sending out hundreds of our research summaries to government officials, state and local advocates, and a host of other groups, the only surprising outcome was that Vice President Gore's Office arranged a meeting for me with the FCC. There, I found that they were totally underfunded to do any accurate information collection.

My information was, in fact, more accurate than the government agency because I had used actual collections of telephone bills from across America, instead of telephone company supplied information. An example: The FCC's information showed that a New York City business Installation fee was \$138.50. When I called NYNEX to order a line, requiring no visit or installation, it cost \$598, tax not included. According to Washington Telecom Week. "Sources at the FCC conceded that the methodology used by NNI was more accurate than their own".(4)

Then in 1993, in conjunction with Probe Research, we published "Consumer Attitudes Toward Telephone and Cable Companies". It is based on a nationwide

telephone survey of 1,000 consumer households, conducted by Fairfield Research. Another similar survey of an additional 1,000 consumers was conducted at the end of 1994.

We found that 0% of the population could read and understand their telephone bills, or could accurately state the price of any service, including directory assistance. Sprint used this research for their Candice Bergen campaign. Our survey question, like their ad campaign, asked: "Do you know how much you pay for long distance per minute?". Virtually no one has a clue.

Also, we found that most people, 71%, couldn't care less about new technology. They just want cheaper prices today, not the Info Bahn tomorrow.

The findings from the first two reports, and comments at our press conference in May 1993, so infuriated Southwestern Bell that they called all of the other telephone companies and told them to stop buying research from Probe. Probe filed a complaint with the Department of Justice, since it is illegal for the Bells to conspire to ruin someone. But it was never acted upon, and Probe decided that NNI's material would cost them more business than it brought in, so they stopped actively publishing the reports. I couldn't blame them.

Around the same time, my phone service was disconnected. I later received a letter from NYNEX stating that it was not their fault. No, a mysterious unidentified third party wanted me disconnected.

"According to our records, the disconnection was arranged by someone that identified herself as your "wife". As you have informed us, you are not married.... The party who placed the call to our office wanted your phone disconnected... The disconnection of your service was not a result of negligence on the part of NYNEX...The disconnection was an act of third party mystery motivation." (SIC)

I had to take the case to the New York Public Service Commission (PSC), and then I had to appeal the decision because the first time the PSC just sided with the telephone company without even contacting me. At the appeal, a year and half later, I learned that NYNEX was in error. But the PSC refused to give me any compensation, stating "We're just a judge, not a consumer advocate per-se." The person who ran the

appeal also informed me later, when confronted, that he had "worked for the telephone company".

Then in 1994, "Regional Bell Revenues, Expenditures and Profits" was published, this time by Phillips Business Information. It received a cool reception even though it documented over \$75 billion dollars in overcharging during the Bells' first decade, 1984-1993. This doesn't include the \$30 billion for the I-Way. It also uncovered the fact that the Regional Bell Operating Companies, (RBOCs), which are holding companies that control the local Bell companies, were draining the local Bell phone companies of staff and all profits.

In fact, an article in the Washington Times even called me a "Phone Bill Fanatic" (5) because I had recommended that the Regional Bells be separated from the local companies to protect subscribers. While most considered the idea "outrageous", over the last few years US West separated their local phone company from other businesses, and Ameritech filed in Wisconsin to create a separate local phone company subsidiary. Unfortunately, none of these companies are doing it in the public interest.

But history and the excitement of the almost imminent Info Highway, with \$90 billion dollars of mergers and over \$30 billion in new promised Info Bahn spending, was upon us and no one cared too much about research.

I also wrote, "The Information Superhighway: Get A Grip" in 1994, which demonstrated that the I-Way plans were seriously flawed and it would never be implemented. There wasn't real consumer interest, the technology costs were much higher than announced, and the filings by the phone companies, written by well-paid consulting firms, including Deloitte & Touche, were biased toward the telephone companies' need to remove regulation and thereby increase profits.

This report was also ignored. However, as fate would have it, some other twists of destiny were upon me. First, being paranoid that the telephone companies had disconnected me on purpose, I wrote a novel "Touchtone", and through a strange connection, my 10th grade English teacher, it is now under development at Warner Brothers as a Made-For-TV movie. The novel is about a telecommunications analyst who finds \$75 billion dollars of overcharging, which results in the phone companies trying to kill him.

Similarly surprising, in 1995 I chanced to see an advertisement by Jacoby & Meyers, which asked "Are you being hit by hidden telephone charges?" After some brief

meetings, we helped to instigate approximately \$5 billion in Class Action suits, hopefully reclaiming some money for my Aunt Ethel.

We are proposing an additional \$30 billion in Class Action suits. Unfortunately, as you will see, regulations, laws and the public utility commissions now favor the Bells, and they work as shields against law suits and reclaiming money.

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- 242 Please note that this exhibit combines revenue from US West Communications Group and US West's Media Group, as well as adding Pacific Telesis with its wireless spinoff, AirTouch.

ENDNOTES**(con't)**

243 When examining revenues, though there are some similarities in definitions for these terms in RBOC annual reports, each RBOC has a different formula for each area. For example, below are two different definitions for the term "Local Service". Ameritech's definition of local service from its 10Q, 3rd Quarter, 1996 includes not only monthly fees and usage charges, installation and connection charges, as well as Public Phone revenues, but also includes sales of Call Waiting and Caller ID.

"Local service revenues include basic monthly service fees and usage charges, fees for call management services, installation and connection charges and public phone revenues. ...Greater sales of call management services, such as Call Forwarding, Call Waiting and Caller ID, also contributed to the increases."

Meanwhile, Bell Atlantic's definition of Local service does not include most calling features, such as Caller ID, or even Touchtone Service. Bell Atlantic 10Q, 3rd Quarter, 1996

"Local service revenues are earned by our operating telephone subsidiaries from the provision of local exchange, local private line and public telephone services."

Because of this disparity in definitions, we will dedicate some time in the next sections parsing the revenues, into various categories.

NOTE: The purpose of this discussion is to give a broad-stroke of the RBOC's earnings and expenses, not a detailed analysis of every line item. For more information see Regional Bell Earnings, Expenditures and Profits. Also, this discussion focuses on information provided in RBOC quarterly or annual reports, filed by the companies with the Securities & Exchange Commission (SEC). Other sources of information about the Bell's revenues include FCC documents titled "ARMIS reports", which are filed quarterly by the Bells on a state-by-state basis. These reports detail many of the specific revenues and expenses by each phone company. However, non-regulated service revenues and profits do not have to be reported.

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- a) The statistics do not always match, even from the same company.
 - b) The FCC supplied information and the Bell companies do not always match.
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 - d) The Bells do not supply break-outs of various data in many categories including local service and the "other" category.
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- 370 ACCESS CHARGES: \$14 BILLION MONOPOLY RIP-OFF, MCI press release 2/17/97

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- 371 Telephone Rate Surveys Ohio Consumer Counsel, (1976-1993) These surveys gives the prices for services in various cities, as well as compares them to a series of states--- the comparison vary based on year. All information quoted is from a specific survey year.
- 372 Advantage Ohio, P.U.C.O. Case No.93-487-TP-ALT
- 373 Robert Harris Berkeley testimony, Opportunity Indiana Part of In the Matter of Petition Indiana Bell, etc.... Petition's Submission of Direct Prefiled Testimony and Exhibits, Indiana Regulatory Commission: Case No. 39705, 6/21/93
- 374 Southwestern Bell 1986 Annual Report
- 375 Southwestern Bell 1988 Annual Report
- 376 FCC's Statistics of Communications Common Carriers, 1995-1996,
- 377 Southwestern Bell Telephone Company 10-K, year ending 12/31/91
- 378 Ibid.
- 379 Ibid.
- 380 Ibid.
- 381 Ohio Bell submitted as part of P.U.C.O. Case No.93-487-TP-ALT
- 382 Testimony of Norman L. Cubellis, Vice president-Regulatory and External Affairs, Indiana Bell Telephone Company, In the Matter of Petition Indiana Bell, etc.... Petition's Submission of Direct Prefiled Testimony and Exhibits, Indiana Regulatory Commission: Case No. 39705, 6/21/93
- 383 Ibid.
- 384 Ibid.
- 385 Ibid.
- 386 Ameritech 1993 Investor Handbook
- 387 Ibid.
- 388 Michigan PSC Assessment of Alternate Regulation, 12/94
- 389 Ibid.
- 390 Ibid.
- 391 Ibid.
- 392 Ibid.
- 393 Ibid.

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- 394 Ibid.
- 395 Audit of the Affiliate Interests of the Pacific Telesis Group, 1994
- 396 Ibid.
- 397 NARUC Staff Audit Oversight Committee Meeting, presented, July 1992
- 398 Audit of the Affiliate Interests of the Pacific Telesis Group, 1994
- 399 Ibid.
- 400 Ibid.
- 401 Ameritech Audit Conclusions Could Turn Tide of Opinion in Congress,
Washington Telecom Week, 4/14/95
- 402 Review of Affiliate Transactions at Ameritech Services Inc., May 95
- 403 Ibid.
- 404 Ibid.
- 405 Ibid.
- 406 Our estimates are based on information supplied within the audit.
- 407 Review of Affiliate Transactions at Ameritech Services Inc., 5/95
- 408 Sources are quotes directly from the Ameritech and Pac Bell Audit
- 409 Competition is Reemerging in the US Telephone Market, Donaldson, Lufkin &
Jenrette 6/7/91
- 410 National Communications Competition and Information Infrastructure Act
of 1993, HR.3636
- 411 The Communications Act of 1994 was the last Democratic version of the future
1996 law.
- 412 Telecommunications and Deregulation Act of 1995 is closer to the version finally
passed in 96 and was based on Republican drivers.
- 413 The Telecommunications Act of 1996 was a Republican based bill.
- 414 The "Competitive Checklist" was around, in parts, during the last five years of
bills. However, it was severely watered down in the Republican versions.
- 415 There were a series of releases pertaining to this trilogy, The place to start,
including the press releases is Report No. CC 97-23, COMMON CARRIER
ACTION, May 7, 1997 COMMISSION REFORMS INTERSTATE ACCESS
CHARGE SYSTEM (CC DOCKET NOS. 96-262; 94-1; 91-213; 95-72)

ENDNOTES**(con't)**

- 416 Senator John Mc Cain, luncheon speech, March 26th, 1997, (broadcast on C-Span)
- 417 Local & Long Distance Telephone Companies Give Record Soft Money During Final Months Of Telecommunications Overhaul, Common Cause, 2/9/96
- 418 Ibid.
- 419 FCC News Report No. DC 96-75 ACTION IN DOCUMENT CASE 8/1/96
- 420 Ibid.
- 421 Kansas City Business Journal, 2/16/97
- 422 Interactive Week, August 30, 1996
- 423 Ameritech press release, October 21, 1996
- 424 From a Single Line to the SuperHighway: Rethinking Universal Service Policy for the 21st Century Consumer, MCI 1994
- 425 Ibid.
- 426 Net Trans Account System proposed by Eli Noam, Professor of Finance & Economics and Director of Columbia Institute of Tele-information, presented by MFS Communications, now part of Worldcom, 1994
- 427 Sources include MCI and Washington Telecom Week, 1995
- 428 See footnote 363
- 429 Larry Irving, was then heading up the NTIA. He spoke at Senator Howard Metzenbaum's Senate Judiciary Committee hearing titled "Telecommunications Industry Regulation", discussing the proposed bill S1822. 9/20/94 (carried by C-Span)
- 430 Documented by actual telephone bills
- 431 The Wall Street Journal, October 24, 1995
- 432 ATSI also published Incidents of Telco Abuse, 6/1/92
- 433 The Big Boys Come Calling---Rochester is Courted by AT&T and Time Warner, Mark Landler, The New York Times, October 23, 1995
- 434 Washington Telecom Week, 10/23/95
- 435 See footnote 433
- 436 Ibid.

ENDNOTES**(con't)**

- 437 This section is based on collections of telephone bills from California customers, telephone bills stuffers and directories, and Pacific Telesis and GTE annual reports.
- 438 Numerous states have done the same trade.
- 439 GTE California residential customer telephone bill, 1/95
- 440 MCI Press Release, 2/6/97
- 441 Ibid.
- 442 Kansas City Business Journal, February 10, 1997
- 443 Ibid.
- 444 Kansas City Business Journal, February 17, 1997
- 445 Advertisement, USTA, 2/97
- 446 Kansas City Business Journal, 2/17/97
- 447 The New York Times, 2/28/97
- 448 U S WEST Communications Asks For Changes to Encourage Competition, Align Prices With Costs, US West press release
- 449 Ibid.
- 450 Interactive Week, November 22, 1996
- 451 Washington Telecom Week, 9/13/96
- 452 Pacific Telesis, 3rd Q Report 1996
- 453 Ibid.
- 454 US West press release
- 455 Telecom Turf Wars, New Networks, released 1995, based on 1,000 randomly selected consumer interviews.
- 456 Ibid.
- 457 Ibid.
- 458 The Wall Street Journal, January 27, 1997
- 459 Ibid.
- 460 FCC Docket 95-116
- 461 MCI poll conducted by Gallup
- 462 MCI press release February 24, 1997

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- 463 Incidents of Telco Abuse, the ATSI, Association of TeleMessaging Services International, June, 1992
- 464 Ibid.
- 465 Ibid.
- 466 Bell may toll for Internet competitors Pittsburgh Business Times 3/17/97
- 467 Telecommunications Act of 1934 is a law established by Congress.
- 468 Ibid.
- 469 Telecommunications Act of 1996
- 470 Decision and Order, Docket No:TO9203058, In the Matter of the Application of New Jersey Bell, Telephone Company for Approval of its plan for an Alternative Form of Regulation, amended 5/3/93
- 471 Ameritech Investor Alert 1/95
- 472 Consumer Federation of America
- 473 Milking the Monopoly: Excess Earnings and Diversification of the Baby Bell Since Divestiture Consumer Federation of America, February 1994
- 474 Excess Profits and the Impact of Competition on the Baby Bells Consumer Federation of America, September 1996
- 475 Consumer Federation of America, 1992
- 476 Consumer Federation of America, 1994
- 477 Milking the Monopoly: Excess Earnings and Diversification of the Baby Bell Since Divestiture Consumer Federation of America, February 1994
- 478 Judge Green's 1987 Opinion
- 479 Ibid.
- 480 Ibid.
- 481 Ibid.
- 482 Access Charges: \$14 Billion Monopoly Rip-off, MCI press release, 2/97
- 483 Probe Research, press release, December 1995
- 485 The Rape of Ma Bell
- 486 Ibid.
- 487 Ibid.
- 488 Ibid.

ENDNOTES**(con't)**

- 489 Anticompetitive and Anticonsumer Practices of the Regional Bell Operating Companies Since the Break-Up of the Bell System. Unity Coalition, 1992
- 490 The exhibit is a composite of overcharging claims by numerous organizations mentioned in previous chapters.
- 491 This exhibit is based on a composite of all Bell Return-on-Equity from 1980 through 1996. The data cross-referenced RBOC annual reports, 10Ks and 10Qs, with the Business Week Scoreboards, 1980-1996
- 492 This chart is a composite of AT&T local service revenues post break-up, using AT&T annual reports, as well as printed summaries by NARUC for 1980-1984. RBOC annual reports were used from 1983-1986
- 493 Business Week Corporate ScoreBoard, 1984, 1985 --- Info for the Bells were compiled by NNI. "All Utilities" and "All Industries" were summaries provided by Business Week.
- 494 Consumer Federation of America press release, 12/10/85
- 495 Summarized from NARUC annual reports, which supplies the information by state.
- 496 Southwestern Bell 1986 Annual Report
- 497 Bell Atlantic 1986 Annual Report
- 498 US West 1992 Annual Report
- 499 Pacific Telesis, 3rd report 10Q, 1993
- 500 This estimation is based on summing up annual reports and is updated from our findings in Regional Bell Earnings, Expenditures and Profits, published by New Networks and available through Philips Business Information.
- 501 US West 1986 Annual Report
- 502 Decision and Order, Docket No:TO9203058, In the Matter of the Application of New Jersey Bell, Telephone Company for Approval of its plan for an Alternative Form of Regulation, amended 5/3/93
- 503 Ibid.
- 504 Ibid.
- 505 Business Week ScoreBoard, 3/3/97 for the year 1996

ENDNOTES**(con't)**

506 Bell Annual Reports summarized. The 1984 through 1991 is an average for all bell companies. 1992 through 1996 are totals for the Bells. Also this is net profits --- after taxes, and all other charges.

507 In two separate reports, Telephone Charges in America, 1982-1992, and Regional Bell Earnings, Expenditures and Profits, we presented, for some 500 pages, a detailed map of the excess profits. Our model was based on two separate methodologies, one, which is the top-down approach to financial analysis, the other which is a "bottom up" analysis,

A Top-Down analysis is relatively simple. The monopoly is supposed to have a steady rate of return, meaning profits, and when this rate of return is exceeded, the companies can be accused of overcharging customers. There is also an analysis of what revenues and expenses constitutes the rate-of-return — were charges foisted on ratepayers that should have been paid for by shareholders?

The Bottom-Up method takes a different look at the problem, examining the minutia and then adding it up. In Telephone Charges in America we created an extensive database of all major charges that appear on a telephone bill, from directory assistance to installation fees. This tedious, but necessary collection was done for every state and therefore, for every RBOC. The data collection spanned 14 years, from 1980 through 1992, (updated for this book through 1997), and was taken from reliable sources, from the telephone directories and actual telephone bills, which was cross referenced with government information, from the FCC to NARUC.

Using this database, we were able to map the increases in prices for telephone services, such as directory assistance or Toll calls. So, we were able to say that the price of a directory assistance call increased an whopping 1326% across America, when an accounting of both price as well as free calls was measured.

508 This exhibit was created by taking the information from the Business Week Scorecard and an average for the Bells by year.

ENDNOTES**(con't)**

- 509 This model is based on using a 13 year average of the Business Week 1000 and the Utilities for "Dividends", "Return on Equity", "Profit Margins", as well as the Depreciation schedules that Consumer Federation and Probe had applied.
- 510 This summary applies the 13 year model described above.
- 511 New Jersey Bell 1994 Annual Report
- 512 Marcopoulos vs the Ameritech et al, Civil Action 96-805 US District Court of New Jersey. Also, Bellcore has an annual report which highlights its revenues and spending.
- 513 CASE 97-C-1297 -Petition of New York Telephone Company for a Declaratory Ruling that the Commission Lacks Jurisdiction over the Sale by its Subsidiary, Telesector Resources Group, Inc. of its interest in Bell Communications Research, Inc., or, in the Alternative, for approval of the Transaction. ORDER DIRECTING DISPOSITION OF PROCEEDS AND APPROVING TRANSFER, November 7, 1997--- NY PSC website
- 514 Audit of Ameritech by NARUC--- Review of Affiliate Transactions at Ameritech Services Inc May 95
- 515 New Jersey Bell 1994 Annual Report
- 516 Ibid.
- 517 see footnote 489
- 518 Sources: Ameritech Audit and the Pacific Telesis Audit
- 519 From Ohio Consumer Counsel Testimony ---FCC "Time Report" letter about Michigan and Ohio Bell, 11/9/92, P.U.C.O Case No. 93-487-TP- ALT.
- 520 FCC letter dated 5/2/90 about Wisconsin Bell
- 521 Ameritech Investor Alert 1/95
- 522 This calculation was summarized in Telephone Charges in America and required a 50 state analysis of toll calls by price and distance as well as revenues. It was based on cross-referencing Bellcore information with a database of prices supplied by NARUC. Unfortunately, the Bellcore information is no longer supplied.
- 523 This information was cross-referenced with other phonebills from across America as well as government supplied information.

ENDNOTES**(con't)**

- 524 Some of the definitions of "Basic Service" varied by state.
- 525 This information was summarized in Telephone Charges in America and compared databases of information for all states, taken from phone bills as well as telephone directories. The information supplied in this book has been updated as of 11/97.
- 526 AARP's 1985 study on phone use by Seniors.
- 527 New York City phonebill, February, 1988
- 528 This exhibit was created directly from telephone bills.
- 529 Consumer Attitudes, 1993
- 530 AT&T supplied product literature, 1982
- 531 These statistics were detailed in Telephone Charges In America. It uses a model that takes the total number phone rentals by year, multiplied by the price charged, then calculates a 100% increase in the price since 1980. The difference between these two figures is the overcharging... i.e. the excess over an increase of 100%.
- 532 Office of Ohio Consumer Counsel publishes annual 'Rate Surveys' giving the prices for phone, electric and gas in a number of areas of Ohio, as well as compared to numerous cities or states in the US. Which information was collected and how it was presented, changed over time.
- 533 Reference Book of Rates Price Indices and Household Expenditures for Telephone Service, The Industry Analysis Division, FCC, March 1997
- 534 NYNEX 1991 Annual Report
- 535 NYNEX Telephone Directory, 1996-1997
- 536 Consumer Union is the source, though the author has not found any corroborating printed material to substantiate the interview.
- 537 This statistic is based on a series of data. First, there is the Consumer Attitudes study by NNI 1993, where we specifically asked about Wire maintenance charges. We found that is few, if anyone, knew if they were paying it. However, when cross referencing actual phone bills and interviews, 70% of the customers were paying the charges, though half didn't know it or stated they never ordered it.
- 538 Linksy vs NYNEX, Supreme Court of the State of N Y County, 8/16/96

ENDNOTES**(con't)**

- 539 The New York Times 11/13/97
- 540 The FCC's statistics for 1995 was \$7.8 billion, NNI estimates that 1996 revenues was \$8.04 billion, based on increases in Bell Access (phone) lines.
- 541 The Tax Bracket, Martin L. Gross, Ballantine Books, 1995
- 542 Ibid.
- 543 Ibid.
- 544 FCC Rate Report, May 1993
- 545 This exhibit is taken from phone bills and was used in Telephone Charges In America.
- 546 The source for this exhibit is phone bills from across America.
- 547 FCC's Statistics of Communications Common Carrier, 1995-96
- 548 Report No. CC 97-23 Common Carrier Action, May 7, 1997 Commission Reforms Interstate Access Charge System, CC DOCKET NOS. 96-262; 94-1; 91-213; 95-72
- 549 Ibid.
- 550 Ibid.
- 551 The Rape of Ma Bell
- 552 Ameritech 1994 Annual Report
- 553 Telephone directories, 1996-1997 editions
- 554 Please note that many directories do not have prices for some services and the variations on which service prices are not listed is virtually endless.
- 555 "Initiating Service" fees average \$10-\$15 dollars per item in 1996-97
- 556 Telephone Directories, 1996-1997 editions
- 557 NYNEX Telephone Directory, Brooklyn, NY, 1996-97 edition
- 558 FCC Rate Report, 1997
- 559 Secondly, the FCC states that the price for touchtone is 48¢. "The average monthly charge has fallen from \$1.52 to \$0.48 over the same period." We believe this is not correct because no charge for touchtone from our survey was below \$1 in 1996. We believe that the number is simply a division of the 95 surveyed cities. Also, many phone companies have just included Touchtone within their local service rates. The FCC

ENDNOTES**(con't)**

- does not track this detail. For example, a phonebill from Bell Atlantic, Lords Valley PA states that "Basic Service includes Touchtone Services, (where applicable)". However, the subscriber's service was not applicable and they were required to pay an additional \$1.33 for touchtone, not to mention an initiating service fee.
- 560 BellSouth's annual reports and 10Ks also supply the number of phonelines.
- 561 Ibid.
- 562 Consumer Attitudes, 1993
- 563 Bell Atlantic 1996 Annual Report
- 564 This exhibit is a guesstimate of the costs without advertising. However, many of these products, from Inside Wire, Touchtone, and Unlisted Numbers have virtually no advertising required to sell the product. And in the case of inside wiring, many people are paying for the service and they didn't even order it.
- 565 The New York Times, 1/14/97
- 566 This information is detailed and originally appeared in Telephone Charges In America. It is based on an data base of the price of all installation fees for all 50 states, business and residential. The sources for this information is NARUC published documents, compiled by Bellcore. The other source used are telephone directories. Unfortunately, both sources do not match, and both were incomplete. The FCC's information also doesn't match and its information is also incomplete.
- 567 This exhibit averages all 50 states' info and uses the national averages for the time required to complete an installation--- the price per hour.
- 568 Phone interview with NYNEX, January 1992
- 569 Ameritech Ohio Bell Telephone Directory, 1992
- 570 The FCC comment is from NNI's FCC meeting, 4/21/94
- 571 Census Information, 1995
- 572 Link Resources Annual Consumer Survey 1995
- 573 The information presented is based on NNI's Telephone Charges Database, 1980-1992, which contains directory charges for every state,

ENDNOTES**(con't)**

- including the number of allowances. The source of this material was the NARUC Annual Surveys. The database was updated for this book, the primary source was 1996-1997 telephone directories, and telephone bills. However, these various sources do not always match, even for the same year.
- 574 Telephone directories and NYNEX telephone bills, 1996-97
- 575 Telephone directories from 1996-1997 editions and NARUC's published annual "Blue Books".
- 576 An average based on 50 states. The primary source: NARUC Blue Books
- 577 Telephone Directories for 1996-1997, NARUC Blue Books for 1983 information, based on 50 state averages.
- 578 First, the "extra cost" is based on 10 calls, and does not include second requests. Secondly, the "increase" is based on 12 calls, including requests. If we used 7 calls, (the national average in 1993) it would be division-by-0, which would not give a usable number, while 10 calls came to 3345% increase, because of the 9 free in 1983.
- 579 To create this information we cross-referenced the Telephone Charges Database which has the price and allowance for all 50 states, with the NNI Consumer Database of consumer responses, 1993. This allowed us to compare the customers' responses to the actual price and allowance for each state and phone company.
- 580 This exhibit is a collection of charges on residential customer telephone bills, 1995
- 581 FCC Rate Report, 1997
- 582 Ibid.
- 583 Actual residential GTE phonebill charges, Los Angeles, Ca. 4/95, 5/95
- 584 Bill Stuffer, NY Telephone, June 1991
- 585 Ibid.
- 586 Bell Atlantic 1991 Annual Report
- 587 Michigan PUC study, see footnote 388
- 588 Pacific Telesis, 3rd Quarter Report 1996
- 589 MCI press release, 3/14/97

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- 590 Probe Research Press Release, 12/95
- 591 Confidential AT&T memo sent surreptitiously to the author.
- 592 Ibid.
- 593 Ameritech Investor News, November 1993
- 594 Ameritech Investors Handbook, 1992
- 595 NARUC's Blue Books, 1993-1994
- 596 Ibid.
- 597 Consumer Attitudes, 1993
- 598 Ibid.
- 599 This information first appeared in Telephone Charges in America and it is based on an extensive database of prices for all Bell Toll Calls, in all 50 states.
- 600 Conversation occurred in January, 1992
- 601 Based on a summary from Bell annual reports, 1996
- 602 New Jersey-Bell Atlantic 1996-1997 Telephone Directory
- 603, MCI press releases, September 16th -18th, 1997
- 604 Ibid.
- 605 Ibid.
- 606 Ibid.
- 607 Ibid.
- 608 Ibid.
- 610 GTE telephone bill, Los Angeles, CA, 1/95
- 611 Numerous articles have commented on this problem and while the amount varies per month, many places simply do not have a local number for access.
- 612 This rounding up problem is inherent in the local phone company's switches. For example, Pac Bell in a recent ruling by the California PSC over Universal Service and school funds, 4/98, stated that they can not bill in increments smaller than one minute, both local and toll calls.
- 613 In Telephone Charges in America we keyed into data bases telephone bills and noticed in our sample, the average was 50% of calls being one minute -- or less. Obviously this varied by person, company, whether they had voice mail, answering machines, etc. However, the overall sum

ENDNOTES**(con't)**

- of calls less than one minute was approx. 50%. This percentage was also found in the average length of Toll Calls based on BellCore information supplied for specific states in 1993.
- 614 1057 Calls: A Telephone Bill Is on Hold, The New York Times, 10/19/97
- 615 The worth of Air Touch is from Pacific Telesis and Air Touch Annual Reports while the settlement number is from the Pacific Telesis Annual Report.
- 616 Audit of Pacific Telesis by NARUC, see foot 395
- 617 Audit of Ameritech's ASI by NARUC, see foot 402
- 618 Bell Atlantic Mobile advertisement in The New York Post, 11/11/97
- 619 Jerry Michalski's Cellular telephone bills from NYC, 8/97 to 10/97
- 620 Ibid.
- 621 Air Touch 1996 Annual Report
- 622 Joint Report issued by Public Communications Associates and the Michigan State University Department of Telecommunications, 1990
- 623 Pacific Telesis Audit
- 624 A quote from Josie Liebenthal, who works at Movies, Movies, Brooklyn, NY 3/24/97
- 625 The New York Times, April 19th, 1997
- 626 New York Telephone Bills from October 1992
- 627 Sprint Television ad featuring Candice Bergen, 2/93
- 628 NYNEX's image campaign running during 1995-96, among other years
- 629 Bell Atlantic's image campaign, 1995-1996, among other years.
- 630 Consumer Attitudes, 1993
- 631 Ibid.
- 632 Ibid.
- 633 Ibid.
- 634 Ibid.
- 635 Ibid.
- 636 Ibid.

ENDNOTES**(con't)**

- 637 Ibid.
- 638 Ibid.
- 639 FCC Rate Report, 1997
- 640 See footnote 349
- 641 The FCC publishes phone penetration by state. However, it is based on numerous caveats and may not in fact be done by the FCC at all but by other agencies, such as the Census group or the BLS, Bureau of Labor Statistics, all of which have their own sets of problems with data collection.
- 642 In 1996, NNI published Reality Check on Online Services, and reviewed over 20 studies. Dr. Hoffman of Vanderbilt U, published a study which discussed the AC Nielsen study that was done for Commercenet, an industry association.
- 643 Intelliquest web site, 1996
- 644 The New York Times, 4/17/97
- 645 1996 Year in Review, Bell Atlantic web site
- 646 Ibid.
- 647 Ameritech 1997 Annual Meeting, 4/16/97
- 648 Ameritech 1992 Annual Report
- 649 Ameritech Annual Meeting, 4/16/97
- 650 Ameritech 1993 Annual Report
- 651 New Jersey Advocate Report, see footnote 82
- 652 Ameritech Investor Alert 1/95
- 653 MCI press release, August 28, 1997
- 654 This plan was originally announced in April 1992 and for it we were called "A phonebill fanatic" by the Washington Times.
- 655 It's Time to Break Up the Bells, Carol Wilson, Interactive Week, 7/2/97
- 656 Probe also published a series of other reports highlighting their proposals.
- 657 From: Internet Futures, by Bob Metcalfe'68 MIT Enterprise Forum, June 26, 1997. Other Metcalfe articles on the topic can be found at www.infoworld.com.

ENDNOTES**(con't)**

- 658 US One went bankrupt.
- 659 LCI's proposal was announced on January 22 1998. The press release LCI Offers Solution To Current Stalemate Blocking Local Phone Competition and the proposal can be found at LCI.com
- 660 MCI's proposal was announced March 24, 1998. The press release MCI Recommends Full Divestiture of the RBOC Network Operations can be found at MCI.com
- 661 Pacific Bell Helps Bring Schools On-line. Pacific Telesis 10Q Report 3/31/94
- 662 CNN, 10/3/97
- 663 XDSL is covers the different types of Digital Subscriber Line offering increased capacity, while HDTV stands for High Definition Television and is a broadcast/cable next generation standard to deliver larger brighter pictures or more channels--- and as of this writing is still not deployed in large quantities.
- 664 Marcopoulos vs New Jersey Bell/Bell Atlantic, see footnote 512

The end