DIVESTITURE PLUS EIGHT:

THE RECORD OF BELL COMPANY ABUSES SINCE
THE BREAK-UP OF AT&T

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DIRECTOR OF RESEARCH

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EXECUTIVE SUMMARY

I. BACKGROUND

Almost eight years after the break-up of AT&T, the world of telecommunications has been turned topsy-turvy again by a federal court decision. Despite the Bell companies' history of anti-competitive practices and consumer abuses, the courts are allowing the companies to expand their local phone monopolies into the electronic information business.

The dangers associated with Bell company entry into information services are clearly demonstrated by their behavior over the last eight years (see Table 1). Even with supposedly thorough regulation and limitations on their commercial activities, the Bells have developed a track record of inflating basic telephone rates, discriminating against potential competitors and abusing the rights of consumers who are dependent upon the Bell's local monopolies.

This report discusses in detail the various types and numerous cases of abusive behavior of the seven Regional Bell Operating Companies (RBOCs) since divestiture. Unless Congress steps in, consumers' local telephone rates are likely to remain inflated and rise inappropriately, as the Bell Companies extend their monolithic control over local phone service to the information world. Legislation, like H.R. 3515, the Telecommunications Act of 1991, and S. 2112, The Information Services Diversity Act of 1991, would limit the Bell companies' propensities and opportunities to engage in these abuses.

ES-1
### Table ES-1: Examples of Telephone Company Abuse Since Divestiture

#### Abuse of Ratepayers

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#### Abuse of Competitors

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<td>Violation of the MFJ</td>
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#### Abuse of Consumers

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II. ABUSE OF RATEPAYERS

A. EXCESSIVE RATES AND CHARGES

This report estimates that since the break-up of the AT&T monopoly, the RBOCs have overcharged customers by approximately $30 billion in the form of excessive earnings and inappropriate expenses. These excesses have been funneled into the acquisition of over $20 billion in unregulated assets -- everything from real estate to foreign exchange deals -- and the pay out of over $10 billion in excess dividends. All of the RBOCs have diverted large sums of resources in this manner.

A comparison between American and foreign telephone companies highlights the abusive nature of these excesses. For example, the RBOCs spend one-fourth of their cash flow on dividends and one-fifth on the acquisition of unregulated entities, while their Japanese telephone industry counterparts (whose modernization plans are frequently praised by the RBOCs) devote only one-twentieth of their cash flow to these non-telecommunications activities.

In the past several years regulators have ordered rate reductions of over three-quarters of a billion dollars, but rates are still much too high -- we estimate over $4 billion per year. Moreover, telephone companies are making a strong push to reduce or eliminate the power of regulators to continue to lower rates when company earnings are too high.

B. GOLD PLATING

In the name of modernizing telecommunications, the RBOCs can make ratepayers foot the bill for a truly extravagant overbuilding of the network. They can absorb excess earnings by increasing costs (i.e. accelerating depreciation) or offering to use excess earnings to upgrade the network, rather than lower rate-payer bills.

In Florida over $100 million has been earmarked for accelerated deployment of fiber optic transmission lines, without any projected need on the part of telecommunications users. Similar proposals have been adopted in Tennessee and pushed in a number of other states including New Jersey, Georgia, and Maryland.

At least four of the RBOCs have come forward with such proposals. A nation-wide deployment of fiber on this accelerated path could require over $200 billion in capital outlays, resulting in an increase in telephone bills of over $400 billion.
C. MISALLOCATION OF COSTS/PROFITS

The Bell companies can charge costs to the wrong services and misallocate profits of regulated services. As a result, the regulation of their monopolies is undermined.

Regulators in 19 states have accused the Bells of allocating Yellow Pages advertising profits to out-of-state subsidiaries rather than using those revenues to keep local rates down. The creation of complex holding company structures that cut across state lines makes the job of regulators in policing cost and profit allocation impossible.

Virtually all of the RBOCs have engaged in this activity.

D. DIVERSION OF EFFORT

With hundreds of unregulated subsidiaries and tens of billions of dollars funneled into these unregulated entities, Judge Greene summarized a deep concern among consumers as follows: "an observer might well be justified in concluding that the participation of the Regional Companies in these far flung enterprises is bound to diminish their managements' interest in and attention to the local telephone business."

As noted, the RBOCs have acquired over $20 billion of such assets and these are now approaching one-third of all Regional Bell Holding Company assets. All of the Bell companies have large unregulated investments.

E. ABUSE OF POLITICAL PROCESS

As a franchise monopoly, local exchange companies have a great deal of leverage both for raising resources and applying political pressure. This power has been repeatedly abused. The companies have used rate-payer funds for lobbying, used company facilities to intimidate legislators and regulators, and manipulated economic development investment proposals to win political favor.

The most recent and blatant abuse of monopoly power for political purposes occurred in Michigan. The local Bell company analyzed billing records to identify certain customers and supplied the list to a telemarketing firm. That firm called the subscribers, lobbied them about pending legislation, and offered to connect them, toll free, with state legislators.

At least five of the RBOCS have engaged in this type of activity.
III. ABUSE OF COMPETITORS

A. CROSS-SUBSIDY

The Bell companies can load the costs of competitive services onto local rates, achieving high profits on their unregulated activities and ultimately undercutting competition. Their complex organizational structures make it difficult for regulators to detect problems.

In the most notable case of cross-subsidy, NYNEX boosted its unregulated profits by having its New York Telephone subsidiary purchase overpriced services and equipment from an unregulated affiliate, Material Enterprises Company (MECO). The practice persisted for several years before a whistleblower and an investigative reporter prompted regulators to take a look at the transactions. Over $100 million was identified as inappropriate cost shifting.

At least five of the RBOCs have engaged in this activity.

B. DENIAL/DELAY OF ACCESS

Because the Bell companies control access to the network they can undermine competition by setting the terms and conditions of access or by withholding technologies until the timing suits their marketing plans.

In one of the most extensively documented cases, the Georgia Public Utility Commission found that Southern Bell had undermined its competition in the voice messaging (VMS) market by favoring its own service (MemoryCall), by setting up technical barriers to competitors and withholding network changes from competitors until Southern Bell was prepared to roll out its own service. As the Georgia Public Service Commission put it, Southern Bell sought to "defeat competition in the VMS market through its influence on whether, how and when competitors can access the local network."

At least five of the regional Bell companies have engaged in such activities.

C. PRICE DISCRIMINATION

The Bell companies can undermine competitors by offering their own subsidiaries favorable terms, or forcing competitors to buy bundles of services that include elements they do not need or could provide more cheaply on their own.

In one celebrated case, which resulted in a ten million
dollar fine, U.S. West charged its affiliate less for access than it charged its competitors and bundled trunk lines at no charge for its affiliate, while the competitors were forced to pay for these services.

At least five of the RBOCs have engaged in such activities.

D. ABUSE OF MARKETING INFORMATION

As the franchise monopolist, the local exchange company is given a preferred position vis-a-vis the consumer. All consumers must go to the monopoly for local service, placing a great deal of information and power in the hands of the local company. It is virtually impossible to prevent the companies from using and abusing these data to advance their own interests and defeat their competitors.

In a number of instances they used customer billing information to identify optimal prospects and then marketed regulated and unregulated service to such persons, even though these customer were only seeking local monopoly services. In Georgia the Bell company went much further. When customers sought to initiate service with a competitor, Southern Bell attempted to divert them to its own subsidiary. In essence, the local company would seek to steal a competitor's business while providing monopoly franchise services without which the competitor could not function.

At least two of the RBOCs have engaged in these activities.

IV. ABUSE OF CONSUMERS

A. FRAUDULENT MARKETING

Because the local companies sell a monopoly franchise service, they can easily influence demand for add on services. The RBOCs have ruthlessly exploited this advantage.

In a number of cases, simple deceit was used. When asking about basic local service, callers were told that a service representative would plan their service. Absolutely no such planning took place. Instead, every potential customer was told to take the same package -- which included all the services that the companies wanted to sell -- regardless of their circumstances.

The entire charade was carefully planned by the companies to maximize sales. Service representatives were trained in the deceit, given scripts and other sales aids, and given incentives to oversell services. The pressures on them were so great that
some engaged in fraudulent recording of services requested. With complex and ambiguous telephone bills, many consumers paid for services they did not want and never requested.

Over $50 million in fines were paid by three RBOCs when these abuses were uncovered.

B. DISTORTION OF DEMAND

A much more common practice is for the Bell companies to use misinformation, hard-sell, pressure tactics and fear campaigns to increase consumption of services. For example, the Bells have misrepresented the responsibility for and value of inside wire maintenance and in some states negative check-offs are used, all resulting in vast over-consumption of services.

C. DISTORTION OF SUPPLY

Where local companies control the network, they can offer services that they think will maximize their income at public expense. They can prevent lower cost or better services from reaching the market.

In the case of Custom Local Area Signaling Services (CLASS), the companies aggressively marketed Caller ID, while they impeded Automatic Call Trace. Automatic Call Trace is a tremendous advance on traditional trap-and-trace services, which were provided free of charge to help prevent abuse of the network. Rather than make Automatic Call Trace available in the same manner as traditional trap and trace, the companies have overpriced Automatic Call Trace, failed to advertise it, or, in some cases, refused to offer it altogether, while aggressively marketed Caller ID as a solution to the annoyance call problem. Since the local company controls the call connection, competitors cannot offer an alternative call trace service.

At least four of the RBOCs have taken this anti-consumer approach in the marketing of CLASS services.

D. IMPROPER SERVICE

As regulated franchise monopolists who are not subject to the rigors of competition in the delivery of local services, the RBOCs have been subject to reporting requirements to monitor the quality of service and the development of the network. Southern Bell is under investigation for falsifying quality control data.
V. POLICY IMPLICATIONS

This eight-year record of Bell Company abuses makes it clear that consumers face inflated basic telephone rates and anti-consumer, anti-competitive monopolistic behavior in the electronic information market unless Congress steps in. Legislation like H.R. 3515 and S.2112 is essential to preserve affordable basic service and promote competition in the information services market. At the same time, vigorous action is necessary at the state level to restore adequate regulatory oversight of local exchange company rates, investment planning, business practices and marketing techniques.
I. INTRODUCTION

A. THE ENDURING PROBLEM OF MONOPOLY POWER IN THE LOCAL EXCHANGE COMPANY

Almost eight years after the break up of AT&T, the world of telecommunications has been turned topsy-turvy again by a federal court decision. Disregarding the Bell history of anti-competitive practices and consumer abuses, the courts have allowed the Bell companies to expand their local phone monopolies into the electronic information business. Consumers now run the risk of experiencing vastly inflated local phone rates and monopoly control over the infant, electronic information market.

The dangers associated with Bell company entry into information services are clearly demonstrated by their behavior over the last eight years (as documented by the examples in Table 1). Despite supposedly thorough regulation and limitations on their commercial activities, the Bells have a track record of inflating basic telephone rates, discriminating against potential competitors and abusing the rights of consumers who are dependent on the Bell's local monopolies. Recent experience shows that the Bell companies have the incentive, the desire and the ability -- despite regulation -- to harm consumers and competition when their local monopolies are allowed to engage in more competitive activities (like information services, manufacturing and provision of interstate long distance services).

Unless Congress steps in, consumers' local telephone rates are likely to remain inflated and rise inappropriately, as the Bells extend their monolithic control over local phone service to the information world. Legislation, like H.R. 3515, the Telecommunications Act of 1991,2 and S. 2112, The Information Services Diversity Act of 1991,3 can limit the Bell companies' propensities and opportunities to engage in these abuses. Legislation is needed to:

0 prevent the Bell telephone companies from expanding their local transmission monopolies into previously competitive information businesses;

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2. Introduced by Reps. Cooper (D-TX), Bliley (R-VA), Synar (D-OK), Schaefer (R-CO), and Bryant (D-TX).

TABLE 1:
EXAMPLES OF TELEPHONE COMPANY ABUSE SINCE DIVESTITURE

ABUSE OF RATEPAYERS

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<th><strong>EXCESS PROFITS</strong></th>
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<td><strong>SEVERAL COMPANIES</strong></td>
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ABUSE OF POLITICAL PROCESS

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SOURCES AND NOTES:

(1) In 1989 and 1990 almost three-quarters of a billion dollars in excess charges were identified by Commissions. See Communications Daily, January 4, 1989; Communications Week, March 6, November 6, December 18, 1989, March 19, 1990; State Telecommunications Report, November 15, 1990.

(2) Judge Greene identified this problem soon after divestiture, Opinion, United States of America v. Western Electric, Inc., et. al., Civil Action No. 82-0192, September 1, 1987, (p. 27, 158) (hereafter Opinion).

(3) Video, Contel, FCC File, No. W-P-C-6575.


(8) Yellow Pages, Advice to the Court by Western Conference of Public Service Commissioners, Civil Action No. 82-0192 (HHG), U.S. District Court, D.C. October 23, 1989. See Oregon PUC press release, December 29, 1989.

(9) See, for example, the Testimony of Richard Gable In the Matter of the Application of Southwestern Bell Telephone Company for Approval of Telestate/21, A Proposal for Rate Stability, Network Modernization, and Price Regulation before the Corporation Commission of the State of Oklahoma, Cause No. PUD 000837.

(11) Telecommunications Reports, March 27, 1989.

(12) In Opinion, United States of America v. Western Electric Inc., et al., September 10, 1987, Harold Greene, p. 161, identifies a series of additional instances of political coercion, including offers of development funds and decisions about where to locate facilities.


(14) In Opinion, United States of America v. Western Electric Inc., et al., September 10, 1987, Harold Greene, p. 161, identifies a series of additional instances of political coercion, including offers of development funds and decisions about where to locate facilities.

(15) Michigan Bell utilized telephone company billing records to identify high volume toll users then provided the list to a telemarketing firm which called subscribers and lobbied them to support deregulation legislation. During the course of the lobbying call, the telemarketer offered to connect the subscriber, directly to the office of his or her state representative, free of charge, Chris Christoff, "Phone Users are Drafted in Rate War," Detroit Free Press, November 2, 1991.


(20) Extensive and subtle forms of cross-subsidy identified, State of New York, Department of Public Service, Staff's Initial Brief, Case No. 27420, January 23, 1984; Staff Direct Testimony, Case 28259 -- Rochester Telephone Corp. Need for and Propriety of a Royalty, April 12, 1985.

(21) The MECO case, State of New York, Department of Public Service, Case No. 91-c-0102 - Proceeding to Investigate the Corporate Structure of New York Telephone Company and Its Affiliates, Plan for Comprehensive Restructuring of NYNEX and Its Affiliates, and accompanying material; Federal Communications

(22) *Comments of Dun and Bradstreet Corporation on Department of Justice Recommendations*, Civil Action No. 82-0192, p. 35-36, citing refusal of BellSouth to grant access to customer information.

(23) Bundling of services in Florida, denying competitors access to specific service elements desired, *Communications Daily*, October 10, 1990.

(24) Refusal to provide service in a timely manner, "Order of the Commission Regarding its Investigation into Southern Bell Telephone and Telegraph Company's Trial Provision of MemoryCall Service," *Georgia Public Service Commission*, Docket No. 4000-U, p. 27.


(30) The cable TV industry and the telephone industry, potential competitors for each other's service, have repeatedly clashed over pole attachments and duct space used in stringing cable to customers (National Cable Television Association, *The Never-Ending Story: Telephone Company Anti-competitive Behavior Since the Breakup of AT&T*, April 1991, pp. 13-14).

(31) MFS co-location denial, Maryland Public Service Commission, 1991.

(32) Yellow Pages, *Communications Daily*, March 5, October 22, 1990.


(37) MFS co-location, California Public Utility Commission, 1991


(47) See generally the comments of Prodigy in the CEI pricing cases (e.g. *In the Matter of New England Telephone Company Tariff Filing to Introduce NYNEX Integrated Services Digital Network Basic Service*, before the State of Massachusetts Department of Public Service, Docket No. T-91-15).


(56) Misreporting of quality control, State Telephone Regulation Reports, April 8, May 6, 1991; Telecommunications Reports, April 8, May 6, 1991.

(57) "Order of the Commission Regarding its Investigation into Southern Bell Telephone and Telegraph Company's Trial Provision of MemoryCall Service," Georgia Public Service Commission, Docket No. 4000-U, p. 27.

- excessive rates and profits,
- misallocation of costs and profits,
- gold plating of the network, and
- diversion of resource to unregulated activities.

Cases of abuse of political process (also discussed in Chapter II) include

- rate-payer funding of lobbying activities, and
- abuse of monopoly position for political leverage.

Cases of Bell abuse of competition (discussed in Chapter III) include

- cross-subsidy,
- price discrimination,
- denial or delay of access to the network,
- abuse of marketing information, and
- violation of the anti-trust decree.

Cases of consumers abuse (discussed in Chapter IV) include

- fraudulent marketing,
- distortion of demand (e.g. negative check-off),
- distortion of supply (e.g. the manipulation of the availability of services), and
- improper service delivery.

Thus, recent experience verifies that consumers are best protected by separating competitive businesses from monopoly ventures. This track record demonstrates the consumer benefits of the restrictions on the RBOCs and the dangers of Bell expansion into more competitive markets. Lifting the MFJ's restrictions would hurt the public by impeding competition for services that utilize the telephone network, by raising telephone rates, and by distorting demand for or supply of services that rely upon the network.
promote cost-effective technological development of our nation's telecommunications infrastructure;

insulate telephone ratepayers from any financial risks or losses that could result from Bell company entry into unregulated, information businesses; and

guarantee that local telephone rates will continue to fall, in inflation-adjusted prices, as they did before the breakup of AT&T.

This issue has been thrust to the fore by recent legal developments. The MFJ structural protection for information services has been eliminated by the Courts; the Senate passed legislation that abolishes the protections for equipment manufacturing; federal regulators have wiped out other structural safeguards. The behavior of the local exchange carriers becomes a crucial concern:

Will the Regional Bell Operating Companies engage in the same negative, anti-competitive actions as AT&T did?

B. PURPOSE AND OUTLINE OF THE REPORT

This report demonstrates that the answer to the question is positive. Based on findings of state and federal regulators and filings of injured parties about actual abuses that have occurred, even within the limited activities allowed by the MFJ, the companies have continued to abuse their monopoly position.

Cases of rate-payer abuse (discussed in Chapter II) include

1. The terms of the AT&T breakup (Modification of Final Judgment [MFJ]) are based on the principle that consumer benefits are maximized if telephone companies providing monopoly services are not allowed to enter adjacent, competitive markets. For the Bell breakup, this required prohibiting the Bell companies -- providers of monopoly, basic local phone service -- from entering more competitive businesses like interstate long distance, manufacturing and information services. Under the consent decree's logic, if incentives to overprice local phone service are reduced and the ability to discriminate against potential competitors is eliminated, consumers should receive maximum benefit from the telecommunications market.
II. RATE-PAVER ABUSE

A. EXCESSIVE RATES AND PROFITS

Since the AT&T divestiture there has been a constant struggle over the level of rates and profits enjoyed by local exchange companies. Immediately after divestiture, huge rate requests were filed, about half of which were granted. Those initial rates were much too high. In recent years commissions have been playing catch up, trying to lower rates with limited ability to do so.2

A variety of measures indicate that telephone companies continue to enjoy rates of return, dividend yield, and cash flow that is far higher than that of competitive sector companies. Since the overwhelming majority of the income of regional operating companies is derived from monopoly telephone businesses -- local service, intrastate long distance and interexchange carrier access charges -- the higher rate of return is also an excessive return.3 It represents returns that are not commensurate with the risk to which that investment is exposed.

1. THE MAGNITUDE OF OVERCHARGES

In 1986, CFA estimated excessive returns to telephone company capital on the order of $2.5 to $3.5 billion per year. Figure 1 shows that this problem continued through 1990. The return on equity earned by the seven RBOCs has been almost one percent point higher than that earned by all manufacturing companies and half a percentage point above the Business Week 1,000 corporations.

Since the overwhelming majority of RBOC profits come from

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1. Common Carrier Bureau, Federal Communications Commission

2. In 1989 and 1990, Commissions identified almost three-quarters of a billion dollars in excess charges. See Communications Daily, January 4, 1989; Communications Week, March 6, November 6, December 18, 1989, March 19, 1990; State Telecommunications Report, November 15, 1990; NCTA, op. cit.; as well as the goldplating cases discussed below. The offer to accelerate deployment of technology often is made in response to excess earnings.

FIGURE 1:

RETURN ON EQUITY
BELL SYSTEM V. ALL MANUFACTURING

monopoly businesses, one can reasonably argue that their return on equity should be lower than other firms which do not enjoy the monopoly power of the telephone companies. The Bell companies face less risk; therefore they merit less reward. Historically, this was the case. In the quarter century prior to divestiture, the Bell system earned two percentage points less than was earned in the manufacturing sector.

Thus, this comparison indicates that earnings are excessive by 2.5 percentage points. Given the equity of the companies, this represents excessive earnings of $1.6 billion per year.

Excess profits are not the only source of excess costs imposed on consumers. Over the years since divestiture the telephone companies also have increased their expenses inappropriately. One major category of expense is the acceleration of depreciation (see Table 2). Such accelerations have occurred in general proceedings -- represcribing

### TABLE 2:

THE IMPACT OF ACCELERATED DEPRECIATION ON TELEPHONE COMPANY COSTS ($000,000)

<table>
<thead>
<tr>
<th></th>
<th>1984</th>
<th>1990</th>
<th>1990 DEPRECIATION EXPENSE</th>
<th>1990 DEPRECIATION EXPENSE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>ACTUAL</td>
<td>AT 1984</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>RATE</td>
<td>RATE</td>
</tr>
<tr>
<td>AMERITECH</td>
<td>.073</td>
<td>.086</td>
<td>1825</td>
<td>1549</td>
</tr>
<tr>
<td>BELL ATLANTIC</td>
<td>.062</td>
<td>.070</td>
<td>2377</td>
<td>2105</td>
</tr>
<tr>
<td>BELL SOUTH</td>
<td>.066</td>
<td>.096</td>
<td>2901</td>
<td>1994</td>
</tr>
<tr>
<td>NYNEX</td>
<td>.070</td>
<td>.088</td>
<td>2337</td>
<td>1859</td>
</tr>
<tr>
<td>PACTEL</td>
<td>.059</td>
<td>.089</td>
<td>1915</td>
<td>1269</td>
</tr>
<tr>
<td>SWBELL</td>
<td>.062</td>
<td>.073</td>
<td>1691</td>
<td>1436</td>
</tr>
<tr>
<td>US WEST</td>
<td>.062</td>
<td>.070</td>
<td>1845</td>
<td>1634</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
<td>14891</td>
<td>11846</td>
</tr>
</tbody>
</table>

**NOTES:** WHERE DEPRECIATION RATES ARE NOT PROVIDED IN THE ANNUAL REPORT, DEPRECIATION RATES ARE CALCULATED AS DEPRECIATION/(PLANT & PROPERTY - PLANT UNDER CONSTRUCTION)

**SOURCES:** ANNUAL REPORTS
billions of dollars directly in real estate, finance, cellular, computer consulting, international operations and other activities. These investments are funded directly by transfers of cash and indirectly by stock swaps in which shares that have been repurchased with excessive earnings are used to purchase new, unregulated companies.

Unfortunately, many of the RBOCs do not provide much detail on the finances and structures of their holding company affiliated firms. Those that do provide some detail make it clear that each has amassed $3 to $4 billion dollars of unregulated assets. Prominent examples of these investments include the following.

- cellular companies -- BellSouth used over $700 million of its own stock, purchased on the market, as payment for MCCA; PacTel has the largest cellular operation;

- foreign telephone companies -- Bell Atlantic and Ameritech purchased New Zealand Telecom for over $2 billion;

- real estate -- US West claims $1.6 billion in real estate; Bell Atlantic claims about $650 million;

- computer hardware, software and service -- NYNEX shows $1 billion of these diversified activities;

- leasing operations -- US West claims over $3 billion;

- foreign currency trading -- Ameritech claims $300 million.

Since these investments, in the aggregate, have not turned much of a profit since divestiture, almost the entirety of the resources used to create these companies has come from the parent. Where debt has been used, it appears to have been in addition to large infusions of capital from the parent. Thus the data show that something on the order of $25 billion has been overcharged to customers of the local exchange companies and used to create unregulated, holding company assets.

The remainder of the overcharges are consumed by excessive investment in network infrastructure and extremely high dividends. That is, the Bell companies have carried out extremely aggressive upgrade programs and funded them almost entirely with internal funds. Most companies are forced to borrow a much larger share of the funds needed for growth than
the telephone companies have since divestiture. Bell companies also declare huge dividends. These dividends have consistently been twice as large those paid by the Business Week 1,000 (see Table 4).

**TABLE 4:**

<table>
<thead>
<tr>
<th>DIVIDEND YIELD: RBOCS COMPARED TO OTHER CORPORATIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Percent of market value)</td>
</tr>
<tr>
<td>-----------------------------------------------------</td>
</tr>
<tr>
<td>AMERITECH 7.3 5.5 5.5 5.8 5.7 5.2 5.3</td>
</tr>
<tr>
<td>BELL ATLANTIC 7.7 5.5 5.1 5.4 5.5 4.8 4.9</td>
</tr>
<tr>
<td>BELL SOUTH 7.4 5.4 5.0 5.5 5.8 4.6 5.2</td>
</tr>
<tr>
<td>NYNEX 7.6 5.5 5.0 5.6 5.8 5.4 6.0</td>
</tr>
<tr>
<td>PACTELL 7.1 6.4 5.5 5.6 5.1 4.1 4.8</td>
</tr>
<tr>
<td>SW BELL 7.2 6.6 5.4 6.1 5.6 4.7 5.1</td>
</tr>
<tr>
<td>US WEST 7.6 5.9 5.4 6.1 5.8 5.2 5.2</td>
</tr>
<tr>
<td>RBOC AVG. 7.4 5.8 5.3 5.7 5.6 4.9 5.2</td>
</tr>
<tr>
<td>BUSINESS WEEK 1,000 3.2 2.8 2.4 2.8 3.0 2.9 2.8</td>
</tr>
</tbody>
</table>

**SOURCES:** Business Week, Scoreboards issues.

3. WHERE SHOULD ALL THE MONEY GO?

This huge cash flow being siphoned out of the operating companies casts a harsh light on the claims of the RBOCs that accelerated depreciation and extremely high rates of return are necessary to achieve rapid modernization of the network. If one accepts the argument that more resources should be devoted to modernization -- and there is some doubt about how much could or should be absorbed -- there is a distinct possibility that the current cash flow would be adequate, if it were applied to different purposes.

The behavior of NTT, the Japanese telephone company, makes an interesting comparison in this regard. The RBOCs frequently point to Japanese plans and commitments as evidence that the RBOCCs should be allowed to invest more in the network. As Table 5 shows, NTT manages its cash flow differently than the RBOCs.

- NTT uses about 5 percent of its cash flow for dividends; the RBOCs use almost 25 percent.
TABLE 5:
CASH FLOW UTILIZATION:
RBOCS COMPARED TO NIPPON TELEPHONE AND TELEGRAPH
(Billions of Dollars)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>CASH FLOW</td>
<td>23.4</td>
<td>12.3</td>
</tr>
<tr>
<td>CAPITAL EXPENDITURE</td>
<td>16.1</td>
<td>13.1</td>
</tr>
<tr>
<td>DIVIDENDS</td>
<td>5.7</td>
<td>0.6</td>
</tr>
<tr>
<td>CAPITAL EXPENDITURE AS A PERCENT OF CASH FLOW</td>
<td>68.8</td>
<td>106.1</td>
</tr>
<tr>
<td>DIVIDENDS AS A PERCENT OF CASH FLOW</td>
<td>24.6</td>
<td>4.8</td>
</tr>
</tbody>
</table>

SOURCES: Annual Reports.

- NTT uses virtually none of its cash flow for non-telecommunications ventures; the RBOCs use almost 20 percent.
- On balance, if the RBOCs behaved like their Japanese counterpart, they would have invested as much as $40 billion more in the telecommunications network since divestiture.

This sum of resources is quite significant. For example, a recent report by NTIA concludes that network investment in the U.S. lagged between 1980 and 1989. This observation gives a misimpression, since the U.S. network was more modern at the start of the decade and more modern at the end of the decade. However, if the RBOCs had behaved like NTT from 1984 to 1990, the U.S. would have been first on the list by far, with over 25 percent more network investment than the Japanese.

Thus, as will be pointed out in the discussion of goldplating, it is not clear that the RBOCs need to accelerate deployment of intelligent network technologies. This discussion indicates that even if they should invest more, they may not need an increase in cash flow in order to do so.
B. GOLDFLATING

Goldflating is another area where the Bell companies have engaged in blatant abuse. They explicitly violate regulatory commission policy on used and useful investment, frequently knowing that the investment cannot be justified for basic service subscribers, then provide sham justifications to regulators.

The quintessential example is the deployment of fiber optic cable to the home.

- Basic telecommunications services do not require fiber and can be provided at a much lower cost without it.
- Standing alone, fiber optic cable in the local loop is not cost-competitive with existing technologies for delivering video and enhanced services.

In short, the telephone companies cannot justify converting the local loop to fiber optic cable for basic telecommunications purposes in a regulatory environment, nor could they justify laying fiber optic into homes for discretionary services in a truly competitive market environment.

Only by misallocating costs to present consumers with promises of future services could the companies convince regulators and legislators to force ratepayers to foot the bill. If successful in their over-investment strategy, the RBOCs will be positioned to argue that they must be allowed to own video and other similar services to pay for their extravagant network.

These arguments also apply to the other components of the intelligent network: digitization of switches and advanced signaling (SS7). Their capabilities far exceed the demand for services and they cannot be justified on cost reducing grounds. Several recent examples demonstrate the problem.

1. FLORIDA

A clear example can be found in recent filings by Southern Bell at the Federal Communications Commission and the Florida Public Service Commission. Bell projects an "avalanche of

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1. Southern Bell, Depreciation Rate Study: General Cable Narrative, Federal Communications Commission, March 1, 1989; Staff Report, Federal Communications Commission, March 17, 1989;
video" demand at the end of the next decade. It argues that cable companies, so pressed to meet this demand, will choose to rent space on fiber optic cables deployed by telephone companies. In order to meet this demand, Bell proposes to accelerate the depreciation of copper cable and the deployment of fiber.

Assuming that every household will need the equivalent of two copper wires (an assumption that is not supportable on the basis of telephone usage) Southern Bell proposes to begin vigorous deployment of fiber in 1994. In less than a decade, the network will be fully fiberized. Of course, ratepayers are asked to pay today for accelerated depreciation and throughout the next decade for accelerated deployment of fiber on the basis of a telephone company guess about demand for new services a decade in the future.

In the Florida accelerated deployment case the staffs of both the Federal Communications Commission and the Florida Public Service Commission found that the company's speculative investment failed the regulatory economic test. Without arguing otherwise, however, the Florida Commission granted Southern Bell's request. In essence it took approximately $100 million out of consumers' pockets and invested it in the network with no reasonable basis for expecting that the investment would ever pay off.

Arguing that the replacement of fiber is unjustified for a decade and that the network will be overbuilt for at least half a decade with the deployment of fiber, CFA estimated that the incremental revenue requirement placed on Southern Bell subscribers will average $5.00 per month for approximately 33 years. It starts at $.50, the cost of accelerated depreciation, and builds to $11.00 per year around the turn of the century, then tapers off through the first two decades of the 21st century (see Figure 2).

2. TENNESSEE

The Tennessee Commission's economic analysis did not even try to justify the accelerated deployment of intelligent network investments. No identifiable stream of services could be

---Continued---


FIGURE 2:

INCREMENTAL FIBER COSTS IN FLORIDA

SOURCE: Mark Cooper, Expanding the Information Age for the 1990s (Washington, D.C., January 1990), P. 68.
found to pay for the investment, but the master plan advocated adding 5% to the gross revenue requirement (essentially a 5% tax) to achieve accelerated deployment of information age services.

The history of telephony from its very beginnings in 1878 has been a story of technological change. These changes have, over the years, reduced costs, and hence prices, drastically...

As we look to the future we see a subtle change in the nature of the evolution of telephone networks...

The conclusion one draws from this is that it will be more difficult to justify new technology based on cost reductions (as opposed to growth) until the penetration of fiber in the loop plant reaches an as-yet unspecified "critical mass."

In the interim, however (which may be as long as a decade), substantial expenditures on telecommunications network will be driven by growth, rehabilitation and new services. The equipment vendors will attempt to sell new features to increase their revenues, and absent growth, the operating companies will need to develop new methods of generating revenues to cover their software related expenses.

The plan involves adding approximately $3.40 per month to subscriber bills every month for 10 years (see Figure 3). The goal is 100 percent deployment of ISDN and SS7 technologies and a 10 percent deployment of fiber in 10 years. Full deployment of fiber would add another $10 per month.

This cost estimate is based on dubious assumptions that suggest a significant underestimation of the ultimate price.

- It assumes multiple lines per household, which is not the case today,
- a virtual collapse in the cost of installing fiber, and

FIGURE 3:

THE COST OF ACCELERATED DEPLOYMENT
IN TENNESSEE

SOURCE: Tennessee Public Service Commission, Telecommunications Technology Deployment (July 12, 1990), Exhibit V-4.
o no improvement in the cost of installing copper.

o It ignores additional switching, terminal equipment, and powering costs, and

o has no credible way to verify claimed maintenance cost savings.

o It makes no provision for acceleration of depreciation and assumes that the costs of special services for businesses will be recovered from those businesses, which is not the case.

Even given these questionable assumptions which seriously underestimate costs, the resulting cost for a ten year acceleration of full fiber deployment nationwide is approximately $400 billion.¹

Florida and Tennessee are two examples where efforts to fund speculative investment have been approved, in spite of little sound economic support for the investment and direct opposition from the staffs of the public utility commissions. The telephone companies have tried in other states and either failed to convince regulators or had significant parts of such expenditures disallowed.² However, even when Bell companies lose at the PUC, they shift to a legislative strategy where the weakness of their

1. Estimates of the cost of fiber cover a wide range. See, L. Taylor, Capital Budgeting for Technology Adoption in Telecommunications: The Case of Fiber (Center for Telecommunications and Information Studies, Columbia University, 1989) and National Cable Television Association, The Cost of Telephone Company Installation of Fiber to the Home (Washington D.C., June 1989). The range of estimates is narrowing. The investment cost estimates for the mid to late 1990s, for fiber only, have now settled in the range of $1,500 to $3,000. See L. L. Johnson and D. P. Reed, Residential Broadband Services by Telephone Companies? (Santa Monica: Rand, June 1990), p. vi; R. Loube, Fiber to the Home: A Competitive Analysis, S. Koper, Fiber to the Home (International Data Corporation, November 1989). National Regulatory Research Institute..... Getting to the integrated, switched network would require additional investment. Investment at this level would require at least a doubling of loop costs.

economic argument can be concealed.\footnote{1}

C. MISALLOCATION OF COSTS AND PROFITS

1. THE GENERAL PROBLEM

The problems of cross-subsidy and goldplating have attracted a great deal of attention because they are blatant abuses which run against regulatory policy. However, in other areas, existing regulatory mechanisms are also highly problematic.

Pricing and cost allocation battles have been fought since the very beginning of the industry. Whenever premium services are added to the basic network, the problem of deciding how to allocate the costs become more intense. While plain old telephone service does not require the improvements, cost allocators which are based on usage place the heaviest pricing burden on basic service consumers. This "piling on" the ratepayer is likely to become more intense if a wider range of businesses is opened to the Bell Companies.

In recent years the setbacks have been particularly troubling. As the Federal Communications Commission shifted more and more costs onto residential ratepayers by imposing mandatory access charges and lowering discretionary long distance charges, state PUCs have shifted more and more costs from businesses to residential users.

The past twenty years have shown that when common costs are incurred to meet the most rigorous quality demand of the highest service applications, the residential ratepayer is vulnerable to cost shifting on both the supply and demand sides.

On the demand side, the pricing philosophy that holds sway today is simple: those consumers with the fewest alternatives pay the most -- the residential ratepayer bears the brunt of the cost burden.

On the supply-side, the fact is that the ever deepening deployment of capital provides little enhanced value for the residential ratepayer. The residential ratepayer gets the smallest value from the enhancement, yet the costs are thrown into common cost pools and allocated primarily to basic services.

\footnote{1}{For example, bills have been introduced in Ohio (Senate Resolution No. 111) and New Jersey (A-5063, S-3617).}
2. EXAMPLES OF THE COST ALLOCATION PROBLEM

The problem of cost misallocation can be quite straightforward. As discussed in the cross-subsidy section, companies can simply allocate costs to the wrong service.

This misallocation need not be based on deceit. It can be based on bad judgment. For example, a telephone company proposes to build a joint video and voice system and proposes to deploy expensive optical fiber and equipment to do so. It splits the cost 50/50 between the two services. Yet simple voice communications do not require the very high level of technical capability of the joint system. Plain old voice consumers are being overcharged.1

More subtly, they can decide to declare certain types of personnel or capital costs as "common" costs and let cost allocators spread them to basic services.2

By and large, the first and largest beneficiaries of extravagant network investment will be high volume data users who demand speed. ISDN and 887 provide almost no benefits to simple, voice grade telecommunications, yet basic rates have borne the burden as these technologies are implemented. When formal allocation mechanisms are used, the reliance on relative usage is the problem.

Humans speak slowly, so the length of a telephone call is dictated by conversational speed. The ability of the network to transmit faster is wasted, since the constraint on speed is the human brain, voice and ear. As the network is upgraded, data moves faster so the amount of time per transaction declines. The result of existing costing methodologies, which allocate costs based on the amount of time transactions last, is to reduce the costs allocated to those who benefit most from the deployment of the technology.

3. EXAMPLES OF THE PROFIT ALLOCATION PROBLEM

The holding company structure adopted by the Bell companies also enables them to misallocate profits. For example,

2. "Testimony and Exhibits of Thomas H. Weiss," before the Illinois Commerce Commission. ICC Docket No. 89-0033 (Remand), July 1991, in which all senior management is declared common, even though some positions are devoted entirely to competitive services.
regulators from nineteen states have complained to the federal courts that Yellow Pages advertising profits, which regulators traditionally used to keep local rates down, have been siphoned out of regulatory reach by the Bells' creation of out-of-state unregulated publishing affiliates, separate from their local phone operations.¹

Recently, the Oregon Public Utility Commission ordered U.S. West to return $29 million in directory publishing revenue to the regulated ratebase because: "U S West formulated a corporate strategy in 1986 to divert directory profits from ratepayers to stockholders. The company acknowledged that the strategy would cause local rates to increase, but nevertheless concluded that it should pursue the goal of flowing as many dollars to the share owners as possible."² Through the few audits and investigations that they have the resources to undertake, regulators have found that the Bell companies allocate excessive costs to ratepayers for inappropriate wiring costs,³ while under-compensating ratepayers for directory earnings.⁴

D. DIVERSION OF EFFORT

In their rush to diversify into other businesses, the Bell companies may have become distracted from the central purpose of their enterprise, which is provision of basic telecommunications service.

An observer might well be justified in concluding that the participation of the Regional Companies in these far-flung enterprises is bound to diminish their managements' interest in and attention to the local telephone business -- that, after all, was these companies' raison d'être, and that is still the aspect of their operations most vital to the public since, under present conditions, if the Regional Companies do not

1. Advice to the Court by Western Conference of Public Service Commissioners, Civil Action No. 82-0192 (HHG), U.S. District Court, D.C. October 23, 1989.
3. Telecommunications Reports, March 27, 1989, p. 5.
attend to local telephone service, no one will or can.¹

In the MECO case the regulatory decision clearly indicates that the interests of the ratepayers were subordinated to the interests of the competitive enterprise.²

E. ABUSE OF POLITICAL PROCESS

The anti-trust court also noted evidence of blatant Bell efforts to influence the legislative process through the exercise of corporate economic power. This included offers or threats to locate offices or make contributions to economic development depending on the outcome of key legislative votes or regulatory decisions.³

Additional instances of political abuse, such as letter writing campaigns and ratepayer funding of lobbying have also come to light. The use of telephone company facilities for a letter writing campaign occurred in an effort to obtain regulatory approval of Caller ID service, which is discussed in the next chapter.⁴ Ameritech, BellSouth and Southwestern Bell have been caught using ratepayer money for corporate lobbying activities.⁵

The most recent and blatant abuse of monopoly power for political purposes occurred in Michigan. Michigan Bell analyzed billing records to identify certain customers and supplied the list to a telemarketing firm. That firm called the subscribers, lobbied them about pending legislation, and offered to connect them, toll free, with state legislators.⁶

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1. Opinion, p. 58.
III. ABUSE OF COMPETITORS

The primary focus of recent legal activity has been on the anti-competitive impact of local exchange company actions and their likely behavior should the restrictions on their activity be lifted. The first triennial review of the MFJ and its subsequent appeals made clear that the structural conditions of monopoly continue to exist and that the local exchange companies continue to exploit the anti-competitive and anti-consumer potential of the local exchange monopoly. At present, there remains a hard and fast monopoly in local exchange service, attested to by the

still almost complete domination over the "last mile" of the telephone network, i.e., their monopoly of the local wires and switches without which few, if any, competitors can reach the ultimate consumers of telephone-based information services. In fact, around ninety-nine percent of the traffic to the ultimate subscriber must still pass, in the end, through the Regional Companies' local loops.1

The monopoly was not created by regulation, but has its origins in the economics of the local network. Although new technologies may make competition for exchange service possible in the future, no technological threat to that monopoly can develop overnight. The market power of the local exchange companies stems not only from their ownership of local switching capacity, but also from their knowledge of calling patterns and volumes and their control over decisions about how to design and construct the network.

A. CROSS-SUBSIDY

1. THE UNDERLYING PROBLEM

In a telephone network where the same equipment and resources are used to provide local, long distance and computer-based services, earnings rise when costs are loaded onto monopoly local phone service (where the public has no alternative provider and regulation is very likely to result in adequate profit). Once costs are shifted to local service, the local phone company is better positioned to manipulate prices for all other services

to benefit its unregulated or more competitive ventures.

Telephone regulators have been incapable of preventing cross-subsidy by local phone companies because cost allocation rules, historically embroiled in political fights, were never firmly established in law. In addition, after divestiture the local exchange companies laid the groundwork for a major structural problem in overseeing the industry. They created "some one hundred-fifty corporations, partnerships, subsidiaries, and other entities having sometimes but a remote relationship to telephone operations."¹

The ability of the RBOCs to engage in cross subsidization has grown because of the increasingly complex organizational structure of the companies,² continuing efforts to escape regulatory scrutiny,³ and the weakening of regulation.⁴ By establishing a complicated web of subsidiaries separate from their local phone companies, the Bells have demonstrated that they can elude regulatory cost allocation designed to protect consumers of regulated services. As an analysis by the National Association of Regulatory Utility Commissioners (NARUC) concluded:

The operations and methods of Pacific Telesis bring to life the worst nightmares of regulators. There appears to be no advantage to the holding company structure except to the unregulated businesses of Pacific Telesis, which are cross-subsidized at every turn by Pacific Bell.⁵

By 1991, during Judge Greene's most recent evaluation of the regulatory process, the ability of regulators to prevent the problem of cross-subsidy was found to be even more suspect.

Although the current regulations include a number of new features, they are, if anything, less likely to be effective than those that were supposed to constrain the Bell System. For what cannot be

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³
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2. Ibid, p. 120.
overemphasized is that, as the structure of corporations becomes more complex and as it deals in more and more different products and services, it becomes increasingly difficult for regulation and regulators to oversee its operations and restrain anti-competitive efforts...

State regulators, who in the main must, perforce operate with meager resources, but who are nevertheless responsible for the regulation of the bulk of Regional Company services, have consistently been unable to exercise control over the vast and powerful Regional Companies. One basic reason for this impotence, in addition to the paucity of resources, is the fact that each of the Regional Companies operates in several states, and all of them are thus effectively beyond the jurisdiction of any single local regulatory body. Indeed, some of the companies, e.g. U S West, have refused to turn over to state regulators their records pertaining to operations within the region but outside of the particular state.

2. EXAMPLES OF ABUSE

The staffs of the two largest public utility commissions, which have the resources and the will to look into the matter, found that the local companies had been engaging in cross-subsidy. Both New York and California found extensive evidence of attribution of executive and management time to the competitive subsidiary that was a small fraction of the economic activity in which it was engaged;

inadequate compensation of time that was

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1. Remand Opinion, pp. 27...31...39.

2. State of New York, Department of Public Service, Staff's Initial Brief, Case No. 27420, January 23, 1984; Staff Direct Testimony, Case 28959 -- Rochester Telephone Corp. Need for and Propriety of a Royalty, April 12, 1985; Public Staff Division, California Public Utilities Commission, A Report on Pacific Bell's Affiliated Subsidiary Companies, June 3, 1986.
billed to the subsidiary;

a complete lack of or inadequate compensation for assets and services utilized by the subsidiary;

cherry-picking the best talent from the parent monopoly company and saddling the parent with costs for training that was more directly related to the activity of the subsidiary; and

imputation of excessive rates of return for services purchased from the subsidiary;

Other RBOCs were found to be engaging in cross-subsidization of competitive activities from the very beginning of their existence. Early cases involve BellSouth,1 Ameritech,2 and the already noted PacTel findings. The most celebrated case is the MECO case in the NYNEX region where the corporate parent drained revenues from the operating exchange company into an unregulated affiliate and then asked for a rate increase to cover the revenue shortfall.3 Other instances include U.S. West,4 PacTel,5 BellSouth,6 and GTE.7

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The revelation of cross-subsidization in the first round of audits did not dissuade the RBOCs from inappropriately shifting costs to regulated services. A second round of audits revealed the practices were continuing five years after divestiture. Indeed, it would appear that being under investigation or even caught for one offense has little impact on altering RBOC behavior.

B. ANTI-COMPETITIVE ACTIVITY

In addition to cross-subsidy, which involves underpricing competitive services and undermining competition, the local exchange companies have engaged in several other types of anti-competitive activity in the post-divestiture period.

1. ACCESS TO BOTTLENECK FACILITIES

The RBOCs blatantly denied or degraded access of competitors to the network. Since information providers must sell their services through the switches and telephone lines, they are dependent on the telephone companies for access to their market. There are a number of ways in which the local exchange carriers have prevented or hindered information service providers from

1. SEARUC Task Force, op. cit.

2. The MECO abuse continued from 1984 to 1988, despite a New York state audit that had identified serious concerns about cross-subsidy in the NYNEX organization. Similarly, BellSouth continued its abuse in Electronic Messaging Systems, in spite of two adverse SEARUC audits.

3. The cable TV industry and the telephone industry, potential competitors for each other's service, have repeatedly clashed over pole attachments and duct space used in stringing cable to customers (National Cable Television Association, The Never-Ending Story: Telephone Company Anti-competitive Behavior Since the Breakup of AT&T, April 1991, pp. 13-14).

4. A repeated problem for almost the entire period since divestiture has been the inability of competitors to co-locate their facilities. See "Order of the Commission Regarding its Investigation into Southern Bell Telephone and Telegraph Company's Trial Provision of MemoryCall Service," Georgia Public Service Commission, Docket No. 4000-U (hereafter, Georgia PSC) and the many disputes involving MFS Inc.
obtaining access.

[They] have designed technical features in such a way as to render them incompatible with competitors' standard equipment; priced the features in such a manner as to raise their rivals' costs; made important and necessary features available only to their own affiliates... delayed implementation of features requested by competitors until the particular regional Company was ready to enter the market... [and] charge[d] more to the customers of their competitors for needed features than they charge their own customers.1

A very recent case in Georgia is a paradigm of the types of abuses which monopoly over local exchange service invites when the monopolist branches out into competitive services that utilize monopoly facilities and sell to captive customers.

In the Commission's view, the evidence presented on each issue shows at a minimum that SBT has both the opportunity and incentive to use its monopoly control over the local network to defeat competition in the VMS market through its influence on whether, how and when competitors can access the local network. Further the evidence shows that SBT has not hesitated to take advantage of this opportunity, has used its monopoly control over the local network to gain an anti-competitive advantage in its offering of MemoryCall service and will continue to do so if left unchecked by the commission.2

The telephone companies can also delay the provision of service.3 This prevents competitors from starting up business. Often the delay serves to give local exchange companies a chance to reposition their own competitive offering. Since many information service firms are small, they may simply disappear or be forced to withdraw from the market, rather than wait out the

2. Georgia PSC, p. 27.
telephone companies. The Georgia Commission concluded as follows:

The evidence in this Docket indicates that the network features necessary for the TAS Bureaus to offer their VMS options on a basis competitive in quality and availability to SBT's current offering of MemoryCall service have existed since the early 1980s. The record is clear that SBT chose not to unbundle the features and offer them on the network on an unbundled basis until SBT was prepared to offer MemoryCall.2

The Georgia Commission drew the necessary implications with respect to the future of the industry, citing Cox Enterprises as follows:

The Commission finds this evidence disturbing enough because of its indication that SBT may have improperly impeded development of the VMS market for almost a decade. The evidence is even more disturbing, however, because of what it may well signal with respect to SBT's purported commitment to a proper Open Network Architecture program.

Under the concept of Open Network Architecture ("ONA"), new features, such as CF-NA and CF-BL, should be made available on a cost basis to whoever needs them as soon as they are technically feasible. ...

As the proceeding has made clear, Southern Bell has a view of ONA all its own. According to Southern Bell, Southern Bell should make new services available only when it plans to offer an enhanced service that can use them. Daniel at 533 ("ONA says when we use those services ourselves, we are required to make them available"). This is nothing less than an acknowledgement by Southern Bell that it views its own outside business ventures as its primary franchise

1. Comments of Dun and Bradstreet Corporation on Department of Justice Recommendations, Civil Action No. 82-0192, pp. 35-36, citing refusal of BellSouth to grant access.

2. Georgia PSC, pp. 31-32.
motivation, not the service demands of its captive telephone ratepayers.¹

There are a variety of ways that the terms and conditions of access can be manipulated to disadvantage competitors. In Georgia one major issue was the location of facilities.

SBT places its voice mail equipment (including hardware) within its central offices, thereby enabling SBT to provide higher quality voice mail service. This action also reduces SBT's overall cost of providing MemoryCall because it eliminates the need for a local transport link to provide the service.

At present, TAS Bureaus must place their voice mail equipment on their business premises. This reduces the quality of voice mail and necessitates paying SBT for a local transport link to the central office that service their customer.

The TAS Bureaus had requested the opportunity to locate their voice mail equipment within SBT's central offices, that is, they have requested the opportunity to co-locate their voice mail equipment.

SBT has received and denied such requests.²

The local exchange companies may also make the network technologically inaccessible.³ They may choose proprietary designs that competitors cannot interconnect with, while their own subsidiaries are ensured compatibility.⁴ This was the case in Georgia.

SBT's MemoryCall service, because of its special access to SBT engineering, recognized the 1AESS switch technical barrier and

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1. Ibid., pp. 33-34.
designed the network and its services to avoid the AESS switch technical barrier. The functional difference is critical, because in an area served by a 1AESS switch that has not been upgraded, the voice message services that can be offered in competition to MemoryCall are grossly inferior in quality and availability. Thus, for at least the first 15 months of SBT's initial entry into the VMS market with MemoryCall, the technical barriers of the network created an insurmountable advantage in SBT's favor regarding the quality of the voice messaging services available as competition to MemoryCall.

2. PRICE DISCRIMINATION

The local exchange companies can also provide unequal access to competitors by charging their own subsidiaries less than they do competitors. A U.S. West case is most revealing in this regard. In seeking to win a government contract, U.S. West charged its affiliate less for access than it charged its competitors. It also bundled in use of trunk lines at no charge, while its competitor would have to pay for these services.

The RBOCs create a more subtle pricing problem when they establish prices which require competitors to buy value added (computer enhancements, etc.) that they do not need. This bundling places competitors at a disadvantage since they must pay twice for functionalities that they do not need and for which RBOC affiliates may not pay.

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3. Other similar instances include discrimination in price or terms in Ohio (Allnet Communications Services, Inc. vs. Public Utility Commission, 1988) and by Southwestern Bell (Wall Street Journal, June 26, 1990, B-8).

3. MARKETING

Another area of anti-competitive advantage enjoyed by the RBOCs is access to marketing information and a captive market. The franchise provides companies with knowledge of subscriber location, status, and calling patterns. It gives them a number of transactions (service start-up, monthly billing, service modification, problem inquires, etc.), which are ideal marketing opportunities. This disadvantage can never be overcome by competitors.

The Georgia Commission concluded as follows:

MemoryCall enjoys a favored status because of its connection to SBT's monopoly control of the local exchange network. A business or residential customer must initially contact SBT to arrange for basic telephone service. SBT uses that contact to solicit interest in MemoryCall. This vast marketing opportunity is uniquely possessed by SBT...

SBT's position as monopoly provider of local exchange service allows it to develop and access a data base of information on customers known as CPNI. CPNI contains all the information SBT has on each telephone customer, including the customer's credit history, number of lines, services, and special calling features. This information, together with customer call completion data that is available exclusively to SBT, is indispensable for a targeted marketing campaign and has been used by SBT in its own marketing...

SBT asserts that it enjoys economies of scale, particularly with respect to marketing, that allow it to offer MemoryCall at prices below those at which its competitors offer their services. It is clear to the Commission that the principle economies of scale advocated by SBT in this proceeding are advantages derived largely, if not exclusively, by virtue of SBT's monopoly position as provider of local exchange.

1. Communications Daily, November 27, 1990, on PacTel's marketing advantage, and Georgia PSC, on BellSouth.