

Approved February 19, 1986
Date

MINUTES OF THE HOUSE COMMITTEE ON COMMUNICATION, COMPUTERS AND TECHNOLOGY

The meeting was called to order by Representative Jayne Aylward at
Chairperson

3:30 ~~xxx~~ a.m./p.m. on February 11, 1986 in room 522-S of the Capitol.

All members were present except:

Committee staff present:

Lynne Holt, Legislative Research Department
James Wilson, Revisor of Statutes
Jean Mellinger, Secretary to the Committee

Conferees appearing before the committee:

Thomas E. Gleason, Jr., Independent Telephone Company Group
Ed Schaub, Southwestern Bell Telephone Company

Chairman Jayne Aylward opened the meeting for hearings on SB 226 and mentioned that the Interim Committee recommended that there be a grandfather clause for the community colleges and gave their approval of the bill.

Tom Gleason had his prepared comments distributed (Attachment 1) and stated that this bill is a fundamental departure from policy previously demonstrated by this legislature. He said that it was important to understand that all local service telephone companies have been given an opportunity to provide service within their certificated territories and at the same time they have been given an obligation to provide service. They believe the effect of resale of local service, if it is to be permitted, is to take away the opportunity and to leave the obligation. He said it is clear that the resellers of local service are not going to make their services available on an equal and equivalent basis throughout the territory but will seek to provide service to high volume, low cost customers. As a result, everyone on the local system that doesn't have the opportunity to get resold service has to pay more for basic local telephone services. More and more costs are being transferred to the local rate payer through access costs, etc. He said they didn't need to have a test to determine whether there will be harm to the local service company; the only value of the test is to determine how much harm will come to the local company. He suggested a policy decision be made by the legislature reaffirming a commitment to universal telephone service at affordable rates and to deny the opportunity for individuals who have access to the new technology to pick and choose those customers that most favor them which will result in harm to the other customers. He asked the committee to support SB 226 and to reaffirm the commitment to the concept of universal telephone service at affordable rates.

Representative Dean mentioned he was speaking of universal service and asked what he was doing for the low economic groups. Mr. Gleason said one of the things was being there at the hearing trying to avoid additional harm and additional impact on their pocketbooks. Representative Dean said some states are establishing lifeline rates for telephone assistance in terms of \$3.50 for the service and \$1.50 for the telephone or something like that and defining what the makeup of the group should be so that when federal laws come in they can go to those groups and asked if they were doing anything in this area. Mr. Gleason said nothing in the context of SB 226 and that there is revenue which is necessary to provide the company an opportunity to earn a reasonable rate on its investment. They are concerned about the poor, about their customers, and maintaining the extent of telephone service they presently have. Representative Dean said there was supposed to be some federal money available with Gramm Rudman (which probably won't come now) if those groups were defined, and he didn't think Kansas or the telephone companies have done anything on this. He mentioned that one of the things was to count the number of calls and they didn't want to put in the equipment to count the calls to the low economical groups. Mr. Gleason, Sr., said the relatively low rates they have had during the past have come about because the KCC has had a large total pool of revenue from which it could equitably apportion the individual rates and under this bill they seek to maintain the larger pool of revenue. Representative Dean asked if they oppose the trial period that the KCC has set up on this. Mr. Gleason, Jr., said the problem is the trial period is going to determine how much an impact not whether resale would be adverse and it is a departure from existing policy established by the legislature. Representative Dean asked how many in their networks were reselling the telephone service and was told they did not have a substantial number.

Unless specifically noted, the individual remarks recorded herein have not been transcribed verbatim. Individual remarks as reported herein have not been submitted to the individuals appearing before the committee for editing or corrections.

CONTINUATION SHEET

MINUTES OF THE HOUSE COMMITTEE ON Communication, Computers and Technology,
room 522-S, Statehouse, at 3:30 XXX/p.m. on February 11, 19 86

Representative Green asked in what way they felt it would be of advantage to their customers to leave the system as it is. Mr. Gleason said he doesn't see any and said they regard SB 226 as a substantial piece of consumer protection.

Representative Helgerson asked if they would provide to this committee the range of the basic rates for the 18 independent telephone companies of Kansas. Mr. Gleason, Sr., said he thought the rates would run from \$7 to \$12 or \$14 for residential, one-party service in a modernized exchange. Representative Helgerson asked if any companies, individuals, universities, or colleges within the area of the 18 independently owned telephone companies have filed with the KCC for exemption and was told they did not believe there had been. Representative Helgerson said it was his understanding that if none have filed in their area, there will not be permitted under the KCC jurisdiction, any resale of services in the test period so there will not be any adverse impact to their companies while the KCC is examining the decision and asked if that wasn't correct. Mr. Gleason said there would not be a direct effect from the test but an indirect effect. Representative Helgerson asked if it is possible, if the KCC determines somewhere down the road that it makes an adverse effect on residential consumers, that it could allocate a larger percent increase to those companies that have taken advantage of the competition. Mr. Gleason, Sr., said that the Commission has the authority to rate design, to move revenue requirements to one class of customers as against the other.

Ed Schaub gave a review of what they see in shared tenant service, resale, and competition and what caused them and the other groups to develop Senate Bill 226 (Attachment 2). He stated that regulation started so that telephones would be available to everybody. He described the difference between a partitioned switch and a non-partitioned switch and said that a partitioned switch would be a solution. If the resellers take up the business where the costs are low and leave the business where the costs are high, the impact on these customers will be very adverse. They think SB 226 is certainly a solution if amendments are added. He said they support the Commission's order that was issued in August and think it is a reasonable order to determine the impact of non-partitioned switches on the telephone companies.

Representative Dean said SB 226 talks about telecommunications and asked what that means. Mr. Schaub said that telecommunications is a term that we know what it isn't. The intent of this bill was essentially the preservation of local basic telephone service. Representative Dean asked why they would buy a partitioned switch. Mr. Schaub said it made a lot of other services available.

Representative Friedeman asked if they had some way of overcoming the Cox Cable decision. Mr. Schaub said it was his understanding that it had more to do with cable companies.

Representative Green asked if this bill has anything to do with microwave and was told microwaves were just for long distance.

Representative Helgerson asked how many companies have petitioned the KCC from their areas. Mr. Schaub said seven or eight had but only one has been accepted at this time. Representative Helgerson asked if they had estimated the effect of the seven or eight companies that have petitioned and was told they haven't since the period of applying hasn't ended yet. Representative Helgerson said it would seem that under the KCC previous decision if they do nothing, except for the seven or eight that applied for the exemption, they still have the status quo. Mr. Schaub said that was right. Representative Helgerson said that on the break up of the Bell Corporation, there are several Bell organizations and asked why some do not have any particular problem with the issue and some do. Mr. Schaub said some are in the business of providing telephone service and others are in other things and perceive this particular issue as being of no harm.

The meeting adjourned at 4:40 p.m.

The next meeting of the Committee will be at 3:30 p.m. on Wednesday, February 12, 1986.

STATEMENT OF INDEPENDENT TELEPHONE COMPANY GROUP IN
SUPPORT OF SB226

Madame chairperson and members of the committee: My name is Tom Gleason. I appear before you on behalf of the Independent Telephone Company group, an informal association of 18 independently owned small, largely-rural telephone companies operating in the State of Kansas. On their behalf and in the interests of their 40,000 small business and residential customers in about half the counties of Kansas, we wish to express strong support for the passage of SB226 as recommended by the interim committee.

The telecommunications industry has experienced, and will continue to experience, major changes due to advances in technology and to the federal drive toward increased competition. The combination of these factors poses a serious threat to the continued universal availability of telephone service at reasonable rates in Kansas and particularly in rural Kansas.

The state has exercised its policy making responsibility by establishment of our current system of regulated monopolies. Such a system assumes properly that the ordinary benefits of open competition must be foregone in order to make this vital service available to all. Local service telephone companies have accepted state limitation of their earnings and the obligation to provide service to all; but they have done so on the assurance

Attachment 1
2/11/86 As. CCT

that they will not be obliged to compete with others who could choose to serve only high-volume low-cost customers. This legislature must act to maintain the system that has served so many so well, or it must consciously and directly choose to permit a new system which abandons any semblance of commitment to the small business and residential local service customers.

Traditionally local telephone service's residually priced local rates have been established after considering all other sources of revenue at the lowest level necessary to provide the operating company enough revenue to be able to earn a reasonable return on its investment. These rates do not reflect the great differences in the cost of providing service to different customers in the certificated territory. Clearly it costs much more per line to serve the isolated farm home than the office building next door to the telephone company's central office. Nevertheless uniform residential and business rates are established, on the theory that all customers have equivalent value through access to the universal system.

Resellers and other competitors clearly seek profit from their efforts, and it is obvious that they seek to provide service to the lowest-cost, highest-volume customers. The inevitable result of their efforts would be a reduction in revenue otherwise available to the local exchange company. Necessarily this will mean that the remaining higher-cost customers will be

saddled with increased rates. Many present customers are only marginally able to maintain telephone service at present rates, and an increase attributable to reseller competition will surely mean degradation of the extent of the system and effective denial of a necessary service to those least able to do without.

The resale of local service would constitute a fundamental change in the system of certificated and regulated availability of local telephone service. Local telephone companies have put years of effort into developing, improving and maintaining our present universal system, and they have done so with both the obligation and the opportunity to provide local service to all customers in their territories. Resale leaves local companies with the same obligation but without the opportunity.

The KCC has undertaken a "test period" to seek information and experience regarding resale of local service. We commend in principle this effort, but this legislature must be aware that such a test will determine not whether, but how much local companies and customers will be harmed by such resale. The largest local service providers may have sufficient volume and revenues to weather such a test period, but the small local companies are not so situated. Any resale of local service is a direct deduction of the revenues available to support local service, and the resulting shortfall must be passed along to the remaining local customers. The KCC "test" can determine, perhaps, the extent of

this shift of burden, but the existence of any shift is purely a policy decision. AS SUCH, THE JUDGMENT SHOULD BE ONE OF POLICY BY THIS LEGISLATURE RATHER THAN BY AN APPOINTED ADMINISTRATIVE BODY.

Additionally, the continuation of the test, itself flawed by the absence of a control group comparison, poses its own problems. Once the negative effect on universal service is demonstrated the state will face the problem of dealing with those resellers who have slipped in through the KCC window. The Commission, having permitted some resale, may confront difficulties in withdrawing authority for these resellers to continue. Similar resellers wishing new authority may reasonably argue that they are unfairly denied the opportunity granted to others. All the while more revenue will be lost to the local service system and more upward pressure will be applied to the local customer's rates.

There is growing pressure from the federal level to continue efforts at deregulation, and to move more to cost-of-service pricing of all telecommunication services. If this State chooses to avoid the resulting harm to the concept of universal telephone service at reasonable rates, prompt and positive action on SB226 is required. This legislature's interim committee has affirmed a commitment to universal telephone service which constitutes "good public policy". Deviation from the system of certificated and regulated local service supply is inherently at odds with that

goal and should, as a matter of good public policy, be prohibited.

While we are unable to quantify the direct affect on the small rural telephone exchanges we represent, we would call your attention to statements made before the Senate Committee hearings considering this matter. A representative of the Wichita Airport Authority in those hearings stated that the authority had invested approximately \$750,000.00 in specialized equipment to accomplish their resale plans, and that they were realizing a net income of between \$100,000.00 and 200,000.00 annually from the provision of the resale services. This is just one example, but we feel it shows very clearly that permissive resale of local service will clearly deny the local exchange telephone companies of very substantial revenues, without any substantial reduction in the local company's cost of operations. Clearly, the end result will be to force the remaining customers of the local exchange companies to bear increase shares of the cost of telecommunication services through higher local service rates.

We also feel that we need to make you aware that the Kansas Corporation Commission appears to be moving in the direction of competitive markets in following the path laid down by the federal government. On January 29, 1986 in docket 127,140-U the Kansas Corporation Commission issued an order in which provides for some degree of competition in the intraLATA long distance

markets in Kansas. In that order the Commission stated its opinion the competition in the intrastate toll markets is "inevitable". The Commission is further considering recommendations of its staff to create an investigation into the pricing structures of local service. In the staff's recommendation the view has been expressed that there may be no need for regulation even in the local service markets in the future.

It is our position that unless the Legislature reinforces its commitment to regulated monopoly services in the Kansas telecommunication industry, the move toward competitive markets will continue to the ultimate destruction of the availability of universal service at reasonable and affordable rates.

Report of Southwestern Bell Telephone Company
to the
Communications, Computers and Technology Committee
Kansas Legislature
February 1986

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Background

Back at the turn of the century when local telephone service was in its infancy, it wasn't unusual to find two or more competing telephone companies serving the same town. In some cases, competing companies served the same street.

As you can imagine, the result of this free-for-all arrangement was a series of problems for both customers and the telephone companies.

The problems ranged from the ridiculous to the unfortunate. For instance, some towns couldn't get a telephone company to serve them at all. Because of economic reasons, no one wanted to serve them. Yet, at the same time in a neighboring town, two companies might be waging a brutal price war to attract new customers.

Customers of one company couldn't call customers of another -- even living on the same block. There were two telephone books and if you really wanted to be up-to-date, and could afford it, you might have two telephones in your house as well.

Some of those telephone price wars left some companies victorious and others vanquished. Often the result was that one company would go bankrupt and the survivor would have to raise rates to survive.

In general, the whole situation was a catastrophe. Things got so bad, in fact, that the general public and governmental officials agreed that one company should serve a certain territory. That company was granted a franchise to be the sole provider of telephone services in that territory (known as an "exchange"). State regulators were given the task of granting these franchises.

Along with the right to be a sole provider of service, state regulators wisely added some major responsibilities to the companies' franchise agreements. They had to serve everyone in their franchise area--all comers, regardless of location and cost. And, they had to do it on a timely and affordable basis. This became the cornerstone and birth of "universal service".

In its simplest form, universal service means telephone service that is universally available to those who want it at affordable rates. The company's prices and customer service standards are regulated to assure the public is well served.

The system of exclusive franchise and universal service has served the citizens of Kansas well these past many decades. The percent of Kansas households having telephone service has increased by approximately 10% over the last twenty years. Approximately 95% of all households in Kansas now have telephone service--the highest residential telephone development of all the five Southwestern Bell states.

But the system of exclusive franchises, with its benefits to customers and operating efficiencies, is being threatened.

The Problem

Today, a new communications service arrangement has emerged called "shared tenant services." In its purest form, this new "shared tenant" concept involves a building owner providing a communications system for tenants of the building. The building owner does this via a very sophisticated communications computer, sometimes called a "smart switch." (See Attachment 1.)

The communications computer can provide an array of sophisticated services to the building tenants such as data communications, energy control, and security. It can also provide shared computer time for functions like inventory control, bookkeeping services and word processing. All of these services can be offered to the various tenants of the building who might be retail shops, business offices or residences.

This state-of-the-art computer capability and the sophisticated services made available to building tenants are not the problem. These kinds of "shared tenant services" can enjoy a healthy co-existence with universal telephone service as is evident in many states, including Kansas. We should all--regulators, legislators, and telephone utilities--encourage this kind of economic activity here in Kansas.

Attachment 2
2/11/86 Hs.CCT

The problem arises when this communications computer is misused by the shared tenant service provider to do one other important thing -- to process voice communications through telephone company lines. With a communications computer capable of handling telephone calls, some shared tenant operators have decided to get into the local telephone business. If the computer -- "smart switch" -- is connected to all the tenants, they reason, then why not lease regular lines from the telephone company and provide local telephone service to the tenants by sharing all of the trunk lines in common (see Attachment 2).

And with this, resale of local telephone service has begun. That second telephone company which governmental officials found detrimental to the public interest and which they took steps to forbid decades ago, has surfaced again in the form of shared tenant services. The Kansas Corporation Commission has already taken some steps to protect universal service from the clear danger of local service resale. It has found "that it is contrary to the public interest to permit resale of local telephone service to the public generally" and has issued an Order stating that such third-party resale shall not be permitted. (Order in Docket No. 141,975-U, December 11, 1984.) But the Commission left open for further examination the area most vulnerable to local resale opportunists and the most dangerous as a threat to continued universal service: the building owner-tenant relationship.

Shared Tenant Services Study

Pursuant to an August 23, 1986 KCC order, a year-long study is about to begin to assess the impact of shared tenant services provided by a building owner to tenants of the building. The goal of this study is to determine whether there is a private benefit from this kind of resale with no harm to Southwestern Bell Telephone and or the public in general.

Procedures are in place to facilitate the study. First, providers of shared tenant services must apply for exemption from current tariff language prohibiting resale of local telephone service to the general public. Application for exemption must be made by February 23, 1986, to the KCC.

Those granted exemption must also sign an agreement setting guidelines for their relationship with Southwestern Bell Telephone Company during the life of the study. This agreement has been approved by the KCC.

The study will continue until February 28, 1987. Southwestern Bell Telephone will gather data pertaining to the following areas of its operations:

1. Revenue impact
2. Investment impact
3. Idled facilities impact
4. Forecasting and planning.

This data is intended to assist the KCC in accurately assessing the impact of shared tenant services on Southwestern Bell Telephone and or the public. It must be forwarded to the KCC before May 1, 1987.

Currently, Hutchinson Junior College is the only shared tenant service provider to both receive the KCC's exemption and sign the agreement with Southwestern Bell Telephone. Other shared tenant services providers are in various stages of the application process.

Today, the customer confusion raised by the specter of local telephone competition is even more complex and threatening than the two telephone books and price wars of earlier times. With the resale arrangement, the shared tenant service operator (now acting as a telephone company) has all his customers using the same local telephone lines in common. (See again Attachment 2.)

This results in a new set of potential problems. Some customers might not be able to complete calls. For example, a doctor's office could be unable to receive or place a call because of incoming calls to a retail store about a special sale. In this age of the computer, this arrangement also aggravates security problems for information in word processing systems and computers used by tenants such as legal and accounting firms.

And there are other threats to universal service if resale of local telephone service is allowed.

The Impact on Universal Service

Local telephone companies stand to lose substantial amounts of revenue if building owners are allowed to resell local telephone service and skim the cream from local exchanges.

Early last year in preparation for Kansas Corporation Commission hearings "to explore all necessary issues incident to resale in a landlord-tenant situation..." Southwestern Bell Telephone formed a task force of interdepartmental specialists and conducted a special case study to determine the financial and operating impacts of resale. The company completed a thorough analysis of the consequences if a large regional shopping mall in Hutchinson, then under construction, were to provide its tenants with shared telecommunications services and resell local exchange service to them.

From this one real-world example, the study indicated Southwestern Bell Telephone would stand to lose \$4,008 a month or \$48,102 a year in local service revenues if resale of local telephone service were allowed at the mall. In addition, if the mall made a direct connection with a long distance company, bypassing Southwestern Bell Telephone's access lines, the loss of interLATA toll access charges would amount to \$1,557 monthly or \$18,684 annually. All of these revenue losses and supporting data were admitted into evidence by the Kansas Corporation Commission during testimony on March 13, 1985.

The revenue impact of the study is quite significant and it is for only one case. The study goes on to identify the potential loss of revenues in the state of Kansas caused by resale of local telephone service could be almost \$20 million a year. If that happens, customers who remain on Southwestern Bell Telephone's network will face significant rate increases for local service.

That \$20 million loss is the equivalent of about \$2 per month per average customer in Kansas. It is significant to note that \$2 a month is more than the increase in local rates granted in Southwestern Bell Telephone's last rate case in 1983. (Southwestern Bell Telephone has never received a local rate increase greater than \$1.35 per month.) Even without resale there are upward pressures on local exchange service rates because of competition in related services and bypass of the local network. The source of revenues to make up for losses due to competition and bypass, no doubt, will be local exchange service. These other services such as long distance, access services, and private line service, which are experiencing competitive and bypass pressures, have helped keep local exchange rates below cost. See Attachment 5 to see who pays for the resale of local service.

But, the revenue impact of resale of local telephone service is only one aspect of the jeopardy to universal service in Kansas. There are problems in the areas of duplicate facilities, facilities already in place that are no longer needed, and forecasting to have proper facilities in place when needed.

Our franchise requires us to be ready to serve the businesses and residences in our exchange service areas. If resale of local telephone service is allowed, we will be required to be prepared to serve both the reseller and the tenants. The two, by nature of their needs, require different types of telephone service. This duplication of facilities results in a portion of our investment in equipment becoming idled.

In the specific example of the Hutchinson Mall, Southwestern Bell Telephone requires an investment of \$13,525 to provide local exchange service to the reseller and tenants. In addition, a central office modification would be necessary in Hutchinson to provide trunking capacity for the reseller's communications computer at a cost of \$27,000.

In the special Southwestern Bell Telephone study, statewide projections showed that almost \$97 million invested in plant in Kansas could be idled if resale is allowed. Customers remaining with Southwestern Bell Telephone would be required to support this investment made idle by a few select customers being served by resellers. Again, all of this financial data has become part of the Commission's record in the hearings of March 13, 1985.

Another problem is that uncertainty in a resale environment makes the task of accurate forecasting difficult.

To be prepared to serve customers on a timely basis, as the franchise requires, Southwestern Bell Telephone prepares forecasts of future customer demands. These forecasts are made with the assumption that Southwestern Bell Telephone serves 100 percent of the market. Optimally, forecasts are issued for anticipated demand 18 months to two years in advance so that sufficient time will be available to construct necessary plant.

If the business of providing local telephone service includes parties who may, at their will and without notice, enter or exit the business at any time, at any location, there will inevitably be cases of serving facility shortages in some locations and serving facility surpluses in other locations.

The special case study described above in connection with the Hutchinson Mall also focused its attention to the high technology center of Kansas business: the Corporate Woods Complex in Johnson County. Southwestern Bell Telephone placed a new central office into service in July, 1985 to meet the telecommunications needs of the customers in that area. If a shared tenant service provider, reselling local service, started serving these customers it would idle about \$290,000 of Southwestern Bell Telephone's current investment.

What if a few years later that shared tenant service operator, reselling local service, decides to move out of Corporate Woods, or decides to quit, or can not financially continue? Facilities probably will not be available to provide service to those customers. The central office equipment would not be available to serve those customers and there probably would not be enough local lines from the central office to the customers. The result for the business customers in the Corporate Woods Campus would be no telephone service or very limited telephone service (less than desired number of lines or forced party line service) for up to a year. That would be a disaster for those businesses, their customers, Southwestern Bell Telephone, and the Kansas City business community. There are no winners in this situation.

It is obvious that the Kansas legislature has a real stake in the development of a dependable, modern telecommunications infrastructure to serve the business and financial centers of our state. The legislature likewise has a public policy role to play to insure that forces outside the control of the locally franchised telephone companies do not frustrate and defeat plans to build and maintain such an infrastructure.

A number of negative impacts on customers and Southwestern Bell Telephone could result from resale of local exchange service through shared tenant services. Confusion in the minds of the public could result in the level of telephone service eroding.

After 107 years of coming to Southwestern Bell Telephone for telephone service, now the customer is faced with major decisions that could have significant impact on the success of his business.

Does this mean that policy makers must choose either on the side of shared tenant arrangements or on the side of universal service?

The Solution

Kansans can enjoy the benefits of both communication computers and universal service. The solution is simple. Each customer simply orders his own local service lines from the local telephone company. Customer A's local service is connected by the local telephone company to the computer, which is programmed so that other customers do not utilize customer A's telephone lines. Each customer is provided service by the local telephone company and enjoys the use of the communications computer.

This solution utilizes the ability of these computers to "partition" each customer's lines into groups. This partitioning arrangement is shown in Attachment 3. With each customer's group of lines provided by the local telephone company rather than a third party many problems for the customer now are solved.

Customers may share the services and costs of the smart switch. However, the doctor's office will not have all of the telephone lines busy because a retail store is running a sales special. The computer files and word processing systems used by accounting and legal firms will be more secure from accidental or clandestine entry by unauthorized users. In addition, the customer's telephone service will not be subject to disconnection when someone else -- the reseller of local service -- does not pay his/her telephone bill or decides to move to a more profitable location. With such an approach, the customer maintains the traditional relationship with the local telephone company.

Other positive aspects for customers obtaining service from the local telephone company by using a partitioned arrangement are: the ability of the tenants to individually choose which long distance company they wish to use; and the ability to independently make a decision about the grade of service they want; and the ability to independently account for changes in business plans.

Most communications computers available in today's market have as a standard feature the capability to partition each customer's telephone lines. Individuals who have operated shared tenant service businesses have testified before the Kansas Corporation Commission in the hearings last March that sharing local exchange lines is not significant to the business plans of a shared tenant service provider. And, there are many shared tenant service providers presently in the marketplace who operate their businesses using a smart switch that partitions each customer's lines into separate groups.

In a local service resale situation, the shared tenant service provider uses a non-partitioned arrangement (see Attachment 2). Then the tenant becomes a customer of the shared tenant service provider. The shared tenant service provider is the local telephone company's customer. This situation is simply reselling local telephone service within the local telephone company's franchised area. However, with each customer using its own group of lines (a partitioned arrangement) and obtaining them directly from the local telephone company, there is no resale of local telephone service. At the same time the shared tenant service provider may successfully continue in business.

Resale of local telephone service would be detrimental to the public and a threat to universal telephone service.

A footnote to this discussion is a January 1986 Federal Communications Commission ruling regarding shared tenant services. In responding to a petition by IBM, the FCC affirmed a shared tenant services provider's right to interconnect a partitioned switch with the public network. However, the FCC rejected IBM's request that the FCC preempt state regulators' right to prohibit resale of local service.

Conclusion

As you can see from its consequences, resale undermines the basic elements of universal service: affordability and widespread availability of local service. Clearly, duplication in the local service area is not in the benefit of the general public.

Shared tenant service should be allowed and the advantages of smart switches should be available to Kansans. However, shared tenant service providers should not be allowed to operate as unfranchised telephone companies. They should not be allowed to jeopardize universal telephone service in Kansas.

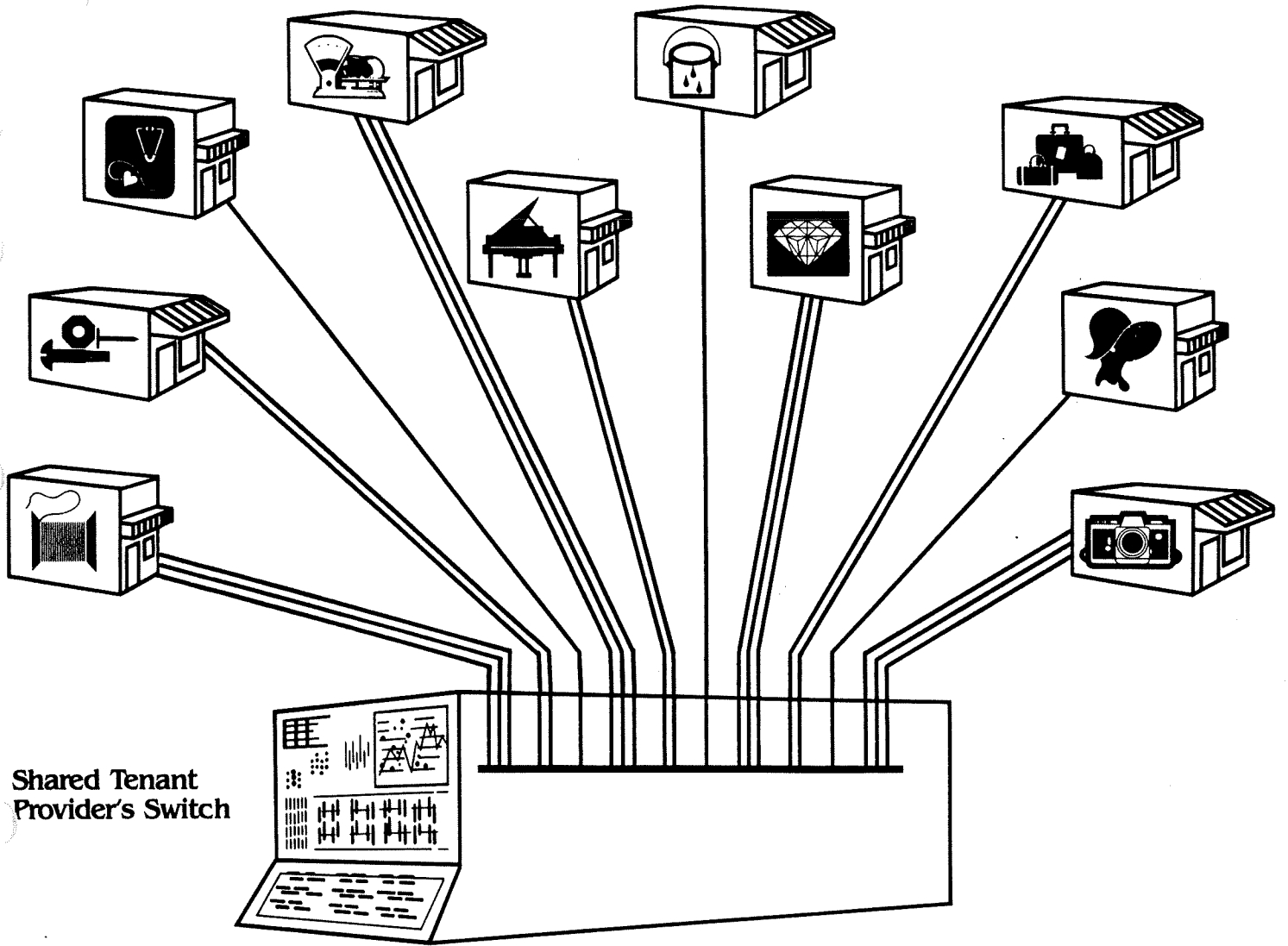
We feel that a solution which best meets the needs of Kansans is a partitioned smart switch for shared tenant service. This solution addresses the concerns of all involved -- the customer, shared tenant provider and the local telephone company.

Competition in the local utility marketplace is a growing concern of the public and the news media. On July 26, 1985, an editorial questioning the wisdom of allowing competition in the local telephone exchange was published by the Topeka Capital-Journal. (See Attachment 6 for this article and others on universal service.)

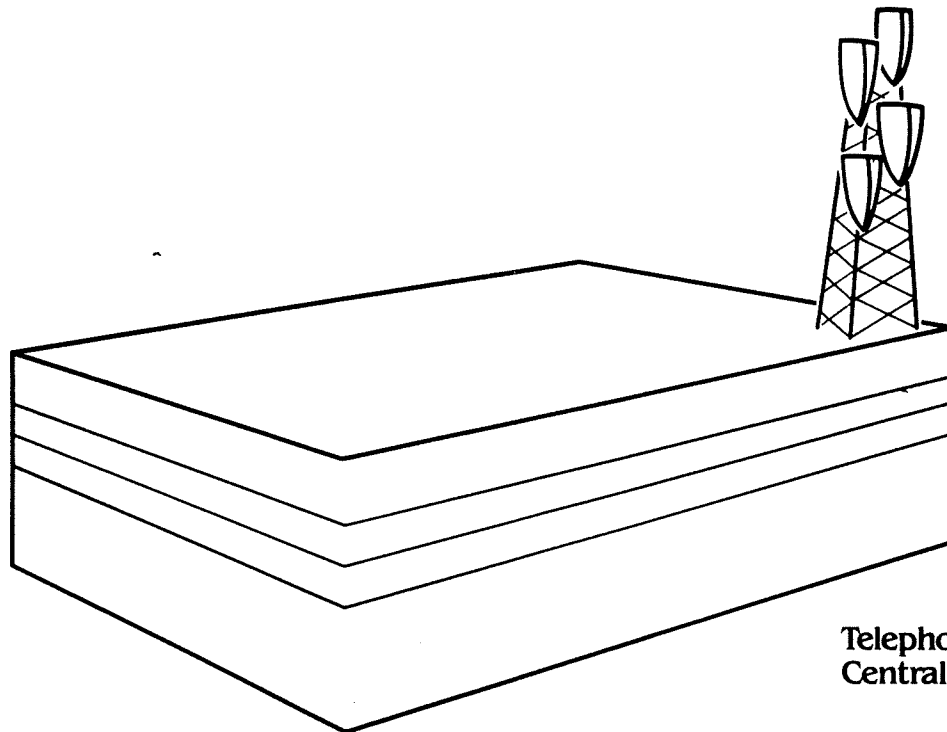
Many legislators have expressed dissatisfaction with provisions of the divestiture of AT&T and Southwestern Bell Telephone. Universal telephone service in Kansas is an issue upon which today's legislators can have an impact.

We believe that the resale of local telephone service threatens the continuation of universal telephone service. This is because of its unfavorable impact on the rates that would be charged to customers who remain on the Southwestern Bell Telephone network and because of the difficulty the company would have planning its network to meet the needs of customers in a timely manner.

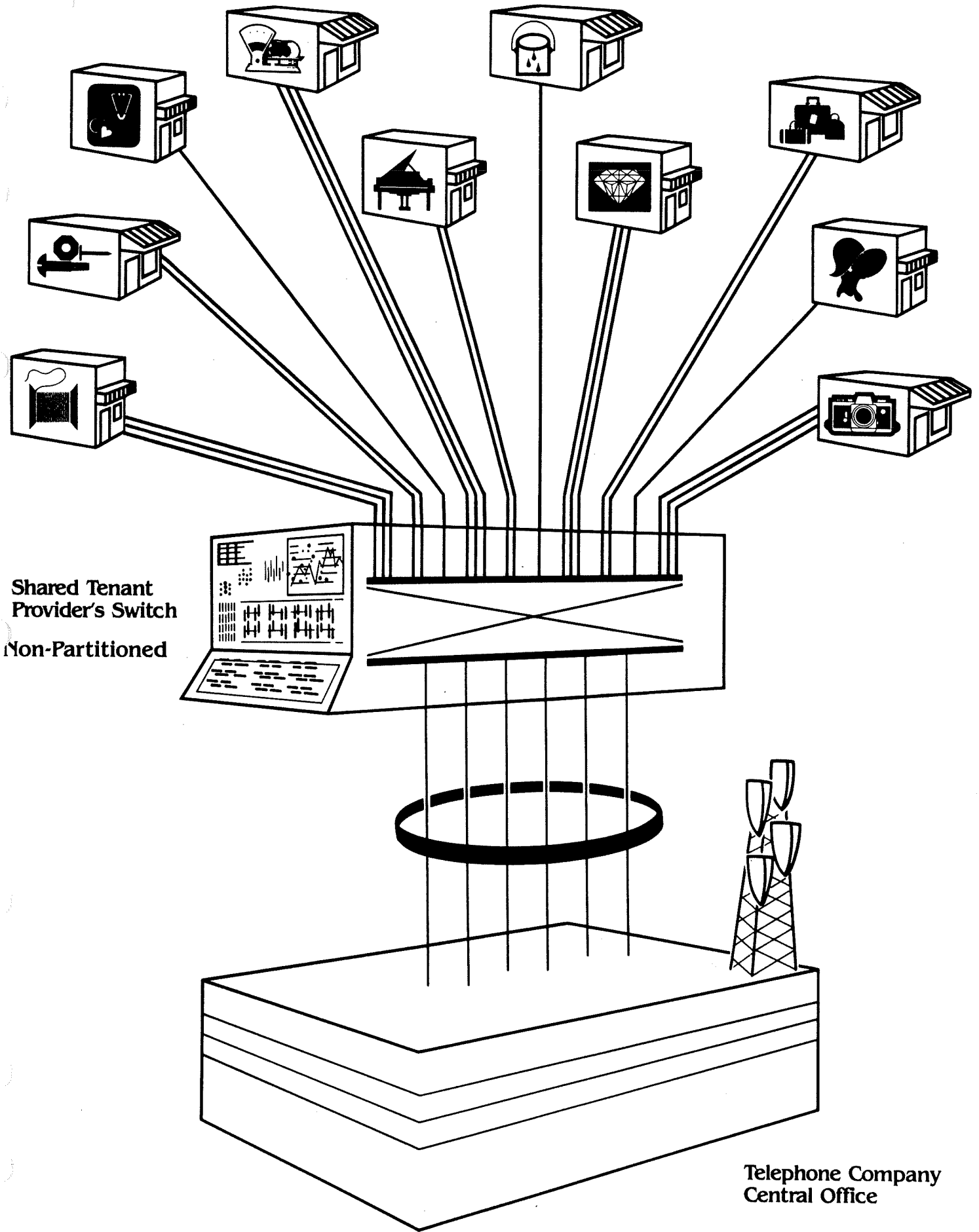
This is critical to Kansas constituents because of the large number of rural customers -- the ones most likely hurt by resale.



Shared Tenant
Provider's Switch

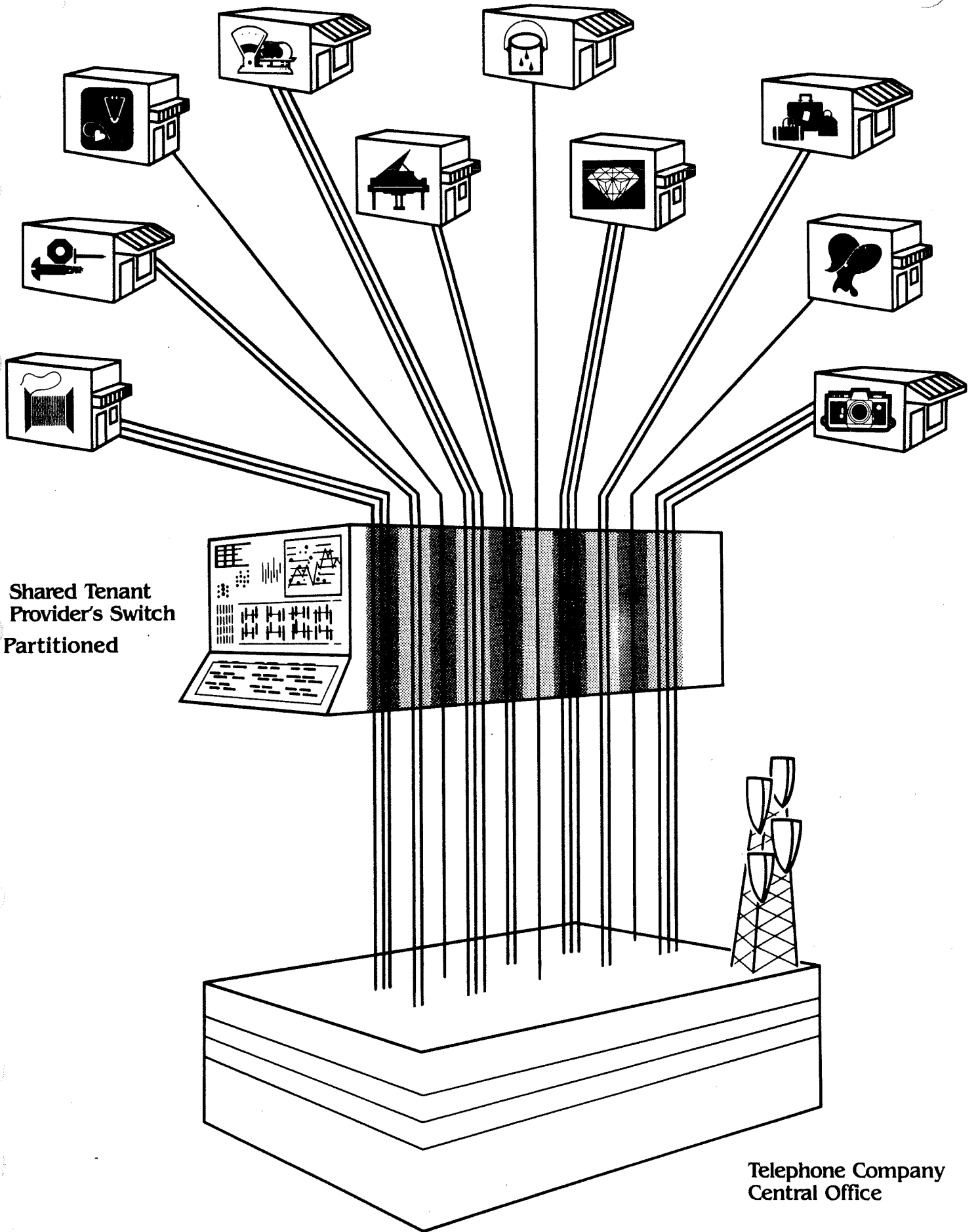


Telephone Company
Central Office



Shared Tenant
Provider's Switch
Non-Partitioned

Telephone Company
Central Office



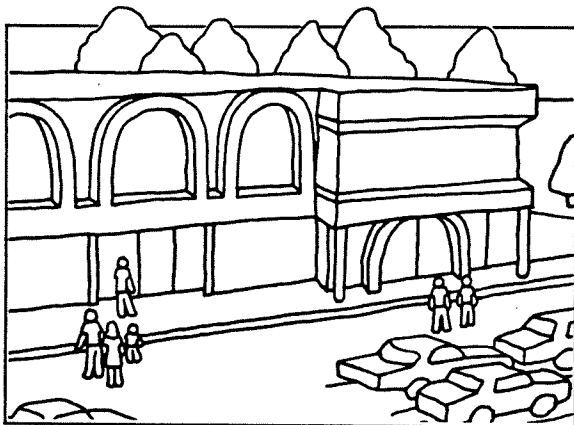
Shared Tenant
Provider's Switch
Partitioned

Telephone Company
Central Office

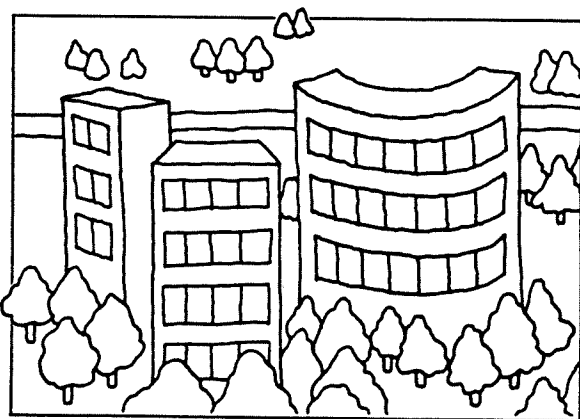
Who Pays for Resale of Local Service?

If resale of
local service
happens here . . .

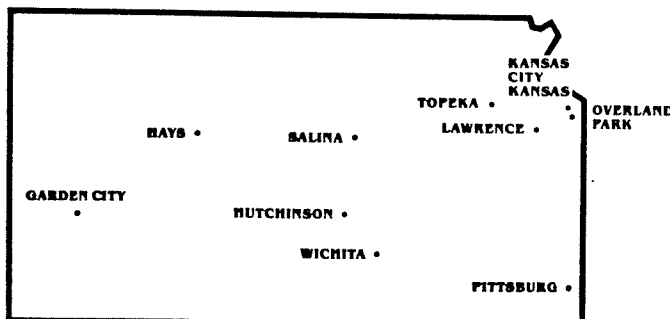
This revenue requirement will be shifted to those who the Shared Tenant Services provider found unprofitable, i.e. the customers remaining with the local telephone company.



Hutchinson Mall
\$48,000



**Corporate Woods
Campus,
Kansas City**
\$489,000



State of Kansas
\$20,000,000

TOPEKA, KANSAS**Topeka Capital-Journal**

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Territorial rights

Although most of the Kansas Corporation Commission's attention has been focused on the Wolf Creek rate hearings this summer, there are some other decisions in the works that could effect how much Topekans pay for their natural gas and telephone service in the years ahead.

One case involves KPL Gas Service's request to require Kansas Industrial Energy Supply Co. (KIESCo) in Wichita to cease operations as a utility unless it is subject to the same regulation as other utilities.

The other case involves resale of local telephone service. Southwestern Bell wants protection from those who, like KIESCo, would come in and gobble up the profitable accounts and leave Bell with the unprofitable ones.

The situations are not new. In the wake of deregulation and the breakup of AT&T, the state has witnessed several attempts at what some call cherry pick-

ing or skimming the cream.

The cases will continue to multiply unless some kind of guidelines are drawn — either by the KCC or the Legislature.

In the world of utilities, the free-market rules of competition simply are not realistic. In their place, utilities have enjoyed the status of regulated monopolies. In exchange for the responsibility of supplying service to all who request it, the utility is granted an exclusive franchise for a specific area.

Naturally, some accounts are much more profitable than others. High volume industrial users, for instance, are more cost effective to serve than individual residences. By serving both, the utilities have been able to use the profits from the former to hold down the costs for the latter.

It is a fair trade off that should be continued. Without it, the average householder will be left with higher bills or less service — or both.

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Local phone exchanges mean high stakes

By John Schneidawind
Financial Writer

Buried in hundreds of pages of testimony that ended last week in Jefferson City are two sentences that send shudders through some of the best customers of the Southwestern Bell Telephone Co.

Southwestern Bell testified: "Under rights granted by the Missouri Public Service Commission, (Southwestern Bell) is authorized as a certificated provider of local exchange service. Local exchange service is all telecommunications service between different customers who are located within the local service area."

Last year's breakup of the American Telephone & Telegraph Co. called for the 22 AT&T subsidiaries that provided local telephone service to be spun off and reorganized into seven regional holding companies. The Bell companies would provide customers with "dial-tone" service and access to long-distance services under rates approved by federal and state regulators.

But, for the first time, the private use of switching systems previously available only to telephone companies has pushed deregulation of the telephone business right down to the local telephone exchange, something that isn't addressed by the terms of the Bell System divestiture.

"I think it's probably more troublesome than the breakup," said Alfred E. Kahn, the inflation-fighting

czar of the Carter administration who testified for Southwestern Bell in its last rate case in Missouri. "You can prohibit competition . . . or you can say that competition is good.

"Society has got to make a decision. Which way does it want to go?"

According to Southwestern Bell, its seemingly innocuous stance is simply the company's attempt to keep "plain old telephone service" affordable to anyone who wants it.

But to real estate developers and telephone-equipment firms, Southwestern Bell's position is an attempt to outlaw technologies that promise to bring greater productivity and jobs to urban centers throughout the Midwest.

Resale of local telephone service has been allowed for decades in hotels and hospitals, a situation that wouldn't change with Southwestern Bell's proposal. But now real estate developers and telecommunications-equipment firms want a piece of the action.

Even cable-television companies, with wire strung out over municipalities, are potential competitors to local telephone companies.

They say that Southwestern Bell's statements, despite utility assurances to the contrary, could outlaw the way they do business or cut them off from potential customers.

If regulators in both Missouri and Kansas, where a similar proceeding is pending, approve the company's recommendation, they may remove a powerful tool that real estate developers are using to attract tenants to several major office complexes being built in both states.

If regulators reject the company's view, industry experts say, they will open the door to competition in the only segment of the telecommunications industry left untouched by deregulation and the breakup of AT&T.

The stakes are high.

TeleStrategies Inc., a telecommunications consulting firm in McClean, Va., estimates that the market nationwide for "smart buildings" — those equipped to provide a range of telecommunications services for tenants to share — will balloon from a \$250 million-a-year business to a \$13 billion industry within a decade.

More important, according to TeleStrategies, most of the increase in shared tenant services will come not from new construction but from the renovation of existing structures. The firm estimates that such renovations will account for 74 percent of the "smart building" business in 10 years.

That prospect threatens to raise telephone rates for Southwestern Bell's remaining customers by stranding millions of dollars of investment in plant and equipment, according to Southwestern Bell. The utility estimates it could lose from \$10 million to \$30 million a year.

The only way left for the utility to recoup that investment, it claims, would be through higher rates for remaining customers.

The systems around which shared tenant service are built — called private branch exchanges — allow real estate developers such as Kroh Brothers of Kansas City and Linclay Corp. to "resell" the local service provided by Southwestern Bell, often at prices far below the utility's regulated rates.

Before "PBXs" became widely available, tenants in office buildings usually were served by individual telephone lines. Even when they made a call to another tenant in the same building, the call first went out of the building to a telephone company's central switching office miles away and then came back to the building to its destination.

PBXs allow developers to offer lower rates than the phone company because the systems reduce the number of trunk lines needed to connect each telephone in a building to the outside world. The systems often allow developers to act as mini-telephone companies, switching calls between tenants who formerly were separate customers of Southwestern Bell.

The resulting economies of scale allow tenants to share a host of sophisticated telecommunications services, including message answering services, energy management, data transmission and the routing of calls

to whichever long-distance company has the cheapest rates at a given time.

The debate in many ways mirrors the arguments made by AT&T decades ago against deregulation of the telephone equipment and long-distance businesses. Open up the market to competition, the Bell System said, and you create confusion for customers without necessarily lowering prices.

Providers of the services have a ready answer. "More and more services can be provided without the need to rely on the monopoly provider," said Al Cramer, general counsel for the Multi-Tenant Shared Telecommunications Association in Washington. "The problem is people pursuing their economic self-interest."

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Rather than stranding investment, the systems allow telephone companies to cut down on costs by providing fewer lines to each proposed new building, he said.

Already, Southwestern Bell's stance on the issue has confused the status of the communications plans of some of Missouri's biggest retail and office complexes now under construction:

- The plans of Melvin Simon & Associates Inc., to provide shared telecommunications services at the St. Louis Centre, a retail project that will cover several city blocks in downtown St. Louis, have been delayed pending a decision on the issue by the Missouri Public Service Commission, according to J. Fred Murray, director of telecommunications.

- The plans of Republic Telecom Corp. to offer a range of sophisticated telecommunications services to tenants at two buildings being built by Executive Hills Inc. have been scuttled until the issue is resolved, according to Pete Lorenz, a vice president with Republic Telecom. Tenants leasing from the real estate developer will now get phone service directly from Southwestern Bell.

- At the Linclay Corp. Main Plaza project, plans to offer shared tenant service are continuing. But — according to Jerry Freeman, a spokesman for Howard Systems Inc., which has designed the system for Linclay — Main Plaza tenants will not be able to talk to each other without going through Southwestern Bell's facilities.

ing through Southwestern Bell's facilities.

Even so, Linclay intends to buy all the local telephone service for the project from Southwestern Bell and then resell that service to its tenants without being certified by state regulators, a position that Southwestern Bell opposes.

"We've had some people tell us not to come into Kansas City and do this because of Southwestern Bell's position," Mr. Freeman said.

- At Kroh Brothers of Kansas City, plans to install a shared tenant service system at its Plaza West office complex on Madison Avenue are proceeding, said Roger Hunt, a spokesman for the company. He said that the system would allow Kroh Brothers to resell a wide range of communication services to its tenants.

In Missouri, Southwestern Bell's proposed redefinition of local telephone service also is being criticized by long-distance companies such as

MCI Telecommunications Corp. and AT&T Communications, the long-distance subsidiary of AT&T.

Even cable-television companies, which can offer local communications services, are concerned.

"We think that Southwestern Bell's redefinition of local exchange service is overly broad and vague," said John Houser, a spokesman for MCI in St. Louis.

Customers of long-distance companies such as MCI now dial a local telephone number leased from Southwestern Bell. The number connects them to an MCI PBX switch, which then takes the call into the long-distance company's interstate network.

At the hearings last week, Southwestern Bell officials said that such a situation still would be allowed under its proposed definition.

"That's nice for them to say that, but we would like to see it in writing," Mr. Houser said.

The case also is important for AT&

T Communications, according to Chuck Ward, district manager for regulatory relations for the company. If Southwestern Bell's position as the sole provider of local telephone service is upheld, then it would be able to refuse service to any large complex that is reselling local service through a PBX.

That could cut off long-distance service to AT&T Communications' customers, he said.

Southwestern Bell maintains that it is not necessarily opposed to developers offering systems that share telecommunications services, as long as they don't do so by cutting down on the amount of lines Southwestern Bell provides to each tenant.

The company has begun offering a new service called Centrex III, which can significantly reduce a customer's telephone-to-line ratio, but only at the phone company's central switching office. The city of St. Louis recently bought Centrex III service,

increasing the number of telephones served by one outside line.

However, that practice does not strand investment as privately owned switches do. "You're not stranding cables," said Lew Scott, a spokesman for Southwestern Bell in Kansas City. "You're reconfiguring circuitry."

"The definition they want for local exchange service would prohibit anybody from providing any kind of (local) communications service," said Bob Niles, president of American Cablevision of Kansas City, which is also a party to the hearings in Jefferson City.

The cable company furnishes Blue Cross-Blue Shield of Kansas City with a cable connection that permits the insurer to make local calls between its two facilities on Broadway.

Southwestern Bell has taken its case for a local monopoly to commissions in other states it serves, with mixed results.

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After two days of testimony KCC staff opposed to telephone resale

TOPEKA, Kan. (AP) — Two days of lengthy testimony and cross examination have "raised some interesting points" but not convinced staff attorneys for the Kansas Corporation Commission to change their opposition to letting smaller companies resell the local telephone service they purchase from state-regulated utilities.

Henry Henderson, an attorney in the KCC's utility division, said Thursday he would still recommend the three-member commission protect the exclusive franchise rights of regulated companies such as Southwestern Bell Telephone Co., because of the economic effect of the bulk of Kansas residential phone customers.

"The staff position will remain the same," Henderson said before he prepared to testify at a KCC investigation in to telephone practices which threatened to drag into late evening. "Just as we said in our prefiled testimony, we are opposed to resale of local exchange service."

In his prepared testimony, Henderson said the staff believes the resale of local phone service, such as by an office-building management to its tenants, or pooled phone service shared by several small businesses, does "not serve the best interest of Kansas ratepayers at this time."

The commission's hearing, which turned into a marathon session that lasted through Thursday night and into the early hours of Friday morning,

wrapped up with Henderson's testimony. The commission set Aug. 31 as the date all parties can file additional briefs and no decision is expected until late September.

"The staff sees several areas of local telephone companies that could be effected by resale," Henderson said. "In general, those area are revenues, long-range planning as it relates to capacity and construction, stranded investment and the effect on universal service."

Henderson said there's "little doubt" local phone companies will risk losing revenues is the KCC allows resale of service. Independent businesses or professionals, such as attorneys, doctors or accountants, could band together and rent one electronic switchboard to serve all their needs.

"The presence of a reseller may significantly reduce the number of business access lines that a local exchange company leases, thus reducing the companies' profits," Henderson said. "In most cases, the general body of ratepayers will end up paying for the capital recovery of the facilities, thus increasing rates."

The Kansas Corporation Commission is investigating whether businesses should be permitted to resell the local telephone service they purchase from regulated utilities.

The hearing was prompted by complaints about telephone service being resold.

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KCC Studies Phone Requests

Deregulation has brought many new problems to our state regulatory agencies as new ideas are being proposed that would require a change in Kansas Corporation Commission policies.

This week the top item involves companies trying to get in on the lucrative business telephone market industry. Their argument is that a change in policy could mean some telephone users would be able to obtain cheaper local telephone rates—another step in the deregulation of the telephone industry.

The hearings in Topeka center on whether local telephone service bought from state-regulated phone companies—such as Southwestern Bell—can be resold at cheaper rates. State officials consider it the widest-ranging telephone case since Southwestern Bell's record rate increase requests last December.

Resale of local phone service currently is not permitted in Kansas.

Southwestern Bell officials warn that the resale of local services would force it to increase charges to its other customers. The KCC staff seems to agree, recommending that the commission not allow the resale of local service because it could lead to increases in rates for other phone customers.

The resale of telephone service would occur when a company buys a phone line from the telephone company to an office building, then resells the local calling service to building tenants—sometimes offering new technology—at rates below what the telephone company would charge.

The probe also includes whether to allow the private ownership of pay phones. At least two firms now sell pay phones to people who can install them in their businesses and collect the money from the phone boxes. In the past, phone companies paid a certain percentage of the money collected from pay phones to the business where the phone was housed.

We feel this week's hearing had the broadest implications of any telephone case since the hearing last December that coincided with the breakup of AT&T into seven regional companies. With the AT&T breakup, state agencies are becoming more involved in the regulation of the telephone industry.

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Same game; two sets of rules

Competition is the very essence of the free enterprise system that this country holds so dear. Yet, just as every good rule has its exceptions, so, too, must that competitive ideal be compromised from time to time.

Take the case of utility companies. Kansas law requires that those companies whose services extend more than three miles from the city limits or who serve more than one community must be regulated by the Kansas Corporation Commission. Those who serve only one community, however, are not regulated.

The original intent of the law probably was to exempt city-owned utilities, which normally operate to provide a service rather than a profit, from having to go to the KCC every time a rate change was needed.

However, creative entrepreneurs have used the law as a loophole to set up shop in a community, and, by undercutting the rates of the regulated provider, lure the high-volume customers away from the regulated utility.

So what? you say.

Well, if the practice is allowed to con-

tinue, the so-what will be higher rates for the average residential customer.

The regulated utility cannot pick and choose its customers; when it goes into a community it must provide service to all residents regardless of profitability. In some cases, it may cost the company more to provide service than it will receive from that service. Therefore, it relies on the high-volume users — usually commercial customers — to make up for that loss. In essence, they subsidize the less profitable residential accounts.

Even the most ardent foe of utilities cannot begrudge the company a right to return a profit on its investment. And the KCC is there to make sure that the profit is not unreasonable.

An example of the disparity involves the private Fairfax Gas Co., which wants franchise rights to sell gas to customers in the Fairfax Industrial District of Kansas City, Kan.

Competition in the open marketplace generally works to the advantage of the consumer. But it has just the opposite effect when a regulated company must try to compete with a company that does not have to play by the same rules.

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(COMPLETE BRIEF SUMMARY)

LOW AND PREPARE

Play by same rules

Editorial-Opinion

THE ADA EVENING NEWS, Thur., Oct. 25, 1984

Lee W. Cook, a referee at the Oklahoma Corporation Commission, has recommended that local telephone service in Oklahoma continue to be provided by regulated companies.

Although we believe strongly in competition and the free enterprise system, in this particular situation we support the referee's recommendation.

Here's why:

The state's regulated telephone companies are obligated to provide telephone service to all members of the public, upon demand and at reasonable rates. To serve all upon demand, telephone companies must design and place their networks so that switches and facilities are in place to provide service when requested. Reasonable rates are maintained, in part, by applying the same rates to the same class of customer, even though the cost to serve highly dense population pockets is less than the cost to serve other areas.

If other companies were permitted to serve select, highly dense population

pockets, the result would be fewer telephone company revenues, increased telephone company costs and a smaller customer base from which to recover the revenue requirements of the regulated telephone companies. Profitable service areas would be siphoned off by the unregulated companies, and regulated company revenues would be lost. Rates for the remaining customers would have to increase.

Basically, what we are saying is that competition is fine as long as all of the competitors play by the same set of rules.

However, in this case, the regulated companies have to serve all areas upon demand and therefore have a sizable investment with the assumption that they will have an exclusive service area. It's not fair for unregulated companies to come in and take the "cream of the crop" without having to worry about major investments or service to unpopular areas.

If we are going to play the game, let's all play by the same rules.

Tony Pippen

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Editorially speaking

An unfair advantage

Yet another tremor from the AT&T divestiture case threatens ultimately to rock the very foundation of regulated telephone service in Oklahoma, with significant consequences for every telephone user.

Southwestern Bell Telephone Co. has petitioned the Oklahoma Corporation Commission to affirm Bell's designation as the sole supplier of local telephone exchange service within its franchise territory. The "vote of confidence" has been sought because non-Commission-regulated companies and individuals are encroaching on Bell's previously exclusive territory with new telecommunications equipment and services.

The University of Oklahoma, for example, has been furnishing its own local telephone service to students residing in university housing; the Williams Companies buy basic phone service from Bell and resell that service to tenants of their Williams Center in Tulsa via the corporation's own inter-office communications system; and private developers across Oklahoma propose to supply their own developments with their own local telephone systems.

These "shared tenant services" bypass Bell's local exchange network, even though the Corporation Commission previously awarded Bell an exclusive franchise to provide local telephone exchange service within designated territories throughout the state.

At first glance it would seem that Southwestern Bell simply objects to the free enterprise system. However, this complex case is not so simplistic.

The Oklahoma Corporation Commission previously awarded Bell franchises — exclusive territorial rights to provide local exchange service in many parts of Oklahoma — because years ago the federal government adopted a policy of "universal telephone service" throughout America. Under that concept, Bell and its then-parent company, AT&T, were compelled to extend telephone service to anyone and everyone who requested it anywhere in the U.S.; unprofitable, sparse areas were subsidized with revenues from profitable, concentrated areas.

If unregulated competitors are permitted to siphon off the revenues

from high-profit, high-density areas, Bell will be left to supply telephone service to the less-profitable, more sparsely populated areas. Handing the choice cuts to independents and leaving the scraps for Bell would translate into cheaper rates for the former and higher rates for the latter.

A referee appointed to the case by the Corporation Commission has concurred with Bell's arguments, and the commission will issue its decision within a few weeks. The Phoenix believes the commission should follow the recommendation of its referee.

The solution is an either/or proposition: Either Bell's competitors must cease and desist, or intrastate local telephone service must be unshackled in the same manner that interstate long-distance service was deregulated earlier this year with the AT&T divestiture.

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Muddling it more

A question now before the state Public Service Commission could add further complications to the already muddled history of the divestiture of AT&T and could end up hurting ratepayers and users of telephone service in Arkansas.

The matter revolves around the long-standing franchise held by Southwestern Bell to provide telephone service in Arkansas. Since AT&T was ordered in court to break up, its former subsidiaries, such as SW Bell, have been riding an unpredictable wave of consequences, few of which seem to have had positive benefits for the telephone customers that the deregulation of divestiture supposedly was going to assist.

For example, customers now have the dubious honor of having to buy phones from one company, have another install them, then perhaps another provide long-distance service to those phones. Because of divestiture, phone service has become much more complicated, without becoming any noticeably cheaper. It's not what you can call a real success story for the court system that brought this about.

As part of the fallout of the divestiture case, entities such as high-rise offices or apartments and planned communities are now beginning to seek to resell local exchange services from SW Bell. The phone company, however, sees this as an infringement on its franchise, and with good reason. In such cases, the bulk of the revenue from these highly profitable groups of customers goes to the entity reselling the service. SW Bell stands to make little profit from the sale of service to individual big customers that then resell the service. All this amounts to skimming the "cream" off the top of providing that service. Ultimately that could leave SW Bell servicing only more remote and less profitable customers. As revenues then plummet, the costs of providing service to the remaining SW Bell customers then would increase.

Deregulation was supposed to be of some benefit to telephone users, but it is hard to see how it has done so, especially in this instance. If the question of the resale of services goes against SW Bell, the phone company will not be able to confidently plan for growth and eventually could be seriously hindered in its business operations. It is true that everyone complains about utility rates, but why an efficient, service-providing company such as SW Bell should be forced to the wall in the name of deregulation is really beyond us.

Let's hope the PSC reaffirms SW Bell's statewide franchise. We all stand to benefit. (G.A.)

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Dobie residents to testify against phone company

Second PUC hearing to be held in response to complaint

By CYNTHIA BRODT
Daily Texan Staff

After circulating two petitions complaining about telephone service provided by Travis Telecommunications, Dobie Center residents have been invited to testify at a second Public Utility Commission hearing at 9 a.m. Wednesday.

Approximately one third of Dobie's 900 residents signed a petition early in November complaining that Travis Telecommunications was billing users for services they never received and was monopolizing the residents' choices of telephone service.

Nathaniel Lack, liberal arts sophomore who helped circulate the petition, said he will act as a rebuttal witness at the PUC hearing Wednesday "against any questions that Travis answers that are partially or 100 percent incorrect."

Lack and Michael Winner, aerospace engineering freshman, testified at the first PUC hearing March

11 that service and billing problems persist and Travis monopolizes long-distance service.

"I still feel that they should withdraw a statement that was on their Travis Telecom phone service contract that says we are not permitted to use any other long-distance service," Winner testified March 11. "My complaint is that I have not yet been given any written assurance that that provision of the contract has been changed."

Southwestern Bell officials requested the commission bar Travis Telecommunications from signing new customers because the company is acting as a public utility rather than a public exchange when it sells local exchange services.

Jon Loehman, Southwestern Bell assistant vice president for rates and revenues, told the commission earlier that Travis discriminates against Bell by making it difficult for residents to use Bell services.

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Southwestern Bell faced with another telephone problem

It's not bad enough that we average Americans let the federal government split up the best telephone company in the world last January. Now, we're sitting idly by as the destruction of what's left of Southwestern Bell continues in the name of competition.

Not that most of us have anything against competition. But, when we allow a little competition into what was a non-competitive environment, you can bet your last penny (and you usually are) the competitors are only interested in serving the most profitable areas—not Helena and West Helena.

The latest example of this is now taking place in Little Rock, where large businesses such as the Southern Baptist Church and other real estate developers are asking the Arkansas Public Service Commission for permission to sell local telephone service within the building, development, or whatever.

In the language of telecommunications, it's called resale of local service or "Multi-Tenant Shared Services." The concept isn't bad at all if you're a tenant in one of those developments. But guess who gets hurt in the long run. That's right. The average Arkansan—the little guy, if you will—you must bear the burden of the cost in the form of higher rates for residential or small business telephone lines.

As customers of Southwestern Bell, it's time we quit being lazy and foolish when your interests are threatened and start listening to the telephone company when they tell us these things are happening. It's also time we told the Arkansas PSC to quit penalizing the telephone company in the name of consumerism and begin proving their interest in consumers by protecting the phone company for a chance from developments that will end up costing the consumer in the long run.

The final decision on the resale of local telephone service is still in the hands of the PSC. Let's hope they'll prevent this further attack on the local telephone system and tell the real estate developers to stay out of the telephone business, now and in the future.

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On the Road to Telephone Deregulation

By Commissioner DENNIS R. PATRICK*

In comments here a member of the Federal Communications Commission vigorously supports competition among providers of telecommunications services, but raises some questions as how best to ensure rational and nondiscriminatory regulatory treatment of competitors. The FCC in its movement toward deregulation of the interexchange market is wrestling with issues of equal access, market power, and universal service. This article suggests an analytical framework for evaluating some of the critical policy options presently under consideration by the commission.

THE telecommunications industry in the United States is well-embarked upon a new road at this time. It is the road to deregulation — a road upon which the industry still has a great distance to travel.

Even with the divestiture of large parts of the American Telephone and Telegraph Company now almost a year behind us, the industry and the Federal Communications Commission must still confront many critical issues. Their resolution will shape the structure of the industry into the twenty-first century. I reluctantly concede that it is still too early for definitive “answers” to many questions we face. It is *not* too early to articulate the issues, and to suggest an approach to analysis. That is the intention of this article.

Points of Consensus

I begin with some points of consensus. Most agree that where there appears to be no natural monopoly or, stated differently, where the market appears potentially competitive, decontrol should follow. This does not mean deregulation for deregulation's sake. For the interexchange market, I believe that there is no longer debate

*Adapted from remarks delivered to the Federal Communications Bar Association earlier this year.



Dennis R. Patrick was sworn in as a commissioner of the Federal Communications Commission in December, 1983, having previously (1981-83) served as associate director of presidential personnel at the White House, and then for a brief time as special assistant to the Administrator of the National Telecommunications and Information Administration at the Department of Commerce. Earlier he was in the private practice of law in Los Angeles. **Mr. Patrick** received his AB degree from Occidental College and his JD degree from the University of California at Los Angeles.

that the model best suited to further the public interest is competition. For this market, the debate is not whether, but when and how to deregulate.

Other points of consensus: That competition can flourish only on something called a “level playing field.” For interexchange services this will require at least three steps. First, we must have a nondiscriminatory, rational system of access charges. Second, there must be an equal access option for all service providers. Finally, the dual system of carrier regulation must eventually be eliminated. Most expect that this last step would be achieved through a phased transition keyed to dominant carriers' loss of market power. Most would also agree that during this transition period, the commission must avoid ad hoc decisions that could disrupt our long-term deregulatory goals. And all this must be achieved with no weakening of our commitment to universal service.

Issues

The same words used to frame the points of consensus can be used to frame the critical, but unresolved, issues. For example:

- 1) What we mean when we talk about: level playing field, or “equal access”?
- 2) How can we recognize the presence or absence of market power?
- 3) Given that the commission must make decisions as matters are presented to it, how can we avoid promulgating a patchwork of “ad hoc” decisions inconsistent with our long-term policy goals?
- 4) And, finally, how can we keep our commitment to universal service in a competitive market structure?

I will comment upon each of these issues in turn.

The “Level Playing Field”

There is agreement that the commission can facilitate

competition by providing for a level playing field. However, I never realized there were so many definitions of "level." Competitors invoke the term freely in defense of their regulatory proposals. Upon examination, some of these proposals look suspiciously "less than level." Indeed, some might bestow upon their proponents a competitive advantage. In my view, the concept of a level playing field cannot be used to justify imposing costs on all service providers to "even the score." Nor should it be used to justify handicapping any competitor merely because it enjoys economies of scale or scope.

In defining the level playing field, the commission must not lose sight of our ultimate policy goal: maximizing consumer welfare. To reach this goal, the commission must protect *competition*, not competitors. The level playing field is one on which all players enjoy an equal opportunity to succeed or to fail on their own merits. It is one in which there are no regulatory barriers to entry. The structure of the market will be a function of its inherent demand, cost, and technology characteristics. It will not depend upon micromanagement by the FCC. The level playing field will *not* be populated by any magic number of players which the FCC alone can divine. Nor will it be characterized by any preordained distribution of market shares. With a level playing field, it will be consumers, not the FCC, that determine which firms will succeed and which fail.

Let me comment briefly on the market share and market power dichotomy. Even AT&T concedes that its lack of market power is a precondition to full deregulation. The issue is: how do we recognize when that precondition is met? In the past, many have focused on market share as the barometer of market power. Today, most economists would say that a large market share is necessary, but not sufficient, to ensure market power. A firm with large market share lacks effective market power if an attempt to raise its prices either induces new competitive entries, or causes consumers to shift to alternative services. Therefore, focusing on market share alone will not give us an adequate view of the market. We cannot ignore supply elasticity, substitutable products, or entry conditions as factors that can significantly affect market power.

A service provider in a competitive market may achieve a large market share because of superior performance. In this case, it does not necessarily follow that traditional, rate base and rate of return regulation is called for. Such regulation might be a disincentive to the efficiencies which led to growth. The FCC should encourage such efficiencies so long as they are passed along to consumers. In sum, we must look beyond any simple assumptions that equate large market share with market power and imminent injury to the public interest. In the future, the commission will have to rely more upon economic analysis and closer monitoring of market characteristics. The recently created Industry Analysis Division in the commission's Common Carrier Bureau is an important step in that direction. The economic analysis provided by the Office of Plans and Policy will continue to be helpful.

As we make these attempts to analyze the market carefully, we must remember that commission action itself may inflate or deflate a competitor's market share. Regulation that imposes significantly greater costs on some competitors — but not on others — surely affects their respective market shares. Different treatment under the competitive carrier docket and the access charge plan are examples of regulation imposing different costs on various players in the market. Failure to recognize the impact of our continuing regulations could lead us to misjudge how competitive a market really is, absent regulatory intervention. Our misjudgment would become apparent only after decontrol, when the market returned to its natural equilibrium, undisturbed by our regulatory intervention.

As we move from regulation to deregulation, there is no easy answer to this analytic dilemma. But we should keep in mind three points:

- 1) All regulation imposes costs and, in some sense, distorts the market. We must remain cognizant of this simple fact as we attempt to discern the underlying state of the market.
- 2) The commission cannot create competition: the demand, supply, and cost characteristics that will support competition either exist or they do not at any given point in time; we assume they *do* exist in the interexchange market.
- 3) As such, the commission's movement toward deregulation should be characterized by policies designed to *allow* competition to flourish, not to *induce* or *create* that competition. In the final analysis, we cannot.

Equal Access

An essential precondition of competition in interexchange markets is equal access. The most recent modification to the FCC's access charge plan created a dual system of access charges to reflect the opportunity cost of the premium access denied the other common carriers (OCCs) before divestiture. The commission committed itself to the elimination of that dual system, with the advent of equal access. Under the modified access charge plan, as feature group D (FG D) would become available at a given end office, the rate differential — designed to reflect the *value* of premium access — would disappear. Implicit in that decision was the equation of FG D with equal access.

We have been called upon, once again, to review the plan by which we phase out the differential. And during that review we shall confront once again the issue of "what is equal access." Interested parties have been quick to provide their own definitions of this crucial concept. On the one hand, OCCs claim that "equal access" cannot become a reality until the equal access tandems are in place and FG D is more universally available. On the other hand, AT&T claims that, at least for terminating traffic, equal access is already here in the guise of now discounted FG B.

The access charge plan was last revised eight months

ago. With the additional insights gained since then, the commission will have to decide whether to revise it once again. I cannot predict what the decision will be. However, I believe it must send a clear signal that while the commission is sensitive to the fact that equal access is essential to fair competition, the commission also remains committed to eliminating any differential not related to the opportunity cost of premium interconnection.

The commission's response to the question "what is equal access," will have both short- and long-term significance. In the immediate future, the definition of equal access will determine the relative cost to AT&T and its competitors of local access. In the long term, how we define equal access will be crucial to the timing of any action to deregulate AT&T. Achievement of equal access will bring competitors significantly closer to the ideal of a playing field kept level by market forces and not by regulatory intervention.

Ad Hoc-ism

This term is much abused. The industry and bar alike use "ad hoc" to describe decisions they do not like. Favorable decisions are more often called "wise policy." Beyond semantics, there is a lesson in the concept of ad hoc-ism. An ad hoc decision is action taken in an individual matter without reasonable thought being given to its effect on overall policy objectives. Ad hoc-ism, in this sense, will keep us from reaching our long-term objectives. Decisions in individual cases should flow logically from the decisions reached in broad rule-making proceedings. Policy — at least anything deserving of, the name — cannot be made ad hoc.

We must recognize, however, that the essentially static telecommunications market of the past is long gone — replaced by a dynamic, rapidly changing market. Time is no longer on our side. The market will not wait and the administrative process requires decisions as matters are presented. When problems arise we must act — and act promptly. If these decisions are consistent with integrated, long-term policy goals, then those goals will be realized, albeit incrementally, on a case-by-case basis.

Universal Service

Thus far readers might reasonably conclude that I entertain a strong presumption that market forces can best shape the interexchange market. And they would be correct. Nonetheless, I believe that where the body politic has consciously articulated a social policy goal, and where that goal would not be sufficiently accommodated by the market, that regulatory intervention, is justified. The best example of such a social policy is universal service. Today, access to telephone service is viewed as a necessity. Congress and the commission both recognize a duty to protect universal service.

As I have already noted, because the market for interexchange services is not a natural monopoly, competi-

tion is the market structure that will give the public the greatest variety of services at the lowest price. Thus, market forces will promote consumer welfare *generally*. But, the market will not ensure universal service because, if unrestrained, competition will drive prices to costs and eliminate cross subsidies. Some form of subsidy is necessary to protect universal service.

Currently, we rely upon an elaborate system of subsidies that is too costly, untargeted, inequitable, and an invitation to uneconomic bypass. The system is too costly because it subsidizes telephone service for those who can afford to pay. It is untargeted because it is tied to a telephone company's traffic patterns. Traffic patterns have nothing to do with a customer's ability to pay, or the cost of local service in that customer's service area. Both of these flaws also make the current system inequitable and extend an invitation to bypass.

In an ideal world, since the body politic has found universal service to be a social necessity, the subsidy to support it would be funded through the general budget. It would go directly to the persons unable to pay the costs of service in their service area. Such an arrangement would eliminate the need for any cross subsidies within the telephone price structure.

Obviously, such an arrangement would require legislative action. Absent such action, the joint board and the commission will use the tools they have to protect universal service. Certain principles should guide these efforts: First, we should insist that the subsidy we create to protect universal service is no greater than is absolutely needed to achieve our goal. The subsidy should be open, and direct, rather than hidden, and it should be narrowly targeted. The joint board is now working toward this goal and will present its recommendations to us later this fall. The commission must also at least consider expanding the base of users who will support the subsidy. If the customer base from which the subsidy comes is expanded to include customers other than message toll service and wide area telephone service users, the burden on any single customer is reduced. This in turn reduces that customer's incentive to consider alternatives to use of the public switched network.

The commission should continue to encourage competition wherever there is no natural monopoly. This means proceeding without delay down the road to deregulation of the interexchange market. There are some hard decisions remaining to be made before we complete our journey on that road. I have discussed some of these decisions here.

The harsh truth is that not all may survive the journey to a market structure uncushioned by regulatory intervention. That is the risk, however, that all run in a truly competitive market. I salute those who will finish the journey. They will have avoided the dungeons, slain the dragons, and their reward will be participation in a robust competition. The real winner, however, will be the American public. The public will enjoy the new and improved services, at lower prices, that I am confident competition will bring.

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THE PUSH TO 'BYPASS' LOCAL TELEPHONE COMPANIES

Striding to his window overlooking downtown Manhattan, Richard F. Morrison, director of information systems for Shearson Lehman/American Express Inc., gestures to nearby rooftops. On top of several skyscrapers perch the semispherical shapes of microwave and satellite dishes, silently carrying voice and data traffic to and from New York's financial center. "You want to see bypass?" he asks. "There's bypass. And there. And there. Everybody's doing it."

To most people, "bypass" conjures up images of heart surgery. But to the telecommunications industry, it refers to the growing number of ways that big businesses, real estate entrepreneurs, and long-distance carriers are bypassing local phone company networks by using alternative communications links. The driving force is lower cost: Users find they can cut their phone bills by exploiting new technology and the subsidy-ridden system of phone pricing left over from the days of a monopoly American Telephone & Telegraph Co. Even AT&T, which eight months ago owned more than 80% of all U.S. local phone networks, is now aggressively trying to bypass its former offspring by going directly to major customers.

This practice has fueled a firestorm of

controversy: Local phone companies say they are losing millions in revenues to people who are violating what is supposed to be their exclusive franchise, while the International Communications Assn., a group of corporate users, says the phone companies are exaggerating the problem to gain regulatory advantages. Whatever the merits, if bypass becomes commonplace, residential phone rates could skyrocket as consumers bear more of the costs of existing plant. Warns Mark S. Fowler, chairman of the Federal Communications Commission: "Bypass is the greatest threat to affordable telephone service."

NEW ENVIRONMENT. At the heart of the controversy lies the time-honored goal of U.S. telephone policy—universal service. For years local telephone companies charged long-distance customers and big businesses far more than the cost of providing them service—to keep local rates low and ensure that phone service was available to all. In New York, for instance, residential customers pay \$7 to \$8 a month in fixed fees, about one-third of what it costs New York Telephone Co. to provide them service. That formula worked fine in a monopoly environment. But once inexpensive alternatives to the phone company's copper wire became widely available, the closed system

of subsidies began to leak like a sieve.

The most common form of bypass systems now are corporate-owned communications hookups, using private microwave towers or two-way cable TV lines leased from cable companies. Eastern Management Group, a New Jersey market researcher, found that 31% of the 500 largest U.S. corporations are using some form of bypass and that an additional 13% expect to do so by 1987. New York Telephone claims bypass costs it almost \$200 million in forgone revenues last year. Others estimate similar losses. But these figures are difficult to verify, because nobody knows how much traffic travels over private systems.

Why do big users want their own communications systems? To begin with, most say that local phone companies are often unable to fill their specialized needs, such as high-speed computer data links. But the low cost of new technologies such as microwave radio, combined with the tax advantages companies can derive from depreciating their own equipment, makes setting up a private link almost irresistible. Shearson's Morrison figures he can pay back the cost of a building-to-building system in as little as six months.

Still, most observers do not see these private corporate systems as a long-term

THREE WAYS TO GET AROUND LOCAL PHONE NETWORKS

Carrier bypass: Using their own local lines, AT&T and other long-distance carriers link up directly to major customers from long-distance switching centers.

Private bypass: Employing such methods as microwave, radio signals from rooftop antennas, big companies set up direct, building-to-building hookups.

Teleports: Private fiber-optic hookups feed voice and data traffic from major companies to these groups of satellite dishes located outside major cities.



threat to local phone companies. For one thing, most big users would prefer not to have to cope with the intricacies of running a communications system. "You take over all the technical jobs that the phone company would have done for you," warns S. I. Gilman, executive director of information resources management at Ford Motor Co., which has no bypass facilities. And while almost all private bypass systems go just from point to point, the phone companies' major business is carrying traffic that goes through a switched network, where one caller can reach anyone else by going through a central telephone office.

Company-owned communications systems are just the tip of the bypass iceberg, however. Numerous other ways to skirt the local phone charges are cropping up all over the country:

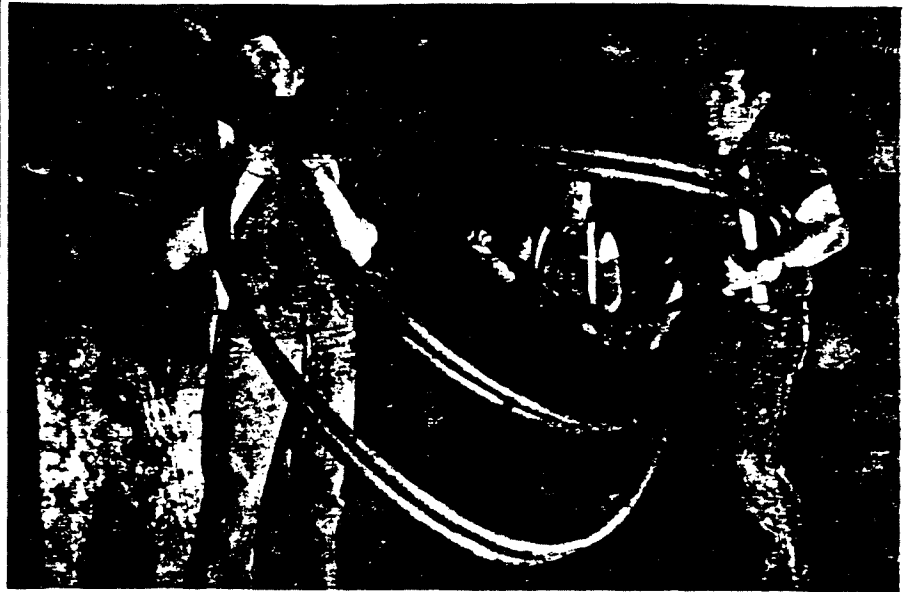
□ **"Intelligent" buildings.** Growing numbers of real estate entrepreneurs are designing buildings with built-in communications facilities. They then resell long-distance service to tenants, usually making the connection via a rooftop satellite dish. Because this traffic would normally go through local phone lines, the practice costs the local phone company revenues.

□ **"Leaky PBXs."** Using private lines leased from long-distance carriers, long-distance calls can be sent into a building through its private branch exchange (PBX) and routed into the local network as if they were regular local calls. Because private-line rates do not include any charges for the local phone company's fixed plant, these calls do not pay their share of the local network's costs.

□ **Teleports.** Most of these "satellite farms" are still on the drawing boards, but when they are built they will suck up lucrative data and voice traffic from major customers. Communications will be sent over a fiber-optic link from a customer directly to the teleport, and from there they will travel via satellite to another teleport or private satellite antenna.

□ **Carrier bypass.** AT&T and its long-distance rivals are making moves to bypass local networks, routing calls directly to customers instead of first going through the local phone company's lines.

This last bypass method poses perhaps the most serious threat of all to the local phone companies. They can ill afford to lose any part of the payments from long-distance carriers, which account for about one-third of the typical local company's revenue base. Arthur L. Harper, an assistant vice-president at New York Telephone, estimates that it costs his company about 3¢ a minute to carry a long-distance call to AT&T's network, but AT&T pays it about 9¢ a minute for the connection. "Long distance is rapidly becoming a competitive market,"



LAYING CABLE UNDER THE HUDSON RIVER: 38.8 BILLION BITS OF DATA PER SECOND

TELEPORTS: GIANT BYPASSES FOR BIG-CITY MARKETS

Deep inside a train tunnel under the Hudson River, a crew of men works all night to splice segments of a fiber-optic communications cable. When completed, the cable will carry 38.8 billion bits of data per second—the equivalent of 300,000 simultaneous phone conversations—between downtown Manhattan and the New York Teleport, a planned satellite communications center just a few miles away on Staten Island. And because the teleport is being built by Merrill Lynch, Western Union, and the Port Authority of New York & New Jersey, none of the millions of dollars worth of traffic will flow through New York Telephone Co. lines.

A creature of telephone deregulation, new technology, and the high cost of phone service, teleports are springing up in many major cities. The idea is to bundle enough long-distance voice, data, and video traffic to justify building a set of big dish antennas on one site to get bulk discounts on satellite circuits—providing communications gateways to metropolitan areas much the way an airport or railroad station serves transportation.

FIGHTING BACK. So far, more than 20 major teleport projects have been announced, including sites in or near San Francisco, Houston, San Antonio, Seattle, and Columbus, Ohio. Only one is operating, near Chicago. But by mid-1985, several other teleports should be working—and offering discounts of 20% to 50% on long-distance rates.

"The top 50 markets will have teleports within 10 years," says Andy Lagueruela, chairman of Sateco, a partner in San Antonio's proposed teleport.

These satellite antenna farms do not have to bypass the phone lines and switching centers of local phone companies. They could, in theory, use the local phone company's network, ensuring that it would still get the "first-mile, last-mile" revenues of hauling traffic to and from the teleport. But in most cases, teleport promoters plan to install their own microwave or fiber-optic links to business districts. That would allow a direct tie-in to the switchboards of corporations and "intelligent" buildings. Phone companies find the prospect unsettling. "If a teleport makes an entry right downtown, then we would be head-to-head," says Charles E. Foster, a vice-president at Southwestern Bell Telephone Co.

To fight back, phone companies are pressing state regulators to enforce local network franchise rights and allow them to offer cut-rate business service. Others may follow the lead of Ohio Bell Telephone Co., which paid \$250,000 for a 20% equity stake in the Columbus teleport, in the hope of positioning itself to provide local links for the dish farm. Its equity position seems to have quieted phone company fears that the teleport would cost it revenues. "Suddenly," says Dale K. Ourts, general manager of the Ohio Teleport Corp., "there is no talk of bypass or other things that had bogged us down."

says Harper. "If bypass is an effective cost-reduction tool, the carriers are going to take advantage of it."

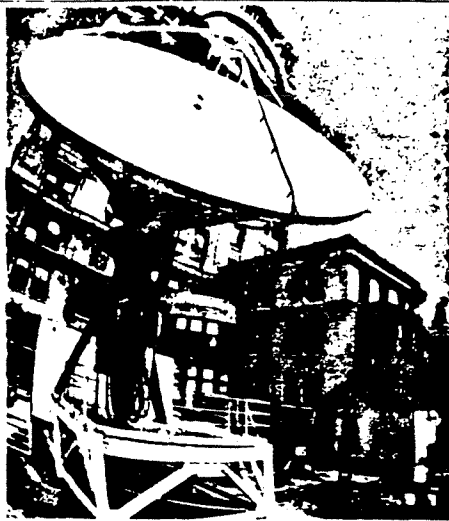
MCI Communications Corp. is already bypassing, using two-way cable TV lines to allow its customers in such cities as Atlanta and Omaha to send calls directly to a local MCI switching center. MCI has also won licenses in 46 cities to offer a new system, called digital termination service (DTS), which will deliver data traffic from customers at very high speeds directly to its long-distance network. "We're going to get to our customers any way we can," vows H. Brian Thompson, MCI senior vice-president. "We'll go by carrier pigeon if we have to."

Even more worrisome to local phone companies is the potential impact of bypass by AT&T, which carries about 90% of long-distance calls. The company has already asked the FCC for permission to hook up directly to customers (unlike MCI and the other discount carriers, AT&T must file with the FCC before it takes most actions). Although its filing was thrown out for unrelated reasons, AT&T says it will file again. The current laissez-faire FCC just might concur. "From our standpoint, anybody has the right to bypass," says Jerald N. Fritz, chief of the FCC's Tariff Div. "But there are important policy issues, which have to be addressed before it becomes widespread," he adds.

REACHING OUT. If the FCC approves, AT&T expects to start servicing customers directly "within a year," says Richard L. Snowden, director of services conception at AT&T Communications. "We've had over 50 inquiries from major customers," asking about direct hookups, he adds. "We would prefer not to follow that course, but we cannot put ourselves in the position of losing customers."

Although AT&T says it will connect only customers who provide their own lines, observers believe it will soon begin to reach out to customers with its own local links. If true, AT&T might charge rates far below those of the local phone companies just to attract more long-distance traffic. "AT&T could run a fiber-optic cable down the center of a busy downtown street, tap in customers off it, and charge practically zero," hypothesizes John F. Malone, president of Eastern Management Group.

What local phone companies have to figure out is how to battle what they call the "bypass threat." Ironically, some are involved in bypass-type enterprises themselves. Bell Atlantic Corp. is building DTS microwave systems in Richmond and Norfolk, Va. Ameritech has a joint venture to service intelligent buildings. If tenants request a microwave system to connect their building with another,



PRIVATE SATELLITE DISHES SIPHON REVENUES FROM THE LOCAL NETWORKS

Ameritech just might comply. "If we don't, someone else will," says James J. Howard, Ameritech president.

A more sensible course, all agree, is to try to change the rate structure. Some state utility commissions are already moving on the issue. Illinois Bell Telephone Co. is now allowed to charge rural and suburban customers more than Chicago customers, who cost less to serve. And the California Public Utilities Commission is considering banning intrastate carrier bypass altogether. "It's an extreme act," acknowledges Commissioner Victor Calvo. "But it might be taken if it looks like Bell will lose significant amounts of revenue by bypass."

Across the country, phone companies are also winning the right to supply fiber-optic lines and other high-tech services at cost, helping them compete with microwave suppliers and cable compa-

nies for corporate orders. BellSouth is marketing a microwave system for data communications in Birmingham, Ala., which the company is free to price against the competition. Southwestern Bell Corp. has filed for similar pricing moves in all five of the states it serves. **SURCHARGES.** The FCC has also been reducing the long-distance subsidy to the local networks, replacing it with direct payments by customers to local companies. The goal: to bring the local part of long-distance prices down to cost, thus discouraging carrier bypass. In late May the commission put into effect so-called access charges on multiline business customers that range up to \$6 per line per month. It also reduced the amount AT&T must pay to local phone companies by 8.5%—and lowered AT&T's long-distance rates by 6.1%. And on Aug. 10 the FCC approved a \$25 monthly surcharge for each private line leased by companies to tap into long-distance networks. This should generate \$240 million a year for local phone companies to help offset revenues lost through leaky PBXs.

The debate engulfing the industry now is how quickly these reforms should be phased in—and how far they should go. Most phone companies argue that they should be allowed to price all services according to costs, as soon as possible. Consumer groups counter that the phone companies are trying to destroy what has become an almost inalienable right—access to phone service for everyone. But almost everyone agrees, in private, that a slow, steady move toward change is the most preferable. Says John L. Clendenin, chairman of BellSouth Corp.: "If you try to rush it through, you'll cause unnecessary political and social turmoil." ■

PHONE WATCH

THE FCC GIVES SATELLITE SERVICES SPACE TO OPERATE . . .

Domestic satellite service, nurtured for more than a decade by federal regulators, has come of age. The Federal Communications Commission decided on Aug. 8 that the market had grown competitive enough to allow carriers to raise or lower prices and offer new services or drop old ones, all without asking FCC approval. The move will give new flexibility to such companies as Satellite Business Systems, BCA American Communications, and Western Union. But observers say the action will have little immediate effect on the industry, which has emerged from an infancy marked by a shortage of channel capacity to become one of the

most competitive parts of the communications business.

. . . AND RECONSIDERS ONE OF AT&T'S COMPLAINTS

Because of the uncertainties of its newly deregulated marketplace, American Telephone & Telegraph Co. has argued that it should be treated differently from its former local phone companies. AT&T has complained about the cap on its rate of return on long distance at the same 12.75% accorded its former operating companies, even though AT&T faces stiff competition and the local companies continue as monopolies. On Aug. 8, the FCC decided to examine the issue, and observers say the agency may set separate rates for AT&T and its progeny.

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THIS guest editorial is adapted from a presentation made by John E. Hayes, Southwestern Bell Telephone Co.'s vice president-revenues and public affairs, at a recent seminar in Washington, sponsored by Law and Business and the Legal Times. Hayes explains the reasons why Southwestern Bell is petitioning the state regulators to clarify the meaning of the company's franchises.—Ed.

JOHN HAYES

GUEST EDITORIAL

WHAT'S AT stake is a clarification of the *obligations* or *duties* to provide service to any customer who requests it—an obligation that goes hand-in-hand with the *right* to be the sole provider. More and more companies want to resell local telephone service. Developers, universities, hospitals, corporations and government agencies are putting in systems to resell local exchange service, bypass private lines or bypass the local exchange network entirely. As the authorized sole supplier in an area, however, Southwestern Bell Telephone is charged with the obligation of providing exchange service to anyone, on a timely basis, anywhere in our certificated area. We can't pick and choose our customers as can would-be vest pocket exchange suppliers who intend to serve only lucrative customers.

As a result, the company plans and designs its network years in advance to have facilities in place when customers request service. The company's investment in millions of dollars of plant is an obligation mandated by our exclusive certificated franchise.

The company's concern is with the entry of non-certificated providers who make duplicate and alternative arrangements to the exchange network.

That network was placed with the clear understanding that we had both the right and duty to provide exchange service to all customers who were situated in our authorized territory.

If Southwestern Bell Telephone must continue to be responsible for providing local exchange service to new customers, without the corresponding right to be the exclusive provider of such service within our territory, then either wasteful duplication of new or additional facilities or delays in installation of service are inevitable results. □

WIFT
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July 19, 1985

Hon. Jim Slattery
U.S. House of Representatives
Washington, D. C. 20515

Dear Jim:

During mark-up of the cable bill last year, many of us were concerned that special treatment for cable companies offering non-cable services--special protection not given to anyone else--would drive up local phone rates by creating an unlevel playing field.


The FCC now plans to do--by administrative fiat--what Congress rejected just last year.

The issue is this: State regulators are charged with assuring that everyone has access to telecommunication service, that rates are fair and reasonable, and that there's no discrimination in providing service. Everyone plays by the same rules. But, if cable operators get the protection they seek, they'll serve only the lucrative customers, not everyone, while phone companies, stuck with serving everyone, will lose significant revenues. State regulators will have their hands tied and have no choice but to raise rates for others.

That's cream-skimming. And there's no reason for it. No state should be forced to allow it, and we rejected that approach just last year.

Although the FCC's record on this closed 14 months before the Cable Policy bill was enacted, the Commission plans to make this change August 7th. I hope you will join me in stopping this abuse of agency discretion and sign the enclosed letter to the Commission.

Sincerely,


A. Swift
Member of CongressAS/SJ
Enclosure

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July 19, 1985

Chairman Mark S. Fowler
Federal Communications Commission
1919 M Street N.W.
Washington, DC 20554

Dear Chairman Fowler:

Our concern with preserving affordable telephone service is well known to you and other Commissioners. In light of your staff's comments that the "cable industry will be very gratified" with the disposition of the Cox Cable decision, you should be aware of our concerns in adopting certain changes in the Cable Communications Policy Act, P.L. 98-549. Specifically, Congress rejected a course that is now--apparently--being pursued by the Commission.

As you will recall, the Senate bill mandated no regulation--state or federal--of such services as data, private line, and voice traffic, if offered over cable even though they would clearly be subject to regulation if offered by anyone else. Had these provisions been adopted, others would have been at a significant competitive disadvantage. The House report states:

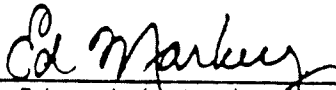
Local telephone companies are obliged to serve all customers indifferently, at prices approved by regulatory authorities. If at the same time cable companies were to be permitted to offer communications services comparable to those offered by telephone companies, but only to a few subscribers at unregulated prices, competition between cable companies and telephone companies might not be fair. ... [That] could create a revenue loss that must be recovered by higher local rates ... [which] could threaten universal service as the poor and elderly are forced to drop off the local network. ... In 1983 the Nebraska Public Service Commission asserted regulatory authority over Comline, the institutional network of Cox Cable Communications, Inc., in Omaha, Nebraska. Cox Cable has requested the FCC to preempt any state regulation of Comline. (In the Matter of Cox Cable Communications, Inc., Comline, Inc., and Cox DTS, Inc. (CCB-DFD-83-1)). ... [The bill] maintains existing authority over all communications services offered by a cable system, including the lucrative private line voice and data transmission services that could compete with communications services offered by telephone companies. [It] preserves the

regulatory and jurisdictional status quo with respect to non-cable communications services. ... [This approach] reserve[s] for state and Federal officials the authority they need to address the issue of competition between telephone and cable companies and the need to preserve universal telephone service.

In short, the Senate bill was grossly unfair to the telephone industry. This was changed by an amendment offered by Congressman Swift, and it was in this form that the bill was signed into law. In the only relevant Senate commentary on the changes, then-Chairman Packwood stated, "In all other respects, the Senate adopts the House provisions." The committee report states clearly that this definition of cable service was intended to "mark the boundary" between cable services (not regulated) and non-cable services (subject to regulation).

Federal preemption would have created an unlevel playing field and, instead, Congress preserved the status quo balance between federal and state authorities. This traditional balance--intrinsic in the federal system and recognized clearly in Section 2(b) of the Communications Act--is needed to address the issue of fair competition and to preserve universal, affordable telephone service. The Commission should not do, by regulation, what Congress specifically rejected just a few short months ago.

Sincerely,



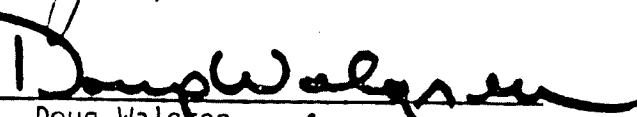
Edward J. Markey




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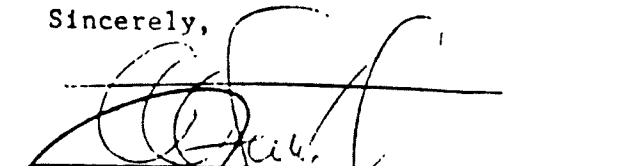
John Bryant



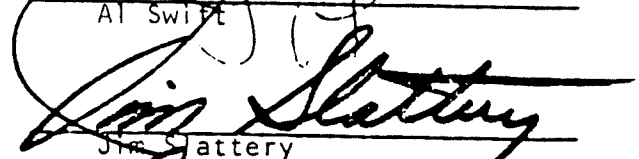
Doug Walgren



Don Ritter




Al Swift



Jim Slattery



Gerry Sikorski



Dennis E. Eckart



Matthew J. Rinaldo