**The original documents are located in Box 8, folder "Communications - Meeting with Charlie Walker, William Ellinghaus, and Paul Hensen, June 9, 1976 (1)" of the James M. Cannon Files at the Gerald R. Ford Presidential Library.**

MEETING WITH CHARLIE WALKER,
WILLIAM ELLINGHOUS, PAUL HENSEN
w/May
Wednesday, June 9, 1976
3:00 - 3:30 p.m.

Re: Consumer Communication Reform
Act of 1976

[June 1975]

William M. Ellinghaus
Vice Chairman of the Board
American Telephone & Telegraph Company

Paul Henson
President
United Telephone Corporation
Kansas City, Mo.

Charls E. Walker
President
Charls E. Walker Associates, Inc.

Cleared 10:30 6/8 KL

THE WHITE HOUSE
WASHINGTON

Charles Walker
William Ellinghaus
V. Chairman of the
Board AT+T

Paul Henson
Pres. of
United Utilities

Wed. June. 9

5/24/76



JMC

Charlie Walker has requested an appointment for himself and representatives of the telephone industry to meet with you on the Consumer Communication Reform Act of 1976 in the next few weeks. Mr. Ellinghouse, President of AT&T was supposed to have spoken to the VP about it who was supposed to have mentioned it to you?

✓ I WILL SEE WALKER AND TELEPHONE REPRESENTATIVES w/Lynn May ✓

_____ HAVE THEM SEE LYNN MAY

j

Ann will let us know how many, & names, etc.

785 9622
Ann

Kris
Clear these names

Wed, June 9

SELECTED STATISTICS OF UNITED STATES TELEPHONE INDUSTRY

Share Owners

| | |
|---|---|
| Bell | 2.9 Million |
| Independent | .9 Million |
| Total | 3.8 Million |

Active Employees

| | |
|---|---|
| Bell | 960 Thousand |
| Independent | 160 Thousand |
| Total | 1,120 Thousand |

Retired Employees

| | |
|---|---|
| Bell | 250 Thousand |
| Independent | 50 Thousand |
| Total | 300 Thousand |

Investment (Net Plant)

| | |
|---|---|
| Bell | $70.4 Billion |
| Independent | $17.0 Billion |
| Total | $87.4 Billion |

# The Crisis in Telecommunications:
## Discussion and Proposed Resolution



### Introduction

Telecommunications service in the United States -- in terms of its availability, quality, reliability and economy -- represents the standard by which other nations measure performance in the delivery of communications services. There is considerable justification for this:

> The availability of telephone service is virtually universal in the United States today. Ninety-four per cent of American homes and practically all American businesses now have telephone service. In 1973, the number of telephones per 100 persons averaged 65.6 in the United States, compared with 34.8 in Japan, 34.1 in the United Kingdom and 21.7 in France.*
>
> Telephone prices in real dollars have declined significantly in relation to the overall level of prices. Since 1960, per capita disposable income has increased 138.6 percent, and the Consumer Price Index 66.5 percent. During the same period, however, the price of residential telephone service has increased only 19.3 percent, and interstate long distance rates have remained essentially at 1960 levels. Also, a Department of Commerce survey has shown that the average manufacturing worker in the United States works about 26 hours annually to pay for telephone service -- the lowest of 15 industrial nations surveyed.**

This remarkable record of achievement is the telephone industry's response to the public policy goal explicitly defined by Congress in the Communications Act of 1934 --" . . . to make available, so far as possible, 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 . . ."

---

* AT&T Long Lines, "The World's Telephones," January, 1974.

** Office of Telecommunications, U. S. Department of Commerce, OT Report 73-17, The Real Cost Of Basic Telephone Service To The Average Worker In Fifteen Developed Countries, August, 1973.

Historical Perspective

It was recognized early in the history of the telephone industry that universal service could be achieved only through rates for basic local telephone service that subscribers could afford. Accordingly, with the participation and direction of legislators and regulators, a rate structure evolved in which the revenues from customers for basic local telephone service cover substantially less than the costs telephone companies would have to incur to provide such a service by itself. The revenues from other service categories -- such as intercity services and optional services and equipment -- make substantial contributions to covering common costs and overheads, thereby permitting rates for basic local telephone service to be lower than they could otherwise be.

Underlying this pricing system has been the philosophy that the traditional telephone companies collectively were to be the single supplier of telephone services to the public. Only with the telephone industry operating as a regulated monopoly within their franchised territories has it been possible to make such great strides toward the social objective of universal service.

The performance of the telephone industry as an integrated system has been determined for the most part by managerial decisions and technical characteristics built into the system from its inception:

> One of the first of these decisions was to operate the service primarily as a network of interconnected lines, rather than as a series of point-to-point connections. The value of each subscriber's service thus increased as more subscribers were connected to the network, and the basis of the mass market, universal service, was laid.
>
> Closely related decisions were to provide complete end-to-end service rather than to sell terminal equipment to subscribers, and to assume full system-wide responsibility for the maintenance of service and the introduction of technological change in service according to quality standards of the time.

These decisions have enabled the attainment of social objectives, efficiencies and economies in telecommunications unmatched by any other nation.

It is something of a paradox that while these decisions were facilitated by the monopoly form of the system, they also enabled the system to achieve economic characteristics that are -- in essential respects -- indistinguishable from those attainable in a classic, dynamic, competitive industry. To test the proposition that the regulated monopoly telephone system conforms in essential respects to the model of a competitive industry, it is necessary only to examine its record over time.* In essence, the telephone industry has outperformed competitive industry in those very attributes multi-supplier markets are supposed to enhance -- in pricing performance, in innovation, in reliability and quality of service, and in assuring ample supply to meet demand.

Recent Regulatory Actions

As the nation approaches the 100th anniversary of the invention of the telephone, the social objectives, efficiencies and economies achieved are now being threatened by recent regulatory actions that have opened selected telecommunications markets to multiple suppliers on the assumption that such an arrangement would be a spur to innovations in the pricing and provision of new communications services.

These regulatory actions, as they have evolved, clearly depart from basic standards of the Communications Act, and further depart from the very objectives the FCC established in its initial decisions. These actions now

---

* See for instance, the testimony of Robert R. Nathan in the Hearings on the Industrial Reorganization Act, S.1167, before the Subcommittee on Antitrust and Monopoly of the Senate Committee on the Judiciary, 93rd Congress, 2d Session. (1974)

threaten the technical and economic viability of the telecommunications network as an efficient, integrated vehicle for providing universal service at reasonable cost.

Terminal Equipment Decisions

The FCC's Carterfone* decision in 1968 permitted the interconnection with the network of customer-provided terminal and station equipment, to the extent that it could be accomplished without jeopardy to the technical integrity of the network. Unfortunately, the FCC left for future consideration the question of whether any economic harms would occur which should be weighed against the asserted benefits of interconnection.

To facilitate the interconnection authorized by Carterfone, and to insure the technical integrity of the network, the telephone companies filed new tariffs requiring that customer-provided equipment be connected to the network only through protective arrangements provided by the telephone companies. More recently, such connections have been permitted or have been recommended by the telephone companies under other programs where equivalent protection can be assured.**

Such an approach seemed to be consistent with previous developments in the area of data processing and the coincident requirement for communications to and from data equipment. In that area, telephone company tariffs long have allowed the interconnection of data processing equipment and terminals with the nationwide network in order to accommodate the unique needs of data users.

---

* Carterfone, 13 FCC 2d 420 (1968).

** See letter from James R. Billingsley to Richard E. Wiley dated July 21, 1975, transmitting the Comments of the Bell System in FCC Docket 19528, and the Comments.

Experience With The Terminal Equipment Decisions

The FCC has been considering even more liberalized rules for the connection of customer-provided equipment to the telephone network. The FCC recently adopted a plan with respect to ancillary types of equipment which eliminates the requirement for network protective arrangements.* This plan will seriously compromise the capacity of the Bell System and the independent telephone companies to preserve and manage the technical integrity and efficiency of the network. Furthermore, this plan is contrary to the very standards of effective protection recommended by the National Academy of Sciences in a study conducted at the Commission's request.**

In the currently contested Telerent*** case, the Commission is maintaining that the states are without power to adopt rules controlling the use of customer-provided terminal equipment for intrastate and local exchange communications which are more restrictive than FCC rules even if state commissions conclude that such interconnection poses either a physical or an economic threat to the provision of local service. In that regard, the FCC is claiming primary jurisdiction over station equipment. Such an assumption of authority is inconsistent with the Communications Act, the language of which is clear in reserving to the states jurisdiction over terminal apparatus.

The interconnection of customer-provided equipment already has demonstrated potential for revenue erosion, particularly among the independent telephone companies.**** These companies -- as well as the Bell System -- are

---

* FCC Public Notice, October 31, 1975.

** Report of a Technical Analysis of Common Carrier/User Interconnections, National Academy of Sciences, 1970.

*** Telerent Leasing Corp. et al, 43 FCC 2d 487 (1973).

**** A.T.& T., 53 FCC 2d 473 (1975). (In particular, see testimony of Mr. C. Ray Ballard, Assistant Administrator - Telephone, Rural Electrification Administration, on behalf of Mebane Home Telephone Company.

faced with the very real prospect that in order to recoup revenues lost to nonregulated equipment suppliers, they will be compelled to increase rates for basic local telephone service.

The Intercity Decisions

The FCC's MCI* decision in 1969 and its Specialized Common Carrier** decision in 1971 authorized specialized common carriers to provide private line services, i.e., communications over dedicated, point-to-point circuits. Such an approach was thought to be consistent with earlier FCC decisions to approve the construction of private telecommunications systems that met the unique needs of railway, pipeline, and other right-of-way companies requiring their own, largely separate communications networks.

The FCC premised its MCI and Specialized Common Carrier rulings on the assertion that the specialized common carriers would offer "new and different" services, filling a "serious deficiency in the communications services to the public" by providing business communications "with unique and specialized characteristics." The FCC further took the position that it would authorize new specialized common carriers only if it were satisfied that the new companies would provide their own intercity facilities to offer genuinely novel services, and explore areas of demand not tapped by the telephone companies.

The FCC concluded that the specialized common carriers would not divert business from the telephone companies or "pose a serious threat to the established carriers' price averaging policies." On the contrary, the FCC said that the development of such specialized common carriers actually would increase the revenues of the existing carriers by expanding the size of the communications market.

---

* Microwave Communications, Inc., 18 FCC 2d 953 (1969).

** Specialized Common Carrier Services, 29 FCC 2d 870 (1971).

Experience With The Intercity Decisions

In practice the FCC's experiments in intercity services have not worked out as envisioned. The specialized common carriers, in general, have simply duplicated the intercity private line routes and the services already supplied by the telephone companies. By electing to serve only the most profitable routes, the specialized common carriers have been able to undercut the telephone companies' averaged rates.

Moreover, the telephone companies' efforts to respond competitively to these challenges have been hampered by delay and indecision:

> The telephone companies were forced to appeal to the Second Circuit Court of Appeals in order to introduce competitive rates for television transmission and to set aside a requirement for special FCC approval to file new rates.
>
> Telephone Company tariffs designed to make private line rates more competitive with the specialized common carriers were delayed for about fifteen months, far beyond the statutory limit, although the specialized common carriers' rate responses were allowed to go into effect on one day's notice.
>
> The limited introduction of DATAPHONE® Digital Service, where no competition existed, was delayed even though there was great demand for the service among business customers. In expanding the service to other geographical areas where there was competition, the telephone companies were required to file rates no lower than prevailing private line rates even though those rates were higher than necessary to recover the costs of the innovative and economical transmission system used.

The Consequences of FCC Decisions

The potential consequences of these decisions involving interconnected equipment and specialized common carriers can best be seen in the effects they have on basic local telephone service rates, averaged long distance rates, end-to-end service responsibility, and the integrity and manageability of the network.

Basic Service Rates

Clearly, the existence of multiple suppliers of communications services will continue to have an increasingly adverse impact on the great majority of telephone customers. Bell System studies* indicate that if contributions from intercity services and optional services and equipment to cover joint and common costs and overheads were lost, rates for basic local telephone service, on the average, would have to increase to levels more than 70 percent higher than prevailing rates. It is not suggested that the full extent of the potential effect, represented by the 70 percent figure, would be realized in the immediate future or at any particular point in time. However, that is what would be necessary if basic local telephone service revenues, by themselves, had to cover all the costs of the facilities it would require if it were the company's only service and all of today's corporate common costs remained.

A study conducted by Systems Applications, Inc.,** on behalf of the United States Independent Telephone Association, USITA, revealed that the economic impact of competition by specialized common carriers and interconnection companies on the independent telephone industry will be severe. The study further indicated that the ". . . ultimate victims will be the users of basic telephone services."

A committee of the National Association of Regulatory Utility Commissioners -- state officials responsible for regulating local rates -- has concurred in the conclusion that competition will have "a substantial adverse economic impact on local exchange telephone subscribers" by forcing increases in local residential rates.***

---

* See for example, Bell Exhibit 1, Embedded Direct Cost (EDC) Study, FCC Docket No. 20003, April, 1975.

** Systems Applications, Inc., Regulatory Policy Changes And The Future Of The Independent Telephone Industry, October, 1975. See also, Appendix I, The Economic Impact of Competition On Telephone Operations In The Continental Telephone System, Comments of Continental Telephone, Docket No. 20003, April, 1975.

*** National Association of Regulatory Utility Commissioners, Committee on Communications, Report After Investigation, May, 1974.

Rate And Cost Averaging

Unburdened by the legal obligation of the telephone companies to serve all intercity routes, the specialized suppliers of intercity private line services -- by largely duplicating telephone company services over lower-cost routes -- have been able to price their services on those routes below the telephone companies' averaged rates. Thus, the telephone companies are deprived of revenues, from those routes, which help to support facilities provided for customers on lower-volume, higher-cost routes. They also are deprived of the contributions from that business toward common costs and overheads.

In order to compete with the private line service offerings of specialized common carriers, the telephone companies have been forced to abandon the traditional practice of averaging private line rates on a nation-wide basis. Although the changes incorporating these "de-averaged" rates are still being contested before the FCC, the consequent shifting of regular long distance traffic to telephone company private line services inevitably will cause losses in contributions from regular long distance service toward common costs and overheads.

Moreover, to the degree that competition and cross-elasticities between services in a multi-supplier market force the telephone companies to relate rates for regular long distance service more directly to the costs involved, customers along lightly trafficked, higher-cost routes -- generally those customers in rural areas and small towns -- will pay more for their calls than is paid for similar calls of equal distance placed by customers served by high-density, lower-cost routes. This will erode the substantial existing revenue contributions from regular long distance service above and beyond average cost levels toward common costs and overheads.

In sum, competition results in more and more long distance traffic being shifted to private line services of all suppliers, telephone companies as well as specialized common carriers. Also, telephone companies' private

line traffic will be shifted to the specialized common carriers because they price their services on low cost routes lower than the telephone companies' averages. Such shifting ultimately results in losses in the contributions to basic local telephone service, and thus in the long run is not in the best interest of the nations' users of basic telephone service.

Furthermore, there are significant economies of scale in a single supplier situation which are lost as duplicative circuits are established. Duplication of facilities inevitably will lead to higher overall costs which must be paid by the consumers.

Competition also will retard the introduction by the telephone companies of higher-capacity, more efficient, and therefore lower-cost switching and transmission systems. The siphoning off of business on a selective basis on busy routes by the specialized common carriers postpones the time when the newer high-volume developments can be introduced economically. This also represents an uneconomic use of resources to the detriment of all users.

End-to-End Service, Network Integrity

High-quality service has been assured by vesting total, end-to-end responsibility with the telephone companies, and by making them strictly accountable for the quality, cost and availability of service to all customers.

The undivided end-to-end responsibility for service availability and quality that rests with the telephone companies is the public's best assurance of high-quality at low cost. The existence of multiple suppliers, on the other hand, can divide that responsibility and compromise the carrying out of that responsibility, and thus lead to deteriorating performance at higher costs to everyone.

The telephone companies believe that the highly integrated, precisely engineered network is too valuable a resource to risk the perhaps irreversible threat to its performance posed by the direct electrical connection of facilities and devices over which the telephone companies have no control. The FCC

has adopted rules for such direct connection of ancillary equipment. With such direct connections end-to-end responsibility will be fragmented and service quality necessarily will be more difficult to maintain.

It is for this reason that the telephone companies, while seeking to open their facilities to as wide a variety of applications as practicable, have consistently maintained that only if they are permitted -- under regulation -- to exercise responsibility for the terms and conditions under which customer-provided terminals and systems may be attached to the network, can they be expected to fulfill their responsibility for the quality of the services they provide to the public.

Finally, an essential principle of the Communications Act is that the nationwide telecommunications network is and should remain a unified system planned, managed and operated cooperatively by the telephone companies. In a fragmented, multi-supplier environment, however, managing the expansion and improvement of the integrated nationwide network -- as well as overseeing its operation and reconfiguration on a day-to-day basis -- will become an intensely difficult and costly task.

The Solution

The provision of communications services by multiple suppliers involves serious consequences that, unless avoided, will violate the intent of Congress as expressed in the Communications Act.

While experiments with alternative communications suppliers may have seemed a logical extension of existing policy when originally proposed by the FCC, their potential effects in terms of higher costs for poorer service were not anticipated, nor are they socially or economically desirable.

Nonetheless, these experiments continue and new specialized common carriers are being permitted to enter the business, and new routes are being granted to existing specialized common carriers. The FCC also is considering

virtually uncontrolled interconnection of customer-provided equipment under a plan of certification and direct electrical connection to the network.

As a result, these efforts are no longer merely experiments in alternative ways to provide communications services. Rather, they have become vital public interest issues which the Congress must resolve. Congress must decide whether it wants the FCC to continue policies that will lead to:

- Sharp increases in basic local telephone service rates, higher overall rates for long distance callers, and differing rates over different routes.

- A weakening and fragmentation of control and management of the technical quality of the telephone network.

- The wasteful use of capital and telecommunications resources, as well as the retardation of network innovation and the consequent inpracticality of achieving the fullest possible economies of scale.

- The continuing preemption of state authority over matters affecting the quality and cost of basic local telephone service, a policy not intended by Congress when the Communications Act of 1934 was enacted.

A number of entrepreneurs already have entered, or are planning to enter, the most lucrative parts of the telephone business, in reliance on the FCC decisions discussed here. Unless this trend is checked promptly, it will become increasingly difficult to reverse, and the unavoidable consequence will be to raise the real costs of telephone service for the American people.

Congress should act without delay to reaffirm the policy of network unity that is at the heart of the Communications Act and to reaffirm the goal implicit in the Communications Act; namely, the widest availability of high quality communications at the lowest overall cost to the entire public.

November 4, 1975

REGULATORY POLICIES WILL CAUSE REVOLUTIONARY CHANGES IN PRICES AND WILL DAMAGE THE QUALITY OF SERVICE FOR COMMUNICATIONS USERS

1. Long distance interstate service provided about $2.6 billion in contribution in 1974 toward covering the costs also involved in providing local exchange services. This amounts to 55¢ out of the $2.00 average L.D. message.

2. In 1974 intrastate services (state toll, vertical, etc) provided about $2.8 billion towards keeping local exchange rates low.

3. The average residential customer's basic local billing (about $9 per month) does not even cover the cost of connecting him to his own central office (about $12 per month). This connection, which is necessary for both local and long distance calls, is needed even if the customer never originates a call. Then, if he makes any calls, there are, of course, additional costs (switching and trunking an average number of local calls costs about $5 per month).

4. If local residential rates had to cover the costs of the basic telephone, customer line and an average amount of local use, they would have to be increased, on the average, over 80%. *

5. The approximately 13 million American households with phone service, having incomes of $5000 or less, will be hurt most by cost related rates.

6. It is expensive to serve rural customers and they do not now have to carry their costs. The investment in outside plant alone to serve rural customers in South Central Bell territory has ranged as high as $12,000 per line. This translates into a monthly cost of $240. In addition, there are other costs involved in providing local service but basic monthly rates only range as high as $29.

---

*Updated 1975 results to replace 75% figure from the 1973 study submitted to the Hart Committee in July, 1974.

7. FCC decisions with respect to specialized common carriers have already forced large increases in private line prices to small weekly and daily newspapers in many small communities.

8. FCC Bureau proposal for private line rates based on its fully distributed cost theory would increase public broadcast TV rates 300%; ETV rates 85%; some Federal Government rates 80%.

9. Rates for over 60,000,000 households will go up; big businesses and very heavy users of long distance will pay less. The average person will find it much harder to afford a phone.

10. The unnecessary duplication of facilities is wasteful, creates a burden on users, and could preclude the benefits of economies of scale. (The cost per circuit mile of a cable that carries 1800 simultaneous conversations is $17.22; it's $3.21 for 32,400 capacity cable and $1.68 for one carrying 132,000 calls.)

11. Economist Robert Nathan noted that by any standard of what we expect from our enterprise economy the telephone industry has performed very well indeed. In the period of 1947-71:

    - Its productivity increased 75% faster than the U.S. average.
    - Its prices increased only half as fast as the average.

12. If your toaster blows a fuse, only you suffer. But one poorly maintained telephone also damages the quality of service experienced by the person at the other end on every call either originated or received (average 2,800 calls per telephone annually).

13. An incorrectly wired or poorly designed terminal device by sending out faulty signals can adversely affect the quality of service to customers not involved in the conversation.

14. In a recent letter (3-17-76) to FCC Chairman Wiley, the owner of the Climax, Michigan Telephone Company, a small independent, related his experience when all terminal equipment was customer owned. Service was poor and when troubles were traced to the customer's phone, repairs were frequently postponed. Service greatly improved only when a company owned telephone replacement program was completed.

15. If Mebane Telephone Company in rural North Carolina lost only 3 of its PBX's to competition, its net income would cover only one-fourth of the cost of its REA loan.

REGULATORY POLICIES WILL CAUSE REVOLUTIONARY CHANGES IN PRICES AND WILL DAMAGE THE QUALITY OF SERVICE FOR COMMUNICATIONS USERS

1. Long distance interstate service provided about $2.6 billion in contribution in 1974 toward covering the costs also involved in providing local exchange services. This amounts to 55¢ out of the $2.00 average L.D. message.

   This is the effect of Separations procedures that, over the years, has resulted in assignment of an increasing proportion of non-traffic-sensitive plant to interstate revenue requirements. This plant would be required even if customers made no toll calls--just to get connected to the network.

2. In 1974 intrastate services (state toll, vertical, etc.) provided about $2.8 billion towards keeping local exchange rates low.

   This is based on a study of incurred costs and realized revenues covering the 1974 time period. Most of this contribution comes from MTS and WATS.

3. The average residential customer's basic local billing (about $9 per month) does not even cover the cost of connecting him to his own central office (about $12 per month). This connection, which is necessary for both local and long distance calls, is needed even if the customer never originates a call. Then, if he makes any calls, there are, of course, additional costs (switching and trunking an average number of local calls costs about $5 per month).

4. If local residential rates had to cover the costs of the basic telephone, customer line and an average amount of local use, they would have to be increased, on the average, over 80%*.

---

*Updated 1975 results to replace 75% figure from the 1973 study submitted to the Hart Committee in July, 1974.

5. The approximately 13 million American households with phone service, having incomes of $5000 or less, will be hurt most by cost related rates.

   As competition forces telephone companies to price its long distance services closer to their costs ... many of the common costs must be shifted to basic residential rates. The resulting increases in local residential rates hits hardest at those with limited or fixed incomes. They won't gain from compensating reductions that might be made in long distance rates or in other discretionary services because they don't use them much. Most of their bill is for local service. Nearly 1/3 of the residential phone customers make no long distance calls in a given month.

6. It is expensive to serve rural customers and they do not now have to carry their costs. The investment in outside plant alone to serve rural customers in South Central Bell territory has ranged as high as $12,000 per line. This translates into a monthly cost of $240. In addition, there are other costs involved in providing local service but basic monthly rates only range as high as $29.

   Tunica, Louisiana is an example where the costs were that high. The average in South Central Bell is in the range of $3000 initial investment per line initially gained. That translates into a monthly cost of $60 per line.

7. FCC decisions with respect to specialized common carriers have already forced large increases in private line prices to small weekly and daily newspapers in many small communities.

   Private Line competition has forced the Bell System to respond by deaveraging rates. Rates to communities served by expensive low-density facilities are now significantly higher than to those communities served by lower cost high-density facilities. The FCC has recognized the need, "The Hi/Lo concept is ... a valid type of competitive response by Bell". (Interim Decision, FCC 19919, par. 14).

8. FCC Bureau proposal for private line rates based on its fully distributed cost theory would increase public broadcast TV rates 300%; ETV rates 85%; some Federal Government rates 80%.

FCC Common Carrier Bureau proposes revamping our ratemaking procedures to make arbitrary cost assignments. This will mean sharp increases for most users of private lines.

The "protected" specialized carriers would then have more cream to skim than they already have. This makes a bad situation, created by the regulators, even worse.

National Association of Broadcasters has testified that many TV stations would have to radically cut back their live programming if AT&T is required to use the proposed ratemaking methods.

9. Rates for over 60,000,000 households will go up; big businesses and very heavy users of long distance will pay less. The average person will find it much harder to afford a phone.

Assuming calling habits remained the same under cost-based competitive pricing, only the heaviest L.D. users among residential customers would benefit. Rates for long distance calls would come down. But, in order for this reduction to fully compensate for the increases due to cost-based rates for local service and facilities, the average local user would have to be using more than $20 per month in Long Distance under present rates. Even customers with annual family incomes of over $30,000 average only about $17 in long distance billing.
Local business rates, on the average, cover the costs of the basic telephone, customer line and the switching and trunking of local calls. Big businesses that use a lot of long distance and vertical services make particularly large contributions to keeping residential rates low. They would benefit the most under cost-based competitive pricing responses.

10. The unnecessary duplication of facilities is wasteful, creates a burden on users, and could preclude the benefits of economies of scale. (The cost per circuit mile of a cable that carries 1800 simultaneous conversations is $17.22; it is

$3.21 for a 32,400 capacity cable and $1.68 for one carrying 132,000 calls).

Millimeter waveguide, lightwave transmission systems of future with far greater capacity, can bring even greater savings, if the level of demand is there.

Duplicating interstate services splinters volumes among many systems, putting off the day when high-capacity systems can be installed. Very simply, volumes justify the cost and bring the unit price down. High capacity commuter trains make economic sense to build and operate where there are enough commuters. Run two half-empty trains, serving the same route, and its uneconomic.

Costs are from the testimony before Senator Hart's Subcommittee on Antitrust and Monopoly in 1974.

11. Economist Robert Nathan noted that by any standard of what we expect from our enterprise economy the telephone industry has performed very well indeed. In the period of 1947-71:

- Its productivity increased 75% faster than the U.S. average.
- Its prices increased only half as fast as the average.

12. If your toaster blows a fuse, only you suffer. But one poorly maintained telephone also damages the quality of service experienced by the person at the other end on every call either originated or received (average 2,800 calls per telephone annually).

Pollution of network can happen, particularly where there are lax safeguards. If individual customers maintain their equipment, some will do a good job; others will let the equipment go. No different than the way people maintain their cars.

The first beer can dropped in Lake Erie didn't pollute the lake... but the accumulation of "dumping" eventually did the job. The network is too valuable to risk to gradual pollution.

13. An incorrectly wired or poorly designed terminal device by sending out faulty signals can adversely affect the quality of service to customers not involved in the conversation.

If signaling is incorrect, annoying wrong numbers will occur. Or, longitudinal imbalance caused by faulty equipment of one customer can cause noise (crosstalk, hum, etc.) in the conversations of other customers who happen to be connected to the central office through the same cable.

14. In a recent letter (3-17-76) to FCC Chairman Wiley, the owner of the Climax, Michigan Telephone Company, a small independent, related his experience when all terminal equipment was customer owned. Service was poor and when troubles were traced to the customer's phone, repairs were frequently postponed. Service greatly improved only when a company owned telephone replacement program was completed.

See attached letter.

15. If Mebane Telephone Company in rural North Carolina lost only 3 of its PBX's to competition, its net income would cover only one-fourth of the cost of its REA loan.

Mebane Telephone Company in rural North Carolina (20 employees, 3600 main telephones) submitted testimony to the FCC making this point. This testimony also said that if Mebane lost its seven PBX switchboard and 47 key system customers to competition it would have to raise basic rates for residence customers 35 per cent. Either that, or go in the red.

There are many small "Mebane's" among the 1600 independent telephone companies that would really suffer from losses to competition.

# CLIMAX TELEPHONE COMPANY

MR. JOHN W. COLLVER, MGR.

CLIMAX, MICHIGAN 49034

PHONE 616 746-4411


March 17, 1976

Honorable Richard Wiley, Chairman
Federal Communications Commission
1919 M. Street N.W.
Washington, D.C. 20554

Dear Chairman Wiley:

I believe the Commission has approved Docket 19528 permitting customer owned terminal equipment to telephone company lines, including extension telephones. This action raises grave concern on my part for the interests of my business and our customers welfare.

Allow me, please, to present my case. Twenty six years ago, following a dozen years in the telephone employment, my wife and I bought this small telephone company which had a very deteriorated plant providing a poor grade of service and all customer owned telephones. I tell you they were very reluctant to invest their money in new equipment so we and they put up with whatever they could buy the cheapest. When trouble was traced to the customers instrument, the repairs would frequently be postponed until it failed completely. When we established a program of replacement with company owned telephones, with an additional monthly charge, it was very well accepted and service utility was greatly improved.

Bad as it was with the old magneto system I shudder to think of the complications when we are dealing with a complex and sophisticated automated system as we now have.

There are a number of practical questions that you may have the answers for, such as: How to assure a ringer balance on a party line? How to assure that a phone on a long loop will have a satisfactory network for transmission purposes? Who shall bear the expense of investigating poor transmission complaints on toll calls and the adjustments granted when it is customer owned equipment at fault? How shall upgrading of the switching and distribution plant be handled if it requires replacement of terminal equipment?

Should this action result in a large quantity of terminal equipment being shelved with unrecovered depreciation charges, who should bear the loss, the customer who use company owned terminal equipment, or me and my wife from our hard earned savings which we have invested in this business.

I fail to see how a return to those "good old days" can possible be in the public interest, however if the real purpose is to create an unworkable situation it should be a roaring success.

Respectfully yours,

John W. Collver

cc; Congressman Garry Brown
Senator Robert Griffin
Admiral William Mott

# Impact of Competition on an Independent Telephone Company

By WALTER S. BAER and
BRIDGER M. MITCHELL

*Continental Telephone System, the subject for this case study on the economic impact of competition on an Independent telephone company, is a regulated common carrier providing local and long-distance service under rates fixed by state commissions and the Federal Communications Commission. The Carterfone and MCI decisions by the FCC in the late sixties opened up competition in two areas: (1) terminal equipment and (2) private-line interconnecting services. Specialized carriers (herein called SCC's) and suppliers of interconnecting equipment (IC) have entered these two markets as the result of common carrier tariffs for long-distance service and terminal equipment which have set rates considerably above costs. Also, regulatory policy had encouraged low rates for local residential service as well as uniform averaged rates. In consequence, business services supported residential, interstate services supported intrastate, and "vertical services" (extensions, PBX switching, etc.) supported basic exchange service. Carriers contend they must either lower prices on profitable services or lose out on their shares of the markets. Interconnects reply that residential now subsidizes business. What is the real effect, especially on the Independents serving small towns and rural areas? This article analyzes revenue-to-cost relations in these situations, as well as the impact of the new competitive trend through 1980.*

THE Federal Communications Commission's current inquiry into the economic impact of competition in the telephone industry (Docket No. 20003) is expected to result in widespread discussion of important and complex issues. The initial round of filings received by the FCC in April, 1975, largely emphasizes the national impact of competition on the Bell system. However, chiefly because of the separations principles used to divide toll revenues between American Telephone and Telegraph Company and Independent telephone companies, the Independents may be effected by competition even more extensively than Bell.

TABLE 1
CHARACTERISTICS OF THE POPULATION SERVED BY THE CONTINENTAL TELEPHONE SYSTEM COMPARED WITH U. S. AVERAGES

| *Item* | *Areas Served by Continental* | *United States Average* |
|---|---|---|
| Location of Population | | |
| Central City of Metropolitan Area* | 1% | 34% |
| Urban Fringe of Metropolitan Area | 29% | 35% |
| Nonmetropolitan Area | 70% | 31% |
| Median 1970 Household Income | $7,072 | $8,486 |
| Households with Residential Telephone Service (1970) | 83% | 87% (Bell system) |

*Standard Metropolitan Statistical Area, generally defined by the Census to be a county or a group of continuous counties that contains at least one city of 50,000 persons or more.

*Source:* Sample of 105 Continental exchanges; 1970 U. S. Census of Population.

Continental is the third largest Independent in the United States, serving more than 2 million telephones in 41 states. Its revenues from domestic telephone operations totaled more than $400 million in 1974.[1]

As shown in Table 1 (page 1 ), Continental's telephone exchanges are located principally in small towns and areas outside the nation's metropolitan center. Households in Continental franchise areas have lower incomes than the nation as a whole, and residential telephone service is less fully saturated. An estimated 83 per cent of households in Continental communities have residential telephones, as compared with 87 per cent in Bell system communities.

## Data and Method

Allocating costs among jointly produced telephone services represents the chief problem in determining revenue/cost relationships. The telephone network provides a textbook example of jointly produced services whose costs cannot be simply determined. For example, the telephone handset and local loop are dedicated to a single subscriber but require virtually the same maintenance expense regardless of whether they are used for both local and toll calls or for local exchange service alone. And central office equipment is used by all classes of customers, as well as for both local and toll calls.

The various methods of cost allocation such as fully distributed costs, long-run incremental costs (LRIC), and embedded costs each has its advantages and disadvantages. The LRIC method has the advantage of indicating the actual costs of supplying an increased volume of service on an existing telephone system. However, this method is beset with major conceptual and practical difficulties when applied to an Independent telephone company. First, estimation of incremental costs requires data, not readily available from company operations, on separate, hypothetical expansions of each type of service. Second, the LRIC method, when used to establish rates, will normally not yield sufficient revenues to cover all costs when overhead and common cost items are included; as a result, analysis requires the introduction of additional pricing principles beyond those of LRIC. Third, LRIC fails to reflect the toll revenues received by Independent telephone companies through the application of separations formulas.

For this study a fully distributed cost method based on the separations principles used to divide toll revenues among Independent telephone companies and the Bell system has been employed. This method allocates investment, as well as operating and overhead expenses, among services according to relative usage. The precise formulas employed are detailed in the "*Separations Manual*" developed by the National Association of Regulatory Utility Commissioners (NARUC) and the FCC. These separations principles have been followed in order to reflect as accurately as possible the effects that interconnect and the specialized common carrier (SCC) competition would have on Continental's operations as an Independent telephone company dependent on settlement agreements for toll revenues.[2]

Data for the revenue to cost analysis came from Continental operating statistics, separations studies, and special traffic and service studies conducted during the summer and fall of 1974. The projections of base line trends through 1980 and the estimated impact of competition are based on those Continental statistics, as well as on the published plans, filings, and testimony of the specialized common carriers and interconnect equipment manufacturers, and the published filings and testimony of AT&T and Independent telephone companies in recent inquiries conducted by the FCC, state regulatory commissions, and NARUC.

## Revenue and Cost Relationships for Business and Residential Telephone Services

On the crucial question of whether contributions from business subscribers support residential services, or vice versa, three services and five classes of customers were considered:

| *Services* | *Customer Classes* |
|---|---|
| Local Exchange Service | Residential Subscribers |
| Message Toll Service | Business Subscribers (other than key and PBX systems) |
| Vertical Services | Key Telephone Systems |
| | Small PBX Systems (under 100 lines) |
| | Large PBX Systems (100 or more lines) |

Excluded from the analysis are private line and TWX services (which together represent less than 3 per cent of operating revenue), directory advertising, mobile and coin telephones, and other miscellaneous services.

Revenues, expenses, and investment associated with supplying local exchange and toll service we derived for the five classes of customers listed above. Average local exchange revenues for main station or trunk service were obtained from a systemwide survey of charges billed in August, 1974, and annualized to the full calendar year. Total toll settlements from the August survey were annualized and distributed among customer classes according to toll usage factors derived from a separate traffic sampling study of Continental exchanges. (See Table 2, page 3 )

Local and toll service costs include operating and overhead expenses; income, property, and other taxes; and a return on net (depreciated) plant. We have calculated these costs for the Continental system, using a base line rate of return of 8.5 per cent on net investment and factors for taxes and expenses from the most recent toll settlements studies.

[1]The full study, "The Economic Impact of Competition on Telephone Operations in the Continental Telephone System," has been filed in Docket No. 20003 as Appendix I, Comments of Continental Telephone Corporation, April 21, 1975.

[2]The authors recognized that the Bell system does not agree with the use of separations formulas for allocating costs among services. Whatever the merits of the Bell system's arguments with respect to its own operations, we believe that cost allocations among services according to separations principles are appropriate for Independent telephone companies whose toll revenues are based on these procedures.

TABLE 2
LOCAL AND TOLL USAGE BY CLASS OF CUSTOMER (1974)

| | Customer Class | | | |
|---|---|---|---|---|
| | *Residence* | *Business* | *Key System* | *PBX* |
| Relative Busy Hour Local Usage (CCS) per Main Station or Trunk | 1.0 | 1.22 | 4.35 | 11.14 |
| Relative 24-hour Toll Usage (Minutes) per Main Station or Trunk | 1.00 | 2.17 | 4.46 | 9.82 |

*Source:* Special traffic sampling study of Continental exchanges.

Investment and expenses were then separated into traffic-sensitive and nontraffic-sensitive categories. Nontraffic sensitive plant (consisting of the local loop and telephone handset, land buildings, and equipment that in ordinary use need not be varied to service an increase in calling) and d associated expenses were allocated equally to each main station or trunk in the system, since this plant is required equally by all subscribers, regardless of the frequency with which they actually use local and toll services.

The need for traffic-sensitive plant (consisting of interexchange trunks, roughly 75 per cent of central office equipment, and other items determined by the volume of calling), however, depends directly on the extent of telephone usage. Cost responsibility for this plant should be assigned to those subscribers responsible for using it. Consequently, we have allocated traffic-sensitive investment and expenses according to the relative usage measured for each class of customers. These usage data are presented in Table 2, using a reference value of 1.00 for residential subscribers. Business local usage during the busy hour is 122 per cent of residential usage, while key system lines and PBX trunks are used 435 per cent and 1,114 per cent more, respectively, than residential lines. Toll calling, reported on the basis of 24-hour usage, is similarly found to be greater for business, key, and PBX system customers.

The results of these calculations are shown in Table 3 (this page). Annual contributions for each class of customer relative to the base line 8.5 per cent rate of return are found by subtracting expenses from revenues. Services earning more than the 8.5 per cent rate of return show a positive contribution; conversely, a negative contribution indicates that the service earns less than 8.5 per cent return.

Table 3 shows clearly that business exchange and toll services in the Continental system support residential exchange and toll services. Local exchange and toll revenues from the average business main station exceeded the sum of allocated expenses and the 8.5 per cent base line return on capital by $91 in 1974. This contribution represented 22 per cent of the local and toll revenue per business main station. In contrast, the average residence main station required $59 of support from other services in 1974. Key system and PBX trunk lines were even more profitable than business main stations, reflecting heavier toll usage by key system and PBX subscribers.

TABLE 3
REVENUES, COSTS, AND CONTRIBUTIONS BY CLASS OF CUSTOMER FROM LOCAL EXCHANGE AND TOLL SERVICE (1974)

*Dollars per Main Station or Equivalent*

| *Item* | *Residence* | *Business* | *Key System* | *Small PBX* | *Large PBX* |
|---|---|---|---|---|---|
| Average Annual Revenue | | | | | |
| Local | 76 | 132 | 139 | 213 | 271 |
| Toll | 126 | 273 | 562 | 1,236 | 1,236 |
| Total Revenue | 202 | 405 | 701 | 1,449 | 1,507 |
| Annual Expense | 261 | 314 | 493 | 898 | 898 |
| Annual Contribution | (59) | 91 | 208 | 551 | 609 |
| Contribution as Per Cent of Revenue | (29%) | 22% | 30% | 38% | 40% |

[a]Including nonrecurring revenue but excluding vertical services, directory advertising, coin, mobile, and other miscellaneous services.

[b]Operating expenses, including taxes, plus 8.5 per cent rate of return on net plant.

The $59 annual negative contribution for each residence main station in the Continental system corresponds to $4.92 per month. This amount is slightly less than the $5.75 negative contribution from single party residence service reported by the Bell system using September, 1973, data.[3]

[3]"AT&T Company Study of the Revenues and Costs of Residence Telephone Service," by M. G. Killoch, Appendix to Statement of E. B. Crosland before the Senate Subcommittee on Antitrust and Monopoly, July 26, 1974. The figure reported is for the "fully allocated, relative use" methodology employed by Killoch, which uses somewhat different assumptions (for example, a 9-1/2 per cent rather than 8-1/2 per cent rate of return) but is generally similar to that used in this study.

TABLE 4
REVENUES, COSTS, AND CONTRIBUTIONS FROM VERTICAL SERVICES (1974)

*Dollars per Extension or System*

| *Item* | *Residence Extensions* | *Business Extensions* | *Key System Common Equipment And Extensions* | *Small PBX Common Equipment And Extensions* | *Large PBX Common Equipment And Extensions* |
|---|---|---|---|---|---|
| Annual Revenue | | | | | |
| Local | 13.92 | 20.76 | 410 | 3,528 | 23,700 |
| Toll | 4.22 | 4.52 | 143 | 1,971 | 19,210 |
| Total Revenue | 18.14 | 25.28 | 553 | 5,499 | 42,910 |
| Annual Expense[a] | 8.37 | 9.21 | 282 | 3,893 | 37,608 |
| Annual Contribution | 9.77 | 16.07 | 271 | 1,606 | 5,302 |
| Contribution as Per Cent of Revenue | 54% | 64% | 49% | 29% | 12% |

[a]Operating expenses, including taxes, plus 8.5 per cent return on net plant.

### Vertical Services

The revenues, expenses, and contributions for extension telephones, key system, and PBX common equipment were calculated in a manner similar to that employed for exchange and toll services. Data on other vertical services such as decorator telephones, answering devices, and data modems were not available, but Continental believes that they represent a small proportion of the vertical service category.

The contributions shown in Table 4 (page 3 ) are positive for all vertical services. Residential extensions earned an annual contribution of approximately $10, and business extensions contributed $16 each. Key systems generated an average annual contribution of $271 per system, and small and large PBX systems contributed an average of $1,606 and $5,302 each per system. In aggregate, these vertical services contributed more than $12 million to the support of other services in 1974. This total represents 39 per cent of the revenue from vertical services and corresponds to $8.64 for each of the 1.4 million main stations in the Continental system.

### Impact of Interconnect Equipment Competition

Although still quite limited in magnitude, interconnection in the Continental system has increased rapidly since the FCC's Carterfone decision. Table 5 (this page) shows that the number of interconnected PBX systems has grown at an average annual rate of 40 per cent during 1969-74. At the end of 1974, interconnected PBX units supplied by competitors accounted for slightly more than 2 per cent of PBX systems in Continental companies.

Interconnect competition affects both contributions from profitable vertical services and revenues from toll settlements. As noted earlier, Continental's toll revenues depend directly on the amount of investment and expenses allocated to toll services and not on the funds collected from toll call billings. To quantify these effects, we first project the growth of Continental telephone operations through 1980, under the assumption of no increased interconnect and specialized common carrier competition over that period. We then use this *base line* case as a reference point from which to measure the impact of different levels of interconnect competition.

TABLE 5
INTERCONNECTED PBX SYSTEMS IN SERVICE IN CONTINENTAL TERRITORIES

| *Year* | *Number of PBX Systems* | *Increase over Previous Year* |
|---|---|---|
| 1969 | 7 | — |
| 1970 | 9 | 29% |
| 1971 | 16 | 78% |
| 1972 | 20 | 25% |
| 1973 | 32 | 60% |
| 1974 | 37 | 16% |

*The Base Line Case: No Increased Level of Competition*

On the basis of Continental's own budget forecasts and the observed rates of growth of various services over the 1971-74 period, we estimate that total system investment in vertical services will grow at more than a 12 per cent annual rate through 1980. This rate is significantly greater than the 5 per cent projected growth in main stations. The increased investment, along with greater toll usage and increased tariffs for PBX common equip-

TABLE 6
REVENUES AND CONTRIBUTIONS FROM VERTICAL SERVICES, 1974-80; BASE LINE CASE

| | *1974* | *1976* | *1980* |
|---|---|---|---|
| Annual Revenue from Vertical Services (000) | $31,418 | 41,866 | 75,194 |
| Annual Contribution from Vertical Services (000) | $12,168 | 17,224 | 34,612 |
| Annual Contribution per Main Station | $ 8.64 | 11.09 | 18.33 |

**Walter S. Baer** is a member of the economics department of the Rand Corporation. He graduated from the California Institute of Technology in 1959, and received his PhD in physics from the University of Wisconsin in 1964. **Dr. Baer** has served as a consultant for many organizations including the Continental Telephone Corporation. This article is based on a recent study conducted for the Continental Telephone Corporation, however, the views expressed in the paper are the authors' and do not necessarily reflect those of Continental Telephone Corporation, the Rand Corporation, or any other organization.

**Bridger M. Mitchell** is a member of the economics department of the Rand Corporation, Santa Monica, California. He received his AB degree from Stanford University in 1962, and his PhD in economics from the Massachusetts Institute of Technology in 1970. **Dr. Mitchell** has been a consultant to a number of corporations, foundations, government agencies, and the Continental Telephone Corporation.

ment, is projected to generate contributions of nearly $35 million in 1980. This amount corresponds to more than $18 per main station, Table 6 (page 4 ).

*Losses from Increased Interconnect Competition*

The competitive threat posed by the interconnect equipment suppliers is principally that of providing vertical service equipment at prices lower than present carrier tariffs. The impact of competition thus depends, among other factors, on whether the carriers reprice vertical service equipment closer to costs.

We distinguish between two principal cases. In Case I, we calculate the effect of tariff reductions on business vertical services (business extensions, key systems, and PBX systems) that would eliminate contributions beyond the 8.5 per cent return on net investment by 1980. Tariffs and contributions from residence extensions are assumed unchanged. Such price cuts should give Continental a commanding position in the vertical services market and effectively forestall additional entry by interconnect equipment suppliers. However, these lower tariffs are estimated to reduce both local revenue and contribution by $1.9 million in 1976 and $8.4 million in 1980, Table 7 (below). Toll settlement revenues are unaffected.

A different set of effects results if we assume that Continental maintains the same tariffs projected under the base line case. In such circumstances interconnect competitors can be expected to capture an expanded share of the market by selling vertical service equipment at lower prices, supplying equipment with additional features, or both. The growth of interconnected units in the Continental system has proceeded at an average annual rate of about 40 per cent during the last four years, as shown above. However, since the base of interconnected units is still small, and the variance in annual growth so large, one cannot simply project these increases forward through 1980.

TABLE 7
PROJECTED NET IMPACT OF INTERCONNECT EQUIPMENT COMPETITION (1976-80)

| | *1976* | *1980* |
|---|---|---|
| *Case I:* Tariffs Reduced to Yield Zero Contribution for Business Extensions, Key, and PBX Systems by 1980 | | |
| Loss of Local Contribution (000) | $1,856 | $8,401 |
| Loss of Toll Revenues (000) | 0 | 0 |
| Total | $1,856 | $8,401 |
| Loss per Main Station | $1.20 | $4.45 |
| *Case II:* Business Extension, Key System, and PBX Projected Annual Growth Rate Reduced by 50 Per Cent | | |
| Loss of Local Contribution (000) | $ 225 | $2,492 |
| Loss of Toll Revenue (000) | $1,190 | $6,499 |
| Total | $1,415 | $8,991 |
| Loss per Main Station | $0.91 | $4.76 |

In the view of the authors the predominant effect of interconnect competition will be to cut into the expected growth of vertical services supplied by telephone companies rather than to replace the installed base of present vertical service subscribers. Consequently, in Case II we assume that competition will reduce the growth in Continental's business vertical service investment projected under the base line case by one-half, or from 12 to 6 per cent per year for key and PBX systems. By 1980, interconnect competitors will thus have achieved nearly a 30 per cent share of these markets. This case results in loss of both local contribution and toll settlement revenue — a total loss of $9 million in 1980.

In contrast, a 10 per cent loss of the business, vertical service market represents, in our judgment, the minimum loss to interconnect competition in 1980. This would correspond to a $3 million loss of local contribution and toll settlement revenue for Continental in 1980.

These results are generally consistent with those estimated in a recent study by the New York Public Utility Commission.[4] The study projected losses of contribution to New York Telephone Company in 1980 of between $6.84 and $8.57 per main station due to interconnect competition. These figures compare with Case I and Case II estimates of a $4.45 to $4.76 loss per main station in 1980. The New York estimates are higher because of the relatively greater investment in vertical services among New York Telephone Company subscribers as compared with Continental subscribers.

## Impact of Specialized Common Carrier Competition

Specialized common carrier competition affects Continental and other Independents in two principal ways. First, direct SCC competition for Continental toll and private-line business will reduce the subscriber line usage (SLU) factor used in determining settlement revenues. Continental customers who switch to the private-line services offered by the SCC's are almost certain to reduce their volume of toll calling and thus reduce the Continental SLU factors for intrastate and interstate toll. It is these reductions in SLU factors, rather than the loss of billed toll revenues, that constitute the major impact of direct SCC competition on the Independent telephone companies.

The SCC's do not generally intend to serve Continental subscribers in their local calling areas, since Continental franchise areas do not overlap with present and planned SCC operating centers. Instead, the SCC's would use foreign exchange (FX) and common-control switching arrangement (CCSA) circuits to connect subscribers in Continental areas to their operating centers. This extends the area of SCC competition to perhaps 50 miles surrounding each SCC operating center and makes it possible for them to reach approximately 25 per cent of all Continental franchises by 1976. These areas also contain most of Continental's large business subscribers.

Present private-line subscribers and large business toll users will be the groups most vulnerable to SCC

[4] "The Revenue and Cost Impact of Interconnection within the Service Area of New York Telephone Company," State of New York, Department of Public Service, January, 1975.

competition. We have adopted a conservative assumption that only business subscribers with toll billings greater than $100 per month will be affected. These subscribers presently account for 10.4 and 15.5 per cent of Continental interstate and intrastate toll minutes of use, respectively — percentages we assume to remain unchanged through 1980.

SCC competition might be expected to reduce interstate toll usage by between 0.2 and 0.4 per cent in 1976, and between 0.4 and 0.8 per cent in 1980. (See Table 8, below.) The higher estimates (Case B) assume extensive use of FX and CCSA connections by the SCC's. Intrastate usage losses are estimated at roughly half the interstate level. The resulting losses in toll settlements revenues range between $290,000 and $612,000 in 1976, and between $1,106,000 and $2,235,000 in 1980.

A second and larger impact may occur as a result of SCC competition with the Bell system, despite competitive responses by Bell such as the Hi/Lo tariff. If competition reduces AT&T net operating income from long-distance services, the resulting decreases in Bell system interstate and intrastate rates of return will reduce settlement revenues to the Independents. We estimate that a 4 per cent decrease in Bell's interstate net operating income due to SCC competition, coupled with only a one per cent loss of intrastate net operating income, would translate into a $5.6 million loss of settlements revenue to Continental in 1980. A 6 per cent decrease in interstate net operating income, coupled with a 2 per cent loss of intrastate net operating income, would result in a $9.1 million loss to Continental.

The losses in revenue from toll settlements — both those due to SLU reduction and those due to decreases in AT&T net operating income — represent net losses in contribution, since they involve negligible reductions in Continental's actual investment or expenses. Under current separations procedures, these losses imply a transfer of investment and expenses from toll to local exchange service, thus giving rise to additional revenue requirements for local exchange service. Table 9 (below) shows that the amount of additional annual revenue requirement in 1980 per main station ranges from $3.55 (Cases A plus C) to $5.98 (Cases B plus D) for the cases listed in Table 8. These effects due to specialized common carrier competition are independent of and additional to any loss of vertical service contribution that would result from competition from interconnect equipment suppliers.

TABLE 8
PROJECTED LOSSES IN ANNUAL REVENUE FROM TOLL SETTLEMENTS DUE TO SPECIALIZED COMMON CARRIER COMPETITION (1976-80)

| | *1974* | *1976* | *1980* |
|---|---|---|---|
| *Base Line Case:* No Increase in Competition | | | |
| Annual Revenue from Toll Separations (000) | $244,191 | 324,373 | 567,137 |
| *Reduction in Subscriber Line Usage (SLU)* | | | |
| *Case A:* Reduction of 0.4 Per Cent in Continental SLU Factor by 1980 | | | |
| Reduction in Continental Annual Revenue (000) | | $ 290 | 1,106 |
| *Case B:* Extensive Use of FX and CCSA Connections by the SCC's; Reduction of 0.8 Per Cent in Continental SLU Factor by 1980 | | | |
| Reduction in Continental Annual Revenue (000) | | $ 612 | 2,235 |
| *Reduction in Bell System Rates of Return* | | | |
| *Case C:* Loss of 4 Per Cent of Interstate and One Per Cent of Intrastate Net Operating Income in 1980 | | | |
| Reduction in Continental Annual Revenue (000) | | $1,284 | 5,605 |
| *Case D:* Loss of 6 Per Cent of Interstate and 2 Per Cent of Intrastate Net Operating Income in 1980 | | | |
| Reduction in Continental Annual Revenue (000) | $2,109 | 9,060 | |

TABLE 9
PROJECTED IMPACT OF SPECIALIZED COMMON CARRIER COMPETITION ON TOLL SETTLEMENT REVENUES (1976-80)

| | *1976* | *1980* |
|---|---|---|
| *Low Impact:* Case A Plus Case C | | |
| Reduction in Continental Annual Revenue from Base Line Case (000) | $1,574 | 6,711 |
| Reduction per Main Station | $ 1.01 | 3.55 |
| *High Impact:* Case B Plus Case D | | |
| Reduction in Continental Annual Revenue from Base Line Case (000) | $2,721 | 11,295 |
| Reduction per Main Station | $ 1.75 | 5.98 |

## Discussion

Existing carriers face either the loss of significant portions of those markets or the need to cut prices to meet the competition. In either case, under present tariffs the losses in local contributions and toll settlements would require increased revenues from basic exchange service. For the Continental system, these added revenue requirements would total between $15 and $20 million in 1980, or from $8 to $11 per main station if allocated equally to each business and residential subscriber. This would correspond to an increase of between 10 and 14 per cent above present average tariffs for residential exchange service.

As an alternative to rate increases, regulatory commissions might consider changes in the present tariff structure in response to increased competition. Such changes could include:

*Tariff unbundling.* Separate tariffs could be established for access lines and station equipment, with each relating more closely to costs. This would lead to lower rates for terminal equipment and higher line charges.

*Revision of exchange flat rates to reflect usage.* The "value of service" concept for determining local exchange rates is based on different demand functions and usage patterns among different classes of subscribers. The present differentials in exchange flat rates, however, do not appear to reflect fully the differences in usage reported in Table 3. With periodic traffic sampling, capacity costs and as-

sociated revenue requirements could be allocated on the basis of average peak period use.

*Usage-sensitive pricing of local calls.* Usage-sensitive pricing (USP) has received increased attention as a way to have all subscribers pay according to usage. In principle, peak and off-peak price differentials should be included as well, since the capacity costs for exchange services are determined by peak-hour usage. However, the added costs of USP metering and billing are high, and may be greater than the gains in economic efficiency. Moreover, we have little knowledge of the price elasticity (deterrence effect) for local service, so that it is difficult to estimate the net effect of usage-sensitive pricing on carrier revenues. Current USP experiments in several states will increase the data available on this effect and should improve our ability to weigh the benefits and costs of usage-sensitive pricing in other areas.

*Changes in toll separations.* By transferring costs and revenue requirements from intrastate to interstate services, current separation procedures make carrier adjustments to competition more difficult, particularly for Independent telephone companies. A loss of terminal equipment to an interconnect competitor brings with it an added transfer of revenue requirements from toll to local services. As shown in Table 7, the impact from separations can be two to five times as great as the loss of local contributions for an Independent company.

In principle, this increase in intrastate revenue requirements due to competition could be at least partially offset by revisions of the separations procedures themselves. Such modifications might remove terminal equipment from cost separations and allocate a higher proportion of other equipment to toll services, include interconnected equipment in the carrier costs allocated to toll, or even substitute a simple percentage of total toll revenues for the current cost-related procedures.

Such changes in separations procedures are at least plausible and merit further consideration. Before adopting them as serious proposals, however, regulators would need an extensive study of their effects on Bell and the Independent carriers, the interconnect and SCC competitors, and the rate-paying public. In any event, it appears highly unlikely that changes of this magnitude will be adopted in the near future.

Interconnect and SCC competition will undoubtedly reduce the telecommunications costs of some business users and may, principally through carrier repricing, lead to a more efficient allocation of economic resources. However, it seems highly unlikely that any method of repricing telephone services in response to competition can avoid making some groups of subscribers worse off than they were before.

---

REPRINTED FROM
PUBLIC UTILITIES FORTNIGHTLY
WASHINGTON D. C
1975

94TH CONGRESS
2D SESSION

# H. R. 12323

IN THE HOUSE OF REPRESENTATIVES

MARCH 4, 1976

Mr. RONCALIO introduced the following bill; which was referred to the Committee on Interstate and Foreign Commerce

# A BILL

To reaffirm the intent of Congress with respect to the structure of the common carrier telecommunications industry rendering services in interstate and foreign commerce; to grant additional authority to the Federal Communications Commission to authorize mergers of carriers when deemed to be in the public interest; to reaffirm the authority of the States to regulate terminal and station equipment used for telephone exchange service; to require the Federal Communications Commission to make certain findings in connection with Commission actions authorizing specialized carriers; and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That this Act may be cited as the "Consumer Communications Reform Act of 1976".

CONGRESSIONAL FINDINGS AND DECLARATION OF PURPOSE

SEC. 2. The Congress finds and declares that—

(a) The revenues from integrated interstate and foreign common carrier telecommunications services, based on charges reflecting both costs and value of service, have contributed toward meeting the costs of facilities used in common for providing such interstate and foreign services and local telephone exchange service throughout the United States, and thereby helped maintain a level of charges for telephone exchange service which is lower than otherwise would be required.

(b) The technical integrity of the nationwide telecommunications system, its coordinated planning, design, installation, improvement, management, operation and maintenance are indispensable elements in the interstate telecommunications network, necessary both to the reasonableness of charges and to the high quality and universality of common carrier telecommunications service, and accordingly Congress hereby reaffirms its policy that the integrated interstate telecommunications network shall be structured so as to assure widely available, high quality telecommunications services to all of the Nation's telecommunications users.

(c) The authorization of lines, facilities, or services of specialized carriers which duplicate the lines, facilities, or services of other telecommunications common carriers—

(1) involves higher charges for users of telephone exchange service by decreasing the interstate revenues that otherwise would be available for contribution to the common costs of providing telephone services throughout the United States;

(2) fosters inefficiencies in the utilization of national telecommunications resources through the creation of unnecessary and wasteful duplication of telecommunications lines and facilities and wasteful use of the radio spectrum;

(3) significantly impairs the technical integrity, the coordinated planning, design, installation, improvement, management, operation and maintenance of the integrated nationwide telecommunications network; and

(4) has an adverse impact on the national objectives of maintaining stability of consumer price levels, conserving national economic resources, improving productivity, and fostering an economy that will maintain adequate sources and reasonable costs of capital;

and is, therefore, contrary to the public interest.

(d) The Congress reaffirms its intent that the complete authority to regulate terminal and station equipment used for telephone exchange service shall rest with the States even though such terminal and station equipment also may be used in connection with interstate services.

(e) The congressional findings and declarations of policy set forth herein are necessary to achieve the purposes of the Communications Act of 1934 as specified in section 1 of that Act; and the Federal Communications Commission shall take no action inconsistent with the findings and declarations in this Act.

CHARGES FOR SERVICE

SEC. 3. Section 201 (b) of the Communications Act of 1934, as amended (47 U.S.C. 201) is amended by adding the following at the end of the first sentence: "No compensatory charges for or in connection with such communication service may be found to be unjust or unreasonable on the ground that it is too low. The Commission may not hold the charge of a carrier up to a particular level to protect the traffic or revenues from a communication service offered or provided by another carrier if such charge proposed by the carrier is compensatory. As used in this subsection, a charge is compensatory so long as it equals or exceeds the incremental cost of providing the communications service. Such incremental cost is the additional cost caused by the provision of the service including, where appropriate, the capital costs of whatever additional facilities are required to provide the service.".

ACQUISITIONS BY AND OF CERTAIN COMMON CARRIERS

SEC. 4. The Communications Act of 1934, as amended, is further amended by adding the following new section 224:

"SEC. 224. Upon application of any common carrier or other person involved in the transaction, the Commission shall have jurisdiction (i) to approve the acquisition of control by a domestic common carrier of any other domestic common carrier or the acquisition of the whole or any part of the property of a domestic common carrier by any other domestic common carrier, or (ii) to approve the acquisition by a person which is not a common carrier of control of any domestic common carrier or the acquisition of the whole or any part of the property of a domestic common carrier, whenever the Commission determines, after full opportunity for hearing on an evidentiary record, that such approval is in the public interest. The Commission shall give reasonable notice in writing concerning any such proposed action to the Governor of each of the States in which the physical property affected, or any part thereof, is situated, and to each State commission that may also have jurisdiction over any of the common carriers involved, and to such other persons as it may deem advisable, and shall afford such parties a reasonable opportunity to participate in any hearings re-

lated to such action. If the Commission approves the proposed acquisition, it shall certify to that effect; and thereupon any Act or Acts of Congress making the proposed acquisition unlawful shall not apply. As used in this section 224, 'domestic common carrier' shall mean a common carrier, the major portion of whose traffic and revenues is derived from communications services other than foreign communications. This section 224 shall not apply where either section 221 (a) or 222 of this Act is applicable or to the acquisition by any person of a telephone common carrier as defined in section 225 (a) (1).".

SEC. 5. Section 2 (b) of the Communications Act of 1934, as amended, (47 U.S.C. 152 (b)) is further amended by striking the clause beginning with the words "except that" following the semicolon and inserting the following "except that sections 201 through 205 of this Act, both inclusive, and section 224 of this Act shall, except as otherwise provided therein, apply to carriers described in clauses (2), (3), and (4).".

REAFFIRMATION OF STATE JURISDICTION OVER LOCAL TERMINAL AND STATION EQUIPMENT

SEC. 6. Section 2 (b) of the Communications Act of 1934, as amended (47 U.S.C. 152 (b)) is further amended by striking "or" at the end of the phrase following "(1)" and substituting therefor the following: "including but not limited to, the charges, classifications, practices, services,

facilities, or regulations for or in connection with the use or connection of any station equipment, terminating facilities, exchange plant, and other like instrumentalities and apparatus used in common for both intrastate communication service and interstate or foreign communication service, whether provided by a common carrier or any other person, or".

SEC. 7. Section 3 of the Communications Act of 1934, as amended (47 U.S.C. 153), is further amended by adding the following new subsection:

"(gg) 'Intrastate communication' means communication or transmission between points in the same State, territory, or possession of the United States, or in the District of Columbia, including among other things, all station equipment, terminating facilities, exchange plant, and other like instrumentalities and apparatus used for or in connection with telephone exchange service or interexchange service, even though such equipment, facilities, plant, instrumentalities or apparatus are or may be used in connection with interstate or foreign communications service. 'Intrastate communication service' means any service which provides intrastate communication.".

FINDINGS TO BE INCLUDED IN COMMISSION AUTHORIZATIONS OF SPECIALIZED CARRIERS

SEC. 8. The following new section is added in title II of the Communications Act of 1934, as amended:

"SEC. 225. (a) As used in this section—

"(1) The term 'telephone common carrier' means any common carrier, the major portion of whose traffic and revenues, in interstate and foreign communication and in intrastate communication, is derived from message telephone services, telephone exchange services, radio-telephone exchange services, or a combination thereof.

"(2) The term 'telegraph common carrier' means any common carrier which provides a public message telegram service in interstate communications.

"(3) The term 'specialized carrier' means any common carrier other than a telephone or telegraph common carrier.

"(4) The term 'message telephone service' means telephone service between stations in different exchange areas on a message-by-message basis, contemplating a separate connection for each occasion of use.

"(5) The term 'public message telegram service' means a substantially nationwide telegraph service for the transmission and reception of record matter where the transmission is not directly controlled by the sender and for which a charge is collected on the basis of number of words transmitted and which is available to the public.

"(b) The Commission shall not grant or authorize any construction permit, station license, or certificate, for the construction, acquisition, or operation of any communication or transmission line or facility, or extension thereof, or any modification or renewal thereof, that otherwise might be granted or authorized pursuant to any provision of this Act, to any specialized carrier that furnishes or proposes to furnish interstate communication service unless the Commission shall find, after full opportunity for evidentiary hearing on the record, that such permit, license, or certificate, will not result in increased charges for telephone exchange service or in wasteful or unnecessary duplication of communication lines, facilities, equipment and instrumentalities of any telephone or telegraph common carrier, and will not significantly impair the technical integrity and capacity for unified and coordinated planning, management, design, and operation of the nationwide telephone network. In finding that such grant or authorization will not result in wasteful or unnecessary duplication, the Commission shall determine, among other things, that the proposed service or services of the specialized carrier, which are the subject of the requested grant or authorization, (i) are not like or similar to any service or services provided by a telephone or tele-

graph common carrier and (ii) cannot be provided by available communications lines, facilities, equipment, or instrumentalities of a telephone or telegraph common carrier. At any hearing involving a matter under this subsection, the burden of proof to support the requisite findings by the Commission shall be on the applicant for such permit, license, or certificate.".

94TH CONGRESS
2D SESSION

# H. R. 12323

## A BILL

To reaffirm the intent of Congress with respect to the structure of the common carrier telecommunications industry rendering services in interstate and foreign commerce; to grant additional authority to the Federal Communications Commission to authorize mergers of carriers when deemed to be in the public interest; to reaffirm the authority of the States to regulate terminal and station equipment used for telephone exchange service; to require the Federal Communications Commission to make certain findings in connection with Commission actions authorizing specialized carriers; and for other purposes.

By Mr. RONCALIO

MARCH 4, 1976

Referred to the Committee on Interstate and Foreign Commerce

# CONSUMER COMMUNICATIONS REFORM ACT OF 1976
(H.R. 12323 Version)

Consumers in the United States enjoy better telecommunications service at lower relative cost than consumers in any other country in the world. The telecommunications system that provides such service is a unique national resource. It is the direct result of the deliberate national telecommunications policy, expressed by Congress in the Communications Act of 1934, that there should be a nationwide, high-quality, low-cost telecommunications service available to all.

The essential point of the Consumer Communications Reform Act of 1976 is to reaffirm the original intent of Congress in passing the 1934 legislation, and to apply that policy goal to the problems which have emerged in recent years. The amendment thus gives indispensable policy guidance for the future development of the nation's telecommunications system. The bill is not intended to affect pending anti-trust litigation.

The provisions of the bill are described below.

## Section 2 -- Congressional Findings And Declaration of Purpose

In Section 2 of the bill, the Congress states that the integrated system of our common carrier telecommunications services has been an essential element in achieving reasonableness of charges and universality of service. Accordingly, the Congress reaffirms its policy that the integrated telecommunications network should assure widely available, high quality telecommunications services to all of the nation's telecommunications users.

The United States telecommunications system has several beneficial features. Among the most important are:

one, the contribution that revenues from long-distance and business services have made toward holding down the rates for basic residential users who comprise the bulk of the nation's telecommunications consumers. The bill acknowledges the role of these

contributions in fulfilling the mandate of the Communications Act of 1934 to make communications service available "to all";

two, private ownership and operation of the system under government regulation. The bill broadens the scope and clarifies the objectives of regulation to assure that it continues to serve the interest of the overwhelming majority of consumers;

three, the maximum efficiency that the United States telecommunications system, as a whole, has achieved through its high degree of coordination. This coordination has permitted nationwide telecommunications service without unnecessary duplication of facilities -- the kind of duplication that results from the introduction of selective competition in interstate services. Under the bill, the Congress finds that authorization of additional suppliers of duplicative interstate services is contrary to the public interest.

While recognizing that competition may be feasible in certain communications services, the bill assures that decisions to depart from the public utility concept shall be based upon searching examination to discern the broadest interest of all users.

Section 3 -- Charges for Service

Section 3 of the bill prevents inefficient suppliers from being artificially protected by regulatory actions that require telephone companies to price above relevant costs. Accordingly, the Congress declares that no charge which is compensatory may be found unjust or unreasonable on the ground it is too low. A charge is deemed compensatory as long as it equals or exceeds the incremental, or added, cost of providing the service in question.

Section 3 thus supports the basic principle that if the Commission finds competition in a segment of the communications business to be in the public interest, the competition shall be free and fair for all. The

Commission should not prescribe limitations upon the service, cost allocation or accounting systems or pricing methodologies for one competitor that do not apply to all competitors. Nor should the Commission require one competitor to price at artificially high levels in order to protect less efficient competitors. Any such discrimination places the Commission in the position of allocating business among competitors -- the opposite of true competition. The consumer thus has the worst of both worlds -- enjoying neither the benefit of an integrated system nor that of true competition.

This section affirms the FCC's pronouncement in 1971 -- when it adopted a policy permitting specialized carriers to enter the private line business -- that there should be no "protective umbrella" for some companies or "any artificial bolstering of operations that cannot succeed on their own merits."

This section also meets the current concern, expressed both in Congress and the Administration, that regulation should permit the lowest fair and feasible price to the public, and should not peg rates artificially high to protect some company or companies from competition.

## Sections 4 and 5 -- Acquisitions By and of Certain Common Carriers

To attain the objectives of the bill, it may be necessary to consolidate duplicative facilities. The bill contains a procedure to cover that possibility. Under Sections 4 and 5 of the bill, the FCC has the authority, upon application and after determining that it is in the public interest, to approve acquisitions of specialized common carriers or of their facilities which duplicate the facilities and services of other communications common carriers. Approval by the FCC exempts such acquisitions from the terms of any other act of Congress under which the acquisitions might be deemed unlawful.

As early as 1921, the Congress recognized that duplication of facilities among competing companies in the telephone business was wasteful and inefficient and resulted in both higher costs and poorer service for consumers. The Congress found that competition "greatly increases the burdens which must be borne by the telephone users." Accordingly, the Willis-Graham Act of 1921, later incorporated in the Communications Act of 1934 as Section 221(a), authorized the appropriate regulatory commission to approve mergers and acquisitions in the telephone business upon a finding that these would serve the public interest. The Act specifically took precedence over the antitrust laws.

At the time of the Willis-Graham Act, Congress was primarily concerned with the effects of competition among telephone companies at the local level. By the time of the 1934 Act it was apparent that Congressional consideration of the best structure for telecommunications extended to long-distance communications as well as local service. A Congressionally authorized report that led to the enactment of the Communications Act of 1934 observed that " . . . there is a monopoly in the telephone service for long distance which has been recognized as lawful in the present act . . . . While the telephone companies . . . may enter into consolidations no such authority has been extended to the telegraph companies . . . ."* In 1943, Congress gave the FCC authority to approve mergers of domestic telegraph companies. The Congress again specifically ordained that if the Commission found that such a merger was in the public interest, these findings would take precedence over the antitrust laws. Thus, it is long-established principle that the FCC -- with the authorization of Congress -- is empowered to approve various types of mergers and acquisitions of communications common carriers.

---

*Report on Communications Companies, H. Rept. No. 1273, 73d Cong., 2d Sess., pt. III, No. 1, at X (1934).

This section does not affect acquisition of telephone or telegraph carriers, which are covered in Sections 221(a) and 222 of the Communications Act. Nor does it affect the power of the states with respect to mergers and acquisitions of such carriers.

## Sections 6 and 7 -- Reaffirmation of State Jurisdiction Over Local Terminal and Station Equipment

Sections 6 and 7 of the bill reaffirm the authority of the states to regulate the terms and conditions of interconnection of customer-provided station equipment and terminal facilities used for local exchange service, even though such equipment may also be used for interstate service.

The Communications Act of 1934 provides that the FCC shall have no jurisdiction over charges, classifications, practices, services, facilities or regulations in connection with intrastate communication service. However, in Section 3 of the Act, providing definitions of terms, there is no definition of "intrastate communication service." Section 7 of the bill provides such a definition.

Correction of this omission is important at this time because a difference of opinion has arisen between the FCC and the State commissions as to jurisdiction over terminal equipment -- devices at the end of a telephone line which send and/or receive signals, such as telephone sets, switchboards, key sets, etc. The differences do not center on the question of jurisdiction over rates but rather on who has the authority over the terms and conditions of connecting terminal devices to the telephone network. The Communications Act of 1934 recognizes that the State commissions are responsible for regulating intrastate rates. In addition, the vast majority of terminal equipment is used primarily for intrastate communication. Thus, it follows logically that the State

commissions should regulate these other aspects of terminal equipment.

The definition in the bill reaffirms the states' jurisdiction over terminal equipment.

## Section 8 -- Findings To Be Included In Commission Grants Of Authority To Specialized Carriers

Finally, Section 8 of the bill establishes explicit standards to be met prior to the FCC's grants of authority to specialized common carriers. The bill requires the specialized carriers to show, in evidentiary proceedings before the Commission, that their proposed services will not raise the price consumers pay for basic, local telephone service; that their proposed facilities will not wastefully duplicate the facilities or services of an established telephone or telegraph carrier; and that their proposed services and facilities will not impair the technical integrity of the nationwide telephone network. In such proceedings the burden of proof would be on the applicant.

94TH CONGRESS
2D SESSION

# S. 3192

IN THE SENATE OF THE UNITED STATES

MARCH 23, 1976

Mr. ROBERT C. BYRD (for Mr. HARTKE) introduced the following bill; which was read twice and referred to the Committee on Commerce

# A BILL

To reaffirm the intent of Congress with respect to the structure of the common carrier telecommunications industry rendering services in interstate and foreign commerce; to reaffirm the authority of the States to regulate terminal and station equipment used for telephone exchange service; to require the Federal Communications Commission to make certain findings in connection with Commission actions authorizing specialized carriers; and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,* That this Act may be cited as the "Consumer Communications Reform Act of 1976".

CONGRESSIONAL FINDINGS AND DECLARATION OF PURPOSE

SEC. 2. The Congress finds and declares:

(a) The revenues from integrated interstate and foreign

common carrier telecommunications services, based on charges reflecting both costs and value of service, have contributed toward meeting the costs of facilities used in common for providing such interstate and foreign services and local telephone exchange service throughout the United States, and thereby helped maintain a level of charges for telephone exchange service which is lower than otherwise would be required.

(b) The technical integrity of the nationwide telecommunications system, its coordinated planning, design, installation, improvement, management, operation, and maintenance are indispensable elements in the interstate telecommunications network necessary both to the reasonableness of charges and to the high quality and universality of common carrier telecommunications service, and accordingly Congress hereby reaffirms its policy that the integrated interstate telecommunications network shall be structured so as to assure widely available, high quality telecommunications services to all of the Nation's telecommunications users.

(c) The authorization of lines, facilities, or services of specialized carriers which duplicate the lines, facilities, or services of other telecommunications common carriers—

(1) involves higher charges for users of telephone exchange service by decreasing the interstate revenues that otherwise would be available for contribution to the

common costs of providing telephone services throughout the United States;

(2) fosters inefficiencies in the utilization of national telecommunications resources through the creation of unnecessary and wasteful duplication of telecommunications lines and facilities and wasteful use of the radio spectrum;

(3) significantly impairs the technical integrity, the coordinated planning, design, installation, improvement, management, operation, and maintenance of the integrated nationwide telecommunications network; and

(4) has an adverse impact on the national objectives of maintaining stability of consumer price levels, conserving national economic resources, improving productivity, and fostering an economy that will maintain adequate sources and reasonable costs of capital;

and is, therefore, contrary to the public interest.

(d) The Congress reaffirms its intent that the complete authority to regulate terminal and station equipment used for telephone exchange service shall rest with the States even though such terminal and station equipment also may be used in connection with interstate services.

(e) The congressional findings and declarations of policy set forth herein are necessary to achieve the purposes of the Communications Act of 1934 as specified in section 1 of that Act; and the Federal Communications Commission

shall take no action inconsistent with the findings and declarations in this Act.

CHARGES FOR SERVICE

SEC. 3. Section 201 (b) of the Communications Act of 1934, as amended (47 U.S.C. 201), is amended by adding the following at the end of the first sentence: "No compensatory charges for or in connection with such communication service may be found to be unjust or unreasonable on the ground that it is too low. The Commission may not hold the charge of a carrier up to a particular level to protect the traffic or revenues from a communication service offered or provided by another carrier if such charge proposed by the carrier is compensatory. As used in this subsection, a charge is compensatory so long as it equals or exceeds the incremental cost of providing the communications service. Such incremental cost is the additional cost caused by the provision of the service including, where appropriate, the capital costs of whatever additional facilities are required to provide the service.".

REAFFIRMATION OF STATE JURISDICTION OVER LOCAL TERMINAL AND STATION EQUIPMENT

SEC. 4. Section 2 (b) of the Communications Act of 1934, as amended (47 U.S.C. 152 (b)), is further amended by striking "or" at the end of the phrase following "(1)"

and substituting therefor the following: "including but not limited to, the charges, classifications, practices, services, facilities, or regulations for or in connection with the use or connection of any station equipment, terminating facilities, exchange plant, and other like instrumentalities and apparatus used in common for both intrastate communication service and interstate or foreign communication service, whether provided by a common carrier or any other person, or".

SEC. 5. Section 3 of the Communications Act of 1934, as amended (47 U.S.C. 153), is further amended by adding the following new subsection:

"(gg) 'Intrastate communication' means communication or transmission between points in the same State, territory, or possession of the United States, or in the District of Columbia, including, among other things, all station equipment, terminating facilities, exchange plant, and other like instrumentalities and apparatus used for or in connection with telephone exchange service or interexchange service, even though such equipment, facilities, plant, instrumentalities, or apparatus are or may be used in connection with interstate or foreign communications service. 'Intrastate communication service' means any service which provides intrastate communications.".

FINDINGS TO BE INCLUDED IN COMMISSION AUTHORIZATIONS OF SPECIALIZED CARRIERS

SEC. 6. The following new section is added in title II of the Communications Act of 1934, as amended:

"SEC. 225. (a) As used in this section—

"(1) The term 'telephone common carrier' means any common carrier, the major portion of whose traffic and revenues, in interstate and foreign communication and in intrastate communication, is derived from message telephone services, telephone exchange services, radio-telephone exchange services, or a combination thereof.

"(2) The term 'telegraph common carrier' means any common carrier which provides a public message telegram service in interstate communications.

"(3) The term 'specialized carrier' means any common carrier other than a telephone or telegraph common carrier.

"(4) The term 'message telephone service' means telephone service between stations in different exchange areas whereby telephone facilities are provided to the public for communications between different exchange areas on a message-by message basis, contemplating a separate connection for each occasion of use.

"(5) The term 'public message telegram service' means a substantially nationwide telegraph service for the transmission and reception of record matter where the transmission is not directly controlled by the sender and for which

a charge is collected on the basis of number of words transmitted and which is available to the public.

"(b) The Commission shall not grant or authorize any construction permit, station license, or certificate, for the construction, acquisition, or operation of any communication or transmission line or facility, or extension thereof, or any modification or renewal thereof, that otherwise might be granted or authorized pursuant to any provision of this Act, to any specialized carrier that furnishes or proposes to furnish interstate communication service unless the Commission shall find, after full opportunity for evidentiary hearing on the record, that such permit, license, or certificate, will not result in increased charges for telephone exchange service or in wasteful or unnecessary duplication of communication lines, facilities, equipment, and instrumentalities of any telephone or telegraph common carrier, and will not significantly impair the technical integrity and capacity for unified and coordinated planning, management, design, and operation of the nationwide telephone network. In finding that such grant or authorization will not result in wasteful or unnecessary duplication, the Commission shall determine, among other things, that the proposed service or services of the specialized carrier, which are the subject of the requested grant or authorization, (i) are not like or similar to any service or services provided by a telephone or tele-

graph common carrier and (ii) cannot be provided by available communications lines, facilities, equipment, or instrumentalities of a telephone or telegraph common carrier. At any hearing involving a matter under this subsection, the burden of proof to support the requisite findings by the Commission shall be on the applicant for such permit, license or certificate.".

94TH CONGRESS
2D SESSION

# S. 3192

## A BILL

To reaffirm the intent of Congress with respect to the structure of the common carrier telecommunications industry rendering services in interstate and foreign commerce; to reaffirm the authority of the States to regulate terminal and station equipment used for telephone exchange service; to require the Federal Communications Commission to make certain findings in connection with Commission actions authorizing specialized carriers; and for other purposes.

By Mr. HARTKE

MARCH 23, 1976
Read twice and referred to the Committee on Commerce

# A New Direction In Telecommunications Policy

# Is It In The Public Interest?

## THE PROBLEM IN BRIEF

The Federal Communications Commission is pursuing policies that will hit hard at the pocketbook of the typical home telephone user.

The FCC is promoting what it *calls* "competition" in certain parts of the telephone industry. What *actually* is developing, however, is an arbitrary division of the market.

An example is the market for intercity private lines—that is, communications channels between cities that are leased for the exclusive use of certain customers, mainly large businesses. The regulated telephone companies serve *all* customers, regardless of cost, regardless of location. Newly authorized suppliers, however, may pick and choose the routes and customers they will serve, "skimming the cream" from the more profitable intercity routes.

## MOST PEOPLE WILL LOSE

Some communications customers—mainly big businesses—stand to gain from these developments. *But for the vast majority of telephone users, it will be a losing proposition.*

Current Federal regulatory policies will force the telephone companies to depart from traditional pricing patterns which favor home users. At the same time, the industry is being made less efficient—because of needless duplication of facilities and the fragmentation of service responsibilities.

In the final analysis, the nation could well be faced with:

- ☐ Higher home telephone rates.
- ☐ Higher long distance rates for less-populated areas.
- ☐ A higher telephone bill for the country as a whole.
- ☐ Lower quality service.

## WHY PUBLIC INTEREST GOALS ARE IN JEOPARDY

The introduction of telecommunications competition, real or contrived, involves major economic implications for tens of millions of home telephone users—*with particular impact on low-income families and those on fixed incomes.*

The reason is simple. For many years the industry and its regulators have pursued the goal of "universal service"—a telephone in every home—a goal which is embodied in the Communications Act of 1934.

To achieve this goal, local residential telephone service must be priced at rates most customers can afford.

Revenues from long distance calls, services for business and optional services are used to cover some of the costs that would otherwise have to be covered by local service revenues. This holds down local rates.

Also, the averaging of prices for long distance calls has helped assure the development and availability of this service across the country. (You can make a call from New York to Chicago, for example, for the same rate as a call from Twin Falls, Idaho, to Pierre, South Dakota—a route of comparable distance but with higher transmission costs.)

Ironically, the very pricing policies that have helped the industry achieve universal service make it vulnerable to new suppliers who seek to capture only those parts of the business which can be served at the least cost and highest profit.

In addition, because of the integrated and interdependent nature of the telephone network, fragmenting responsibility for service among many competing companies will adversely affect its quality and efficiency.

The network presently consists of trillions of intricate parts, designed to work on command 24 hours-a-day to make any one of 10 million billion possible connections among 144 million telephones. The unity of this network explains why more Americans enjoy better telephone service at lower rates than people in any other nation.

## THE BOTTOM LINE

Most Americans think that competition always benefits the "little man." More often than not, this is true.

But in the case of the regulated telephone industry, competition reduces the funds available to hold down the cost of basic telephone service to home users.

**The bottom line is this:**

If the telephone industry is forced toward pricing basic home telephone service on a stand-alone basis—that is, denying it the revenue support it currently gets from other services—charges to residence customers will have to be increased sharply.

If, over a period of time all support from other services were to be lost—because of losses to competition or because of repricing to respond to competition — monthly rates for home phones would have to be increased by about 75 per cent to cover full costs. Future inflation could, of course, drive rates up even further.

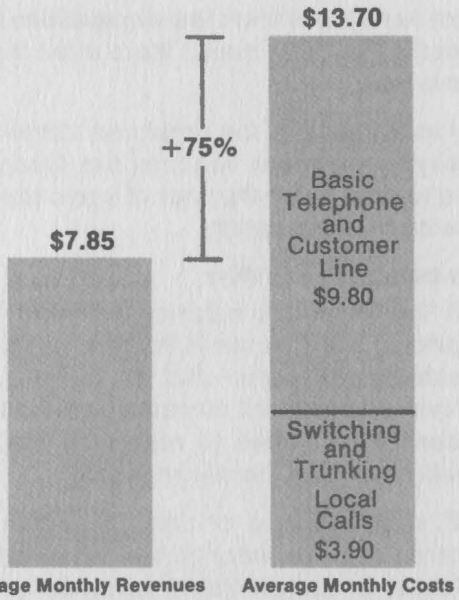
To the extent that competition fragments responsibility for the telephone network, the quality of service will suffer. To the extent that it duplicates facilities, the cost savings and improved services otherwise available to users—through more efficient, higher capacity systems—will be lost.

## A QUESTION OF NATIONAL POLICY

Studies by government and private organizations have repeatedly found that telephone service in the United States is by far the best in the world.

**Why Federal regulatory policies will force home telephone rates upward**

Long distance and other services now cover substantial costs of facilities needed to provide local telephone service. To the extent this support is eroded because of regulatory policy, charges for local home phone service will be forced upward.




NOTE: Corporate overhead costs are not included; if they were, the 75% differential would be higher. The customer line and basic telephone are used for both local and long-distance services. (Based on a study of individual-line residence service submitted in testimony by the Bell System to the U.S. Senate in July, 1974.)

The regulated telephone companies feel strongly that the policies currently being pursued by the FCC *will undermine this performance* . . . both in terms of quality and in the price of basic service for 67 million American households.

*This is an issue of major national policy that Congress must decide,* and decide promptly, before the current course cannot be reversed. Toward that end, the telephone industry is supporting the Consumer Communications Reform Act of 1976 which has been introduced in both houses of Congress. This legislation would reaffirm the basic goal of "universal service" set forth in the Communications Act of 1934.

Among its provisions, this legislation seeks to protect consumers by preventing wasteful duplication of interstate services, as well as unnecessarily higher rates for home telephone users and impairment of the high quality service customers have come to expect.

It does *not* rule out the provision of truly innovative services by suppliers other than the established telephone companies, so long as they do not affect the quality or cost of service for all users.

This effort has the support of the United States Independent Telephone Association, Independent telephone companies, large and small—including cooperative telephone companies—the Bell System, and unions representing telephone employees. The need for legislation also is supported by other groups interested in reasonable telephone rates, such as rural organizations.

If you support the idea that the interests of average telephone users should be weighed in deciding whether to continue with the major changes that have been made in the nation's telecommunications policy, you might write your representatives in Congress to urge that hearings be held on the Consumer Communications Reform Act. This bill was first introduced in the House of Representatives by Congressman Teno Roncalio of Wyoming (H.R. 12323) and in the Senate by Senator Vance Hartke of Indiana (S. 3192). Such hearings will give every point of view an opportunity to be aired.

You can reach your Senators by writing them in care of the United States Senate, Washington, D.C. 20510, and your Congressman, by writing in care of the House of Representatives, Washington, D.C. 20515.

WHEREAS, The Federal Communications Commission has pursued a policy of authorizing lines, facilities and services of specialized common carriers which duplicate the lines, facilities or services of other telecommunications common carriers; and,

WHEREAS, The Federal Communications Commission has also pursued a policy of extending its jurisdiction over terminal and station equipment used in telephone exchange service in such a way as to reduce revenue contributions to residential telephone service; and,

WHEREAS, Such policies result in higher charges for users of telephone exchange service, foster inefficiency in the utilization of national telecommunication resources, and significantly impair the technological integrity, coordinated planning, management, design, productivity, improvement, operation and maintenance of the integrated nationwide telecommunications network; and,

WHEREAS, Such policies adversely impact the national objectives of fostering universal telephone service, maintaining stability of consumer price levels, conserving national economic resources, improving productivity, and encouraging adequate sources of capital at reasonable costs; and,

WHEREAS, Such policies of the Federal Communications Commission are contrary to the public interest and to the purpose and the intent of the Communications Act "to make available, so far as possible, to all the people of the United States a rapid, efficient, nationwide wire and radio communication service with adequate facilities at reasonable charges"; and

WHEREAS, Congress should act to bring the Commission's policies into conformance with the public interest and the original purpose and intent of the Communications Act; now, therefore, be it

RESOLVED, By the Board of Directors of the United States Independent Telephone Association that Congress should promptly enact legislation to reaffirm the purpose of the Communications Act to make possible the provision of communication service at reasonable charges with adequate facilities to all the people of the United States; and be it

FURTHER RESOLVED, That the United States Independent Telephone Association and its members support appropriate legislation directed toward this purpose; and be it

FURTHER RESOLVED, That the officers of the Association and the Legislation Committee be empowered and directed to marshall and coordinate the efforts of the telephone industry and all other interested parties to obtain the prompt enactment of such appropriate legislation.

NARUC RESOLUTION
AS PASSED FEBRUARY 25, 1976

# RESOLUTION FOR SUPPORT OF BASIC TELEPHONE SERVICE

# CONSUMER BENEFIT LEGISLATION

WHEREAS, Continuation of recent policies of the FCC with respect to the regulation of the provision of local terminal and station equipment constitutes pre-emption of States' jurisdiction; and

WHEREAS, Such preemption constrains the States in the execution of the mandate to insure the best interests of the local telephone service consumer; and

WHEREAS, The proliferation, of "specialized common carriers" constitutes wasteful duplication of facilities and wastefully duplicative use of resources; and

WHEREAS, The operation of "specialized common carriers" and liberalized interconnection serve to divert revenues which would otherwise flow to the benefit of the local basic telephone service consumer; and

WHEREAS, The results of the aforementioned actions are not in the best interests of local service consumers as confirmed by detailed studies conducted by the NARUC Committee on Communications, the staffs of member commissioners and others; and

WHEREAS, Continuation of the debate of these and related issues represents an unwarranted expense to the rate paying consumer of telecommunications services; now, therefore, be it

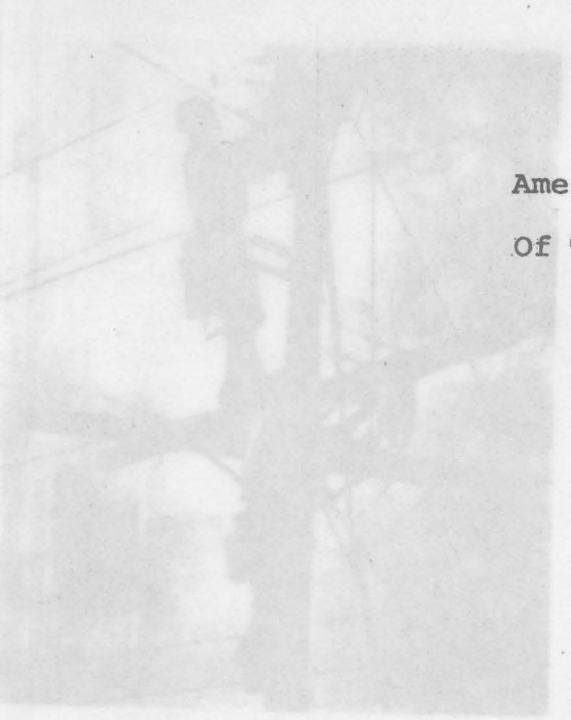
RESOLVED, That the Executive Committee of the National Association of Regulatory Utility Commissioners, hereby supports such legislation as has been and may be introduced in the Congress of the United States that, in the judgement of the President of this Association and the Committee on Communications, whose membership is nationally diversified, will serve to resolve the matters herein described to the benefit of the general ratepayer and consumer of basic local telephone service and directs the Officers of the Association to seek the enactment of such legislation by the Congress and its' approval by the President of the United States.

Sponsored by the Committee on Communications

* * * * * *

American Farm Bureau Federation Resolution

Of The 57th Annual Meeting -- January, 1976



# Rural electrification and telephones

We support the goal of attaining an efficient interstate telephone system that will provide telephone service to rural consumers at a reasonable cost. We oppose policies which erode those revenues that traditionally have contributed to maintaining service at reasonable rates over the entire telephone network.

We support rural electric and telephone cooperatives organized and operated in accordance with cooperative principles and practices.

Local ownership by well informed members is the best safeguard for true cooperative principles.

We commend the rural electric systems for their efforts in establishing the National Rural Utilities Cooperative Finance Corporation (CFC) to enable electric systems serving rural areas to borrow from nongovernment sources. We encourage Farm Bureau members who are patrons and leaders in electric cooperatives to urge all such cooperatives to participate in and support this effort.

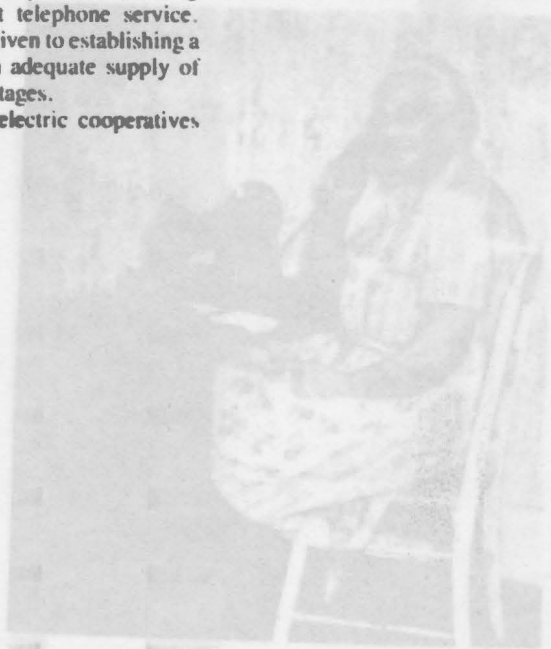
The 1973 amendments to the Rural Electrification Act provide a means of assuring adequate capital from the private money market for rural electric cooperatives through REA insured and guaranteed loans.

We urge the Congress to authorize annual levels for the REA electric loan program which, along with other loan programs will adequately reflect the capital needs of the rural electric systems, thus insuring that the growing power requirements of rural America will be met.

We also support the rural telephone bank system in assuring that rural people have available efficient telephone service.

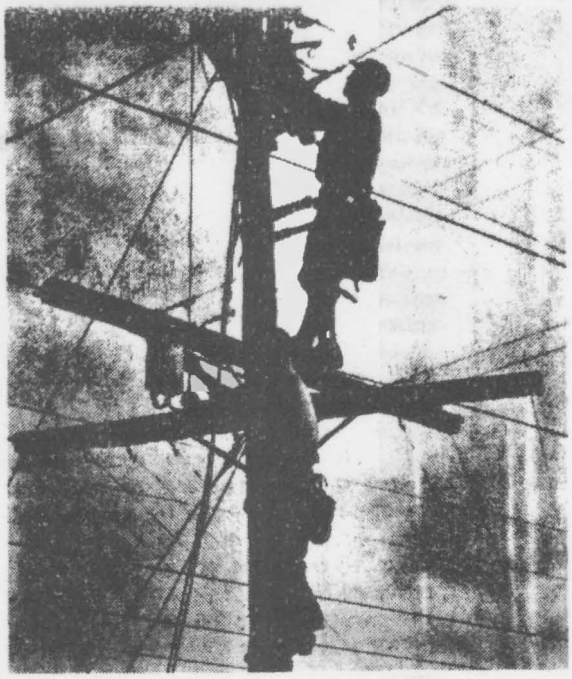
We believe that consideration should be given to establishing a pool of electrical power to help assure an adequate supply of electricity during periods of localized shortages.

We oppose any effort to convert rural electric cooperatives into a public power system.



## Could We Be Heading For . . .

# TROUBLE ON THE LINE?



by Mel Woell

First came the farm-to-market roads, rutted and poor. Over them came the mail. Alongside the pitted track a line of telephone poles eventually marched, followed later by another set—this time carrying electricity for rural lights and power.

**In this fashion, rural America was liberated from its isolation and loneliness, and its positive response was an outburst of productiveness that has startled the world.**

Of them all—mail, telephone, radio and electric power—direct voice communication by farm and ranch people with each other and with the city centers meant the most.

**But telephone service did not come to rural America without a struggle.** With few nearby farm exceptions, power and telephone lines were confined to the city, for the cost of great amounts of poles and miles of wire to connect a country phone or two was prohibitive.

Farm and ranch spokesmen led those in business and elsewhere in calling for a national philosophy eventually expressed by Congress in the Communications Act of 1934 **" . . . to make available, so far as possible to all the people of the United States, a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges . . . "**

The definition of what is a "reasonable charge" and how to assure it, was the catch back then and remains the nub of a major problem today. What is "reasonable" for a user living within a large city telephone system has little relation to the cost (and a reasonable charge) for similar service provided an isolated rancher living on the other side of the mountain.

Here's what early planners of telephone service rates did: They placed all costs involved in providing telephone service to a given area into a "pot" and sweetened it with enough regulated profit to keep the telephone companies financially healthy. They knew that charging each customer on the particular cost of providing him service would mean some people would not be able to afford a telephone. So they averaged out the costs, and even set business charges a little higher to help keep the price of home telephone service within reach. And for long distance calls inside states and between states, they made the rates the same for calls of equal distance—even though the cost of providing the service might vary greatly.

This rate planning approach has served agriculture and city systems well for many years. It is a structure now being challenged by regulators, some members of Congress, and others, who have been pressuring to inject new competition into the national telephone system.

Indeed, regulators have permitted new companies, competitors of the phone companies, to offer long distance communications services, mostly microwave systems serving large business firms. These communications companies have chosen to serve the high-volume routes between major cities where the costs are low and the profits high. By serving just these routes, the new companies can under cut the telephone companies' "averaged" rates.

The telephone industry has been much concerned about what effect opening high volume routes to others might mean to all phone users—calling the proposed competition "artificially contrived" (through the power of the Federal Communications Commission, which has regulatory authority), and warning of general cost increases to follow.

Telephone industry spokesmen say that opening their high volume routes to others not now involved in serving all of the nation "with adequate facilities at reasonable charges" amounts to nothing more than allowing the new systems to skim off the cream, the easy profits, without responsibility for full, in-depth service.

Such skimming, they say, can have only one result—increased rates for all residential services, with everyone, including farmers and ranchers, picking up a much larger share of the total telephone costs.

Testified one phone official: if everyone's service were now priced according to costs, and all contributions from the more profitable services were eliminated, **your monthly bill for basic local service could increase by about 75% . . .**

Rural people—vulnerable in the extreme to any downgrading in their telephone service, and already hard pressed by inflation—are more than a little concerned by the jockeying going on. At the recent American Farm Bureau Federation annual meeting, the voting delegate body again stated support for an efficient interstate telephone system that provides telephone service to rural consumers at reasonable cost.

Significantly, they added: **"We oppose policies which erode those revenues that traditionally have contributed to maintaining service at reasonable rates over the entire telephone network. . . "** □

NTCA RESOLUTION
As Passed 2/11/76

## COMPETITION INTERCONNECTION LEGISLATION

WHEREAS, the entire area of "competition" and "interconnection" in the telecommunications industry has become a potentially grave problem for operating telephone companies in the past few years, and

WHEREAS, NTCA shares the concern of other elements of the industry and several of the state regulatory commissions that directions mandated by the Federal Communications Commission may result both in unnecessary duplication of services available to subscribers and in adverse financial affects to telephone companies which must eventually cause higher residential rates;

THEREFORE BE IT RESOLVED, that NTCA explore legislative resolution of these problems and work toward development and introduction of legislation which is feasible and will provide a rational answer to industry problems, and

BE IT FURTHER RESOLVED, that NTCA keep the membership fully informed of proposed activities and legislation.

TIU News (March 1976)
(Telecommunications International Union)

# COMPETITION RESOLUTION ADOPTED

One of the major subjects considered at the recent Delegates' Conference was the issue of competition in the telephone industry. A.T.&T., the independent telcos, and the telephone unions are sounding out Congressmen on the prospects of legislation that would create a national communications policy. Administration Assistant Bob Leventhal reported on the topic, and, after some thoughtful consideration of the several sides of the problem, a resolution was adopted:

1. The American Telephone and Telegraph Company, and its subsidiaries, as the prime provider of telephone service in the United States, has constructed and maintained a telephone system unequaled in the world. Members of the Telecommunications International Union have played an integral role in the success of the system through their on-the-job efforts.

2. Under the legislative mandate of the Communications Act of 1934, this system operates as a regulated monopoly, providing the benefits of a universal, low-cost basic residential service through a sound technical network.

3. In recent years, decisions by the Federal Communications Commission have eroded the concept of the regulated monopoly by introducing the element of competition into the industry. Competition was intended to benefit the public interest by the creation or expansion of markets for the telecommunications services. FCC and state regulatory agency decisions have not produced these benefits but have threatened the traditional goals for which the telephone industry has operated - high-quality, broad-ranged services at reasonable prices.

4. In view of this continuing threat to the regulated portion of the telephone industry, the Congress of the United States will be asked to reaffirm and reestablish the meaning and intent of the national policy embodied in the Communications Act of 1934, with due consideration for technological change within the industry.

Therefore, be it resolved, by the Telecommunications International Union, meeting in Delegates' Conference, that the T.I.U. play an active and aggressive role in a legislative effort with other segments of the industry - fellow telephone unionists, the A.T.&T. Co., and the independent telephone companies - intended to eliminate the confusion spawned by the actions of the federal and state regulatory agencies, and

Be it further resolved that the Legislative Committee of the T.I.U. be charged with the responsibility for directing a legislative campaign designed to impress upon the Congress the importance of a national communications policy, and

Be it finally resolved that the members of the Telecommunications International Union be encouraged to participate in such a campaign by contacting their Senators and Representatives to urge their support of legislation recommended by the officers of the T.I.U.

Communications

GLENN E. WATTS, *President*

CWA

Workers of America

(AFFILIATED WITH AFL-CIO)

1925 K STREET, N.W.

WASHINGTON, D. C. 20006

TELEPHONE: AC 202/785-6710

April 12, 1976

File: 3.35

The Communications Workers of America has had a continued interest in decisions of the Federal Communications Commission pertaining to "so-called" competition, and the rates established for various aspects of furnishing service to the consumer.

Attached is a copy of the statement of the Communications Workers of America entitled "Telecommunications Policy" which was adopted at a recent meeting of the CWA Executive Board.

Also attached is a document on the same subject which was prepared for the Communications Workers of America by Robert R. Nathan Associates, who, as you know, are very knowledgeable in communications economics.

Sincerely yours,

Glenn E. Watts

Glenn E. Watts
President

Attachment

CWA EXECUTIVE BOARD STATEMENT THURSDAY, MARCH 26, 1976

TELECOMMUNICATIONS POLICY STATEMENT

In 1921, the Congress adopted legislation to affirm a national policy of fostering a unitary switched telephone network, so that each American with access to a telephone could reach any other residential or business telephone. This concept was incorporated into the Communications Act of 1934, whose statement of national policy was that the regulation provided therein would "...make available so far as possible, to all the people of the United States a rapid, efficient, nationwide and worldwide wire and radio communication service with adequate facilities and reasonable charges...,"

The near-universality of telephone service in the United States is shown by the 94% penetration, that is, into 67 million residences achieved by the industry through the employment of mostly private capital. The industry provides more than 140 million telephones, employs more than one million American men and women, and takes in some $30 billion a year in gross receipts.

The Federal Communications Commission, created by the 1934 Act, has in recent years made several decisions which have pushed its regulatory policy away from the original intent of the national policy. Over the years, telephone companies have developed rate structures which tend to level out the revenue requirements and prices to business and residential customers, allowing the latter group to be kept within reach of the ordinary family budget. State and Federal regulators recognized that business users and other customers in densely populated areas should pay higher rates, in order that the widespread use of the telephone could be continued, for the mutual benefit of business and residential customers.

In the late 1960's, the FCC issued the "carterfone" and "Specialized Common Carrier" decisions, which injected an element of so-called competition into the telephone industry. However, the competition from companies supplying "interconnect" and private line data and voice services has begun to drain off revenues from the telephone companies, which for many years have had the total responsibility for integrated end-to-end service. A significant fall-off in telephone company revenues, which is apparent from business trends, will cause the operating telephone companies to seek new rates, which will be calculated on a smaller revenue base. If business use of "interconnect" and "Specialized Common Carrier" services furnished by other than franchised telephone companies shows a sizeable growth, the residential user of telephone service will be forced to pay considerably higher rates -- or to do without telephone service. The "interconnect" and "Specialized Common Carrier" companies, which do not bear the heavy expense of providing integrated end-to-end service, are assisted in "cream-skimming" by the action of the FCC, which in the last decade did not stop to analyze the long-term economic effects of such "competition" in the telephone industry.

Some smaller telephone companies, and even larger ones, have recently begun experiencing revenue fall-offs due in great part to FCC tolerance and permissiveness for a "pick-and-choose" kind of telephone service. Public utilities of all kinds are in a tight financial situation because of inflation, a factor which shows little sign of subsiding in 1976.

Because the FCC only recently undertook what appears destined to be a long-term study of the economic effects of the so-called competition in the telephone industry, at a time when such a study is at least five years overdue, the industry has begun to prepare a drive in Congress for a clear statement of direction to the Commission, to fulfill the policy of the Communications Act of making service available as widely as possible.

After review, we conclude that the Congress should reaffirm its long-standing policy of network unity, with the network providing all needed services within its capabilities. Further, we believe the Commission should only authorize "Specialized Common Carriers" to provide services not readily available through the present telephone network, and under conditions that do not pose economic or technical threats to network viability.

RESOLVED: That the Executive Board of the Communications Workers of America on behalf of, and in the interest of its Members, does hereby call upon the Congress to clarify and reemphasize the intent of the law so that the viability of the industry will be preserved and strengthened and to specify without any doubt the responsibility of the Commission to ensure that the intent of the law be carried out and thus to ensure further that the State and Federal regulatory agencies, in conjunction with more than 1,700 operating telephone companies, can keep residential rates within reasonable limits, for the benefit of all consumers.

RRNA

ROBERT R. NATHAN | ASSOCIATES, INC.

1200 EIGHTEENTH STREET, N.W., WASHINGTON, D.C. 20036
PHONE 202/833-2200 TELEX 248482 CABLE NATECON

March 19, 1976

Mr. Glenn Watts
President
Communications Workers
of America
1925 K Street, N.W.
Washington, D.C. 20006

Dear Glenn:

In accordance with our earlier discussions, RRNA has prepared a brief analysis of the current regulatory issues concerned with competition in providing equipment and services in the telephone industries; specifically the "interconnect" equipment and private line intercity services. The analysis cites some of the principal problems generated by competition in this highly integrated industry and some of the possible adverse effects on the performance of the system and on its rate structure and revenues. We have also outlined current pending legislative proposals for dealing with these issues.

Of course, whatever affects the workings and revenues of telephone companies has repercussions also on their employees. It is for this reason that our analysis may be useful to you and your colleagues in CWA. We hope it will be.

With best wishes.

Cordially yours,

Robert R. Nathan

Attachment

# CURRENT ISSUES IN TELECOMMUNICATIONS POLICY

## Summary: The Issues of Competition and Suggested Legislative Response

Recent decisions of the Federal Communications Commission encouraging competition in telephone equipment and services, if carried to their logical conclusion, could result in higher rates for local telephone service.

The FCC has encouraged "specialized common carriers" to provide competing private line services which, when tied in with the switched network, enable subscribers to virtually duplicate message toll services of telephone companies. Yet telephone companies are being restrained in their efforts to meet this competition.

The FCC has also required the interconnection of terminal equipment manufactured by unregulated companies to the telephone network, overriding the regulations of state authorities and undermining the end-to-end, system-wide responsibilities of telephone companies for the quality, maintenance, and functioning of telephone equipment.

If FCC encouragement of these kinds of competition results in diversion of substantial revenues from telephone companies, rates for remaining services, particularly basic residential services, will have to be raised in order that total system revenues will cover total system costs. If this were to happen, the result would be less business and less employment for telephone companies.

These new attempts to force competition in the telephone industry may have serious consequences for users and employees as well as providers of telecommunications. Our telephone system is too good to risk disrupting its quality and its rate structure for the sake of theoretical but unproven benefits of competition. To protect the system, the telephone companies are suggesting legislation by which the Congress would reaffirm the commitment inherent in the Communications Act of 1934 to an integrated telephone system with unified responsibility for equipment and services. In such a system, revenues from profitable business services and toll services are available to hold down rates for basic residential service.

A summary of these issues and of the suggested legislation follows.

## Background: The Integrated System

For nearly 50 years telephone communications in the United States have been operated as a single, integrated system, consisting of the Bell companies and cooperating independent telephone companies. For almost all of that time, two principles have guided the development and operation of the system: first, the principle of universal service; and second, the principle of undivided responsibility for constructing, equipping, operating and maintaining the system as a whole. The result has been surely the world's best telephone service, at rates which, in relation to levels of consumer's incomes, are the world's lowest.

The principle of universal service recognized the fact -- unique to telephone communications -- that the usefulness of every subscriber's telephone depends on the number of other telephones with which he can communicate and which can communicate with him. It was thus to the

advantage of everyone, and to the benefit of the society and the economy as a whole, that telephones should become as widespread as possible. Indeed, this principle is recognized as national policy in the Communications Act of 1934. Policies of the regulatory agencies and of the telephone companies both were consciously designed to promote the spread of telephone service by offering basic service at low rates to bring it within reach of nearly everyone. In relation to consumers' incomes, telephone service has been declining in price for many decades; the average American worker can now pay for his basic telephone service for a year with the earnings of about 3 days of work -- less than in any other country. So convenient a service at so low a price has built a mass market that has made telephone service all but universal, covering about 95 percent of American households.

Telephone service in the United States is not only low-priced; it is also good. This is one of the few countries in the world where a new subscriber can obtain installation and service practically on demand, without the protracted delays common elsewhere in the world. Telephone communication in the United States is also loud and clear, and almost instantaneous over any distance. Interruptions or abnormalities in service are usually corrected in a matter of hours by maintenance personnel thoroughly trained in the maintenance of each piece of the equipment, precisely because it is standardized in the system. All this is essentially the result of a highly integrated, planned system, tying together telephone companies throughout the country in a single network of compatible equipment and operations.

There can be little dispute that it has worked well. As a result of continuously improving technology, the quality

of service has improved and its cost has declined relative to other prices and incomes in the economy. Innovations have been introduced continously but gradually, to incorporate improved technology while avoiding premature (and costly) obsolescence of serviceable equipment, and to maintain compatibility of the new equipment with the old. The system has expanded year by year. Output per unit of labor and capital has risen steadily as the efficiency of equipment and proficiency of personnel have improved, and real costs (making allowance for the general inflation) have declined as a consequence.

## Current Policy Issues

### Technical Issues

The most recent Federal Communications Commission decision, throwing open to unrestricted competition the market for terminal equipment, is the culmination of a series of decisions over the past several years, which will weaken the technical and operational unity of the telephone system and break up the end-to-end responsibility of the telephone companies for its efficient operations. The Commission has permitted the attachment to the network of a vast array of equipment made by many unregulated manufacturers, with a minimal assurance of quality and compatibility with existing switching and terminal equipment. The Commission has also opened the door to an unlimited number of specialized common carriers to provide private line and other specialized intercity communications services for large business firms, and has ordered that these systems be connected with the network.

Each of the Commission policies presents problems to the telephone system, its users and its employees.

The latest FCC order relaxes the requirements for protecting the network and employees from "harms" which a panel of the National Academy of Sciences in 1970 found could result from interconnection of unsuitable or incompatible equipment. The new rules require registration for conformity with FCC standards as the only assurance against voltage surges and other harm or interference with the network and other equipment connected to it. Even this requirement may be most difficult to enforce particularly because a large volume of terminal equipment is imported. Moreover, since the makers of the equipment are unregulated, there are no standards of maintenance and repair, and no assurance of the proper operation of the network and the protection of employees.

In the case of specialized common carriers the problem lies in the possibility of wasteful duplication (in the guise of "innovative services") of telephone company facilities with unused capacity, and the fragmentation of the market which will preclude, delay, or limit the introduction of high-capacity equipment capable of handling more traffic at lower unit costs.

Skimming the Cream

Beyond these technical problems, there is an overriding economic problem arising from the integrated nature of the telephone system itself and the rate structure resulting from decades of regulatory policy and practice.

For reasons of public policy, to encourage universal telephone service, telephone companies at the urging of regulatory agencies, have kept the rates for local service low enough to be within the reach of most households. Long

distance toll services, both intrastate and interstate, notwithstanding their declining rates, have yielded revenues sufficient to contribute to maintenance of low basic residential rates. The same is true of revenues from many other vertical services.

All of this was not by accident or miscalculation. It was the result of deliberate policy decisions by regulators and telephone companies in agreement on the desirability of holding basic rates low. For example, as new technologies brought greater and greater economies in long distance services, regulators used only part of the resulting savings to reduce long distance rates and made part available to hold down rates in basic local service. By now, if basic local rates had to cover all the costs of the basic telephone instrument, the subscriber line, and local service, without any contributions from long distance and other services, rates for local residential service would have to be about 75 percent higher than they are.

As the result of these policies to adjust the rate structure to benefit the basic local household service, long distance and many business services maintain larger margins between revenues and direct costs than they would standing alone. Thus competitors, having no basic local services to support, see an opportunity to undercut the rates of telephone companies on those services which help to support the basic local services. We call these high-margin services "cream" and the competition aimed at them -- "creamskimming," leaving the telephone companies with the skimmed milk of the less profitable though equally essential services.

Effects of Regulation

In a series of decisions in the past decade, the Federal Communications Commission has adopted the proposition that competition can play a role in stimulating innovation in terminal equipment and specialized intercity services and ought to be encouraged. The Commission, accordingly, has moved to do away with the requirement for protective arrangements to shield the network and its workers from potential harms from customer-provided equipment, and has moved to supersede the states' regulatory authority over the interconnection of terminal equipment within their jurisdiction. (This may, in fact, be inconsistent with the grant of authority over intrastate services conferred on the states by the Congress in the Communications Act of 1934.)

In the matter of specialized common carriers, the FCC has authorized them to offer "new and different" services, by providing communications "with unique and specialized characteristics" not presently offered to business subscribers. The authorization was premised on the assumption that the specialized carriers would offer innovative services in response to demands that were untapped or unmet. In fact, the specialized carriers have largely duplicated facilities and services already offered by the telephone companies.

Experience to date has indicated that the competitive opportunities, both in terminal equipment and in specialized communications, derive more from the way the telephone industry rates are structured under regulation than from competitive innovations in equipment or service. The real basis of competition has been the opportunity for competitors to undercut the high-margin rates in vertical services by which telephone companies generate total revenues to support low rates for basic local service. Because of this, competitors can offer services at lower rates even though their

costs are as high as or higher than those of the telephone companies. While there may be some degree of innovation or difference in product or service, product differentiation alone would have offered only a limited and very specialized market.

For the sake of supposed benefits of this kind of competition, the FCC has used the regulatory processes to facilitate entry of competitors while slowing down the efforts of the telephone industry to take advantage of its inherent efficiencies to meet this competition. For example, the telephone companies have been impeded in their efforts to make their charges more competitive by reducing rates for private line services on routes where high-density traffic lowers average costs. The intent of the FCC may be to assure that the larger competitor does not misuse his size to lower his prices just to drive out the smaller competitors. But the effect has been to deprive the public of the advantages of a truly competitive market.

Whether the telephone companies eventually reduce their rates to meet competition, or are restrained from reducing rates and thereby lose business to competition, the revenues from their most profitable services will be curtailed, and the contributions that are keeping rates low on the low-profit services -- notably the basic residential service -- will thereby be reduced. The effect in the long run will be to reduce rates for some large business firms but to increase the rates on the basic residential service. The more the regulatory authorities promote and shelter this kind of competition, the greater the danger of higher rates for millions of residential customers.

## Proposed Bill

To deal with these issues, the telephone industry offers a proposed bill to present the issues for decision.

The basic intent of the bill is to reaffirm the policy of Congress underlying the 1934 Act and to restate it to apply to the technological, economic, and social situations of the 1970's and 1980's. It would confirm the goal of an integrated common carrier telecommunication service as an essential condition of achieving universality of service and reasonableness of charges. It would not eliminate competition by specialized carriers if they provide services that are truly unique and would not result in needless duplication of facilities.

To assure that competition would be open and free, the bill would provide that no charge may be found unjust or unreasonable on the ground that it is too low as long as it is compensatory; that is, as long as it equals or exceeds the incremental costs incurred in providing the particular service.

The bill would reaffirm the jurisdiction of state regulatory agencies over terminal equipment and facilities used for local exchange service, including the interconnection of customer-provided equipment to the network, even though the equipment was also used in interstate service.

The bill would establish standards for authorizing specialized common carriers, requiring that such authorization would not result in increased charges for basic local exchange service, would not wastefully duplicate facilities, and would not impair the technical integrity of the network.

The bill would permit restructuring of the industry by giving the FCC exclusive authority to approve those acquisitions and mergers within the industry which it determines to be in the public interest. Such authority is already conferred in Sections 221(a) and 222 of the Act of 1934 with respect to local telephone companies and telegraph companies.

The FCC seems to interpret the Communications Act to permit competition in equipment and services which it contends are separable from the natural monopoly of the local switched network. The telephone industry believes that the law contemplated an integrated system with unified responsibility for service, equipment, and maintenance, under a system of Federal and state regulation to ensure reasonable rates and profits. It believes that the system has worked too well to risk jeopardizing the service and disrupting the rate structure for the sake of hypothetical, unproven benefits assumed to flow from fragmentation of the market. The solution is to ask the Congress to clarify the law.

March 19, 1976