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FEDERAL TELECOMMUNICATIONS LAW:

A LEGISLATIVE HISTORY OF

THE TELECOMMUNICATIONS ACT OF 1996

PUB. L. NO. 104-104, 110 STAT. 56 (1996)

INCLUDING

THE COMMUNICATIONS DECENCY ACT

Volume 9
Document Number
173

BY

BERNARD D. REAMS, JR.
ASSOCIATE DEAN AND PROFESSOR OF LAW
ST. JOHN'S UNIVERSITY IN NEW YORK

AND

WILLIAM H. MANZ
EXECUTIVE LAW LIBRARIAN
ST. JOHN'S UNIVERSITY IN NEW YORK

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INTRODUCTION

AN OVERVIEW OF THE TELECOMMUNICATIONS ACT OF 1996

The "Telecommunications Act of 1996," signed into law on February 8, 1996, opens up competition between local telephone companies, long-distance providers, and cable companies; expands the reach of advanced telecommunications services to schools, libraries, and hospitals; and requires the use of the new V-chip technology to enable families to exercise greater control over the television programming that comes into their homes. This Act lays the foundation for the investment and development that will ultimately create a national information superhighway to serve both the private sector and the public interest.

President Clinton noted that the Act will continue the efforts of his administration in ensuring that the American public has access to many different sources of news and information in their communities. The Act increases, from 25 to 35 percent, the cap on the national audience that television stations owned by one person or entity can reach. This cap will prevent a single broadcast group owner from dominating the national media market.

Rates for cable programming services and equipment used solely to receive such services will, in general, be deregulated in about three years. Cable rates will be deregulated more quickly in communities where a phone company offers programming to a comparable number of households, providing effective competition to the cable operator. In such circumstances, consumers will be protected from price hikes because the cable system faces real competition.

This Act also makes it possible for the regional Bell companies to offer long-distance service, provided that, in the judgment of the Federal Communications Commission (FCC), they have opened up their local networks to competitors such as long-distance companies, cable operators, and others. In order to protect the public, the FCC must evaluate any application for entry into the long-distance business in light of its public interest test, which gives the FCC discretion to consider a broad range of issues, such as the adequacy of interconnection arrangements to permit vigorous competition. Furthermore, in deciding whether to grant the application of a regional Bell company to offer long-distance service, the FCC must accord "substantial

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weight" to the views of the Attorney General. This special legal standard ensures that the FCC and the courts will accord full weight to the special competition expertise of the Justice Department's Antitrust Division--especially its expertise in making predictive judgments about the effect that entry by a bell company into long-distance may have on competition in local and long-distance markets.

Title V of the Act is entitled the "Communications Decency Act of 1996." This section is specifically aimed at curtailing the communication of violent and indecent material. The Act requires new televisions to be outfitted with the V-chip, a measure which President Clinton said, "will empower families to choose the kind of programming suitable for their children." The V-chip provision relies on the broadcast networks to produce a rating system and to implement the system in a manner compatible with V-chip technology. By relying on the television industry to establish and implement the ratings, the Act serves the interest of the families without infringing upon the First Amendment rights of the television programmers and producers.

President Clinton signed this Act into law in an effort to strengthen the economy, society, families, and democracy. It promotes competition as the key to opening new markets and new opportunities. This Act will enable us to ride safely into the twenty-first century on the information superhighway.

We wish to acknowledge the contribution of Loris Zeppieri, a third year law student, who helped in gathering these materials.

Bernard D. Reams, Jr.
William H. Manz
St. John's University
School of Law
Jamaica, New York
April 1997

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TRANSITION IN THE LONG-DISTANCE TELEPHONE INDUSTRY

HEARINGS

BEFORE THE

SUBCOMMITTEE ON TELECOMMUNICATIONS, CONSUMER PROTECTION, AND FINANCE

OF THE

COMMITTEE ON ENERGY AND COMMERCE HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

ON

THE TRANSITION TO COMPETITION IN THE TELEPHONE INDUSTRY: MEETING THE NEEDS OF CONSUMERS

FEBRUARY 19 AND 20, 1986

Serial No. 99-145



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TRANSITION IN THE LONG-DISTANCE TELEPHONE INDUSTRY

WEDNESDAY, FEBRUARY 19, 1986

HOUSE OF REPRESENTATIVES,
COMMITTEE ON ENERGY AND COMMERCE,
SUBCOMMITTEE ON TELECOMMUNICATIONS,
CONSUMER PROTECTION, AND FINANCE,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room 2123, Rayburn House Office Building, Hon. Timothy E. Wirth (chairman) presiding.

Mr. WIRTH. If the subcommittee would please come to order. Today is the first day of 2 days of hearings in which the subcommittee will address several important public policy issues related to common carrier policy.

These issues include the development of competition in the telecommunications industry and how Federal regulatory policies may affect the ability of consumers to benefit from that competition.

As we enter this information age, these issues are crucial not only to the future of this industry, but also to the future of our economy and to the future of all Americans. Our Nation is in the midst of an extremely critical transition to a more competitive telecommunications marketplace. How did we embark on this transition?

During the 1970's, a strong bipartisan consensus emerged on several fundamental policy goals that should be pursued in setting telecommunications policy.

The first goal is to foster technological innovation in order to improve economic productivity and efficiency and to maintain our international preeminence. A second goal is to save consumers money while expanding their choices. And a third goal was to promote universal telephone service to ensure that all of us are connected to family and friends, to work, to emergency services, and now to an increasing array of new and diverse sources of information.

These public policy goals are no longer the subject, nor were they I think ever, of partisan debate. All of us agree that the pursuit of these goals are of paramount importance to our Nation's future growth and vitality.

There has been debate, however, on the best means to achieve these goals, and out of that debate another broad consensus emerged—that competition is the best means for promoting innovation and new technologies, lowering costs and expanding choices

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for consumers, while still ensuring affordable local telephone service.

Consumers have just begun to reap significant benefits from the emerging competition in telephone equipment and long distance. Consumers could reap even more benefits as competition intensifies.

If our future looks so bright today, you might ask, why then are we here? We cannot let the insensitivity of Federal regulators erode consumers' ability to save money, threaten our economic future or jeopardize universal telephone service.

Democracy depends on a well-informed citizenry. We must not allow ourselves to become a society of information-haves and information-have-nots.

And we cannot stand by idly while Federal regulators pursue policies that could undermine efforts to innovate and build our future. We cannot tolerate a rush to deregulate for its own sake.

We are at a crucial juncture in this important transition to competition. Most importantly, we now cannot afford to be complacent. We all must take an active role during this transition.

As our national and international economies rely more and more on the exchange of information, and as our cultural growth and vitality depend more and more on the exchange of ideas, keeping us all connected will be the cornerstone on which we and future generations build a better tomorrow.

I would like to ask if other members have opening statements they would like to make and note, without objection, that opening statements from members here and others will be included at the appropriate point at the beginning of the record.

[Mr. Wirth's prepared statement follows:]

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STATEMENT OF
THE HONORABLE TIMOTHY E. WIRTH
U.S. House of Representatives

February 19, 1986

Good morning. Today is the first of two days of hearings to address the development of competition in the telecommunications industry and how actions by federal regulators will affect the ability of consumers to benefit from that increasing competition.

Telecommunications is the backbone of the emerging Information Age. Telecommunications is also one of the most promising sectors of our economy in the international arena since American telecommunications products and services are world leaders. Telecommunications is a major growth industry that is one of the basic underpinnings of our domestic economy. It is a means by which businesses can cut costs and increase productivity, where computers can talk to computers, and where voice, data, and video can be sent across nations and oceans as easily as they can be sent across town.

But let's not forget where telecommunications most commonly begins -- with the telephone in the home, with the local telephone service provided to consumers.

In the new communications environment confronting consumers, there is good news, and there is some bad news.

The good news is that consumers are benefitting from increased competition. This Subcommittee has supported policies that have encouraged competition for a decade now, because competition yields substantial consumer benefits and spurs technological innovation. In the technically complex and ever-changing world of telecommunications, we sometimes lose sight of why competition is such an important objective. Competition is the fundamental cornerstone of our economy and our free enterprise system. As with virtually every other market, competition in telecommunications results in lower prices and more choices for consumers.

In the days before competition, consumers considered themselves lucky if they could choose the color of the phones that they had to lease from the telephone company. We were limited to rotary-dial or ordinary push-button telephones. Now, we all can purchase telephones from dozens of vendors eager to offer new, innovative features -- such as speed-dialing and call-forwarding -- at highly competitive prices. In the days before competition, we were forced to rely on AT&T for long-distance service. Now, we can save money by choosing from at least half a dozen long-distance companies. Long-distance rates have declined approximately 12 percent during the past two years.

A family who buys its phone (rather than continuing to lease it from a telephone company), and who uses a competitive alternative to AT&T for long-distance, can save hundreds of dollars on their monthly

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telephone bill in just a few years -- even when they use as little as $10 per month of long-distance service.

Everyone can reap the benefits of increased competition -- not just Cliff Robertson, Joan Rivers, and Burt Lancaster. Farmers and fishermen, stockbrokers and secretaries, computer programmers, construction workers and cab drivers, doctors and dockworkers also can benefit from competition. You might not think that these people have all that much in common. But one thing that they do all have in common is their concern about the cost of telephone service.

Which brings me, unfortunately, to the bad news for consumers. We won't continue to reap the benefits of competition unless it develops fully. We are still in the midst of a very delicate transition in the telecommunications industry. In the long-distance market, for example, the recent merger activity reflects the industry's continuing efforts to adjust to competition.

Just because consumers have begun to enjoy the first benefits of the emerging competition, regulators must not rush forward believing that the job is done, that the transition is finished.

For example, the AT&T break-up was clearly insensitive to the needs of telephone consumers. Divestiture unnecessarily disrupted the marketplace; competition could have been promoted effectively by far less extreme measures. You can call it deregulation for deregulation's sake. You can call it going too far too fast. You can call it insensitivity. Call it what you like. But no matter what label you use, the impact of federal regulators' decisions on consumers' pocketbooks is enormous -- involving billions of dollars. Blind allegiance to mere ideology must not jeopardize the ability of consumers to get the most for their dollars.

In addition, we cannot tolerate a situation in which the benefits associated with lower long-distance rates and lower equipment prices are eroded by significant and unjustified increases in the charge for local telephone service. Neither Congress nor the Federal Communications Commission can set local telephone rates. But the issues and policies that we will be considering today do affect local rates.

For example, the FCC's imposition of monthly access charges on local telephone customers has had an impact on local rates. The Subcommittee has dealt with this issue before, by adopting measures that would prevent local consumers from being unfairly burdened with all of the fixed costs of local telephone service. We stand prepared to visit this issue again -- and again -- if necessary.

Regarding bypass activity, the FCC has allowed new tariffs to take effect that could result in bypass of an unprecedented magnitude. At stake is the continued financial viability of the local telephone companies -- and both the cost and the quality of the service they provide is entirely dependent on their viability.

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Finally, in helping to ensure that local rates are kept affordable, we have a special obligation to make sure that everyone -- including the elderly and low-income households, the disabled, and people living in remote rural areas -- can afford local telephone service. Local telephone service is a "lifeline" for millions of people. The elderly or disabled person who relies on the telephone to maintain contact with family, friends and vital medical and emergency services must be able to afford that lifeline. And people living in rural America must not be relegated to the communications "backwater." We cannot allow our society to develop into a nation of Information "haves" and "have-nots."

Today, the Subcommittee will examine several key policy issues affecting the development of competition. We will hear from three former Chief Counsels for this Subcommittee on the efforts of Congress to encourage the development of competition in the telecommunications industry, and how consumers have benefited from these policies.

We will then turn to the issue of how to protect local telephone companies and their ratepayers -- including the elderly, low-income, and rural customers -- during this transition to competition. Key public policy issues include access charges, bypass, depreciation, the FCC's lifeline program, and the local telephone companies' recovery of their fixed costs.

Finally, today's hearing will address the development of competition in the long-distance market. We will focus on the cost and quality of access to local telephone company facilities, long-distance customer assignment, the FCC's so-called "flexible pricing" guidelines, and federal deregulation of AT&T.

Before we begin, I would like to thank today's witnesses for agreeing to provide us with their insights into these complex policy issues that are so crucial to the development of competition in the telecommunications industry.

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Mr. RINALDO. Mr. Chairman, I have an opening statement, but I defer at this point to Mr. Oxley to give his.

Mr. WIRTH. The gentleman from Ohio, Mr. Oxley.

Mr. OXLEY. Thank you, Mr. Chairman. As we embark on 3 days of hearings to relive the halcyon days of the AT&T divestiture, I would urge my colleagues to pause and reflect on what's really going on here.

While I would agree that there may be some areas that are not yet fully resolved in the wake of the breakup, and that there are a number of issues actively being considered by the FCC and elsewhere, I am certainly not aware of any groundswell of support for common carrier legislation in this Congress.

Mr. Chairman, the question cannot help but linger in my mind, what is the real purpose of these hearings? One could certainly make the argument that they serve one major purpose—that is, a political one.

Mr. Chairman, your role in the breakup of AT&T is a matter of history. The record is clear, both in transcripts of hearings and in letters you wrote to the President of the United States and to Judge Greene, in the divestiture proceedings that, first, you urged the case be continued and then said the divestiture was, a "good step" and consistent with the policies you have developed in this subcommittee.

Mr. Chairman, there is no question that customers are beginning to benefit from competition in the telephone industry. There is also no question, however, that a number of problems still remain.

I think we must distinguish between divestiture and competition. I am, and always have been, a firm believer in competition, and I truly believe we could have had competition without breaking up the best telephone service provider in the world.

During my 3 years on this subcommittee, I have learned a great deal about the divestiture, both the events leading to it and its aftermath, and about the telephone industry in general. I think what most struck me, however, is the inordinate number of acronyms used when describing the phone industry, many of them just different versions of the same thing.

We have the RBOC's, also known as the RHC's, which are not to be confused with the BOC's, all of which, of course, were spawned by the MFJ which arose from an agreement between DOJ and AT&T.

We have LATA's—divided, of course, into inter-LATA's and intra-LATA's—ENFIA—since apparently changed to the more appealing, if not somewhat misleading term "equal access," a concept that more acronyms like MCI, GTE and other OCC's, are trying to come to grips with.

The confusion we in Congress face with this maze of letters and terms is nothing compared to what the average telephone customer has had to face in the wake of the divestiture.

Our proverbial little old lady in tennis shoes is the one who faces these problems. Customers are faced with choices and are forced to make decisions they had no expectation of ever having to make prior to the breakup.

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I believe, Mr. Chairman, as I have stated earlier, that efforts to reopen these issues are certainly political in nature. But if we are going to revisit history, I hope we will not try to revise it as we go.

Thank you.

Mr. WIRTH. Mr. Bryant.

Mr. BRYANT. Thank you, Mr. Chairman. I would like to thank the chairman for calling these hearings today to look at the state of the telephone industry 2 years after the break up of AT&T and express my sincere regret that the chairman would have to field suggestions, to put it mildly, from the gentleman from Ohio that there would be a purpose for these hearings other than to oversee the state of the telephone industry at this critical juncture.

And I would point out to the gentleman from Ohio, and any who might be persuaded by his characterization of this hearing as political, that the chairman would have been quite remiss not to follow through and have these hearings.

I would also point out to him that the studies done by Booz & Hamilton that were commissioned by GTE/Sprint, as well as numerous other studies, have indicated that the state of the other common carriers who compete in the long-distance business with AT&T is critical at this stage, that in fact even under the best, most optimistic, in fact unrealistically optimistic, assumptions most of those companies are either in serious trouble or going to be in serious trouble unless this Congress acts or unless we get the FCC to do its job and act.

We are facing a critical situation with regard to telecommunications in this country that the chairman has recognized in calling this hearing. I would have to say that if anyone wants to play politics, the best thing to do would be not to have a hearing at all, and not to bring the issue up at all.

So I very much regret and disagree with, and object to, the characterization of the calling of these hearings as being political.

I commend you for calling these hearings, Mr. Chairman. With just over 2 years of a divestiture environment behind us, it's a perfect time to take stock of where the industry and the marketplace are at the present time and where we are going.

As you know, I've had a particular interest in maintaining competition in the long-distance market and protecting ratepayers from unnecessary rate increases and preventing any decline in subscribers due to such increases.

To support these ends, I have authored and cosponsored legislation to impose conditions on the industry and responsibilities on Federal and State regulators to ensure the survival of both competition and universal service. In my view, it is clear that the purpose of divestiture was to benefit consumers and competitors.

Yet, to date neither have been as well served as had been hoped.

And I would point out in response to a comment made earlier this morning—I think the gentleman from Ohio stated—that it's a shame that they broke up the telephone system, we could have had competition without breaking up the best phone system in the world. I don't know anybody who doesn't in some way or another regret the break up of AT&T, but apparently the Court found that we couldn't have competition in view of the way AT&T managed

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its business and continually violated the commercial laws of the United States.

That's why the telephone system was broken up, not because of this Congress, in spite of the constant assertions by others that somehow Congress had something to do with it.

I would point out, Mr. Chairman, that recent surveys by the Consumer Federation of America reveal that rates have gone up from 35 to 52 percent, with an average local increase of $3.74 per month since January 1, 1984. That is not a result that we had hoped for.

Also, the Consumer Federation of America studies indicate that the percentage of households with telephone service has leveled off, if not actually declined, since 1980 census figures showed that 93 percent—that 93 percent of residences had phones.

I would like to find out in these hearings if that is the case or not. I would point out there are some bright spots as well, for example, the study by the National Strategies and Marketing Group finding that if consumers use the advantages offered by competition and purchase their phones rather than continue to rent them, and shop for an alternative long-distance company, they will save money. I think we are going to hear more about that today as well.

Mr. WIRTH. Mr. Rinaldo.

Mr. RINALDO. Thank you, Mr. Chairman. Since the previous speaker has discussed what he considered a problem in the characterization of the hearing by the gentleman from Ohio, perhaps I can endeavor to clear that up.

I'm looking forward to the testimony we will be taking today and tomorrow, as we examine the status of competition in the telephone industry. In my opinion, our obligation is to place on the record accurate information about divestiture, be discriminating about those things that require congressional attention and those that don't.

And I think the problem and the consternation on the part of the majority can perhaps be cleared up, Mr. Chairman, if you will be kind enough to engage in a short colloquy with me regarding this particular hearing.

Mr. WIRTH. I'm always delighted to have colloquy with the gentleman from New Jersey.

Mr. RINALDO. Thank you.

The first question we would like to know is has any legislation been introduced concerning divestiture, competition, or any of the areas that you mentioned in the opening statement that you gave?

Mr. WIRTH. There have—if the gentleman will yield——

Mr. RINALDO. Yes, I will be pleased to.

Mr. WIRTH. A number of pieces of legislation have been introduced by various members of the subcommittee. In addition, various members of the subcommittee, minority and majority, have expressed an interest in concerns related to competition, the status of the BOC's and so on, and have asked me personally if we would please have hearings on those and other issues.

Mr. RINALDO. Are any of the bills that you just mentioned going to be the subject or focal point of these hearings?

And if so, which specific pieces of legislation?

Mr. WIRTH. We are not focused on any specific legislation. As the very thorough briefing document that was sent out to all mem-

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bers—I think it's about a 40-page document outlining the history of several issues what the remaining issues are, what members have been concerned—as that briefing memo very carefully and torturously points out, there are a series of issues which we face today that are related to the status of the BOC's, the request for the BOC's to be allowed to move beyond some of the constraints of the modified final judgment set up by Judge Greene. In addition, there are many concerns related to competition in the long-distance market, concerns related to "lifeline" telephone service and concerns related to the employees of AT&T and the BOC's.

And finally other issues have been brought to my attention by members of the subcommittee and are outlined in that every extensive document to members attempting to give a perspective on the vortex of issues that is now focused on the subcommittee.

Mr. RINALDO. Does the chairman or the majority plan as a result of these hearings to introduce any legislation, to push any legislation?

Or, does the majority feel compelled to enact any kind of legislation this legislative year in response to the subject areas you mentioned?

Mr. WIRTH. I think it's premature to suggest that. I would only go back and quote the gentleman, if I might, from his opening statement, that our first obligation is to place on the record accurate information about divestiture and to be discriminating about those things that require congressional review and oversight and those that do not.

Mr. RINALDO. I was pleased to help you repeat the first paragraph of my——

Mr. WIRTH. Well, I thought the gentleman's statement was accurate. We do have the obligation to place on the record and develop information about what may or may not be going on, and to——

Mr. RINALDO. That isn't in my statement.

I want to thank the chairman. I think that at least sums up, and perhaps answers, some of the concerns that we had on this side of the aisle.

So I think that what it really boils down to is that this, at the very best, is an oversight hearing. There is no legislation that is the subject matter of this hearing. There is no legislation at this point in time at least that the majority intends to push or would like to see enacted this year.

And I would like to make one thing clear from the outset. We are now in the beginning—we are still in the beginning of a new era in telecommunications. And I believe it would be premature at this point in time, this legislative year, for this subcommittee to recommend legislation to deal with any so-called problems, many of which may prove to be transitory without giving divestiture a chance to work and the FCC to do their job.

I don't think there can be any question whatsoever about what took place in 1984 or in 1985 as we move from monopoly to competition in the telephone industry.

There was confusion among consumers. And that was expected. But much of this had to happen when we altered a system which affected nearly every American and which was so much an accepted fact in our daily lives.

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I think right now we are beginning to see the results of real competition and the benefits that will come along with that competition.

For the most part, the FCC has acted responsibly in minimizing the disruptions of competition to the consumer. The modification of the access charge order, the decision on competition between AT&T and the OCC's, the decision two months ago on life line; these are indications I think that the public interest is being served as we enter this new era of competition.

From 1982 to 1984, the number of OCC customers doubled from over 2 million to over 4 million, and revenue increases were even higher. In the same period, they rose from $1.6 billion to about $5.5 billion.

And the OCC's themselves invested about $3 billion in new facilities and equipment in 1984.

At the same time I think we have to remember that the United States is just one member of an international telecommunications marketplace. The competition we encourage domestically will make us stronger in international markets.

In fact, the Energy and Commerce Committee recently reported legislation, H.R. 3131, that builds upon an earlier proposal that I had introduced for a fair system of international trade in telecommunications. So, I think we should approach these hearings with a comprehensive and balanced outlook about what the needs are, what's already been done, what the FCC has done, what can be done, and whether or not anything should be done in the future.

Mr. Chairman, I look forward to the testimony we will receive over the next few days so that the members can have the benefit, you might say, of this educational type of approach to an event that has already taken place.

Thank you.

Mr. WIRTH. I thank the gentleman for his very constructive opening statement and would again point out that the thrust of these hearings are not to readdress divestiture. That has come and gone. But rather to look at the status of competition in marketplaces and how that may be impacting on such issues as access by all people to telephone service, the status of competition in long-distance and other important issues.

The gentleman from Massachusetts.

Mr. MARKEY. I thank the Chairman very much. And I thank him for conducting these hearings as well.

And I would restate just for a bit of historical perspective that it was not the U.S. Congress that broke up AT&T, it was the Department of Justice working with the Federal courts. And our role here in the Congress I believe is to monitor very closely activities which are transpiring right now in a very volatile economic climate that have profound long-term economic consequences for this industry and for consumers in the country.

There are tremendous choices that are being made out there right now with regard to opportunities made available to consumers and regulations, rules being applied by the FCC in terms of their decisions as to how competition can, in fact, be fairly created out in that hard, tough world that competitors to AT&T have to compete.

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And so there are, in fact, real issues that have to be dealt with here. And, in fact, Mr. Chairman, legislation might have to be considered before the end of this year. I don't think that we should rule that.

I think that it should, in fact, flow from the types of testimony which we hear in these next few days. But I think that, in fact, you are providing a public service for the Congress and for the public in conducting them, because that is our job.

Our job is to put a spotlight on important public policy issues. It's not to abrogate it to executive agencies. After all, we are ultimately responsible.

And it is then our job I think to take control of these issues and to ensure that, in fact, the consumer is ultimately the beneficiary. So, I welcome the inquiry into the progress and the pitfalls of deregulating the U.S. telecommunications market.

I know that you have had these hearings scheduled in the past and that because of circumstances beyond our control we have had to cancel them. And so I'm glad that we have been able to now put them on the schedule and begin this process.

Although we are making progress towards our ultimate goal of a truly competitive telecommunications market, the situation is still not stable. For example, in the long-distance market, AT&T still controls 90 percent of the market and retains enormous advantages over its competition in areas such as capital resources and customer marketing.

Before divestiture, AT&T was Ma Bell, someone who was always there when you called, reliable as your mother. But she's not our mother anymore. She's not even family. She is a giant stranger. And her presence in a deregulated marketplace raises the fear that she will trample the so-called competition which is the fear that all of us have I believe.

And as a result, it is the job to have that kind of check maintained within the economic climate. Given the circumstances we, as public policymakers, must face the possibility that all the good associated with competition can quickly turn into a disastrous defeat for consumers if the deregulation process is mismanaged.

Another example of instability is the local exchange carriers which are caught in a peculiar economic dilemma. On the one hand, they are threatened with the loss of business customers who can avoid the cost of access charges if they bypass the local exchange. As the pool of remaining users shrinks, the BOC's will be forced to charge higher and higher rates to pay for their plant and their equipment.

On the other hand, many BOC's are planning to cater to those business customers by providing the bypass equipment themselves, thereby encouraging bypass of the switch network.

Consumers can easily get stepped on during this delicate dance. It is ironic that the role of the regulator has only grown as deregulation and divestiture magnify these economic strains.

Each act or failure to act gives advantage to one competing interest or another. The consequences of poor judgment can be monumental for consumers and competitors alike.

This is why I am particularly disturbed by the manner in which the Federal Communications Commission is treating the issue of

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bypass. The Commission knows how serious it can be if its bypass decisions are flawed.

Yet current practice at the FCC, as demonstrated most recently in the so-called Megacom and SDN tarriff proceedings, is woefully inadequate. The Commission allowed the Megacom tariff to become effective without any public hearings or investigation. And it allowed the SDN tariff to take effect without a hearing.

Moreover, it made clear in its SDN order that even if it had found injurious impacts from SDN it would have still allowed it to go ahead as a new service. It is folly to treat AT&T's request to initiate bypass activities as routine tariff proceedings.

AT&T's reach is nationwide. And its capital assets dwarf its competitors. When it proposes a service to bypass the local switch network, the FCC has before it the largest telecommunications company in the world and a threat to local telephone rates, which is widely considered to be potentially one of the most serious in the market today.

To restore a process of considered deliberations at the FCC, I introduced legislation, Mr. Chairman, and for the information of the minority, this week to require the FCC to give a hard look to tariffs proposed by AT&T whenever they threaten to lure key customers away from the local exchange.

Instead of placing the burden on the public to show why a bypass tariff should be suspended and investigated before it becomes effective, my bill would place that burden where it belongs, on the FCC and AT&T.

In 1986, we will approach or pass such milestones as implementation of common carrier equal access, increases in subscriber line charges, and reconsideration of line or business restrictions on the Bell operating companies. We still have no effective national life line requirements.

These hearings can lay the foundation for establishing a more coherent Federal policy, one which encourages competition and technological innovation but which is also sensitive to the limitations of laissey faire economic doctrine.

I look forward to exploring these issues with the witnesses here today and in the ensuing days, and I again want to congratulate you on an important set of hearings which I think will be looked at by this entire country as the key oversight into what has taken place in one of the most important industries in this country.

I thank the Chairman.

[Mr. Markey's prepared statement follows:]

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EDWARD J. MARKEY
7TH DISTRICT, MASSACHUSETTS

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COMMISSION ON SECURITY AND COOPERATION IN EUROPE

Congress of the United States
House of Representatives
Washington, DC 20515

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WASHINGTON, DC 20515
(202) 225-2836

DISTRICT OFFICES
2100A JOHN F. KENNEDY BUILDING
BOSTON, MA 02203
(617) 223-2781

464B SALEM STREET
MEDFORD, MA 02155
(617) 395-4800

OPENING STATEMENT OF
EDWARD J. MARKEY

AT HEARINGS OF THE
SUBCOMMITTEE ON
TELECOMMUNICATIONS, CONSUMER PROTECTION AND FINANCE
February 19 and 20, 1986

I welcome this inquiry into the progress and pitfalls of deregulating the U.S. telecommunications market. Although we are making progress towards our ultimate goal of a truly competitive telecommunications industry, the situation is not stable. For example, in the long distance market, AT&T still controls 90 percent of the market and retains enormous advantages over its competition in areas such as capital resources and customer marketing data.

Before divestiture, AT&T was Ma Bell--someone who was always there when you called, reliable as your mother. But she's not our mother anymore. She's not even family. She's a giant stranger, and her presence in a deregulated marketplace raises the fear that she will trample the so-called competition which is supposed to hold her in check. Given these circumstances, we, as public policy makers, must face the possibility that all the good associated with competition can quickly turn into a disastrous defeat for consumers if the deregulation process is mismanaged.

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It is ironic that the role of the regulator has only grown as deregulation and divestiture magnify these economic strains. Each act, or failure to act, gives advantage to one competing interest or another. The consequences of poor judgment can be monumental for consumers and competitors alike.

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This is why I am particularly disturbed by the manner in which the Federal Communications Commission is treating the issue of bypass. The Commission knows how serious it can be if its bypass decisions are flawed. Yet, current practice at the FCC, as demonstrated most recently in the so-called "Megacom" and "SDN" tariff proceedings, is woefully inadequate. The Commission allowed the "Megacom" tariff to become effective without any public hearing or investigation, and it allowed the "SDN" tariff to take effect without a hearing. Moreover, it made clear in its SDN order that even if it had found injurious impacts from SDN, it would still have allowed it to go ahead as a "new service."

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In 1986 we will approach or pass such milestones as implementation of common carrier equal access, increases in subscriber line charges, and reconsideration of line-of-business restrictions on the Bell Operating Companies. We still have no effective national lifeline requirements. These hearings can lay the foundation for establishing a more coherent federal policy--one which encourages competition and technological innovation, but which is also sensitive to the limitations of laissez-faire economic doctrine. I look forward to exploring these issues with the witnesses. Thank you.

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Mr. WIRTH. Mr. Tauke.

Mr. TAUKE. I thank you, Mr. Chairman. As I look at the number of people here, I'm not sure if we will ever get to the witnesses. But I will nevertheless share a couple of observations.

Nobody ever said it would be easy. And, in fact, it has not been easy to move from the era of a monopoly to the era of competition. Of course, we haven't arrived yet at the era of competition. We still are in that transitory stage.

But already we are beginning to see some of the benefits that are available to consumers because of competition, and we know what the problems would have been for the telecommunications industry and for consumers if a monopoly had been allowed to remain in place.

There is a lot of blame that can be passed out about some of the problems that have arisen as a result of the movement from a monopoly to a competitive arena. But today for a moment I would just like to suggest that things haven't turned out nearly as badly as most of the people on this panel predicted years ago.

I can remember many hearings that we sat through in which witnesses and Members of Congress, including yours truly, made dire predictions about some of the problems that would befall the telephone consumers of the Nation and the telephone industry.

I'm not here to tell you all is well, but I will say that all isn't as bad as we thought it would be. And so it does seem to me that today as we look at the—where we are in the transition from monopoly to competitive arena that we can say that we have made substantial progress, we have come a long way.

Obviously, some fairly decent decisions were made along the way. And hopefully, we can be helpful in guiding some more of those decisions in the right direction.

One thing that is somewhat distressing, it seems to me, is that Congress has not been a significant maker of policy, if you will, in the telecommunications arena over the last several years. In large part, we have allowed that policy for a variety of reasons to be made by the courts and to be made by the regulatory agencies.

We have allowed ourselves to fall into a role where we are helping shape that policy, but because of a whole variety of procedural problems in the Congress we haven't been able to make that policy and give the direction that we should to the courts and to the FCC.

And I would hope that over the next couple of years that Congress would be able to develop better policy direction in the form of legislation for the courts and the FCC so that we can exercise our role in a way that goes beyond simply beating up on those who have to make the tough decisions, which has been pretty much what we have confined ourselves to over the last few years.

It's tough, obviously, to try to get the Congress to make these kinds of policy decisions, but I do think it is our role. And I hope that this is a start of trying again to address some of those difficult issues.

Let me just observe that I do have one bill, H.R. 3800, which speaks to the issue of the Bell operating companies and the restrictions imposed by the MFJ. I think there is other legislation that is needed.

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For example, in the area of transition in the long-distance arena. It seems to me that some direction needs to be given to the FCC. Small rural telephone companies still have concerns that could be addressed by policymakers. And we could all go on.

But I know you didn't come here primarily to listen to my views, which you can hear quite frequently, but to hear what witnesses have to say. And that's why I came, too.

So thank you, Mr. Chairman.

Mr. WIRTH. Thank you, Mr. Tauke. And your concerns and views have always been taken very seriously by the subcommittee, so much so that the issues addressed in your legislation, H.R. 3800, are the subject of a hearing scheduled early in March.

Mr. Synar.

Mr. SYNAR. Thanks, Tim. I would like to say three things.

First of all, I don't subscribe to the ostrich theory of oversight in legislation, which is that you shouldn't look at these issues as some have advocated, and these are not serious hearings.

Folks, the facts of the matter are that Tom, and Al, and I, and John have been beating on Tim to have these hearings, as well as a number of other members, Republicans and Democrats, because of the seriousness of the issues which we face.

Now, I'm not—you know, politicians by their very nature are pretty sold on themselves and sometimes egotistical, but I'm going to admit to you there's a lot of things about this industry and what's going on that I don't understand, and we couldn't have enough hearings for someone like me to get a better feel for what needs to be done. And obviously, I don't want to legislate out of a vacuum of no knowledge or limited knowledge.

So, I'm glad we are having these. I'm sorry it has taken us so long to get here from November. But I'm glad we are going to do it.

There's problems. Everyone who has spoken this morning has talked about them. I would just point to the fact of the merger fever that's going on in this country with respect to this industry, GTE–U.S. Telcom-Lexital, Allnet, IBM–MCI.

That doesn't happen where a thriving competitive situation exists. And if for no other reason than that, I think we ought to look at this. And I think we ought to review it.

So, I'm glad to be here. I've got a lot of questions. Tom mentioned right before at the end of his statement that he thinks some long-distance changes are necessary. I agree.

I've got some legislation that we are floating around that we are going to ask questions with a number of the witnesses later this afternoon. So, let's get on with it. I'm glad we are having them.

Mr. WIRTH. Thank you, Mr. Synar. And I might note for the record that these hearings were initially scheduled for November, and we couldn't have them then because the Chairman of the FCC was not available.

And out of courtesy to him, we delayed the hearings until early 1986.

Mr. Bliley.

Mr. BLILEY. Thank you, Mr. Chairman. Mr. Chairman, I must admit that I am a little bit confused about why we are holding hearings on the telecommunications industry in the postdivestiture era.

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We have before us today no legislation, no proposals. I am concerned that these hearings might not be the best use of the subcommittee's time or the taxpayer's money.

Nonetheless, I will listen with interest to the testimony and questions raised. I hope that these hearings will be conducted in a manner that serves to clarify the issues rather than to obscure them.

Mr. Chairman, our telecommunications industry has seen tremendous changes in the past few years. And I suspect we will see changes just as dramatic over the next few years.

As a result of the Justice Department's lawsuit, the world's finest telephone network was broken up. Many of the consequences were inevitable. The public was both angry and confused. And long-distance competitors demanded statutory and regulatory protection.

It was also probably inevitable that we would see our edge in the world's telecommunications equipment market greatly diminished. Prior to divestiture, the Bell operating companies bought virtually all of their equipment from Western Electric. Most Americans had American phones in their homes and offices.

As a result of challenges from abroad, our domestic companies are being forced to cut their work forces. AT&T, which prior to divestiture, was one of our Nation's most stable employers, has announced job reductions of over 40,000 people in the last 2 years.

Last year, the subcommittee and full committee passed telecommunications trade legislation. This legislation was not protectionist. It was designed to open foreign markets, not to close our markets.

Mr. Chairman, we must do something to restore our position in international markets. The Canadian, Japanese, and European Governments openly assist their domestic manufacturers in their efforts to penetrate foreign markets.

Unfortunately, they also erect barriers to keep out American equipment. I am opposed to protectionism. I am not opposed to helping our companies and workers compete fairly abroad.

If there are regulatory practices which are hindering our companies' ability to compete, these practices must be discontinued. The time has come to remove the shackles from our workers and our company.

In closing, Mr. Chairman, let me say that I think our time could be better spent. I would suggest that you and the chairman of the full committee use your influence with your Democratic leadership to schedule action on H.R. 3131 as soon as possible.

Thank you, Mr. Chairman.

Mr. WIRTH. Mr. Scheuer.

Mr. SCHEUER. Thank you, Mr. Chairman. I'm not very familiar with the specific pieces of legislation that various members have referred to, but I want to thank you and congratulate you for having scheduled these hearings.

I think the time is exactly right for the kind of broad gauged policy oriented oversight hearings that you have scheduled. I think that's exactly what the doctor ordered.

Our country has gone through a terrific trauma in the last few years, since the transition from monopoly to competition along

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with the reorganization of the Bell System and the divestiture by AT&T of its local operating companies.

We've had massive industry upheaval and massive consumer confusion. We are all concerned with giving the consumers a break, of assuring adequate service to rural areas, to the poor wherever they may be, to the elderly wherever they may be. And quintessentially, I think we are all concerned above everything else with maintaining the finest communication system in the world, which we had under a system of monopoly.

There are advantages to competition. The much vaunted advantages of the spur of competition are familiar to all of us. And we hope that vast new advances in telecommunications technology will be available, will be proliferate throughout the industry and will benefit consumers.

It's our job here as policymakers to make sure that that happens. And before I think we leaped to considering specific pieces of legislation. Admirable as they may be, and finely honed as they may be, I think it behooves the committee to do exactly the task that you have set before it, Mr. Chairman, and that is engage in a thorough, searching, very thoughtful policy-oriented look at the whole warp and wolf at what has happened to the state of the technology, to the plight of consumers, to the condition of some members of the labor community who seem to be hurt, to every aspect of this whole telecommunications community that has gone through wrenching change.

I'm sure we will know—all of us will know a hell of a lot more about this at the end of these very well put together hearings than we do now. And I welcome that opportunity.

And again I congratulate you on scheduling these hearings.

Mr. WIRTH. Mr. Ritter.

Mr. RITTER. Thank you, Mr. Chairman. Mr. Chairman, late last year this subcommittee and later the full committee adopted unanimously H.R. 3131, the Telecommunications Trade Act of 1985. And I was heartened that both sides of the aisle recognized the importance of adopting policies that would help keep American companies competitive in world markets.

This is a crucial issue, perhaps the most important issue that we, as members of this subcommittee, should be concerned with, the international competitiveness and the global economy of the American telecommunications industry.

We will be talking about history here today, and it was just a few years ago that we endlessly debated a proposal known as H.R. 5158. Since we are going to go back into history and since some are going to even perhaps claim that 5158 was the answer to some of the problems that we are facing today, I would like to go on record with some comments about this history.

Some, I believe, are going to try to convince us that H.R. 5158 was proconsumer legislation, intended to smooth the way to divestiture. But my recollection was that that legislation was different.

I recall that it would have expanded regulation, made it more difficult for the FCC to deregulate as competition developed, disrupted the use of technology in AT&T's network, prohibited AT&T from entering into joint ventures, restricted Bell Labs' abilities to fund basic research, placed development of network technology

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under government control for the first time, forced AT&T to subsidize competitors and required almost a wholesale giveaway of AT&T Bell Labs' technology to its competitors, including foreign competitors.

While we were considering that bill in July 1982, Business Week magazine had a cover story on the Bell Labs, entitled "Bell Labs, the Threatened Star of U.S. Research." If you read this July 5, 1982, article carefully, it's clear that the threat to Bell Labs was from two sources, foreign competition and H.R. 5158.

The article quotes Dr. John Mayo, then Bell Labs' executive vice president for network systems, as saying: "The bill tears at the very heart of the thing that has made Bell Labs so productive over the years."

The article explains Dr. Mayo's concern with the section of the bill that would place barriers between Bell Labs and its long-distance company, restricting funding for the labs. As a scientist, I was shocked and was concerned with the treatment accorded Bell Labs by that legislation and was pleased when the legislation was withdrawn.

Had that bill passed, the result would have been a significantly weakened Bell Labs and a significantly weakened AT&T in the face of what I believe is the critical issue, and that is expanding foreign competition.

I believed then, as I do now, that it's time to move away from outdated notions that allow for handicapping and restricting our very best competitors, like AT&T and Bell Labs.

This was not, and is not, good government policy. It's time we adopted policies for a more, not less, competitive America. And the focus on H.R. 3131 would be most pertinent for this committee at this time.

Thank you, Mr. Chairman.

Mr. WIRTH. Mr. Bates.

Mr. BATES. Thank you, Mr. Chairman. Just briefly, I commend you for holding these hearings. I have to agree with Congressman Synar, that I certainly could use as much information on this issue, as is possible. I think we need to know what not to do as well as what to do.

I would like us to keep four principles in mind as we move through these hearings and toward any regulation, that we need more competition, less regulation, less subsidy, and more true cost pricing.

Thank you.

Mr. NIELSON. Mr. Chairman, I have a very brief statement.

Mr. WIRTH. Mr. Nielson.

Mr. NIELSON. First of all, I am a little confused as to why we are having these hearings also, but that has been discussed also and so I will just mention a couple of things.

In my State, 92 percent of the telephones are handled by Mountain Bell and AT&T. AT&T is willing to serve the entire State and even the rural areas.

Its long distance competitors are not willing to make themselves available in other than just the Wasatch front. I think that's an important aspect of—it was mentioned by a colleague of mine that they were not our mother, they were not even our family.

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But nevertheless they are more willing to take care of the rural areas than are their long-distance competitors who, in my view, want to skim off the cream—at the top and get all the financial advantages without really serving the rural areas.

Many important issues will be discussed during the course of these hearings, but I want to highlight two items, the importance of continued availability of long-distance phone rates, service at reasonable rates to rural America, the importance of continuing the FCC's efforts to lessen regulation.

I would like to subscribe to the comments of my colleague from Pennsylvania, I also oppose the particular bill that we tried to pass last year, 5158, because I felt it was going in the wrong direction; it was deserting the rural areas to ruinous pricing which would have occurred had that bill passed as written.

AT&T continues to serve both customers in areas as a carrier of last resort its competitors chose not to serve. In my State of Utah, very few customers are served by the other long-distance carriers I mentioned.

Competition, by its very nature, drives the prices charged for service close to the actual cost of providing this service. It has not brought competitors to rural areas.

Benefits of competition should be for all Americans and likewise the burden should be borne by all. Some proposals now before FCC could result in higher long-distance rates for States like Utah.

I hope we come away from these hearings with a better appreciation of the complexity of the rural question, both local and long-distance rates, find a way to encourage competitive long-distance service to rural Utah.

And let me indicate, U.S. West, which is the surviving corporation in Utah and some other Midwestern States, had in 1982 to 1983, an 11.9-percent increase in rates, from 1983 to 1984, an 18.3-percent increase in rates. And that began to get us alarmed.

As soon as we dropped our legislation and it would no longer be a threat, in 1984 and 1985, the rates dropped by 7.9 percent. In 1986, the rates are predicted to stay the same as they were in 1985.

So, we are already starting to see that things are starting to get back to normal. And I hope we don't mess things up with a hasty legislation like we tried to do 2 years ago.

Thank you.

Mr. SYNAR. Mr. Chairman, just for the record I want to—since H.R. 5158 has been brought up, that bill, Wirth, Tauke, Swift, and Bliley introduced it. It was passed out of subcommittee unanimously with the support of Broyhill and Rinaldo.

Mr. Nielson said he opposed the bill. You weren't in Congress then, were you?

Mr. NIELSON. I'm talking about the bill in 1983. I was in Congress, yes.

Mr. RINALDO. If the gentleman will yield, I recall I very, very vocally opposed that bill on the floor.

Mr. WIRTH. If my colleagues will——

Mr. RINALDO. And I think the record will show that. So that there is no misunderstanding about the bill, I felt it was a bad bill then and I still feel it was a bad bill.

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Mr. WIRTH. I'm not sure the subject of H.R. 5158 is what we are having a hearing about today, much as I know that Mr. Bliley and Mr. Tauke and others would like to engage themselves once more in that.

Mr. NIELSON. If the chairman would yield one more time. I think, Mr. Synar, there are two different bills we are referring to. I was referring to the bill—I think it was 42 something last session, but the one I didn't like.

And probably I wouldn't have liked the other one either.

Mr. WIRTH. Mr. Luken.

Mr. LUKEN. Thank you, Mr. Chairman. If my plane had been a little later, I would have spared you all of this as far as my participation in it.

But I must participate to some extent. I think that I should express the fact that I'm pleased that the chairman has scheduled these very timely hearings to examine the impact on consumers of the transition of the telephone industry from a regulated to a competitive market.

As a member of this committee and this subcommittee, I've had an opportunity to observe firsthand the evolution of this industry from one that is heavily regulated, with a limited number of participants, to one that now promises to be in the forefront of the technological revolution. I get questions about these matters everyday, and I get mail on it from constituents.

So, we certainly know that the interest is out there. And it's something that we have to deal with, and we have to deal with it in a timely fashion.

A comprehensive review of these matters in the next 2 days is time well spent. The last several years have seen significant congressional activity on these common carrier issues.

In 1981 and 1982, our colleague, Mr. Wirth, and other members of this committee attempted a comprehensive revision, or at least looked at a comprehensive revision of the 1934 Communications Act. Unfortunately, the AT&T divestiture interrupted those considerations, and the agreement between AT&T and the Justice Department brought about many of the problems that we are now faced with and should be considering.

In 1983, Congress was forced to defend universal telephone service against an assault by the FCC. Thanks largely to House passage of H.R. 4102, the Commission retreated from its initial decision to add access charges of up to $7 per month on local telephone bills.

The modified plan that went into effect this month for residential and single line business charges was only $1 per month. An additional $1 is scheduled to go into effect again in June of 1986.

And we must be prepared to hold the Commission to its assurance of a full review of the entire issue before any attempt to impose additional access charges is made on the local ratepayers. Now this again is the best time, I believe, to lay the foundation for that review in the next couple of days.

It is essential, I believe, in our collective zeal to encourage innovation, and the development of new services, that the American consumer continue to receive the kind of service that remains the envy of the world. Under the leadership of our chairman, Mr. Wirth, we have attempted over the past several congresses to pro-

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tect that consumer from bearing the brunt of the changes in communications that resulted in deregulation.

Our actions to restrict the access charges, which I've just mentioned, paid by residential consumers were instrumental in preventing the FCC from imposing them at levels that might threaten universal service.

This hearing will enable the members of the subcommittee to review the regulatory developments of the past 2 years. I will be interested to see if the threat of bypass, for example, of local revenues, or of local exchanges by long-distance carriers will deprive them of revenues necessary to serve the local customers.

I understand that our next hearing will focus on the competitive situation for local companies. In that regard, I have asked the GAO to review the issues involved with the BOC efforts to expand in the new services, such as information services and the like.

We shall have a report within 30 to 40 days outlining that review and the loss faced by our local companies and any problems that any new businesses may have as they enter into the competition. And I will be glad to share that report with the committee.

In summary, I think that these inquiries are timely, and I, again, congratulate the chairman for calling this session.

Mr. WIRTH. Thank you very much, Mr. Luken. Mr. Fields.

Mr. FIELDS. Mr. Chairman, I have an opening statement.

Mr. WIRTH. The gentleman is recognized.

Mr. FIELDS. OK. Mr. Chairman, 2 years ago the best telephone system in the world was broken up through a lawsuit brought by the Department of Justice. The breakup was but one of a series of governmental decisions designed to bring competition into the telephone industry.

While I question, and I questioned at the time, the wisdom of the divestiture of AT&T, that decision has been made and now we must ensure that all ratepayers benefit from the breakup.

If the divestiture was intended to stimulate competition in the industry, Government should not stand in the way of that competition. It is for this reason that I am cosponsoring H.R. 3800, the Telecommunication Equipment Information Service Act of 1985.

The passage of H.R. 3800 will permit the local telephone companies, formerly owned by AT&T, to compete with AT&T and other industry giants like IBM and Northern Telecom in the domestic manufacturing of telecommunications equipment and provision of information services.

Ratepayers will benefit because competition will lower prices for this equipment and those services. We must also find ways to assist American companies to penetrate markets in Canada and abroad.

H.R. 3800 will help by allowing the Bell companies to use their technological expertise to manufacture high technology products. But H.R. 3800 does not go far enough.

AT&T is still handicapped by Federal regulatory policies which inhibit its ability to compete abroad. With the telecommunications trade deficit rising at an alarming rate, we cannot afford to tie our companies' hands.

Canada has placed prohibitive tariffs on American equipment, and the Japanese and European Governments openly assist their companies to penetrate our markets. We must be equally support-

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ive of our companies, or we will lose our position of leadership in this industry.

Thank you, Mr. Chairman.

Mr. WIRTH. Finally, we have been joined by one of the senior members of the subcommittee, the gentleman from Washington, Mr. Swift.

Mr. SWIFT. Thank you very much, Mr. Chairman. I don't intend to take very long. I wasn't here earlier, but I understand that somebody suggested that these were untimely hearings.

If that is true, it's only because they are a little late. These should have been started a long time ago. I am very glad that we have begun them, because it's terribly important that we, who have the policy responsibility in this area, stop sitting on our duffs and get something done.

I thank you, Mr. Chairman.

Mr. WIRTH. Finally, the Chair recognizes the gentleman from Oregon, Mr. Wyden, a member of the full committee who has been very concerned with a variety of issues in this area.

Do you have an opening statement, Mr. Wyden?

Mr. WYDEN. I do, Mr. Chairman, just a very brief one. First of all, Mr. Chairman, I want to commend you for holding these hearings, because I think it's clear that Congress—not the Federal Communications Commission—ought to be setting telecommunications policy.

The fact is that there are a lot of issues out there on the table. And Congress—not the FCC—ought to be making the policy choices.

The only point that I want to make, Mr. Chairman, is that if there have been any benefits of divestiture, they have been spread very unequally across this country. If an American makes a lot of long-distance calls or buys their phone, chances are they have benefited from these changes.

But the fact is that millions of Americans such as senior citizens and others—make mostly local calls. And they have not benefited from these changes.

I think one of the issues that we have to examine in these hearings is how to make sure that all Americans have an opportunity to share in the benefits of the information age and not just those who are well-to-do and happen to make a lot of long-distance calls and buy their phones.

The other reason that I think we need these hearings, Mr. Chairman, is that I think we are chipping away at the universal service ethic, which has always been the foundation of telecommunications policy in this country.

There are 22,000 people in my State, according to the Rural Electrification Administration, who don't have a phone. In my congressional district, there's a community phone where people who can't afford a phone go to a church to use a phone.

I'm just concerned that if we continue to see the erosion of what has been the foundation of our telecommunications policy, which is universal service, those 22,000 Oregonians aren't going to see phones for quite some time, if ever. And we will see more community phones around this country.

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So, I think it's very timely that you hold these hearings, Mr. Chairman. I want to particularly commend you for letting an interloper from the full committee participate. I look forward to the hearings.

Mr. WIRTH. Thank you very much, Mr. Wyden. And I also want to thank all of the members of the subcommittee for their interest and concern and attendance.

I think 18 members have shown up this morning and the Chair, after almost 6 years of chairing the subcommittee, has learned a lesson this morning, that if you hold a political hearing you are going to get a lot more attendance than if you don't hold a political hearing.

Our first panel this morning——

Mr. RINALDO. Mr. Chairman, will you yield for a unanimous consent request?

Mr. WIRTH. Absolutely.

Mr. RINALDO. Mr. Moorhead asked me to express his regret that he had to leave. He has a meeting of the Judiciary Committee and he has two bills in place over there, but he would like an opening statement to be put into the record.

Mr. WIRTH. Without objection.

[The prepared statement of Hon. Carlos J. Moorhead follows:]

OPENING STATEMENT OF HON. CARLOS J. MOORHEAD

Mr. Chairman, despite the turmoil and confusion over the past couple of years, we should not fail to recognize and be proud of the fact that the U.S. telephone industry continues to be the best in the world. That's not to say that the industry doesn't face significant challenges in the upcoming years, but rather to indicate that the industry is responding well and must be given a reasonable opportunity to adjust to the new procompetitive environment without undue legislative intervention.

The Federal Communications Commission, led by its Chairman Mark Fowler, has attempted to respond to the realities of today's telecommunications marketplace. Things are pretty well on course. The FCC, for example, has shortened the regulatory review cycle so new service offerings can be brought to the market more expeditiously. It has also granted AT&T Computer 2 relief which allows it to market its equipment and services as a single enterprise, which will lead to greater efficiency and lower prices ultimately. It should now grant the same relief to the telephone companies. While this progress may have been too long in coming, and much remains to be done, the FCC must be encouraged to continue in their present direction. Eliminating the burdensome regulatory requirements that were designed for a monopoly age will speed innovation, reduce costs and lower prices.

In summary, I'm not sure we really need these "oversight" hearings but would urge the Committee to view them as background, to understand the "changes" that have been set in motion and will sort themselves out without legislative activity. In my opinion, to do otherwise, would impede the orderly transition from a regulated to a competitive environment and needlessly distort the results.

Mr. WIRTH. We want to welcome our first panel this morning, including three gentlemen who were all chief counsels of this subcommittee. Their combined tenure with this subcommittee comprised more than 10 years during which the Congress encouraged competition in the telecommunications industry.

Their work with the subcommittee was during a period of enormous change, as has been discussed so far this morning. The three of them will review, for the record, the role of the Congress in shaping Government policy and promoting competition in the telecommunications industry, and examine how consumers are benefit-

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ing from competition in the equipment and long distance marketplaces.

We will hear first from Mr. Harry "Chip" Shooshan, who was chief counsel and staff director of the Telecommunications Subcommittee from 1975 to 1980 and is the cofounder of Shooshan & Jackson, Inc., a firm in Washington.

Second on the panel is Mr. Bernard J. Wunder, a managing partner of the McNair firm. Mr. Wunder was chief counsel and staff director of the subcommittee from 1980 to 1981. And following that Mr. Wunder was Assistant Secretary of Commerce in the present administration.

We will finally hear from Mr. David Aylward, who was chief counsel and staff director from 1981 to 1985. Mr. Aylward is now managing partner of the National Strategies and Marketing Group.

Gentlemen, we greatly appreciate your being here, and I know that you are all very happy to be back. As you can see, the Commerce Committee is, as it has ever been, placid and a collection of members in total agreement on the issues facing the committee and the Congress.

Thank you very much for being here. And, Mr. Shooshan, why don't we start with you on the basis of seniority and go right down, if we might do so.

STATEMENTS OF HARRY SHOOSHAN, SHOOSHAN & JACKSON, INC.; BERNARD J. WUNDER III, WASHINGTON, DC; AND DAVID K. AYLWARD, MANAGING PARTNER, NATIONAL STRATEGIES AND MARKETING GROUP

Mr. SHOOSHAN. Yes, I had noticed that to some extent it was like a remake of an old movie this morning, but I am certainly happy to be back here today. And I guess that I'm supposed to help provide a little bit of the history of how we all got into this in the first place.

I think it would be helpful to go back and look at the way things stood in the late 1960's, early 1970's when these issues began to come to a head, because after all that's when the transition from monopoly to competition really began.

In the—certainly by the early to mid-seventies, the telecommunications industry in this country was undergoing its own form of industrial revolution. And there were a number of factors at work here.

Primarily I think the tremendous explosion of technological innovation, whether it was in the area of consumer electronics, computers or microwave radio, it was becoming cheaper and cheaper all the time for new entrants to challenge the monopoly structure of the telephone industry in this country. And entry was made easier by a rather inefficient pricing structure that had grown up over the years for AT&T.

In addition to the technological change that made entry easier, there was a breaking down, if you will, of the rationale for supporting monopoly which, after all, had been the way in which telecommunications had developed from its very early days in this country. The rationale for monopoly had largely eroded, that rationale

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being the necessity of monopoly in providing universal telephone service.

Now, to put things in perspective, I think if you go back relatively recently to the end of World War II, you found that less than 50 percent of the homes in this country had telephone service. By the 1970's that was no longer the case. Nearly 100 percent of all homes had telephone service.

The idea that monopoly should be defended in order to provide and extend universal service had begun to break down. And as a result, the telephone industry itself could no longer rationally defend against the interest of new entrants from entering the market.

And in addition I think the era of the 1970's, the early and mid-seventies, was also marked by an increasing interest on the part of Government and the Congress in introducing competition to traditionally regulated industries. We had seen it in airlines, and we were to see it in railroads and trucking. And telecommunications was not immune.

Ten years ago—10 years ago this month, as a matter of fact—AT&T and the telephone industry attempted to respond to this dilemma by seeking the introduction of legislation with the beguiling title of the "Consumer Communications Reform Act." That legislation, which by the end of the 94th Congress had attained 180 cosponsors in this body, had a very clear set of answers to this policy dilemma.

It would have rolled back what competition there was at the time and would have confirmed in effect that the best way to provide telephone service in this country was to give one company or one set of industry players an end-to-end monopoly over everything from what you plug into the phone lines to the long distance and local lines that you use to make a phone call.

But despite the fact that the telephone industry came up with 180 cosponsors in the 94th Congress, they did not come up with an adequate rationale for continuing monopoly. If I could go back to the brief excerpt from the opening statement of your predecessor in that chair, Mr. Wirth, Congressman Van Deerlin of California, 10 years ago in this room, in September 1976, similar hearings were held on competition in the telecommunications industry.

And Chairman Van Deerlin said in his opening statement:

> In our Nation, competition is generally assumed to be the best means of assuring high quality goods and services at reasonable prices. Monopoly, particularly where it's maintained by governmentally imposed restrictions on competition is the exception. It seems reasonable to expect those arguing for restraints on competition to accept the burden of proof.

And, in fact, that's what that set of hearings was all about. Could the telephone industry meet its burden of proof that monopoly, not competition, should be the direction in which this country went?

And I'm reminded of an exchange during that hearing between one of the members of the subcommittee, one of the few members who isn't here this morning, Congressman Waxman, and then chairman of AT&T, John deButts. Congressman Waxman asked him what future he saw for telecommunications in this country, what was his vision of the future as chairman of AT&T.

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And he thought for just a brief second and said: Well, I think that the future that I see is pretty much like the past—I'm paraphrasing here—that monopoly is the best direction for us to go. Mr. Waxman pressed him a little further and said: Do you see, Mr. deButts, no area in which competition might be beneficial to consumers? And Mr. deButts did not pause, and said: No, quite frankly, my personal view is that monopoly is the best direction for us to take.

Well, suffice it to say, as those hearings proved and subsequent legislative efforts, the telephone industry did not meet the burden of justifying a retention of monopoly. But at the same time, the Bell bill with 180 cosponsors, sent a very clear message I think which was, it was time for Congress to get involved in the policy debate that heretofore had been left primarily to the Commission and the courts.

And I think if you look back over all the legislation that has been introduced from 1978 on, both in this House and in the Senate, that it's striking to me how common the main themes are that run through that legislation.

All of the bills favored competition and marketplace forces over Government regulation and monopoly. All of the bills opposed extending regulation into industries and services that heretofore had been unregulated, such as data processing, computers or what has become known as enhanced services. And, third, all of the legislation supported competition by all firms in every market.

In other words, the legislation sought to open up markets to competition. One exception to that, or one major exception to that, was the prohibition on AT&T's entry into electronic publishing.

For the most part, the legislation sought to find ways to allow all firms to compete in all markets. Well, the fact that Congress has yet not passed the domestic telecommunications bill, to me, is not a sign of failure on the part of this body, because in fact what Congress did, and has done very effectively over the years, was to push others to make decisions and to take actions that it, for whatever reason, could not do itself.

Let me give you some examples. In 1980, the FCC adopted its computer inquiry II rules which was a landmark decision setting the future for the development of enhanced services in this country.

The framework for what the Commission adopted was lifted almost directly from a bill, H.R. 6121, that was originally cosponsored by every member of this subcommittee. The Commission's "Competitive Carrier" decision, where it found that carriers, intercity carriers, that lacked market power should be deregulated. That was a concept proposed first in legislation sponsored by members of this subcommittee.

In addition, the adoption of the universal service fund by the Commission as part of its access charge order was both a concept and the actual name of the same fund that had been established in the draft legislation that we considered here.

And there are elements of the MFJ relating to equal access, definition of LATA's, and the bar on electronic publishing where literally the language as well as the concept was lifted directly from legislation that had been proposed on the Hill.

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So, in my mind, there is no doubt if you look back over the last 10 years that the legislative efforts have produced results, albeit in other arenas, and I think that's something the subcommittee can claim its share of credit for.

Mr. Chairman, I wanted to focus on one other issue, and that is to try to identify, if I could, in the time that remains the major reason why Congress has not effectively been able to pass a domestic telecommunications bill. You have passed major international legislation, you've passed a landmark cable bill.

Why no domestic telecommunications legislation? Well, certainly in the period of 1976 to 1982, the major reason was concern over the structure of AT&T. Or, actually more accurately, what policy made sense for permitting a firm with monopoly power to participate in competitive markets? That was the essential debate.

Now, in 1978 in a draft bill that was introduced by Congressman Van Deerlin and Congressman Frey, we proposed a modest restructuring of AT&T to accomplish this end. There were no takers.

Subsequently, the Senate proposed drawing a dividing line in effect between AT&T's long distance and local markets. There was vehement opposition to that proposal and very little support.

As a result, it became very clear to those of us working on legislation in the late 1970's, early 1980's, that Congress was not about to legislate the restructuring of AT&T. In fact, privately, even AT&T's competitors didn't want to see Congress intervene because they had great stakes in both the Government and the many private antitrust suits pending against AT&T.

So, Congress, foreclosed, in effect, from dealing with the problem of competition by a company with monopoly power through restructuring, sought to do it through regulation. And that became our legislative tar baby. Every proposal that was advanced became stuck on the issue of how much or how little regulation was needed to permit AT&T to participate in competitive markets.

Well, divestiture, it seems to me, whatever we might think about it, solved that problem and solved it reasonably well, and has facilitated I think the transition to competition that we are in the midst of right now.

But fortunately, at least for those of us who now must make a living in the private sector, divestiture has brought with it problems of its own, or at least as I would suggest has recast old problems in a new light. The critical issue facing us today is still the issue of on what basis do you allow firms with monopoly power to participate in competitive markets, except now the focus is on not AT&T but the seven RBOC's.

It's the issue that's at the heart of computer inquiry III, which the Commission is now involved in; it's the issue which is at the heart of the review of the MFJ, which the Department of Justice is now in the midst of; and, it will be the subject of your hearings next month.

I think that resolving this issue as it relates to the RBOC's marks the next and last stage of the transition from monopoly to competition. And hopefully all of us will learn from past mistakes in coming up with solutions.

And I hope in that process we might also remember a question that Congressman Lou Frey, the ranking minority member of this

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subcommittee, asked in those hearings 10 years ago in this room: "This Nation faces some basic public policy questions regarding telecommunications which only Congress can answer. Rather than cast this issue in academic, economic schools of thought, monopoly versus competition, I believe that we have to drive it down to the basic issue."

And his question was: "What course of action is in the best interest of the public?"

Thank you, Mr. Chairman.

Mr. WIRTH. Thank you very much, Mr. Shooshan.

Mr. Wunder was the chief assistant to the minority and to Congressman Collins from Texas and then under Mr. Van Deerlin became chief counsel of the subcommittee, again reflecting the nonpartisan nature of the subcommittee's activities, and went from there to NTIA.

Thank you, Mr. Wunder.

STATEMENT OF BERNARD J. WUNDER III

Mr. WUNDER. Thank you, Mr. Chairman. It's a pleasure to be back.

As I understand it, what the three of us have been asked to do today for the subcommittee is to review the historical evolution of this committee's involvement in telecommunications/common carrier issues generally, and common carrier legislation more specifically.

As Mr. Shooshan pointed out, we are looking at the 10th anniversary of the Bell bill which was really three bills. Collectively, they had the 180 cosponsors. Two of those bills provided for antitrust immunity for the telephone system monopoly. One did not.

And the purpose of that legislation was to preserve that monopoly. It was also a reaction to the antitrust case that had been brought by the Justice Department in 1974, which would have served to have broken up the Bell System.

Interestingly, your remarks, Mr. Chairman, about the nonpartisan treatment of these issues, the Bell bill, was bipartisan. It had both Democratic and Republican cosponsors. The opposition to the Bell bill was bipartisan.

These issues have not, in my experience, lent themselves well to ideology or party. The issues have been more complex than that. And then you are right, things have essentially proceeded in a nonpartisan fashion.

After the demise of the Bell bill, what then emerged in the Congress was a move away from the notion that monopoly was best and that competition was evil, and it moved toward a consensus with respect to competition being the new era and monopoly being the old era. And competition in varying degrees and with varying degrees of deregulation became, in this committee, the dominant theme.

This is true not only in the House but was also true in the Senate.

Another dominant theme that existed in the Congress was that there was—that divestiture was not required in order to provide competition; that AT&T restructuring, as Mr. Shooshan alluded to,

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could be accomplished in the fashion that did not require divestiture.

The extent of the restructuring of AT&T, the transition mechanisms, and the timing were the battleground for all of the legislative efforts during my time on the committee.

I can also tell the committee, for those who weren't here, that it was my impression always that this committee—and this was also true in the Senate—that there was more concern about ratepayers, about rural areas, about national security than existed in either the executive branch or the courts. And even after the settlement that we discussed today, the committee continued to be concerned about the impact on ratepayers, suggesting changes which by its actions were unnecessary to the settlement that was agreed to by AT&T.

As Chip pointed out, many were adopted by the court in its review of the settlement.

Thank you, Mr. Chairman.

Mr. WIRTH. Thank you very much, Mr. Wunder.

Mr. Aylward.

STATEMENT OF DAVID K. AYLWARD

Mr. AYLWARD. Thank you, Mr. Chairman. It's a pleasure to be back. I'm a little awed seeing the number of members of the subcommittee here today. I recall too many hearings in 1977 when Chip was the chief counsel, with 1 or 2 members here and only 10 or 15 lobbyists who followed all of them.

The difference between then and now I think is a reflection of how important these issues have become. Members of Congress have realized, as has the press, how many billions of dollars of consumer money are at stake in these issues.

My prepared testimony directs itself to three particular myths that I think have got in the way of good policy or of good public understanding in this area. First, the myth that consumers generally have been the major losers in the new competitive world; second, the myth that we didn't need competition at all; and, third, that big business may have benefited from competition, but small business is being left out.

The first one of these, that consumers have come out behind, is so pervasive that I want to focus on that in my allotted time. And there I would like to take a page from the book of Mr. Tauke, as I always used to do, except in the area of broadcasting.

There is an awful lot of good news here. In the past, we spent a great deal of time worrying about where consumers would end up, but in fact consumers have come out very, very well in this area, with only the beginnings of competition.

What's fascinating about it is most people are unaware of this. A Harris poll taken last month, reported in Business Week, says that 16 percent of the American public thinks that their long-distance rates have gone down. A flat contradiction of the facts.

Even if you stayed with AT&T, your long-distance rates have gone down 8, 9, 10, 11 percent. But most of the public does not know that.

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Last fall, an NBC poll, in the Wall Street Journal, showed 67 percent of consumers thinking that their overall telephone bills have gone up. Again, that's not true. Yet, the public believes that.

And because they believe that, they don't act on the competitive choices they now have available to them and they end up losing money. They are not consumers because they are confused. They are confused because the constant barrage of media that they read is focused on local rate increases; focused on the problems that divestiture clearly caused.

As a result, they are losing out. They are losing the options that you and many others have worked so hard to provide to them.

Without dwelling on it in detail, following page 6 of my prepared testimony, there are three charts that I would commend to you; one, because we worked hard on them; and, two, because I think they are simple and instructive.

They show that even small users of telephone service—the first one shows a family that only has one rotary telephone and makes only $10 a month of long distance—not big users of long distance, not big users of telephones on a national average are paying only 18 cents more a month for telephone service than they were before the breakup, providing they bought that rotary telephone and they subscribed to a competitive long-distance carrier.

Eighteen cents more, and that's before you count inflation. If you go up to the other end of the usage scale and look at a family which bought two touch-tone telephones—this is the third chart—in 1983, and made $30 a month of long-distance calls, it is now paying 16 percent less than it was before the breakup.

Now, I didn't know those numbers before we did this study. I was kind of impressed that you can come out ahead. If you have kids in college, the way I do, and your phone bill is way over $30 a month because you have lost the WATS line that you had when you worked in the House, you come out way ahead.

The point is that the benefits are there. Consumer benefits are there. Consumers can save if they know their options, and if they start acting like consumers, like consumers do in any other area.

And the subcommittee can take a lot of credit for this. Many of the members of this subcommittee have spent a lot of time over the years trying to bring about these consumer benefits, whether it was Lionel Van Deerlin, Lou Frey, or John Moss back in 1976–77 saying, "No, monopoly is not such a good idea," but it was many of the same members, and some of you, pushing competitive bills like H.R. 6121 or H.R. 5158, or whether it was many more of you involved in trying to modify either the divestiture agreement or FCC-access charge orders.

I don't think the specifics of those bills are terribly relevant at this point. I think what is important for you to remember as you face the issues in the future is the role reflected by you during those proceedings. It needs to be reflected in the future.

There are many antitrust experts down at the Justice Department, some legal and technical experts down at the FCC, but it is really only here, in this institution, where each informal committee member's conversation was focused on the little old lady from Squim.

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We heard about the little old lady from Squim as a representative of the average American consumer over and over and over again. We heard about rural customers in Iowa over and over and over again. It is that consumer focus that came out of this subcommittee and should continue to come out of this subcommittee. That focus has helped move the decisions in other bodies in a very positive way in the past, and should do so again in the future.

I leave you with one final thought. The benefits that we talk about here come from what I would call a fully competitive customer premises equipment market, but a long-distance market where competition has only just begun. Only 15 percent or so of the long-distance market is competitive, and there are a lot more benefits that can come down the line if we continue the transition to full competition that is in front of you.

There is a long way to go, but the consumer perspective that this subcommittee has brought in the past is what is really necessary, and I would encourage you to continue it in the future. Thank you very much.

[Testimony resumes on p. 90.]

[Mr. Aylward's prepared statement follows:]

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TESTIMONY OF
DAVID K. AYLWARD
MANAGING PARTNER,
NATIONAL STRATEGIES AND MARKETING GROUP, INC.
BEFORE THE
SUBCOMMITTEE ON TELECOMMUNICATIONS,
CONSUMER PROTECTION AND FINANCE
OF THE
COMMITTEE ON ENERGY AND COMMERCE
U.S. HOUSE OF REPRESENTATIVES

February 19, 1986

I am David K. Aylward, managing partner of National Strategies and Marketing Group, Inc., a government relations, consulting, and business development firm located here in Washington. I have been privileged to work with the members of this Subcommittee on communications issues for nearly nine years, first as legislative director to Chairman Wirth from 1977 to 1981, and then as chief counsel and staff director of the Subcommittee from 1981 through March of last year.

As you noted in your letter of invitation, Mr. Chairman, the telecommunications industry is currently in the midst of a critical transition from decades of monopoly to a more competitive environment. That transition ranks as one of the most extensive reforms of federal regulation of any industry in our nation's history.

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For nearly a decade, this Subcommittee has recognized that increased competition in communications could offer major new choices and financial savings to residential consumers and small businesses, and in the process significantly strengthen our nation's economy. With that in mind, since 1976 the Subcommittee has sought to encourage a gradual introduction of competition into key areas of the communications industry and to promote an orderly transition to a more competitive environment.

Unfortunately, where the Subcommittee was successfully encouraging evolution, AT&T and the Justice Department intervened in 1982 and wrought a revolution. And, in contrast to the Subcommittee's more gradual approach, the AT&T-Justice Department divestiture agreement was framed with narrow antitrust principles, rather than the consumer's interest, as its paramount concern. The result has been a wrenching transition, widespread consumer confusion and frustration, and large local telephone rate increases granted by state public utility commissions who feared for the financial health of local operating companies under the terms of the divestiture agreement.

The confusion and frustration of divestiture have clouded most discussions of communications issues over the past two years, spawning a number of broadly accepted and inaccurate myths.

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MYTH #1: "COMPETITION HAS BENEFITED BIG BUSINESS, BUT HAS PRODUCED ONLY HIGHER TELEPHONE BILLS FOR RESIDENTIAL CONSUMERS."

Sixty-seven percent of the respondents to a national NBC News/Wall Street Journal poll last November believed that their overall telephone bills had increased over the past two years. That figure demonstrates an overwhelming lack of knowledge on the part of consumers of the choices available to them -- and a very serious need for extensive public education.

While we have a long way to go before telecommunications is fully competitive, consumers are already benefiting.

In fact, because of competition, the vast majority of American consumers can pay less today for residential telephone service than they did prior to divestiture, despite local rate increases.

Last fall, my firm performed a nationwide study of residential telephone costs since January, 1983. The results of that study are summarized in the charts following page 6 which show the overall monthly telephone service costs of six average families over the past three years. All data used in the study were drawn from Consumers' Checkbook surveys, filings with the

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FCC and state public utilities commissions, reports of the Bureau of Labor Statistics and the National Telecommunications and Information Administration, and from information obtained directly from AT&T and local operating companies.

The results contradict the popular wisdom:

o The majority of residential consumers who have taken advantage of competition simply by purchasing their telephones and subscribing to lower cost long distance services are paying from 10 to 16 percent less in overall monthly telephone costs than they did prior to divestiture, not counting the effects of inflation -- which increase these savings;

o These savings do not require any extraordinary effort on the part of consumers -- neither extensive shopping for the best possible buys in telephone equipment nor hours of pouring over long distance rate charts. They can be achieved solely by buying a telephone instead of renting it, and switching from AT&T to virtually any competing long distance service;

o The savings are available nationwide -- even where local telephone rates have risen most. Local rates in the District of Columbia have undergone the steepest rise since divestiture of any major jurisdiction in the country -- over 60 percent. But even here most consumers who have taken advantage

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of competition in equipment and long distance service are achieving savings similar to the national average. Consumers with low telephone usage -- owning one rotary telephone and using $10 or less per month of long distance service -- are paying only cents more per month than they did prior to divestiture -- and less if inflation is factored in.

Contrary to the popular wisdom, these benefits extend to families with very low telephone usage. The first chart following page 6 shows the overall monthly telephone costs of two low usage families from 1983 to 1985. Both subscribed to unlimited flat rate local service from their local telephone company. Each used one rotary telephone, used an average of $10 per month of AT&T long distance service in 1983, and maintained the same amount of long distance calling during 1984 and 1985. Family #1 has made no changes in its equipment or telephone service since divestiture -- it continues to rent its telephones and to use AT&T long distance service. As a result, with increased local rates and the imposition of the FCC access charge last June, (averaging $.58 per month during 1985), its overall monthly telephone bills have risen from an average of $22.12 in 1983 to $24.33 in 1985.

Family #2, on the other hand, purchased its telephone in 1983 and subscribed to a competing long distance service in March, 1985. Eliminating $1.50 per month in rental charges and

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reducing long distance bills -- for the same amount and pattern of long distance calling -- to $8.55 per month, Family #2 has offset virtually all of the local rate increases which occurred following divestiture. Its average monthly telephone costs have risen only 18 cents in the past three years, and gone down when inflation is factored in.

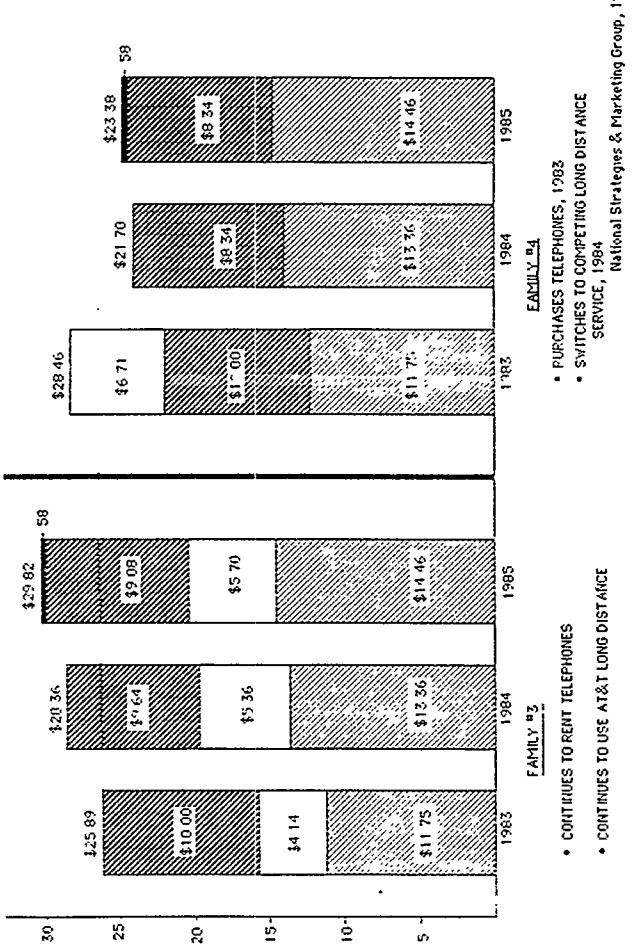
These savings go up as usage increases. The succeeding chart compares the monthly telephone costs of two families using two push-button telephones and the equivalent of $10 per month in long distance at 1983 AT&T prices. Family #3 continues to rent its telephones from AT&T and subscribes to AT&T long distance. With increased local rates and a 40 percent national average increase in AT&T Touchtone telephone rental charges, its monthly telephone bills have risen from $25.89 in 1983 to $29.82 last year.

By contrast, Family #4 purchased two equivalent quality telephones in 1983 and subscribed to a competing long distance service in 1984. As a result, its average monthly telephone bills today are 10 percent below what it would have paid to the Bell System in 1983 and 22 percent less than Family #3 is paying today.

<u>These families are not taking advantage of options brought about by divestiture. They are taking advantage of two compe-</u>

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titive choices permitted by the FCC in the late 1970's for which members of this Subcommittee fought: the right of consumers to own their own telephone equipment, and the availability to residential consumers of alternatives to AT&T long distance service.

The introduction of competition that members of the Subcommittee worked to achieve prior to divestiture is bearing fruit for millions of Americans already, and will for millions more as the long distance equal access process is completed in 1986.

Most studies of local telephone rates since divestiture, and most media stories, have left the impression that consumers have been big losers in the transition to communications competition. However, they have failed to distinguish among sectors of the communications marketplace. Residential consumers have experienced major cost increases only in the single market segment which is still a monopoly: local service. In both segments of the market in which competition has been introduced -- equipment and long distance service -- prices have consistently declined over the past three years. The largest declines have occurred where competition is strongest, in telephone equipment. In long distance, where AT&T's competitors hold only approximately 15 percent of the market, rate declines have been smaller, but still significant.

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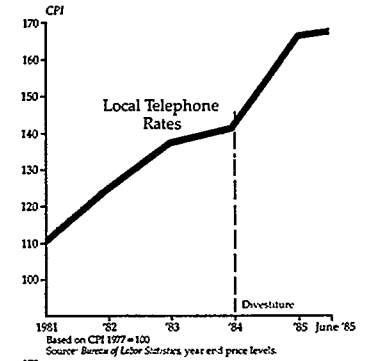
Despite the continuing monopoly nature of local service, competition is still likely to provide indirect benefits to consumers in that market, as well. Until divestiture, local operating companies were captive customers of Western Electric for their network equipment needs. Since 1984, competition in that multi-billion dollar market has begun and shows signs of intensifying in sales of network equipment to local operating companies. In the long run, lower network equipment prices produced by competition should help relieve significant upward pressure on local telephone rates.

In areas where direct consumer choices are involved, a freer communications marketplace does not guarantee consumers higher or lower telephone equipment and service costs. What it does guarantee for the majority of consumers is that we now bear the responsibility for our own equipment and service choices -- and for the prices we pay.

Consumers are now in the midst of a transition from acting as passive telephone ratepayers to behaving as active communications consumers. Those who have made that transition are already receiving the benefits of competition.

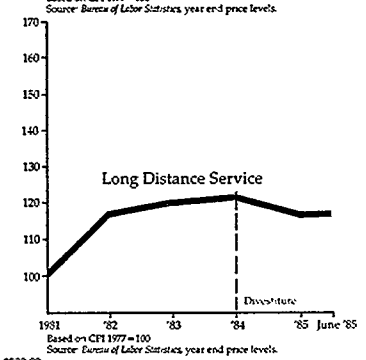
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Consumers and Communications Competition: Services and Equipment



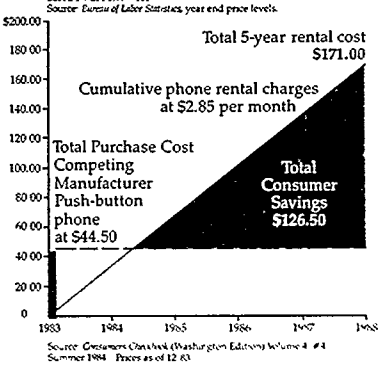
Local Telephone Rates

This is the only area in which residential consumers have no competitive choices—local telephone companies are the sole providers of local telephone service. While the local companies publicly blame the Bell System break-up for their large rate increase requests, their filings with state public utility commissions offer entirely different reasons. Most are unjustified: even where requests have been denied or cut back, local phone companies have remained profitable and financially healthy. State commissions can halt unjustified increases if they do their job.



Long Distance Service

The beginnings of competition have already brought about a nationwide average decline in long distance costs. AT&T continues to hold over 85% of the market. But as millions of consumers are learning to choose among the alternative services available to them, their monthly long distance bills are declining, and AT&T itself is being forced to lower rates. If competition continues to grow, the cost declines will continue.



Residential Telephone Equipment

Competition has advanced furthest in this market, and it is here that the largest number of consumers are realizing the greatest dollar savings. By buying rather than renting telephones, consumers can save literally hundreds of dollars over the seven- to 20-year average life of their new equipment. In the representative example shown here, based on *Consumers' Checkbook* surveys, a top quality push-button phone pays for itself in only 16 months. (This example is based on 1983 prices, when the first great surge in residential telephone purchases began; aggressive competition has pushed the price of good quality equipment even lower today, further increasing the savings consumers can realize.)

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MYTH #2: "THE TELEPHONE SYSTEM WE HAD WAS THE BEST IN THE WORLD. WE DIDN'T NEED COMPETITION."

It was the best, but it wasn't good enough to meet the demands of a computer and information based economy.

AT&T and the Bell System developed the best telephone system in the world for simple switched voice transmission. With a strong push from the federal government in the form of REA loans to build rural telephone systems, by 1960, universal service was already by and large a reality -- telephone service was available on request for a minimal monthly fee to all but a handful of rural Americans. Bell System service and equipment set standards of excellence for all sectors of the utility industry.

Although the Bell System monopoly satisfied the needs of the residential consumer, changes in the system were inevitable because of several factors: rapid technological innovation following World War II, the changing needs of the U.S. economy as we entered the "information age," and the inability of a monopoly to respond to the specialized needs of diverse users.

World War II produced numerous innovations which were commercially applicable in U.S. industry following the war. One

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of these was microwave radio, which made airborne telecommunications transmission possible for the first time. After the war, the FCC began allowing railroads, mining companies, pipelines and other industries operating in remote areas not served by the Bell System to build their own microwave systems for the first time.

Later, several industries asked the FCC to permit construction of private microwave networks, even where Bell telephone service was available, and the FCC agreed in 1959.

In the 1960s, competition in the emerging computer industry began producing a wealth of innovation and technological progress. Industries from aircraft manufacturing to hotel chains began computerizing operations to cut costs and improve productivity. Boeing, for example, faced with foreign challenges to U.S. dominance of the world aircraft market, was working on new generations of jets. The company invested heavily in sophisticated computers to help solve increasingly complicated design problems and to cut costs by keeping constant track of inventories and production.

But Boeing faced a problem that was to frustrate industry after industry. For computers to be truly useful, they must communicate with one another rapidly and accurately -- office to office, warehouse to plant, headquarters to suppliers. The

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monopoly telephone system with its 1950's technologies simply was not up to the job. To marry computers and communications most efficiently, a variety of new, more sophisticated services and equipment were needed. The U.S. had developed the best voice telephone network in the world, but the system was not designed to transmit computer data quickly and reliably, which Boeing and other firms needed it to do. Nor was it designed to meet the rapid expansion and diversity of demand for voice uses by businesses.

The changing needs of the aircraft manufacturing industry were symptomatic of many other sectors of the U.S. economy. During the 1960's and 1970's, the United States was increasingly challenged by competition from abroad. The need to utilize the newest technologies grew as electronic communications became more and more a backbone of this country's infrastructure.

The Bell System monopoly was not geared to respond to these rapid changes. This was not due to any shortage of technological expertise. Bell Labs, AT&T's research arm, won Nobel prizes quite regularly. The problem came in getting new technologies to market. Any monopoly with heavy investments in existing plant, equipment, and product inventory has little incentive to rush improved technology to business or residential consumers. In fact, given billions of dollars of investment, 30-year depreciation schedules, and an expanding rate base, no sane

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businessman would rush improved technologies to business or residential consumers -- technologies which would make current products obsolete and necessitate huge write-offs.

In addition, as a vertically integrated monopoly the Bell System had a captive market for its own equipment offerings. Having a captive market reduces a company's incentive to innovate and improve efficiency. A monopoly has every incentive to reject the advances of outside manufacturers regardless of the price or quality of their products. For example, when computer technology made electronic switching possible, the Bell System shunned IBM -- a leader in the technology -- and at great expense had Western Electric develop its own electronic switches.

AT&T responded with the typical and natural behavior of any monopoly which has top-to-bottom control over its markets -- use any and all means to block competitors' products from eroding your markets. As technological advances created new communications markets faster than the Bell System could, or wanted to, serve diverse needs, it erected every roadblock at its disposal to prevent competitors' products and services from reaching businesses and consumers -- competitors who were ready, willing, and able to fill the niches underserved by Bell. These roadblocks were erected in the market itself, at the FCC, in the courts, and in Congress. This classic monopolistic fight against encroaching

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competition served to raise prices to all consumers, reduce innovation, and limit the diversity of available products and services -- all to the detriment of the U.S. economy.

Not only was this resistance to change damaging to the telecommunications market, but it acted as a ball and chain on all other sectors of the economy which were coming to rely increasingly on computers, information transfer, and telecommunications.

Below are several examples of industries which were caught up in the changing needs of the U.S. economy and new technologies which were emerging to meet those needs. These examples clearly illustrate how a telecommunications monopoly cannot possibly respond to all the diverse needs spawned in a dynamic and booming economy. As F. Graham Crawford, a Sears Roebuck & Company witness before this Subcommittee in 1976, said:

> "All of us have different needs, and there is a segment in the marketplace out there that will take the risk to provide specialized kinds of service. In a company the size of Bell, a particular specialized product may be only a drop in the bucket and difficult to get them to produce."

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The Airline Industry

Despite the fact that the airlines were among the Bell System's largest customers, AT&T repeatedly rejected their requests for new technologies.

(1) In the early 1960's, with air travel growing almost exponentially, the airlines asked AT&T to use new technology to develop a computerized switching system and to upgrade its mechanical facilities to handle their increasing volume of passengers, flights and data transmission. AT&T refused.

The airlines were forced to turn to outside suppliers who developed and installed the first "electronic store and forward switching system" (ESS) in the early 1960's. By 1976, the ESS had grown immensely, incorporating equipment from numerous non-Bell suppliers. It was the core of airline communications, providing for in-flight communication, ground communication and links to the public. AT&T finally introduced a version of the ESS into its long distance network for the first time in 1976.

(2) The automatic call distributor (ACD), a critical part of the airlines' regional reservations system, holds incoming calls and distributes them to the next available ticket agent.

In 1968, the airlines, flooded with reservations calls

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generated by the explosion in air travel, asked AT&T to develop an advanced, electronic call distributor which could handle the increased volume. AT&T informed the airlines it would make no decision on whether to develop a new call distributor until 1975, and even if it decided to do so, the new distributor would not be available until 1980. The airlines turned to competing suppliers that the FCC was now allowing into the marketplace, who installed the first advanced electronic call distributor in 1974.

The Securities Industry

The securities industry has always depended on communications systems to distribute information on prices and transactions to the greatest number of people as quickly as the latest technology will allow. Throughout most of this century, the stock exchanges and brokerage houses were some of the Bell System's largest and most loyal customers.

In the early 1970's, three things brought an end to the securities industry's long loyalty to the Bell System:

- The securities markets began to experience rapid growth as small investors entered them in large numbers. In 1970, the New York Stock Exchange traded a daily average of 11.6 million shares. By 1975, volume had swelled to 18.6 million shares a day, a growth of over 60 percent in only five years.

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- A change in securities regulations to require negotiated commissions, instead of fixed rates, put pressure on securities firms' profits. A major drive to cut costs and improve productivity began.

- The outdated technology of the Bell network simply couldn't keep up with the massive new volumes of data the exchanges and brokers had to transmit and receive, and the industry's communications costs -- its second largest business expense -- were unnecessarily high.

In 1972, the industry founded the Securities Information Automation Corporation (SIAC), a non-profit subsidiary, to take advantage of competing transmission and equipment services the FCC had just allowed to enter the market in the Carterfone and Specialized Common Carrier decisions. Using a mix of competing transmission services and new equipment suppliers, SIAC redesigned the industry's communications systems.

Through new communications competition, the exchanges and brokerage houses achieved their goal of more timely communication of bids, offers, last sale prices and transaction confirmations, while cutting costs significantly. Today, it is possible for the New York Stock Exchange to handle routine trading of more than 100 million shares in a day, ten times the volume in 1970, and

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communicate that activity all over the country and the world, in real time.

As the above examples show, throughout the 1960's and 1970's many big businesses had little choice but to seek alternative suppliers which were ready and willing to take advantage of AT&T's unwillingness to address their needs. Small businesses, lacking the buying power and resources of these big firms, did not even have the option of seeking alternative suppliers. They had to wait until competition was allowed to reach them in the late 1970's to begin to get some of these benefits.

It is also important to point out that many of the technologies which today benefit consumers and businesses, and are now taken for granted, were not initially made available by AT&T and the Bell System. As I stressed earlier, this was not due to any shortage of technological expertise within the Bell System. Bell Labs was, and is, the premier private research facility in this country. However, the Bell monopoly was far less successful in getting new technologies to the marketplace where businesses and residential consumers could take advantage of their capabilities.

For example, developments in electronics and integrated circuitry in the 1960's made it possible to computerize telephone equipment for the first time. AT&T's competitors brought the

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first wave of electronic PBX's and telephones to the market in the early 1970's. These electronic systems were faster, less expensive, more reliable and offered many new features not available to businesses previously. These features are discussed in detail in the small business section of my testimony.

In addition, the major breakthroughs leading to relatively widespread use of fiber-optic cable came from two large Bell System competitors.

My point is not to denigrate AT&T, but instead to point out what its monopoly was not providing.

And how is AT&T now responding? By cutting costs. By rapidly bringing new technologies and products to market. By going to customers and finding out what they want and need. In short, it is itself starting to respond to competition, instead of just attacking it.

MYTH #3: "COMPETITION IS BENEFITING ONLY BIG BUSINESS. IT HAS LITTLE TO OFFER SMALL BUSINESSES."

Another persistent myth regarding the benefits of competition in communications asserts that big businesses alone are

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reaping the benefits from competition or, put more directly, small businesses have seen only local rate increases and confusing telephone bills rather than benefits equal to those of large users of telecommunications services. There is no more validity to this position than to the myth that residential consumers have been the losers.

Small businesses have seen significant and dramatic benefits from competition in long distance and equipment markets. These benefits have steadily increased over the last few years and will continue to multiply. The growth in the benefits to small businesses will parallel the growth in the diversity and strength of competition. The importance of this fact cannot be overestimated, as small businesses are increasingly the largest source of innovation and new jobs in our economy.

As with all myths, it is not hard to trace the origins of the idea that only big business could take advantage of competition. In the early 1970's there was actually a tremendous amount of truth to it, so it is understandable that it persists today. Following the first pro-competitive FCC decisions in 1968 and 1969 which started to open the long distance and equipment markets to competition, only large telecommunications users were able to realize the cost savings, productivity improvements, and other benefits of the newest communications technologies.

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The competitive long distance services offered at first, after the FCC's Specialized Common Carrier decision, were limited to private line services -- too expensive to be economical for a small business -- so only large businesses benefited from the improved or cheaper computer data transmission and voice communication services offered by the non-Bell carriers. Small businesses did not have the high volumes of a large user which made the competitive long distance services cost-effective.

Likewise, when the FCC opened the customer premises telephone equipment market to competitors' products, the local Bell Operating Companies sought to kill competition by requiring a "Protective Connecting Arrangement" (PCA) before the new products could be attached to the existing telephone network. In many cases, the local phone companies priced these connectors at a level which wiped out the cost savings of competitive equipment for all but the biggest buyers. Finally, the FCC barred PCA's.

Aside from the regulatory timetable, this progression of technological innovations which were initially affordable or available only for large users is an exact parallel to the development of the U.S. computer industry. In the early 1960's, computers were only used by the largest corporations and huge government institutions. Only they could afford them. Today, the personal computer is on the verge of completely altering the way many Americans live, work, and interact -- if it hasn't

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Small Business and Communications Competition

Services and Equipment Only Big Business Could Afford Ten Years Ago

- Communications competition is bringing small businesses new telephone equipment and services which result in major cost savings, new business opportunities and improved management.
- Most were first offered or made affordable by competitive long distance companies or competitive equipment manufacturers moving into the small business market the Bell System had ignored. Competition then forced AT&T to follow with its own small business offerings.

SERVICES & PRODUCTS	BENEFITS TO SMALL BUSINESS
AFFORDABLE LONG DISTANCE SERVICES	Competitive carriers offer savings of 5-25% off AT&T's long distance rates. Competitors' resale of AT&T services allow a small business to reap the savings of the bulk discounts AT&T offers only to big businesses. Shared 800 (incoming WATS) and other shared specialized business services are offered by long distance competitors at a price small businesses can afford, providing better customer service and stimulating new business.
ELECTRONIC OFFICE TELEPHONE SYSTEMS (PBX, SMART TELEPHONES)	Companies can now purchase their own phone systems, eliminating rental fees and saving thousands of dollars annually. Investment tax credits increase these savings. Managers are able to prevent unauthorized long distance calls from being charged to their business without their knowledge. Office systems automatically select the lowest cost long distance service for each outgoing call, saving hundreds or even thousands of dollars a year. Telephones can be moved as needs change without rewiring, saving expensive installation charges. Frequently dialed numbers can be called with the push of one button and conference calls involving three or more cities can be made without costly operator assistance.
AFFORDABLE DATA TRANSMISSION	Local retail companies can keep daily inventory records at their various stores through a central computer, and order from suppliers by computer. Independent insurance agents in the field can transmit claims and new policy information directly to the home office computers, thus avoiding delays and cutting expenses. Small retailers can instantly verify credit cards and checks. Local financial services brokers can access up-to-the-minute price and trading reports from a New York information base.
CALL ACCOUNTING SYSTEMS	Systems can automatically itemize calls by client, which assists in billing and cost allocation for a small law firm or other business. Detailed records of calling patterns are possible to allow for analysis and better cost control

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already. Any business professor can tell us that this is a normal and predictable pattern for any new technology and the products which are developed and marketed from it.

The accompanying chart, "Small Business and Communications Competition," provides a detailed listing of many of the benefits which millions of small businesses throughout the country are realizing today. Cost savings stemming from the fledgling competition in the long distance industry are significant, five to 25 percent per year. In addition, new long distance services, such as shared 800 service offered by resellers, are an opportunity for better customer service and new business.

Equipment which can be purchased and depreciated, rather than rented for a never-ending monthly fee, offers thousands of additional dollars per year in savings. Small businesses have new resources, such as call accounting systems and office switchboards which automatically select the lowest cost long distance carrier. They provide improved management and increased cost control.

Data transmission services which are now affordable for nearly any small business allow for computer communication between geographically dispersed offices. This type of communication, which we take for granted today, provides up-to-the-minute sales information for inventory control, electronic mail,

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timely reports of financial market activity, credit card verification, and an infinite variety of other uses.

In addition to newly available technologies, small businesses across the country are benefiting from new, competitive packaging of services previously available only to big businesses. AT&T's 800, WATS and private line services were developed and continue to be priced for larger businesses. Long distance resellers nationwide, recognizing the underserved small business market for service less expensive than regular MTS, purchase AT&T capacity and offer it on a shared basis to small businesses which otherwise would have no alternative to MTS. The result is large long distance cost savings for small businesses.

The benefits mentioned above and in the accompanying chart are only the obvious benefits being enjoyed by small business in the U.S. Only 10 years ago small businesses had absolutely no choice in long distance and, for all practical purposes, there was no choice of equipment or its features. Small businesses could purchase their own equipment from the Bell System's competitors, but prior to 1978, the local Bell Operating companies had the power to require customers to rent a PCA when using a competitor's equipment. When the FCC eliminated the requirement for connecting arrangements in 1978, the resulting explosion in the customer premises equipment market demonstrated the pent-up demand.

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Finally, we should examine a few concrete examples of real small businesses reaping some very real benefits from communications competition. It is one thing to talk in the abstract about theoretical benefits. It is another to venture out into the free enterprise system and witness what is taking place as a result of competition. For example:

-- Eddie Bauer, the camping gear and clothing retailer headquartered in Seattle, has 40 stores across the country, a mail order operation, and two warehouses. In the highly competitive retail business, it is important for companies to take advantage of every opportunity to cut their overhead and create administrative efficiencies. Competition in the telecommunications market has allowed Eddie Bauer the opportunity:

- to purchase a competitor's switch, or PBX, which, according to Eddie Bauer staff, "was three worlds ahead of everyone else at the time" and is, eight years later, still up-to-date with present technology;

- to institute least cost routing of long distance calls on the switch. Since "it would be impossible to get 300 employ-

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ees at corporate headquarters to learn which WATS lines to select;"

- to subscribe to a competing long distance service which has reduced the company's long distance phone rates by 23 percent;

- to poll the computerized cash registers at each store every night to keep track of sales and inventory more efficiently.

-- Crescent Electric Company, an electrical supplier and wholesaler headquartered in Dubuque, Iowa, has 70 branch offices in 12 states and some important communications needs. Competition has offered Crescent the opportunity to:

- cut as much as 30 percent off long distance costs that usually run about $1400 dollars a month by using an alternative long distance carrier;

- "improve internal communications" by purchasing a competitively-manufactured, premises based switchboard which "has

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just about all the bells and whistles available." The new system not only saves Crescent money over leasing costs, but "makes it easier for the receptionist to process calls;"

- o speed communications between offices and eliminate paperwork by transmitting data between the headquarters and branch offices' computers over leased data lines.

-- The FAX Marketing Group, located in Tulsa, Oklahoma, is a direct marketing agency and as a result, relies on the telephone for a great deal of the work that it does for its clients. While the company brokers out some of its telephone marketing business, it handles some of its clients' phone related projects itself. Its phone needs vary according to the number and type of projects on which it is currently working. Because clients and their billing are always changing, it is difficult to forecast needs and finances. Telephone bills and cash flow are frequently at odds. Competition allows the firm to balance its communications needs and finances.

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FAX uses its competitive options to:

- save 15-20 percent on long distance costs by using several long distance carriers;
- implement least-cost-routing of long distance calls through a PBX that automatically selects the least expensive line;
- use a variety of long distance carriers in order to stagger payments of long distance bills. By shifting long distance usage among carriers, the firm can maximize its credit with each company and incur the costs when cash flow permits;
- purchase equipment to save unnecessary leasing fees.

These and thousands of other small businesses across the country are already taking advantage of technologies and services which the evolution of communications competition has produced.

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CONGRESS AND COMPETITION

Finally, I would like to review briefly this Subcommittee's extensive contributions to opening the communications marketplace to competition. A federal communications policy supporting competition did not emerge overnight. It evolved slowly over a period of 20 years, and, given the clear evidence that communications competition was urgently needed, it is easy to understand why pro-competitive policy came to be pursued unanimously by both parties and all three branches of government throughout the 1970's. A consensus is not always an easy thing to find here in Washington, but virtually all telecommunications policy-makers finally agreed that a gradual shift to competition would bring greater choice and price reductions to all consumers, residential and business.

Why review history? Because the most widespread misconceptions about this industry arise from the lack of public knowledge of the events of the past decade. The immediate future in the telecommunications industry will undoubtedly be a continuation of the rapid changes and upheaval we have witnessed in the past two years. Many current issues will require resolution and these decisions will ultimately benefit or harm the American consumer. Developing solutions presents an opportunity for Congress and the FCC to restore the faith of the American public which is still extremely disillusioned about divestiture and its impact.

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For the first time in several decades, Congress, in 1976, became deeply involved in common carrier policy with the introduction of the "Bell Bill," or the Consumer Communications Reform Act, as it was officially titled. This extreme piece of legislation was the Bell System's answer to MCI and the FCC's pro-competitive decisions between 1968, with Carterfone, and 1975, with the elimination of the requirement for special connecting arrangements for all competitive equipment. This bill would have effectively guaranteed the Bell System's monopoly in both the long distance and equipment markets.

It is hard to imagine where consumers and businesses in this country would be today had the "Bell Bill" been enacted into law. Fortunately this Subcommittee, and in particular Lionel Van Deerlin and Louis Frey, had the foresight to conduct extensive hearings on "Competition in Communications." John Moss, Chairman of the Oversight Subcommittee, took a similar approach. The testimony overwhelmingly documented the need for more competition, not less. Several of you here today can reflect on your involvement in what was the first public review of a fundamental change in communications policy: competition versus monopoly. It was not then an easy choice to pursue competition and many of the benefits were only theoretical predictions of what might happen. This Subcommittee had the wisdom, and was willing to take the risk, to work to further competition.

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The immediate result of the hearings and attention surrounding the "Bell Bill" was the search for a Congressional consensus on what action to take. After several false starts, the Communications Subcommittee, under Chairman Van Deerlin, adopted HR 6121 in 1980 -- legislation which would have entirely rewritten Title II of the Communications Act of 1934, establishing competition as U.S. telecommunications policy and creating a separate subsidiary for AT&T's competitive offerings. Again, with this Subcommittee leading the way, HR 6121 was adopted by the House Commerce Committee, but never reached the floor for consideration by the full House.

In 1981, the Senate passed S.898, a bill similar to H.R. 6121, but even more pro-competitive. In December, following months of extensive hearings and deliberations by members of the Subcommittee, HR 5158 was introduced in the House, once again promoting competition as the cornerstone of national communications policy. HR 5158 proposed the creation of separate subsidiaries for the Bell System's competitive activities and set up a system for deregulating communications markets when they became fully competitive.

Congress never proposed divestiture. Instead, it struggled to develop regulatory mechanisms to allow AT&T to enter competitive markets while the company still had monopoly domination of long distance and local service.

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The gradual evolution towards competition came to an end in January, 1982. AT&T and the Justice Department announced their settlement of the government's massive anti-trust case originally filed in 1974. After the announcement of the settlement and hearings about it, HR 5158 was modified to take into account the divestiture agreement and to respond to new problems created by the sudden and unexpected decision. These amendments would have made several significant modifications to the private settlement AT&T negotiated with the Justice Department. Among other modifications, the bill would have given the Yellow Pages to the Bell Operating Companies (BOC's) instead of AT&T, allowed the BOC's to sell customer premises equipment, and established a process to ensure equitable distribution of the debt and assets between the BOC's and AT&T.

The bill would also have minimized the biggest potential bypass problem -- the danger that AT&T would provide service directly from its largest customers to its long distance switches, skipping the local operating company -- by placing a five year moratorium on bypass by AT&T. This would have helped ensure adequate time for the local companies to adjust to the new framework of the industry.

This bill passed the Subcommittee unanimously, but bogged down in the full Committee. However, it had a major impact.

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It was at least partially responsible for saving billions of dollars for the BOC's and, for residential and small business consumers. Many of the changes made by Judge Greene to the original break-up agreement in his Modified Final Judgment can be traced directly to the efforts of this Subcommittee. Where this Subcommittee had built a consensus, positive actions resulted. For example, the BOC's got the Yellow Pages, preserving hundreds of millions of dollars in profits which subsidize local rates for the average consumer. The BOC's were allowed to sell customer premise equipment in competition with AT&T and numerous small interconnect companies which had sprung up during the 1970's. This contributed to the intense competition which we see today in the equipment market and the actual declines in price of nearly all communications equipment over the past two years. And the BOC's were emboldened to speak up for their own interests in the terribly complicated and critical details of dividing a huge company.

In other words, many of you were directly responsible for salvaging significant consumer benefits out of the most radical and least understood industry restructuring in history. Consumers would not be enjoying as many of the benefits of competition in the aftermath of divestiture had the original agreement between AT&T and the Justice Department been allowed to stand unchallenged.

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In late 1982, the FCC announced the first of several decisions concerning access charges which proposed to shift billions of dollars of fixed costs off of long distance service and onto local telephone service subscribers -- a captive market. The FCC also radically increased the access charges of the competing long distance carriers, even though their inferior connections to the local network had not begun to be improved. In addition, in late 1982 and continuing throughout 1983, many of the local telephone companies petitioned state regulatory authorities for massive, and, in many cases, unjustified rate increases.

In response to these anti-consumer trends, this Subcommittee sent HR 4102 to the full House. This bill would have prohibited the FCC from imposing access charges on residential subscribers, and would have forced fair treatment of competing long distance companies, along with other consumer protection measures such as a fund supporting high cost rural telephone service. HR 4102 passed the House in November. The FCC, bowing to pressure from the House and from imminent action on a similar bill in the Senate, agreed to reconsider its access charge decision. This had the effect of saving residential consumers from a national average $7 per month hike in their telephone bills by 1990, not including inflation or any other increases granted to the local company by state utility commissions. Instead the FCC set a $2

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residential charge, shelved its OCC rate increases, and instituted a rural support fund much like the one in HR 4102.

The efforts of this Subcommittee over the last 10 years can be characterized by three goals:

- Encouraging the growth of healthy competition;
- Providing a careful transition to a more competitive marketplace, avoiding radical disruption; and
- Protecting consumers in the process.

You understood how much had to be changed, and we understood how long it would take to change decades of monopoly policy.

Members of this Subcommittee can indeed be proud of their record of promoting competition and protecting the interests of the average consumer. Again, it would be hard to imagine the status of the telecommunications industry and the well-being of residential and small business telephone consumers without the efforts of many of you and the positive changes which resulted. Those efforts have contributed strongly to bringing the benefits of competition to residential and small business consumers and to our nation's economy.

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* * *

The communications industry is undergoing a highly complex transition, and there is an unfortunate tendency to oversimplify the major changes under way. Unlike other industries -- notably the airline and trucking industries -- the challenge in communications is not simply "to get government out of the way" in order to spur increased competition.

Both airlines and trucking were already structurally competitive before Congress enacted deregulatory legislation in the late 1970's and early 1980's. In trucking, the nation's largest carrier, United Parcel, commanded only a 12.4 percent share of the market in 1979, the year prior to deregulation. In airlines, United Airlines, the nation's largest air carrier, held only a 21.2 percent market share. In neither industry had federal policy created anything approaching a monopoly structure. Deregulation was successful in enhancing competition in these industries because each market was already characterized by healthy competition among competitors firmly established with significant market shares.

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Despite the slow evolution of competition in communications during the 1970's and its acceleration since divestiture, the structure of this industry is very different. Only one communications market sector is now highly competitive: customer premises equipment. In that sector, competition is so strong that price competition is approaching the status of a price war. When I purchased equipment for my own small business, I was offered discounts of up to 33 percent from list equipment prices, for example.

In other communications sectors, competition is in its infancy. In long distance, AT&T continues to hold at least an 85 percent market share, and its nearest competitor, MCI, slightly over six percent. As a result, AT&T maintains enormous market power. With AT&T getting around 70% of consumer selections during the equal access process, this market power is unlikely to disappear soon. Similarly, in network equipment, competition is only two years old and the market not fully developed.

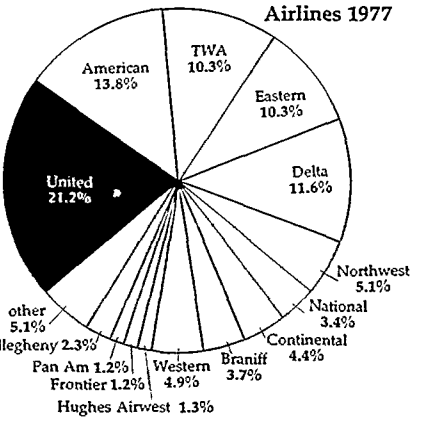
A healthy, truly competitive communications industry will not develop -- and residential and business consumers, along with our nation's economy, will not reap its full benefits -- if federal policy follows a simplistic deregulatory approach. In this industry, which has decades of monopoly history rather than a history of healthy competition, something far more complex is required, as this Subcommittee has previously

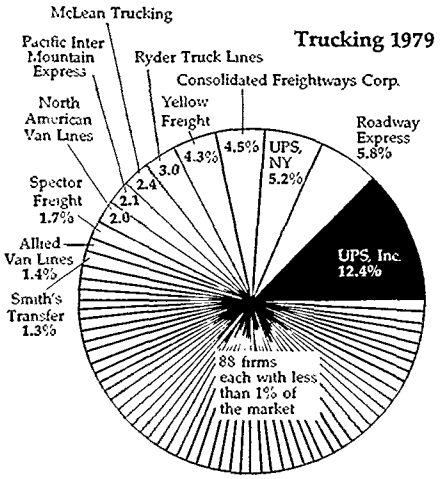
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Market Power and Deregulation

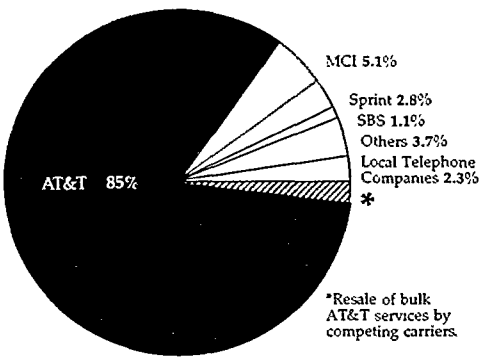
The structure of the trucking and airline industries just prior to their deregulation provides a revealing contrast to today's long distance telephone industry as the Federal Communications Commission continues to loosen restrictions on AT&T

Tremendous competition existed in trucking and airlines the year before government regulation was lifted in each industry. Competition could protect consumers more effectively than any federal regulation and oversight.





Each of these industries was structurally competitive, meaning that no one firm held market power over the entire industry. United was the largest airline with a 21% share of the market; in trucking, UPS was the largest carrier with a 12% market share.



In the long distance telephone market, however, the dominant firm, AT&T, still maintains overwhelming control with at least an 85% market share.

Sources: *Department of Transportation, Interstate Commerce Commission; National Telecommunications and Information Administration.*

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recognized.

Two years ago, the Justice Department struck the divestiture agreement with AT&T based on narrow antitrust concerns, without an adequate eye to the consumer's interest in an orderly, gradual transition to communications competition. In closing, I would urge this Subcommittee to do the opposite -- to maintain its long-held commitment to consumers and return federal policy to a course of gradual evolution -- an evolution which can produce a truly competitive communications marketplace.

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NATIONAL STRATEGIES AND MARKETING GROUP

Robert G. Beckel
Timothy W. Finchem
David K. Aylward

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SUMMARY

Despite the sizable local telephone rate increases which followed the 1982 announcement of the AT&T-Justice Department agreement dismembering the Bell System, average residential consumers who have taken advantage of emerging competition in long distance service and telephone equipment are paying less today for telephone service than they did under the old telephone system:

o By taking advantage of competition -- choosing a lower cost long distance company and buying telephones rather than paying never ending rental fees -- average residential consumers are either paying less today for their telephone service than they did three years ago, or in the case of consumers who still use a traditional rotary telephone, have largely offset the local rate increases which occurred since January, 1983. Rotary telephone customers' savings are less because they are unable to access competing long distance services -- one of the major benefits of communications competition -- until their area has been converted to 1-plus dialing.

o Residential consumers with touchtone telephone service who have purchased their own telephones and subscribed to lower cost long distance services pay from 10 to 16 per cent less per month in total telephone service costs in 1985 than they did prior to the Bell break-up. Consumers with rotary telephone service who took advantage of competitive options pay only $ .18 more per month in 1985 than they did in 1983, (a .8% increase or a decline in monthly telephone costs if inflation is taken into account);

o Consumers who have purchased their telephones and subscribed to lower cost long distance services are paying 8 to 22 percent less monthly for telephone service than those who have not. To achieve these savings, consumers need only purchase their own telephones and choose nearly any alternative long distance service. This study does not assume benefits from any promotional discount offered by any equipment supplier or long distance carrier; cost savings are derived solely from national average costs of good quality telephone equipment and averages of the rates charged by major long distance competitors.

o Residential consumers who purchased a rotary-dial telephone in 1983 and switched to a lower cost long distance carrier this year have saved $40 over similar consumers who did not; families with two push-button telephones who purchased their own equipment and subscribed to competing long distance carriers have saved from $126 to $213 since January, 1983.

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o More than half of a 24 percent increase in national average local telephone rates since 1983 has been offset by lower long distance rates for consumers who have subscribed to competing long distance services, whose current rates average approximately 17 percent less than those charged by AT&T prior to the Bell break-up. Those who continue to use AT&T long distance service have benefited from a nine percent decline in AT&T long distance rates;

o Consumers are deriving these benefits from the mere beginnings of competition in consumer communications. Although the Federal Communications Commission removed the final regulatory impediments to home telephone ownership in the late 1970's, it was not until 1983, with the announcement of the Bell break-up, large numbers of residential consumers began to take advantage of the option to purchase their own equipment. The consumer financial benefits of competition in long distance service are of more recent origin: competition in this field is in its infancy, with AT&T currently holding at least 85 percent of the long distance market.

o Residential consumer who continue to rent Touchtone telephones from AT&T have suffered large increases in telephone rental rates. A push-button telephone in most urban areas rented for approximately $2.07 per month prior to the AT&T divestiture; AT&T rents the same telephone nationwide today for $2.85 per month, an increases of nearly 40 percent. Rotary telephone rental charges have remained constant since 1983.

The conclusions are based on the following case studies of six representative families. Families #1 and #2 use a single rotary telephone and the equivalent of $10 a month in long distance service (measured in AT&T rates prior to the break-up); Families #3 and #4 use two push-button telephones and $10 a month in long distance service (measured again in 1983 AT&T rates). Families #5 and #6 also have two push-button telephones, but a higher long distance budget equalling $30 a month prior to divestiture.

All data in these case studies was drawn from public documents and filings at the Federal Communications Commission, the National Telecommunications and Information Administration, the Bureau of Labor Statistics, state public utility commissions and from information requested from AT&T and local Bell operating companies.

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FAMILIES #1 AND #2

FAMILIES #1 AND #2 each have only one, rotary-dial telephone. Each used $10 per month of AT&T long distance service in 1983. Their billable minutes of long distance service and their long distance calling pattern remained the same in 1984 and 1985.

FAMILY #1 has ignored the changes in the telephone system that have taken place over the past two years. It continues to rent its one rotary telephone from AT&T and continues to subscribe to AT&T long distance service.

FAMILY #2, rather than continuing to rent, purchased its leased rotary from the local telephone company, as many families did following the extensive media coverage of the Bell System break-up (announced in January, 1982) and the Bell System's subsequent promotional efforts to sell its leased telephones. In addition, in the cities surveyed the local telephone company began to install technologies allowing competing long distance carriers to be accessed through "1-plus" dialing on the average in March 1985. This allowed Family #2 to subscribe to a competing service. (In areas where local telephone companies have not yet installed "equal access" technology, only touchtone telephone users may access competing long distance services.)

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NATIONAL AVERAGE FAMILIES #1 AND #2
AVERAGE MONTHLY TELEPHONE COSTS, 1983-1985

FAMILY #1	1983	1984	1985
Basic Monthly Local Service	$10.62	$12.08	$13.17
Long Distance Service	10.00	9.64	9.08
Telephone Rental	1.50	1.50	1.50
Federal Access Charge	-0-	-0-	.58*
TOTAL	$22.12	$23.22	$24.33

FAMILY #2			
Basic Monthly Local Service	$10.62	$12.08	$13.17
Long Distance Service	10.00	9.64	8.55**
Telephone Purchase	1.66***	-0-	-0-
Federal Access Charge	-0-	-0-	.58
TOTAL	$22.28	$21.72	$22.30

* A nationwide access charge mandated by the Federal Communications Commission took effect on June 1, 1985. Averaged over the 1985 calendar year, access charges for 1985 equal 58 cents per month.

** Conversion of local telephone exchanges to "1-plus" dialing which enables rotary telephone users to access competing long distance services, began in the cities surveyed on the average in March, 1985, and is progressing exchange by exchange. This example shows the savings Family #2 achieved if its exchange was converted March, 1985. If it was converted later, the savings would diminish proportionately. However, nationwide conversion is scheduled to be completed within the next year, so that access to competing long distance carriers should become available to all Bell Operating Company customers by the end of 1986. If Family #2's local exchange was not converted during 1984 or 1985, its monthly AT&T long distance charges would be the same as Family #1's, and its 1984 and 1985 monthly total bills $21.72 and $ 22.78 respectively.

*** Total purchase cost of $19.95 for a previously rented rotary telephone, divided by 12 months. (the local telephone company 1983 purchase price for leased rotary telephone.)

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NATIONAL AVERAGE FAMILIES #1 AND #2
ANNUAL TELEPHONE SERVICE COSTS, 1983-1985

	FAMILY #1	FAMILY #2
1983		
Basic local telephone service [1]	$127.44	$127.44
Long distance service [2]	120.00	120.00
Rotary telephone [3] (#1 rental, #2 purchase)	18.00	19.95
1983 TOTAL	$265.44	$267.39
1984		
Basic local telephone service	$144.96	$144.96
Long distance service	115.73	115.73
Rotary Telephone	18.00	-0-
1984 TOTAL	$278.69	$260.69
1985		
Basic local telephone service	$158.04	$158.04
Long Distance Service (#1 AT&T, #2 competing service from 4/1/85)	108.97	102.57
Rotary Telephone	18.00	-0-
Federal Access Charge ($1 per month from 6/1/85)	7.00	7.00
1985 TOTAL	$292.01	$267.61
TOTAL TELEPHONE COSTS, 1983-1985	$836.14	$795.69
FAMILY #2 SAVINGS FROM COMPETITIVE LONG DISTANCE SERVICE AND EQUIPMENT		$ 40.45 (4.8%)

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FAMILIES #3 AND #4

FAMILIES #3 AND #4 each have two touchtone telephones and subscribe to unlimited flat rate service from their local telephone company. Each used $10 per month of AT&T long distance service in 1983. Their billable minutes of long distance service and their long distance calling pattern remained the same in 1984 and 1985.

FAMILY #3 has ignored the changes in the telephone system that have taken place over the past two years. It has made no changes in its telephone service or equipment since the break-up of the Bell System, continuing to rent its two touchtone telephones from AT&T and using AT&T long distance service.

FAMILY #4 has taken advantage of the new consumer choices available. Rather than continuing to rent, Family #4 purchased two good quality touchtone telephones from a competitive supplier in January 1983, as many families did following the extensive media coverage of the Bell System break-up (announced in January 1982) and AT&T's subsequent promotional efforts to sell its new and leased telephones. In addition, Family #4 subscribed to a competing long distance service in January 1984. (Touchtone telephone customers have been able to access competing services since 1979, regardless of the availability of "equal access" or "1-plus dialing" in their area.)

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NATIONAL AVERAGE FAMILIES #3 AND #4
AVERAGE MONTHLY TELEPHONE COSTS, 1983-1985

FAMILY #3	1983	1984	1985
Basic Monthly Local Service*	$11.75	$13.36	$14.46
Long Distance Service	10.00	9.64	9.08
Telephone Rental	4.14	5.36	5.70
Federal Access Charge	-0-	-0-	.58**
TOTAL	$25.89	$28.36	$29.82
FAMILY #4			
Basic Monthly Local Service	$11.75	$13.36	$14.46
Long Distance Service	10.00	8.34	8.34
Telephone Purchase	6.71***	-0-	-0-
Federal Access Charge	-0-	-0-	.58
TOTAL	$28.46	$21.70	$23.38

* Includes monthly Touchtone line charge. See footnote [1].

** A nationwide access charge mandated by the Federal Communications Commission took effect on June 1, 1985. Averaged over the 1985 calendar year, access charges for 1985 equal 58 cents per month.

*** Total purchase cost of $80.52 for two touchtone telephones, divided by 12 months.

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NATIONAL AVERAGE FAMILIES #3 AND #4
ANNUAL TELEPHONE SERVICE COSTS, 1983-1985

	FAMILY #3	FAMILY #4
1983		
Basic local telephone service [1]	$141.00	$141.00
Long distance service [2]	120.00	120.00
Two Touchtone Telephones [3] (#3 rental, #4 purchase)	49.68	80.52
1983 TOTAL	$310.68	$341.52
1984		
Basic local telephone service	$160.32	$160.32
Long distance service (#3 AT&T, #4 competing service from 1/1/84)	115.73	100.09
Two Touchtone Telephones	64.32	-0-
1984 TOTAL	$340.37	$260.41
1985		
Basic local telephone service	$173.52	$173.52
Long Distance Service	108.97	100.03
Two Touchtone Telephones	68.40	-0-
Federal Access Charge ($1 per month from 6/1/85)	7.00	7.00
1985 TOTAL	$357.89	$280.55
TOTAL TELEPHONE COSTS, 1983-1985	$1008.94	$ 882.48
FAMILY #4 SAVINGS FROM COMPETITIVE LONG DISTANCE SERVICE AND EQUIPMENT		$ 126.46 (12.5%)

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FAMILIES #5 AND #6

FAMILIES #5 AND #6, like Families #3 and #4, each have two touchtone telephones in their homes and subscribe to unlimited flat rate service from their local telephone company. Families #5 and #6, however, used an average of $30 per month of AT&T long distance in 1983. Their billable minutes of long distance service and their long distance calling pattern remained the same in 1984 and 1985.

FAMILY #5 continues to rent its telephones from AT&T and continues to subscribe to AT&T long distance service.

FAMILY #6 purchased two good quality touchtone telephones in January 1983, and switched to a competing, lower cost long distance service in January 1984.

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NATIONAL AVERAGE FAMILIES #5 AND #6
AVERAGE MONTHLY TELEPHONE COSTS, 1983-1985

FAMILY #5	1983	1984	1985
Basic Monthly Local Service*	$11.75	$13.36	$14.46
Long Distance Service	30.00	28.93	27.25
Telephone Rental	4.14	5.36	5.70
Federal Access Charge	-0-	-0-	.58**
TOTAL	$45.89	$47.65	$47.99

FAMILY #4			
Basic Monthly Local Service	$11.75	$13.36	$14.46
Long Distance Service	30.00	23.49	23.44
Telephone Purchase	6.71***	-0-	-0-
Federal Access Charge	-0-	-0-	.58
TOTAL	$48.46	$36.85	$38.48

* Includes monthly Touchtone line charge. See footnote [1].

** A nationwide access charge mandated by the Federal Communications Commission took effect on June 1, 1985. Averaged over the 1985 calendar year, access charges for 1985 equal 58 cents per month.

*** Total purchase cost of $80.52 for two touchtone telephones, divided by 12 months.

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NATIONAL AVERAGE FAMILIES #5 AND #6
ANNUAL TELEPHONE SERVICE COSTS, 1983-1985

	FAMILY #5	FAMILY #6
1983		
Basic local telephone service [1]	$141.00	$141.00
Long distance service [2]	360.00	360.00
Two Touchtone Telephones [3] (#5 rental, #6 purchase)	49.68	80.52
1983 TOTAL	$550.68	$581.52
1984		
Basic local telephone service	$160.32	$160.32
Long distance service (#5 AT&T, #6 competing service from 1/1/84)	347.19	281.89
Two Touchtone Telephones	64.32	-0-
1984 TOTAL	$571.83	$442.21
1985		
Basic local telephone service	$173.52	$173.52
Long Distance Service	326.98	281.25
Two Touchtone Telephones	68.40	-0-
Federal Access Charge ($1 per month from 6/1/85)	7.00	7.00
1985 TOTAL	$575.90	$461.77
TOTAL TELEPHONE COSTS, 1983-1985	$1698.41	$1485.50
FAMILY #6 SAVINGS FROM COMPETITIVE LONG DISTANCE SERVICE AND EQUIPMENT		$ 212.91 (12.5%)

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NATIONAL AVERAGE NOTES

[1] Basic Local Monthly Rates:

Cost of Rotary Telephone Service

1983
$10.62 x 12mo = $127.44

1984
$12.08 x 12mo = $144.96

1985
$13.17 x 12mo = $158.04

To calculate the cost of Touchtone telephone service simply add the average Touchtone line charges in the above calculations.
1983 = $1.13 1984 = $1.28 1985 = $1.29

Note: Cost of unlimited, flat rate service.

Source: Consumer Federation of America,
U.S. Department of Labor, Bureau of Labor Statistics,
Touchtone line charge represents average of 15 cities surveyed.

[2] Long Distance Cost

AT&T's Rates
FCC ordered across-the-board 6.1% rate reduction for AT&T to coincide with introduction of multi-line business access charge, effective May 25, 1984.

FCC ordered across-the-board 5.6% rate reduction for AT&T to coincide with introduction of $1.00/mo residential line access charge, effective June 1, 1985.

Competitive Long Distance Service Rates
Savings from using a competitive service were calculated from 1984 and 1985 price surveys by Consumers Checkbook. They reflect prices in effect on August 1, 1984 and July 15, 1985. The average savings using a competitive service is the average of prices for AT&T's top four competitors in the residential phone market.

For consumers averaging $10 of long distance per month the average savings off of AT&T rates were as follows:

1984	13.5%
1985	4.2%

For consumers averaging $30 of long distance per month the average savings off of AT&T rates were:

1984	18.8%
1985	7.1%

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Long Distance Service Costs 1983 - 1985

1983
The examples assume either $10 or $30 of AT&T long distance calling per month at 1983 rates.
$10.00 x 12mo = $120.00 or,
$30.00 x 12mo = $360.00

$10 per month of AT&T Long Distance Calling

1984
AT&T { (A) }
($10.00 x 5) + [($10.00 - 6.1%) x 7] = $115.73/yr

Competitive Service { (A) }
[($10.00 - 13.5%) x 5] + [($9.39 - 13.5%) x 7] = $100.09/yr

1985
AT&T { (B) }
($9.39 x 5) + [($9.39 - 5.6%) x 7] = $108.97/yr

Competitive Service { (B) }
[($9.39 - 13.5%) x 5] + [($8.86 - 4.2%) x 7] = $100.03/yr

$30 of AT&T Long Distance Calling

To calculate the average 1984 and 1985 rates for families using an average of $30 of AT&T long distance per month simply substitute the following:
18.8% for 13.5% savings from competitive service in 1984
7.1% for 4.2% savings from competitive service in 1985

Long distance calling patterns for the two families were assumed to be the following:

Average Call Length	12 minutes
% of evening calling (5-11pm, Sunday - Thursday)	40%
% of weeknight (after 11pm) and weekend calling	50%
% daytime calling	10%
% of calls to urban or suburban areas	80%
% of calls to other areas	20%

Source: Consumers Checkbook, Summer 1984 edition, and Summer 1985 edition.

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[3] Telephone Rental Rates:

1983		
Average rotary telehone rental fee	=	$1.50
Average equipment rental fee for a desk top Touchtone phone	=	$2.07
1984		
AT&T average rotary telephone rental rate	=	$1.50
AT&T average Touchtone rental rate	=	$2.68
1985		
AT&T national rotary telephone rental rate	=	$1.50
AT&T national Touchtone rental rate	=	$2.85

Source: Bell Operating Companies for 1983 rental rates, represents the average of 15 states surveyed. AT&T Information Systems, Consumer Products Division for 1984 and 1985 rates.

Telephone Purchase Cost

The cost of purchasing a telephone is taken from a Consumers Checkbook survey of phone purchase prices in 17 major metropolitan areas between March 19, 1984, and April 6, 1984.

Average lowest purchase price for a top-grade touch tone desk phone	=	$ 40.26
$ 40.26 x 2 phones	=	$ 80.52

Note: Families #2 and #4 could have saved an additional $10 to $15 off of the purchase price of a new phone by buying their existing AT&T Touchtone phones as millions of Americans did.

Source: Consumers Checkbook, Summer 1984 edition.

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Mr. WIRTH. Gentlemen, we thank you very much. Let's go to members in their order of appearance. Mr. Bryant.

Mr. BRYANT. Thank you, Mr. Chairman. I would like to ask Mr. Aylward a rhetorical question here. As I heard it, the central point you made was that consumers have experienced cost increases only in the area which is still a monopoly, and that is local service; is that correct?

Mr. AYLWARD. That is correct except there has been about a 40-percent increase in the cost of renting a touch-tone telephone, which I was not aware of until we did this study, and most people are not aware of it. However, the biggest cost increase has been local rates. That is correct.

Long distance has come down, both AT&T's and the competitors, and the cost of buying telephone equipment has come down rather substantially.

Mr. BRYANT. But is it correct to conclude that what you said is that in both segments of the market, where competition there has been introduced—equipment and long-distance services—prices have consistently declined over the past 3 years? I am reading from your testimony.

Mr. AYLWARD. Absolutely.

Mr. BRYANT. There is no qualification to add to that. Competition has delivered some benefits to the consumer.

Mr. AYLWARD. Yes, sir.

Mr. BRYANT. And where it does not exist, the consumers still are not in as good a shape as they might be.

Mr. AYLWARD. That is correct, sir.

Mr. BRYANT. Many of my constituents, particularly residential and small business telephone customers, believe that telephone costs have increased in recent years. Have you figured out in the course of your studies why they believe that?

Mr. AYLWARD. They believe it for the same reason that most of you believe it; for the same reason that most people who we talk to at cocktail parties believe it; it is what we read.

There has been a constant media barrage since divesitture on how local telephone rates have gone up. People translate that into overall rising rates. They really don't look at the other side where rates have come down, and this results in an enormous misperception that causes people not to act. It causes people not to buy phones. It causes people not to look around for long-distance choices, and as a result, they end up paying substantially more than they did before the divestiture.

Mr. BRYANT. Now, what is the situation from the standpoint of your organization and your studies with regard to local rates. Have they gone up? How much have they gone up, and why?

Mr. AYLWARD. They have gone up. It depends on the jurisdiction. In Boston, for example, unlimited flat rate service hasn't gone up at all. So, Mr. Markey has come out completely on the plus side.

Most places they have gone up an average of 25 to 30 percent.

Mr. BRYANT. Now, why is that?

Mr. AYLWARD. There are numerous reasons for that, sir. One was unjustified fear of what would happen after the breakup, that the local Bell companies would be in very deep financial problems. So

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they were granted many of the rate increases that they might not otherwise have been granted.

Part of it has to do with salutary changes in depreciation rates that the FCC made, which have directly caused some local rate increases. Some of it has been the access charge decision, as reflected in the $1 a month charge on each residential bill that started last June and will go to $2 this year.

Mr. BRYANT. I would like to ask Mr. Shooshan a question, if you would. We hear a great deal here about the bypass threat, its potential impact on local telephone companies and their customers.

I wonder if you would give the committee a simple explanation of bypass, and why we should or should not be concerned about bypass?

Mr. SHOOSHAN. Well, Congressman Bryant, let me answer the last question first, and that is I believe you should be concerned about bypass. There are two types of bypass I think that you need to be concerned with. One is what we might call facilities bypass, and that is the one that often gets looked at. That is where there is bypass by either a customer or someone competing with the local telephone company, actually building facilities. Whether it is an alternative cable, like a cable system would provide, or whether it is microwave radio, where there is a competing facilities base system for handling that local traffic.

There is evidence that, as the cost of technology declines, there will be more and more of this facilities bypass.

The other type of bypass is what we might call service bypass. That is where the facilities being used are still those of the local telephone company, but what is being bypassed is the switched network, and there are a whole host of ways in which customers can do this. The primary basis for it, and one confirmed by a study that our firm made to be a serious problem for the local operating companies, is the use of special access, which is a private line service which does not bear some of the cost burdens borne by the switched service. So as customers, particularly large users, seek options for lowering the cost of that local connection to the long-distance carrier, they are looking at both facilities bypass and service bypass.

And again to come back to your second question, I think it is a serious problem. I think it is a problem that is primarily caused by a misalignment of prices, and I think the biggest mistake that this committee and the commission could make is to wait to do something about it until you see the dead bodies, or the smoking guns. That seems to be the way the Commission has approached it. I think it is a real problem and ought to be dealt with now.

Mr. BRYANT. Thank you.

Mr. WIRTH. Thank you, Mr. Bryant. Mr. Rinaldo.

Mr. RINALDO. Thank you, Mr. Chairman. I want to thank the panelists. I just have one question that I would like to ask Mr. Aylward. I have a copy of the National Residential Telephone Cost Study that you put out, and is it correct to state that that study focuses exclusively on cost, and does not examine or take into account quality of service?

Mr. AYLWARD. Yes, sir. It does not take into account a whole variety of things like features, options that one might want to get on

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equipment. For example, it only studies simple touchtone telephones, or simple rotary telephones. It does not deal with features like automatic redial or speed dial. Nor does it address operator service attached to a long-distance service, or the kind of quality that one gets, no sir.

Mr. RINALDO. Thank you, Mr. Chairman. I have no further questions.

Mr. WIRTH. Mr. Scheuer.

Mr. SCHEUER. Thank you, Mr. Chairman. Adopting the simile we have just heard of the dead bodies and the smoking gun, looking at this whole system as a system, as we move from monopoly to competition, first looking at the users, with the business community, individuals, middle class individuals, the poor, the elderly, the rural, and then looking at the system quai system as the greatest telecommunications system in the world, which we want to protect almost regardless of cost, where are the dead bodies and the smoking guns. If you had to identify problems that we ought to be looking at now, where would you say the problems are? Either in maintaining the integrity of the technology of the system, the research and development, the application of new technology throughout the system, the preservation of incentives for research and investment—research and development, the incentives for savings and investment in the system, and from the point of view of the ultimate users, the consumers, the assurance of universal access to the local net, to the network, where would you say you have gotten enough early warning signals that we ought to be worrying about some dead bodies and some smoking guns, if not tomorrow next year or the year after? Any of you?

Mr. SHOOSHAN. I guess in a general response to your question, Congressman Scheuer, I would say that it is the pricing problem that still troubles me.

The fact that we have opened these markets to competition, but we still have not allowed the prices that are charged by various companies for various services to seek the competitive levels is a critical problem. It relates to my answer to Congressman Bryant about the—the concern about bypass.

I think that another issue that is right there ahead of us that we need to deal with is the one I alluded to in my opening statement, which is the fact that we have simply postponed dealing with this question of how do we let firms with monopoly power into competitive markets; well, first whether we do, and then if we decide the answer to that is, "yes," under what ground rules?

Divestiture answered that for AT&T, but has not answered it with regard to all of the RBOC's, and I think we need to come to grips with that. Third, what I would put on the table, is what happens to universal service in the midst of all of this? And, in fact, are we going to see what we have come to believe is universal service eliminated, and my answer to that in effect is again it relates to pricing more than anything else.

The fact is that through things like optional measured service we can address that problem of the last mile in maintaining universal service, but these are tough decisions for Federal and State regulators to cope with.

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Mr. SCHEUER. On the question of universal service for the poor and the elderly poor especially, do you think we ought to do it through regulation of phone company rates, or should we simply have a Federal program of assisting the poor and the elderly to afford phones, and just give them the wherewithal to pay their phone bills apart from the rate structure.

Mr. SHOOSHAN. Intellectually and theoretically, I think I would opt for the latter. It is what we do in every other sector of the economy, whether it is health care or whatever, where we have a direct subsidy that flows from all the taxpayers to that limited group that needs help. One of the problems that you have with building the subsidy into the phone rates is that you end up subsidizing a lot of people who don't need the subsidy, and I think that is a serious problem, but I think the concern is one that we have to continue to wrestle with.

Mr. SCHEUER. Did the other two of you agree that the major problems facing us are pricing and access, access by the poor, and not problems of the integrity of the system, this great American system of telecommunications which you would appreciate more if you ever do any traveling around the world, not only the developing world, but in the developed world, too.

Mr. WIRTH. Do you all agree?

Mr. SCHEUER. Any problems in that area?

Mr. AYLWARD. There are a number of areas, sir, that we were concerned about several years ago and aren't any more. We were worried that some of the casualties were going to be the Bell Operating Companies. In 1982, that was a dominant concern of the subcommittee. A number of changes in the divestiture agreement were made or advocated here, a consensus was developed.

I recall Mr. Swift, Mr. Tauke and others talking about giving Yellow Pages to the Bell operating companies for example, and the Bell operating companies now are extremely healthy and doing very well.

There was great concern about average consumers coming out behind, and I think the facts are clear that they aren't. There was concern about the end of new technology coming into the network, but we are seeing billions, and billions being spent on fiber optics, new kinds of digital switching and so on. I would agree with Chip that the pricing issues haven't been resolved, and I would agree that despite the study that we did that the people at the very bottom of the income scale need to be protected. I see no reason why that can't be done with a regulated lifeline program exactly the way you pushed for it to be done for rural areas, and it is now being done for rural areas. The same idea could be done for poor people.

Mr. WIRTH. Thank you, Mr. Alyward.

Mr. WUNDER. I want to add just one thing. I would echo what Mr. Synar said in his opening statement. Mr. Synar is not here now, but my concern at this moment in addition to what Mr. Aylward and Mr. Shooshan said, is the continued viability of enough substantial competitors to AT&T in the long-distance market. I think the evidence of the mergers, as Mr. Synar suggested, is evidence that things are not going all that well in that particular sector.

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Mr. WIRTH. Mr. Oxley.

Mr. OXLEY. Thank you, Mr. Chairman. Mr. Aylward, you said that consumers in the telephone industry are not acting like consumers in any other unregulated market. Do you have any feel for why that is?

Mr. AYLWARD. It is all new to them, and quite understandably divestiture caused a lot of confusion. A lot of people didn't know where to take their phone to get it fixed. A lot of people didn't know whether they should buy a phone or rent a phone. Those kind of unnecessary results were exactly the reasons why most of you never supported divestiture. Those problems are now working themselves out. My point is not that consumers are stupid, but that they need to start acting like consumers. The media needs to start telling them to be consumers, and when they do, they can come out ahead.

Mr. OXLEY. So you are optimistic that at least in some reasonable period of time that all will work its way through the system.

Mr. AYLWARD. I think the confusion is working its way through the system. The price benefits and quality benefits on equipment are already there. You have price wars in equipment.

I went out as a small businessman and started my own firm, and it was very nice to get a 33-percent discount off the list price to buy equipment. That didn't happen back in the good old days, but that hasn't happened in long distance. There isn't nearly as much competition there.

But once there is, I think we will see the same kind of benefits there.

Mr. OXLEY. I would like to ask this question of each one of you on the panel, we had testimony—it has been probably 2 years ago—which included in many cases a lot of horror stories about what would happen if the FCC access charge were to go into effect. I would like to ask you, first of all, whether you agreed with the concept of the access charge as put forward by the FCC, and No. 2, whether in fact you feel that those horror stories that we heard 2 years ago have actually come to pass.

Maybe we can start with Mr. Shooshan, and go right down the line.

Mr. SHOOSHAN. Well, Congressman, actually I think that I would have to answer your question honestly by saying that I agree with the direction. I may be unique here in this group. I agree with the direction in which the Commission is going with its plan. I would like to think of what is happening not in terms of some rates going down and some rates going up, but rather that subsidies are being shifted from one set of users to another, and that creates some problems and dislocation. I don't think that the Commission necessarily did a very good job selling its proposal and explaining the need for it to this committee, but I think ultimately and inevitably that it is the direction that we have to go in if we are going to deal with this problem of misalignment of costs and rates.

Mr. OXLEY. Thank you.

Mr. WUNDER. The way it ultimately came out, what the FCC did, I would agree with that direction. What they had originally proposed, I thought it was too much too soon, just like divestiture was too much too soon.

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Mr. AYLWARD. I agree with that. What we ended up with is $2 a month on peoples' phone bills, which isn't going to hurt too many people. What was originally proposed in some States would have ended up as $10 a month on a phone bill, and a national average of $6 or $7 a month on a phone bill, which is a different matter.

The way it ended up, I don't think we are going to have those kind of problems because the amount isn't the same.

Mr. OXLEY. And in that regard, have you seen any evidence of consumers being upset with the access charge in any way? Was that an area that you studied, Mr. Aylward?

Mr. AYLWARD. We did not study consumer reactions per se. We stuck with numbers. We included those numbers in the study. People may not like having a dollar added to a bill but that is not going to break the bank.

Mr. OXLEY. One other question for the panel, if I may. Mr. Shooshan, you mentioned the concept of universal service.

I think we all agree that we do have universal service today, isn't that correct?

Mr. SHOOSHAN. I would say to a large extent, yes, that is right.

Mr. OXLEY. And the figures that I have seen on the number of people who have telephones, would indicate that, indeed, universal service has increased, not decreased. Is that also true?

Mr. SHOOSHAN. That is my impression as well, yes, sir.

Mr. OXLEY. Do both of you gentlemen agree with that?

Mr. WUNDER. Yes, sir.

Mr. OXLEY. If I can just follow that up, in your comments you seem to indicate that there may be a threat to universal service. If so, what would that threat be, and how would it be carried out?

Mr. SHOOSHAN. I say that I think that if we are ultimately to have full and fair competition at all levels in this industry, which I think is desirable, that we may need a mechanism, and I would prefer, as I said to Congressman Scheuer that it be a form of direct subsidy of some kind to deal with those people who truly could not or would not be served in that situation.

And as I reiterate again, the problem with the current set of subsidies is a lot of people benefit from them who don't need to in terms of their economic status, and that is a concern.

Mr. OXLEY. OK. If I may, Mr. Chairman, I know I am past my time, but one more question just on that point. It seems to me that there are other options.

In Ohio, for example, we have the one-party measured service that in 1982 was $7.15; it is now $6.90. Isn't that a much more effective mechanism to provide universal service to everyone, than to talk about subsidies or talk about telephone stamps or some of the other things that have come down the aisle lately?

Mr. SHOOSHAN. I would agree that it is. I think that having optional measured service is a real step forward for State regulators, but it has been a very unpopular step, and one that has been politically very difficult for State regulators to take in the past.

Moving away again from what people—consumers were used to, which is flat rate service where you used as much of it as you wanted and paid a flat rate, and we have to reeducate consumers, so I think it is an important part of meeting the need.

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Mr. WUNDER. I agree with you, Mr. Oxley, that going to a measured service system of the sort that you suggest is far preferable to having the analog to the food stamp program for telephones.

Mr. OXLEY. Mr. Aylward.

Mr. AYLWARD. There are a number of States which have very good life line plans now which I support. The problem is the lack of a national plan to take care of it and follow up on what Mr. Scheuer said earlier. We have always viewed this as a nationwide telephone system.

We have a nationwide rural high cost policy. There is no reason why there shouldn't be a nationwide low-income telephone policy which I would hope would give the lead to the States in implementing it, because situations do change. However, something needs to be there in place to keep those people on the network.

Mr. WIRTH. Mr. Markey.

Mr. MARKEY. Thank you, Mr. Chairman, very much. In my opening statement you heard me voice my opinion that the Megacom and SDN decisions were made hastily and did not reflect a serious regard for the dangers of bypass. You have followed the bypass issue for some time, Mr. Aylward.

Could you comment on developments in the marketplace that have affected bypass, particularly new developments that should heighten our concern about bypass?

Mr. AYLWARD. As Chip was saying earlier, bypass in many ways has been around for a long time. When I was 9 years old bypass started when the Commission allowed—in the 1959 above 890 decision—companies to start building private systems. Since that time we have had hundreds of thousands of circuit miles of bypass systems, private telecommunication systems, built across the country.

Rates haven't doubled, they haven't gone through the roof, et cetera.

Bypass has happened for cost reasons. It has happened for new technology reasons when firms couldn't get what they needed from the phone company. That kind of bypass I don't think you should be concerned about. In fact, I think you ought to encourage it. That is competition.

There is a new kind of bypass that Chip was referring to, that I think is worth being concerned about. It has to do with the move by not just AT&T, but all the common carriers—the people who carry what is known as switched traffic between cities—taking that traffic and instead of ending it through the local companies on switched service, ending it through so-called special access.

That is not new technology. It is not anything other than repricing an existing service, which may result in a situation where the local companies end up losing a tremendous amount of revenues which have to be picked up by the remaining customers.

That, however, is a transitional issue. There is a long-term answer to that question—repricing. In the short term I don't think it helps a lot for the FCC to say well, this is a price decrease, let's approve the tariff without considering the broader context that this is being proposed in.

Mr. WIRTH. Mr. Wunder.

Mr. WUNDER. I have never viewed bypass as an excessively great problem, although it is a problem.

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I will give you an example. When the committee was considering H.R. 4102, one of the people that spoke to me about the charge to be placed on bypasses was a defense contractor.

For reasons of security of transmissions between various of their plants, they essentially had to go to a bypass system. The public switch network was not as secure as it needed to be for their purposes. I am not sure how much of the bypass that we talk about is for those types of purposes or for efficiency purposes for other bypassers, although I think the problem is becoming ameliorated by the things that Mr. Aylward talked about which are the declining long-distance rates, which drove a lot of the bypass that was based upon the high price of long distance, which was high priced because of the subsidy that we are providing to local service.

Mr. MARKEY. What kind of confidence do you have that the FCC knows what is going on, or has a policy that reflects their known of what is going on?

Mr. WUNDER. I would——

Mr. MARKEY. You can decline to answer on the grounds that it would incriminate you if you want to.

Mr. WUNDER. I just don't know how to phrase it as opposed to declining. I think it is an area that needs to be studied more by the FCC.

Mr. MARKEY. Mr. Shooshan, can you comment?

Mr. SHOOSHAN. Mr. Markey, I think bypass is a problem. I think it is appropriate to be focusing on it. But again, my solution would not be to prevent the long distance carriers from finding less expensive ways to get to their big customers. That is inevitable. It is going to happen. You can't turn that back, you can't legislate against it.

I would take steps that would enable the Bell operating companies and other local exchange carriers to enhance their networks and to provide services at competitive prices so they can meet that challenge, and I think that is the way bypass should be addressed. Assuming that you may next ask me as well about the Commission's role in this, I would have to say there, again, I think the Commission should have and could be looking at this much harder than they have. Again, I get the feeling that what people are waiting for is the dead body or the smoking gun.

If you look around you, you can see bypass is a problem, and I think the Commission with its expertise in this area should be doing a better job of calculating what the nature and impact of that is, and making sure they have a cohesive regulatory policy for dealing with that.

Mr. MARKEY. Thank you, Mr. Chairman.

Mr. WIRTH. Let me suggest for those who are standing that there are a number of seats up here and over here that I can see. If you all want to come around and quietly take a seat, if you would like to do that, please do so.

You all look uncomfortable enough. The whole process of these issues, and I thought that maybe sitting down would make you more comfortable. Mr. Tauke.

Mr. TAUKE. Thank you, Mr. Chairman. Gentlemen, we have appreciated your observations this morning, but you aren't quite as

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pure as you were when you were all working for this subcommittee.

I wonder if—for the record—and I don't want to spend a lot of time at it now, but I wonder for the record if you would give us a listing of your telecommunications clients during the last year, so that we know from whence you speak now.

Mr. WIRTH. In other words, you will stand up.

Mr. TAUKE. We just want to see our good things are after Congress Mr. Chairman.

Mr. AYLWARD. We are looking a good Republican in our firm, Mr. Tauke.

Mr. TAUKE. I am sure that all of your answers are totally objective, but I just want to see what the connections are.

In any event, we spent some time talking about how we have gotten to where we are now. I would like to spend just a moment trying to look ahead into the future. How much longer do you think that the local service monopoly will last?

Mr. SHOOSHAN. I think for some people there is no local service monopoly today. I think they are effectively large customers, and there you can include in that category the Federal Government. Large users effectively have options available to them today, alternatives to the local phone service.

Mr. TAUKE. We were just talking about some bypass.

Let me rephrase it a little differently. How long do you think the local monopoly will last for the average residential consumer, or perhaps from a policymaker's standpoint, how long before we have to start making some decisions about transition from a local monopoly to a competitive arena in the local telephone service area?

Mr. SHOOSHAN. I think for the average residential customer that the local monopoly, and this is my personal view, probably will continue for the foreseeable future.

However, that doesn't mean that now is not the time to begin to look at that transition that you spoke of, because again my feeling is that whether it is a facilities-based competition or a service-based competition, that ultimately you will have to deal with that last mile of the competitive road.

Mr. TAUKE. Mr. Wunder.

Mr. WUNDER. I think you need to start looking at it right away, Mr. Tauke. One of the flaws in the Justice Department's view, what remedy was required to deal with AT&T was the notion that local phone service was a natural monopoly. It wasn't true then in 1982. As Mr. Shooshan has suggested, it is becoming ever increasingly true that it isn't as long as we go.

Mr. TAUKE. Mr. Aylward.

Mr. AYLWARD. I think it is going to take a long, long time before you get to a fully competitive market in long distance—long before you get to the question of local competition. It is interesting to see, for example, when people are selecting their long-distance carrier, somewhere around 65 or 70 percent of the people are choosing AT&T on top of an 80 percent to 85 percent market share base today.

So, AT&T's long-distance market power is going to continue. It is certainly true at the local level that big customers can, for certain purposes, have options today, primarily for connections to a toll

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carrier. But there is always going to be a need for ubiquitous local telephone service, and I can't imagine a set of circumstances in the next 20 to 30 years where that is not going to be monopolized by the local telephone company.

Mr. TAUKE. Do you think that technology is permitting more and more people—not only permitting—but encouraging them, making it feasible for them to bypass or escape the local telephone network?

Do you expect that to continue?

Mr. AYLWARD. A little bit of it is happening now, and more of it will happen and I think that is salutory. What is has caused the local companies to do is to become much more customer oriented, much more marketing oriented. It started to make them move some of their costs around, and I think we are seeing some salutary effects of a little bit of competition at the local level, and we will get some more of that, but——

Mr. TAUKE. You don't see it as dangerous.

Mr. AYLWARD. No, no, not at all.

Mr. TAUKE. OK. When we were concerned a few years ago about the Bell operating companies, one of the reasons we were concerned is we felt that they had a confined base, if you will, and that base was going to be gradually eroded.

Are you suggesting that because things have gone well so far we don't have to have concern about that in the future. I think I hear a little different comment from the different people in the panel. Why don't we get an answer on that issue?

Mr. AYLWARD. I think you ought to be concerned about it. I think you ought to look at it. If the Federal Government, for example, goes off Centrex in Washington, which they are talking about perhaps doing, C&P is going to lose an awful lot of revenues.

Now, if C&P does nothing else, if they don't change the way they price service here, they are going to come out behind as the Federal Government links its offices together with a different private system, if you will.

So, there can be some significant——

Mr. TAUKE. And if they come out behind, consumers will pay more.

Mr. AYLWARD. Presumably, but that doesn't mean there aren't other ways that one could price local service. The Federal Government is still always going to call somebody who is not on the network—not on the Federal Goverment network. You do have to look at those issues. I just don't think you want to overplay it.

Mr. TAUKE. Do the other panelists have an answer?

Mr. WUNDER. If you look at the amount of time that has been involved, and Mr. Shooshan gave a good rundown of it, to where we are today in long distance, it is something that has to be addressed, because the base of the local operating companies in my view will not dramatically, not wildly, but it will be gradually eroded, and I think that what we ought not to see happen again is to get behind the power curve again.

Mr. SHOOSHAN. Let's take David's Centrex example, where C&P certainly has the concern about losing the Federal Government account.

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I think it is significant that before C&P could even effectively bid on that contract, they had to go in to the FCC and get a waiver of the computer 2 rules which prohibited them from offering a service and the equipment for that service, the customer premises equipment, as a single entity. I think those kinds of handicaps are the ones that need to be looked at. Also, I want to respond to your question about is this nice little niche that Judge Green has established for each of the RBOC's to operate safe or protected.

Well, one example that he always uses in defending his decision, is to point to what he did for the RBOC's on Yellow Pages? Judge Greene let them keep Yellow Pages.

But as we have seen with ads in the Washington Post within the last week, the RBOC's are now competing against each other in their home territory for Yellow Pages revenues, so I think that the construct of that decree, going back to what Bernie said, is a fallacy and a serious problem that needs to be dealt with.

Mr. TAUKE. There are lots of questions. I am out of time. Thank you.

Mr. WIRTH. Thank you, Mr. Tauke. Earlier in opening statements there were a number of references made to the number of acronyms and other initials, and I would note for the record that the exchange between Mr. Tauke and Mr. Alyward created a new one, ULTS, which is Ubiquitous Local Telephone Service, ULTS. Thank you gentlemen very much.

Mr. Swift.

Mr. SWIFT. Thank you, Mr. Chairman. I really think it has been an excellent reminder of how we got where we are, the entire presentation of the panel.

I have some sympathy with the public for not understanding. I know Members of Congress who think that we voted to break up the Bell System. They don't know when the vote was—and they sure as hell hope they voted right—but it is a hard thing for the public to understand.

Mr. Aylward, you suggested that the consumers would act more like consumers if they understood the situation better, and I think that is true. It has been hard to get the media to cover this in depth.

I remember having a major conference in Seattle with some of the large telephone users, and the Seattle Times sent two people from their business office, but no reporter. They were concerned about it in terms of how it was going to affect their business, but the editor didn't see it as an issue that was important enough to cover. That has changed. Media bashing is always fun.

The fact is, this is a tough story to tell. To write or to tape or to film in a way that someone would read, listen, or watch.

Do you have any suggestions as to how the process could be speeded up so the consumer understanding what options there are, and getting off the kind of glitch you feel they are hung up on?

Mr. AYLWARD. Yes; in fact, I think it is very simple. The first part is to stay away from SPF and SLU. The second one is to say: Buy your telephone, and don't rent it. Look at your long distance options, and choose one. Don't just accept what they give you. If that is all you do, you will come out ahead.

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That is not a complicated story, but it is a story the media, for the most part, haven't written. I think the reason is that everybody including the media, was confused, but the message is really quite simple. You would not begin to think about buying a stereo, by only going to one store and not looking at any other options. You wouldn't do that.

But that is what we were trained to do for years in telephone service, and now it is different. People have to start acting differently.

Mr. SWIFT. I don't know. Do you know if any of the consumer magazines, consumer reports, that kind of thing, have they done stories on this that would be useful to consumers?

Mr. AYLWARD. Yes, some of them have. In fact, much of the data from our study was taken out of Consumer Checkbook, which has done extensive research. It is more the generalized media which has it. Your example of the Seattle newspaper is a very good one, and that has been repeated across the country in lots of cases.

Mr. SWIFT. I suppose one last point. A lot of us were making a lot of noise about what was going to happen to local rates during a period in the process in which the access charge looked like it was going to be $8, or $6, or $10, whatever figure you wanted to choose, and I think we had to raise that issue very clearly.

Probably it was less well reported, and maybe we talked about it less when in fact that access charge didn't come out at $8 or $6 or $10, but it came out at $2, and there may be some lag in the public perception with regard to local rates in that regard.

While I am pointing that out, I think it might be useful that if anyone wants to know what this committee ever did for the telephone consumer, in my judgment it was the passage of legislation through the House of Representatives that basically forced the FCC to reexamine that access charge, and we probably can be credited with saving every telephone consumer in this country $4 a month forever and that, Mr. Chairman, I would suggest was a pretty good day's work. I yield back the balance of my time.

Mr. WIRTH. Thank you, Mr. Swift. Mr. Ritter.

Mr. RITTER. Thank you, Mr. Chairman. I would just like to ask a question related to Mr. Swift's last comment.

What would happen to the overall telephone bills were there to be a greater balance between access charges and the subsidization of local rates by long distance? Do you have any feel for that, Mr. Aylward?

Mr. AYLWARD. You mean what would happen if you had gone with the original FCC plan, and there was no——

Mr. RITTER. Or thereabouts—we are at a dollar now, I guess. What would happen to the overall bills? What is the opinion of you three experts. What would happen to the overall bills?

Mr. AYLWARD. In the numbers that we looked at at the time, sir, it would have varied by State. In your State, it would have been about $4, $4.50, I think, per month per customer, when the plan had gone into effect fully. In other States it was more in the order of $10 a month.

Mr. RITTER. That's the charge itself. But what about the balance between long-distance charges being reduced, and access charges being increased. What are your impressions?

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Mr. AYLWARD. Long distance charges would have gone down substantially. The AT&T rate reductions of around 10 percent in the last 2 years have come about from exactly that.

Mr. RITTER. I guess my point is to try to apportion the costs where they are in reality. What would have been the prospect had access charges been higher, and long-distance rates been lower in the final telephone bills that our consumers are seeing today?

Mr. AYLWARD. The aggregate telephone bill for the country would have been the same. What would have happened is that those people who make many long-distance calls, perhaps over $20, $25 a month, would have come out ahead, and those that made less than $20 or $25 a month would have come out significantly further behind than they are today.

Mr. RITTER. There would be no greater efficiencies in the system with a more appropriately apportioned cost structure?

Mr. AYLWARD. I think there would have been greater efficiencies, but——

Mr. RITTER. My question is does that eventually come down to lower average cost for consumers? Mr. Shooshan, do you want to take a crack at that?

Mr. SHOOSHAN. I think I agree with what David said. It is hard to quantify, Congressman Ritter, what the impact would have been. Theoretically, if you deload toll, and you shift some of those costs back to the local ratepayer, the toll rates ought to fall. But the fact of the matter is, although the Commission seemed to suggest there was some kind of nice symmetry here, that toll rates are really constrained by a number of other factors as well. For example, where the competitors are? How much market share a carrier like AT&T really wants to have in a competitive market, which I think is a critical issue.

So, I think the problem with what the Commission proposed originally was as Bernie said, it was too much too soon, No. 1. No. 2, I think that it seemed to reflect that there was going to be some immediate compensating reduction in toll rates, which was not necessarily true. But I think that ultimately, and this is the point I made in answer to a question earlier, moving in that direction is something that has to be done it seems to me, and I would be concerned about stopping at the $2 figure.

Now, the question is: How do you get from $2 to where——

Mr. RITTER. The reason I bring this up is that there seems to be a general belief that we are really saving the consumer money by keeping very strong downward pressure on the access charge. I am just wondering if, in the final analysis, perhaps we haven't saved the consumers as much money as we like to tell them. Mr. Wunder.

Mr. WUNDER. Mr. Ritter, I have always looked at this proposition in the following fashion. Having been a proponent of competition, still am, what we need to do is have a transition to where I think you want to go and I want to go over a period of time.

What you don't need, and thus my answer, as Mr. Oxley said, what you don't need in a postdivestiture era is perception amongst the public that rates are going out of sight, it is a function of the breakup, which it wasn't, but you need to move this ball along slowly and gradually and not so abruptly.

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As an economic proposition, we needed to deload toll. That's what the FCC was essentially all about.

Mr. RITTER. In the final analysis, would the overall system efficiencies end up in lower or higher rates for the consumer?

Mr. WUNDER. I guess the only way to answer that, Congressman Ritter, is to say that it depends on who you are. Some types of users will benefit; some will not.

I then go back to the original debate over the access—over the Commission's original access charge order, where Congressman Swift had said that what disturbed him in particular was the fact that even the ratepayer that made no toll calls—or the telephone user that made no toll calls would in fact only see his or her rates go up as a result of what the Commission proposed.

It's hard to argue that that customer is benefiting under this transition.

Mr. RITTER. Yeah. I——

Mr. WIRTH. If we can come back around, we might do that. Thank you, Mr. Ritter.

Mr. Luken.

Mr. RITTER. If I just might follow up on that last comment. I mean, I'm not arguing that. What I'm kind of looking for is what the average cost to our customers and consumers would have been.

Mr. WIRTH. Mr. Luken.

Mr. LUKEN. Thank you, Mr. Chairman. Let me suggest an answer to a question that has been asked somewhat rhetorically perhaps earlier by a number of the questioners of the witnesses. I think, Mr. Aylward, you referred to it in your citing of the polls. Why do consumers wrongly believe that rates have gone up?

I suggest that the answer may be that divestiture seems to have gone against the grain, that today consumers look for one stop shopping and they are looking for simple kinds of solutions to their shopping problems; whereas, what has been presented to them is a 10-page telephone bill—that would disorient one right there—and complex, sophisticated questions about which carrier to choose, which kind of equipment, whether they should choose wiring or their own wiring.

The consumer is suffering from some kind of psychosis or neurosis, his mental health is being jeopardized. Maybe this is the reason that people don't realize that things are as they seem.

Is there anything to that?

Mr. AYLWARD. I agree with that. I think there is a lot to that, except that I don't think that we ought to treat American consumers as babies and idiots.

Mr. LUKEN. We ought not to treat them as computers either.

Mr. AYLWARD. Well, no, I'm not suggesting that they are at fault somehow. Divestiture was a mistake and the reasons you gave are the primary ones why it was a mistake.

It caused a lot of confusion and disruption in a very short period of time. American consumers may want one stop shopping. An awful lot of them also like to save money.

And if they are given the information as to how easily they can save money, I think they will start acting. But, don't get me wrong. I'm not blaming consumers. They are not the ones that caused the confusion.

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Mr. LUKEN. Is there any relief in sight, or is it going to get more complicated?

Mr. AYLWARD. I think it's getting simpler and simpler all the time, because people are starting to——

Mr. LUKEN. Are the bills getting shorter?

Mr. AYLWARD. In fact, they are. A telephone company out in the West figured out that you don't have to do it in 10 pages, you can put it all on 1 page. You just have to make the 1 page a little bit bigger.

Mr. LUKEN. Can we pass a law to require that?

Mr. AYLWARD. Yes, sir, you can.

Mr. LUKEN. Just think of the votes we would get.

Mr. AYLWARD. I would do it.

Mr. LUKEN. Well, it is true also, is it not, that those who are the least sophisticated are those who are the ones who are likely to be paying more? I mean, that would be the result.

Those who were least sophisticated in figuring all this out would be those in the lower end of the economic spectrum—not those that would likely pay more, but who could least afford to pay more in this situation we are in.

Let me just pursue this a little bit further. I note, Mr. Aylward, as far as I can tell—some discrepancy between your figures, not a great discrepancy perhaps, and those of a subsequent witness, Mr. Kimmelman of the Consumer Organization. Your chart following page 6 of your testimony would indicate that a family which continues to rent telephones, would be paying $22 in 1983, and in 1984 $24 total.

Is that right, by the way? That family would be paying a couple dollars more a month overall, right? That's an average family.

Mr. AYLWARD. That's the family that has one rotary telephone and makes $10 a month in long distance and——

Mr. LUKEN. The one that doesn't like to be involved in neurosis.

Mr. AYLWARD. And doesn't want to hear about neurosis, that's right.

Mr. LUKEN. But that one still would pay a couple dollars more, right?

Mr. AYLWARD. Yes.

Mr. LUKEN. But the other one that gets the computer out and figures it all out would still pay as much, right, $22.28 to $22.30?

Mr. AYLWARD. That one would pay 18 cents more a month than they were in 1983.

Mr. LUKEN. But then I thought I heard you say that the average family would save 10 to 16 percent in your narrative.

Mr. AYLWARD. I don't think that's an average family, that example.

If you go to the next chart, sir——

Mr. LUKEN. Oh, you didn't mention it wasn't an average family.

Mr. AYLWARD [continuing]. The two touchtone telephones, with $10 a of long distance a month.

Mr. LUKEN. But the average family would come out about even then if they did all the saving——

Mr. AYLWARD. If you considered an average family to be one rotary telephone and $10 a month, yes. And you didn't count inflation.

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Mr. LUKEN. Well, if I could just continue to ask about Mr. Kimmelman's statement, he says: Unfortunately, for the 75 percent of consumers who make a few long-distance calls each month, these long-distance rate reductions don't even come close to offsetting postdivestiture local rate increases. Only consumers who on average make more than $40 a month in long-distance calls are coming out ahead.

Do you have any opinions whether that is right?

Mr. AYLWARD. Mr. Kimmelman's study did not consider the impact of buying telephones. It is only looking at long distance, and the numbers here use $10 a month of long distance.

The average residential long-distance bill was around $15.50 last year, according to AT&T.

Mr. LUKEN. So, purchasing the telephone is a big factor.

Mr. AYLWARD. Yes. I don't disagree with Mr. Kimmelman's numbers. The point is, he didn't look at the same things we did.

Mr. LUKEN. Thank you.

Mr. WIRTH. Thank you very much, Mr. Luken.

Mr. Nielson.

Mr. NIELSON. Yes, thank you. I would like to followup on the comments by Congressman Bates and Congressman Ritter.

Congressman Bates said that the rates of the long distance have gone down because we have a lot of competition there but the rates for local have not gone up where there is no competition.

And Mr. Ritter said: That's because we have been subsidizing the local rates with long-distance rates for many, many years.

Isn't that more of a factor, Mr. Aylward, that the reason the long distance has gone down is the fact that they no longer have to subsidize the local?

Isn't that the major reason rather than the fact that there is competition?

Mr. AYLWARD. In the case of AT&T's rates, that's absolutely correct. AT&T's rates were reduced twice I believe on the direct order of the FCC to pass through the savings of those flat charges that were added to the local telephone bills.

The competitors generally price their services below AT&T. I'm not suggesting that the long-distance market is a fully competitive market. In fact, I'm suggesting just the opposite.

The equipment market is competitive, however. And I think you are seeing price wars there and enormous cost savings.

Mr. NIELSON. So, in general, the fact that long-distance rates have gone down is because they no longer subsidize the local, rather than that competition is fully there?

What about the local rates? It was asked earlier, how can we introduce competition there to maybe stop them from going up after having to absorb the long distance dropping or dropping their rates?

Mr. AYLWARD. Well, one of the things that has happened is that in the last 2 years, we have started to have a great deal of competition in the area of network equipment—the billions and billions of dollars that are spent every year by the local telephone companies to build the local transmission plant.

Up until 2 years ago, they bought almost all of that equipment from Western Electric, part of the family. Now we have competi-

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tion there. I think you will start seeing a savings from that competition being reflected in local rates over the next couple of years.

Network equipment is an area where competition ought to directly benefit local rates.

Mr. NIELSON. One last question to you, and then I have one of Mr. Wunder.

You mentioned on page 4 that they can achieve these savings without having to pour over books and comparison shop. They can be achieved by buying a telephone instead of renting it and switching from AT&T to virtually any other competing long-distance service.

What if they just simply buy the telephone but don't switch, then what would happen? Just do one of those things, buy the telephone instead of renting it but stay with AT&T.

Then, what would happen? What would happen to the average rates?

Mr. AYLWARD. If you look at one of the charts we have, for example, the second one, sir, the equipment cost of two touchtone phones in 1983 would have been $4.14. The same cost today would be $5.70. You would eliminate that from your bill.

Mr. NIELSON. But you wouldn't save the extra $5 or so by switching long distance?

Mr. AYLWARD. If you removed that from the equation and just looked at the equipment, you are going to save money on equipment.

But there are instances in which renting a phone makes sense. If you've got small kids who like to knock the phone off the table all the time, you would probably want to rent a phone. But most people don't.

Mr. NIELSON. Mr. Wunder, I'm——

Mr. WUNDER. Yes, sir.

Mr. NIELSON [continuing]. Told that you and Secretary Baldrige testified at the AT&T settlement agreement in 1982 before the Senate Commerce Committee, and that you said: One of the good things about the agreement was it would promote foreign trade.

That's what you are alleged to have said. Since the divestiture, our trade situation has gotten worse.

How do you relate your statement in 1982 that foreign trade would get better with the agreement as to what's happened; and, second, as a follow on, what would you do about it at this point if you were in our shoes?

Mr. WUNDER. Boy, I don't ever recall making that statement.

Mr. NIELSON. I'm quoting, "One of the good things about the AT&T settlement agreement is it would promote foreign trade."

Mr. WUNDER. To tell you the truth, what I really feel about that is the breakup of AT&T eliminated the world's largest nontariff trade barrier. And the situation in equipment has deteriorated since that time.

If you look at the predivestiture numbers on imports, telecommunications products, we were in a supposition in 1981, but today, we are in a deficit position.

And something that Mr. Aylward alluded to is, you haven't seen anything yet, because the big equipment purchases are coming and those are the megadollar purchases.

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Mr. NIELSON. So it has improved foreign trade for the other guy?

Mr. WUNDER. For the other guy, it sure did. Yes, sir.

Mr. NIELSON. OK. Now, would you have supported, or would you support the bill that we have to allow the Bell operating companies to go back into manufacturing?

Would you support that?

Mr. WUNDER. Mr. Nielson, if there's any American company that wants to manufacture telecommunications equipment in the United States, I would let them.

Mr. NIELSON. You would allow the Bell operating companies to do that?

Mr. WUNDER. Sure.

Mr. NIELSON. And I assume you would also approve of the bill to open up the Japanese market that we passed?

Mr. WUNDER. Oh, I would say, sure, I would approve it. But I think that—quite frankly, I'm not very optimistic about the Japanese market ever being open. I think the Xenophobia in Japan presents a situation where they are just not going to buy products other than their own.

And I don't care what barriers you eliminate and whether the Prime Minister goes on television and urges people to buy their products or not, I don't think that is going to be significantly impacted upon.

If I were the Japanese, I would just eliminate all the barriers and the situation would be about the same.

Mr. NIELSON. Thank you, Mr. Chairman.

Mr. WIRTH. Mr. Coats.

Mr. COATS. Thank you, Mr. Chairman. I appreciate you calling this hearing and the subsequent hearings, because it's an area that we do need to delve into.

It is a complex area, and as simple as we try to make it, it's complex.

Mr. Aylward, you stated earlier in your remarks that the benefits to the consumers are clear. In fact, I wrote the quote down, that the consumers have come out very, very well. If the consumers don't believe that, then it's essentially the media's fault or the consumers haven't educated themselves as to the benefits of all this.

But I would suggest the problem goes much further than that and goes beyond the consumers sitting down and weighing the potential benefits and costs in terms of strictly economic matters.

Let me just give you an illustration of what I think the problem is. When I came to Congress, I figured I've now got an excuse to turn over all the bill-paying to my wife. I finally convinced her that she ought to pay all those bills and that I was going to be busy down here writing laws and all that sort of thing.

For example, take the telephone bill. Just one bill, one piece of paper. There's a flat rate on there and then they list your long-distance calls and just check those, and then it adds up to one little number down here at the bottom where I check every month and it's done.

So I went off to business here in Congress to write some new regulations for the telephone industry or deregulate it, and about 2 years later she comes to me and says: Remember that simple little

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telephone—and she teaches math, by the way. Remember that simple little telephone bill, she said: Well, I got 17 sheets last month and there's 50 cents for this and a dollar for that and $2 for this, and I can't begin to figure this thing out. It says: See Code X, Y, Z on the back and A over here, and this is this company and so on and so on.

She said: Who is responsible for this mess that I have to go through every month, and how can people possibly figure it out? And my response was: I know no one on the Energy and Commerce Committee is responsible, because no one has taken credit for this particular thing. I said: It must be the staff.

Because no member will acknowledge that they had anything to do with this, then it has to be the staff. So, I'm pleased to see the staff here today to tell us, not maybe what went wrong, but did you anticipate, or should we have anticipated the consumers real complaint?

And that is, they don't understand what's going on. They don't understand the complexity of this thing. How come I have to have 18 different pieces of paper and it's so complex? I don't think they are so concerned about the cost as they are the confusion and the complexity.

Now, given that confusion and complexity that I think we would all admit is out there, is there anything that we can do at this point to simplify this very complex deregulatory process?

Should we be looking for an adjustment? Should we be recommending anything to the FCC in terms of how we can simplify for the consumer? Is there a light at the end of the tunnel, or is it just going to get more and more complex as more and more elements pour into the pot here in terms of this deregulation?

Mr. AYLWARD. Let me answer your question, sir. When you and I were working to reduce the deficit, there was an intern over in the House annex who did all this.

Nowhere in any bill that I [redacted] drafted for any of you, that Bernie ever drafted for any of you, or Chip ever drafted for any of you, was there a requirement that telephone bills should be longer than one page, be confusing, et cetera. There is nothing in any regulation I'm aware of that requires that.

In fact, as I mentioned earlier, there is one good-hearted telephone company out West—I think it may even be Utah—that has come up with a one-page bill. It is out there someplace. There is nothing that required confusing telephone bills.

I agree the bills are confusing, and I don't see why there has to be a page to tell me that I'm about to get my equipment costs and a page to tell me I'm about to get my long-distance costs. But that is the phone company's problem and they ought to straighten it out.

Your broader point is correct, that divestiture caused a lot of changes very quickly, confused an awful lot of people, and that created problems. That confusion is starting to work itself out at this point. I think there are a number of things that could be done. One, the FCC ought to spend more of its time trying to communicate to the public what is going on and what they should do about it.

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I think you might want to spend a little time communicating to the public about what is going on.

Mr. COATS. I tried that, but it was a disaster. First of all, I couldn't understand it myself, and second, I found that people just weren't receptive to the explanations as to why it had to go from what it was to what it now is.

Mr. AYLWARD. I wouldn't try that one. I tried that a lot. My wife doesn't buy it either. But I would try simply "Buy your phone and choose a long distance carrier, don't let them do it to you. You can save money." And you have got the statistics there to prove it. I wouldn't try to explain.

Mr. COATS. I'm up against Cliff Robertson, who keeps saying don't buy your phone and don't choose.

Mr. WIRTH. Let me, if I might, have the people from Mountain Bell talk to the people from Indiana Bell. It is Mountain Bell that has gone in Colorado to one page, moving Utah and all of the Mountain Region to one page, finding out how to do that.

Mr. COATS. That is only part of the problem, I would suggest, but the other part is the complexity of multiple choices and so forth. I understand that in deregulation you go through a transition period.

I guess my ultimate question was is there light at the end of the tunnel? Are we sorting these things out? Is it going to be simpler, easier, cheaper for the consumer in the long run?

Mr. AYLWARD. Yes, I think they are being sorted out. The benefits will become clear to people as we go along. You might suggest to your constituents that somebody is proposing a bill that will allow only one kind of personal computer, only one kind of stereo, and you can only rent it, and see what their reaction is.

People are going to start within a few years to view telephones in the same way they view other electronic appliances, and by that point I think it will be worked out. It is unfortunate people had to go through what they went through, however.

Mr. WIRTH. The time of the gentleman has expired.

Mr. Wyden.

Mr. WYDEN. Thank you very much, Mr. Chairman.

Just two very quick questions.

Mr. Aylward, first of all, I have long admired your work and I think you know that, and I have listened carefully to the Aylward formula. It has been very clear. If you buy a phone, if you shop for long distance, according to your formula, in most instances your telephone costs are likely to be pretty much OK.

My problem is that doesn't jibe with what my constituents, including senior citizens and small businesses, are saying. I am getting indications that the government doesn't exactly see it that way either. Specifically, it is my understanding that the Consumer Price Index shows that telephone costs for local, long distance and equipment combined was up 9 percent in 1983–84, and an additional 4 percent in 1984 and 1985. That would seem to be inconsistent with your findings as well.

Now, how would you explain what the government is producing with regard to telephone costs?

Mr. AYLWARD. The numbers we have here, sir, come from Consumer Checkbook, on the one hand, but most important, by calling

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AT&T and the local phone companies and asking them what their rates were in 1983, 1984, and 1985. These are actual numbers of actual rates that people were actually paying, and that is where they came from.

Now, there is clearly a perception to the contrary. That's my whole point. There is an enormous perception to the contrary, and some things have been done that you don't agree with and I don't agree with. For example, a $6 flat access charge on a three-line small business that doesn't make a lot of long distance telephone calls is not a really neat thing to have happen.

Mr. WYDEN. But how would you explain the government's finding? The government's finding is in line with what my constituents are saying, and that's why I think it's important, and I would be interested in your explanation. Are they just off base?

Mr. AYLWARD. This study has been out since December. No one has attacked its findings. Usually, as you know, when I say something that might be controversial, there is somebody around who will attack. They haven't disputed at the numbers.

Mr. WYDEN. Well, it certainly doesn't jibe with what the government is saying, with what the Consumer Federation of America is saying and with what senior citizens and others who come to my town hall meetings are saying, but we have great respect for your work and are going to continue to look at it.

Mr. AYLWARD. To be fair, Mr. Wyden, are they saying that it is cheaper to rent a telephone than to buy one?

Mr. WYDEN. They bring me their bills. That is what it is all about out there. We have talked a great deal about consumer motivation and divestiture, but people bring me their bills, and their bills, plus the Consumer Federation study, plus the government numbers with respect to the Consumer Price Index don't jibe with your work.

I say this being an admirer of yours and I will pursue this thing.

Mr. AYLWARD. One of the things that has happened on those bills is that the cost of renting a Touch-Tone telephone has gone up 40 percent in 2 years, and most people don't know that.

Mr. WYDEN. We certainly have more work to do with respect to education. We all agree on that.

One other question, gentlemen. I would be interested in your thoughts about whether or not the definition of universal service is being redefined in this country. It used to be that universal service meant more and more people were going to get telephone service in this country, and everybody thought that that was a good idea. Now it seems to be if you even hold your own with respect to market penetration, that is OK, and the evidence I have from the census data indicates that we have already dropped a point in terms of market penetration.

The Census Bureau data for November 1985 indicates 91.9 percent of the households had a telephone. In 1980 it said 92.9 percent.

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It is my conclusion that we are not even holding our own, that we are actually dropping, and I would be interested in your thoughts on what I see as a redefinition of universal service and whether you think that is going to be a problem.

Mr. AYLWARD. I think any trend away from universal service is a problem and you ought to do everything you can to stop it.

Mr. WYDEN. Well, I don't gather any of our other witnesses want to comment. I would just say that I think universal service is clearly something that Members of Congress since the thirties have wanted to support, and now the business has changed very dramatically. People are in the business to make a profit first, and universal service, I think, is sliding away. We are not even holding our own, according to the numbers that we have from the Census Bureau.

I thank the Chairman.

Mr. WIRTH. I thank the gentleman. The gentleman's time has expired.

Gentlemen, we thank you very much for your help and your assistance to the subcommittee and your very valuable testimony. We will leave the record open for other questions from other members or further followup from members who are here.

Mr. Shooshan, Mr. Wunder, Mr. Aylward, thank you all very much for being with us.

Our second panel this morning will focus on the impact of Federal regulatory decisions on local rates. The panel, in order of appearance, will include Assemblywoman Gwen Moore, chairman of the Utilities and Commerce Committee, the State Assembly, Sacramento, CA; Mr. John Sodolski, president of the U.S. Telephone Association in Washington; Ms. Sharon Nelson, chairman of the Washington Utilities and Transportation Commission, Olympia, WA; Mr. Gene Kimmelman, legislative director of the Consumer Federation of America; Mr. Russell Heeren, American Association of Retired Persons in Washington; and Mr. David Schmidt, president of the Heart of Iowa Telephone Cooperative, National Telephone Cooperative Association, in Washington.

We thank you all very much for being here. Ms. Moore has an airplane that she has to catch back to California, and Gwen, we will start with you. Why don't you start right off, if you would.

Thank you very much for being here.

If I might add, I think all of you are all familiar with the rules of the subcommittee. We will ask you to please hold your testimony to 5 minutes. We will have a timer on each. There will be a clock in front of you which will run a red light when your 5 minutes is up.

Your statements will be included in full in the record.

Thank you all for being here.

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STATEMENTS OF GWEN MOORE, CHAIR, UTILITIES AND COMMERCE COMMITTEE, CALIFORNIA STATE ASSEMBLY; JOHN SODOLSKI, PRESIDENT, U.S. TELEPHONE ASSOCIATION; SHARON L. NELSON, CHAIRMAN, WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION; GENE KIMMELMAN, LEGISLATIVE DIRECTOR, CONSUMER FEDERATION OF AMERICA; RUSSELL HEEREN, AMERICAN ASSOCIATION OF RETIRED PERSONS, ACCOMPANIED BY KEN BRUNETTE, LEGISLATIVE STAFF [AARP]; AND DAVID L. SCHMIDT, ON BEHALF OF NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

Ms. MOORE. Thank you, Mr. Chairman, for allowing me to go out of order. I do have a 12:50 flight. I do appreciate the opportunity to appear before this committee.

It is indeed a pleasure to come before you again to share a state legislator's perspective on Federal telecommunications policy. I am appearing in my joint capacities as chairwoman of the California State Assembly Committee on Utilities and Commerce, and as the chairwoman of the Committee on Transportation and Communications of the National Conference of State Legislators. The NCSL, you may know, is the sole national organization serving the Nation's 7,500 State legislators.

When I last appeared before you, in 1983, I lamented a growing policy gap between the Federal Communications Commission, which regulates interstate telecommunications, and the States, which regulate interstate communications. The worst case scenario which I described to you then is a reality now.

The FCC is shifting the costs of telephone service, billions of dollars annually, from long distance, mostly corporate customers, to local, mostly residential and small business customers. We in the States bear the brunt of the public reaction. I only wish I had time to share with you the many letters and phone calls I, my colleagues, and State legislators across this Nation get from citizens who complain about the mysterious Federal access charges, the confusion inherent in choosing a long distance carrier, and their general dissatisfaction with the disjointed state of telecommunications service in America today.

The background material for this hearing indicated that you want to know how we can handle the transition from regulation to competition. At the conclusion of my comments, I will list three steps Congress can take that would help us to move through this transition. But I respectfully submit that competition, like regulation, is only a means to an end.

The ultimate goal for which you and the Congress, as indicated by numerous bills and resolutions proposed by members of this committee, and we in the state capitals are striving is the universal accessibility of innovative, useful and affordable telecommunications services for all Americans.

I suggest first and foremost that Congress must make a declaration to this effect and provide appropriate guidelines for the Federal and State authorities to ensure that we reach our mutual goal.

In California in the last 2 years, when all the price shifting, FCC-imposed enduser access charges and surcharges are added in, the price of basic local telephone service has increased by 40 percent,

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from about $7 to $10. Other States have experienced the same phenomenon, resulting in even higher basic costs.

Only last month the FCC's Common Carrier Bureau preempted the Texas Public Utilities Commission, allowing a large customer to pick and choose among local telephone companies. If this decision is upheld, it will wipe out 75 years of utility law, in particular the important principle that the protected franchise utility must serve all equally. The Bureau, by removing the protection granted the franchisee by the State, would release it from its obligation to serve all citizens. I note that Chairman Fowler has personally defended this action.

California's lifeline law, which I authored in 1983, levies a small tax on long distance carriers to fund a discounted local service for low income customers. As refined by our PUC, the law allows 1 million eligible households to keep a telephone in the home without cutting back on groceries. One of our concerns had been that there would be a great deal of abuse. Happily, abuse is low, even with self-certification, and satisfaction is high, especially in the rural areas. I would respectfully recommend that the Congress, consider a national lifeline-policy based on the California model. It has served us well. But I caution you to remember that lifeline only protects those who otherwise would have no service at all.

What about the large middle class of customers whose local rates continue to rise but who do not realize the commensurate benefits enjoyed by a relative handful of large corporate and Government users? If we are serious about stimulating the growth of an information economy, we should think carefully about burdening the vast majority of customers with higher prices for the local service they find most useful.

Mr. SWIFT [presiding]. Do you want to summarize the three points briefly?

Ms. MOORE. First, there is definitely a need to clarify, through resolution or legislation, the jurisdictional boundaries set forth in the Communications Act, which define the respective legitimate interests of the Federal Communications Commission and the States.

Second, specify by amendment to the Communication Act the criteria for determining what is a "vital public telecommunications or informational service" subject to regulated provision. This criteria should be broad so that the regulated utilities are not precluded from providing future services which merit public service status.

And finally, I would like to suggest that Congress prescribe procedural guidelines for the FCC which enforce and enhance the public's ability to participate in important policy deliberations. As one of the members of this committee has pointed out, the FCC has been free to amend its procedures to suit its own purpose. The result has been a less open process, hardly the setting for the broad policy discussions which this committee has advocated.

The FCC has shortened the response period for parties to proceedings, curtailed publications, and conducted proceedings via electronic mail. I would suggest strongly that Congress take a look at setting guidelines for the FCC, in terms of keeping the policy open.

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I thank you for your consideration of these proposals and for your invitation to the National Conference of State Legislators to be represented here today.

[Testimony resumes on p. 127.]

[The prepared statement of Ms. Moore follows:]

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REMARKS OF THE HONORABLE GWEN MOORE
CHAIRWOMAN
CALIFORNIA STATE ASSEMBLY

COMMITTEE ON UTILITIES AND COMMERCE BEFORE THE
HOUSE SUBCOMMITTEE ON TELECOMMUNICATIONS,
CONSUMER PROTECTION, AND FINANCE

"FEDERAL TELECOMMUNICATIONS POLICIES FROM A STATE PERSPECTIVE"
FEBRUARY 19, 1986

CHAIRMAN WIRTH AND MEMBERS:

IT'S A PLEASURE TO COME BEFORE YOU AGAIN, TO SHARE A STATE LEGISLATOR'S PERSPECTIVE ON FEDERAL TELECOMMUNICATIONS POLICY. I AM APPEARING IN MY JOINT CAPACITIES AS CHAIRWOMAN OF THE CALIFORNIA STATE ASSEMBLY COMMITTEE ON UTILITIES AND COMMERCE, AND AS CHAIRWOMAN OF THE COMMITTEE ON TRANSPORTATION AND COMMUNICATIONS OF THE NATIONAL CONFERENCE OF STATE LEGISLATURES. THE NCSL, YOU MAY KNOW, IS THE SOLE NATIONAL ORGANIZATION SERVING THE NATION'S 7500 STATE LEGISLATORS.

WHEN I LAST APPEARED BEFORE YOU, IN 1984, I LAMENTED A GROWING POLICY GAP BETWEEN THE FEDERAL COMMUNICATIONS COMMISSION, WHICH REGULATES INTERSTATE TELECOMMUNICATIONS, AND THE STATES, WHICH REGULATE INTRASTATE TELECOMMUNICATIONS. THE "WORST CASE"

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SCENARIO WHICH I DESCRIBED TO YOU THEN IS REALITY NOW: THE FCC IS SHIFTING THE COST OF TELEPHONE SERVICE -- BILLIONS OF DOLLARS ANNUALLY -- FROM LONG-DISTANCE, MOSTLY CORPORATE CUSTOMERS, TO LOCAL, MOSTLY RESIDENTIAL AND SMALL-BUSINESS CUSTOMERS. WE IN THE STATES ARE BEARING THE BRUNT OF PUBLIC REACTION. I ONLY WISH I HAD TIME TO SHARE WITH YOU THE MANY LETTERS AND PHONE CALLS I AND MY COLLEAGUES GET FROM CITIZENS WHO COMPLAIN ABOUT MYSTERIOUS "FEDERAL ACCESS CHARGES," THE CONFUSION INHERENT IN CHOOSING A LONG-DISTANCE CARRIER, AND THEIR GENERAL DISSATISFACTION WITH THE DISJOINTED STATE OF TELEPHONE SERVICE IN AMERICA TODAY.

THE BACKGROUND MATERIAL FOR THIS HEARING INDICATES THAT YOU WANT TO KNOW HOW WE CAN HANDLE A TRANSITION FROM REGULATION TO COMPETITION. AT THE CONCLUSION OF THIS ADDRESS, I WILL LIST FOUR STEPS THE CONGRESS CAN TAKE TO MOVING US THROUGH THIS TRANSITION. BUT I RESPECTFULLY SUBMIT THAT COMPETITION, LIKE REGULATION, IS ONLY MEANS TO AN END. THE ULTIMATE GOAL TOWARD WHICH YOU IN THE CONGRESS AND WE IN THE STATE CAPITALS ARE STRIVING IS THE UNIVERSAL ACCESSIBILITY OF INNOVATIVE, USEFUL, AND AFFORDABLE TELECOMMUNICATIONS SERVICES FOR ALL AMERICANS. I SUGGEST, FIRST AND FOREMOST, THAT THE CONGRESS MUST MAKE A JOINT DECLARATION TO THIS EFFECT, AND PROVIDE APPROPRIATE GUIDELINES FOR THE FEDERAL AND STATE AUTHORITIES TO ENSURE THAT WE REACH OUR MUTUAL GOAL.

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IN THE ABSENCE OF THIS DECLARATION, A STRING OF RECENT FEDERAL COMMUNICATIONS COMMISSION DECISIONS IS CREATING A RISING ALARM AMONG STATE LEGISLATORS. ALMOST DAILY, IT SEEMS, THE COMMISSION ANNOUNCES DECISIONS WHICH ENCROACH ON THE RIGHTS OF STATE AND LOCAL GOVERNMENTS, AND WHICH THREATEN OUR GOAL OF ACCESSIBLE, INNOVATIVE, AND AFFORDABLE SERVICES. LET ME RECITE THE LITANY.

THE FCC HAS IMPOSED ON LOCAL CUSTOMERS END-USER ACCESS CHARGES, A FORM OF EXCISE TAX. THE FCC HAS TOSSED OUT LOCAL ZONING LAWS, TO FACILITATE THE INTERESTS OF SATELLITE DISH OWNERS. AND, ONLY LAST MONTH, THE COMMON CARRIER BUREAU PREEMPTED THE TEXAS PUBLIC UTILITIES COMMISSION, ALLOWING A LARGE CUSTOMER TO PICK AND CHOOSE AMONG LOCAL TELEPHONE COMPANIES. IF THIS DECISION IS UPHELD, IT WILL WIPE OUT 75 YEARS OF UTILITY LAW -- IN PARTICULAR, THE IMPORTANT PRINCIPLE THAT THE PROTECTED FRANCHISE UTILITY MUST SERVE ALL EQUALLY. THE BUREAU, BY REMOVING THE PROTECTION GRANTED THE FRANCHISEE BY THE STATE, WOULD RELEASE IT FROM THE OBLIGATION TO SERVE ALL CITIZENS. I NOTE THAT CHAIRMAN FOWLER HAS PERSONALLY DEFENDED THIS ACTION.

NOW, IN HIS APPARENT SWAN SONG, CHAIRMAN FOWLER CALLS FOR COMPLETE DEREGULATION OF LOCAL TELEPHONE SERVICE. THIS IS BECAUSE, HE ALLEGES, COMPETITION EXISTS IN KEY MARKETS. THAT'S DEBATABLE. BUT EVEN IF IT DID, COMPETITION IS NOT A SUBSTITUTE FOR SOUND REGULATION. PUBLIC UTILITIES ARE GRANTED MONOPOLY FRANCHISES BECAUSE THEY SUPPLY VITAL PUBLIC SERVICES WHICH

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SOCIETY CANNOT ALLOW TO BE JEOPARDIZED BY MARKET FLUCTUATIONS OR THE VAGARIES OF PRIVATE CORPORATIONS. REGULATION, IN TURN, SEES TO IT THAT PROVISION OF THESE SERVICE BY THE PUBLIC UTILITIES REMAINS PUBLICLY ACCOUNTABLE.

IN SOME CASES, THE FCC HAS PERSUADED FEDERAL COURTS TO TAKE ITS SIDE AGAINST THE STATES. THE CONGRESS'S MANDATE TO THE STATES, TO RESPONSIBLY REGULATE INTRASTATE COMMUNICATIONS, HAS BEEN WEAKENED BY THE COURTS' RELIANCE ON THE FCC'S SHAKY TECHNICAL THEORIES. THE COMMISSION HAS CLAIMED, FOR EXAMPLE, THAT INTERSTATE AND INTRASTATE COMMUNICATIONS CANNOT BE DISTINGUISHED ONE FROM ANOTHER. IN FACT, MODERN COMPUTER TECHNOLOGY MAKES IT EASIER, NOT HARDER, TO DETERMINE A SIGNAL'S PATH FROM POINT TO POINT. (IF IT DIDN'T, MODERN PACKET SWITCHING WOULD BE IMPOSSIBLE.) THE STATES WOULD APPRECIATE CONGRESS'S REMINDING THE COURTS THAT "INTRASTATE COMMUNICATIONS" HAS A PRECISE MEANING THAT IS IMPORTANT TO NATIONAL AND LOCAL INTERESTS.

ONE HUNDRED AND TWENTY-FIVE YEARS AGO, CHARLES FRANCIS ADAMS SAW THE FOLLY OF "ENFORCED COMPETITION," OF THE SORT THE FCC ENCOURAGES. COMMENTING ON THE CONSEQUENCES OF ENFORCED COMPETITION IN MASSACHUSETTS, ADAMS OBSERVED:

> THE LACK OF AN INTELLIGENT SYSTEM AND AN ILL-CONSIDERED FAITH IN MANUFACTURED COMPETITION HAS SADDLED [NEW ENGLAND'S] TRADE . . . WITH A WHOLLY UNNECESSARY DEBT, WHICH IT CANNOT SHAKE OFF. . . . UNDER THE SYSTEM OF COMPETITION, FOUR [RAIL]ROADS, WITH ALL THEIR COSTLY MACHINERY AND CORPS OF OFFICIALS, MUST BE SUSTAINED BY BOSTON, WHILE ONE EACH SATISFIES BALTIMORE AND PHILADELPHIA.
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HOW FAMILIAR IT SOUNDS. TODAY, IN THE 1980'S, MULTIPLE TELECOMMUNICATIONS PROVIDERS, ENCOURAGED BY THE FCC'S "UNREGULATION," COMPETE FOR THE RIGHT TO SERVE LARGE CORPORATE AND HIGH-VOLUME RESIDENTIAL CUSTOMERS, AND FOR THE RIGHT TO GO BELLY UP. MANY OF THESE SPECULATIVE VENTURES ARE FOLDING, LEAVING BEHIND TECHNOLOGICAL SYSTEMS, CONSTRUCTED AT GREAT COST, FOR WHICH THERE IS NO DEMAND. LONG-DISTANCE CARRIERS, WITH THE COMMISSION'S ASSENT, ARE PLANNING NATIONAL HYPER-NETWORKS, FINANCED BY HIGHER LOCAL RATES, TO SERVE AN ELITE CORPS OF CORPORATE CUSTOMERS.

AND THE LOCAL TELEPHONE COMPANIES, WHIPSAWED BY THE THREAT OF BYPASS, ARE TRYING TO BECOME "MORE COMPETITIVE" BY GETTING THEMSELVES DEREGULATED AND BY SELLING UNWARY CUSTOMERS, IN BOILER-ROOM FASHION, PACKAGES OF LUXURY SERVICES, LIKE CALL-FORWARDING, CALL-HOLDING, AND CALL-WAITING. IN SOME CASES, AS WITH OUR OWN PACIFIC BELL'S "PROJECT VICTORIA," NEW TECHNOLOGIES ARE BEING MARKETED TO A HIGH-TECH, HIGH-INCOME AUDIENCE WITHOUT MUCH REGARD FOR THEIR BROADER APPLICABILITY.

IF WE LEAVE THE MIGHTY FORCES OF TECHNOLOGY IN PURELY PRIVATE HANDS, SOCIETY WILL PAY A DEAR PRICE. THIS IS THE TACK THE FCC HAS TAKEN, AND ITS CONSEQUENCES ARE CLEAR. LAST WEEK, AT A UTAH CONFERENCE OF STATE REGULATORS, DR. LEWIS PERL, THE WELL-KNOWN COMMUNICATIONS ECONOMIST, DEMONSTRATED THAT COMPETITION HAS NOT LOWERED THE PRICE OF TELECOMMUNICATIONS. HE DEMONSTRATED THAT, WHEREAS THE PRICE OF TELECOMMUNICATIONS WAS

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DECLINING ACROSS THE BOARD PRIOR TO DIVESTITURE, PRICES ARE NOW WIDELY VARIABLE. LONG-DISTANCE AND TOLL PRICES ARE FALLING, BUT LOCAL PRICES ARE SKYROCKETING. AND NO WONDER! LOCAL RATEPAYERS, PRIMARILY RESIDENTS AND SMALL BUSINESSES, ARE BEING ASKED TO PICK UP THE TAB FOR NATIONAL CORPORATIONS WHO USE INTERSTATE AND TOLL SERVICES.

IN CALIFORNIA, IN THE LAST TWO YEARS, WHEN ALL OF THE PRICE-SHIFTING END-USER ACCESS CHARGES AND SURCHARGES ARE ADDED IN, THE PRICE OF BASIC LOCAL TELEPHONE SERVICE HAS INCREASED BY 40 PERCENT, FROM ABOUT $7 TO $10. OTHER STATES HAVE EXPERIENCED THE SAME PHENOMENON, RESULTING IN EVEN HIGHER BASIC RATES. AND THE FCC STATES, MORE IS TO COME.

DR. PERL'S SOLUTION IS TO CHARGE FOR TELEPHONE SERVICE BASED ON INCOME, SO THAT THE CORPORATIONS AND PROFESSIONALS WHO RECEIVE THE DISPROPORTIONATE BENEFITS OF LOW COST LONG-DISTANCE SERVICE HELP TO SUPPORT LOCAL SERVICE FOR THE POOR, WHOSE COSTS HAVE RISEN DRAMATICALLY. IN CALIFORNIA, WE HAVE DONE JUST THAT. CALIFORNIA'S LIFELINE LAW, WHICH I AUTHORED IN 1983, LEVIES A SMALL TAX ON LONG-DISTANCE CARRIERS TO FUND A DISCOUNTED LOCAL SERVICE FOR LOW-INCOME CUSTOMERS. AS REFINED BY OUR PUC, THE LAW ALLOWS ONE MILLION ELIGIBLE HOUSEHOLDS TO KEEP A TELEPHONE IN THE HOME, WITHOUT CUTTING BACK ON GROCERIES. HAPPILY, ABUSE IS LOW, EVEN WITH SELF-CERTIFICATION, AND SATISFACTION IS HIGH, ESPECIALLY IN RURAL AREAS. I RESPECTFULLY RECOMMEND THE MOORE ACT AS A MODEL FOR CONGRESSIONAL LEGISLATION. (THE MOORE ACT AND BACKGROUND MATERIALS ARE ATTACHED).

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BUT LIFELINE ONLY PROTECTS THOSE WHO OTHERWISE WOULD HAVE NO SERVICE AT ALL. WHAT ABOUT THE LARGE MIDDLE-CLASS OF CUSTOMERS, WHOSE LOCAL RATES CONTINUE TO RISE, BUT WHO DO NOT REALIZE THE COMMENSURATE BENEFITS ENJOYED BY A RELATIVE HANDFUL OF LARGE CORPORATE AND GOVERNMENTAL USERS? IF WE ARE SERIOUS ABOUT STIMULATING THE GROWTH OF AN INFORMATION ECONOMY, WE SHOULD THINK CAREFULLY BEFORE BURDENING THE VAST MAJORITY OF CUSTOMERS WITH HIGHER PRICES FOR THE LOCAL SERVICE THEY FIND MOST USEFUL. MR. CHAIRMAN AND REPRESENTATIVES, HIGHER PRICES AT THE HANDSET WILL REDUCE THE INCENTIVE FOR AN AVERAGE CUSTOMER TO MAKE USE OF ELECTRONIC MAIL, VIDEOTEX, AND ALL THE WONDERFUL INNOVATIONS WHICH COMPETITION IS SUPPOSED TO BRING.

IN THE WAKE OF THE FCC'S DECISIONS AND PRONOUNCEMENTS, THE NCSL HAS ADOPTED A POLICY STATEMENT EXPRESSING ITS STRONG CONDEMNATION OF THE COMMISSION'S FUNDAMENTAL DISREGARD FOR OUR FEDERALIST FORM OF GOVERNMENT. (A COPY IS ATTACHED.) THE NCSL POLICY STATES, IN PART:

> . . . THAT THE CONGRESS SHOULD CLARIFY THE JURISDICTIONAL BOUNDARIES BETWEEN THE STATES AND THE FEDERAL COMMUNICATIONS COMMISSION, SO AS TO PRESERVE THE STATES' ABILITY TO MAKE REASONABLE COMMUNICATIONS POLICY TAILORED TO THEIR RESPECTIVE UNIQUE NEEDS AND REQUIREMENTS, AND TO PREVENT AND REVERSE EROSION OF THEIR CONSTITUTIONAL AND STATUTORY POLICY AUTHORITY.

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TO FURTHER DEMONSTRATE ITS CONCERN, THE NCSL HAS JOINED WITH ITS SISTER STATE AND LOCAL GOVERNMENT ORGANIZATIONS TO FILE AN AMICUS BRIEF IN A VITAL PREEMPTION CASE NOW BEFORE THE U.S. SUPREME COURT, LOUISIANA PUBLIC SERVICE COMMISSION V. FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA. AS THIS BRIEF STATES, "THE ORDINARY MEANING OF THE [COMMUNICATIONS ACT] -- ADOPTED AFTER CONSIDERABLE DISCUSSION IN THE CONGRESS -- "PLAINLY RESERVES TO THE STATES AUTHORITY TO REGULATE INTRASTATE TELECOMMUNICATIONS."

FAR FROM IMPEDING THE FEDERAL PURPOSE OF "MAKING AVAILABLE TO ALL THE PEOPLE OF THE UNITED STATES A RAPID, EFFICIENT, NATION-WIDE, AND WORLD-WIDE WIRE AND RADIO COMMUNICATION SERVICE WITH ADEQUATE FACILITIES AT REASONABLE CHARGES," THE STATES ARE HELPING BRING IT TO FRUITION. CONSEQUENTLY, THERE IS NO JUSTIFICATION OR NEED FOR FEDERAL PREEMPTION. AND YET PREEMPTION OCCURS, BECAUSE THE FCC, LIKE OTHER BUREAUCRACIES, CANNOT TOLERATE VARIETY. IT WIELDS PREEMPTION CARELESSLY, IN PURSUIT OF A MEANINGLESS NATIONAL UNIFORMITY.

IN FAIRNESS TO THE COMMISSION, STATE LEGISLATORS, IN THE PAST, HAVE NOT BEEN ACTIVE PARTIES TO ITS DELIBERATIONS. WE HAVE ALLOWED THE STATE REGULATORY COMMISSIONS, WHO COME FROM A DIFFERENT PLACE, TO CARRY THE LOAD. BUT THIS IS CHANGING.

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THE FCC'S ACTIVISM HAS PROVOKED MANY STATES, FOR THE FIRST TIME, TO TAKE INFORMATION POLICY SERIOUSLY. SEVERAL STATES HAVE APPOINTED SPECIAL LEGISLATIVE COMMITTEES TO EXAMINE EXISTING AND PROPOSED TELECOMMUNICATIONS AND INFORMATION POLICIES. MY OWN LEGISLATURE, IN COOPERATION WITH THE UNIVERSITY OF CALIFORNIA, IS PREPARING TO FUND AN INSTITUTE FOR TELECOMMUNICATIONS AND INFORMATION POLICY RESEARCH. THIS INSTITUTE WILL ADVISE PUBLIC OFFICIALS IN CALIFORNIA ABOUT CURRENT AND EMERGENT ISSUES IN INFORMATION POLICY. OTHER STATES ARE DOING THE SAME.

LAST YEAR THE NCSL FORMALLY RESOLVED TO WORK MORE CLOSELY WITH THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, TO DISCUSS OUR COMMON GOALS. STATE LEGISLATORS DO NOT ALWAYS AGREE WITH STATE REGULATORS, IN THE SAME WAY THE CONGRESS DOES NOT ALWAYS AGREE WITH THE FCC. BUT WE ARE MAKING AN HONEST EFFORT TO SORT OUT OUR DIFFERENCES AND BUILD ON OUR MUTUAL GOALS. YOU MAY HEAR MORE ABOUT THIS FROM THE STATE REGULATORS HERE TODAY. IF NOT, I WILL BE GLAD TO INFORM THE SUBCOMMITTEE FOLLOWING THESE HEARINGS.

LATER THIS YEAR THE NCSL WILL BE HOLDING A CONFERENCE ON STATE TELECOMMUNICATIONS POLICY, TO SHARE EXPERIENCES AMONG THE STATES AND DISCUSS OUR VARIOUS PLANS FOR THE FUTURE. ALONG THE SAME LINES, THE NATIONAL GOVERNORS ASSOCIATION HAS CHARTERED A TASK FORCE, UNDER THE LEADERSHIP OF NEBRASKA'S GOVERNOR KERRY, TO EXAMINE TODAY'S TELECOMMUNICATIONS REGULATORY AND MANAGEMENT ISSUES. I AM GLAD TO REPORT THAT THE NCSL AND THE NGA HAVE A VERY COOPERATIVE WORKING RELATIONSHIP IN THIS AREA.

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THE STATES ARE ALSO EXPERIMENTING WITH NOVEL APPROACHES TO RATE AND SERVICE REGULATION. IN ILLINOIS AND IOWA, LEGISLATION HAS BEEN PASSED TO ALLOW STATE REGULATORY COMMISSIONS TO DEREGULATE SERVICES FOUND GENUINELY COMPETITIVE. IN VERMONT, THE LEGISLATURE IS CONSIDERING A BILL WHICH WOULD PROVIDE IRONCLAD PROTECTION FOR BASIC LOCAL SERVICE, WHILE ALLOWING FOR THE INTRODUCTION OF INNOVATIVE SERVICES ON A MARKET BASIS. IN CALIFORNIA, WHERE TELECOMMUNICATIONS UNDERGIRDS OUR ENTIRE STATE ECONOMY, WE REMAIN COMMITTED TO TRADITIONALLY COMPREHENSIVE, BUT FLEXIBLE, REGULATION. TRULY, THE STATES HAVE BECOME THE LEADING "SOCIAL LABORATORIES" IN THE AREA OF INFORMATION POLICY, AS WE ADJUST OUR POLICIES TO SUIT OUR LOCAL NEEDS AND CONDITIONS.

THE STATES AGREE WITH CHAIRMAN FOWLER THAT THERE SHOULD BE A NATIONWIDE DEBATE ON THE FUTURE OF COMMUNICATIONS POLICY IN AMERICA. BUT, AS THE NCSL DECLARED IN A RECENT RESOLUTION, THE FCC HAS TRUNCATED THE REGULATORY PROCESS TO EFFECTIVELY PRECLUDE PUBLIC PARTICIPATION IN THE POLICY PROCESS. WE CAN DO BETTER IN THE STATES. IN FACT, IN CALIFORNIA THIS YEAR, I AM CONVENING AN "OPEN PLANNING" TASK FORCE ON COMMUNICATIONS POLICY, COMPRISING CITIZENS, LEGISLATORS, LABOR, REGULATORS, AND INDUSTRY EXECUTIVES. WE WILL REWORK OUR EXISTING CODES TO ACCURATELY REFLECT SOCIETY'S INTEREST IN THE INFORMATION INDUSTRIES. OTHER STATES MAY DO THE SAME. THE FCC COULD BE A BIG HELP IN THESE EFFORTS, BUT NOT IF IT TRIES TO SHOVE UNPOPULAR, IDEOLOGICALLY "CORRECT" BUT IMPRACTICAL DEREGULATORY SCHEMES DOWN OUR THROATS.

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LET ME END ON AN UP-NOTE. RIGHT NOW, UNDER CAREFUL STATE SUPERVISION, ADVANCED FORMS OF PUBLIC TELECOMMUNICATIONS ARE BEING DEVELOPED THAT WILL MOVE AMERICAN SOCIETY DECISIVELY INTO THE INFORMATION AGE. NEW JERSEY HAS THE FIRST PACKET NETWORK, ILLINOIS HAS AN ISDN, AND CALIFORNIA HAS ITS CONSUMER-VIDEOTEX EXPERIMENT, "PROJECT VICTORIA." SOME STATES ARE ALSO ENCOURAGING THE PROVISION OF SUPPLEMENTAL SERVICES (FOR EXAMPLE, THOSE OFFERED BY CABLE TELEVISION FIRMS), WHERE THEY COMPLEMENT THE PUBLIC TELECOMMUNICATIONS NETWORK'S CAPABILITIES. THESE INITIATIVES ARE BEING TAKEN, NOT BECAUSE WE FEAR FCC ACTION, BUT BECAUSE WE THINK THEY ARE IN THE BEST INTERESTS OF OUR CITIZENS.

IN THE FIELD OF TELECOMMUNICATIONS POLICY, THE STATES ARE TAKING THE LEAD. WE RESPECTFULLY ASK YOU IN CONGRESS TO INSTRUCT THE FEDERAL COMMUNICATIONS COMMISSION TO ACKNOWLEDGE OUR CAPABILITIES AND TO WORK COOPERATIVELY WITH US, SO THAT THE LESSONS WE LEARN IN THE STATES CAN BENEFIT THE NATION AT LARGE. SPECIFICALLY, WE HAVE FOUR RECOMMENDATIONS FOR CONGRESSIONAL ACTION WE WOULD LIKE YOU TO CONSIDER:

(1) CLARIFY, THROUGH RESOLUTION OR LEGISLATION, THE JURISDICTIONAL BOUNDARIES SET FORTH IN THE COMMUNICATIONS ACT, WHICH DEFINE THE RESPECTIVE LEGITIMATE INTERESTS OF THE FEDERAL COMMUNICATIONS COMMISSION AND THE STATES.

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(2) SPECIFY, BY AMENDMENT TO THE COMMUNICATIONS ACT, THE CRITERIA FOR DETERMINING WHAT IS A "VITAL PUBLIC TELECOMMUNICATIONS/INFORMATION SERVICE" SUBJECT TO REGULATED PROVISION. THESE CRITERIA SHOULD BE BROAD, SO THAT FUTURE SERVICES WHICH MERIT PUBLIC SERVICE STATUS ARE NOT EXCLUDED FROM PROVISION BY REGULATED UTILITIES.

(3) PRESCRIBE PROCEDURAL GUIDELINES FOR THE FCC WHICH ENFORCE AND ENHANCE THE PUBLIC'S ABILITY TO PARTICIPATE IN IMPORTANT POLICY DELIBERATIONS. IN CALIFORNIA, WE ARE CURRENTLY WORKING WITH OUR PUC TO PREPARE A UNIFORM ADMINISTRATIVE MANUAL TO ACCOMPLISH THIS END. THE FCC, ON THE OTHER HAND, HAS BEEN FREE TO AMEND ITS PROCEDURES TO SUIT ITS OWN PURPOSE. THE RESULT HAS BEEN A LESS THAN OPEN PROCESS, HARDLY THE SETTING IN WHICH A WIDE OPEN AND ROBUST PUBLIC DIS CUSSION OF POLICY MIGHT TAKE PLACE. (THIS FCC HAS REDUCED THE PUBLIC AVAILABILITY OF NOTICES REGARDING DOCKETS AND OTHER PROCEEDINGS, SHORTENED THE RESPONSE PERIOD FOR PARTIES TO PROCEEDINGS, CURTAILED PUBLICATION AND ACCESSIBILITY OF COMMISSION DOCUMENTS, AND CONDUCTED PROCEEDINGS VIA ELECTRONIC MAIL, WITHOUT PUBLIC HEARINGS OR DISCUSSION.) THE CONGRESS SHOULD INTERVENE.

THANK YOU FOR YOUR CONSIDERATION OF THESE PROPOSALS, AND FOR YOUR INVITATION TO THE NATIONAL CONFERENCE OF STATE LEGISLATURES TO BE REPRESENTED HERE TODAY. I STAND READY TO ANSWER YOUR QUESTIONS.

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Mr. SWIFT. Assemblywoman Moore, it is a pleasure to have you before the committee again.

Ms. MOORE. I would be happy to respond to whatever further questions the subcommittee may have. I'm just sorry that I have to leave. I looked forward to this.

Mr. SWIFT. Good luck on your way.

We will then proceed with the witnesses in the order they appeared on the agenda. I repeat what the chairman said while the confusion of the transition between panels was going on, that we would appreciate it if you could summarize your testimony in 5 minutes, and I would recognize Mr. John Sodolski, who is president of the U.S. Telephone Association.

Mr. Sodolski.

STATEMENT OF JOHN SODOLSKI

Mr. SODOLSKI. Thank you for the opportunity to appear to testify on behalf of the U.S. Telephone Association. My name is John Sodolski and I am president of USTA, which is an organization that represents the interests of the Nation's more than 1,400 telephone companies.

While our organization has been in existence for over eight decades, it is no exaggeration to say that the last couple of years have presented us with our greatest challenges ever. The historical event of divestiture and the transition toward a competitive environment has created new opportunities for our industry, and with those opportunities, new challenges.

I want to digress. The magnitude of what happened escapes many people. I think only in the industry is it apparent that this may have been the largest corporate change in the history of Western capitalism, but we believe the challenges are being met and that the transition goes reasonably well. Certainly, some of the more dire predictions have missed their mark.

For example, the number of households with telephones has not decreased. In fact, there has been a slight increase. Census Bureau data in November 1985 showed that 91.9 percent of all households in the United States have a telephone. This compares with 91.8 percent level of subscribership in July 1985, and it represents a one-half percent increase from the previous two November surveys.

Now, the current Census Bureau methodology has been in use since 1983. Earlier, a different and less precise method was used for measuring what we call penetration. Thus, pre-1983 and post-1983 data cannot be directly compared.

But the important thing is that during the course of the last 2 tramatic years, the measurements that can be used consistently show a stability in subscribership. Furthermore, there appears to be no reason to take an alarmist point of view about certain demographic groups. Subscribership among those over 65 years of age, measuring an average 95.5 percent, is actually higher than the nationwide average. And for the three lowest income groups, those below the Federal poverty level for a family of four, there have been no statistically significant changes.

Certainly, such findings do not negate the need to be concerned about those who have a limited income. For their part, local tele-

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phone companies, where necessary, have and will continue to devise options to help all customers control their costs.

States, meanwhile, are taking the initiative to provide help to the eligible low income. An August 1985 survey indicated budget options or lifeline plans in 30 States, with many others considering plans.

At the same time that steps are being taken to address certain demographic groups, a plan is being implemented to help maintain service at affordable rates for certain geographic groups. The universal service fund created by the FCC places a minimal charge on interexchange carriers. It is distributed to eligible exchange carriers to help them keep local rates down in high cost, predominantly rural, areas. USTA endorses this fund as an important means by which to protect universal service during these times of change.

Importantly, there are good indicators that the most serious impact of the events of the last 2 years is diminishing. In 1985, State regulators granted $1.3 billion in rate increases. That compares with $3.8 billion in 1984. Rate requests are equally telling: $2.96 billion sought in 1985, compared with $7.3 billion in 1984.

Even if the $1.7 billion pending for 1985 were approved, and history suggests that only about half of it will be, we are still looking at a dramatic reduction from the previous year and a remarkable reduction from the $6.9 billion that was pending at the end of 1983.

To put the price of telephone service in perspective with other costs, one can look at the fact that the Consumer Price Index rose 110 percent over the past 10 years, while nationwide telephone rates rose 55 percent.

Does that translate meaningfully for customers? We did a recent Gallup poll of 1,200 customers. Sixty-five percent said the cost of basic service was reasonable, and one in three said it was a better value when compared with electricity, home heating fuel, gasoline, postal service.

Also, with regard to the quality of that service, 82 percent judged it to be the same or better than 2 years ago. Customers generally seem to be satisfied with service and not overly alarmed by rate increases, even if they do not quite understand the tremendous changes taking place.

Given the long history of the telephone system in this country and the few demands it made on the average person for understanding, we should not be surprised. Indeed, the complexity of that system, coming to terms with how to allocate costs to its now separate parts, challenges even those in the industries and regulators.

When the components of local service, long-distance service and telephone equipment were available from one provider, the price for anyone could be related to others. The structure that was devised by regulators to do this reflected social philosophy as well as what was perceived to be customer perception of service value. In particular, there was overpricing of long-distance service to keep local rates low.

Because a subsidy has built into the system, price relationships were often opposite cost relationships, but with the dismantling of the system, of course, comes the question of what to do about the subsidies. The local loop, or that portion of the network that must

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exist regardless of whether calls are long distance or local or made at all, represents a tremendous fixed cost.

Under the subsidy mechanism, interexchange carriers and, indirectly, their customers are paying an average of three times their share. Today they have other options, and their increased movement to those alternatives, to the public switch network, have grave implications on universal service.

Companies have come forward with a number of interim plans for dealing with the problems of fixed or nontraffic-sensitive costs. We have urged the FCC to act sooner rather than later on these plans. They would allocate fixed costs to interexchange carriers on a more rational basis.

The caveat we have set is that the plan should be transparent to the carrier common line pool and that they should be seen as a partial solution for an interim period, not as a substitute for further implementation of subscriber line charges.

In summary, we find much in our review of the last 2 years to indicate that the transition goes reasonably well, but there is much to be done to apply sound economic principles to a system that has been guided to a large extent by social goals.

The introduction of competition and the logic behind it requires that any service be priced closer to its actual cost, and to the extent that subsidies are needed, they must be more targeted. It should be noted, however, that while local telephone companies have incentive for bringing prices in line with costs, they also have an incentive for keeping and expanding their customer base. The more customers a telephone company has, the greater the potential that company has for generating revenue.

Higher local rates would not mean higher revenues if many customers had to cancel their services. Thus, the universal availability of reasonably priced service will continue to be of the utmost importance to our industry.

Thank you very much.

[Testimony resumes on p. 141.]

[The prepared statement of Mr. Sodolski follows:]

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Written Statement of

John Sodolski

President, United States Telephone Association

Introduction

Thank you for the opportunity to testify on behalf of the United States Telephone Association. My name is John Sodolski and I am president of USTA, an organization which represents the interests of the nation's more than 1,400 local telephone companies. While this organization has been in existence for some eight decades, it is no exaggeration to say that the last two years have presented us with our greatest challenges ever.

The historic event of divestiture and the transition toward a competitive environment has presented our industry with new opportunities, and with these opportunities, new challenges. But we believe the challenges are being met and that the transition goes reasonably well. Certainly, some of the more dire predictions have missed their mark.

The number of households with telephones has not decreased. Plans have been initiated for keeping local service available and affordable for those who would most likely be affected. There continues to be general customer satisfaction with the dependability and efficiency of local service. And the commitment to improve on the network and to increase productivity while bringing services of the Information Age to all customers, large and small, has been demonstrated.

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Still, there is much to be done in order to apply sound economic principles to an industry that has to a large extent been influenced by sociological objectives. The overpricing of what were once considered discretionary services in order to underprice basic services was a system that worked in the old monopoly environment because the public telephone network was itself a "system." The introduction of competition, and the logic behind it, changed all that. Now, new logic must apply. The price of any service must come closer to representing the actual cost of that service, and to the extent that subsidies are needed, they must be more targeted.

It should be noted that while local telephone companies have incentive for bringing prices in line with costs, they also have an incentive for keeping and expanding their customer base. The more customers a telephone company has, the greater the potential the company has for generating revenue. Higher local rates would not mean higher revenues if many customers had to cancel their service. Thus, the universal availability of reasonably priced service is a goal that will continue to guide this industry.

Universal Service/Lifeline

One measurement of universal service is the number of subscribers on the network, and in the face of substantial changes over the past two years, that measurement has held steady. The Federal Communications Commission earlier this month released the most current of data that is reported to it three times each year by the Census Bureau. The November 1985 survey showed 91.9% of all households in the

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U.S. have a telephone, the highest level of subscribership since the surveys began in 1983. (The figure represents a slight increase from the 91.8% level of subscribership reported in the July 1985 survey, and a half percent increase from the previous two November surveys.)

The Census Bureau's current statistics are from a nationwide sample of about 58,000 households, the same survey used to calculate the unemployment statistic each month.

Penetration levels prior to and after 1983, cannot be directly compared because they are based on different methodologies. The important thing is that during the course of these last two traumatic years, the measurements that can be consistently used show a stability in subscribership.

To help maintain that stability, the Universal Service Fund (USF), based on a minimal charge to interexchange carriers, was created by the FCC. As various regulatory changes which could cause rate increases in high-cost and rural areas are phased in over the next few years, the USF will similarly be phased in to mitigate the effects of those changes.

USTA endorses the Universal Service Fund and believes it will help protect universal service in particular geographic areas.

Furthermore, while there may be reason to be concerned about certain demographic groups, there appears to be no reason to take an alarmist point of view. The National Telecommunications and Information Administration, in analyzing July 1985 data, found no statistically significant changes for the elderly and low income. Subscribership among those 65 to 69 years of age averaged 95.5%, and among those over 70 the average was 95.6%. Similarly, for the three

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lowest income groups (below the federal poverty level for a family of four), changes were not statistically significant.

Certainly, such findings do not negate the need to be concerned about those who have limited income. For their part, local telephone companies where necessary have and will continue to devise options to help all customers control their costs; states, meanwhile, are taking the initiative to provide help to the eligible low-income. An August 1985 survey by the National Association of Regulatory Utility Commissioners indicated budget options or lifeline plans in 30 states, with many others considering such plans.

The Federal Communications Commission has offered encouragement to the states through a plan whereby the FCC will match state assistance for low-income households up to the amount of the federal subscriber line charge for residential customers ($1 currently, scheduled to go to $2 in June). Assistance will be available automatically; no dropoff in telephone penetration is required. Eligibility is targeted to those who receive such already established forms of assistance as Supplemental Social Security Income or Aid to Families with Dependent Children.

We are pleased to see recognition of the primary roles that states should play in fashioning lifeline plans to their needs. However, we believe that financing should come from states' general revenue funds, not from other telephone ratepayers. The federal contribution to lifeline programs will be derived from the carrier common line charge collected from long-distance service providers; indirectly, of course, that means their customers, some of whom will be recipients of lifeline assistance. Thus, while the plan has much merit, in some ways it is an

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attempt to rely again on a "system" that no longer exists -- to look backward instead of forward for solutions to problems.

Now it is true that change, if it is to be carefully pursued, cannot take place overnight. January 1, 1984, brought the largest restructuring in corporate history, but certainly not all the necessary adjustments were worked out by the close of business that day. The companies involved, and indeed now the entire industry, continue to work them out.

Rates/Service

Importantly, there are good indicators that the impact of the events of the last two years is diminishing and rates will continue to moderate. In 1985, state regulators granted $1.32 billion in rate increases; that compares to $3.8 billion in 1984. Rate requests are equally telling: $2.96 billion sought in 1985 compared to $7.3 billion in 1984.

The data, compiled by the FCC's Industry Analysis Division and covering about 95 percent of the nation's access lines, illustrates a certain maturity in dealing with change. Even if the $1.7 billion pending for 1985 were approved -- and history suggests only about half of it will be -- we are still looking at a dramatic reduction from the previous year and a remarkable reduction from the $6.9 billion that was pending at the end of 1983.

To put the price of telephone service in perspective with other costs, one can look at Bureau of Labor statistics that show the Consumer Price Index increased 110% over the past ten years while

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nationwide telephone rates increased 55%. Even though telephone rates have not increased as much as the Consumer Price Index, telephone bills -- as opposed to telephone rates -- are getting larger. To a large degree, this is because customers are making more calls today, both local and long distance, than they did ten years ago.

To gain some insight on how customers distinguish one part of their telephone bill from another and to gauge their reaction to the changes of the last two years, our association commissioned the Gallup Organization to conduct a public opinion poll this past summer. In interviews with a representative cross-section of 1,200 plus heads of households, 68% said they understood their current telephone bills.

With regard to the basic local service portion of their bills, 49% found it inexpensive or about right. When the question was asked another way, 65% said the cost of their basic local service was reasonable. One in three respondents said basic local service was a better value compared with electricity, home heating fuel, gasoline and postal services.

With regard to the quality of local telephone service, 66% judged it to be about the same as two years ago, while 16% said it was somewhat or much better.

The fact that customers seem generally to be satisfied with service and not overly alarmed by rate increases speaks well to their acceptance of the changes -- even if they do not quite understand them. In that same Gallup poll, customers were asked about the breakup of the Bell system. Awareness registered a high 90%, but understanding was another story. One third said they did not understand very well

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why the breakup occurred, and another 12% said they did not understand at all.

Given the long history of the system and the few demands it made on the average person for understanding how its parts made up a whole, we should not be surprised. Indeed, the complexity of the parts and coming to terms with how to allocate and recover costs for each, now that they have been separated, challenges even those in the industry and regulatory agencies.

Cost Allocation/Bypass

When the components of local service, long-distance service and telephone equipment were available from one provider, the price for any one could be related to the others. The complex structure that was devised by regulators to do this reflected social philosophy, as well as what was perceived to be customer perception of service value.

Thus, color telephones were priced higher than black telephones, although they cost no more to manufacture. Long-distance calls were priced higher than necessary to keep local rates lower.

Because subsidy had been built into the system, price relationships were often opposite cost relationships. Discretionary services were priced above cost because they were perceived as having more value to customers -- primary among them, long-distance service.

But with the dismantling of the system, of course, comes the question of what to do about subsidies. The local loop, or that portion of the network that must exist regardless of whether calls are long distance or local, or made at all, represents tremendous fixed

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costs. In an economic sense, any form of allocation of fixed cost is arbitrary. However, historically, these fixed, or non-traffic sensitive costs, have been allocated according to use of the local loop. Under the subsidy mechanism, interexchange carriers (and indirectly their customers) are paying on average three times their share based on actual use -- and for large users, many times the total cost of the facilities. Today, they have other options because there are competitors to the local network.

Put another way, a substantial amount of more than $10 billion in interstate non-traffic sensitive costs is now picked up by those who are in the best position to avoid the costs. Interexchange carriers and their largest customers, those businesses with a high volume of long-distance calls, can take advantage of increasingly numerous alternatives to the public network. The choice of alternative methods to connect customers to long-distance carriers in order to avoid the subsidy built into switched access charges is a growing problem with grave implications for universal service.

Few if any residential customers will find it feasible to divert usage from the public switched network. What they will find is that they make up a smaller base over which fixed costs must be spread, and that in time means increased rates.

To deal with the escalating problem of uneconomic bypass, local telephone companies need more flexibility to allocate costs on a rational basis and to strategically price their service offerings. Companies have come forward with a number of plans for interim solutions to the non-traffic sensitive cost recovery problem; these plans are based on fixed fees as opposed to or in conjunction with

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usage fees. All of the Bell Regional Holding Companies have presented plans or are participating in state plans; non-Bell companies are involved in their service areas, as well. Our association is encouraging the implementation and testing of these plans, and we consider timing critical.

The caveat, we have said, is that a plan should be transparent to the carrier common line pool and that it should be seen as a solution for an interim period, not as a substitute for further implementation of subscriber line charges.

Subscriber line charges actually reflect costs of linking a home or business to the network, not the provision of whatever services a customer chooses to receive over that link -- and they are, in the end, the most equitable way to allocate fixed costs. The $6 per line per month that multi-line businesses are now paying and the $1 (scheduled to go to $2 in June 1986) for single-line businesses and residential customers represent a step in the right direction. Our industry has never felt that these sums were sufficient to the need, but supported the FCC when it implemented them. The FCC should undertake a study of non-traffic sensitive costs and subscriber line charges immediately rather than later this year. We believe the FCC will find that rational economics dictates acceleration of subscriber line charges.

Other Concerns

Likewise, we believe that the FCC will find that small companies have made a very strong case in a petition the association filed yesterday for reduced reporting and accounting requirements. For all

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companies, and therefore their customers, the cost of regulation is of concern. But for companies with a small customer base, there is special concern.

The Small Company Committee of USTA, in an informal poll among its members last fall, found the administrative cost of complying with regulations as high as $5 per access line per month. That kind of cost burden cannot be afforded when small companies are at the same time trying to keep their customers' rates reasonable and maintain universal service. It seems ironic that in the movement toward less regulation, the cost of regulation goes up.

The petition that has been filed with the FCC asks that the Regulatory Flexibility Act be applied to small companies with 20,000 or fewer access lines. There are 1,106 companies that meet that limitation. Application of the act would require the FCC to assess the impact of all decisions on small companies. In addition, the petition asks the FCC to significantly reduce certain reporting requirements and cost support data, allowing small companies to file their own traffic sensitive interstate tariffs. At present the cost for filing such a tariff for small companies is exceedingly high per access line. These changes would be of great benefit to small companies and their customers, who represent just 2.7% of the interstate access market.

Another area of concern to all companies, but again with a special set of problems for small companies, is the tax reform effort. This is a capital-intensive industry with tremendous need to modernize and remain competitive in the new era. We have an excellent record of

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internally generated funds and of using investment tax credits in the spirit in which they were intended.

We have construction plans totaling more than $20 billion this year to bring state-of-the-art service to customers large and small, urban and rural. I might add that work provides significant employment and bolsters local economies. But the vast majority of our companies are small ones that would be at the greatest disadvantage in seeking funds on the outside market, and whose doing so would impact their customers' rates and strain the goal of universal service.

Conclusion

The local exchange carrier industry finds itself still very much in transition. It must be ready to meet the challenges of the competitive era, which means being freed from any restraints based on a system that no longer exists and a philosophy that is couched more in sociology than economics.

That the transition goes well thus far, as evidenced by the discussion in this testimony, speaks well for the dedication of all of those whose responsibility it is to make the changes work. And in time, it can be expected that the public will become increasingly aware of and understand the changes and the benefits that can be derived from them. Meanwhile, I can assure you that the local exchange carrier industry will continue to strive to meet the worthy goal of universal service at reasonable rates.

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Mr. SWIFT. Thank you, Mr. Sodolski.

Sharon Nelson, who is chairman of the Washington State Utilities and Transportation Commission, who I understand had the marvelous joy of coming in on the Redeye today, which means you crash in about 2 hours and 37 minutes, from my experience.

Ms. NELSON. I may fall on my microphone.

Mr. SWIFT. Please.

STATEMENT OF SHARON L. NELSON

Ms. NELSON. Thank you, Mr. Chairman.

Thank you for the invitation to be here today. I am testifying on behalf of the National Association of Regulatory Utility Commissioners [NARUC].

I have previously submitted my testimony. I will just attempt to summarize it.

It starts with a description of conditions in Washington, and the reason for that is to let you know that I agree with much that Mr. Sodolski said and much that has been said by the previous panel. The sky hasn't fallen and it is not in immediate danger of falling in the near term.

We have experienced in Washington State robust competition in the mobil services and paging services and in equipment. We do not see skyrocketing local rates, contrary to predictions that happened with divestiture. We have, however, seen modest rate increases in Pacific Northwest Bell territory, and we have seen some rather substantial increases in one rural telecommunications company.

However, our local exchange companies are viable, they are healthy. PNB's unadjusted results of operations indicate that it is earning around 11.9-percent rate of return on an intrastate basis, and on an interstate basis, it is exceeding its rate of return by a considerable amount, around about a 15-percent rate of return.

Our other more rural companies are earning at or close to their authorized rates of return.

I am not as sanguine as Mr. Sodolski, however, about the future. The hard issues are beginning to appear in our hearing room, and they have mostly to do with competition in those transmission markets. Since I dictated my testimony, we have had several hearings on several companies' repricing proposals.

One, a GTE filing on depreciation represcription, has raised the conflict between urban and rural ratepayers in a rather dramatic way. The Washington Independent Telephone Association Companies have indicated that the proposed GTE equalization of urban and rural rates may not be to their liking because of the precedential value of that case.

In another related case, the Pacific Northwest Bell rate design case for WATS and 800 services, we see PNB wanting to reduce WATS and 800 rates, which will benefit small business users but concomitantly raise private line rates some 15 percent. That particular repricing scheme would have a million dollar impact on the State of Washington on an annual basis alone.

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In that case, thus, we have large business users squaring off against the residential rate payers. The Public Counsel and the large business group are completely at odds.

Unfortunately for us who have to decide the case, the data on which both sides are relying are very rough. We are intent on trying to price close to cost, but the cost data is between 12 and 9 years old and it is proving to be a very difficult task.

Another issue that is appearing in our hearing room is related to the movement from POTS—plain old telephone service—an acronym you have all heard—to PANS—pretty advanced new stuff. PNB proposes to replace all of its switches with digital switches in the next 3 years, and of course that raises the question of who will pay for PANS, pretty advanced new stuff, and who will benefit from it.

I just want to describe these because I think it is important to remember that FCC policies have differing impacts depending on which part of the country you are in. Congress knows that. I agree with Gwen Moore that the FCC rarely seems to remember it. We should congratulate them for their recent use of the Joint Board mechanism to consult with the States on major policy issues, and we would like to see more of that occurring.

However, as I detail in my testimony, there are several decisions which are pending which will have substantial impacts on local rates, and unfortunately, these decisions have been taken on the basis of largely paper records and largely on the basis of theory.

In the States, we are still required to listen to testimony and hear it cross-examined in a formal hearing setting. We think this gives us some more accurate indications of how these various policy decisions will actually impact real consumers.

The other trouble with the FCC's recent past is that it troubles even commissions, such as ours, which have welcomed competition and are attempting to promote it where it is actually factually going to benefit consumers. But as Edythe Miller, the commissioner from Colorado has said, waiting for the FCC to shift its policy direction is like waiting for a centipede to drop its next shoe. The decisions change, the decisions change 180 degrees, and it is a very difficult climate in which to undertake corporate planning, much less State regulatory commission planning.

I would like to commend the committee for undertaking these hearings. We think, obviously, the structure and pricing questions which face the whole country should be examined at the Federal level. We are, after all, dealing with interstate commerce and competition policy.

However, we firmly believe that Congress ought to be vigorously examining FCC decisions and setting broad policy for the FCC to implement. And, it is appropriate for Congress to undertake this kind of examination because all of you do have awareness of what is going on in your various States and an understanding of the impacts on the consumers, ratepayers and voters in your State.

I have appended to my testimony the corporate organization chart of U.S. West, and I did that because I do think Congress needs to examine the structure of the holding companies, but I would like to submit to you that all of this reflected on this chart has happened in 2 years. This chart is just, I think, a thing of

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beauty, but it defies regulatory control, it creates complexity. It creates a problem for State regulators with respect to a very important question, and that is the question of cross-subsidization.

As I think you all know, soon after the divestiture occurred, most of the regional holding companies set up a separate subsidiary for Yellow Pages. Yellow Pages used to provide a contribution to keeping local exchange rates low. In most States now, Yellow Pages are provided by a separate subsidiary.

While it is true that publishing is a competitive business, that loss of revenues has grave implications for raising local exchange rates. The more subsidiaries we see being formed by the regional holding companies, the less opportunity the State regulators will have to monitor the flow of subsidy between the still monopolistic operating companies to the unregulated subsidiaries. I think I can speak for all commissions that we are very concerned about this kind of diversification effort.

What the appropriate structures ought to be I will leave to future discussion, but just close with saying that NARUK will be looking at the line of business restrictions on regional holding companies as the Justice Department prepares its report to Judge Greene, and we will be pleased, obviously, to participate in any future hearings you may have on the structure of the industry.

Thank you very much.

[Testimony resumes on p. 159.]

[The prepared statement of Ms. Nelson follows:]

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Testimony of Chairman Sharon L. Nelson
Washington Utilities and Transportation Commission
Before the Subcommittee on Telecommunications,
Consumer Protection and Finance
Committee on Energy and Commerce
U. S. House of Representatives
February 19, 1986

Mr. Chairman, members of the committee, thank you for your invitation to testify before you today. My name is Sharon Nelson. I am Chairman of the Washington Utilities and Transportation Commission (WUTC), a position I have held for a year. Before that, I was staff counsel to a state legislative committee investigating regulatory reform in the telecommunications industry. I serve on the National Association of Regulatory Utility Commissioners (NARUC) Committee on Communications, and recently have been appointed to the Federal Communications Commission Joint Board on the proposed revision of the uniform system of accounts. I am a member of the National Governors Association Task Force on the development of the telecommunications infrastructure as an essential element of state economic development efforts.

Today I am testifying on behalf of the NARUC. The NARUC is a quasi-governmental, nonprofit organization founded in 1889. Within our membership are the governmental agencies of the 50 states, the District of Columbia, Puerto Rico and the Virgin Islands which are engaged in the regulation of utilities and carriers. The association's chief objective is to serve the

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consumer interest by improving the quality and effectiveness of government regulation in America.

The members of the NARUC appreciate your invitation to express our views on the impact of federal regulatory decisions on local telephone rates. As the national representative of the state regulatory commissions, the NARUC has taken an active interest in federal efforts to reshape regulation of the telecommunications industry in the wake of divestiture and emerging competition.

The policy questions these hearings are intended to address are at once practical (the dollar impact on local rates) and theoretical (the appropriate roles of federal and state government in regulating a vital industry.) Today, I will discuss conditions which obtain with respect to competition and local rates in one state, Washington; the difficulty posed for the states by erratic federal policies; and recommendations for future regulatory policy directions.

Local Conditions

Traditional theories of federalism contemplate that the 50 states will serve as laboratories for the development of governmental policy. In telecommunications regulation today, the state commissions are attempting to perform that role, adopting a variety of approaches to deal with the differing conditions found in each state.

Contrary to the experience in many other states, Washington State ratepayers have so far avoided severe local rate increases caused by FCC deregulatory policies or the divestiture of AT&T. Many

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analysts predicted a rapid doubling or even tripling of local rates after divestiture. In Washington, local residential rates for Pacific Northwest Bell (PNB) have increased 12 percent since January, 1984, when the Bell System divestiture occurred. This increase includes the $1.00 end-user access charge ordered by the FCC. For residential users outside PNB territory, rates have not increased dramatically. Currently, monthly rates for one-party residential service range from $3.59 to $35.70, although most of the basic rates for our five largest companies range between $4.49 and $13.70. As in the other states, consumers in Washington State have experienced reduced rates for long distance services.

It is important to note, however, that significant pressure for local rate increases is building. For example, ratepayers have begun to experience the effects of depreciation changes and access charge changes. Potential local rate increases due to depreciation policies are pending for Pacific Northwest Bell and General Telephone of the Northwest. Recently AT&T, PNB, and the local independents proposed an intrastate access charge plan which could yield a $4.00 per month increase per access line for local residential users. In addition, one rural company has proposed a 64 percent rate increase to offset the combined effects of reduced long distance toll revenue and accelerated depreciation. This trend could spread to other rural companies in the state.

Washington State's regulatory scheme traditionally has had no barriers to entry for any telephone company. Since 1911 we have functioned with a scheme which allows "initial tariffs" to go into effect automatically. There is no public convenience and

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necessity test applied. Thus, we have had many alternative carriers and resellers enter business simply by filing a tariff. Further, unlike many states, Washington has never prohibited intralata or interlata competition. We have at least 22 facilities based alternative common carriers and resellers operating within the state. Our statutory scheme was quite rigid, however, in other significant respects. For example, we could not forebear from regulating competitive companies or services or allow banded rates.

Intrastate Regulatory Reform

In 1983, the Washington State Legislature undertook a special study of competitive conditions in the state and the need for regulatory reform. In 1985, the Legislature enacted a new statute, the Regulatory Flexibility Act. The new act is based on the premise that competitive supply will serve the consumer best by enhancing consumer choice, promoting innovation and stimulating price competition. It essentially deregulates the following services: privately owned systems, including shared tenant services; cellular telephone and paging services; customer premises equipment. Further, in markets where competition actually exists, the Commission may reduce regulation and allow pricing flexibility. The Act makes it clear, however, that in order to protect captive customers, the Commission will work to prevent cross-subsidies from regulated monopoly services to unregulated "competitive services".

The primary intent of the Legislature in passing the Act was to allow competition and market forces to govern the pricing and provision of telecommunication services when effective competition

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actually, factually, exists. However, the Legislature also recognized the considerable risk of premature deregulation to ratepayers in those markets where monopoly supply still persists. In crafting this law, which represents a balance between the interests of companies for pricing flexibility and of ratepayers for regulatory protection, the Legislature carefully evaluated the level of competition in the state. For example, the Legislature commissioned a major study of bypass by Ernst & Whinney as it developed this legislation. We have provided a copy of the Ernst & Whinney bypass study to your staff. The study indicated that in Washington State the development of bypass, defined precisely as privately-owned systems, was not much of a threat to the growth and stability of the established telephone companies. Obviously, different levels of competition will be found in other states.

The Legislature also directed the Commission to prepare annual reports on the level of competition in the state, so that the regulatory scheme may be adjusted if needed. The Commission has just forwarded to the Legislature its first annual report, the bulk of which again was prepared by Ernst & Whinney. This study indicates that in Washington State, in June 1985, the most significant competition was in equipment sales and mobile services. In transmission markets, the most significant form of competition was between the private line service and other services provided by the local exchange operating companies and/or AT&T. OCCs held minuscule market shares in the market for long distance service. We have also made this study available to your staff.

I should note that both of these studies have been criticized by telephone companies operating in our state for defining bypass

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too narrowly and, in the case of the competition study, for taking too static a view of a "dynamic market." Unfortunately, these telephone companies have provided limited written critiques. Their chief criticism appears to be based on anecdotal evidence of Boeing Computer Services' plans to acquire additional telecommunications equipment and the fact that the equal access balloting program is being implemented. Despite these criticisms, we are taking a rather skeptical view of the need to rush to any simple deregulatory or repricing scheme to obviate the problems of bypass. Obviously, the conclusions we have reached in our state would not necessarily hold for other states. For example, the New York Commission recently issued its order and findings on bypass. That Commission is considerably more concerned with bypass because of recent developments such as Merrill Lynch's planned Teleport and its effect on the growth and revenues of New York Telephone.

In short, the Washington State telecommunications industry appears healthy. All of our local exchange companies are reporting earnings at, or above, their authorized rates of return. The major exception, AT&T Communications of the Northwest, is reporting losses on an intrastate basis. In addition, AT&T's earnings on an interstate basis have been volatile, although some analysts attribute these problems to losses from the equipment subsidiary. Recent staff reports indicate that, in Washington, Pacific Northwest Bell is earning close to its authorized 11.44 percent intrastate rate of return, and exceeding its authorized interstate rate of return by several percentage points.

I have spent a great deal of time discussing conditions in Washington State because I think it is important to remember

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that the effects of federal policy decisions, such as those of the Federal Communications Commission and the Federal courts, are felt differently in different sections of the country. In some states, bypass may be a more severe problem and may warrant different regulatory approaches. In other states, rural issues may need more attention. Federal telecommunications policy should not deny the states the ability to assess and respond to local conditions.

FCC Preemption Policy

The Communications Act of 1934 establishes a rather clear distinction between the jurisdiction of federal and state regulators. Through aggressive preemption, the FCC has blurred that distinction and reduced the ability of state regulators to ensure that monopoly ratepayers remain protected. NARUC has established a special subcommittee to study federal preemption and believes that the FCC's actions deserve vigorous Congressional oversight. Even in my state, where we have attempted to welcome competition, we believe the FCC's rush to create the network of the year 2000, within the market structure of 1986, may decrease the quality and increase the price of local service. We believe that federal policymakers should give the market time to evolve and allow state regulators to acquire the tools needed to protect monopoly ratepayers during the transition to fully competitive market conditions.

FCC Chairman Mark Fowler, in a recent speech, said, "Too often during transitions regulatory intervention is altered continually, sending false, interrupted, and sometimes reverse signals to players." State regulators couldn't agree more. Colorado

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Commissioner Edythe Miller has said that waiting for the next policy shift from the FCC is like waiting for a centipede to drop its next shoe. Decisions such as the FCC's preemption of depreciation prescription, the access charge case, Computer Inquiry III, and the Cox Cable decision inevitably will affect local rates.

Sometimes the FCC actions directly affect local rates by changing cost recovery mechanisms. For example, 26 billion dollars in unrecovered depreciation expenses are subject to the FCC rule on depreciation. The FCC has called for accelerated depreciation, which will result in increased local telephone rates because the companies will be forced to recover their investment over a shorter period of time. The FCC based its decision on Section 220 of the Communications Act, which merely states that the FCC has the authority to set depreciation rates for carriers, without specifying which carriers. These depreciation issues are pending before the Supreme Court.

A second example of FCC action directly affecting local rates is the access charge decision, which increased local telephone rates by adding the monthly subscriber line charge. Like many members of this Committee, NARUC bitterly opposed the FCC's initial access charge plan in Congress and in court. However, we were persuaded that the implementation of the plan probably was inevitable. Accordingly, the NARUC worked with the FCC through the Federal-State Joint Board process to reduce the charge from $4.00, to $1.00 in June, 1985 and $2.00 in June, 1986.

Other FCC decisions indirectly prompt local rate increases by creating market conditions which will increase the burden on

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local ratepayers. An example of this is the FCC's Cox Cable decision, which enables cable companies to compete with local exchange companies in the provision of nonvideo services, private line voice, and data services. The FCC preempted the states' ability to restrict entry, but at the same time held that the cable companies were not common carriers. Commissioner Quello dissented, arguing that cable companies represent a significant bypass threat, capable of depriving local exchange carriers of business. Moreover, to the extent that similar services are provided by local exchange companies, and those revenues contribute to keeping local rates low, any decrease in revenues derived from these services by local exchange carriers may result in local rate increases. Federal policy decisions such as Cox Cable, which indirectly create pressure for local rate increases are perhaps the most difficult for local regulators to address.

It also should be noted that the FCC preempts and deregulates at the same time. Historically, when federal agencies preempted or occupied a field of regulation there was a concomitant increase in the consistency or toughness of federal regulations. In the current context, the FCC is preempting and setting the companies free.

The FCC's abdication of certain fundamental regulatory responsibilities may also work to reduce state regulation to the lowest common denominator. For example, most analysts agree that regulators should approve prices which cover the costs for regulated services. To ensure that correct price signals are given, cost of service methodologies should be developed to protect the monopoly ratepayer if Bell Operating Companies are allowed to

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compete in competitive transmission markets. Otherwise, a clear incentive and ability will exist to price monopoly services well above cost to generate funds for underpricing competitive ventures. The development of cost of service methodologies has been retarded by erratic FCC decisions on access charges and structural separation rules. In Computer Inquiry III, the FCC appears ready to repeal its previous separate subsidiary requirement for the BOCs which provide enhanced services. At the same time, it has done very little, if anything, to improve accounting rules in order to protect captive customers. Competent cost allocation schemes are critical to the success of our state legislation. Development of such cost methodologies are even more critical if separate subsidiaries are not required. The public is not being well served if regulators, at both the federal and state level, do not examine these issues in a clear and rigorous way.

Recently, the FCC's appears to be searching for a "technological fix" which will stimulate competition for all services, removing the possibility of monopoly abuse. Chairman Fowler's latest proposal to try an experiment in deregulation of local exchange service, after the achievement of "open architecture" technological arrangements, is a logical next step in the process the FCC has been employing at the interstate level. Unfortunately for users of local exchange service, economies of scale and scope are such that local exchange service retains all the characteristics of a natural monopoly. Chairman Fowler's current technological fix, which was first proposed by the U.S. West companies, envisions complete deregulation of intrastate services in exchange for which "the FCC might deregulate that state's telephone companies access charges." How this might be viewed as an attractive offer to a state regulator eludes me.

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State concerns with FCC preemption, whether explicit or implicit, are not born of nostalgia for the "good old days" of a united AT&T, nor of a desire to slow innovation and technological change. The governors of the western states are very concerned about telecommunications as a key element in economic development. The states recognize that a high quality telecommunications network is essential to attracting and retaining "information age" businesses, and to the continued health of many traditional industries. However, we are concerned that prematurely freeing the BOCs could lead to overinvestment with concomitant local rate increases. On the other hand, reliance on a simplistic solution to the cross-subsidy problem such as capping local rates, could lead to substantial disinvestment in local exchange facilities.

State regulators and legislators' own good faith efforts at policy making may be frustrated by continued federal adjustments to the industry structure. For example, the legislation which we are implementing in Washington State was based on the premise that the state did not need to concern itself with structural issues. We did not explicitly treat the problem of cross-subsidies from the local exchange companies to various other subsidiaries of the same parent, because we assumed that the Computer II structure would remain in effect and that the conditions of the modified final judgment would be retained and enforced. Now, however, six months after the effective date of our new law, current federal initiatives may provide incentives for U.S. West to adopt a corporate form which will result in just the kind of cross-subsidies our local legislation was designed to prevent. Prematurely removing these restrictions may be simply encouraging the regional holding companies to view the operating companies

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less as a telephone company and more as a "bank" for competitive ventures.

Future Policy Development

As you well know, Congress currently is being asked to rewrite the MFJ and allow the BOCs back into manufacturing and information services. At the same time, the FCC is rushing to rewrite Computer II and remove the requirement that enhanced services be housed in a separate subsidiary. Instead, regulators would rely on accounting rules to police cross-subsidy. Since much of the relevant accounting data are in the hands of Regional Holding Companies, or their unregulated subsidiaries, which often resist state efforts to review data for ratemaking purposes, I personally am skeptical that accounting rules will protect the public. The interplay of these efforts is important to understand. At the same time that the BOCs are attempting to get back into information services and manufacturing, subject to FCC rules, they are working at the FCC to weaken those rules and to avoid state regulation entirely.

When the Washington State Legislature enacted our new flexibility act, it assumed that federal policymakers' vision of the future structure of the industry would remain somewhat constant. Certainly, some confusion was to be expected, and some adjustments will be needed as the new market structure evolves. It is true that the American public focuses on the divestiture of AT&T as the cause of its dissatisfaction with the new environment. Judge Greene is a very convenient target, and the market structure he approved in the MFJ may not be the best for all time. In agreeing on the basic structure, AT&T and the Department of Justice did not achieve

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perfection. Nevertheless, as a state regulator I am very concerned about diversification efforts by all of the utilities that we supervise. In the case of U.S. West, we have no effective way of finding out how much capital may have been diverted from the still monopolistic operating companies to the deregulated subsidiaries. Washington has one of the toughest affiliated interest laws in the nation, but we still have very little information on the flow of money and resources from the monopoly ratepayers to the unregulated U.S. West subsidiaries. For your information, I have appended the most recent organization chart of U.S. West.

Further, state regulators are concerned that federal policies which encourage diversification and corporate complexity may not serve the interests of either ratepayers or shareholders. As you are well aware, the admission of AT&T into computer markets was intended to have beneficial disciplinary effects on the existing computer industry. Unfortunately, AT&T has not yet measured up in that field. Likewise, state regulators are very concerned that Bell Operating Companies and regional holding companies which stray very far from the traditional business of providing telephone service could simply waste a lot of ratepayer derived capital, driving up local rates. U.S. West's corporate organization chart seems to be leading to more complexity, more opportunities to shift costs and more ways to realize cross-subsidies. Even aside from these concerns, it is difficult to understand how such complex corporate structures and layers of management could promote more efficiency and return to shareholders. Certainly, this is not the industry structure envisioned when divestiture occurred.

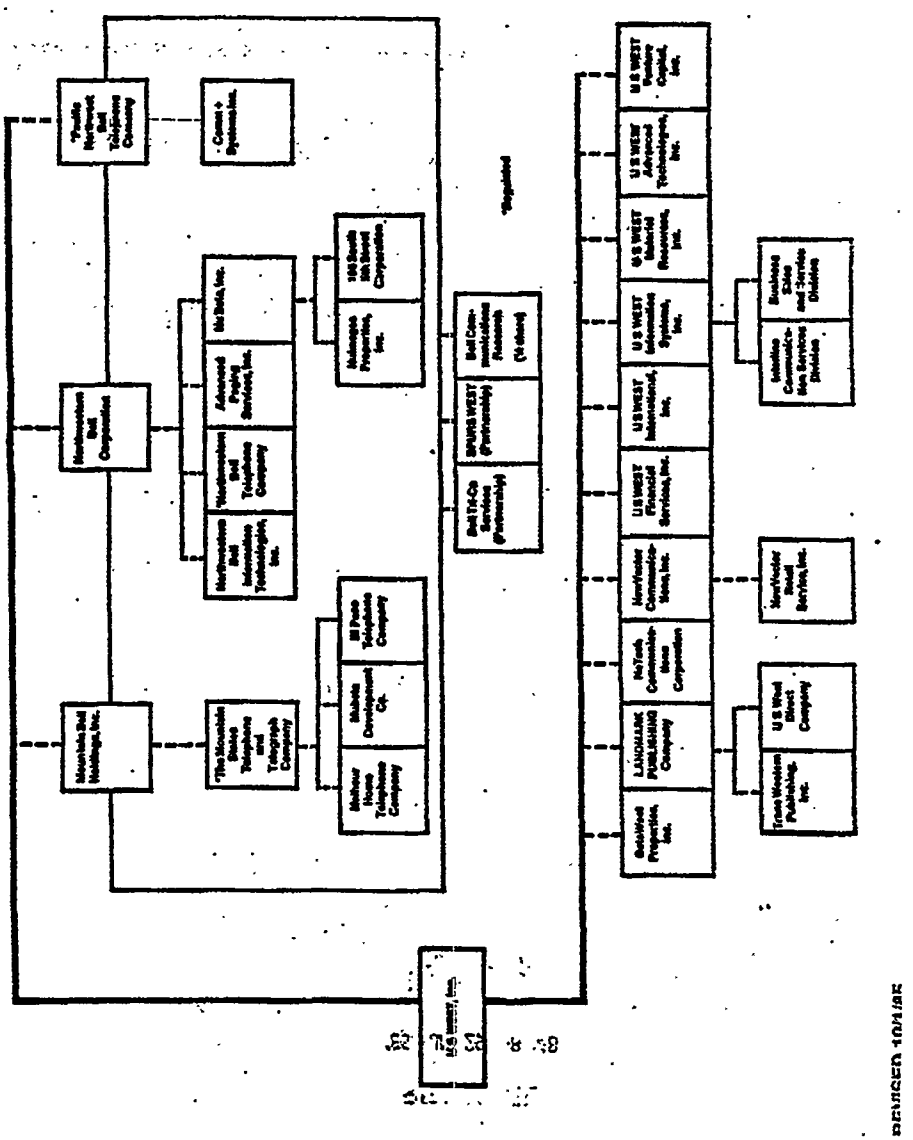
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The continuing lurching of national regulatory policy to a find an appropriate industry structure should not stampede Congress into premature action. Nor should it dissuade Congress from engaging in thorough and tough-minded oversight of the FCC's rush toward preemption and deregulation. It appears to us that the real hard thinking about appropriate industry structure is yet to be undertaken. Congress should enunciate overall policy goals, and overall industry structure to achieve those policy goals. These goals should include maintaining universal service and promoting efficient companies, which use their shareholders' and ratepayers' capital fairly.

Thank you for your attention. I would be pleased to answer any questions.

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Mr. SWIFT. Thank you.

Mr. Gene Kimmelman, who is the legislative director of the Consumer Federation of America.

STATEMENT OF GENE KIMMELMAN

Mr. KIMMELMAN. Thank you, Mr. Chairman.

Mr. Chairman and members of the subcommittee, I am going to get right at the heart of the matter quickly. I think that from the consumer perspective, the greatest benefits of competition in the postdivestiture era are not reaching most consumers, are not reaching the average consumer.

In key areas, from local rate increases to Federal cost-shifting policies to relaxed regulation at the Federal level, consumers are getting the short end of the stick.

I am here to ask you, the Congress, to step in and set straight public policy priorities in telecommunications, to preserve affordable phone service for all and to make sure that the benefits of competition reach the entire public.

Let's look at the facts of what has happened since divestiture. First of all, local rates. In aggregate, local phone companies have asked for $10.6 billion in new revenue since divestiture and gotten $5.2 billion granted from State commissions, about 49 percent.

What that means in terms of local rates is this: On average, for flat rate service, an increase of 35 percent for local service, and measured service, up to 52 percent; flat rate went from $10.50 to $13.29 plus $1 for the subscriber line charge. Now, we know we are going to get another dollar in access charges, the second dollar of the subscriber line charge in June of 1986.

In addition, there is pressure on the States to conform their intrastate long distance rates with interstate long distance rates, and what that means for the consumers is pressure for additional cost shifting into local rates.

We have seen decisions related to acceleration of depreciation by the FCC for new equipment, and at the same time we see additional pressure for depreciation of old equipment still on the books. There is a petition before the FCC to accelerate depreciation of $26 billion worth of old equipment. Now, if that were done in the next 5 years, you are talking about $5 a month on the average consumer's monthly phone bill.

It is true long-distance rates have come down. As the access charge went into effect, long-distance rates dropped 5 to 6 percent in each of the last 2 years, 10 to 12 percent over 2 years. The competitor's rates are slightly lower, but I would like to point out that they are only slightly lower.

Now let's look at subscribership on the network. I believe the experience of the 1980's indicates that we are at the end of an era of an expanding telephone network. Between 1960 and 1980, penetration rose at about one-half percent a year, going from 78.5 percent in 1960 to 92.9 in 1980.

During this same time, the real cost of all telephone service was declining. Interestingly enough, since 1980, we have seen a stagnation and a possible 1-percent decrease in penetration as the real cost of telephone service has been rising.

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In addition, there is a tremendous difference in the ability of different people to have a phone. Less than 80 percent of those below the poverty line have a phone, compared to over 95 percent of people who earn more than $10,000 a year. Even worse for people below $5,000 in income, only 72 percent having a telephone.

Well, what is the FCC's response to this? We believe the FCC is putting the final nails in the coffin of the era of an expanding telephone network. First of all, the Commission seems to define universal service as the status quo. This is quite convenient when you want to look at penetration rates since the recession of 1982. Subscribership has been stable. But I would like to point out that there has been a tremendous growth in real income in that period of time that somewhat offsets the effect of local rate increases.

In addition, the Commission seems to be trying to minimize the relationship between the cost of service and demand for service, even though all economists who have looked at this issue and studied it believe that rate increases do affect demand for service.

Now, the FCC acknowledges that there are many factors that affect why someone would have or not have a telephone, but they have refused to analyze these factors, especially some of the most important ones like changes in employment, changes in income, or to use studies that control for these factors as they look at what effect rate increases have on subscribership.

We believe the FCC has even gone so far as to distort figures. Looking at a combination of both the Consumer Price Index and the Producer Price Index to try to indicate what has happened with the cost of telephone service is like mixing apples and oranges, and interestingly enough, the Producer Price Index, which they use for local service, does not include the subscriber line charge.

One thing the FCC has done is that they have recognized that low-income subscription is much below subscription for everyone else, but their response is to set up a voluntary subscriber line charge waiver program, providing no Federal response to the inability of low-income people to afford service except where the States act first. Instead of responding to this clear evidence of the end of an era of an expanding network, the FCC leaves key issues of affordability to the States, refuses to try to reduce the gap between low- and high-income subscribership, and refuses to even consider that many who keep a phone only do so because they have to give up other necessities.

In the areas of benefits of competition, we are concerned with recent FCC policies. We believe the FCC is not following a path that will distribute those benefits equitably to all consumers.

The result of this, Mr. Chairman, is that consumers now face considerable local rate increases, additional pressures to shift costs into local rates, and the uncertain availability of cost saving competitive services.

For this reason, we believe that Congress must intervene, first of all to reestablish the goal of affordable service for all Americans. Where competition is desirable, the Congress must ensure that the benefits flow to the many and not to just a few, and where network equipment is shared for many services, Congress must make sure

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that those who use these services pay their fair share for the upkeep of the network.

In conclusion, Mr. Chairman, unless we redirect national policy, consumers will have gone through a confusing, sometimes agonizing transformation of their telephone system, only to get substantially higher local rates and little or no benefit from limited competition in other telecommunications markets.

We believe this can be prevented if Congress steps in to preserve affordable phone service and spread the fruits of competition equitably to all Americans.

Thank you.

[Testimony resumes on p. 203.]

[The prepared statement of Mr. Kimmelman follows:]

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Consumer Federation of America

Statement of

GENE KIMMELMAN
LEGISLATIVE DIRECTOR

CONSUMER FEDERATION OF AMERICA

Before the

Subcommittee on Telecommunications, Consumer Protection and Finance of the Committee on Energy and Commerce

on

The Transition to Competition in the Telephone Industry: Meeting the Needs of Consumers

February 19, 1986

1424 16th Street, N.W., Suite 604 • Washington, D.C. 20036 • (202) 387-6121

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INTRODUCTION

The Bell system breakup was supposed to produce consumer benefits through increased competition. Instead, local rate increases and federal regulatory policies threaten the affordability of basic phone service and the potential consumer benefits of competition. Congress must intervene to prevent price increases in monopoly, basic telephone service from wiping out price decreases, fostered by competition, in other telecommunications services.

I. The End of an Era of Network Expansion

A. Local Rate Increases

Two years after the divestiture of American Telephone and Telegraph (AT&T), consumers continue to pay more and get less for their phone-service dollar. Between January 1, 1984 and January 1, 1986, local telephone companies asked for $10.6 billion and received $5.2 billion -- 49 percent -- in revenue increases from state regulators.[1] In addition, $1.7 billion of revenue requests are currently pending nationwide.[2]

During the same time period, the Federal Communications Commission (FCC) decided to transform $2 billion of long distance charges into local rate increases.[3] Starting in June 1985, all residential customers, regardless of whether they make any long distance calls, began paying a $1/month "subscriber line charge" for equipment costs formerly charged to interstate long distance users. In June of 1986, this charge will rise to $2/month.

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1. Flat-Rate Service

These new local charges translate into an average increase in residential flat rate (unlimited local calling) service of $3.74/month since the Bell breakup (see Figure 1). This 35 percent increase* consists of the following elements: an increase in flat rate service from $10.55/month at the end of 1983 to $12.73/month at the end of November 1985; a $1/month subscriber line charge imposed by the FCC in June, 1985 that appears on each customer's local phone bill; plus $.56/month to maintain telephone wiring (this wire maintenance charge, though optional, used to be included in pre-divestiture local service charges). So, today, it costs consumers $14.29/month to receive what cost only $ 10.55/month two years ago. In addition, consumers must now pay for local directory assistance calls, purchase or pay $1.50/month to rent a phone, plus pay considerably more for installation -- 27 percent more in 1984 alone.[4]

2. Measured-Rate Service

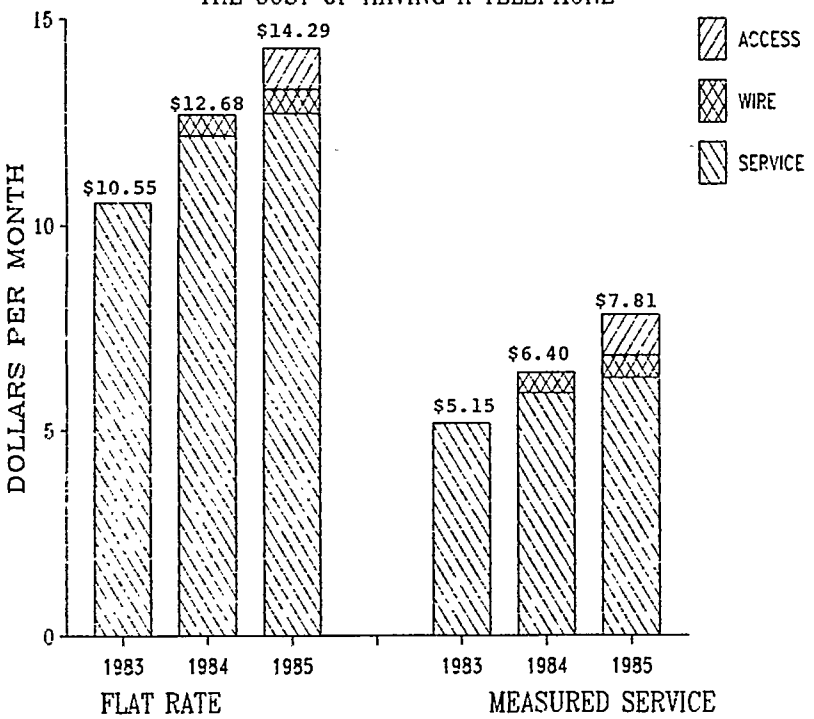
Consumers have been hit with similar rate increases in residential measured service. The average cost of the cheapest residential measured service, available for $5.15/month prior to divestiture, has risen to $7.81/month (including the $1/month subscriber line charge, and $.56/month to maintain telephone wiring). This is an increase of 52 percent or $2.66/month (see Figure 1). In addition, charges for each call have risen slightly.

*The Consumer Price Index for this same two year period shows a slightly lower (28%) increase in local residential rates, because the CPI includes local and state taxes, telephone equipment rental and message unit charges, which have risen only slightly since the Bell system breakup.

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FIGURE 1

THE COST OF HAVING A TELEPHONE



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3. State-By-State Local Rate Changes

Table 1 presents the average local residential rates in each state. The estimates of national average increases are based on state-by-state weighted averages. Average rates within states are weighted estimates based on the size of exchanges (i.e. local calling areas) and differences in rates between exchanges. The state averages are then combined into a weighted national average based on population.

Table 2 presents the national estimates of prices and the population in the states to which each estimate applies. Note that the measured service population is smaller than the flat rate population because some states do not have measured service available. The wire maintenance charge estimate is based on a smaller population because we were unable to obtain relevant information from all the states. Even in this case, our survey covers over two-thirds of the national population.

B. Long Distance Rate Reductions

In return for these significant post-divestiture local rate hikes, consumers have received a slight decrease in long distance rates. In 1984 when the FCC's subscriber line charge went into effect for business customers, AT&T was ordered to reduce its long distance rates about 5 percent.[5] Long distance rates were cut an additional 5 percent in June 1985, when residential customers began paying a subscriber line charge.[6] Unfortunately, for the 75 percent of consumers who make few long distance calls each month,[7] these long distance rate reductions do not even come close to offsetting post-divestiture local rate increases. Only consumers who, on average, make more than about $40/month in long distance calls are coming out ahead.

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TABLE 1

STATE-BY-STATE AVERAGES RATES: 1983 - 1985

STATE	FLAT RATES			MEASURED SERVICE RATES		
	1983	1984	1985	1983	1984	1985
ALABAMA	15.75	18.47	19.16	11.81	9.24	9.58
ALASKA	8.53	12.55	12.55	3.73	6.55	7.30
ARIZONA	8.79	10.94	10.94	7.19	7.19	3.60
ARKANSAS	11.64	12.26	13.68	3.84	6.75	7.52
CALIFORNIA	7.72	8.25	8.25	4.14	4.45	4.45
COLORADO	6.09	7.31	7.31	2.35	2.82	2.82
CONNECTICUT	9.28	11.77	11.77	3.31	6.63	6.63
DELEWARE	8.70	10.43	10.43	4.20	4.93	4.93
WASHINGTON, D.C.	8.83	12.49	13.52	2.20	3.11	1.69
FLORIDA	11.80	11.72	11.72	N/A	N/A	N/A
GEORGIA	13.95	15.14	15.74	N/A	N/A	N/A
HAWAII	8.78	9.18	9.18	N/A	N/A	N/A
IDAHO	10.55	11.42	11.92	4.62	4.76	5.97
ILLINOIS	9.10	11.18	11.38	3.56	5.51	5.51
INDIANA	12.52	15.35	15.35	7.68	9.42	9.42
IOWA	10.07	10.07	14.55	.00	6.53	9.72
KANSAS	10.25	11.76	13.50	4.90	6.41	6.41
KENTUCKY	15.52	16.28	16.92	8.46	8.46	8.46
LOUISIANA	11.52	11.92	11.91	6.32	6.57	6.57
MAINE	9.91	11.67	11.67	4.24	5.00	3.80
MARYLAND	11.08	16.64	17.38	4.28	5.67	11.15
MASSACHUSETTS	10.82	10.66	10.66	3.66	3.61	3.61
MICHIGAN	9.72	10.84	10.84	7.45	8.31	8.31
MINNESOTA	14.13	16.49	16.49	6.49	8.46	8.46
MISSISSIPPI	11.45	17.41	17.41	6.35	9.58	9.58
MISSOURI	8.34	10.57	13.92	4.58	5.83	6.16
MONTANA	8.18	8.76	10.37	N/A	2.58	3.05
NEBRASKA	10.89	15.27	15.27	8.14	9.86	9.86
NEVADA	7.13	7.13	8.91	3.33	3.33	5.31
NEW HAMPSHIRE	12.61	14.00	13.92	5.40	5.65	5.62
NEW JERSEY	7.52	7.52	7.99	4.86	4.87	6.43
NEW MEXICO	15.30	15.23	16.75	7.68	7.68	8.45
NEW YORK	13.34	15.15	16.54	3 00	3 74	3.93
N. CAROLINA	11.25	14.39	12.89	5 70	6.48	6.48
N. DAKOTA	9.48	10.77	10.77	6.24	8.64	8.64
OHIO	12.95	14.95	14.95	5.80	6.70	6.70
OKLAHOMA	7.59	7.59	9.86	N/A	N/A	N/A
OREGON	12.97	14.88	14.88	5.65	6.97	6.97
PENNSYLVANIA	5.33	10.06	10.23	6.18	6 18	6.35
RHODE ISLAND	14.07	14.63	18.41	5.88	6.12	6.58
S. CAROLINA	15.82	15.42	16.48	8.32	7.50	8.24
S. DAKOTA	9.68	11.91	12.44	4.75	4.75	7.59
TENNESSEE	11.76	12.99	15.23	4.73	5.18	6.10
TEXAS	9.11	9.40	9.40	5.93	4.73	4.73
UTAH	11.78	11.78	14.17	8.34	8.34	8.66
VERMONT	9.82	11.96	11.96	5.06	6.66	6.66
VIRGINIA	11.71	16.28	16.28	6 12	6.25	6.25
WASHINGTON	11.84	12.30	12.30	2.83	3.06	3.06
W. VIRGINIA	14.64	12.17	22.08	4.55	5.51	7.07
WISCONSIN	11.78	16.19	16.86	4.39	8.21	8.84
WYOMING	8.17	8.17	14.06	5.08	5.08	5.62

SOURCE: Consumer Federation of America, Divestiture: Two Years Later, December 10, 1985.

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TABLE 2

Estimated Telephone Charges
and the Population to Which They Apply

	1983	1984	1985 Granted	1985 Pending
Flat Rate				
Charge ($/mo.)	10.55	12.17	12.73	13.27
Population(in millions)	228	228	160	67
Measured				
Charge ($/mo.)	5.15	5.89	6.25	6.60
Population(in millions)	209	209	141	67
Inside Wire				
Charge ($/mo.)	none	.51	.56	NA
Population(in millions	none	160	156	NA

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C. Percentage of Households with a Phone

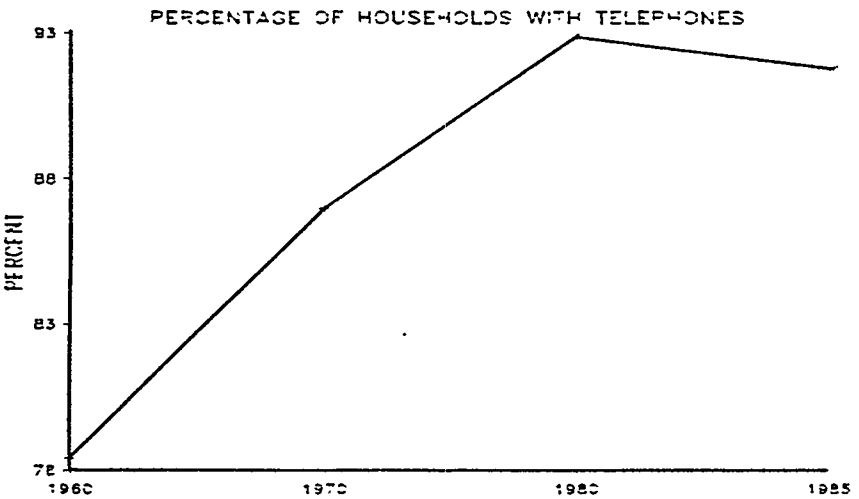
The ongoing trend of residential rate hikes has ended an era of consistent increases in the number of American households with a telephone. From 1934, when universal telephone service became a national goal,[8] until 1980, the percentage of households with a phone grew steadily. In 1960, 78 percent of all households had a phone. By 1980 almost 93 percent had a phone.[9] Not suprisingly, this trend toward universality coincides with a consistent decline in the real cost of telephone service (see Figure 2). As phone service became cheaper in comparison to other commodities and income, more and more families got a phone. Yet since 1980, with local phone rates rising much faster than inflation, the percentage of households with a phone has declined slightly.[10]

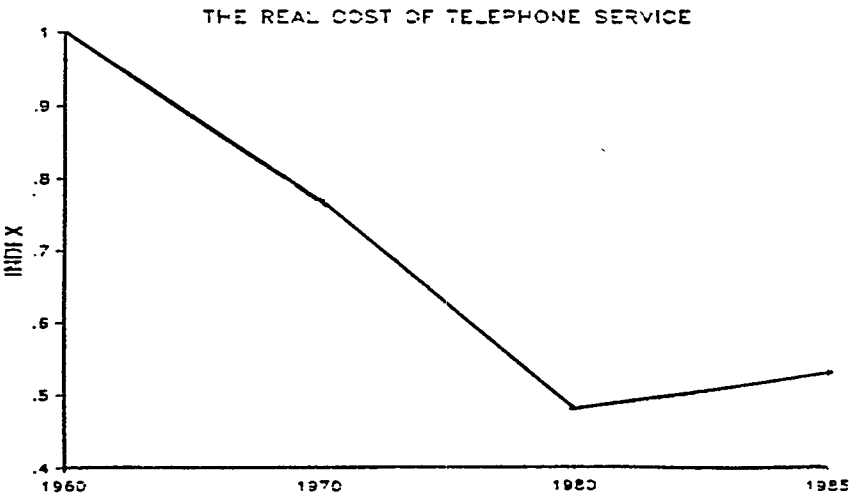
Based on a computer model devised by Lewis Perl of the National Economic Research Associates for the Central Services Organization of the Bell Operating Companies, the percentage of households with a phone would be over one percent higher now had we not experienced post-divestiture local rate increases in excess of inflation (see Appendix A, pp A-9 - A-11)[11]. This means that in the two years since divestiture, had local rates not outpaced inflation over one million more households would be able to afford phone service today.

The damage caused by local rate increases is concentrated among low and lower-middle income groups. While almost 92 percent of all households in the nation have a phone, and virtually all middle and upper income families have a phone, less than 80 percent of households with income below the poverty line have a telephone. [12]

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FIGURE 2





Source: Bureau of the Census, 1960, 1970 and 1980 Census of Population and and Housing; Current Population Surveys, March 1983 - July 1985.

Bureau of Labor Statistics, Consumer Price Index

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Unfortunately, federal agencies have demonstrated a greater interest in preserving the status quo than in developing a statistical understanding of the effects of local rate increases. The Department of Commerce has mischaracterized CFA's conclusions about the nature of demand for telephone service (see Appendix A, p. A-15) and the FCC has erroneously criticized the model on which our analysis is based.[13] Yet, careful analysis of the Bureau of the Census data which both agencies rely on in evaluating telephone subscribership demonstrates, as CFA has consistently claimed: that local rate increases reduce demand for telephone service; that rising income increases demand for phone service; and that there is a lag in time between price changes and their effect on demand (See Appendix A, pp A9-13). It appears that the FCC and Department of Commerce are so ideologically commited to telecommunications deregulation, that they dismiss and distort data which challenge their view of the telecommunications market (see Appendix A, pp A-2 - A-9).

II. Increased Long Distance Competition or Remonopolization?

Despite the dangerous trend toward significant local rate increases, many deregulation proponents argue that the benefits of long distance and equipment industry competition outweigh the post-divestiture burdens shouldered by consumers. They claim that further deregulation -- at both the federal and state levels -- will foster continued long distance rate reductions and stable local rates.

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A. Long Distance Regulation

While there is no doubt that consumers have benefited from competition in the equipment and long distance markets, it is unclear whether these benefits will continue or will be equitably distributed if the long distance market is deregulated. Without appropriate regulation, AT&T could use its market power -- control of almost 90 percent of the long distance market outside local phone company calling areas [14] -- to underprice competitors in the most lucrative markets and thereby drive them out of business. For long distance competition to grow and flourish in less lucrative markets -- like for the almost 75 percent of residential consumers who make few long distance calls per month[15]-- a reasonable number of challengers to AT&T must become firmly established in the long distance market.

So far, the growth of long distance competition has benfited a small segment of the population. Only the business and residential customers who make a considerable number of long distance calls have saved much money by shopping around for long distance service. All long distance carriers -- whether seeking to preserve market dominance, like AT&T, or trying to break into the market, like the other common carriers -- have aimed their marketing at big business customers, because the carriers stand to gain the most by competing for the largest volume users of long distance service.

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The public at large may only benefit from long distance competition if the most lucrative long distance business is divided among a sizable number of firms. If only one or two firms survive, they are most likely to focus their price-cutting attention on the most profitable market -- the 10 percent of business users that generate 75 percent of long distance revenue.[16] If a larger number of carriers survive in the long distance market, and the most profitable business is broadly dispersed, carriers are more likely to vie aggressively for the business of low volume users -- both business and residential.

While it would be inappropriate for federal regulators to seek specific market allocations, it would serve consumers' interest for the FCC to preserve an environment that, at least in the short term, fosters the growth of AT&T's competitors.* Unless a number of small long distance carriers survive, consumers are likely to be saddled with the costs of deregulation -- substantial local rate hikes, confusion and complexity -- without receiving the fruits of long distance competition.

The fact that continued regulatory promotion of competition may diminish AT&T's share of the long distance market should be of little public concern. After all, a necessary condition of the change from monopoly to competition is that the monopolist, AT&T, loses some of its market to competitors. In addition, the divestiture agreement enabled AT&T to enter the computer business by releasing the company from the conditions of a 1956 consent decree.[17] So even though AT&T may lose a portion of its long distance business, it stands to enhance its financial strength by expanding into the unregulated computer market.

*We applaud the Commission for its decision to allocate default traffic -- users who fail to choose a primary long distance carrier during the equal access process -- among long distance carriers. This decision gives consumers an incentive to shop for long distance service as they do for other products in competitive markets.

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B. Local and Enhanced Service Regulation

It is often forgotten that a market with emerging competition is not the same as a competitive market. The lawsuit that led to the Bell breakup was initiated because the government believed AT&T was thwarting the growth of competition, not because the telecommunications market was already competitive.

The development of new technologies has transformed a unified, monopoly telecommunications market into a segmented mixture of monopoly and competitive submarkets. Unfortunately, these monopoly/competitive marketplace mixtures are not split evenly among services or classes of telecommunications users. The most competitive markets consist of high volume usage of computer (enhanced service) equipment and long distance transmission -- predominantly big-business services -- while the least competitive market is the network of lines and switches necessary to connect all calls.

Without regulation, the partial competition of a segmented telecommunications market distributes benefits to large volume, long distance/computer customers (i.e., big businesses), and loads costs on everyone else (i.e., residential and small business customers). Telephone companies that serve both competitive and monopolistic markets have an incentive to maximize profits by shifting costs from the most to the least competitive services.

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Federal and state regulation can balance the mixture of costs and benefits in a less-than fully competitive market through structural separation of monopoly and competitive services, and equitable cost allocation rules. With so much equipment -- $30-40 billion worth -- used jointly for local and long distance calling, and an industry with incentives to charge these costs to the monopoly, local services, regulators must intervene to ensure that these costs are spread properly among all services to keep local phone service affordable. Similarly, regulators must require that other competitive services are either separated from the telephone network or, if linked to the network, pick up a reasonable portion of network costs, so that local ratepayers do not subsidize competitive telecommunications services.

Unless competition expands to the point where monopoly submarkets disappear, regulation will be necessary to prevent undue price discrimination. While consumers are willing to pay their fair share for local, enhanced and long distance services, they should not be required to subsidize competition for services they do not use. Until competition expands and flourishes in the markets where network equipment is shared, consumers can only rely on regulation to protect them from shouldering an inordinate share of network costs.

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C. Local Phone Companies' Strategy

The steady, post-divestiture increase in local residential rates is likely to continue unless regulators reject local phone companies' new pricing proposals. Despite a financial performance that far exceeds other industries and utilities since January 1984 -- including profit margins, return on equity, sales growth, and earnings per share of stock (see Table 3), local phone companies are pleading poverty in an attempt to squeeze as much money as possible out of local ratepayers. These companies realize that an infusion of ratepayer money would help finance diversification into more profitable markets, without disrupting the local service market, because consumers have no alternative but to pay up or lose their phones. For example, in addition to the alarming rate requests filed since announcement of the breakup, the Bell operating companies have asked the FCC to accelerate the depreciation of $26 billion worth of old local equipment.[18] Full depreciation of this equipment between now and 1990 would cost consumers over $5/month in local rate increases.

D. FCC Abandonment of Ratepayer Protection

1. Access Charge/Bypass

Rather than oppose telephone industry efforts to shift network costs from all services into local rates, the FCC has adjusted its regulatory policies to coincide with industry objectives. For example, the Commission's interstate access charge (subscriber line charge) will account for a $4 billion annual shift ($2 billion residential and $2 billion business) from long distance to local charges in 1986.[19] After 1986, the FCC is likely to continue this process; the Commission previously endorsed shifting up to $7 billion more, per year, from long

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TABLE 3

	Sales Growth		Profit Margin		Return on Equity		Earnings Per Share	
	1984	1985	1984	1985	1984	1985	1984	1985
All Industries	NA	5	4.9	4.4	13.2	11.8	3.30	2.96
All Utilities	NA	6	8.4	10.4	13.1	12.9	3.39	3.27
Regional Bell Operating Cos.								
Ameritech	NA	8	11.9	12.5	14.1	14.2	10.17	10.55
Bell Atlantic	NA	13	12.0	12.2	13.1	13.8	9.94	10.68
Bell South	NA	12	13.2	14.2	13.4	14.9	4.28	4.82
*NYNEX	NA	9	10.4	10.3	12.9	13.1	10.10	10.43
Pacific Telesis	NA	9	10.6	11.8	12.8	13.8	8.46	9.17
Southwestern Bell	NA	11	12.3	12.3	12.9	13.7	9.04	9.94
US West	NA	8	12.2	12.8	13.3	13.7	9.24	9.85

Sources: 1984: Business Week, Corporate Scoreboard, March 22, 1985, pp. 62-65.

1985: Business Week, Corporate Scoreboard, November 18, 1985 pp. 133-136.

*1985: Business Week, Corporate Scoreboard, August 19, 1985, pp. 106-107.

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distance to local rates.[20] In an effort to establish a stronger factual basis for increasing the subscriber line charge, the FCC has permitted AT&T to offer bypass services (i.e., SDN and Megacom tariffs) that may drain a significant portion of long distance business from the public network.[21]

2. Lifeline

Despite clear evidence demonstrating that the era of a consistently expanding telephone network has ended, the FCC has refused to implement a lifeline program that would help achieve the goal of universal service. Rather than promote the Communications Act's goal of reasonably priced phone service for all Americans (universal service), the Commission's lifeline decision is designed to preserve the status quo. The FCC's lifeline program provides only a waiver of the FCC-imposed subscriber line charge for low income consumers in states that voluntarily develop a targeted lifeline rate. [22] The Commission refused to establish a mandatory lifeline program because it claims that telephone subscribership has not decreased.[23] Yet this disregards data since the 1980 Census showing a one percent decrease in subscribership and data showing low-income penetration rates stagnating at a level 10-20 percentage points below the national average (see supra, p. 7). Evidently, the FCC believes that the Communications Act's goal of universal service has been achieved, even though since the Bell breakup, only about 72 percent of people with income below $5,00/year, 85 percent of people with income below $10,000/year and 95 percent of everyone else has had a telephone(see Appendix A, pp. A-13 - A-14).

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III. Making Competition Work For Consumers

The only way of ensuring that all consumers will benefit from the Bell breakup is through federal rate-relief legislation. Current market conditions leave most consumers worse off today than they were prior to divestiture, and the FCC shows no sign of stopping this trend. Congress must intervene to prevent price increases in monopoly, basic telephone service from wiping out price decreases, fostered by competition, in other telecommunications services.

A. Equitable Distribution of Costs and Benefits of Divestiture

To make the benefits of competition available to all consumers, legislation should require that the cost of equipment used to provide local, long distance and computer services is equitably distributed among those services. If each service covers the costs that are unique to it, plus a reasonable portion of the cost of equipment used jointly for numerous services, local phone rates would remain reasonable while all other services could be competitively priced. Congress must step in to ensure that everyone who uses services connected to the telephone network pays to maintain the network.

In addition, legislation must prevent the premature deregulation of markets that are not fully competitive. Until the fruits of competition are available to all Americans, only regulation can prevent market segmentation and price discrimination that favors high volume telecommunications users over the general public.

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B. Lifeline

To achieve the goal of universal telephone service, legislation should provide that everyone who benefits from the telephone network contributes to making phone service available to those least able to afford it. Increased competition in telecommunications will only benefit consumers if they can afford the basic phone service that links them to competitive markets. CFA believes that lifeline service should be a simple, cheap, local phone service option designed to ensure that no household need be without basic phone service because they cannot afford it.[24] Building on an existing telephone industry internal subsidy mechanism for rural, high-cost areas, Congress should require local and long distance companies to pool resources to fund a "lifeline" program that provides cheap, basic phone service for the millions of people who otherwise will go without a phone or give up other necessities just to keep their phone.

Conclusion

Two years after the divestiture of AT&T, consumers face disturbing inequities in the distribution of benefits derived from increased competition and costs imposed by new pricing policies. Federal regulatory policies have accentuated this imbalance by shifting long distance costs into local rates and reducing scrutiny of cost allocation problems. Without renewed efforts to distribute the benefits and costs of a transformed telecommunciations marketplace equitably, the average consumer will be denied the fruits of the post-divestiture era.

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NOTES

1. Telephone Subscribership in the U.S., Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, Washington D.C., February 6, 1986, "Trends in Telephone Service January 1986."

2 Id.

3. In the Matter of MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72 and 80-286, adopted December 19, 1984, released December 29, 1984.

4. Comments of the Consumer Federation of America and U.S. Public Interest Research Group, In the Matter of MTS and WATS Market Structure, CC Docket Nos. 78-72 and 80-286, April 26, 1985, p.4 and Appendix C pp. C-11 and C-12.

5. Memorandum Opinion and Order (Second Reconsideration Order), MTS and WATS Market Structure, CC Docket No. 78-72, 49 Fed. Reg. 7810 (March 2, 1984).

6. Id.

7. Wall Street Journal, April 2, 1984.

8. Communications Act of 1934, 47 U.S.C. Section 151.

9. Bureau of the Census, 1960,1970 and 1980 Census of Population and Housing.

10. Id., and Bureau of the Census, Current Population Surveys, March 1983 - November 1985.

11. "Divestiture: Two Years later," A Report on the Status of Residential Telephone Consumers Two years After the Breakup of AT&T, Consumer Federation of America, December 10, 1985.

12. Id., p.8, and Letter to Mr. Edward C. Finkel, Managing Director FCC from Kenneth A. Riccini Chief, Current Population Surveys Branch Bureau of the Census, dated January 7, 1986.

13. In the Matter of MTS Market Structure; Further Report on the Effects of Federal Decisions on Universal Telphone Service, CC Docket No. 78-72, Phase IV, Adopted December 19, 1984, Released January 4, 1985, p. 34. The FCC continues to rely on this logic despite continued refinements in the NERA model (see Appendix A and Comments of CFA, op. cit.,).

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14. "Did it Make Sense to Break Up AT&T?" Business Week, December 3, 1984, p. 92.

15. Wall Street Journal, op. cit.

16. Comments of Bell System Operating Companies and AT&T In Response to the Fourth Supplemental Notice of Inquiry and Proposed Rulemaking, In the Matter of MTS and WATS Market Structure, CC Docket No. 78-72, Phase I, August 6, 1982 p. 92.

17. United States V. AT&T Co., 552 F. Supp. 131 (D. D.C. 1982) and United States V. Western Electric 569 F. Supp. 990 & 1057 (D. D.C. 1983)

18. Issues in Domestic Telecommunications: Directions For National Policy, U.S. Department of Commerce, July 1985, pp. 134-143.

19. In the Matter of MTS and WATS Market Structure..., op. cit.,and Memorandum Opinion and Order Amendment of Part 67..., op. cit.

20. MTS and WATS Market Structure, CC Docket No. 78-72, Phase I, Third Report and Order, 48 Fed. Reg. 10319 (March 11, 1983).

21. "FCC Permits AT&T Tariff for 'Software Defined Network' Service To Become Effective," (CC Docket 85-203), and "FCC to Investigate AT&T's Megacom and Megacom 800 Rates," FCC News release, Action by the Commission October 31, 1985 by Memorandum Opinion and Order.

22. In the Matter of MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Dockets No. 78-72 and 80-286, adopted December 10, 1985, released December 27, 1985.

23. Id., pp. 5-7.

24. Comments of the CFA, op. cit.

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APPENDIX A

SORRY, WRONG NUMBERS:

FEDERAL AGENCY ANALYSES OF TELEPHONE SUBSCRIBERSHIP IN THE POST DIVESTITURE ERA

MARK N. COOPER

FEBRUARY, 1986

HeinOnline -- 9 Bernard D. Reams, Jr. & William H. Manz, Federal Telecommunications Law: A Legislative History of the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) including the Communications Decency Act 183 1997

INTRODUCTION

Since the breakup of the American Telephone and Telegraph Company demand for telephone service has received a great deal of analytic and policy attention.1/ The central question has been, Did divestiture or other changes in telecommunications policy at the Federal Communications Commission (FCC) jeopardize the goal of universal service?

Achieving universal service is one of the paramount goals of the National Communications Act. The Act has as one of its purposes the establishment of the FCC for the

> purpose of regulating interstate and foreign commerce in communications by wire and radio so as to make available, so far as possible, to all people in the United States a rapid, efficient, nationwide, and worldwide wire and radio communication service with adequate facilities at reasonable charges.2/

Although the goal has been part of national policy for half a century assessing the impact of recent changes in the industry has proven politically fractious and analytically complex in part because the very definition of universal service has been hotly debated.3/

> Should universal service be measured only by the percentage of households on the network? What percentage constitutes universality?
>
> Should usage be included? If so, how much?
>
> Can affordability be measured by the mere fact that a household continues to subscribe to telephone service, or must one also examine the cost of service relative to the income of the household?

Even narrower questions, such as changes in the percentage of households on the network (called the penetration rate) have been hotly debated. In a series of papers the Consumer Federation of American has applied a model developed for the Bell system to analyze residential demand for service to estimate the effect that recent increases in telephone prices have had on the penetration rate.4/ For a year, industry and government spokesman disputed CFA's analysis without providing either detailed criticisms or alternative analyses.

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On December 10, 1985 the National Telecommunications Information Administration (NTIA) issued a report entitled Telephone Subscribership in the United States: A Post-Divestiture Analysis, which claims to reach conclusion that contradict CFA's earlier analysis.5/ The FCC has recently begun to release data on penetration rates and prices (most recently on February 6, 1985).6/ These, too, purport to contradict CFA's analysis.

This paper demonstrates that the NTIA study, in particular, but also the FCC's analysis, is riddled with conceptual, analytic and empirical flaws. The NTIA analysis is particularly dangerous because it claims to address important policy questions and several of its conclusions are just plain wrong. The NTIA and FCC aproaches are so simplistic that they are more likely to mislead policymakers than inform their decisionmaking. Worse still, as this paper clearly demonstrates, the data is available to the NTIA and the FCC with which to provide much better answers to the important policy questions before the FCC and the Congress.

BASIC FLAWS IN THE NTIA AND FCC ANALYSES

By presenting simple penetration rates over time both the FCC and the NTIA analyses average together the income elasticity which is positive and the price elasticity which is negative. Both find that the result is pretty close to zero. This should not be surprising; one frequently finds that plusses and minuses cancel one another out. That does not tell us anything about the size of the plusses and minuses, however.7/

The NTIA's analysis of the presence or absence of a rate increase ignores the magnitude of increases. The one instance in which the report looks at the magnitude of rate increases relies on absolute values, but the fundamental principle of the analysis of economic behavior is to examine behavior at the margin. It is rates of change -- measured as percentages or in logarithms -- that forms the backbone of the analysis of price and income elasticities, which are at the core of the debate over demand for telephone service.

The FCC's analysis of local rate increases utilizes the producer price index, rather than the consumer price index and it compares the consumer price index for other items to the producer price index for telephones. Local residential rates as measured by the consumer price index, which is a much better measure of what consumers actually pay, are available and have been larger than those measured by the producer price index. Choosing the producer price index for local rates is strange, comparing it to the consumer price index borders on deception.

The NTIA does not take into account the timing of rate

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