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THE ECONOMIC ISSUES OF A CHANGING TELECOMMUNICATIONS INDUSTRY

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BEFORE THE

SUBCOMMITTEE ON AGRICULTURE AND TRANSPORTATION

OF THE

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THE ECONOMIC ISSUES OF A CHANGING TELECOMMUNICATIONS INDUSTRY

MONDAY, OCTOBER 3, 1983

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON AGRICULTURE AND TRANSPORTATION
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:15 a.m., in room SD-138, Dirksen Senate Office Building, Hon. James Abdnor (chairman of the subcommittee) presiding.

Present: Senators Abdnor and Jepsen; and Representative Snowe.

Also present: Dale Jahr, Christopher J. Frenze, and Robert J. Tosterud, professional staff members.

OPENING STATEMENT OF SENATOR ABDNOR, CHAIRMAN

Senator ABDNOR. The Subcommittee on Agriculture and Transportation of the Joint Economic Committee will come to order.

I am pleased to welcome our distinguished panel of witnesses: Alfred Kahn; Karl Korsmo; Bill Garrison; and Lee Richardson.

The Joint Economic Committee feels very privileged and fortunate to have you gentlemen come this morning and be witnesses on this very important subject. Your expertise, both collectively and individually, will give considerable insight into the complex and the confusing issues of the telecommunications industry. Your backgrounds insure that the views of regulators, officials and consumers will be discussed in depth. And it is my hope that your recommendations will provide a clearer understanding to the public and the Congress.

The communications industry is going through a tremendous change; change that is offering consumers a greater variety of services and products; change that is ushering in the "information age." But this change exposes the public to risks as well; rapid changes are straining the regulators' ability to monitor the industry. Also, if we in Congress are not careful, the public interest in maintaining universal service at reasonable rates could be jeopardized.

Allowing competitive and market forces to enter the industry is being heralded as the solution to the problems of a changing industry. Although competition will make improvements in the current market, I sincerely doubt that it will provide all the answers because many Americans will not share in the benefits of competition.

Now let me share with you a profile of the telephone industry which leads me to believe that millions of people face either dramatically rising rates or loss of service entirely:

We have found that 90 percent of all business customers generate just 25 percent of business revenue—the top 10 percent make up 75 percent.

Now the top 10 percent of residential customers generate as much revenue for the phone system as the other remaining 90 percent; 90 percent of all WATS line customers generate just 40 percent of WATS revenue.

Now this concentration of usage is located largely in major metropolitan areas, but 53 million persons reside in nonurban and rural areas, that cover 98 percent of the land area of the United States.

The cost of providing basic monthly service in 1981 was about $26 when the charge to customers was less than $10 on the average.

In 1980, 40 percent of residential customers had long distance bills under $5 per month, and almost 60 percent were under $10, indicating that most customers do not provide much revenue support for the national phone network.

These facts lead, in my belief, to a myth that I would like to discuss. The issue of universal telephone service is not an urban versus rural controversy like so many suggest. If competition is carried to an extreme, almost all residential customers could be affected adversely. Most advocates of competition say that the cost causer should be the cost payer. Yet, most residential customers, both urban and rural, do not pay the full cost of service.

Finally, it is a mistaken view to assume that millions of urban residents are subsidizing residents in high cost areas. Rather, the small number of high usage, very profitable customers, are subsidizing all the rest of us.

So, gentlemen, those are the few comments that I want to make. I look forward to our discussion here this morning. We welcome you.

I would like to introduce to you the prettier side of the committee here, Congresswoman Olympia Snowe from Maine, who is a very important part of this committee and subcommittee and I am delighted that she could find the time to be here this morning.

Do you have any comments Congresswoman Snowe?

Representative SNOWE. Senator Abdnor, I do have an opening statement that I would ask unanimous consent to include in the record.

And I would just like to say, Senator Abdnor, that I want to commend you for calling today's hearing on this very timely issue. Today's hearing provides, I think, a much needed forum to examine and assess the effect of AT&T's divestiture on telephone service in this country. I trust that today's hearing will give us an idea of what divestiture will mean to individuals and businesses throughout the country.

We would also be interested in knowing from our witnesses as to what recommendations they would have for congressional action to insure that universal policy, universal service, will remain a basic tenet and assumption of our national policy and that, at the same time, to realize divestiture's intended goals of competition and enhanced technology throughout the decades to come.

So I am looking forward to the testimony that is to be provided by the witnesses today on what is to be a very critical issue to be considered during this Congress, particularly with so many pieces of legislation that will be coming before the Congress for our consideration.

[The opening statement of Representative Snowe follows:]

OPENING STATEMENT OF REPRESENTATIVE SNOWE

I commend my colleague, Senator Abdnor, for calling today's hearing on this timely issue.

Today's hearing provides another most-needed forum to examine the effect of the AT&T divestiture on telephone service in this country.

Undertaken with the laudable intent of increasing competition within the telecommunications industry, the effects of the AT&T divestiture are just now bearing fruition. Most attention has been focused on the FCC's recent access decision which attempts to allocate the costs of phone service among the various categories of users of the system.

What is uppermost in my mind as I review the FCC's decision, is that the concept of universal service embodied in the 1934 Communications Act be maintained. I believe we all can agree that such service benefits all users and that a nationwide telephone system is in the national interest.

I am therefore disturbed by predictions that some low-income individuals may have to drop phone service as a result of the FCC's access decision and other rate increases before state public utility commissions.

Phone service is not a luxury, but a necessity. We must assure the elderly, the handicapped, those living on fixed or low incomes, and those in rural areas that such service will continue and will be reasonable in cost.

Since divestiture and the FCC's access decision are scheduled to take effect on January 1, Congress is under some pressure to act quickly to ensure that affordable phone service is maintained.

I trust that today's hearing will give us an idea of what divestiture will mean to individuals and businesses. We will also be interested in knowing what recommendations our witnesses have for Congressional action to ensure that universal service remains a basic tenet of national policy and that divestiture's intended goals of competition and technological efficiency are realized.

Thank you.

Senator ABDNOR. Thank you very kindly, Congresswoman Snowe.

Gentlemen, we are very, very anxious to hear from you, so we will go right in order, if we might, starting at my left, your right. Mr. Garrison, we are delighted to have you.

STATEMENT OF WILLIAM B. GARRISON, JR., PARTNER, CARRUTHERS, DEUTSCH, GARRISON & WILLIAMS, INC., WASHINGTON, D.C.

Mr. GARRISON. Thank you, Mr. Chairman. I am honored to be here today to testify before your subcommittee.

I believe that the economic health of the telecommunications industry should be of highest national interest because of the increasingly important role telecommunications and information services are playing in the economic health of our country.

My comments today represent my own personal views. They certainly do not represent any collective view of my clients, nor of my firm. My firm's clients include a large range of parties interested in telecommunications—very small and very large telephone companies, international carriers, record carriers, mobile radio companies, State governments and regulatory agencies, investment houses, foreign governments and telephone administrations, equipment manufacturers, cable television operators, and enhanced service offerors.

As you can imagine, I must professionally view these interests from numerous perspectives.

I do very strongly feel that the committee should concern itself with the problems presented for telephone companies, especially the small ones which have inordinately high costs. I agree with your staff's paper that this is not a problem of rural versus urban, but I would suggest that instead it is a problem of high cost versus lower cost.

Finally, I would make two brief miscellaneous points. My firm provides consulting services to investment houses regarding changes in the telecommunications industry. Consequently, I feel reasonably confident in telling you that the Nation's investment community is greatly confused about the implication of these changes for the financial health of this industry. Congress should be mindful of the adverse impact which the current uncertainty regarding public policy is having on the financial standing of the entire telephone industry. Because many investment counselors do not fully understand these changes, I believe they tend to overreact to FCC decisions and to the actions of congressional committees and subcommittees.

This industry is overdue for regulatory stability. Continued uncertainty about the future of telephone companies' profitability in the postdivestiture environment will greatly increase the cost of capital available to those companies. That unnecessary cost must be recovered from the ratepayer through rate increases.

As a final observation, I am growing increasingly concerned about the implications of a weakened telecommunications industry for America's international trade position. Because of the work of my firm for foreign governments and PTT's, and for international communications carriers and equipment manufacturers, I now believe the growth in foreign competition must be given a higher level of public attention.

While this country continues year after year to cast about for coherent telecommunications policies, other nations are eroding our positions of leadership in equipment and service markets.

I would suggest to you that Congress cease concentrating myopically and exclusively on the issue of local rates and should expand its attention to the world. If telecommunications and information industries are truly to be one of the principal keys to our future prosperity, then the people's representatives must begin to better understand the full dimensions of their responsibilities for the future prosperity of those industries.

I hope these comments and opinions will be of assistance to the subcommittee. I would like to submit for your record copies of the studies which my firm has performed for the States of Illinois and North Carolina, as I believe these studies will be helpful to you.[1]

Thank you, Mr. Chairman.

Senator Abdnor. Thank you. We will look forward to the studies, Mr. Garrison, and very excellent testimony.

[The prepared statement of Mr. Garrison follows:]

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[1] The studies referred to for the hearing record may be found in the subcommittee files.

PREPARED STATEMENT OF WILLIAM B. GARRISON, JR.

Mr. Chairman, I am honored to be here today and to testify before your Subcommittee. I believe that the interest shown by the Subcommittee in the economic issues which are developing in the telecommunications industry is very encouraging. I believe that the economic health of this industry should be of highest national interest because of the increasingly important role telecommunications and information services are playing in the economic health of our country.

My comments today represent my own personal views; they certainly do not represent any collective view of my clients nor of my firm. My views are derived from my work over the past seven years, first in state government, then at the National Telecommunications and Information Administration in the U.S. Department of Commerce and now in private consulting. My firm's clients include a wide range of parties interested in telecommunications -- very small and very large telephone companies, international carriers, record carriers, mobile radio companies, state governments and regulatory agencies, profitable when price differences for services are not based on actual costs and are not derived from differences in technological performance. Under current regulatory policies, uneconomic bypass is encouraged because large toll users have incentive to escape the continually escalating long-distance rates from which subsidies for local service have been ~~are~~ derived.

When bypass systems are deployed in a local market, they siphon concentrated business traffic from the local exchange company. As pointed out in this Committee staff's background paper, a very small percentage of business users produce an inordinately high percentage of interexchange calls. As those users leave the network, telephone companies face severe revenue loss without accompanying loss of NTS costs. Consequently, the telephone company's NTS costs must be recovered in higher percentage from low-volume users. The natural result of this economic phenomenon is ever-rising local service rates for marginal or low-volume users.

The Committee should understand that bypass arrangements can be obtained from common carriers other than the local exchange carriers or from privately-owned systems. Because the cost of telecommunications technology has been so dramatically reduced over the past several years, large corporate users can now invest capital in a system to meet their own communications needs. The marginal costs of operating such systems are generally not significant, so that the initial capital investment can be recovered in a relatively short time period and substantial savings in telecommunications costs, therefore, can be realized over the long term. Once a large user has made such a decision, he is lost as a customer to the public network and with him is lost a very substantial revenue source. During the course of my firm's studies in North Carolina and Illinois, we found several corporations now building or with plans to soon build such systems. If the economic incentives to such large users to bypass are not altered, consumers will soon pay significantly higher (and ever-increasing) rates, both local and long-distance.

The legislation now under consideration would attempt to require bypassers to contribute to the subsidization of local service. While such charges might appear to be reasonable and equitable, any scheme of bypass charges will be almost impossible to devise and to administer.

Initially, a workable classification of bypassers must be devised. Any bypass system which directly or indirectly connects to the public network would be included. However, systems which completely bypass the public network present a very difficult problem. First, a question of equity arises -- why should systems which do not use the public network contribute to the defrayal of its costs. One might equally propose that highway users be taxed in order to subsidize the railway industry for the reason that transfer trucks bypass and compete with trains.

A second and very practical difficulty would arise from the exclusion of non-interconnected systems from the bypass charge. Most bypassers will simply migrate to such non-interconnected systems and thereby ultimately defeat any bypass charge scheme.

The administrative problems attendant to any bypass charge scheme promises to be a nightmare, imposing additional costs to industry and consumers. What will be the criteria for the assessment of the charge? What administrative unit will collect the charge? The telephone companies cannot and should not be expected to do so. Inevitably, the government will be required to collect the charge. Is there any reason to suppose that this won't lead to increased bureaucracy and regulation?

In comparision with these difficulties inherent in any scheme of charges on bypassers, the FCC's access charge plan would seem to be a model of efficiency and balanced treatment. The eventual shifting of a significant percentage of NTS costs to end users will allow local exchange carriers to make their facilities available on terms which would be economically competitive with other local facilities. Thus the access charge plan should substantially reduce the economic incentives supporting non-economic bypass. To my mind, this solution to the problem of uneconomic bypass is more efficient, economically sound and consequently greatly preferable to the secondary problems which must arise from the bypass charge proposals.

SUBSIDIES FOR HIGH-COST SERVICE

During the course of debate on rural service over the past seven years, I have observed that no party to the debate has ever begun with the fundamental requirement of sound analytical process; to wit, a definition of the problem or a testing of assumptions.

Everyone seems to assume that all of rural America is characterized by isolated farms separated by great distances with massively subsidized telephone service being the only feasible means of communications. Moreover, the extraordinary amount of time and energy devoted to the debate over rural service has tended to inflate the magnitude of the problem. An example of this tendency is the unquantified assertions which have been made that the alteration of separations and settlements and the implementation of a system of access charges will result in a doubling, tripling or quadrupling of local service rates for rural consumers.

First of all, the Congress should bear in mind some basic facts about contemporary rural demography. The majority of rural Americans live in towns and communities and do not live on widely separated farms. While there are vast areas of the nation characterized by geographically dispersed population, the citizens living in these regions constitute an very small percentage of the American population. Moreover, most rural Americans are no longer employed in agriculture but instead, in growing numbers, are employed in business and industry.

Approximately 80% of America's telephones are serviced by the Bell Operating Companies. Of the remaining 20%, approximately 15% are served by major independent telephone companies. Less than 5% of the telephones in this country are served by local exchange companies which could even conceivably be qualified recipients of any of the proposed rural subsidies. Moreover, these small local exchange companies serve only 13% of the nation's rural population; the Bell Operating Companies, in contrast, serve 53% of rural Americans. Thus the full dimensions of the local rate problem reaches a small percentage of the nation's rural population and an even smaller percentage of the nation's population as a whole.

The local rates charged by companies serving this 5% of the nation's telephones and 13% of the nation's rural population should be the focus for the concern over rural rates. The ratemaking process for these companies requires analysis if one is to establish workable subsidies. The nature of costs varies substantially among this class of telephone companies.

Because there may have been less population growth and movement in some segments of rural America, local distribution facilities may have been installed when costs were lower and may be more fully depreciated than counterparts in more urban places. Such rural plant may have initially been installed with federally-subsidized financing, such as the REA loan program, reducing costs even further. Nonetheless, as a rule of thumb, the costs for provision of service are generally higher for these companies than for larger companies. Consequently, continued subsidization of some of those costs may well be good public policy.

Another point worth bearing in mind in this discussion is that universal service is <u>not</u> a statutorily-mandated policy.

The concept of "universal service" was created by AT&T as a public relations device in the early part of the century. So prevalent has been the Bell System in the public mind in all matters regarding telephony that this advertising slogan has been transmutted over the years into a commonly accepted policy equal almost, it would seem, to a Constitutional right. While I vigorously support the concept of universal <u>communications</u> service, I think that it is healthy to always remember the genesis of "universal service" and that, in the modern world of telecommunications, universal service may not necessarily equate with universal <u>telephone</u> service. I do not believe that the maintenance of universal service requires <u>no</u> local rate increases. The proper goal should be that no local service customer experience sudden rate increases of such magnitude that significant "drop-off" from the public network will occur. This is a reasonable and achievable goal.

The FCC access charge plan envisions a transition of six years as the interstate toll subsidy diminishes. For some Bell Operating Companies and major independent customers, rates may increase as much as 100% over that time period. In North Carolina, for example, this change would mean that the average monthly rate charged to Southern Bell customers would go from approximately $11.60 to $24.00 over seven years. I cannot believe that such an amount of money over seven years is going to result in significant economic burden to the vast majority of those ratepayers. Many of the small telephone companies which serve rural areas have local service rates well below the current national average. One company in North Carolina has a monthly rate of approximately \$4.50, a rate which has not been significantly increased in 20 years. Even if this company's rates were to quadruple within the next seven years, the consumer within that company's territory would be paying approximately \$18.00 per month for local service.

I do not cite these examples in order to deny that increases in local rates, particularly for the small companies, will not be a problem. I merely wish the Committee to have some idea of the actual dimension, particularly in terms of dollars and cents, of this controversial issue.

I do very strongly feel that the Committee should concern itself with the problems presented for telephone companies, especially the small ones, which have inordinately high costs. I agree with your staff's paper that this is not a problem of rural vs. urban, but I would suggest that instead it is a problem of high costs vs. lower costs. I do believe that the various funds proposed to help defray high costs together constitute a reasonable approach to this problem, so long as the subsidy funds go to companies with demonstrably excessive costs and that such costs are directly related to cost of service and not to management inefficiencies. Another approach which has been considered by Congress is a subsidy targeted to consumers with provable need. This, too, is a reasonable approach from a public policy perspective and should also be given careful consideration by this Committee.

The work which my firm has performed in the past two years has shown that many rural telephone companies are facing unique and very difficult challenges which are worthy of Congressional attention and concern. However, the actual economic dimensions of these challenges are not yet fully quantifiable and will only be quantified as the industry moves through a transition away from separations and settlements. That infamous process is inherently anticompetitive, rewards inefficiency and penalizes innovation. Any "solution" to the problem of local rate increases which would prolong or replicate the effects of separations and settlements is the worst possible public policy that could be forced upon this nation's telephone industry as it faces a future of great change and uncertainty.

MISCELLANEOUS POINTS

I should like to briefly mention two points of concern to me which I believe should also concern the Congress. My firm provides consulting services to investment houses regarding changes in the telecommunications industry, particularly concerning the divestiture and the access charge decision. Consequently, I feel reasonably confident in telling you that the nation's investment community is greatly confused about the implications of these changes for the financial health of this industry in general and its constituent companies in specific. In fairness, I should observe that the issues of costs and rates in telephony in this country are almost past human understanding and defy even the most subtle logic!

However, Congress should be mindful of the adverse impact which the current uncertainty regarding public policy is having on the financial standing of the entire telephone industry. Because many investment counsel~~l~~ors do not fully understand these changes, I believe that they tend to overreact to any FCC dockets or decisions and to actions by Congressional committees and subcommittees. One example of the effects of such overreaction is the recent precipitous drop in the value of MCI's stock following the FCC reconsideration decision of the access charge plan. Financial analysts drew broadly generalized conclusions concerning the possible effects of the Commission's decision. These conclusions triggered "dumping" of MCI's stock on the exchange. Similarly, Moody's Investors Service has lowered the bond ratings of the Bell Operating Companies because of the divestiture and the assumed adverse climate for satisfactory cost recovery and revenue generation.

This industry is overdue for regulatory stability in public policy. Continued uncertainty about the regulatory future of telephone companies in the post-divestiture environment will greatly increase the cost of capital available to those companies. That unnecessary cost must be recovered from the ratepayer through rate increases. Those increases will simply add to the already-projected rate increases which have been of so much recent concern to Congress.

As a final observation, I am growing increasingly concerned about the implications of a weakened telecommunications industry for America's international trade position. In the past, I have generally not regarded this issue as one worthy of significant attention. Because of the work of my firm for foreign governments and PTTs and for international communications carriers and equipment manufacturers, I now believe the growth in foreign competition must be given a higher level of public concern.

While this country continues, year after year, to cast about for coherent telecommunications policies, other nations are eroding our positions of leadership in equipment and in service markets. I do not think I need to discuss the Japanese activities in this regard. However, I wish the Committee to realize that we face very effective and increasing competition in our domestic, as well as in foreign markets, from a growing number of trade rivals. I would suggest to you that the Congress should cease concentrating myopically and exclusively on the issue of local rates and should expand its attention to the world. If telecommunications and information industries are truly to be one of the principal keys to our people's future prosperity, then the people's representatives must begin to better understand the full dimension of their responsibilities for the future prosperity of those industries.

CONCLUSION

I hope these comments and opinions will be of assistance to the Committee. I would like to submit, for your record, copies of the studies which my firm performed for the States of Illinois and North Carolina. I believe these studies will be helpful to you as you consider the issues which I have touched on today.

Thank you, Mr. Chairman.

Senator ABDNOR. Our next witness is Mr. Lee Richardson, vice president of the Consumer Federation of America.

Mr. Richardson, we welcome you to our panel.

STATEMENT OF LEE RICHARDSON, VICE PRESIDENT, CONSUMER FEDERATION OF AMERICA, WASHINGTON, D.C.

Mr. RICHARDSON. Thank you, Mr. Chairman. I want to compliment the fine paper that I was presented with that outlined many of the issues. I might say that unusual among such papers is the fact that I, as a consumer, could read it without the usual gobbledy-gook of specialized language. It was really quite well done.

Senator ABDNOR. Thank you.

Mr. RICHARDSON. A quote from a trade publication, "Telephony," I think sums up the dilemma that consumers see. In an editorial, it says:

> On the heels of announcement of divestiture of the BOCs came a number of requests for local rate increases, long-winded explanations of the need for local access charges, and stout denials that the divestiture had anything to do with these proposed rate increases.

I think the basic contradiction may have a lot to do with why stockholders, employees of Bell System companies, the general public, the press, and people in their roles as consumers, are quite frustrated by the scenario of changes that are about to come about in the industry.

The divestiture, indeed, though, did not cause the rate increases. You might say divestitures have to do with divesting. AT&T is being divided into 8 major parts and each corporation will have about $15 billion or more in assets.

Once separated, these companies will no longer stifle or delay or impede competition and innovation, as it is alleged in long documents before the courts that they have done so in the past.

Aside from some one-time restructuring costs for AT&T, this divestiture should bring about eventually lower prices, better products and services, and more choices, all beneficial for consumers and probably superior to anything that a central bureaucracy of one company could have produced for us in the 1980's and beyond.

But, nonetheless, the threat of rate increases is, indeed, a real one. There seem to be two basic causes for the immediate concern. One is the FCC's access charge decision of last December announced to us just before Christmas as a present, I suppose, from the Commissioners. And then the State-level rate cases that have been initiated largely by the Bell affiliates.

The FCC's access decision cuts back on the amount of payments by long distance companies, primarily AT&T, to the local telephone companies. The FCC reasons that this is necessary since customers require access, regardless of the types and amounts of services that they will obtain from this connection.

On the other hand, it seems to fly in the face of the long-established, similarly economic type of policy in which two services or several services would share in the costs of this connection to the local network.

There are several problems with the access charge decision, in my view, that should be noted and I still think are unresolved. One is that the access charge decision is based upon an incomplete and often criticized accounting system that is used by the FCC, and thus, has become the standard for the industry, that tries to place costs in particular categories for reasons that really are not relevant to today's economy. Cost causation and other generally accepted principles of accounting or economics are just simply not inherent principles in the accounting system that we now have.

The General Accounting Office, in its criticism of September 1981, has yet to get a good response from the FCC other than the creation of a massive committee of outsiders, no less, who are supposed to come up with this accounting system to help FCC straighten out its mess of many decades.

Well, because of the lack of decent accounting, it gets circuit-riding economists and other expert witnesses rich, going from State to State trying to argue different economics and different approaches to cost that are simply not possible to resolve in a scientific sense.

The new economic theory of the Bell System and the FCC is also, I think, not theoretically sound. The access charge economics essentially argues that the local customers should pay all joint costs of their connection to the long distance, as well as the local telephone network.

It seems to imply that we have a local system sitting there to which we add a long-distance system to connect it. One could also turn that argument around and point out that if we had a long-distance system in place, which we do, we could argue that much of the local system has been added to that, so therefore, why not have long distance bear the cost instead of local customers bear the costs of these connections?

Either is probably the wrong approach and the answer lies in dividing the costs between different services that use the system.

Well, I think the FCC's economic approach would not be compelling unless they had added the question of bypass and the predictions of the amount of future bypass to their argument.

They believe that inherently in this justification of the decision, that they can avoid much of the horrors of bypass by moving to the new access charge type of system. We have to note that they are forecasting technology in a very uncertain environment, but they are very certain in the fact that they wish to shift $7 billion, or whatever the appropriate number is, in costs to local customers to avoid these horrors of bypass. In order to protect the local customers against the horrors of bypass, we see, then, an $8.50 nationwide average per customer per month charge as the solution to the alleged horrors that bypass will bring us.

I think we could perhaps look at the statistics here where we have a certain cost of $8.50 per customer per month and weigh that against the strength of the evidence about bypass, which, of course, is highly speculative, as FCC would, of course, have to admit.

Now also, as we look at bypass, the FCC, upon closer reading, is not really able to offer a complete solution to bypass. They are only talking about something called "uneconomic bypass," which is that amount of bypass which would be caused by the extra cost of long distance under the current type of separation system.

So, in other words, the FCC's solution is only to a portion which they allege to be uneconomic, a portion of the bypass problem and not to try to attempt to forever hold off bypass.

So, again, the $7 billion as a solution to just that portion of bypass that they think might be affected by the change to the access charge system.

Well, it is true, I think, that the old separation and settlements process could stand a good, hard look. And I think that there are probably fine-tunings that would have been done if we were not throwing the system out, basically, over the next few years. It is also quite easy to argue, as some have, that perhaps all the alleged benefits of separations and settlements did not always come through just to the local small business and residential customers, that there was not a direct flow-through.

It is very hard to identify these things in view of the accounting system's imperfections. But, certainly, there are many experts who have argued that, for example, equipment sales were somewhat beneficiaries of the separations and settlements flow, that these may not have been supporting their own weight and thus, taking away from the benefits that residential and small business customers were supposed to have been receiving under the system.

It is just very hard to measure this.

Another problem is that one bypass solution leads to another bypass problem. If it is alleged that increased bypass costs, increased cost to the long-distance system as a result of the current method of allocating costs, causes bypass, to some extent, then if we shift those costs to the local system, to the local customers, that raises their prices and thus, creates another kind of bypass potential, and incentive for competitors, current and future, to find ways to bypass a much higher cost local exchange system.

And here we are talking about possibilities such as cable and many others that at least have been talked about as potential bypassers. To the extent that we raise local rates, we give a greater incentive for local bypass systems to develop.

It seems to me the FCC should have taken a much harder look at what the loading of these costs onto the local system would have done for purely local bypass purposes in the future.

A benefit that consumers have heard that they are to receive as a result of the access charge system is reduced interstate long distance rates. I would suggest that as the policy of pricing long distance unfolds, that the small customer, the rural customer, residential and small business customers, will be those least benefiting from these types of new long-distance pricing system.

I make a certain number of predictions in my prepared statement about the design of those types of future long-distance services and the rates of those services. It is of note, I guess, that today, AT&T is to file a particular case proposal before the FCC. I am not predicting that today's filing would contain these elements of pricing. I do not think that AT&T is foolish enough in the politically charged atmosphere here to make it look like all benefits of lower prices in long distance are going to go to only the large customers.

My prepared statement is about future pricing, not a prediction for today's filing.

Finally, the local rate case problem as sort of part two of much of the sky-is-falling atmosphere that we have concerning rising rates of telephone service for local customers. I think if you look at the local rate cases that are being considered today, or have been recently resolved by the States, that much of the content of those rate cases is sort of the old Christmas tree of desires and hopes and wishes of many of these telephone companies. Much of these local rate cases are justified by press releases and general statements from the company as somehow being necessitated by uncontrollable Federal decisions that are beyond State jurisdiction. But, I think that the results of a closer examination of most of them will show that they are asking for the same old things in these rate cases, in large part, and that they do not deserve them strictly as a result of the change in the Federal level.

This concludes my testimony, Mr. Chairman.

[The prepared statement of Mr. Richardson, together with the attached appendixes, follows:]

PREPARED STATEMENT OF LEE RICHARDSON

"On the heels of announcement of divestiture of the BOC's came a number of requests for local rate increases, long-winded explanations of the need for local access charges and stout denials that the divestiture has anything to do with these proposed rate increases."

In this keen observation by Telephony (August 22, 1983) (see Appendix A), AT&T's hugely successful public information campaign to sell the nation on the need for massive rate increases is reduced to the essence of its logical inconsistency.

The public opinion leaders, journalists, and regulators have almost accepted the notion that higher rates are morally right even if painful. All this is necessary now, we are told, in conjunction with a divestiture of AT&T that didn't really cause it.

Such gobbledegook economics should have caused more sharp questioning much sooner than it did.

The divestiture, indeed, did not cause rate increases. Divestitures are for divesting. AT&T is being divided into several parts, all eight of which will be among America's largest corporations with $15 billion or more in assets. When separated, their interests no longer in one vertically and horizontally combined "Ma Bell," they will not stifle, delay, and impede competition and innovation as it is alleged they did so often in the past. Aside from some one-time costs of restructuring AT&T, the divestiture should bring lower prices, better products and services, and more choices--all far more beneficial than what central planning in the old company bureaucracy would have brought us in the 1980's and beyond.

The threat of enormous rate increases is nonetheless a real one. "The sky is falling" as a result of two major causes:

1. The FCC access charge decision in Docket CC78-72.

2. State level rate cases initiated by Bell affiliates.

The two causes are interrelated in the sense that state rate cases include elements that are needed to make up for the revenue deficits that the FCC decision imposes on local companies.

Access Charges

The FCC's decision cuts back on the amount of payments by long distance companies (primarily AT&T) to local telephone companies. The FCC reasons that customers should pay for their access to the local telephone network since they require the access regardless of the types and amounts of service they obtain from the connection.

This is new economics to say the least. In fact, it is not an appropriate concept either in theory or in practice. No reasonable economic theory could lead to the FCC's conclusion that uniformly raising the costs of local service connections for millions of diverse customers reflects the proper allocation of costs for the nation's multi-purpose telephone system. The FCC is wrong in theory and principle for several reasons:

1. The correct definitions of accounts and their allocations among different services that use the telephone network are yet to be properly determined. To this very date, the FCC has failed to develop a proper telephone cost accounting system. The FCC thus has assumed its own antiquated accounting system generated the proper cost data upon which to base its calculations of the revenue shifts needed to make local customers pay their full access costs.

The most telling critique of this failure in accounting is that of the General Accounting Office on September 24, 1981 (CED-81-136). Hence, there is enormous disagreement among accountants and regulatory economists about the proper assignments of costs in state rate cases. Regulators, in turn, accept widely varying arguments about costs depending on whether Bell System economic consultants are persuasive in a particular case or whether the intervenors are more convincing.

Circuit riding expert witnesses who appear in many states for the Bell System are unusually uniform in their approaches to the cost issues, though claiming that they are acting independently of AT&T and on behalf of AT&T's soon-to-be-divested interests. It is a travesty of the regulatory process. This procedure has placed the Bell operating companies (BOC's) in favor of dumping multi-billion dollar costs on their customers -- costs which have been borne heretofore by long distance services. The willingness to saddle themselves with huge costs may be corporate suicide for the Bell operating companies. Logically, the BOC's should be in Washington trying to overturn the burdens created by the FCC's access charge decision.

2. "Access charge economics" is far less theoretically sound than the previous policy whereby there was an attempt to allocate costs among services. While the cost data is open to question, the idea that each service should share in the costs was sensible economics as well as a national policy established by a court decision (Smith v. Illinois Bell) that pre-dated the Communications Act of 1934. "Access charge economics" essentially argues that customers of local service companies should pay all joint costs of their connection to the long distance as well as local telephone network.

Outside of purely monopolistic, regulated environments, there are no parallels to this FCC approach to economics. Yet this new system, it is argued, is made necessary by the increasingly competitive nature of toll service. The mix of regulated and competitive services using local customers' connection facilities results in that worst of all possibilities that economists of all persuasions seek to avoid: monopoly services subsidizing competitive ones. The FCC has made this subsidization of competition a matter of national policy.

3. The FCC's shaky economics would not be convincing if left to stand on its theoretical principles, but FCC and the Bell System have added the problem

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of "by-pass" to further confuse the situation. We are to believe that by-pass can be avoided in large part by the access charge system.

Upon examination, one wonders just how serious by-pass can be in view of the fact that FCC is willing to shift $7 billion (or more) in costs to local customers to avoid it! Rates will rise somewhere in the vicinity of $8.50 (nationwide average) per customer per month as a result of the FCC's access charges for interstate service -- the "solution" to the by-pass problem.

In spite of this scenario, the threat of by-pass is essentially undocumented. No definitive forecast of its effects has been offered by AT&T or any other source. The by-pass threat is argued as a strong possibility supported only by incidents where some by-pass has already occured. Oddly enough, telephone companies provide private line services, which by-pass the local networks. Thus, telephone companies could be said to be the nation's major "by-passers" (of their own services, no less!).

Moreover, the FCC's access charge plan is not an attempt to eliminate all forms of by-pass. According to the FCC, in the old separations system, by-pass caused by payments from long-distance companies to support the local non-traffic sensitive system, was based on false economic signals. The FCC is only concerned with the "uneconomic" bypass due to these extra payments.

But, "economic" by-pass is likely to occur even where long distance rates are lowered as a result of the access charge decision. In many cases where heavy calling volumes and newer technologies are present, the economics of by-pass will be overwhelmingly favorable.

The argument that local telephone revenues will be seriously reduced by by-pass should be examined. This seems suspect in view of the more obvious impact on by-passed long-distance services, which will no longer be provided interstate (or inter-L.A.T.A. within states) by Bell operating companies. By-pass is clearly a problem mostly for long distance firms.

Finally, the by-pass revenue impacts on local companies, while small, seem to be poorly defined by those who argue the by-pass case. Where local companies are by-passed, revenues derived from facilities and operations related to those long distance customers will be affected. There seems to be an implication that huge unpaid-for facilities will lie abandoned all about local company territories. But by-passers will still need and pay for local services and connections. It is difficult to conceive of totally abandoned and unusable facilities caused by so-called uneconomic by-pass.

Of course, under the new FCC plan, by-pass will have almost no significant revenue impacts on local companies. The FCC has eliminated the potential problem by eliminating the opportunity for local companies to share in revenues that could help them split costs of common facilities connecting customers to the local and long distance services.

4. Local exchange customers, particularly smaller business and residential customers, may not have been treated fairly in the current separations and settlements revenue division process. Given that the accounting systems are imperfect, subsidies other than to the basic residential and small business subscribers could easily have occurred. This allegation needs more attention. For example, equipment sales may have been subsidized. If true, then it would follow that local rates could fall as local Bell companies abandon customer equipment sales activities.

However optimistic one might be about these claims, there is little evidence that any such savings are recognized in state rate case proceedings now taking place. Consequently, there is little chance that any offsets will be found from this source to soften the FCC access charge impact.

In fact, the FCC's precedent for interstate rate design has become the signal for telephone companies to recommend similar designs for state regulated intrastate rates. This would have enormous impact on local rates. In many states, intrastate revenues have been made more critical by the practice of setting such rates far in excess of the FCC's interstate rates. In those states, the revenue impacts of parity with the new Federal rates would be especially severe. Again, one wonders at the suicidal tendencies of Bell operating companies who openly support such intrastate access charge decisions.

Altogether, it is hard to be optimistic that new state rate designs for residential and small business customers will offset the affects of the FCC's access charge decisions. The reverse is more likely.

5. Local customer by-pass of local exchange has not been given adequate attention. Increased local rates simply make it more likely that competitors may arise to help local customers by-pass the more costly service. While difficult to forecast, to the extent it does occur, the revenue impacts on local companies will be relatively far greater than equivalent amounts of long distance customer by-pass. The local revenue loss of local customers leaving the local network is, of course, 100% of that revenue. It should not be surprising that long distance companies and their interstate regulator (the FCC) have shown little concern for this possible result of the access charge decision. Since the BOC's are still units of AT&T, they should not be expected to present the case against the access charge impact on local customer by-pass in 1983.

Reduced Interstate Long Distance Rates

For most telephone users, it is unlikely that reduced rates will fully offset the damage done by the FCC access charge decision.

First, due to actual or perceived threats of competition, AT&T will have incentives to restructure its long distance rates to meet the competition. Mindful of the potency of public outrage and importance of legislative timing, it is not likely that AT&T will immediately seek to restructure its long distance rates to favor big customers. Certain changes will be likely, however, once the FCC's access charge is implemented, making it much harder to overturn. Among the new principles AT&T will follow are:

1. Big discounts to the handful of large (Fortune 500 and other major service industry) companies who threaten to by-pass or who might expand their usage of the long distance network.

2. Low prices for important new services such as electronic mail, in order to build its customer base ahead of the competition. AT&T especially will be tempted to take advantage of its great edge in existing facilities to entice customers with this type of market penetration pricing strategy for new services.

3. De-averaging of nationwide rates. There may be competitive reasons to establish lower rates in certain markets. Much of the fears of rural customers could be realized as it appears most likely that urban areas would be the favored targets of such discounting.

4. Raising short-haul rates. Two weeks ago, in "leaking" its plans of the likely design of the interstate rates in today's filing, AT&T admitted that short distance calls would not be reduced much. Rural customers, who live in small local exhanges, will be the most disappointed because they often make quite a large number of toll calls as part of their normal business and personal lives.

A second effect of the anticipated filing is that it may set precedents for intrastate rate designs. There are relatively more short distance intrastate calls than there are interstate calls. So, intrastate revenues will, on the average, be reduced less. AT&T's inter-L.A.T.A., intra-state business thus would not experience much revenue reduction where state rates are on a parity with the Federal rates.

5. Volume discounts for residential customers. The FCC has already allowed AT&T to conduct experiments with an array of volume discount offerings to high use residential customers. This type of pricing would help AT&T against competitors

such as MCI and Sprint and thus is almost certain to be proposed nationally before very long.

The sum of all these developments is not promising for residential customers, the vast majority of whom are relatively light users of long distance telephone service. Not all of these developments are inherently bad or uneconomic, but they do mean reduced rates are largely going to benefit the small numbers of large customers--especially the big volume business users.

One fear that consumers may again realize is that future proposals may get superficial treatment in the hands of the FCC. The FCC has limited resources, virtually no consumer participation in its rate cases, an inadequate cost accounting system by which to evaluate the fairness of rate design changes, a bias toward any proposal than can be made to seem like it is made necessary for competitive reasons, and an overall history of reacting to AT&T rather than making its own proposals in the public interest. Altogether, the occasional long distance user might rightly fear that the FCC will permit his rates to subsidize AT&T's competitive wars with MCI, Sprint and others.

Local Rate Cases

Pending rate cases in the states now add up to $5 to $10 billion. Collectively, they constitute an even more significant potential for raising local phone rates in the near future than the first installment of the FCC access charge plan. There is some overlap in the two, and thus double counting, where a state rate request includes some anticipated revenue shortfall due to the FCC. This is indeed an example of the confusion in operating company policies, since some companies had already sought rate increases related to the FCC decision before the FCC made it final just two months ago. The final order made unexpected changes in the dollar amounts for both residential and business customers in 1984.

Every state rate case is individual in its design, argument, and the conditions with which companies and their regulators have to contend. Nonetheless, it is useful to note that many of the cases how outstanding and pending follow a general pattern.

Many are justified by press releases and general statements that tie them to Federal decisions totally beyond state jurisdiction. The public thus is led to believe that "Washington did it again" and their local company is not to be blamed. The public is deceived.

Most such rate cases are really rather familiar and traditional in content. As such, state regulators can produce some pleasant surprises for their respective constituents by applying the usual yardsticks and deflating the company requests at the time judgements upon these requests are made. Indeed, many state regulators have done just that because they have found company accounting practices, desires for massive rates of return increases, and rate design changes lacking justification. In sum, Washington didn't cause the rates to go up -- it was mostly just the usual rate case with a convenient new scapegoat in the form of the inevitable confusion caused by the FCC and the far-reaching impacts of divestiture.

Telephone rates for Impacted Populations

A continuous theme of AT&T as well as its competitors in the wake of access charges is that the impact of all of the anticipated rate increases can be largely offset by rate redesign at the local level.

This is true to some extent, but several points should be kept in mind concerning this solution:

1. This argument is based on premises that should be scrutinized and rejected. It implies acceptance of access charges and local rate requests, the two major villains in the scenario, and both of these should be challenged on numerous grounds as shown above.

2. Whatever relief is granted to some residential consumers results in revenue losses that must be made up somewhere else by the local company on other customers (business or residential).

3. Much of the telephone industry solution actually comes in the form of local measured service (LMS). LMS is wonderful for large telephone company revenue purposes,

but is essentially not desired or chosen by customers in those places where it has been introduced already (and unlike New York City where customers have a flat rate option available to them). Opposition by senior citizen groups and others to LMS (See Appendix B) has seen it rejected in total by regulators in a number of states in recent years. Virtually no demand exists for LMS -- customers and consumer groups almost never support it in state rate cases.

4. There exist budget and lifeline rates in a number of states where those customers who really desire them can and do choose them over optional flat rate services. Historically opposed by the Bell companies (who often subject these plans to proposed rate increase),these rates can, up to a point, be used to meet the needs of impacted populations. Basically such rates are set at a low monthly minimum ($2 - $10 below flat rate options) and allow calls to be made subject to a per call charge. An allowance of perhaps 20 to 65 free calls may be included in the minimum monthly charge under these plans. There is no single best way to design and price such rates. Each state should establish such options best suited to the circumstances it faces.

This concludes my testimony.

Appendix A

telephony
THE JOURNAL OF TELECOMMUNICATIONS SINCE 1901

AS WE SEE IT

A sleeping giant awakes

PARTICIPANTS in the tumultuous telecommunications industry of the last 15 years may find it difficult to believe, but there is a vast, increasingly restless group that, having been given a taste of telecommunications deregulation, is beginning to make a face and may try to spit it out.

The group with the bad taste in its mouth is the U.S. public, which has managed to remain steadfastly ignorant of developments in the telecommunications industry, particularly in regard to the antitrust suit pressed by the Dept. of Justice against American Telephone & Telegraph Co. (AT&T), which has resulted in an ambitious plan to divest the Bell Operating Companies (BOCs) from parent AT&T as of next Jan. 1.

Two questions: why did the public so long apparently choose to remain uninformed about the most drastic business reorganization in the nation's history, and its consequences; and, why, now that they're listening to the news, have they decided they don't like it?

In answer to the first question, the public remained ignorant of developments in telecommunications because it is the public. Consumers, it is said by those who study the dynamics of the group, don't act, they *react*. It is futile to call on consumers to work against a possibility, even a probability; they are stirred only by direct effect on themselves.

And, that fact suggests an answer to the second question (Why are they waking up now?). On the heels of announcement of divestiture of the BOCs came a number of requests for local rate increases, long-winded explanations of the need for "local access charges" and stout denials that the divestiture has anything to do with these proposed rate increases.

The public is awake because it is about to be hit in its most sensitive spot, its pocket.

Also, sensing the simmering public wrath over higher telephone rates (for which the public already is blaming "the government"), newspaper columnists, magazine writers and business news editors all are covering the imminent demise of the Bell System.

As we see it, Jan. 1, 1984, may not mark the beginning of recovery from a foundation-shattering earthquake; it may mark only the beginning of a long period of after-shocks. □

Appendix B
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Usage Sensitive Pricing

The Case Against Local Measured Service

From the consumer's perspective, Lee Richardson challenges the mythology of local measured service. The proponents of LMS, he says, have failed to present a convincing reason to change the present rate system.

By Lee Richardson

Local measured service (LMS) is designed to increase telephone bills to consumers, make it difficult to figure out how a rate increase will affect one's bill, and increase the profits of the major telephone companies.

The effect on consumers will be to make bills almost incomprehensible, vary bills greatly from month to month, and make telephone service almost unaffordable for some families—rich and poor, rural and urban, older and younger.

The goal of the Bell System is to make LMS the predominant form of residential service by 1985.

In the past two years, many state public service commissions have decided to reject even optional or trial-basis local measured service plans.

Even if only half of the foregoing statements are true, it does seem reasonable for consumers to examine the efforts of the major telephone companies to sell this new rate system. Even more, it is imperative for small businesses, farm operators, community and church organizations, and others who rely heavily on telephones for a living or for social contacts to study the subject closely. Otherwise, you may have to decide whether to opt for LMS before you are ready to do so.

The case against the current proposals for LMS is multifaceted. First, the myths espoused by proponents need to be shot down.

Myth I:

It is reasonable to pay for what you use.

There is reason to pay for what you use—but only if you pay according to the costs you impose on the telephone system by using a given service.

LMS is frequently presumed to offer a way for consumers to pay a fair share of the costs.

Not so.

Maybe so, eventually.

Today, there is no cost accounting system in standard use in the telephone industry. What this means is that there is really no way to determine whether proposed usage charges reflect actual costs, unless "special studies" are conducted by the utility itself or unless some other unconventional accounting techniques are em-

Lee Richardson is president of the Maryland Citizens Consumer Council and vice-president of the Consumer Federation of America. He has frequently testified as an expert witness in utility rate cases.

ployed to justify costs. A September 1981 study by the General Accounting Office (GAO), an arm of the U.S. Congress, severely criticized the agency charged with completing this task. The Federal Communications Commission, GAO concluded, has failed over the past 20 years even to develop the principles of accounting that should be used to sort out costs in the industry.

Keep in mind that usage charges—per call, per minute, or per mile, for example—could vary dramatically from one telephone system to another.

One chilling real-life example is the caller within Dade County, Florida with LMS who can pay as much as $3.74 for a 60-minute local call. The question to ask is whether that call should cost $3.74—or 3¢ or—?

Myth II:

The choice is flat rates or LMS.

There are any number of choices besides a precise package of an access charge and four usage charges (for frequency, duration, distance, and time-of-day). Measurement could be made of additional variables, including calls not completed (busy signals), incoming calls, or any others that an imaginative ratemaker might invent. Also, instead of four usage charges, why not one?

The telephone industry has long resisted a simple form of frequency-only service: Lifeline. Such a service, for example, might cost $2 to $4 per month and include an allowance of from 30 to 60 calls (without a charge for local distance, duration, or time of day). Additional calls would be billed per call. Simple, neat, understandable, economy service for those who want it. Why not?

Myth III:

LMS will help low-income and senior citizen customers.

LMS will help any consumer (residential or business) who can avoid making a lot of calls. But many people depend heavily on their phones, including

- large families
- families with teenagers
- people who need to make frequent outside communications because they are confined to their homes
- people whose residences are physically isolated, as in rural areas
- people who are afraid to leave home (particularly in cities)

Even these examples don't identify all of the individual reasons why some people choose to use their phones a great deal instead of driving their autos, using the mail, or meeting face to face. After all, the telephone has been promoted successfully by the industry for decades and is truly essential in its many uses.

In effect, you can benefit from telephone usage-sensitive pricing only by using your phone less than others do.

Myth IV:

LMS is optional.

In order for anyone to save money, someone else will have to pay more. LMS costs extra to administer and implement (above what flat-rate systems cost), and these costs have to be paid for, too.

Where LMS is introduced as an option, experience confirms what logical consumers will do. Those who can save money will choose it. The major telephone companies, however, have to make up the lost revenues, and they have stated their general intentions to raise flat rates to cover the deficit. Thus, a spiral is set in motion as customers with flat-rate service start shifting in increasing numbers to LMS. The spiral will continue until only a few customers remain on what the Bell System intends to call "premium" flat-rate service. This premium service may cost two or three times more than what a flat-rate system would have charged.

Optional LMS, once introduced, is the beginning of a road toward the predominance of LMS in a community. For many people, the option will be uneconomic—premium flat rates or high LMS charges—unless they learn to live without the normal use of their phones. For parents who can't control children or themselves, the only remaining options may be to remove the phone, lock it up, or hide it.

Is this necessary?

Continued p. 47

> ". . . Some people choose to use their phones a great deal instead of driving their autos, using the mail, or meeting face to face. After all, the telephone has been promoted successfully by the industry for decades and is truly essential in its many uses."

Appendix B

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> If we gain efficiency at the expense of low-income and fixed-income families who are forced by economic necessity to reduce telephone use, we will have deceived ourselves in the name of economic efficiency.

The Case Against LMS
from p. 19

Myth V:

LMS will enable people to reduce their phone bills by controlling their use.

Any measurement system offers this possibility. But telephone use involves two parties and thus "conservation" is not totally under the control of the would-be telephone conservationist. Friends may not want to cut off conversations. Grandmother may not want to move closer to cut the distance charges. Doctors have to be called when they are needed. The hardware store may not choose to remain open at midnight to save your time-of-day charges.

Control means controlling all family members as well as visitors, roommates, and babysitters. For businesses, it means controlling calls of employees trying to escape LMS at home.

Sure, control is possible, but is it really necessary?

Myth VI:

LMS will lower overall telephone costs to society.

This is a desirable goal if wasteful use is eliminated, if the existing telephone plant is used more efficiently, and if the national telephone bill can be lowered as a result.

The huge investment by the industry in telephone plant has required a major use of capital in the U.S. economy. But if we gain efficiency at the expense of low-income and fixed-income families who are forced by economic necessity to reduce telephone use, we will have deceived ourselves in the name of economic efficiency. If people have to change their lifestyles, reduce their participation in community life, stop volunteering for church membership drives, and drive their cars more often, we will have lost more than we have gained.

Hold the Line

The telephone companies that are proposing LMS are making a great effort to implement it, at least on an optional basis at first. Although this drive has met with little success, it will continue.

The LMS proposals imply a new kind of predominant telephone service rate system—not an optional service.

The major companies have not made their case for LMS match their theoretical explanations. Economists can speak of LMS approvingly in theory, but the proposals to date that have come before regulatory commissions fall short.

The burden of proof for a radical change in a heretofore satisfactory flat-rate system (85 percent of the nation's residential customers have flat rates today) rests with proponents. Flat rates may not be the best system for 1990 or the year 2000, but we know the current approach has worked well so far.

If it ain't broke, don't fix it.

Notes for Rural Telcos

- At this time, local measured service offers few benefits, if any, for rural telcos—particularly those that have central offices with fewer than 5,000 subscribers. It is possible that the cost of the needed measuring and billing equipment would simply increase both the telco's operating costs and the subscriber's rates—without any corresponding savings. Or, LMS might offer only a new way of distributing the cost of service.
- For digital central offices with more than 5,000 subscribers, LMS may be feasible. The costs and benefits, however, must be weighed carefully—from the perspective of both the telco and the subscriber.
- For now, usage sensitive pricing can best be applied toward solving problems related to Extended Area Service and toward reducing the telco's costs of providing directory assistance.

Appendix C

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SCHOOL OF BUSINESS
MARKETING DEPARTMENT

Lee Richardson is Professor and Martin Marietta Eminent Scholar at the University of Baltimore's Department of Marketing.

An author of numerous scholarly articles and three books used in university marketing and finance courses, he was chairman of the Department of Marketing and full professor at Louisiana State University. He has taught at Southern University, the University of Pennsylvania, and the University of Maryland. He has business degrees from Richmond and Emory universities and obtained his D.B.A. in marketing at the University of Colorado.

In 1974, he created and then directed what is now the U.S. Department of Energy's Office of Consumer Affairs. He was director and served in other capacities with the U.S. Office of Consumer Affairs (USOCA) in 1972-74 and 1977-79. He was appointed a member of the F.C.C.'s Telephone Industry Advisory Group, a body charged with a revamping the accounting system of the U.S. telephone network by 1985.

He initiated a policy of formal interventions by USOCA and also gave testimony in those proceedings. Cases were entered at the Federal Energy Regulatory Commission (involving New Hampshire's Seabrook Plant), the Federal Communications Commission (involving alleged excess profits of AT&T), and the Interstate Commerce Commission (involving coal shipping rates by railroads). He was the first private citizen appointed as a consumer advisor on a U.S. trade delegation (1977) and was selected four additional times by the U.S. State Department for European negotiations on sugar trade agreements and other meetings.

Dr. Richardson appears as an expert witness in electric and telephone cases before courts and utility commissions in numerous states. He is a specialist in cases involving local measured telephone service and writes frequently for national publications on this method of pricing telephone service by the amount of use. He recently authored several publications on consumer education and has delivered more than 240 speeches and talks on consumer affairs in the past decade. He is a member of several advisory committees to industry

He has published the Lee Richardson Letter, "the newsletter of consumer affairs:, since 1979. He was elected twice as president in 1976 and 1977 of the Consumer Federation of America, the nation's largest consumers' organization, and is now CFA vice-president. He was a founder and president of the Louisiana Consumers; League and is in his second term as president of the Maryland Citizens Consumer Council, the statewide consumer advocacy organization. He chairs the Consumer Affairs Advisory Board to Howard County, Maryland. He is a frequent consumer consultant to government agencies, consumer organizations and businesses.

Senator ABDNOR. Thank you, Mr. Richardson. We appreciate that input.

Our next witness is a gentleman with whom I am vaguely familiar because I know he has worked on South Dakota's telephone problems. Mr. Korsmo, we really welcome you to the committee. We would be pleased to hear from you.

STATEMENT OF KARL J. KORSMO, PARTNER, ERNST & WHINNEY, TACOMA, WASH.

Mr. KORSMO. Thank you, Mr. Chairman.

I thank you for inviting me to comment today on the economic issues facing the telecommunications industry.

At the request of the committee staff, I will concentrate my remarks on the problems facing rural and other high cost areas of the United States in an increasingly competitive telecommunications industry.

I am a partner in the telecommunications consulting group of Ernst & Whinney, a public accounting firm. During the last several years, I have worked with a number of independent telephone companies which serve predominantly rural areas. We have attempted to find solutions to the problems of implementing competition and maintaining universal telephone service.

Our focus has been on the proceedings at the Federal Communications Commission involving access charges and allocation of access costs between the Federal and the State jurisdictions.

In my opinion, the challenge we face today is not to correct mistakes of the past, for I believe that the industry structure of the past has yielded tremendous benefits to the American consumer. Rather, the challenge is to adopt a new industry structure consistent with the rapid technological progress in telecommunications, while preserving the quality and near-universal penetration of basic telephone service.

Studies conducted by Ernst & Whinney and others of the cost of providing telephone service have demonstrated wide variations in costs between geographical areas in the United States. The total monthly cost of providing an access line to a customer ranges from $10 to $15 in low-cost areas to between $40 and $60 in some high-cost areas.

The current system of compensating telephone companies for these costs relies heavily on contributions from users of long-distance services. The result has been that the monthly telephone bills paid by customers, particularly those customers in high-cost areas, have not shown the same extreme variations as the cost of providing the service.

Most people in the industry have recognized for some time that the current system of cost compensation and pricing must change to fit the competitive environment. Thus, the FCC has reached a decision in its access charge proceeding and is near to a decision in its jurisdictional cost allocation proceeding.

The FCC has decided that, over time, long-distance users should contribute less than today toward the cost of each customer's access line. This will shift more of the cost burden onto customers in the form of monthly charges. This concept, in my opinion, is sound in this competitive environment, but must take into account the cost variations I previously mentioned.

Rural areas of the United States are typically areas of relatively low population density. This results in longer distances between the telephone company's office and the customer. The cost of providing much longer access lines disbursed over a wider area than in an urban context is typically greater than the national average cost. For example, the nationwide average cost per access line per month is approximately $17 to $19, somewhere in that range. However, Ernst & Whinney has clients in States such as Nebraska, Wyoming, Nevada, and South Dakota with costs of $35, $30, $43, and $33 per month in those States, respectively. And there are more extreme cases.

The customers in these and similar high-cost areas of the country will not be well served by the FCC's access charge plan. Customers in these areas face extreme rate increases which will only partially be mitigated by the so-called universal service fund adopted by the FCC.

For example, the South Dakota company's contribution from the universal service fund is estimated to be $2.40 per month after transition, compared with its total cost of $33. The Nebraska company I mentioned may receive only $3.26 from the universal service fund, compared to its $35 total cost. And I might emphasize that these are estimates because the final decision on the amount and the qualification for the universal service fund has yet to be made.

The customers will be asked to bear the remainder, which, in each of the cases I mentioned, is an increase of over 200 percent from the current monthly rates.

Rural areas face additional problems which have not yet been adequately studied. In particular, the cost of providing long-distance services originating and terminating in rural areas is probably much greater than in urban areas for comparable distances. The unit cost of high capacity transmission and switching facilities typically serving large population centers is much lower than the unit cost of low capacity facilities serving low density areas.

As competition forces prices toward cost, rural areas potentially face higher long-distance charges than under the current system of long-distance rate averaging.

The burden of supporting the high cost areas of the country is relatively small. Studies submitted to the FCC demonstrate that the minority of total telephone subscribers live in areas where monthly rates would be significantly in excess of the national average. Continued support for these areas could be accomplished without significant disruptions to the development of competition and without significant encouragement to bypass telephone company facilities.

While I believe that the FCC's proposals for the universal service fund have been inadequate, I believe that implementation of end-user access charges should be permitted to proceed. Implementation in 1984 of a limited end-user access charge as ordered by the FCC will provide valuable information on the benefits which economic theory states will result from proper pricing of telephone service. The FCC has taken a conservative approach and is establishing elaborate monitoring mechanisms. If the FCC's plan is not allowed to proceed, at least in its initial years, a significant opportunity to observe consumer reaction to and public benefits from an economic pricing mechanism will have been lost.

In conclusion, advances in technology have permitted viable competition in telecommunications. Competition, in turn, demands that we revise the industry pricing structure, including the price for access.

In doing so, however, our objective should not be to disregard the goals of quality and universal service. Competition can bring the benefits of innovation and technology to many people. But we must insure that the quality and affordability of telephone service is not sacrificed in rural and other high cost service areas.

Thank you.

Senator ABDNOR. Thank you, Mr. Korsmo.

Now we have a gentleman that I had the pleasure of working with back a few years ago and I always have respect for his views. I see that he has a good topic on his statement today: "Some Thoughts on Telephone Access Pricing." I guess that is exactly what we are interested in, Mr. Kahn, and we are happy to have you back in Washington. We are anxious to hear from you.

STATEMENT OF ALFRED E. KAHN, PROFESSOR OF ECONOMICS, CORNELL UNIVERSITY, ITHACA, N.Y.

Mr. KAHN. Thank you very much, Mr. Chairman. It is an enormous pleasure to be here.

As you point out, I do not have a prepared statement for this hearing and I am awfully sorry for that. But I do have that paper on access pricing, which has most of my ideas in it and I have made it available to the committee for the hearing record.

I should point out at the outset that I have over the years advised various parts of the Bell System on regulatory policy. And I have appeared, until recently, in several States in proceedings on the question of the proper—on behalf of some of the operating companies on the question of the proper regulatory response to the dramatic changes in the industry. But I insist on emphasizing also that I have actively opposed the Bell System over the middle 1970's, and their policies. I testified three times before congressional committees in opposition to Bell-sponsored bills which would have suppressed competition.

And the only reason that I am representing them now is that their views have changed, not mine. [Laughter.]

There is nothing that I am saying today that I did not write in my book 15 years ago.

My job, in setting a few basic propositions before you, is greatly assisted by the excellent paper that your staff prepared for you. I do genuinely commend it and you. I must admit that I am somewhat mystified by Mr. Richardson's praise of that draft because, as I read it, it disagrees with him in almost every respect. And so the evidence makes me rather skeptical of his assertion that he found it easy to read.

The first proposition—when the Bell System enjoyed a totally protected, governmentally franchised monopoly, we relied on the Bell System not just to provide us with good telephone service, which it surely did, but to engage in all kinds of subsidizations, to tax some users by charging them rates far in excess of cost and use the proceeds to hold down other rates.

The whole system was shot-through with that kind of subsidization. But, above all, the basic monthly charge for hooking people up to the system and giving them a dial tone, that charge was unquestionably subsidized by heavy and ever-growing transfers of cost—every year, more and more cost transfers on to long distance calling.

And as I hear the testimony here, at least three of us acknowledge that essential fact.

I know that there have been arguments to the contrary and I am perfectly happy to take time, if you wish, to answer those arguments. Your staff has already answered them. All I can do is assure you that those answers are based on ideology or theology and not economics. Your staff has it right. I observed with interest—Mr. Korsmo has cited some additional evidence and studies by Ernst & Whinney in which they point out that the cost of providing an access line to customers varies between $13 and $60 a month. We have to get that fact straight at the outset.

Now I am not going to go into the question of whether the accounting records are good or bad. Let me, instead, point out the acid test, which is the test of the marketplace. What happened when we opened the industry to competition? Where did the competitors go? Have the competitors been begging the regulatory commissions for an opportunity to lay down access lines to the hundreds of millions of people in the country? Have they been begging for the right to go into rural areas and put in the access lines? Of course not because those rates are far below cost.

I do not mean to suggest that there is not a problem here, which I will get to. But those rates are far below cost. No. Where they have entered, first of all, was with private users after the decision, putting in their own private microwave systems. These are the big users, who were being overcharged for their long distance calling, and therefore, found that they could save money by putting in their own systems. And then when we got the MCI's, these specialized common carriers, and the Sprints and the Satellite Business Systems, they are not rushing in to put in access lines. They would be crazy to do that because those charges are below cost. What they are doing is going to the big users, especially of long-distance services, whose rates are unquestionably inflated far above the cost of serving them in order to maintain this subsidy.

Mr. Richardson says at one point, we do not have to worry about bypass. They would still need to pay for the local services and connections. Exactly. They are happy to pay for the local services and connections because those charges are way below cost. So it is exactly their coming in in the area of supplying their own and big users' long distance needs because those rates are far above cost, and that is the nature of the problem.

And, by the way, that was true even though the FCC did all that it could to equalize the competition by putting a big charge on MCI and Sprint, putting on them 55 percent of the burden that AT&T was bearing in order to equalize that competition.

The result is that they were charging MCI a lot more than they were charging Sears, Roebuck & Co. for the same facilities. And even though they were trying to equalize the struggle, MCI, Sprint, Satellite Business Systems, and now bypass systems, are now growing very, very rapidly.

So that is the first point. We have got to get it straight—there is this major internal subsidy. That subsidy is sustainable only as long as we keep competition out. Such subsidies are not sustainable once you permit competition and, of course, the reason is that competitors will come into the areas where prices are held way above cost and dry up the sources of the subsidy.

I find it mysterious, therefore, that Mr. Richardson is in favor of competition, but at the same time, says that there is no problem about continuing to hold the basic monthly charge down where it is now. And that is the virtue of competition. It drives prices down to cost. It stimulates innovation and that is good for our country. The 60-percent tax that we now levy on long-distance calling is a powerful drag on our country's economy. It limits our exploitation of the most dynamic, progressive technology we have—communications and data handling and processing and storage, et cetera. To cure the economic stagnation that we have been suffering for these 15 years, the loss of international competitive position that has afflicted us—we want to promote the use of communications technology and therefore, this gross tax, this 60 percent transfer of cost which discourages it is intolerable.

The other side of the coin, of course, is that these subsidies have served a valuable social purpose. In 1940, 37 percent of our households had telephone service, only 40 years ago, 37 percent. Today it is 92 percent. But this has been an immensely costly and inefficient way of approaching universality of service. If we had let the price of providing people with a dial tone just go up with costs, we would not be at 92 percent today; we would probably be at 85 to 87 percent. The best studies I know conclude that.

The point is, however, that this annual subsidy, which amounts, as your staff study points out, to $10 to $12 billion a year—that is $10 to $12 a month for every telephone line in this country—was given to people regardless of need. So it was many times larger than necessary to maintain universal service. And it was used to subsidize flat rate local service. Most of the people in this country, the overwhelming majority, get flat rate local service, unlimited calls of unlimited duration at no extra charge.

So what we have got is a massive discouragement to long-distance calling, where you pay per call, per minute, and depending on what time of day, to subsidize the flat rate service, which is a kind of a Cadillac service in which you get all the calls you want to, and there may be young people in a family at the busy hour who may call for 30 minutes and an hour going pitch-by-pitch over the latest baseball game—and if it goes to extra innings, why, they will continue to go pitch-by-pitch—which may impose billions of dollars of cost on the system if it is on peak and that has a zero charge. It is totally irrational.

The point is we should have learned from our history the slovenliness of trying to achieve social goals, important social goals, by tampering with prices. The regulation of crude oil—surely, we have learned that that was not the way to help poor people. What it did instead was put us in bondage to an OPEC cartel and expose us to enormous increases in the world price, which drained $80 to $100 billion each year out of our collective pockets.

The same thing is true of natural gas regulation. Or look at rent controls, the attempt to hold poor people by holding down rents for everybody. Compare that with food stamps and medicaid, which have been dramatic successes in wiping out hunger in this country and reducing infant mortality rates. But they go to people who need it.

The solution has got to be to develop some sort of openly subsidized lifeline service—in this I agree with Mr. Richardson and the others—for the people and for the high cost areas that we really do want to protect. That may cost as much as 20 percent of the present tax, but no more than that, if we did it selectively and did it where it was needed.

Legislators and regulators all over the country these days are playing a game of "chicken" with the Bell System. They are trying to make them continue to bear the burden of subsidies. They are assuring them that they are crying "wolf," that they are exaggerating the danger of competition. They are insisting that they can continue to put these big charges on big users far above cost. Why should we want to run that risk? The Bell System is an immense national asset. The fact that I opposed them violently when they tried to prevent competition didn't mean that I ever denied that the Bell System was an immense national asset. Why should we wish to continue to impose on them in the new competitive era the burden of collecting $10 to $12 billion of taxes every year to subsidize people, regardless of need, when it is undeniable that the people we want them to tax are escaping?

That is what bypass means. That is what MCI and Sprint and Satellite Business Systems means. That is what it means that Merrill Lynch is laying fiber-optic cable under Wall Street right now, totally circumventing the New York Telephone Company, hooking up with big customers, taking them on that line out to what will be a teleport on Staten Island, transmitting their messages privately to a satellite and right down to other people, totally bypassing the telephone system.

That is, in fact, happening. There can be a quarrel about how fast it is happening, but that it is happening under competition I think is absolutely undeniable.

Now, I think that there is a real danger that we are going to end up in this country with two kinds of communication systems—a shiny, efficient, new, technologically modern, low-cost system for the big users and an antiquated, decaying, high-cost system for the small, captive customers. The big users can take care of themselves. Nothing can deprive them of the benefits of modern technology. But whether the rest of us experience deteriorating service will depend very heavily on the intelligence of our regulatory policy. And I think it depends on our removing from the telephone companies the burden of continuing to try to subsidize everybody in a new competitive era when those subsidies cannot be maintained. And what we should do instead is make certain that the people we subsidize and the areas we subsidize are only the ones that need it.

Now I have, I confess, simplified. I have not tried to do justice to how fast this transition is going to take place. These things are not going to happen tomorrow. I do not think the local companies are going to go the way of the railroads. On the other hand, I cannot be 100-percent certain that they will not go the way of the railroads if they continue to be treated the way the railroads were treated.

But it is happening. What we have to do is to decide what is the direction in which our country is going to go. The direction is the direction of competition, and that means efficiency, that means prices driven down to cost, and that means that we have to take care of universality in a more efficient, in a more direct, and in a more explicit way.

Thank you very much.

[The paper referred to in Mr. Kahn's statement follows:]

SOME THOUGHTS ON TELEPHONE ACCESS PRICING

by

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Based on comments delivered at
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The transformation of interexchange telecommunications from a regulated, franchised monopoly to an unregulated, competitive industry has been under way for a quarter century. AT&T now faces competition in almost all of its intercity markets, including residential toll, and the local operating companies face the prospect of partial displacement by a number of emerging alternatives to the wired exchange network.

It is probably a sign of good mental health that we seem to be spending little time looking back and asking ourselves whether the course on which we have embarked in telecommunications is the right one. Whether it is or is not is not only an unanswerable question: it is irrelevant. Further movement toward freer competition is inevitable, at least for the foreseeable future: once we had microwave, the *Above 890* decision was probably inevitable; once *Above 890*, then *MCI* and *Specialized Common Carrier;* and once those decisions, *Execunet*. While I "estimate" a small but positive probability that ten or twenty years from now we will look back and conclude that the entire venture was a ghastly mistake,[1] I am convinced that probability can be reduced substantially by the adoption of intelligent pricing policies by incumbents and their regulators.

In these comments, I begin with an exposition of the inefficiencies of present pricing policies; because they are so flagrant, this section can be brief, as can the succeeding section, which sets forth the economic solutions in broad outline. Section III describes and appraises various qualifications and reservations to the preceding argument—some of them defensible, others that can only be characterized as demagogic. Sections IV and V deal, respectively, with the transition to more efficient pricing and ways of attempting to overcome the political obstacles that companies and regulators will undoubtedly encounter—indeed themselves construct—along the way.

I. The Inefficiency of Present Pricing Policies

Present telecommunications pricing policies are inefficient in three major ways.

First, both local and long distance rates are in large measure (the latter entirely) based on cost averages, even though the cost of serving subscribers and callers in different areas may differ substantially.

Second, a large portion of the costs of providing access to the telephone network are recovered in charges for *using* the system, even though those costs are largely independent of usage: customers impose access costs on the system when they are connected to it, regardless of whether they then proceed to place or to receive calls. This practice has two adverse consequences, each the counterpart of the other. On the one hand, the basic monthly service charge is far too low: people are encouraged to become customers—and, even more flagrantly undesirable, to order additional lines—when the value to them of that access is less than the cost to

[1] We may one day raise similar questions about the AT&T Consent Settlement, although I doubt we'll alter our present, apparently close to unanimous approval of its having let AT&T out of the 1956 Consent Decree box. For the rest, this much is clear. Whatever new problems it has created, the Settlement has burst through a horrendous collection of roadblocks; it forces us to get on with the job of devising a new, economically more rational set of communications policies, and from that standpoint has been unequivocally beneficial. In conjunction with the FCC's deregulations, the basic structural change it effected—the separation of the local telephone companies from the interexchange operations—and the requirement of cost-based, non-discriminatory access charges in place of separations and settlements—force us to deal explicitly with all the industry's present, irrational pricing policies—policies that could be perpetuated under tight regulatory cartelization but cannot survive under deregulated competition.

Charges for using the long distance network are artificially inflated (on the order of 60 percent).

society of providing it. And, on the other side, the charges for using the long distance network are artificially inflated (on the order of 60 percent), because customers are required by the jurisdictional separations and settlements process to contribute to costs that would not be avoided if that usage were curtailed. The result is very inefficient: the artificial, 60% tax discourages people from making calls by grossly exaggerating the cost burden that they place on society when they do so.[2]

Third, the monthly charges for local telephone service typically take no account of usage. Since additional local calling, at least at busy hours, requires extra capacity, the general practice of providing service on a flat rate basis—with no charge per call or per minute—results in excessive local calling: people place calls, of varying durations, the value of which to them is less than the costs they impose on society.

As a result of these last two defects, long distance service under the present system grossly subsidizes local service: the former is charged on a per call per minute basis far more than the additional costs of each call or minute, while the latter in most areas pays far less—in point of fact, so far as the charges per call are concerned, zero. What's more, the subsidy is very big—about $7 billion in 1981 from interstate toll calls (with a few billions more from intrastate toll), which amounted to about $7 *per month* for every telephone line in the country, on average—and, at the extreme, *$27 per month* in Nevada.

Some state regulators are being presented with testimony purporting to demonstrate that local service fully covers its fully distributed costs, and that the asserted subsidy of local charges is therefore a fraud. In economic terms (and I can't think what other terms are relevant) those demonstrations are nonsense. They hinge arithmetically on the (economically) false proposition of *Smith v. Illinois Bell* that interstate usage should bear some part of the non-traffic-sensitive costs of providing subscribers access to the local exchange. Only by allocating some portion of those costs to interstate usage do these studies "demonstrate" that the basic charge for local service fully covers the "cost" of providing it. Once one accepts the economically incontestable propositions, instead, that costs that do not vary with usage should not be recovered in charges for usage, and that there is no such separate service or phenomenon as access to the interexchange (as distinguished from the local) network, one recognizes inescapably that—again, as a matter of economics—imposition of any of those costs on usage constitutes an improper subsidy.[3]

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[2] Where measured local service is provided, local calling is typically similarly burdened with charges per message markedly higher than marginal cost, in order to hold down the flat monthly charge.

[3] This is not to deny that under certain "second-best" conditions, to some of which I will refer shortly, some such cross-subsidy may be economically desirable. I am aware of no demonstration, however, that would justify anything remotely approximating the present level of subsidy.

I do not suggest, either, that there may not be other ways, under the present charging system, in which local service charges recover some costs properly chargeable to interstate usage or to "vertical" services, or may not do so in the future, depending on the terms on which assets are transferred between the Bell operating companies and the other portions of AT&T from which they are to be separated. The license contract fee, hitherto incorporated in intrastate revenue requirements, for example, undoubtedly helped finance research and development of sophisticated terminal equipment that will henceforth be sold by the successor parent company. The FCC is requiring AT&T to account for benefits such as these, with a view to compensating the operating companies for them, in order to avoid or undo any such possibly unjustified burden on the basic monthly local charge.

The general practice of providing service on a flat rate basis results in excessive local calling.

II. Economic Solutions

By separating local exchange from interexchange operations, the AT&T Settlement imposes on the operating companies (BOCs) the responsibility for imposing charges covering the non-traffic-sensitive costs of providing exchange access—as well, of course, as the traffic-sensitive costs that interexchange service causes them to incur. This is as it should be, because it is they who provide the facilities and incur those costs. In addition, by putting the burden of access charging on the operating companies, on the basis of their own, individual costs, the Decree clearly encourages de-averaging—across operating companies and across state lines—which is also the direction economic efficiency dictates. There will undoubtedly have to be a substantial amount of residual averaging, in order to avoid intolerably abrupt increases in charges in high-cost areas, heavily subsidized under the present system; but the only way I can see of eliminating the disincentives to efficiency inherent in the present system of separations and settlements is to move towards de-averaging as quickly as possible. The ultimate goal ought to be a situation in which each carrier sets its own exchange access charges, on the basis of its own costs, to its own customers.

The Settlement also strengthens the case for the "Pure II" approach considered and essentially adopted by the FCC as an eight-year goal in Docket No. 78-72—levying the "interstate" access costs directly on subscribers in a lump sum monthly charge. Since the operating companies will be responsible for recovering all of their exchange access costs from their customers—who alone cause those costs to be incurred—they are less likely to be under the illusion that they can extract the dollars from some external "interstate" entity, and correspondingly more likely to collect them from people as they impose the costs on the system.

Of course, the operating companies will probably want to continue to levy some part of the non-traffic-sensitive costs on the other interexchange common carriers (OCCS) and AT&T, necessarily on the basis of usage, in order to hold down the requisite increases in the basic monthly charge. They almost certainly will be pressed to do so also by the regulatory commissions. But because they and the state commissions are the ones that will now be responsible for recovering these costs, they will no longer be able to ignore the consequences of attempting to levy too much of them on usage. They will see when and where, if those charges are too high, it could mean bypass of their facilities and lost revenues, with resultant injury to themselves and to the consumers whom it is their responsibility to protect. And this argues for moving toward "Pure II."

Under this new arrangement, the local companies and regulators will be in a position also to vary the balance of recovery of non-traffic-sensitive costs between a flat access charge and usage-related rates, depending upon local market conditions. They will have to decide, from market to market, how fast they have to go to put those costs entirely in the flat monthly charge, because usage

The ultimate goal ought to be a situation in which each carrier sets its own exchange access charges, on the basis of its own costs, to its own customers.

Providing a universally subsidized basic access charge is an excessively imprecise and inefficient way of preserving the external benefit.

charges can no longer be forced to bear them. And as AT&T suggested in its reply submission in FCC Docket No. 78-72, there may be an encouraging inverse relationship here between competitive necessity and the size and painfulness of the required change: in rural areas, where the access costs tend to be quite high, the bypass possibilities are relatively slight, and therefore there could conceivably be a longer transition, with a longer-continued, relatively low, subsidized access charge and a relatively high recovery of these costs in usage. In contrast, in cities, where the cost of providing access will on the average be somewhat lower but the bypass possibilities higher, because of the concentration of the traffic, the transition must be more rapid, but is likely also to be less painful: where high-usage customers can more readily escape the burden of non-traffic-sensitive costs, it is more urgent to put such costs in the flat charge, but it will presumably also be politically easier to do so because there is a shorter distance to go, to reach the sanctuary of Pure II.[4]

III. Some Qualifications and Counter-Considerations, Rational and Demagogic

There are three valid qualifications to the proposition that all access costs should be recovered in the basic monthly charge.

- Subscribers benefit from being able to reach other subscribers; if some drop off the system in response to cost-based access charges, this will reduce the value of the service to those who retain it.
- Various social or political considerations as well might call for subsidization of access by certain groups.
- Prices based on "costs," if these are taken to mean average revenue requirements, with a large embedded cost component, are not economically ideal.

The first of these—the benefits that one subscriber confers on all the others—could, in principle, justify making heavy users, who presumably get the most benefit from the system, subsidize the basic access charge, so that they can continue to reach those who would, under Pure II, drop off the network.

Since this consideration is a familiar one, I confine myself to two observations about it. First, the argument can easily be overdone: it is difficult to measure the size of the externality; and it is not at all clear to what extent the heavy users are particularly interested in reaching all of those who would decide they do not want service if it were priced at its full cost. Second, providing a universally subsidized basic access charge is an excessively imprecise and inefficient way of preserving the external benefit. For one thing, the *particular* heavy users who are especially interested in being able to reach and be reached by *particular* customers—impecunious relatives, for example—who would drop service under Pure II could

[4] I have surely oversimplified. On the one hand, the costs of providing and maintaining exchange access may be very high in some very dense center cities, which would aggravate the dilemma of sharp increases in monthly charges or rapid bypass. On the other, I owe to Walter Hinchman the suggestion that moving to Pure II in rural areas may be easier than commonly supposed, because rural customers are, precisely because of their comparative isolation, disproportionately burdened with inflated toll charges, which would come down as the basic monthly charge went up.

There are possible areas of public policy in which conceptions of fairness may conflict with economic efficiency. But it is by far the greater wisdom to recognize that for the most part, the major departures from economic efficiency in our public policies today are also demonstrably unfair.

be expected to help pay those bills directly, without forcing the burden on others who would reap none of the benefit. For another, if we want to offer a subsidized service, there are ways of defining it more precisely, and subsidizing it at lower private and social costs than our present system.

The consideration of network externalities is reinforced by various non-economic considerations that could lead us as a society to subsidize some basic access service at the expense of usage: a possible social consensus that we ought to do something about people who would be excluded by purely cost-based prices from enjoying what we would regard as a necessary component of a minimum acceptable standard of living, *accompanied* by an inability, for whatever reason, to agree on the economically superior method of doing so by direct government subsidy. This consideration is on the one hand so familiar and on the other so frequently abused that I consider it more important to refute the demagogic contentions with which it is all too frequently associated than discuss the qualification itself—other than to observe, once again, that there are far less costly and inefficient ways of achieving this goal than simply rejecting economically efficient pricing.

The vulgar arguments to which I refer are such contentions as that the dictates of economic efficiency are in flat conflict with principles of equity, or that shifting more costs to the monthly charge is bad for "consumers," and must therefore be opposed by all who profess to speak for them.

Clearly there are possible areas of public policy in which conceptions of fairness may conflict with economic efficiency. But it is by far the greater wisdom to recognize that, for the most part, the major departures from economic efficiency in our public policies today are also demonstrably unfair; and that, for the most part, movement in the direction of economic efficiency is also compatible with increased fairness. It is *fair*, as a general proposition, to impose costs on people in so far as they impose costs on society.

The "consumer" is not one single corporate entity but a collection of diverse individuals, with varying patterns of behavior and needs; and what is involved in questions of the proper pricing of communications services is how best to distribute a given burden of costs among these various groups of consumers—"best" being defined, first, as most fairly, and second, most efficiently, so as to maximize the flow of benefits net of costs for all consumers collectively.

There is a group of consumers who make local calls infrequently, or, when they make them, make them off peak, or briefly; and there are others who make local calls all the time, often on peak, and talk without limit. To oppose local

To oppose local measured service on the ground of equity or of "protecting the consumer" is simple demagoguery.

Our tendency to try to help "consumers" by holding all prices down ends up subsidizing nobody and injuring everybody.

measured service, then—as some consumer advocates do—on the ground of equity or of "protecting the consumer" is simple demagoguery. There are consumers who want to make a lot of calls in an extended area at no extra charge, and there are others who happen to live in the country, or on the borders of local calling areas, whose equally short-distance calls are subject to inflated toll rates: to imply that the interest of both of these would be similarly adversely affected by a more efficient pricing system is ridiculous. Similarly, there is a difference between the consumer who uses directory assistance all the time and the one who takes the trouble to look up numbers in the phone book. To oppose charging for directory assistance on the ground of "protecting the consumer"—and of course all of these arguments have in fact been made, publicly and loudly—is to make an argument unworthy of respect.

It is not unfair to consumers—who have to bear all the costs in any case—to distinguish among them on the basis of the respective costs that they impose on society.

Returning, then, to the second qualification—our desire to keep telephone service affordable to poor people—the task of social policy is to identify the people whom we agree we would like to help, and then find a method to help them, rather than primarily others, in a way that imposes the minimum cost on all of us—which *includes* them. Our tendency to try to help "consumers" by holding all prices down ends up subsidizing nobody and injuring everybody. If we are to retain a subsidy for basic service, it has to become far less grossly, negligently, slovenly distributed than it is now—more tightly targeted at those who really need it—both geographically, among and within states, and among different subscribers.

It is possible that the way costs are actually incurred in providing access may allow for a partial solution that is both economic and equitable. This is the import of my third qualification of the Pure II approach: it is a way of distributing a certain kind of "costs"—regulatory revenue requirements; and to the extent that marginal costs of access diverge from average revenue requirements, which have a large embedded or historic cost component, Pure II is not, by any means, economically ideal. (But it is still highly likely to be better than the present method of collecting the necessary revenues.)

The marginal costs of providing genuinely new access will probably be higher than average embedded costs, because of inflation. Further, as I understand it, the real marginal costs of access could vary widely between new and old customers. For those premises that already have inside wiring and drop lines, whose costs are largely sunk and perhaps unrecoverable by salvage, the marginal cost of providing access would consist, in both the short and long run, only in the current costs of maintenance. For new area developments, in contrast, the marginal cost would be much higher. If this is so, it could significantly mitigate the apparent conflict between the efficient recovery of access costs and continued universality of service—new customers will bear the higher costs they impose on the system; old customers will be spared those costs, and therefore less inclined to discontinue service.

It helps to understand why this distinction is in principle sound, if we contrast it with the argument of many electric utility companies and some "consumer advocates" that new customers should pay higher electric rates than existing

There's no reason why the people being served in existing service areas, by existing drop lines, should be subsidizing the people who are causing the system to incur new, higher costs of access.

customers because they are responsible for the high "marginal costs" of additional capacity. In the case of electric service that argument is nonsense, when applied to generating costs. The demands of new and old customers for generated electric power are economically indistinguishable so far as their marginal cost responsibility is concerned: the need to build more costly new generating plants would be saved just as much if existing customers conserved as if new customers didn't join the system; economic efficiency therefore requires that every kwh demanded be confronted with that same marginal cost. Electric distribution costs, in contrast, are indeed geographically specific to particular categories of customers. So with telephone access costs, which are so very large a part of the total: levying the same access charges on new and old customers, when the marginal costs of attaching them differ substantially, would involve subsidizing new, higher cost subscribers at the expense of existing ones.

The logic of this distinction, as a matter of both economics and equity, is the same as underlay the recent decision by the FCC that the costs of connections, installations, and moves should be expensed and charged directly to the customers responsible, rather than capitalized and thereby charged to everybody. There's no reason why the people who don't move should subsidize the people who do. Likewise—if my factual assumption is correct—there's no reason why the people being served in existing service areas, by existing drop lines, should be subsidizing the people who are causing the system to incur new, higher costs of access to the network.

There may, therefore, be some room, even in terms of economic efficiency, for providing a low-priced, lifeline service to existing customers—access alone, with separate charges (conceivably far above marginal costs in the case of new installations) for each call—as a means of minimizing the burden on poor people and the surrender of service while also minimizing the overburdening of usage.

IV. The Transition to More Efficient Pricing

Any transitional arrangement that leaves a portion of the non-traffic-sensitive costs to be recovered in usage must confront the danger of uneconomic bypass—uneconomic because it will have been encouraged by the excess of rates over marginal cost. Since this possibility grows with the individual subscriber's use of the network, a very important component of those interim rate structures will have to

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Progress toward more efficient telecommunications pricing policies will meet with a great deal of political resistance.

be some sort of taper, a declining rate for incremental usage that will provide a progressive quantity discount. The economic case for the taper, in these circumstances, is unexceptionable, so long as the rates for the successive blocks of usage do not go below marginal cost. True, such a discount will help the big users; but if they have an escape from the economically excessive charges, the BOCs will have no choice but to reduce rates to them, if they are to make any contribution to the access costs which the small users would otherwise have to pay totally. The taper is clearly needed in these circumstances, then, in the interest of both economic efficiency and minimizing the danger that small users or impecunious subscribers will drop off the system.

The FCC has already responded to a second necessity for the transition in Joint Board Docket 80-286, by "capping" the usage factor on the basis of which the share of the total non-traffic-sensitive costs allocated to the interstate jurisdiction is determined. Had we retained the previous formula for separations, on the basis of usage, it would have defeated the entire purpose of the 78-72 exercise—to reduce the rates for toll calling below what the traffic will no longer bear, to a closer approximation of marginal costs. That is going to stimulate interexchange traffic; continued allocation of costs between the jurisdictions on the basis of usage would then have produced, perversely, a bigger and bigger allocation of costs to that service—a move in just the wrong direction.

Allowing for a gradual—but not too gradual!—transition to efficient pricing can serve a valuable economic as well as political purpose in two ways, provided the end result is clearly announced. First, it may serve as a justification for avoiding uneconomic upgrading of service. I recently heard a regulatory commissioner from a sparsely populated western state complain of the public pressures his local phone company was under from rural customers to go from four-party to one-party service, knowing full well that he could not hope to permit the company to charge the $30 a month that they estimated it would cost. An announcement that the costs of that superior access would after a time necessarily go into the basic charge might go far to relieve those pressures.

Second, it may give alternative technologies, better adapted to serve the high-cost customers, an opportunity to be introduced or developed, whether by the phone companies themselves or others. That is to say, when rates begin to become rationalized it offers the hope for technical solutions to the problem of providing quality service to high-cost areas, the development of which is discouraged by the present cross-subsidized rates. Could it be, for example, that an announcement of where local rates in rural areas are going would make radio telephony over those long, sparse routes economic?

How long the transition ought to be or politically will have to be, I don't know. How long the residual subsidy will remain and how large it will be, say, five years from now, I don't know. Whether it can ever be totally terminated, I don't know. What I am certain is that its total size can safely be drastically reduced, that its distribution can be more precisely directed to where it is really needed, and that it can be financed far less inefficiently than it is financed today. The new regime of competition compels it; economic efficiency—which our country badly needs—requires it; equity demands it.

People seem to believe that if something is regulated it can defy the principles of economics: the same people who may be paying $15-$25 per month for cable TV, Home Box Office, and the like seem to regard a $6-$10 rate for unlimited local calling as a God-given right.

V. Overcoming Political Obstacles

Progress toward more efficient telecommunications pricing policies will meet with a great deal of political resistance. Court tests of whether the new policies comply with *Smith v. Illinois Bell* are also likely.

The resistance is likely because efficiency and the pressures of competition require higher direct charges for access, and a consequent substantial increase in the basic monthly rate. These increases will in the short run be magnified by other consequences of intensified competition and technological change—notably the required increase in depreciation rates. State regulators will find themselves compelled to resist these changes, because people seem to believe that if something is regulated it can defy the principles of economics: the same people who may be paying $15-$25 per month for cable TV, Home Box Office, and the like seem to regard a $6-$10 rate for unlimited local calling as a God-given right. People buying $70,000 houses regard it as heinous if they are required to pay the $150 or more that it costs to install a telephone.

There are no miraculous solutions to these political obstacles. And yet there are ways of circumventing or confronting them; and there is reason to anticipate at least partial success because technology and economics are powerful allies.

1. One politically helpful course is the one the FCC has already adopted: it has itself assumed responsibility for its part of the rate increase in the form of a separate charge for "interexchange access." While, as I will explain presently, this strategy has one possible weakness, it surely makes the job of state regulators easier to have this unpleasant task taken out of their hands. One advantage of the federal system is that it may make it possible to do some necessary but distasteful things at the national level that it would be politically impossible to do locally. Possible—by no means certain; all the more reason to applaud the FCC's courage in this instance.

2. Second, we must patiently explain to the courts and the public at large the fallacy of the widely held opinion that if you *use* some facility and get some benefit from it, it is only fair that you pay some share of the cost of *providing* it, even though your *using* it imposes no sacrifice on anyone. Anyone who has argued in a public forum the merits of peak responsibility pricing will recognize how profoundly held that view is.[5] I fear it is the underlying rationale of *Smith v. Illinois Bell.*

For its attempt to reconcile that popular opinion and *Smith v. Illinois Bell,* on the one side, with economic reality by imposing a lump sum charge for "interstate access," the FCC surely deserves an A for effort and ingenuity. Unfortunately its

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[5] I recently had a pleasant conversation with the owner of a trucking company that has prospered under deregulation. He expressed enthusiasm for that reform, but expressed chagrin that he was finding himself compelled to charge higher rates on his front-hauls than on his (thinner) back-hauls; it struck him as unfair. I attempted to reassure him.

One advantage of the federal system is that it may make it possible to do some necessary but distasteful things at the national level that it would be politically impossible to do locally.

proposed solution invites the response: "I don't want *interstate* access.... I don't make any long-distance calls, so why should I have to pay for it?" And to the counter-argument that there is no way of choosing to have or not have interstate access, separate from local access, the rejoinder: "If there is no such thing as interstate access, how come you're proposing to charge for it?" In short, I fear that the attempt to satisfy *Illinois Bell* while nevertheless removing the tax from *usage*, in this particular way, may well be unsuccessful.

I suspect, therefore, that it is eventually going to be necessary to expose the anthropomorphism of the notion that "interstate" is some identifiable entity on to which "local" consumers can shift some of the costs of the system. What we have to explain clearly is that it is only real people—"local" people—who pay the costs of providing them with telephone service; and that how these costs are properly and equitably distributed among them should surely depend upon their respective causal responsibilities for the system's incurring them.

Access costs are incurred when the subscriber subscribes—not to interstate service, not to intrastate service, not to local service, but to the *availability* of any and all of these. To interpret *Smith v. Illinois Bell* as holding, then, that because the subscriber uses the facility for both interstate and intrastate calling—much or little—the cost must be levied on that use rather than on the act of connection that causes the costs to be incurred, would be to elevate legal fiction above economic reality. Or perhaps the following version of the same reality might be easier for the courts to accept, because it avoids direct confrontation with *Smith v. Illinois Bell*'s assumption that fairness requires *users* to share the common costs of the facilities that make that use possible: Subscribers *use* telephone facilities in a number of ways; they use certain facilities when they ask merely to be hooked up; they use others when they pick up the phone and dial a local call; they use others when they make interexchange calls; they use others when they receive calls. It's hard for me to believe—I wish it were harder for me to believe than it really is—that *Illinois Bell* would have to be interpreted, in 1983, as inconsistent with a system of charges that differentiates these various *usages* and charges each with the costs that it imposes on society—and only with those costs.

The answer, in short, is to assume the responsibility for teaching the courts elementary marginalism, but—a mild tactical suggestion—without using that word.

3. Third, in driving home this lesson, in and out of the courts, it is important to point out that so far as the exchange access charge is concerned, we

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are talking not about additional revenue requirements but only about rate structure reform—not charging consumers more but redistributing the burden among them.

4. Indeed, fourth, we should never pass up an opportunity to point out that a closer conformance of rate structures with costs will *reduce* bills—except as people choose voluntarily to take more service when rates are reduced. Cost-based pricing is a powerful way of reducing the cost burden of the cross subsidizations with which communications pricing today abounds. The more services one charges less than marginal cost, the more uneconomic use one encourages and the heavier the consequent burden on subscribers generally.

5. Fifth, we must emphasize and reemphasize the inequity of mindless, unfocussed internal subsidizations. Both of these last two points are powerfully illustrated by the experience with directory assistance charging. The New York PSC was attacked by every demagogue in the state on its introduction—I have no doubt the experience was repeated elsewhere—on the ground that it was letting the phone company charge people for something that was previously free. The Commission (just before I joined it) wisely introduced the system outside of the context of a rate increase, so that it incorporated a charge and a rebate. When we were able to point out, after two months' experience, that directory assistance calling went down 45 percent, that 85 percent of the subscribers in the state got the full rebate, from which it appeared the 85 percent had previously been subsidizing the other 15, the opposition disappeared.

In the same way, we must keep clearly in mind that the lesser number of other phones a rural subscriber can reach is no reason in itself for lower rural than urban rates, when the difference is unjustified on grounds of relative costs, and that the greater purported virtues of rural life are no reason for inhabitants of center cities further to subsidize it in their telephone bills. Similarly, the enormous disparity between intrastate toll rates and the charges for mileage bands within an extended service area should be openly challenged—on grounds of fairness as well as economic efficiency.

6. Sixth, telephone companies and their regulators should resist pressures to upgrade service for which the charges fall short of costs. It should surely be possible to show rural subscribers what it would cost to go from four- to one-party service, or to give them extended area service, and enlist public support for not doing so unless they are willing to pay those costs. An informed public, one would hope, is unlikely to regard merely improved quality of service as a necessity, which people are entitled to receive at non-compensatory rates.

7. Seventh—and this one really embraces the previous six—unbundle, unbundle, unbundle. It promises a large number of benefits. In the present context, the most important one is that it is the way to pinpoint the residually subsidized service and its recipients: offer access alone, a subsidized basic, or low-priced four- or eight-party service; and make sure its availability is widely publicized. In that way companies and commissions can truly claim to be meeting any reasonable con-

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ception of their social responsibility—namely, to see to it that there is an inexpensive service available for people who are really poor.

Unbundling means measured local service, and that raises the serious question of whether the benefits will exceed the cost of measurement. Where ESS is available, observers like Bridger Mitchell have found costs and benefits are likely to be comparable. But even where measurement costs exceed the direct benefits, we probably should start measuring. For if measurement is necessary to move us away from the gross inefficiencies of the present system, its heavy deadweight costs will prove to be a small price to pay. Besides, it also is fair: heavier users, who impose heavier costs on the system (and also presumably benefit more from it—an economically proper consideration in a system in which all prices cannot be set at marginal costs, consistently with the companies covering their revenue requirements) *should* pay more than light users.

If it is to be truly efficient, however—indeed, if it is to avoid the real danger of making the system less efficient than it is now—unbundling must incorporate time of day differentials into local message charges.

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It is not easy to be either a regulator or a telephone company executive these days. Competition complicates all our lives, *but* its beauty is that it forces us to comply with the dictates of economic realities; and its consolation is that to the extent we do, there will be improved welfare for most of us and efficient ways of taking care of the ones who fall behind and genuinely deserve help.

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Senator ABDNOR. Thank you very much. I thank all of you gentlemen for your very fine testimony which gives us some insight into the problems and the difficulties facing us in the telecommunications system.

You must realize the concern I have, I guess parochially, coming from a little State like South Dakota and what it is all going to mean out there. Of course, I am equally concerned about what it means for the whole nation.

Several of you have made reference to the staff study. I, too, think that it was very well done. It was prepared by Dale Jahr, our staff economist who handles this subject. It provides an overview of the telephone industry and the changes that are taking place.

For those of you who have not seen it, we have a few copies on the table and there will be more. In the very near future, there will be additional printed copies.

We think it is a good background paper, an overview of the problems facing us. Of course, we are really grateful for your statements, because they really put the issues in the right perspective.

Since we began this morning, our Chairman of the overall Joint Economic Committee, Senator Jepsen, has joined us. I am extremely happy that he is able to be here today. He has a vital interest in this topic. Before we go into questions, Senator Jepsen, would you care to say anything?

Senator JEPSEN. Well, thank you, Mr. Chairman, and I certainly commend you for the work that you have done in this area and holding these hearings. This is just another example of your championing the constituency that you represent and represent so well in rural areas.

We are finding that we have in the changes in the telecommunications industry, the rural folks are going to get it in the neck, it looks like. I was concerned about gas deregulation, forcing the choice between food and fuel. Now it appears that it is a choice between food and fuel and telephone for rural residents. They are increasingly becoming disadvantaged when it comes to the essential services of life.

I hear tell how we have to have competition and I think my past entire history of public service, as well as work in the private sector, indicates that I would come down on the private sector and the side of things and for competition. As I see all this deregulation taking place, we have the trucking industry and then we have the airline industry, the telephone industry, telecommunications industry. And the only thing that happens is that it seems at this point, that people, communities, are losing service. Companies are going out of business. And I am not sure that what we all ought to put a sign up in our offices in Congress and that it should read: "Do not fix it if it is not broken."

Productivity is something that we cry and talk about and we really need and we are all pleased to see that progress is being made in it. Productivity is coming back into being in vogue in this country. But part of being productive is that you be more efficient, better money managers, do a better job of cutting down overhead and so on. That means sometimes merging. And yet, time after time today, when companies try to get together to merge and do a better job, they end up in court.

So somewhere in this whole milieu, there are some things, the force of the statutes, or whatever it is, that are not quite ringing true and coming together.

I find it quite strange that we have changed the system, as Mr. Kahn stated, in the interest of providing service. What was wrong with the system that went from—what was it, Mr. Kahn, 38 percent in 1940 to 92 percent of the people having telephones? That is not a bad record.

I have been in Europe. So have you. I have been in the Middle East. I have been in Asia. Try to make a telephone call over there. You cannot even get a call from one room to another, let alone downstairs to the switchboard to get an out-line.

I would suggest that recent changes create a potential for unprecedented huge increases in charges for basic phone service. My constituents, many Iowa consumers, especially the rural consumers, have discovered that the phone rates are going to go through the roof.

As a result, much hardship may be imposed on the low income and the elderly Americans and many consumers may be forced to drop their telephone service; thus, the congressionally mandated policy of universal service is threatened. Increased competition should not lead to increased prices, it does not seem to me, if it works right. But apparently, the phone industry is an exception.

I am very concerned about the impact that these developments have on the people of Iowa. Despite the fact that the phone service is an absolute necessity, many Iowans may find themselves without it, and this would be totally unacceptable.

Unfortunately, it is too late now to put Humpty Dumpty back together again. I think that is realistic. But we must come up with some resolution to minimize the overall problems as well as to avoid creating additional problems for the industry and its customers. And I appreciate the blue ribbon panel of witnesses today, Mr. Chairman, that you have here. They will provide valuable testimony and they have on the principles that should be included in the telecommunications policy.

I do have some questions, but I would defer to you, Mr. Chairman. In a parting shot, in leaving, when we say that we have been subsidizing some to provide service for others, that is not new in this country. We have transit systems, urban transit systems, that have been subsidized by rural residents that will never take a ride. They have been doing it for many years.

Senator ABDNOR. Thank you, Senator Jepsen. You use that term, "Don't fix it if it isn't broke." I must confess, I have always thought that we have had probably the finest phone network service in the world. I gather, in listening to you expert gentlemen, I realize you feel that things could be done to make it a better system.

As a layman, I must confess, I have a lot to learn about this. It is somewhat confusing.

Now just let me bring this to your attention. AT&T recently announced a possible $1.75 billion reduction in long distance rates if the access charge goes into effect. Here last Saturday, telephone companies across the Nation indicated that they are going to file for some $20 billion in long distance access charges—and of that figure—residential and business customers would pay about $3.3 billion and long distance carriers such as AT&T, MCI, and Sprint would pick up the remainder.

Now, in addition, phone companies have filed for the largest rate increase in history with the State regulatory commissions.

Now, it is befuddling to me. What is the impact of all of this? Maybe I would like to ask all of you that, and see what your views and thoughts on charges like this are. In that way, we might see if we are all thinking on the same wavelength.

Would you care to give me your comments on it, Mr. Garrison?

Mr. GARRISON. Well, I would say—initially—that the current impact of all of these rate cases is mostly confusion. I think that Mr. Richardson is absolutely right in the implication that he made that our State utilities commissioners, contrary to some public statements that they have made before the Congress, are, in fact, extremely well practiced at denying rate increase requests. And most of those Bell operating company requests are, in fact, based on a very long wish list that has nothing whatsoever to do with divestiture or the end of separations and settlements. Consequently, I think by the time the rate cases are actually processed in the coming year, the rate increases that will be granted from State to State will be relatively less important, certainly less significant to the consumer.

What bothers me is that the Congress is going to go forward with legislation that could muck all of that up rather badly without waiting to see what, in fact, the real rate increase dimensions will be.

That is why I say the most immediate impact is largely confusion.

Senator ABDNOR. Mr. Richardson.

Mr. RICHARDSON. Well, part of these filings have to do with the access charge, of course. That means that we are talking about, at least to the extent that these $20 billions, which I have not seen unaggregated, see what they are composed of, but these $20 billions may not reflect even all of the future increases that are due to the access charge.

It is really myopic to look at just January 1, 1984, where residential, for example, is increased by $2. We should be looking at what we have started, if we even begin step 1 in the implementation of the access charge system.

First off, we probably make it very hard to roll back the system once we get it underway. Institutionally, it just becomes more difficult to make changes.

Second, the totals here—pick your number, $7 billion, $10 billion, $12 billion—we really do not know—in fact, the FCC has left that kind of open-ended in the last 3 years of the implementation. So we do not know exactly what these dollar amounts will be just on the interstate portion. The intrastate rate changes that will probably somewhat, if not entirely, parallel the Federal changes have uneven impacts from State to State.

If a State with high intrastate toll rates decides to go to parity with the Federal system, not only will they be reducing toll rates within the State in proportion to the Federal changes, but they will have to eliminate further that amount which they are already charging over and above the Federal interstate rate.

So depending on what the State policy has been and what the State's relative dependence on intrastate toll is, big States versus small States, you will see differences.

Then I think we will have a true perspective on the importance of these rate cases.

What I think I am saying is do not trust the $20 billion figure in the Post as particularly meaningful at this point. I think it may be a whole lot larger as we see these changes unfold over the next few years.

Mr. KORSMO. Mr. Chairman, I would agree with the comment of Mr. Garrison that, in spite of the large numbers being thrown around in all the States and at the FCC and at the present time, there is total uncertainty about the ultimate impact of all of this on the consumer. Many State rate cases have yet to be heard, much less decided. And, of course, at the FCC level, it is much more certain at this point what the FCC's plan has in mind as far as the access charge to be levied on the customer.

I guess what we have to do is wait for all these rate cases to shuffle through the administrative process and for consumers to react once the rates go onto their bills before we really know the ultimate impact.

Senator ABDNOR. Once we get going, if we are off the wrong track, can we reverse ourselves?

Mr. KORSMO. Well, my experience to date in the access charge proceeding has been mainly at the FCC level. And I can only say there that there have been extensive proceedings over the last 2 years. I think it extends back even more than 2 years, in fact. There have been filings by many, many telephone companies, testimony by many expert witnesses, and a lot of paper flying around. The consensus, however, with a few exceptions, is that the plan that the FCC has come up with is worth trying and is the correct plan for today's environment, that is, the environment that will exist in 1984.

So that is why I said in my comments that I do not think that to reverse totally the Federal direction at this point is a wise thing to do.

Senator ABDNOR. Thank you. Mr. Kahn.

Mr. KAHN. I will try just to supplement the preceding comments, with which almost entirely I agree. There is one big element, there is one big specific way in which the introduction of competition does in the short term necessitate higher rates. And that is a big piece of these rate increases that you are looking at. And that is that when you have a monopoly, you can write your equipment off over 30, 40 years. And you can pace the introduction of new equipment. But once you begin to have competition, that equipment becomes obsolete much more quickly. That is the reverse side of the coin of more innovation and, therefore, a large part of these requested rate increases are requests for more rapid depreciation rates following a decision by the FCC.

I will just give you one example. Southwestern Bell in Texas asked for rate increases on depreciation alone of $500 million a year. So you add that up for all the States and you have got a huge hunk of the $20 billion.

Now, the other thing is, in answer, in agreement, with the other three statements, Texas gave them $100, not $500 million.

I am not in a position to say what was the correct amount, but that supports the second point, that we ought not to be panicked by these huge sums.

Apart from that increase in depreciation rates, which you just have to have—competitive industries have much more rapid rates of depreciation than the regulated public utility monopolies—and apart from inflation, general cost increases, the rate changes that we are talking about are not net increases; they are transfers. They reflect the reduction of the subsidy from interexchange and transferring it, over the years, on to the basic monthly charge.

That is why the Bell System—I have no doubt also for public relations reasons—announced that they were prepared to have a decrease right away of $1.7 billion in the long-distance rates. In the same way, for intrastate, within the State, long-distance calling—those rates are outrageous. In California, for example, the rate for a 5-minute long-distance call, it costs the company 32 cents. The rate is $1.54. In Missouri, for an 80- to a 100-mile call, it costs the company 49 cents. The rate is $2.19.

Now who do you think is paying those? Largely, rural people who make these long-distance calls. People who make long-distance calls are people. They are real people, too. And you would be amazed at the percentage of long-distance calling—you have probably seen the numbers—that are done by rural constituencies. Those rates are outrageous. One of the last things that I did when I was chairman of the New York Public Service Commission was institute a proceeding to start getting down these inflated intrastate long-distance call rates. And we have done studies showing that poor people with incomes of less than $10,000 a year do a lot of long-distance calling.

So, beyond that, I guess I agree with, I think, everything that the people have said. But I do have to say one thing, Senator Jepsen, I am not going to talk about airlines, unless you want to. [Laughter.]

Or trucking. But I will say this—that there was never the same clear case for deregulation of communications that, in my opinion, there was for airlines and trucking. It is a very different kind of industry. There is much less clarity that we might not have been better off—I said many times we may find 20 or 30 years from now we wished that we were back at the monopoly stage. But if we go the way of competition, all I am saying is that we have to be consistent. We cannot try to push water uphill.

And being consistent means that if we had wanted to continue the present system of subsidization, we should not have introduced competition. Once you introduce competition, you have got to find other ways of helping rural people, not all of whom, by any means, are poor, or poor people who would drop off the system. And it is that that I was addressing myself to, and that is what the committee ought to do, to really think how can we, in a new system, get rid of the old, which is going to go anyhow because it is not sustainable, and how can we continue to achieve the social protections, which I agree with you, are terribly important.

Senator ABDNOR. Thank you. Representative Snowe.

Representative SNOWE. Thank you, Mr. Chairman. I, like my colleagues, certainly have some concern about what the future represents in terms of the impact on individuals and businesses because of the uncertainty that lurks around this issue.

First of all, let me get an understanding from the panel here—do you agree or disagree with the premise that we should have universal service to customers throughout the country?

[Mr. Garrison nods in the affirmative.]

[Mr. Richardson nods in the affirmative.]

Representative SNOWE. You would agree, Mr. Garrison, Mr. Richardson, yes. Yes?

Mr. KAHN. Remember that 92 percent is not precisely universal, but I think something on the order of 90 to 92 percent, not only we can, but we should. I mean, not only we should, but we can.

Representative SNOWE. Do you think it is possible, then, if all of you are in agreement, to provide universal service at a reasonable rate? As I look over the material that has been presented to me and some of the costs that will be charged to customers in the future—for example, we have the access charge and that is going to be an issue that is going to be debated in Congress. We have interstate access charges that could be passed on to the consumers. We have equipment and repair and/or equipment rental and purchase. Those are other options that are not going to be options to the consumer because presently, consumers do not pay for equipment repair. Now they are going to have to purchase that—is that true?

Mr. GARRISON. No, that is not entirely true. If you will forgive me——

Representative SNOWE. OK. Let me get through the list.

Mr. GARRISON. All right.

Representative SNOWE. Equipment rental and/or purchase, so consumers are either going to have to buy their equipment or rent their equipment.

Depreciation costs, which is something that is also going to be part of this divestiture plan.

I assume that the local companies and the consumer are going to pick up portions and/or all of the costs of divestiture. I am not clear on that as well.

Ultimately, it also means higher local costs because now we are providing a cost based on the service provided rather than on the usage.

So all of that to me represents a phenomenal increase in the cost to the consumers over the short-term and over the long-term. And as I look at a list that was in the Congressional Quarterly recently, of about a thousand companies represented, by 1990, there are substantial increases represented for many of the telephone companies.

So I am just wondering, is it possible to provide universal service at an affordable and reasonable rate to the consumers in this country?

Mr. GARRISON. Well, it seems that I have already injected myself into this. Let me say that one of the things that you must bear in mind is that the system that we have had up until now recovers all of the costs that you have named indirectly and on a recurring basis month after month after month.

Those costs are extended over long periods of time and recovered from every consumer in one accounting formula or another, regardless of whether the consumer has actually incurred the cost.

Consider the last time you had your actual telephone repaired. Yet, you have been paying a cost for a service to repair that telephone every month that you have paid for a telephone bill. You have rented a piece of equipment every single month that you have paid your telephone bill throughout your, presumably, adult life. And one could have apportioned some cost to you as a child in the form of your parents' bill. Yet, that telephone can be purchased for a very reasonable price of somewhere around $40 to $50, or even less, depending on some of the regulatory decisions on embedded base.

These are one-time costs incurred by consumers which will then be taken out of the rate base. So we are going to have an entirely different way of setting costs and rates once we have gone through this transition. The concern I think that utility regulators and members of State legislatures, as well as Members of Congress, should have is that the transition is done in such a way so that it does not create significant and sudden rate increases that would cause someone to be unable to adjust their allocation of monthly income in such a way that they could continue to have telephone service. And I believe that that can be accomplished. And that, I think, is the principal concern for Members of Congress relative to consumers.

Now, you know, you can go through a recitation of all kinds of difficulties, but all of those can, in one way or another, be addressed so that at the end of a transition period, we have, in fact, got a lot of those recurring costs out of the rate base and will have begun to price future service on the basis of real cost for providing that service.

The second level of question I think the Congress needs to think about, and they have not thought about it sufficiently in the Commerce Committees, is whether we are going to continue to subsidize telephone companies or whether we are going to subsidize needy consumers.

In rural areas, a rural consumer may be paying, as in North Carolina, $11.60 in a Bell territory. A rural consumer in the next county, but served by a different telephone company, may be paying half or even less than that for comparable service. So we have two rural consumers both paying widely divergent local rates.

Are we going to continue to subsidize the lower rate company, which may be a higher cost company, in order that millionaires living in that county will pay $5 a month, and yet, the poorest sharecropper in that county must also pay $5 a month? Or do we prefer, as a matter of social policy to subsidize the consumer who has the need and let the consumer without the need pay something more on the order of actual cost?

I think that that is a very important question. It has tremendous implications for the competitiveness of telecommunications in this country and I do not believe that Congress has seriously addressed that question.

Mr. Richardson.

Mr. RICHARDSON. I think the major pressures that we are talking about here are the access charge, the FCC decision and the implications that has for State regulation of long distance as well.

So if we deal with that pressure at the source of the pressure, such as reversing the FCC's decision, is one way to get at the problem. Secondly, on which I think all of us have agreed, tougher State regulation in rate cases is another way to deal with these pressures.

Now if, indeed, through one way or another many of these costs start coming through that must be borne by the residential and small business customers, then there is still one last line of defense. And that is in the design of rates at the State level. There is still at this point a regulated local service that the State regulator looks at and decided on the basis of costs or universal service objectives or whatever objectives are pertinent in that State, who pays what rate.

And there, we have some basic choices to be made. The telephone industry has argued, in effect, that we institute some sort of welfare-oriented services where we target, as in a welfare program, a particular type of person who can qualify for a reduced rate. Other proposals are a lifeline type rate which can come in many forms and be made universally available to anyone who chooses it.

Admittedly, some of these will be two-income professionals who do not use their phone much, except on the weekend, and who will probably take a lower lifeline rate. That will happen somewhat.

Well, we have a choice to make and it is a State choice between some type of targeted, qualifying welfare system for telephone users or a general lifeline type of program available to any customers who want it.

I might say among consumer groups there is almost a universal abhorrence of one of the forms of so-called lifeline and that is using the long distance kind of charging system in what is called local measured service as a solution. It is certainly not necessary to go to that type of complex service to provide an alternative that works for consumers.

Representative SNOWE. Thank you. Mr. Korsmo.

Mr. KORSMO. In answer to your question, I think it will be possible in the future to provide affordable and universal service, even in light of all the changes that you mentioned. On the subject of equipment charges that, for example, I agree with Mr. Garrison, competition in the telephone equipment area has made available to consumers lower prices than they otherwise would have paid in the past when there was no competition.

Many people now can purchase their telephone. They have a range of prices from which they can choose rather than one price from the telephone company and, in fact, can today reduce their equipment charges below what they would have had to pay had they been forced to take a telephone from the telephone company. So that is, I think, one example of where competition has benefited consumers.

I hope that the cost of divestiture is a one-time cost and we will be paying that in exchange for future benefits that we all hope will accrue from the divestiture.

Representative SNOWE. Would you tell me, do all of the costs of divestiture pass on to the consumers, or does AT&T assume some of the cost, which is estimated to be $1.9 billion over the next five years?

Mr. KORSMO. I am sorry, I really do not know what percentages apply. I just have not studied that.

I believe that access charges are obviously necessary and that, given the type of protection for high cost areas which I advocated in my comments, and given the access charges that we are talking about levying on customers in the form of flat rate monthly charges, certainly comments, and given the access charges that we are talking about levy- mechanisms which can be implemented within the framework of the telecommunications industry, such as the universal service fund mechanism which the FCC has decided upon. I believe the amount of that protection is inadequate at this time. The FCC has not taken a conservative enough approach. But I hope they will; and if they do, I think that consumers in high cost areas will be protected.

I would take exception to one example that Mr. Garrison mentioned and that was the example of the local rates today in, say, a Bell rural area. I think he mentioned the number $11 versus a rate of $5 in an adjacent independent, again rural area.

I do not think that one can look at local rates today and really draw many conclusions as to the cost of providing service in those two areas. For example, I used to live in what would be called a rural area served by a Bell Telephone company. Yet, for my local rate, which was approximately $11—it was in a different area of the country than Mr. Garrison mentioned—I could access via extended area service arrangements a half million people.

So, obviously, that $11 included the cost of a lot of things other than just my local access line. However, in a typical rural area, far away from a metropolitan center, a subscriber may not have access to that type of a calling scope and therefore would not incur that type of cost for that calling scope.

I am not necessarily trying to justify the local rates of today, but I am saying that you cannot look at the local rates today and say, well, this is fair, this is unfair, because there are so many things built into those rates that will change in the competitive environment.

Last, I would like to mention that I believe that the depreciation rates that Mr. Kahn mentioned are necessary in the competitive environment. When you look at the depreciation ratios—that is, the percent of undepreciated plant in the regulated versus the unregulated companies, like MCI and others—you see wide disparities. And if we are going to go to a competitive environment where telephone companies, in effect, are competing with bypass alternatives which are seeking to circumvent their networks, then we must allow those telephone companies to maintain an adequate depreciation reserve.

Representative SNOWE. Thank you. Mr. Kahn.

Mr. KAHN. Again, I will try to supplement. I do urge you, however, to reread what Mr. Garrison said in his answer to your question. It was a superb answer.

The important fact that he emphasized is that we are paying all these costs now. What we are talking about is a change in the distribution of the burden. What we do not like is paying for them visibly. When my commission introduced charging for directory assistance in 1974, there was outrage expressed by people: you are charging us for something that was free. It was not free. The people were paying—at that time, the next year, our estimate was that they would be paying $100 million a year for directory assistance service, but they did not see it. They simply paid it in their basic bills.

When we introduced charging for directory assistance, we gave people some free calls. We found that at the end of 2 months, they had reduced their directory assistance calling, people in the aggregate, by 45 percent. That meant, in the long run, we would save $50 million a year just by people seeing what it cost to provide it and then economizing. And 85 percent of the people got a full refund. So that there was some small, 15 percent of the people, mainly salesmen, I suspect, who were just not bothering to use their telephone books.

Well, that, writ large, is the story of having charges that show people what it costs. That is, of course, the case for local measured service. Mr. Richardson says that consumers do not like it. I am a consumer; I love it. I want it to be available, optionally, so that the people who place a lot of calls on peak, for a long time—there are people who have computers. They hook up with other computers and they talk for 24 hours to one another and they pay nothing, or they may pay for one message. That is absurd. The people who use the system on peak at the busy time and impose costs, they should pay for it. People who are willing to evercise restraint, just as in the case of gasoline, who are willing to buy cars that are fuel efficient, they should not have to pay for it.

So that, apart from the depreciation, it is essentially a transfer.

Now he said something else that you may not grasp right away. It is very important, but it applies to depreciation as well.

It used to be that we would postpone these costs and we would just put them in the rate base. We would depreciate only 3 percent a year, so that 97 percent would be in the rate base and consumers would continue to pay that and they would pay a return on that.

If you pay more rapid depreciation, you put up more dollars now, but then it does not go into the rate base and you do not pay a return on it. So that when you pay now, you get a return on your money. It is a wash in that sense.

When people would have installation of their telephone service, and it might cost $150 to put in a phone service when you are building a new house, people would spend an average of $70,000 for a house and they would assume as a matter of course that they should pay what it costs to build a house. They would pay for the flush toilets and they would pay for the electricity system. The one thing they thought they did not have to pay for was the telephone. So, instead, they would pay $25 or $30 to put in the telephone. Where would the rest go? It would go into rate base and all rate payers would pay on it from then on in perpetuity. They would pay 3 percent per year depreciation and they would pay a return on it.

You talk about buying your phone. Well, but the difficulty is under the previous system, you were buying your phone every 18 months. That $40 cost, you are paying $2, $2.50 a month. In 18 months, you paid for it then for the rest of your life, if you have the good fortune to have a life expectancy of 60 years, you will have bought yourself 30 telephones.

Well, I regret the loss of the rental alternative, and I am not sure to what extent that still is there. But a telephone is like a toaster. And you can get guarantees, but you may get your guarantees from Radio Shack or Sears, Roebuck. The point is that an economist believes that cost should be visible, so that people know what it is costing society. And then people who are profilgate pay for it and people who are not, who are parsimonious, do not pay for it. And you take care of poor people.

And Mr. Richardson has outlined some of the possible ways of taking care of the universality problem and I agree with those.

Representative SNOWE. Thank you. Thank you, Mr. Chairman.

Senator ABDNOR. Thank you. Senator Jepsen.

Senator JEPSEN. Yes. Mr. Garrison, I understand you are from North Carolina.

Mr. GARRISON. Yes, Senator, I am. And I grew up in a rural area.

Senator JEPSEN. I understood that, too. It seems to me that the old "Andy Griffith Show" took place in Mayberry, N.C.

Mr. GARRISON. Yes.

Senator JEPSEN. Now are the residents of Mayberry, N.C., and all other towns in rural settings going to be—they are going to be affected by the changes in this telephone industry, the things that are happening.

Mr. GARRISON. Yes.

Senator JEPSEN. Can you just kind of make a, tick off a quick list of the changes that are going to take place? In eastern Iowa, I am advised by rural telephone exchange there, just as recently as about an hour and a half ago, that the rates will go from $7 to $25. That is the base rate. That is forgetting about access and all the other things that are going to happen. That is a 350 percent increase. You say in your prepared statement, and you correct me if this is not an accurate feedback. I gather from the things you have said that these things will be phased in over 7 years or so and it is not going to be all that bad.

Mr. GARRISON. Oh, I think that it will be controllable, yes.

Senator JEPSEN. OK. What is happening in Mayberry, N.C., now? Let us assume that all of these things that are on the border and they are coming down the line, what is going to happen in the next 12, 18 months to those folks who have a telephone?

Mr. GARRISON. Well, to echo the answer that I gave earlier, I think they are going to have a year or two of very substantial confusion about what in the heck is going on here. And that concerns me greatly. I think that consumers have not been given the full story on all of this, both in terms of the advantages and disadvantages.

Senator JEPSEN. Who is not giving that story?

Mr. GARRISON. Well, I think that the utility commissions have the principal responsibility as public officials. In many States, I think that the utility commissioners have not taken what I would call a reasoned or measured reaction. But, instead, for various purposes, have overinflated the magnitude of the change that is coming and what it will mean.

Now, I do think that Members of Congress, I think the administration in Washington have the responsibility to make a greater effort. The news media has made an effort. Some members of the media have done a reasonably good job. Others, I think, have been after a sensational news story. So that is a mixed proposition.

I do feel like that the FCC has not done a fully adequate job in explaining what its access charge decision means and what the basic presumption behind it is.

Now, in defense of the Commission, they have almost all that they can say grace over in any given day. And they may not see it as their principal duty to go to great lengths to publicize and explain these matters. But I think that this is a very fundamental change for American consumers and for the American economy and I do believe that the Commission could do a better job than they have done in that regard.

For instance, people believe that they are paying an access charge for a service that they may not use, which is to say long distance service. That really is not true. It is a question of recovering cost for telephone service, both inter- and intra-state toll, and local exchange costs. And because the system that we have employed in the past is to the average person's mind and most any person's mind, irrational, at best, and past human understanding, it takes a good deal of effort and careful work-through for people to understand what the concepts of recovery of cost really mean for a consumer paying his monthly bill.

And I am concerned that people in Pittsboro, N.C., which is really Mayberry, do not understand and are not being assisted by their public officials in understanding what is going to happen to them beginning in January and continuing for several years.

Nonetheless, I still do believe that in the long run, if reasoned judgment prevails, we can transition these issues in a way that the economic impact will not be nearly so burdensome as many people have been given to understand.

Senator JEPSEN. I heard you say that there needs to be a much better job of education of this whole thing. You have to educate before anyone is going to understand and then before they are going to appreciate it, they have to understand it. And once they understand it, they will better appreciate it and it will not be nearly as painful.

The utility commissions have not done a very good job. The Administration and Congress should do a better job. The media has done a fair job, you say, but they could do better. The FCC has not done a very good job.

What is all this confusion in the meantime going to cost the folks in Mayberry?

Mr. GARRISON. Well, as a matter of fact, in Pittsboro, that was but one of the examples that I had in mind—but with different rate figures—when I was talking earlier about the difference in one county that is served by a Bell Telephone Company, or in the case of the people in Durham County, N.C., General Telephone, and from people in the portions of Chatham County N.C., where Pittsboro is located, paying widely divergent local rates.

Now there is no demonstrable difference in one person living in any one district from another. And there is no demonstrable difference in economic income for people living in those areas on an average basis. And yet, the cost for local service is very much different. I think that that is an irrational scheme of things, when this cost of delivering the service to people in each of those districts, while it is some variation, is not so widely variable that it justifies such differences in rate schedules.

Now I think that for the people living in Pittsboro, their rates will go up, but they will go up over a gradual basis in such a way that they will not drop telephone service. And I hope that one of the side effects of increasing local rates over the next decade will be the ability of the companies that serve people in Chatham County, N.C., to generate more revenues to invest in better service. And because those companies will continue to be a regulated monopoly, there is every reason to believe that those revenues will, in fact, go back to the ultimate benefit of the rate payer.

Senator JEPSEN. Would the FCC's access charge decision achieve its major objectives, as we heard them spelled out here; namely, that is insuring universal service, encouraging increased efficiency and prevention of an economic bypass?

Mr. GARRISON. Well, to answer that in an absolute sense, I would have to be a prognosticator of an ability much beyond my capacity, Senator. I think that the access charge order is a reasonable and reasoned way of approaching these problems. It is certainly not the only one. And I can well understand the public debate over the concept of an end-user access charge.

But the Commission did work on this issue for any number of years with a great allocation of staff time and resource. And as was pointed out earlier, many, many interested parties filed expert testimony before the Commission on this matter.

It is a very difficult one. It is not easily understood. And I do think that the Commission came out with a reasonable decision. It is certainly not the only way that you could proceed.

Senator JEPSEN. In closing, Mr. Chairman, I thank you. I would like to ask for a response from each one of the panel members—do you believe that the subsidization of some of these costs now, an increase and so on, should it be done as a direct subsidization by government?

First of all, should it be done? Second, if it should, should the government just out and out give sort of a flat subsidization of it?

Mr. GARRISON. Well, let me say for my answer that I believe, to give you a general response, yes, some of those costs should be subsidized for companies that have extraordinarily higher costs than average. However, the costs that are to be subsidized need to be better understood and quantified than they are presently.

I would like to make one point that may seem slightly indirect to answer the second part of that, Senator Jepsen, but I think it is important for your consideration, particularly, and I think it might help understand where we go in the long range.

Many other nations, most other nations, in fact, with the exception of Canada, principally, have their telephone companies run by the state, through state-owned and managed bureaucracies. We, of course, here in the United States and in Canada have developed an industry on the basis of private investment and service delivery, but heavily and pervasively regulated.

Now there is basically one difference between all the other countries and our system that no one has really considered when they say that "we have the best telecommunications service in the world; why are we changing it?"

The other countries, because it is a State-owned asset, do not allow the telephone administrations to make profit on revenues, as we would let it, and to return those into the updating and modernization of the network and, consequently, to improving the service delivered to consumers. As long as the service is maintained to a certain level of what is considered by government bureaucrats to be adequate, then all of the revenues derived, all the profits derived, above the cost of providing that fairly low quality service is turned back as compensation to the government or is turned back into the form of subsidization.

Now we, of course, do not do that in this country. Those revenues go back to the shareholders in the regulated utility and in very substantial measure, are returned to the upgrading of our network.

That is why we have had the best telecommunications system in the world, because those massive amounts of revenue have, in fact, been put back into constant modernization and improvement.

However, you should know that any number of our major competitors in the industrial world have now decided that, at a direct cost to the rate-payer and the taxpayer, they are going to put millions and millions of dollars into upgrading their network. And in doing that, they are not doing it simply to provide residential consumers better service. They do not care about that. They are doing it because they see the national network in their country as absolutely a vital key to future industrial growth.

In France, they are well underway with this. In Japan, they are well underway. And they are beginning to start the same process in any number of other European countries. That is something you should think about when you consider what are the benefits to all consumers, both residential and industrial, that every other major industrial power is looking at the proposition of massive public subsidization or modernization of their public communications network.

The only country that I know of that is not seriously pursuing that line is the United Kingdom, which is, instead, trying to remodel its system after ours; that is, believing that private competition will ultimately bring better service at lower cost for both residential and industrial consumers.

Thank you.

Mr. RICHARDSON. I think, again, the best way to deal with subsidy is to first ask ourselves whether that is where the problem is. I think a lot of the discussion of the subsidy has been by the implication that all of these costs and all of these changes must go through. Therefore, let us talk about subsidy.

So I would again say let us get at the costs that are causing some of these problems to arise and see if we should not change the way the burdens are being shifted, such as through the FCC access charge decision.

Then, I think the States can alleviate much of the problem through—I guess I will call it their normal rate design procedures in rate cases. Presuming for all sorts of social, political, economic reasons that universal service continues as an objective in State rate design, I think that the States can deal with much of the problem at that level.

Where there are abberrations, where unusual changes have occurred and perhaps a small, a small rural area or a small group of customers are adversely affected, then, of course, I think we should have targeted efforts to deal with those customers, be they urban or rural.

But if Federal regulation or State regulation, by law, makes some major change, then I think, as part of that change, some consideration of the impacts has to be considered and subsidy, if necessary, used to alleviate the problem.

Senator JEPSEN. I would like to just keep tabs very quickly if I might just go back very quickly. Mr. Garrison, did you say that you did believe that there should be some subsidization? Just yes or no.

Mr. GARRISON. Yes.

Senator JEPSEN. Yes; and Mr. Richardson, did you believe there should be some subsidizing?

Mr. RICHARDSON. Yes.

Senator JEPSEN. All right, Mr. Korsmo.

Mr. KORSMO. On the issue of subsidization, I think that everyone agrees that there has been subsidization going on within——

Senator JEPSEN. I am talking about government subsidization, direct government subsidization.

Mr. KORSMO. Going on within the industry today and I think the sort of subsidies that we have been talking about to preserve universal service during this transition to competition can and should continue within the industry in the short term, rather than relying on a direct government subsidy, which means to me subsidy through tax revenues run by a government agency, something of that order.

Senator JEPSEN. You are against government subsidization?

Mr. KORSMO. Well, I think in the short run it would perhaps create more confusion or add confusion to the existing confusion more than it would help.

Senator JEPSEN. So you are not for government subsidization?

Mr. KORSMO. I think in the long run, if competition runs its full course, it may be necessary. It may not be sustainable within the industry structure.

I think in the short run the subsidy program should be visible so that we know who is paying and who is receiving the subsidy. But I think it can be run within the industry itself as proposed by the FCC.

Senator JEPSEN. Mr. Kahn.

Mr. KAHN. Senator Jepsen, the only kind of intervention I think you should be considering is direct government subsidization at this time. One of the virtues of that is that then you will find yourself asking the same question as President Reagan asked about the qualifications for food stamps. And he said, and it seems to me perfectly sensible, well, we really ought to confine the availability of food stamps to families with incomes that run up to 130 percent of the poverty level because then we say, all right, these are the people that need it and we want to take care of them. I think such a subsidy is a perfectly sensible thing to consider. That is No. 1.

No. 2. I find it hard, however, in these present days of budget concerns, which trouble me very much over the next couple of years, I believe that we are likely to do that, that we are likely to have an additional government appropriation when we are so worried about deficits.

And my real fear is that what we will do instead will be to try to have some system of internal subsidization which just holds the price down for everybody, not for families with 130 percent of the poverty level, but everybody.

Now, with that, I agree with Mr. Korsmo entirely. It is premature. The price of gasoline in the last decade has gone up from 30 cents to $1.20. The price of a house has gone up. You used to be able to build a house for $15,000. Now it costs $70,000. You know what has happened to the price of electricity.

Part of our problem in this industry today, the thing that we are having so much trouble with is that we messed with it so much. There is no reason why telephone rates should be $5, $6 a month and have been roughly that for 20 years, when everything else has gone up. I think that the main advice we can have is that we should stop messing with it. And what the FCC is trying to do is to reverse that. We set up—we got the State public utility commissions. We have got the FCC. I urge you, above all else, to give it time to see what happens. They will certainly cushion the blow.

But if you do feel the need for intervention, then I think direct subsidy, like food stamps, is the thing to do.

Senator JEPSEN. You say do not fix it if it is not broken. Is that what you are saying? Do not mess with it?

Mr. KAHN. I think that that is much closer than the hysteria that we are seeing now when people, faced with the possibility that the average rate will go up from $7 or $9 to $11, where it has been—people who are paying $30 a month for Home Box Office and people who are buying $70,000 houses somehow feel, and here, I think, they are being disserved by their leaders.

But, yes, if you are worried about people not being able to afford the system, help the people who cannot afford it. That is where I began.

Senator JEPSEN. Mr. Chairman, I thank you. I have an announcement before you close that I would like to make about some more hearings. This testimony has been very helpful. If nothing else, it does reinforce what I think I have heard from each and every one of you here, that this whole process is very confusing. It has not been communicated. The education leaves a lot to be desired, the lack of understanding.

Mr. Kahn, I would guess that you would be a strong believer in a cost-justified, if you could just nail it out, rate increases; is that correct?

Mr. KAHN. That is certainly correct.

Senator JEPSEN. In your judgment, then, given the comments of Mr. Garrison regarding the confusion which was on top of his list by the State authorities, the utilities commissions, are State public service commissions prepared to accurately judge these recent rate increase proposals as we come out?

Mr. KAHN. I think that they are probably more qualified to do so than Congress rushing into it. My only fear is that they, too, are intensely political animals. Their time perspective is almost as short as that of a Congressman. They are worried about the next year or two. And it has been precisely because of their resistance as well to letting prices move with costs, which is what the fundamental principle of our economy is, that has helped create our great difficulty.

But I would rather leave it to them than to hasty legislation.

Senator ABDNOR. One last question that I would like to ask and I guess I do not really need to do it because throughout the questions and answers and your statements it has pretty well been answered, I guess. But just in a few words—what advice, what kind of action would you take for solving the problems we have been talking about? Some of you may think that, well, maybe we should not take any action.

What advice would you have for Congress and for Federal regulators and State regulators? Have we paid enough attention to the rural situation? Your answer, please, in a few words.

Let us start with you, Mr. Kahn. We always leave you at the end. Let us start you at the beginning.

Mr. KAHN. Sure.

Senator ABDNOR. Please summarize what you think we, as Congress, we in Congress and all the other agencies, should be doing.

Mr. KAHN. I will try to do so while avoiding repetition. So I think that I can be very brief. First, let the FCC decision stand. It was an intelligent decision. It was a moderate decision. It was a courageous decision.

No. 2, your legitimate central concern is what may happen to people in rural areas who may have their bills go up very sharply, or poor people. Consider designing legislation, not putting it into effect right away because nothing is happening as yet and some gradual changes to correct the underpricing of the last several years is desirable. But consider—and by the way, I urge you to work with your staff. After reading that report, I am confident that you can safely take their advice.

Senator ABDNOR. Thank you.

Mr. KAHN. And see whether it is possible to devise a restricted subsidy, preferably taxpayer-financed, but if not—I testified in California in favor of a bill that would impose a 4-percent tax on carriers, and they were going to try to get private systems as well, in order to provide a lifeline of a subsidy. Four percent is so much better than 60 percent, that I think it is a reasonable arrangement.

Try to think about devising specific subsidies that will help the people that you are worried about. But then wait and see before you rush in.

Senator ABDNOR. Thank you.

Mr. Korsmo.

Mr. KORSMO. I agree with Mr. Kahn in that I believe that Congress should leave the basic structure of the FCC's plans intact, certainly with regard to the end-user access charge. However, it may be useful for the Congress to clear away some of the confusion and uncertainty that the consumers feel right now as to the status of universal service by enacting some legislation, planned resolution, or whatever, that guarantees them that universal service will be maintained.

I know that there have been a lot of proposals before the Congress and in the bills introduced to date for universal service plans. Some of those are very good, I think. And that sort of thing may be useful to at least inform consumers that, amidst all this confusion, there will be help when they need it.

Senator ABDNOR. Thank you. Mr. Richardson.

Mr. RICHARDSON. The one thing that I think Congress should do is to reverse the FCC's access charge decision, just simply eliminate that decision, reverse it. Tell them to go back and consider whatever they must do in light of universal service objectives of the Nation.

I think if we do that, if Congress acts in that way, that many of the other problems will be a lot less severe and Congress will have served the Nation well by that one single action.

Senator ABDNOR. All right. Mr. Garrison.

Mr. GARRISON. Well, I say this with respect to Lee—I couldn't possibly disagree with him more. I think it would be the worst possible thing that you could do for this industry. As I said, they need some regulatory certainty and that would just throw things in turmoil for who knows how long. At least another year and that is a year lost in which we begin the divestiture. I think that that would be very erroneous public policy.

Now as to what you should do, I suppose it is because of Mr. Kahn's presence and his well-publicized abilities and talents as a Savovard that I am inclined to be a little bit flip, but I mean this, again, with respect, in suggesting that Sir W. S. Gilbert wrote a lyric once that very much is telling to my mind about the current situation you are looking at. Gilbert once wrote that Great Britain's most glorious days were those days in which the Parliament did not interfere in matters which it did not understand. [Laughter.]

Now the Commerce Committees believe that they understand this issue. I think that that assertion of jurisdictional expertise bears a lot of careful thought by every Member of the U.S. Congress. If you can, after today, each of you think that you really sufficiently understand these issues and these problems to second-guess the FCC, then you may feel comfortable in going with Mr. Richardson's suggestion.

However, if you do not, then I suggest that you bear in mind Gilbert's wisdom.

Thank you.

Senator ABDNOR. Thank you. I appreciate that.

Well, Congresswoman Snowe would like to get one last question in.

Representative SNOWE. That is right. Mr. Garrison, I assure you that if we were convinced and everyone else is convinced as to what was going to be happening, we would feel a lot better about where we were going. [Laughter.]

One final question on this access charge. Judge Green, who was supervising the reorganization plan of AT&T and the telephone companies, criticized the FCC's plan for the access charge and said that he did not understand why they were acting at odds with the divestiture agreement.

Would you care to comment? And also, in your comments, would you just tell me whether or not this access charge is also assessed to the carriers, in addition to the consumers who will be paying this access charge?

Mr. Kahn.

Mr. KAHN. May I try? I must be terribly careful not to be held in contempt of court. [Laughter.]

Jurge Green does not want to go down in history as the man who raised basic telephone rates. And Judge Green is right to the extent that he is worried that the decree, the anti-trust decree, will be held responsible. And it would be incorrect to attribute these pressures for reforming, moving the prices of telephone services closer to cost, to attribute those to the decree.

In that he is right.

But in not understanding or professing not to understand what competition does, the competition that he espouses, in not understanding that it is the inevitable consequence of our competitive policies in this industry, which may or may not be correct, but the road on which we have embarked over the last 20 years, that their inevitable tendency is to eliminate monopoly surcharges on certain services because competitors will enter, and therefore, to wipe out the possibility of generating huge surpluses from monopoly services and transferring them to hold other charges down, in professing not to understand that, it seems to me that he is professing not to understand how competition works and what it is supposed to do.

On your second question, to the extent we are talking about the costs of providing subscribers with a dial tone, that is what we mean by access to the network. Those costs eventually must be levied on subscribers in their basic monthly charge. It is when they say "I want to be a customer" that the drop line has to be provided and that the two wires going to the central office, all of those things have to be provided just for you to be a customer. And those costs, those are the ones, those so-called nontraffic sensitive costs have been the ones that year after year have been shoved over onto usage. They are not caused by usage.

If you place a long distance call, those costs do not change. That is why when you have competition, those rates, those costs will be squeezed out of those rates. So, in the long run, we have to permit a reduction of the levying on the interexchange companies, the long distance companies, levying on them these so-called nontraffic sensitive costs.

Now, of course, there will be other costs that do vary. They will continue to pay access charges. But other than a residual, like the universal service fund where most of us accept the necessity for some fraction of that being retained, economics dictates—it dictates—that those nontraffic sensitive costs be taken off usage, the big users are escaping them, and be put in the basic monthly charge.

Representative SNOWE. Does anybody else care to comment?

Mr. KORSMO. As to Judge Green's criticism of the FCC's access charge, I can only say that Judge Green, unfortunately, did not have the opportunity to participate in the years of FCC debate and comment about what an access charge plan should be. I think if he had, he may not have made the same criticism he did.

As to whether the access charge that the FCC has devised is also assessed to carriers, yes, it contemplates carrier charges, not only for the so-called traffic-sensitive costs, but also in the interim and permanently for nontraffic sensitive (NTS) subscriber across line costs.

I think it is important to note that, initially, in 1984, most nontraffic sensitive subscriber access line costs will be paid by long distance carriers as they are today. It is only the $2 a month for residents and the $6 a month for businesses that will be paid by the subscriber. Most of the NTS costs will still be paid by the carrier. Most of the costs will be paid by long distance carriers for a few years during the transition plan that the FCC has devised.

Some of the nontraffic sensitive costs will be paid permanently by the long distance carriers through the universal service fund charges and that, of course, has been the subject of an intense debate over how much of the NTS cost should not be ultimately transferred to end-users, but should flow through the carriers to keep these local charges down.

Mr. RICHARDSON. I wonder who in the United States has been exposed to more economics of the telephone industry than Judge Green. He got it from all sides by all interests who spared no expense to provide the best statements that they could possibly assemble to tell the Judge about the nature of competition in that industry.

He certainly made a very radical decision as to accepting the modified judgment, or modifying the proposal that the company and the Justice Department brought before him. He acted swiftly with some confidence that he understood these economics.

I am absolutely appalled at the thought that somehow, in all of that exposure to the nature of competition and the economics of the industry, that he did not somehow hear in advance that there was a $10 billion subsidy in there some place. I find that incredible and I wish that the Judge was here to expand on his earlier statements.

No one had presented an argument to him concerning where the subsidy was, if any. He chastised the FCC and all parties for not having examined this question.

I think he was also appalled, and I would agree with Mr. Kahn to some extent, about some of the politics involved in that the FCC certainly played politics. They waited for the point where the judgment appeared to be irreversible, December, the holiday season, in 1982, and then they decided that they would implement this decision January 1, 1984, obviously timed well to hide the impact of their decision by mixing it in with the dates of the divestiture.

Representative SNOWE. Thank you. Mr. Garrison.

Mr. GARRISON. Well, I have a great deal of respect and admiration for Judge Green. I think it is important that you bear in mind that as a judge of the Federal court, it is his business, and I might say his very good competence, to preside over issues of antitrust law in dealing with the divestiture of AT&T. Those matters do not make him, and I do not imagine that the Judge would even suggest himself, that they have made him omniscent in matters of regulation, particularly of this industry.

Now the fact that he is not omnicompetent is proven not only in my mind by his what I believe to be erroneous comments about the access charge concept, but by the fact that in various points, he has been factually incorrect, one of the most egregious being a statement that the Judge made that all states but Virgina, where I happen to live, allow intrastate competition. When that was made, there were no more than eight States which allowed intrastate competition. So on the face of it, the fact and the policy which further followed from that in his order were absolutely incorrect.

So the Judge's opinion is not necessarily the final court of appeals on the matter of access charge and its wisdom.

I think one point that it would do well for everyone to bear in mind, and I think it would again be helpful for the public, Senator Jepsen, along the education lines that we discussed a few moments ago, for people to know and understand that there are really two types of access charges involved here. And rather like Humpty Dumpty, it is a case of a word is what I say it is in the particular circumstance that I am dealing with.

We have talked about end-user access charges which will be charged to residential and business consumers to access the interstate long distance network. There is another type of access which is really much, much more important economically and that is the access which the carriers will pay to the local exchange companies to access and use their local exchange facilities to originate and terminate long distance calls.

That access charge will, for all of the telephone companies in this country, generate billions of dollars of revenue per annum over the coming years and, as it does now, in an indirect way. And how that is structured and how that is implemented is much more important for the health of the telephone industry in this country and ultimately for the service which consumers are provided than the other access charge which is significant, but much more politically, I think, controversial.

Thank you.

Representative SNOWE. Thank you.

Senator ABDNOR. Well, thank you. Senator Jepsen, you had something.

Senator JEPSEN. Yes. I note the word "politics" being used and "political" being used, not always in a very positive sense. This is not atypical. I think sometimes we take so many things for granted in this country and we seem to forget that we do derive our powers from the bottom up, not from the top down, and that is not always the most efficient way of doing things, and so on, but I will take my chances with that.

And so that the folks who are held accountable, as those of us in politics are. Contrary to the utility commissions, we are held directly accountable. We are held directly accountable, some of us, every two years, some of us every six years. And I would point out that there is a difference between that direct accountability and those in the utility commission or those in the consultant business or those in the news media or those in the FCC.

And having said that now, I would announce that there will be hearings—I will be holding an informal information forum for Iowa residents on this telephone issue on the 11th of October. Senator Abdnor will be holding a similar one on October 14 for the residents of his State. And then on Monday, October 17, there will be a regional field hearing sponsored by the Joint Economic Committee which will be held in Des Moines, Iowa with regard to this subject. I would invite any and all of the people here today in this room who may have interest in this to attend, if it is possible. At that time we will hear from the people who we are accountable to about this problem and, at the same time, we will try to share with them on a positive basis any information that we can give them.

And I thank you, Mr. Chairman.

Senator ABDNOR. Thank you, Senator Jepsen. In conclusion, just let me say that I am extremely gratified by what has come out of this hearing today and I am very grateful to all of you for coming. I know that you are all extremely busy and Mr. Garrison, if that jet lag does not catch up with you, I do not know what will. You have to be an enduring person to be able to constantly be going back and forth to England and Europe for your business.

I appreciate your efforts. I would like to feel free, if we would so desire, to submit questions to you gentlemen. We just barely touched some of the questions that were going through our mind. You seem to be the source to get the answers from. And we would appreciate it, if we felt like it was necessary, to continue to submit questions to you.

This concludes our hearing. By way of an announcement, in a continuing effort to highlight rural economic issues, the full committee that is chaired by Senator Jepsen, will conduct a hearing on the "Emerging Economics of Agriculture." That will be Wednesday of this week at 10 a.m. in this same room we are in.

The Council for Agricultural Science and Technology will be delivering to the committee at this time—at that time, I should say—its study on alternative farm policy options. I think it is going to be a very promising and enlightening session. I am certainly looking forward to it. I think it will be interesting in light of the full hearing, the hearings we have been holding this last year on what we are looking for in new farm policy.

So I urge anyone interested to come Wednesday for that hearing and again, thank you very much.

This concludes our hearing. Thank you.

[Whereupon, at 12:30 p.m., the subcommittee adjourned, subject to the call of the Chair.]

THE ECONOMIC ISSUES OF A CHANGING TELECOMMUNICATIONS INDUSTRY

TUESDAY, OCTOBER 11, 1983

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 12 noon, in the King Memorial Chapel, Cornell College, Mount Vernon, Iowa, Hon. Roger W. Jepsen (chairman of the committee) presiding.

Present: Senator Jepsen.

Also present: John Conrad, legislative assistant to Senator Jepsen; and Dale Jahr, professional staff member.

OPENING STATEMENT OF SENATOR JEPSEN, CHAIRMAN

Senator JEPSEN. It gives me great pleasure to welcome everyone here to the Joint Committee hearing on the future of telephone service in Iowa. Private colleges have long been in the forefront of community activity and deeply interested and involved in contemporary issues facing the community and I wish to thank Cornell College and President Secor and Vice President Charles Cochran for providing the facilities to us today. Iowa has a very strong private college system and we are very happy to be at this great institution of learning. And it also gives me pleasure, and I express my gratitude to all the distinguished panel members who have both prepared ahead of time and have traveled some distance to be here at this hearing today.

I would like to introduce on my right Mr. John Conrad on my staff. John Conrad, by the way, is from Conrad, Iowa. We say Conrad and Conrad when he answers the phone. And this is Dale Jahr. Mr. Jahr is a recent new member of my Joint Economic Committee staff, although he has been working on and with the committee for some time but with another Senate office and we have been so impressed by his work that we rescued him from the other Senate office and brought him to the Joint Economic Committee staff.

I think by way of background, let us set the stage so that we all might share just where we are at today and why we are having these hearings. I wish to review the telephone issue—what has been happening and what changes are taking place in the industry.

First of all AT&T is divesting itself of its operating companies, and here this afternoon we will refer to them as the BOC's. Bell operating companies will be divested from AT&T on January 1. The BOC's are going to offer local service and AT&T will offer long-distance service and manufacture phone equipment and do research in the Bell laboratories, which is the world's largest research and development facility.

No. 2, the Federal Communications Commission, FCC, has allowed competition in the long-distance market and customers can now own their own phone equipment.

No. 3, the BOC's have filed for the largest rate increase in history for 1984. Now that is collectively in all 50 States, and some BOC's have filed for larger increases than others. Collectively it is the largest rate increase in history. Many experts consider this to be sort of a posturing process or move in light of the breakup. In other words when negotiating for higher rates, you come in on the high side. Now I am not vouching—I will put in a disclaimer here—for the right or wrongness of this. This is the way the analysts see it. Most public service commissions it is felt will not allow most of the rate requests or rate increases.

For another item, AT&T has filed for a $1.75 billion decrease in long-distance rates, this is about 5 to 10 percent for most calls, on an average, with some long-distance rates going down as much as 15 percent. The Federal Communications Commission, FCC, is phasing out its current cross-subsidy system where long-distance users pay most of the subsidy and is in an access charge system which is imposed on all customers. A $2 monthly charge on residential and a $6 monthly charge on business customer phones will begin on January 1 if no legislative directives preempts this. In other words, over the years with the advance in technology, actually what has happened, as I understand it, is that the cost of long distance has actually gone down. But with the acquiescence or agreement among the Government, regulators, and the telephone companies, the increased profits on the long-distance rates were going to lower the cost of local service. That money has been used to subsidize the local service across the country.

Now, effective on January 1 this is not going to be so any more and that subsidy will not be there if the FCC decision is implemented. Hence, there will be an increase in the cost of local service both for residential and business and $2 monthly residential and $6 monthly charge on business customer phones will automatically begin on January 1 and that is called an access charge.

Finally a universal service fund will be created to provide assistance to high-cost areas. Iowa is not considered a high-cost area even though some smaller rural phone companies have higher-than-average costs.

Because of rapid technical advances, regulators are admitting that the practice of regulating the phone industry as a monopoly is not going to be appropriate in the future. However, opening the industry to competition is not going to produce uniform and entirely beneficial results. In fact, the question is being asked more and more every day by people I visit with, as this date of January 1 draws near, they say what can we do, what did we fix that was not broken and they are starting to wonder. Rural and residential areas may not see much competition and may not benefit much from all these changes.

Even though the $2 access charge is not all that harmful in and of itself, there are many customers and small phone company officials that are concerned about it because they feel it will open up the door to all kinds of rate increases. Local service now is being subsidized rather substantially. The cost per phone line averagewide is about $26 per month while the average cost to the customers that they can charge is about $11, and I am speaking of a national average. So competition is brought into play and the government regulatory apparatus is being withdrawn somewhat. Then you pay for what you get so to speak and on a a raw cost basis it would mean on the basis of these statistics, $11 being the average cost of the charge now and $26 being the actual cost, that in many cases the local service will mean a doubling and in some cases a tripling of rates.

This summarizes where we are today; it is that kind of situation. The Senate is considering legislation which would alter the Federal Communications Commission access charge and the current version of the bill at this point in time would impose a 2-year moratorium on access charge for residential and one-line business customers. It would require the FCC to conduct a nationwide study of the effects of competition, access charges and other charges to customers. And it also finally would establish a universal service fund with two purposes: One to assist high cost areas and the other to assist low-income and other disadvantaged citizens who would be adversely affected by these changes. So you see there is already a proposal for subsidizing from a different source being proposed in the Senate. That is where we are today.

And at this time I would invite Signi Falk, who is the chairwoman of the Legislative Committee Heritage Agency on Aging, Cedar Rapids, to come up. And will you make sure that you help, John, that they do not stumble on the way. Kathryn Moon, and I do not mean that as any reflection on your ability. Kathryn Moon, Legislative Committee, Heritage Agency on Aging, Iowa City, and Elmer Sorenson, who is the Bell Telephone Users Group representative from West Des Moines, Iowa. I would welcome all three of you to this hearing. I would advise all of you that any written statement that you have will be entered into the record as if read. You may read that or you may summarize as you so desire. Indeed, any written statement that you have will be entered into the record as if read. And now Signi Falk, we will start with you and you may proceed in any manner you so desire.

STATEMENT OF SIGNI FALK, CHAIRWOMAN, LEGISLATIVE COMMITTEE, HERITAGE AGENCY ON AGING, CEDAR RAPIDS, IOWA

Ms. FALK. Thank you, Senator Jepsen. Good morning friends and supporters. I am addressing my remarks to the low-income elderly and to those on limited incomes. According to the last census data there are 40,000 Iowa households which do not have phones. The elderly make up 10,000 of those households or one-fourth of those phoneless homes are of senior citizens. There are in Linn County 17,000 elderly who are 65 and over. It is estimated that 1 out of 5 of these elderly fall under the poverty line. In other words, over 3,000 exist at or near the poverty line. The Council on Aging in a 30-minute check of clients, discovered that 14 did not have phones. The director estimates that there are possibly 50 homes without a phone and this would be in and near Cedar Rapids. According to a HACAP survey, not yet completed, of clients who qualified for fuel assistance during the 1982–83 winter, of the houses in Linn County, 27 out of 636 had no phones. An incomplete survey of Jones County shows that of 227 houses, 17 had no phones. Those working on the survey noted that the lack of phones in rural areas made the isolation of these people that much more severe. The personnel feels that a comparable check next year will better tell the story of those who had to give up their phones because of increased costs. The elderly in the low-income bracket in our seven county area make up 15 percent of the low-income elderly in the State, or about 7.800 individuals. Another 15 percent border on the low-income range. That means that over 15,000 low-income Iowans live in Linn, Jones, Johnson, Benton, Washington, Iowa, and Cedar Counties.

Particularly in rural areas, where lack of transportation has isolated the elderly more severely in recent years, the lack of phone service can be a matter of surviving a serious illness or accident—of not surviving a serious illness or accident. Phone service for the household may be the only contact with the outside world. It can be a matter of physical survival, as well as mental well-being. It is a necessity, not a luxury. The deregulation of the telephone industry will increase the problems not only of the low-income elderly but those who remain independent but must watch their budgets carefully. Steps must be taken to protect not only these seniors, but citizens of all ages.

What should Congress do? These are suggestions. One, limit the access fee, do not allow it to rise indefinitely. Attention must be given not only to the low-income elderly but to those on a fixed income. Two, enact the teleclub legislation, the amendment to H.R. 3261 proposed by Congressman Ed Markey and the comparable amendment to S. 1660. Three, work out a formula for an elder care fund to be administered by a local agency such as the Linn County Council on Aging. Four, work out a program comparable to the food stamp program, perhaps issue a warrant to be certified by a local agency that would enable the poor to have phone service. Five, give tax breaks to companies who give special consideration to the low-income elderly.

The concern repeatedly voiced in this area is that the elderly on a fixed and low income already face the uncomfortable option of choosing between food, medicine, and heat. With rising costs more people will not be able to afford phone service.

Senator JEPSEN. Thank you. Ms. Falk, before we get into questions or exchange of ideas we will hear from the rest of our panel. At this time I will introduce Kathryn Moon and invite Kathryn Moon to proceed in any way she desires. I will remind the panel again we will enter written remarks into the record as if read and you may proceed any way you so desire.

STATEMENT OF KATHRYN MOON, MEMBER, LEGISLATIVE COMMITTEE, HERITAGE AGENCY ON AGING, IOWA CITY, IOWA

Ms. MOON. Thank you, Senator Jepsen. Friends as I look about this beautiful, beautiful old church the thought occurs to me where else in all the world could a group of older people, younger ones, business, government, labor meet for a townhall meeting, and that is what this is. Thank you, Senator Jepsen, for giving us the opportunity to speak to you regarding the proposed plan for telephone rates.

May I be a bit personal, as I view the increase in rates for telephone service, I am a widow well past the 70 years, John, thank you for helping me up, living alone in my own home, paying taxes and attempting in a small way to be a contributing member of the community in which I am so lucky to live. I speak for many of my peers living in their own homes, apartments, and condominiums. We do not consider our telephone as a luxury. Let us look for a moment at the meaning of the word "luxury." Webster says luxury is something desirable, needed but costly, hard to secure, few can afford. But then on the other hand let us look at the meaning of necessity. A state of being in need, a requirement. We are here and we read a lot about the desirability of keeping the elderly in their own homes. In the mid-1970's, the University of Texas did an exhaustive study on this very topic. In all instances it was found to be economically more feasible and certainly psychologically wiser to provide every means of keeping elderly in their own homes as long as possible.

And thus some of us began to seek funds with which to provide when necessary home health care, chore services, meals on wheels, lifeline, and telephone reassurance. We have been somewhat successful in providing these services, all of which means and needs a communication system between the user and the service provided. But now along comes the matter of telephone deregulation bringing with it the prospect of exorbitant increases in rates for consumers, users, us little people. If the request of the telephone company is granted, and not all rates have been specified, many of us will be forced to do without telephone service. After all, retirement dollars are not that elastic.

May I point out to you that my security, the security of many, many elderly people depends upon the availability of help in case of illness, accident, or even should there be, as there was at my home, be an intruder at 2 o'clock in the morning. So how valuable that telephone was to call the sheriff. Living in an urban area my security does depend upon my reaching out for help, but those who live in rural areas are even more dependent upon the availability of help. Am I now referring to a luxury or a bare necessity? You judge that please.

We are sure that you, Senator Jepsen, are just as aware as we that the dollars that retirees are using were put into retirement when a dollar was a hundred cents' worth of most anything and today some of the economic whiz kids say that a dollar buys really 27 cents' worth. You also know I am sure, Senator Jepsen, that 5,000 Americans turn 65 every day of the week, every week of the year, and thus the problems of the elderly continue to increase. Dollars needed for food, energy, and housing continue to be the major expenditure of older Americans. And now should we be forced to add the proposed telephone rate increase, you can readily see what we will face.

We are a graying America. How many times have you heard that? And in this very county there are 12 percent more people over the age 65 than there were when the 1970 census was taken. Those are census figures.

Senator Jepsen, everyone of us believes with all our heart that all service providers are entitled to reasonable profits. We wonder if you believe that the increases may come if the telephone company gets the present rate, would be fair and reasonable. For those of us who are faced with the danger of giving up telephone communications, we will be giving up our security. We would like for you to know that we have great fear in that regard. In 1975 when then-Governor of this great State of Iowa, Robert Ray, asked a few of us a very sharp penetrating question, he said what is happening to elderly Americans not living in long-term care facilities, and some of us through the area agencies, through our church, our service clubs, have been attempting to reply to the Governor's question by seeking to make available those aids that will keep elderly Iowans comfortable and secure in their own home.

And now may I quote from the United States Code, vol. 4, page 777, entitled Public Health and Welfare. Section 3026, each area agency shall provide, A, service associated with transportation, outreach, information and referral; B, in-home services, homemaker, home health aids, chore services and telephone reassurance. No. 6, each area agency shall serve as an advocate, a focal point for elderly by monitoring, evaluating and commenting upon all policies, programs, and hearings which affect the elderly.

That is why we are requesting your very special attention to our request, that you work for amendments to the proposed increases. We ask the Congress in its wisdom amend the proposal and guarantee the elderly in Iowa and the other 49 States the security that having a telephone gives. Was it not Theodore Roosevelt who so aptly said a nation is best judged by the way in which it cares for its aged and its veterans.

Senator Jepsen. Thank you, Ms. Moon. Elmer Sorenson representing the Bell Telephone Users Group, West Des Moines, Iowa.

STATEMENT OF ELMER SORENSON, REPRESENTATIVE, BELL TELEPHONE USERS GROUP, WEST DES MOINES, IOWA

Mr. Sorenson. Thank you, Senator. Normally I do not need a mike, I will put it here and if there is distortion in that, let me know. I normally speak out loud enough so people can hear me. Can you hear me OK in the back, is the mike picking it up OK?

I think I was put in a spot here of having two very outstanding speakers ahead of me which puts me in a tough act to follow. I am going to be making some statements that maybe will sound like they do not agree with what the two of you said, but I want to assure you that I am very concerned about the things that you brought up and I think they are things that definitely have to be taken into consideration, something done about. I try not to act it but I am right up there with the two of you, but I try to act like I was 40. I am going to make some statements which are definitely my own ideas. I am not an expert, but I would like to give a little background on myself to maybe give a little credit to the statements that I am going to make. I feel that I am an average citizen, moderate income, worked all my life and felt that we led a pretty average life and I feel that I have developed a pretty good knowledge of people, their thoughts and actions throughout the years. And here I would like to give you a little of my background to tell you why I have that.

I have been in private business. I worked as an hourly employee punching a timeclock for some years. I spent the last 10 years of my working career in management. I semiretired in 1974 and then I became active in several nonprofit organizations. I was on the mobile meals homemaker service board for 3 years, on the West Des Moines Human Services Board for 3 years and been on the home incorporated board in Des Moines for 10 years. All of these boards deal with problems and needs of people. I have also, for the last 9 years, been very active on the West Des Moines Community Education Board and am on the State community education board, and this again deals with the needs of people and their wants and we do a lot of work with the elderly. I have also served on the Bell Telephone consumer panel since it was formed. And incidently, I do not want you to get the false impression here, I have no connection period with the telephone company. I do sit on the consumer panel which is really nothing but an information gathering or way of the telephone company finding out what we as consumers feel. So I have no ties with the telephone company but I have served on there during this period of deregulation and Bell has been very good at trying to keep us informed as to what was going on, but it is still very confusing to me so it is no wonder that the public is confused as to the meaning of access charge and what all is going on. And I feel that somebody definitely dropped the ball along there some place and not explaining to the public exactly what access charge means. Everything I have read and heard said that it had to do with making long-distance telephone calls. As I have said, I am no expert, but my understanding is that the telephone, the long-distance calling part of it is a very small amount. I feel the public has not been served properly by being informed of exactly what this means.

I also believe that the well-informed consumer wants to continue to have dependable service which we have come to expect and knows that this cost money to maintain but are willing to pay their fair share that we can have a dial tone when we lift the receiver and the call will be completed.

Now this brings me to the methods which are being discussed for making equitable charges to various consumers to replace the subsidy that has been supporting the local service. Normally I am not happy with bureaucratic decisions that are being made in Washington all the time. it is somewhat disturbing. But I feel that the formula which the FCC has recommended for a transition seems very sound and very basic. By adding a charge to the long-distance users for only the cost incurred by the use of the local equipment will make this part of the business competitive and let anyone who can supply the best service at the bast price have a free hand. I understood that the main reason for going through this hassle in the first place was to open up the telephone company for competition. Mr. Fowler, the Chairman of the FCC, I felt made a very sound projection and he stated that long-distance service could be provided at a reasonable cost, the volume will increase so greatly due to the present technology and technology yet to be developed that the revenue from the long-distance calls then would increase greatly to your local service which again would pump more money into the local service to where they can hold down their rates. I think it is just plain economics.

The amount that the local customer will have to pay for their service after January 1, 1984 has been of great concern, and rightly so, and I believe this concern is why Congress has been working on methods to try to ease the pain. I would like to say that I feel the method used for billing telephone service in the first place is completely wrong. Let me give you some examples. A person decides to open a shoe repair shop so he has to have a business phone. That puts him into a higher rate. That phone really is not going to be used in that business, will be used very little. A person opens a business next door, this person is in direct sales, the phone is going constantly. Both pay the same rate. Which customer is causing the need of all the switching equipment and related equipment to be sure that there is a dial tone for us? It is not the one that is making very few calls, it is the one that is using it continually. But both businesses are paying the same rate. It is the same situation with residential phones. Years ago when our children were home and my wife and I were very active our phone was going continually. Now it is used very little but our phone charges are based on exactly the same basis as the woman that has teenagers and both the husband and wife are very active and that phone is here again going continually. To me the situation is very similar with the power company. They also have a large investment in generating equipment and distribution equipment to be sure that the power is there when it is demanded. Now we pay a percent of the overall costs of that equipment and the distribution but I feel that we are paying, the large user is paying for all of that generating equipment that is serving his purposes than I am sitting there in a small two-bedroom home. To me it is more fair that we proportionately pay the cost of overhead and generating expenses based on the amount that they use.

It scares me every time people try to control the flow of economics. To me people's moods and desires are really what controls economics. If we all decided to buy something the prices will go up. If we all decided to hold on to our money the prices drop. We cannot change human nature. To me fooling with economics, and I am relating to this because I think that is what we are trying to do by charging here, to subsidize here that type of thing in business, to me it is as risky as if we try to fool around with mother nature. I think maybe I can prove my point a little bit. I have seen the last 50 years of us fooling around with economics and our conditions today, I do not think it has helped a bit.

And in closing, Senator Jepsen, I would like to ask Congress to give the present proposal the FCC has put forward, after I understand many years of planning and thought, let us give it a year or so to work and let us see what happens. Then if things are not going the way they should then step in and make some changes. But let us give it a good chance to work. Thank you for a chance to give my views.

Senator Jepsen. Thank you, Mr. Sorenson. In my opening remarks I failed to mention that in our first hearing, which we held in Washington last week, that Mr. Kahn, the well-known economist, indicated that he felt, or he believed that, or understood that there were about 92-percent coverage of people with phones nationally. Some people say 96-percent coverage under the present system that we have had, which is quite complete when you take the entire Nation. I think that

I heard all three of you say in one way or another that a telephone is a necessity, do any of you disagree with that?

Mr. SORENSON. I would just disagree up to one point. I think a 100 percent is ridiculous; 96 sounds very high. Because of certain people, the desire to live in certain areas, they would give up that right to a phone, that is their choice. I think there are limitations there.

Senator JEPSEN. If we qualify it by saying that your panel, that a telephone is a necessity for retired persons, would that be more accurate?

Mr. SORENSON. I would go along with that.

Ms. FALK. I would say yes, particularly in the rural sections.

Senator JEPSEN. Particularly to rural sections. I would ask the panel, each of you, to respond as briefly as possible if you would please to the following questions: If consumers or users are going to receive better service and a greater variety of services because of changes in the industry, should then we be agreeable to reasonable increases in phone rates?

Ms. MOON. I would like to answer that question. It would be, I think our fear is that we have no assurances that one access would not pile on another and another and another, that is our fear. As I said in my presentation, all of us, I think everybody here and all older people in general, are quite willing to admit that every service provider is entitled to a fair return. And what we are saying is that we do not wish to have layer upon layer of costs.

Senator JEPSEN. Do we have anything different or anything else to add?

Ms. FALK. We really have been riding along very easily on low phone rates, that residential users have not paid their proportionate share. My concern, I think that Americans are willing to pay what the fair share is, my concern is with the low-income elderly that some arrangement be made so that they will not discontinue a phone if they already have it or they will be without a phone.

Senator JEPSEN. Do you have anything to add, Mr. Sorenson?

Mr. SORENSON. Yes. That is one of the reasons that I brought up. I feel that the present billing system is very unfair because we have the situation that a retired person who makes very few phone calls a day, and if they do they are probably local, but they are being billed at the same basis as the household with teenagers where a phone is going 12, 14 hours a day. I think a lot can be done in the local areas within the States to equalize these, measured service or other methods that will make it more proportionate in what we are paying in our phone rates.

And I would like, I like what you said, that you feel people should pay for what they are getting, but if you are making 6 phone calls a day, why should you pay the same rate as a person who is making maybe 50 phone calls a day. That is my point, and in that maybe we can bring down these rates for the elderly and other low income where they can get good service for a reasonable price.

Senator JEPSEN. Mr. Sorenson, as you are probably aware, there are a number of States who offer what we call "lifeline" telephone services for elderly and disadvantaged and this "lifeline" rate typically is about $4 or $5 per month for the first 30 phone calls and they have a small charge per call for any additional monthly phone calls. It is your opinion that this type of approach to making phone service affordable would be something that should be considered?

Mr. SORENSON. I would like, if nothing else, I guess I am very bullish on people paying for what they get and measured services at the present time, which has been in several places and Bell has been experimenting in Marshalltown giving the elderly a new reduced rate, but it is still a subsidized service because the others out here, they are not under that, and are making few calls have to pay for that. What I am saying, and I do not know, it is probably impossible to ever get it where everybody pays their fair share, but if nothing else would work, yes. And I definitely say we need to do something like that to assure that they have a phone service.

Senator JEPSEN. Ms. Moon, do you have any comment about "lifeline" telephone service that some States have?

Ms. MOON. I was familiar with some States do have that and I think it is an excellent approach to solve a very, very acute problem. I would not object to it.

Senator JEPSEN. Ms. Falk, do you have any comments?

Ms. FALK. I think I would agree.

Senator JEPSEN. I think a lot of people would agree with you, Mr. Sorenson, about your statement indicating you were not always happy with some of the bureaucratic—I believe that is the word you used—decisions that are made in Washington, D.C. But there are a lot of good things that happen there too. Will Rogers once said, you know, that the further he got away from Washington, D.C. the more hope he had for the country and I think a lot of people rightly or wrongly feel that way.

I thank all of you and I would ask at this time do any of you have any statements, final statements that you would like to make prior to adjourning this panel?

Ms. MOON. I just want to plead that somehow or other, subsidizing, I do not blame you for being opposed, that older people who really need telephones will have the opportunity to have them. That is my plea.

Senator JEPSEN. We have your message and I thank all of you for your very well thought out remarks and your obvious study and research that you have made of this to represent the organizations. Thank you for attending and thank you for your contributions.

At this time I would like to call panel No. 2, under the general heading business users and that consists of Gary Shontz from the University of Northern Iowa, Cedar Falls, Barbara Ashbacker from Harnischfeger Corp., Cedar Rapids. Paul Brower, Iowa Electric Light & Power, Cedar Rapids along with Mr. Richard Damisch. Carl Heathcote, a consultant, with CarGen Co., Davenport. We will proceed in the order that the panel members are seated. Going from my left to right we will start with Gary Shontz of the University of Northern Iowa. And I again would remind the panel that your written statements will be entered into the record as if read. You may wish to summarize and not read every word that you have or you may read your statement. You may proceed in any manner you so desire. Welcome to you, Mr. Shontz.

STATEMENT OF GARY SHONTZ, CONTROLLER, UNIVERSITY OF NORTHERN IOWA, CEDAR FALLS, IOWA

Mr. SHONTZ. My name is Gary Shontz. I am the Controller of the University of Northern Iowa in Cedar Falls, a board of regents institution. I have been at the university for 9 years and the duty of controller as I said. In that time I have seen a lot of changes in the telephone industry and I have been responsible for the University of Northern Iowa telephone accounts. The views expressed today are my own rather than the university. I received a call yesterday and I confirmed arrangements at 3 o'clock yesterday afternoon to accept this speaking engagement.

Senator Jepsen, in my opinion there is absolutely no justification for a user access charge. To me there is no proof of a cross-subsidy for local loop as opposed to the long-distance loop or the toll loop. And also to me the direction of any cross-subsidy that might exist is not clear. This speaker this past summer learned to his dismay in talking to the chief executive officer of a large Iowa telephone company after receiving a bill with a 27.2-percent increase, that that telephone company does not have any cost figures of bringing a product to market, that that company does not know what its internal rate of return is on that product and that company also does not know what contribution these products are each making to the company's overall profit. I find this to be ludicrous, frankly. This is this speaker's view that a private business could not survive without basic knowledge about the costs of the product that they bring to the market. This speaker believes that the cost accounting of today's telephone system is quite antiquated. So I find little basis for determining, at present anyway, how much the local rates subsidize long-distance rates or if it is really the other way around.

The Federal Communications Commission, in a classic example of a Federal bureaucracy at work, gave birth to interstate access charges on the allegation that local telephone companies would not survive without some form of subsidy to replace a toll subsidy. Apparently the FCC does not realize there are alternatives to rising rates. Telephone companies, like other forms of business, need to diversify to survive. Other types of avenues that telephone companies might take to bring in revenue would be as follows: Yellow page advertising, directory assistance charges, equipment sales, telephone billing and screening services for the various common carriers. And then they could do some more novel things such as distribute a local cable TV service signal, provide cable for burglar alarms and fire alarms, control city traffic lights, regulate energy consumption within buildings for subscribers, and any number of things that involve cable connected to computerized business systems. There is absolutely no reason that the local ratepayer has to pay the entire cost of local telephone service.

Access charges are intended to pay for assets owned by the local telephone company, which are partially used for providing long-distance service. It is difficult, if not impossible, to determine which local telephone utility asset should be allocated to local calling and which should be allocated to long-distance calling. To cite an example, in Waterloo, Iowa, there is a combined telephone facility at 403 Sycamore Street. This building serves Northwestern Bell Telephone Co. and also AT&T and the intercity services. One floor of that building contains a rather large switch room. On the floor of that building is a taped line across the floor to separate that facility between local calling service and long-distance calling service. I submit to you that that is artifically dividing the segments of a particular business. Employees of that firm either work for Northwestern Bell or AT&T and are not allowed to cross the line. It simply does not appear feasible to this speaker to allocate plant between local facilities and long-distance facilities. I personally do not believe, after my experiences recently trying to find out the telephone company's costs of rendering a particular service, that the telephone company now has the cost accounting savvy to make that type of a determination.

The cost of access charges is one more charge that the Iowa business subscriber must pay in addition to everything else, to all the other charges he is paying for telephone service. This past year business trunk in Iowa experienced a 21.25-percent rate increase largely because of deregulation at this point because the Iowa Commerce Commission deregulated both inside wiring and customer premise equipment as of June 8. The telephone subscriber will receive absolutely nothing for paying for access charges. We must realize that AT&T communications did announce a 10.5-percent rate reduction on the average for long-distance calling as of January 1, 1984, and an out-WATS price reduction of 7 percent. However, as I said, these decreases definitely should not be viewed as a trade off. These price decreases represent AT&T's recognition that there indeed is competition in the telephone industry. So let us face it, folks, AT&T has lost a lot of business to other common carriers and is now realizing this by adjusting its prices.

Beginning January 1, 1984, Iowa business subscribers will pay $6 per month per trunk for interstate access and another $6 per trunk for intrastate access, or $12 per month per trunk, which translates to a 25-percent increase. This is in addition, of course, to the 27-percent increase experienced this year by my employer, the University of Northern Iowa. The same charges apply for straightline business telephones. The percentage increases are much higher as you can see because straightline business customers pay less than, less than the typical trunk charges. Centrex telephone service is an exception. If the centrex line was installed before July 27, 1973, there will be a $2-per-line-per-month interstate access charge. If the same line was installed July 27, 1983, or later, the access charge will be $6 a month. These centrex charges of course, must be doubled because there will be an intrastate access charge in addition to interstate access charge. Higher usage charges apply for WATS, foreign exchange lines, private lines, and telephone lines. There will be a $25 per month access charge per closed end of these facilities.

This speaker believes that the access charges were not well thought out. There appears to be little logic in the access charges. Here are two examples: No. 1, since there is no physical difference between an out-WATS local loop, a PBX local trunk, a local loop connected to a business phone, a local loop connected to a centrex line, or a local loop connected to a residence line, there is absolutely no logic for charging $25 versus $6 versus $2. Or in the case of centrex lines $6 versus $2. This speaker believes that a pair of copper wires should not be taxed differently. A second example, there is no logic in charging business customers access charges for lines not used to place or not capable of placing longdistance calls. Most large business customers employ WATS lines, foreign exchange lines, tie lines, and private lines in connection with automatic route selection equipment and station message detailed recording. These companies restrict the one-way local out trunks so that all traffic is routed over the special facilities and none over the local trunks. Why should an access charge be imposed on a trunk that is not capable of receiving or placing a toll call.

This speaker's conclusion is that access charges indicate hurried change on the Federal Communications Commission's part. Access charges are full of pitfalls and are not liked by anyone. Access charges are not acceptable to individuals, to business or to resellers in the present form. Access charges will drive Iowa business customers from centrex telephone service in a hurry. In Iowa there are approximately 30,000 lines in State government alone connected to the centrex system. When one considers the State capital complex and board of regents institutions, all 30,000 of these centrex lines will be replaced within the next 2 years with PBX lines, mainly because of these access charges. Since PBX traffic routed over trunks shared by users rather than a dedicated pair of copper wires to each station, it is evident that less revenue will be collected from centrex subscribers since there is a much lower total access charge for a PBX system than a centrex system. Surely most other centrex customers will migrate to PBX systems, also. This change will have two effects: No. 1, it will decrease the revenues that the local telephone companies have to operate with. And No. 2, it will result in a smaller accumulative pool of access charges. The effects of these two changes will be felt on every one. If either pool of money is not adequate, rates or access charges respectively will have to be increased.

We would hope that in competition in the long-distance area would be increased. This may be true but only to an extent. It appears to this speaker that a number of resellers will fold due to the increased charge for the local loop. The local loop charges for resellers might be as high as $400 to $500 per connection. The higher local loop charges for resellers has been a result of the FCC order because telephone companies over a 3-year period will be required to furnish equal access to longdistance resellers. As subscribers find, it is just as easy to place a longdistance call by Teleconnect, by MCI, or a number of other vendors, and that the quality of the conversation is just as good and that these resellers furnish acceptable time measurements as to the duration of the call. The spread between charges for long-distance calls of AT&T and the other resellers will diminish. Central service switching systems in a good percent of the country must be changed out because of this FCC action to require that equal access be furnished to all resellers. This is because many telephone switches in the country are not computer driven. They indeed must be computer driven to furnish equal access to the resellers.

This speaker feels that the Packwood bill, S. 1660, appears to be the most acceptable of the numerous access bills in Congress as there would be no user, no in-user access fees, but there would be the needed universal service fund. Telephone utilities in rural high-cost areas would receive 90 percent of the revenue shortfalls from the universal service fund. The Lautenberg amendment to the Packwood bill makes sense to me. Under the amendment the FCC cannot implement access charges until January 1, 1985. By January 1, 1985, the impact of the AT&T divestiture would be known and an appropriate access charge could be assessed if such is found to be necessary. Access charges, if implemented, should be on a logical basis with all customers paying the same rate. This should not, certainly should not be the $25, $6, and $2 discriminatory basis that is proposed right now. Access charges should be paid solely by the long-distance vendor with a surcharge in my opinion on each minute of the long-distance call. Access charges for voice carriers and data carriers should be equal. One will find at present that Western Union voice calls receive preferential treatment in access charges and one will also find at the current time that data carriers receive favorable treatment. Timenet is an example of a data carrier. A plan should be devised to impose the same surcharge on business with their own microwave system that utilize bypass to bypass the local loop so that a universal service fund can be adequately supported.

Senator JEPSEN. Mr. Shontz, on a very short notice I am most impressed by your attention to detail and your knowledge of the subject. I would like to see you address the subject when you had a little bit more time to prepare.

Mr. SHONTZ. I would have brought the whole truckload if I had a little bit more time.

Senator JEPSEN. Just out of curiosity, do you have readily available, at least a ball park figure, of how many actual dollars that the proposed present increases in telephone rates would cost the University of Northern Iowa?

Mr. SHONTZ. The University of Northern Iowa has 132 trunks, that will cost $12 each. The university has eight or nine WATS lines. that will have a $25 increase on each. I looked at our long-distance billing. I tried to prepare with the thought to determine exactly what this will do to us, it is unfortunate AT&T, as of, I believe, October 3, did release what its charges will be for interstate calls, but they did not release, to my knowledge anyway, what the rates are going to be for calls within the State of Iowa so it is not possible to determine on the Iowa part. I do know that we are going to be paying out more money than we save on access charges on calls made in the other 49 States.

Senator JEPSEN. Thank you. Barbara Ashbacker, do I pronounce it correctly, Ashbacker?

Ms. ASHBACKER. That is correct.

Senator JEPSEN. From Harnischfeger Corp., Cedar Rapids. I will quit while I am ahead, you may proceed.

STATEMENT OF BARBARA ASHBACKER, COORDINATOR, OFFICE SERVICES, HARNISCHFEGER CORP., CEDAR RAPIDS, IOWA

Ms. ASHBACKER. Thank you, Senator. As you stated I am representing Harnischfeger Corp. in Cedar Rapids. I am the coordinator of office services and I have just been involved with this for 2 years so I am not quite as knowledgeable as Gary, but I do agree with quite a few of his comments.

To give you a little background, we manufacture P&H hydraulic cranes. We are part of a very depressed construction equipment industry. We are just trying to survive until the economy improves and right now we do not expect that to happen until the spring of 1984. Right now we have only one-third the number people that we had in 1981. We have approximately 400 employees versus 1,350 at that time. We have had many layoffs and this year we have had approximately 15 weeks of plant shutdown so it has not been a good year for us but we have had to try and cope.

We have been asked to talk about the access charges and other telephone changes. As several people have mentioned, and Gary mentioned that, beginning January 1 the business customer will be asked to pay an additional $6 interstate and $6 additional intrastate. We have 24 trunks which means an addition of $288 in our operating costs per month. Now that does not sound like a lot but for a company our size, that is significant. If the access charges were the only increase that we would expect in January 1, that would be one thing, perhaps we can handle it, although as Gary said I do not think it is necessary. But I understand that other increases are under consideration and most likely will be forthcoming. Some of these are an increase in cost for dedicated seal trunks, private line access charges or tie lines, increases for data lines, access charges and surcharges for dedicated WATS lines, an increase in VTPP charges, or variable term purchase plan. In other words, TRB contract charges will be increased. When we purchased our system in 1979 we bought it on the two tier, this is the VTPP plan, and our tier A has dropped off but we were under the understanding tier B would continue indefinitely, and of course that is not going to happen. I do not have exact figures on all of these increases, but I know they will be substantial.

We have been reading that long-distance rates are going down; where is that reduction coming from? It has been our experience with the telephone that whenever there is a decrease in phone costs, there is also an increase somewhere else that more than makes up for the decrease. We would definitely be in favor of postponing or finding another way of handling these access charges.

I understood we were also to talk on the effects of the AT&T divestiture, and we have been affected in several ways. One thing that has always bothered me is that I understand that AT&T has been given the ability by the FCC and the ICC to guarantee its investors a return on their investment, yet private industry is not able to make that guarantee to their investors. Our management must do what it feels necessary to make the company successful and in recent times just survive.

We are doing whatever cost-saving methods, or using whatever cost-saving methods that we can. We try to be efficient and innovative in accomplishing these goals. Part of it is keeping our operating cost down. One cost-saving idea was the upgrading of our dimension system. We upgraded our dimension system from feature package 4 to feature package 15 on January 28 of this year and we also added a customer administration panel. With that we are able to program our phones and make a lot of changes that we normally had to have the phone company come out to do. It saved us up to $30 per change and we calculated that was about $5,000 since January.

But we have had many frustrations and additional costs due to this breakup of AT&T. There has been much confusion and the people involved are not really sure what is going on. One example, we were planning for this upgrade since October of last year and we did not know until December 22, 1982, that Northwestern Bell would handle our upgrade instead of American Bell. So there we were dealing with two different sets of people and on very short notice. We expected a savings of $1,478.95 a month from upgrading our system, we never realized this savings because of increases that came about in January and throughout the year. Some of these have been detailed, but just briefly, on January 14 there was an increase that did not include the WATS or long distance in Iowa, but most other monthly charges we had. January 28, of course we had our upgrade which involved increases in credits due to our upgrade. March 1 the State of Iowa increased our State tax from 3 percent to 4 percent which affected our phone bill. March 4 there were other increases and decreases. June 8, as was mentioned, the cost of our trunk, we had an increase of $4 for each trunk, which amounted to $96. And then there were other miscellaneous increases. The charges were eliminated for our inside wiring but they began charging for service calls on a time and materials basis.

Another example that I would like to share with you is how our telephone costs have increased. Remember we have only 400 people now and our costs have increased 153 percent from November 1982 to September 1983, that is for our basic telephone service. Now we also have WATS lines, incoming and outgoing. We have data lines, tie lines and other services that is added to that and if we took the figures for our total phone service, we have an increase of 198 percent for that same 11-month period. In 1981 our average monthly bill for our basic service was approximately $7,000, and at that time we had 1,300 people. We are still paying approximately that much but we are not getting any additional service for increased costs. In fact, we are getting less because we have had to decrease our equipment in order to try to control our costs.

This may be a minor point, but it is a very frustrating one to me. Telephone service used to be taken care of by one person. I could call the phone company, in our case Northwestern Bell, and tell them what we needed and everything would be coordinated by the phone company. Now if I have a change to make I must call at least two people and sometimes three different companies and it is up to us to do the coordinating. Many times even the people at the various phone companies do not know who I should talk to.

We are right now in the process of consolidating our services and offices and closing an outside office in Cedar Rapids. Besides removing a number of phones we also are removing a number of data lines and modems. In order to accomplish that I talked to five different people from five different phone companies, a number of those were out of State. Everyone concerned knows the date and they assured me that they know what they are to do but with so many involved I just hope they show up in the proper order.

The format of the bill has also, our phone bill, has also changed. Each time a major increase occurred I had to go back to our phone company to help us work this out. We just do not pay the phone bill without checking on any changes that there are. It has taken our local people at least a week to 10 days to figure out how the computer calculated our charges. There is no set formula for any one company or person. Then it took our people another week to break down the charges item by item to be charged back to the proper department. I understand we will also be getting additional bills with the breakup of AT&T and that could mean as many as three different phone bills from that many different companies. But as we get more bills they are simplifying them, at least simplifying them for the phone company, by lumping like items together and showing little or no detail. This is not a help to the business customer. We need to know what costs make up our statement so that we can charge them back to the proper department and so that we can see that they are correct. We have often found errors that have to be corrected and we will not just accept the word of the phone company as the final word.

So I would just like to conclude by saying that our company, as well as many other companies in our situation, in this type of economy, knows that the divestiture of AT&T will only increase our phone costs further than they have been. It appears that costs will get much higher before we see any relief, if we get any relief at all.

Thank you.

Senator JEPSEN. Paul Brower, Iowa Electric Light & Power, Cedar Rapids.

STATEMENT OF PAUL BROWER, REPRESENTING IOWA ELECTRIC LIGHT & POWER, CEDAR RAPIDS, IOWA, ACCOMPANIED BY RICHARD DAMISCH

Mr. BROWER. Senator Jepsen, ladies and gentlemen. I would like to also mention that Rick Damisch is here next to me from Iowa Electric. It may seem a little bit odd to you that a company that has been in the newspapers of late regarding their own rates is here represented on this panel by two people concerned about their costs of doing business, but we are very much concerned about the cost of doing business when we project a 30-percent increase next year in our total phone charges.

To back up now, I would like to comment about the total divestiture. Most of you probably are not aware that the trouble really started back about 1965 with the famous Carter phone case, and since then it has steadily increased in intensity as to the effect on our communications system in this country. If any of you have ever visited in a foreign country, you soon become very aware of the fact that we are privileged in this country to have, what I consider at least, the finest phone system in the world. It is going to be interesting to see what happens in the next 5 to 10 years if we continue in the direction we are going. There is much, I do not want to call it misinformation, but lack of proper information regarding the effects of divestiture, the access charges. Because between Judge Green's court and his decisions, the Department of Justice, several attempts on the part of Congress to rewrite the Communications Act of 1934, the actions of AT&T in the breakup of the telephone system, even at State levels, the actions of local Bell operating companies, or the

BOC's as they were referred to earlier, you cannot get a straight answer from anyone, not even the telephone company because they really do not know. And that, of course, is what the Senate and House bills are trying to do something toward correcting, but I am not sure they are going to get the job done.

I would like to indicate to you what the results of some of these access charges will mean to Iowa Electric Light & Power Co., and please understand and you have heard before, there is no such thing as a free lunch, because any costs, any operating costs, I do not care what business it is, whether it be a utility or small business, down the street, any costs, operating costs that that company has must eventually be paid for by the customer. When you walk into the restaurant, the dime store, the service station, the telephone cost in that place of business or the lighting costs are paid by you and me as the customer of that business and there is no way of getting around it and that is the same way we look at our costs at Iowa Electric, to see what we can do about our telephone costs. We have heard $6 access charges for business lines, both intrastate and interstate to the total of a possible $12 per month, $144 per year. In the case of Iowa Electric we have a Centrex central office system. Now to you that may not mean much but it is a special type of switch system that is located in the central office on Third Avenue and Seventh Street in Cedar Rapids. Every one of our telephones in the IE Tower and other places in the city has two pairs of wires which go from that telephone instrument to the central office down there on Third Avenue and Seventh Street. All of the switching is done in the central office. That is what Mr. Shontz was referring to when he was saying it is cheaper to put a PBX on site. In other words, on the customer's premises. In the case of a Centrex unit—well, this $6 charge for business lines, the FCC, in their infinite wisdom, did not apply to Centrex central office equipment. They applied the same $2 rate that will apply to residential phones.

And let me digress just a moment. No one has mentioned here this morning, that I thought at least, that that $2 access charge for residential phones will increase to $3 in January 1985 and to $4 in January 1986.

Back to Iowa Electric Centrex. We have 600, approximately 600 telephones in our system in Cedar Rapids alone. With a $2 access charge that applies to each and every one of those telephones, that is $14,400 a year just for those phones to have access to the long distance network. Now I have been told by an appropriate official of Northwestern Bell that they will not collect this fee, period, that if it is listed on a bill then it will be deducted from some place else on that bill because it was stated very flatly to me that if we tried, speaking for Northwestern Bell, if we tried to charge our customer a $2 access on a Centrex central office system we would soon lose all of our Centrex customers. Because it is the same thing that Mr. Shontz said a little bit ago, it is cheaper under those conditions to put a PBX on your own company premises.

In addition, Iowa Electric has a number of lease circuits that we use. We have one interstate system, we have some 120 intrastate leased circuits. These will also increase in costs. Our WATS service will increase in cost. Let me just give you some rough figures. The total charges for 1 year for our Centrex system, the interstate lease line, the intrastate lease lines and our WATS lines is $600,000. Presently as a part of our operating costs, according to the best that we can figure out of the information that we have about the FCC application of access charges, our costs next year, or after January 1 of next year, will be at the rate of $909,000 a year.

In addition to our lease circuits we have a substantial microwave, private microwave system, that operates across the State as do the other six major utilities in the State of Iowa. This is used to measure the power flow at substations, to control circuit breakers to tell us the condition of whether your lights are on or off. We could not possibly provide you with the quality of service that you receive if we did not have that microwave system. It also provides internal communications for the company between our substations and our control center in the IE Tower downtown. The present version of the Senate bill provides severe restrictions on private microwave systems. I have not seen a copy of the bill as yet, I will ask for one, but I was told this morning by legal counsel in Washington that it can only be viewed, the way the bill is presently written, it can only be viewed as a, as to being evidence of a very strong AT&T influence on the writing of the bill because it is obvious that AT&T would like to get rid of all private communication systems. It would be much more advantageous to them from a financial standpoint if they could force not only Iowa Electric and other electric utilities, but gasoline companies, railroads that all have private microwave systems in order to keep their particular system running, whatever kind of business they are in.

Let me back up a minute. In connecting a private microwave, private communications system together, be it microwave or anything else, the FCC rules have dealt with what we call bypass, or leakage, and by that the bypass is a more descriptive term, is where you bypass the public switched telephone network to make a long-distance call say by using a private microwave communications system. They term it bypass. The official word, it is kind of referred to in the vernacular as leakage, it is leakage from the AT&T pocketbook is what it is. The Senate version of this bill for not reporting that your system is capable of a bypass is $100,000. If that law becomes in effect, that is a worse penalty than is applied to any other segment of the Communication Act. Violation of the segments of the Communication Act of 1934 carry a maximum penalty of $10,000.

Another item that has occurred as a result of the divestiture agreement that the country has been broken up into different LATA's, which stands for local access transport area, do not ask me who dreamed that one up, but you got to have a certain amount of alphabet soup in everything you do these days. The FCC has, as a result of the acceptance of these LATA's by Judge Green's court, has said we will govern the communication between LATA's, in other words, intra-LATA communication on the same basis that we do interstate. Now I understand the present plans, the State of Iowa will be divided into three LATA's, maybe four, but basically let us say three for simplicity, approximately the same as the three dialing area codes that you presently use, the 712 in the western part of the State, 515 in the central and 319 in the eastern area. The FCC will now be able to govern the rates that are applied in, for instance in dialing, the access to a long-distance network between here and Des Moines. In other words, Senator, I would like to suggest that the Federal Government has gone one step in further putting its nose into the State's business.

In closing, last night and this morning I looked over some of the material that I had and I could not help but realize there was something real strange going on here. That all of a sudden we have to apply access charges to cover the costs of doing something we have been doing for a long time with this, what has been called the subsidy for local telephone companies. Now the subsidy for local telephone companies, the desirability of removing that, came about because of, they wanted all classes of service to pay the total cost of the service of that class. In other words, your home has a residential phone. If you have a business it has a business phone. There are different voice circuits, there is a data circuit, and each one of these was supposed to bear its own cost charges. All of a sudden we have all found that our telephone rates are going up. In order to make it simple, the FCC has said we will apply an access charge on a per station or per telephone basis. Now that means that whether you dial one long-distance phone a month or 10 an hour, you will only pay the $2 access charge at your residence. I do not understand what is so formidable that we could not continue to do just as we have been doing and apply an access charge as a fixed percentage of whatever the long-distance bill was. That would mean that the elderly, the low-income people, they could still access to the telephone or have an access to the long-distance network from their telephone without paying excessive charges. Mr. Shontz mentioned this division of equipment in the central office as a case in point. With the age of computers there is nothing unreasonable about suggesting that they could make those charges on a basis of a fixed percentage of your telephone bill.

I thank you, Senator Jepsen, for giving us the privilege of being here.

Senator JEPSEN. Richard Damisch, do you desire to talk?

Mr. DAMISCH. I pass to Mr. Brower.

Senator JEPSEN. Mr. Carl Heathcote, consultant for CarGen Co., Davenport.

STATEMENT OF CARL HEATHCOTE, CONSULTANT, CARGEN CO., DAVENPORT, IOWA

Mr. HEATHCOTE. I am a retired executive of an eastern Iowa meatpacking business which I was responsible totally for the telecommunications for a 10 plant business. I am now consulting in the telecommunication field. I want to say, Senator, that except in the State of Iowa, the access charge appears to be only the first of many charges which business and residences are going to have to be picking up. And the reason I say that is the news release we have just had this week in the State of Iowa, where because the Iowa Commerce Commission has deregulated all the customer's phone equipment and the FCC has required that this be turned over to the American Telephone and Telegraph Information System, or ATTIS. That we have now heard a news release, or a rate increase from the American Telephone and Telegraph effective November 1 for each residential phone. If it is right here, I believe the figure was $0.20 per month for a touch tone in a residence, it is going to be $0.70 per month. And they are only to bill quarterly. They will be doing their own billing and they will bill quarterly and I assume they are going to operate 3 month's payments ahead of time. Now the access charge in January will become, if it is instituted, will become instituted in the State of Iowa, as all over the country, and of course this will add the additional $2 to residential and $6 to business lines. I have written Chairman Fowler of the FCC and also Chairman Varley of the Iowa Commerce Commission to find out why it is necessary to have an access charge at all because I have always been led to believe by my friends at the phone company that $0.15 or $0.20 that you pay excess for that first minute of telephone on a long-distance call is in effect an access charge. In other words, you are paying to get into the network. That you, which in effect may mean that AT&T has always been collecting an access charge except on the first minute thing. And I have not heard from either of those gentlemen yet. I hope to before it is all over with.

But I think it is a case in point. Also in their wisdom the Federal Communications Commission has decided to continue what I call predatory price practices, or migratory strategy which AT&T has been proven to have had in all of the Centrex cases all over the country in that they have laid on the Centrex business the only equipment that the local BOC are going to be able to operate right away because that is their basic equipment working out of their local switch. And I have been pricing this for some customers. We have found that they have decided to use station charges instead of trunking charges only in the Centrex in deference to a company who has its own switch or PBX, or they charge you trunking charges or an access charge. For example, a company has a Centrex, or avails itself of a Centrex from the local BOC if they were under the access charge, if they were using the trunk charge, and here I am taking figures of which I am familiar with, of 48 trunks or 300 stations, these 48 trunks using the Iowa figures of $6 per trunk for Federal and an additional $6 for State, would be $576 per month added cost for Centrex pricing using the access charge. However, because the FCC in its wisdom has decided that the Centrex prices should be on the basis of stations, this 300 stations, using the $4 figure would be $1,200 a month extra increase in charges. This, you know, I do not quite understand why the Federal Communications Commission has allowed to maintain this migratory pricing strategy which they adopted from AT&T in their Centrex pricing.

I think also—it is going a little further with Mr. Brower—that all of the companies that have their own private network, whether they are leasing from AT&T or from somebody else, are going to get a big increase in cost. In fact, it is going to be so great that they are going to be forced to go back into the regular network, which I think is part of the reason that AT&T is suggesting that there is going to be more use of the long-distance network. There is going to have to be, as you indicated in your opening remarks, there is an average of 10-percent increase, but it is interesting that more people would have, more companies that have their own private network, by this I am talking about the networks between plants where we have 10 tie lines or whatever going from your switch to the cities where you have high volume, they are going to raise these 15 percent or higher, which is a tremendous added cost to some company networks using AT&T facilities.

And finally I would like to address and make a part of the record a report from the department of general services of the State of Iowa which was published and made available to me regarding independent telephone companies in the State of Iowa.[1] Now why are we concerned about this. Well outside of these 155 independent telephone companies, there are a lot of businesses in these companies and they are not one-line businesses, the multiline businesses which means that they are going to be big business for pricing which means they are going to pick up this 12 percent. This report is a report entitled, "Divestiture and Its Effect on Independently Operated Telephone Companies of Rural Iowa." I want to read just briefly from this report. What they did, they did a study of removing certain portions of the subsidy which they are now receiving from the long-distance carriers, AT&T if you will, and charges they made. When 25 percent of the subsidy is removed from the operating revenues, 28 companies of the sampling show an immediate loss and they have to raise their local service charges by 21.42 percent just to break even. When 50 percent of toll revenue is removed, 132 of the 155 companies, 85 percent will show an immediate loss and they will have to raise local revenues by 35 percent. When 75 percent of the toll revenue is removed 153 companies out of the 155, or 96 percent of the sampling will show a major loss. In other words, what we are saying there are only two telephone companies in the whole State of Iowa that are profitable enough right now, and these are independent companies, that are profitable enough right now to take more than a 75-percent loss of subsidization from the long-distance revenues and break even without a major increase in their local rates.

And I think you are familiar with the fact that United Telephone here in the State of Iowa has already filed for a major increase, almost 100 percent on local service, which is the type of thing that business, you know, you are talking about a $6 access charge for business, but that $6 access charge, or $12 in the case of Iowa as we know it now, is going to be passed on to the consumer. So the rate increases we are seeing at the consumer level, this $2, is just a drop in the bucket to the total that the consumer is going to end up paying.

Thank you, sir.

Senator JEPSEN. I think that I heard a unanimous feeling by the panel that the cost of having phone service is going to increase substantially for everyone on the panel, is that accurate?

Mr. HEATHCOTE. That is correct.

Senator JEPSEN. Out of curiosity, at Iowa Electric, will the increases in phone costs that you will incur, be put in your rates?

Mr. BROWER. Just like any other operating cost, they go into the rates. That is a cost of doing business and it has to be paid from somewhere.

Senator JEPSEN. Then do you take into account those rates, when you decide how much you are going to apply for in your own rate cases, and your rate increase request then has to go to the commerce commission, is that correct?

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[1] The report referred to for the hearing record may be found in the committee files.

Mr. BROWER. That correct.

Senator JEPSEN. Telephone rate increases have to go to the commerce commission?

Mr. BROWER. That is correct.

Senator JEPSEN. Without singling out the Iowa Commerce Commission, just in general experience with any of you, any knowledge you may have or opinion or facts based on your research, do you feel that commerce commissions of the various States have the expertise to rule with some credibility on rate increases? Let us keep the discussion pertaining to telephone companies right now. Does anyone want to comment on that?

Mr. HEATHCOTE. I would say, Senator, that my experience has been that, and I think Mr. Brower referred to this, nobody really knows what it cost to produce or to terminate a phone call from point A to point B. So the Iowa regulatory commissions are almost entirely dependent upon the company who is submitting the requests to give them the accurate figures because they do not have people that are well versed in this type of thing. In fact, if the companies in the State of Iowa had not gone out and gotten expert witnesses to come in, and this happened in several other States on the Centrex rate cases all over the country, it is obvious that this would have been passed without any problem at all. Because I think it is interesting, and here again I am talking from the State of Iowa standpoint, commerce commissions write the rules but the people that sit on the committees that write the rules are the industry people that they are regulating. There is no consumer input on that at all.

Senator JEPSEN. Well now, and I do not mean to single Iowa Electric Co. here, but as a utility company you can pass on your phone rate increase to your customers. In fact, for the most part, according to the way things are done, you are guaranteed that you can do whatever is necessary to have some return on your investment.

Mr. BROWER. Yes.

Senator JEPSEN. Barbara, a guaranteed return does not hold true for your private company, does it? That is the point you were making.

Ms. ASHBACKER. No, that is not true. And in the state of the economy we are in right now we would not dare to raise our prices. In fact, we have to sell at a discount to be able to sell at all at this point. But if we were, if things were more normal, that, our overhead costs are added into the cost of our products, also, but we cannot guarantee that to our investors. Am I understood?

Senator JEPSEN. Yes. Deregulation and the AT&T divestiture are occurring in order to promote competition, is that not what I hear?

Mr. BROWER. That is what we are told.

Senator JEPSEN. All right. But once AT&T turns its attention from divestiture and that is done, how long do you think competition will last? Does anyone want to comment on that? The telephone companies are coming up next, they will have their turn at bat here.

Mr. HEATHCOTE. I will be happy to respond to that. We are making a bet about 2 years on the resale carriers at the present time. For example, it would be advantageous for a business to be able to have lines directly in to a resale carrier's switch in order to reduce costs. These are the small businesses who cannot afford WATS, that do not want to get involved with WATS and this type of thing. A resale carrier, what you have to do now is, the way it is designed, and we really do not know that it is going to change, although they give you some indication that it is, that you have to dial a local number to get into their FX line, which gets them into where their switch is and then you key in a six-digit number, which is your ID number so that you can be billed for the call and then you continue dialing the 11 digits to complete the call, or 10 digits to complete the call. The problem, the ideal situation would be that if we could get into these resalers directly from your company, so that companies that are large enough to have their own WATS and FX's, and here again you do not trunk enough to allow everybody every time you pick up the phone you are going to get through. You are billed in a certain rate basis but any overflow would go to the less costly service than on the long distance network.

But in the discussions that we have had we really think that AT&T is going to under price, or is going to drive the prices down so greatly that many of the resellers are just not going to exist in the State of Iowa, Senator. Except in the major areas across Interstate 80, Davenport, Omaha, Council Bluffs, we do not have any other competition for carriers, they are just not there except for maybe three fellas that are buying lines from the local telephone companies to get into some of the cities.

Senator JEPSEN. Well, we are hearing a lot of negative views. Is there anyone on the panel that can see any positive things resulting from what is going on at all?

Mr. SHONTZ. I have seen a number of positive things in the past. You used to see a certain number of telephone company employees who knew that they had your business and they did what they had to do but they were not real eager to do things right. Now I have noticed that there is real care existing in the account. That they perform the research that I tell them as a customer I would need before I would make a buying decision.

Senator JEPSEN. You found a change in that?

Mr. SHONTZ. Yes. And I found the attitude of the plant managers just great, lately. They do not featherbed the job at all any more. Because I am charged so much for a quarter of an hour and they are extremely efficient because when they get done with the work they have to bring that invoice for me to sign that that was the actual charges for the time they spent on the job. So in that, the attitude of employees, I am greatly impressed.

Ms. ASHBACKER. I will agree with that. In all of the work we have done recently, I have noticed a great improvement.

Senator JEPSEN. You mean competition is changing the work ethnic?

Ms. ASHBACKER. Evidently, at least temporarily.

Mr. BROWER. I guess I would like to give that a positive vote too. Another item that occurs to me, that I have noticed in the last several years, is the availability of equipment from people other than the telephone company for the simple reason that the regulations have made it such that we can put different types of equipment now on and hook it to a telephone line without Ma Bell raising particular Cain. You may be able to remember that some years ago there used to be a list of things in your telephone book that you could not put any foreign attachments on your telephone, and this included things like shoulders for your handset, the advertising dial plates that people gave advertising their business that had the numbers and letters on the outside of the dial, the little index pad that you fastened underneath the telephone you could slide out to get a telephone number. Those were all basically illegal from a tariff standpoint that the phone company, Ma Bell Company, had filed with the various commerce commissions. You could not hook a recorder for example on a telephone line because there just was not any way you could do it legally. Today you have got pickups for the telephones, you have got message recorders, things like that. I remember when I was in the consulting business, we wanted to put a call diverter at a sheriff's office. You think we could get one from the telephone company. No. They did not work right. But we put one there and the sheriff was very happy with it. We found we had to ignore the fact that it was again the telephone company rules and they kind of ignored it too. But I have seen a great change in that respect here with the advent of a little more competition, that we have been able to do a lot more of these things. We are using our communication system more than we used to and I think that is a positive.

Senator JEPSEN. When did it all take place?

Mr. BROWER. Ten years or less.

Senator JEPSEN. How long have they been talking about deregulation and divestiture?

Mr. BROWER. Five years.

Senator JEPSEN. So did it accelerate this attitude change, do you think that would be accurate?

Mr. BROWER. I think it did.

Senator JEPSEN. Well now if the customers are going to receive better service and a greater variety of services that you have been talking about because of the change in the industry, is it reasonable that there is some rate increase for these things or not?

Mr. HEATHCOTE. Are you talking about services or equipment?

Senator JEPSEN. Well either one. You were talking about both.

Mr. HEATHCOTE. On equipment, the marketing due to the divestiture is already pricing itself at a level for industry. If I may give one example: I have recently participated in some quotations for an organization where we had, it was being quoted by American Bell and two interconnect companies. That was happening in June. It happened in June and July and between the time the original price proposals were made, and when they were finally finalized American Bell decided to sell equipment, interestingly enough which had been one of the big pluses, I guess the fact that you are now able to buy your own equipment from the telephone company. Anyway, the cash-flow situation on this, on Bell equipment was on the basis of lease was going to be $3,000 more than the prices from the interconnect companies. When they decided to sell that equipment they offered it for sale at $5,000 cheaper than the bids from the interconnect companies. And that is just fantastic, that is kind of in my business, consulting and working with companies. We are saying hey, let us hold off and find out what really is going to happen after January 1 on this pricing thing. Just do not jump, do not jump into it now because it is just too close to the change.

Senator JEPSEN. To summarize this hearing thus far, we have heard the request and the sense of concern from the first panel for keeping telephone service accessible for senior citizens. Some States offer a "lifeline" telephone service for $4 to $5 a month for the first 30 to 40 phone calls. We have had some recommendations to our committees just from the fact that we have announced that we are holding these hearings, some of the things suggested that we, rather than create a universal service fund, we would be more practical to increase social security and welfare payments by the amount of access charges and then eliminate a new bureaucracy. That action would not affect, however, access charges on small businesses and so on.

I hear how the utilities and some of the more regulated businesses would handle these changes. I have great concern, and appropriately so, for our senior citizens and for special problem areas in our society. We should be compassionately concerned about and interested in and doing something about these needs.

Now we're hearing from small business, and as it always is, small business seems to end up hanging by the thumbs. Yet small business provides the overwhelming majority of jobs in this country. It is really the backbone of our economy. How does business benefit from having a universal phone network? Let us pretend for a minute, that only 75 percent of the households had phones. How would that affect mail order companies, banks, main street stores and other commercial buinesses? How does business benefit from having a universal phone network? Let us start with Mr. Heathcote. Is business taking advantage of the telephone system both locally and long-distance calls, and do they benefit more than any other segment of our economy as a service user?

Mr. HEATHCOTE. I think from the standpoint that they only, and only business are allowed to advertise in the yellow pages, which are a part of the telephone directory. They take advantage of it, as well they should. It is a cost of doing business and many, many businesses are telephone intensive. They absolutely have to have the telephone to do their business, particularly in my business and my background, it is very, very volatile and you have got to know what is going on and you have to have communication.

Senator JEPSEN. Do you believe competition will benefit the business community or do you believe it will cause problems?

Mr. HEATHCOTE. I think it will be a benefit to the business community, absolutely. Unfortunately the State of Iowa, because we are such a rural State and have small metropolitan areas, we are not going to be able to avail ourselves of the competition which is available in metropolitan areas like Chicago and St. Louis. As you know, the big problem with this has always been that they came in and took the cream. They took the major metropolitan areas for their switching and left everything else to AT&T and then they are justified in this.

Senator JEPSEN. By the same token, even those businesses that made a large volume of the long-distance calls were, up to this point anyway effectively at least subsidizing the general accessibility of the telephone, basic telephone service in this country.

Mr. HEATHCOTE. That is correct. Businesses do subsidize the rest of the telephone industry, there is no question about that.

Senator JEPSEN. Is that fair?

Mr. HEATHCOTE. It is fair?

Senator JEPSEN. Is it as it should be? Your answer might make a difference in how all this legislation comes out.

Mr. HEATHCOTE. I understand what you are saying. I, you know, it is kind of hypothetical. Certainly if you lower the business rates and you raise the residential rates so that the telephone company has the rate of return which is, you know, basically they more or less demand, and under regulation, what eventually is going to happen is that, at least the picture that we see coming at least from the older Americans, is that hey, we just cannot afford a telephone so I am not going to be able to call down and get my drugs and place my orders and this type of thing. And it is going to affect business. If I did not use them, they would not have them in there to start with. I just, I cannot really give you an intelligent response to this. It has, let me put it this way: it has worked, it is working, and your original remark why change something, why go out and do differently.

Mr. BROWER. May I respond to your question. I just, I know we have some telephone company people here and maybe during their panel session one or more of them would comment on what percentage of their revenues come from business and what percentage come from residences. Now you were asking the question should businesses pay more than their, well pay more for their services. Was that what you were asking?

Senator JEPSEN. I do not recall that I asked the question that way, so let me rephrase it. Over the years, as I said in my opening remarks, due to the increase in technology, the cost of placing and conducting long-distance calls has been reduced. But instead of reducing the price of long-distance calls, the regulators, with the cooperation of Ma Bell, has decided that they would divvy up long-distance profits and provide it to lessen the cost and make it easier for everyone to have a phone. That is why we have 96 percent of the people in this country have phones.

I would like to point out, this is not out of Ma Bell's selfishness. We can all be pleased about it, because we have phones that work. And if anyone has ever left the continental United States once, they come back home and appreciate it. I was in Cairo just a few years ago and I tried to call from my room downstairs and I just gave up and walked down and went in and watched a switchboard where there are some 11 million people. And I saw their phone book and it was kind of a roughed up, scruffy, little torn-page thing with pencil marks through it. It had perhaps 50 to 60 pages altogether, with a lot of erasures. They were trying to do their best to make it work. When the phone equipment worked, which it usually did not, it probably did not make much difference because you probably could not find the name anyway. Well, I do not mean to talk about Cairo or anywhere else.

Mr. HEATHCOTE. May I just respond a little bit on that, Senator. I think we should realize, and I agree with this, that the long-distance network as it now stands is designed to supply business with the capability of making calls during the business day. It gets as big as it is because that has to be that big. And I also feel that, you know, after 5 o'clock in the afternoon, from wherever you are, that network is sitting there almost totally idle. And so anything that comes in there after that, even from residential, is gravy for the phone companies. But they are geared toward business and that is what it is for.

Mr. BROWER. That is why the rates are lower after 5 o'clock.

Senator JEPSEN. Please remember the remarks that I am making are just intended to add a little flavor to these hearings, because we do have serious problems in this country. And whatever I have hearings on, the problems we face are real, indeed. Still we should, at some time, stop and reflect, and thank the good Lord that we can sit down like we are doing today, exchange ideas, gather the facts as we do in this democratic or representative country of ours, and then try to resolve them. In any event, whatever we have done, we have done so and produced a quality of life that is second to none anywhere else in the world and we are all thankful for that.

Now then, we need a break. We will have a 10-minute recess before we call our third panel which consists of telephone service providers, including Northwestern Bell and General Telephone of Midwest, Cascade Telephone Co., Citizen Mutual Telephone Co., and South Slope Co-Op Telephone Co.

I will ask any of the panel members if there is any closing statement or comment they would like to make, and I would also advise you that if you have any further remarks or facts that you would like to put in the record we will receive them and put them in within a reasonable period of time, say by the end of this week should something come up that you would like to put in the record. So if I might start from my left to right, Mr. Shontz, do you have anything here?

Mr. SHONTZ. I just have one little comment that I did not mention earlier and that is about the Universal Telephone Service, the "lifeline" concept. I'm very much in favor of the lifeline concept but I think that that concept has to be regulated. In the State of California for example, they provided lifeline service for about $3.50 a month and what the studies indicated that it was not just the elderly that participated in this service, it was 60, it was people with $60,000 to $80,000 a year income that placed calls from work, from the club and so on. So I think that lifeline service is important but I think that it has to be offered just to people that are identified that need lifeline service or else it can be another form of subsidy.

Ms. ASHBACKER. I do not feel that I have any additional comment except to say that I hope we get this resolved one way or another soon and get over the transition period. I think that is what we are really unhappy about. And hopefully the resulting charges for telephone service will be equitable to everyone concerned.

Mr. BROWER. We recently signed a Centrex rate stabilization agreement with Northwestern Bell for a period of 3 years and the main reason we decided that was we saw no way that we could, that things would settle down enough and we could make a decision as to which way we wanted to go, whether we wanted to continue with Northwestern Ball or whether we wanted to install our own PBX. So we hope that by the end of another 3 years, or better then, things will have settled down enough that we can make a decision and go about our business.

Senator JEPSEN. Mr. Damisch, you have been sitting there and you have not said anything. If you would like to say a word you may go ahead.

Mr. DAMISCH. The transition has probably been the most trying part of the whole case. That is the uncertainty that it has evolved the misinformation and the different sources of information has been very difficult to reach. And it seems like every day we hear something different and I would like to say that is the most important thing to me is get it over with.

Senator JEPSEN. Along that line is there one area, one group, or one source that is most responsible for this that we could, or ought to put in the record that could do better?

Mr. DAMISCH. I do not know of one. I have just heard, there has been a rate case from Judge Green I have heard about and it seems like Congress has all these bills and the different groups and organizations and opponents to it. And it is just, there is different conflicting information from all sides and I think a hearing such as this will help possibly straighten it out and come up with an answer that everybody can live with and that is equitable to everyone. There are different sides to every story. I know as far as lifeline, we have customers when they are without electricity they have to call into us, that is a case where not everybody can afford telephones. That is a problem for our customers and I just like to say that I hope we can resolve the information.

Senator JEPSEN. Mr. Heathcote.

Mr. HEATHCOTE. Senator, I would say that it looks like, that Congress is going to be deluged with letters, probably exceeding what you received from the banking industry and the savings and loan industry regarding withholding of interest, will be on the access charge. I do not know if you had occasion to see the ad that is coming from—it is in the paper yesterday—AT&T, where all their stockholders are asking let us leave things go until we find out what is going on. Here again, whatever knowledge is raised from these hearings, and the hearing that you have in Washington, it is important I think that all the issues, that everybody knows what all the issues are because I think all of us sitting here on this panel in some basis can, we have been asking questions and unable to get answers, and I hope pretty soon some of these answers become available so that there can be a positive response from the Federal Communications Commission and some of the answers that they have to give.

Senator JEPSEN. It is not too easy to take a lead on a new order of things, especially when you have both public and private sectors. They do not have the same type or sense of urgency for deadlines and so on. There is something that is making it much more of a relaxed atmosphere and conducive to triple committee meetings and hearings when you are dealing with no deadlines and a payroll that has to be met from private capital. I wish that it were otherwise and I would suggest that these letters that you are talking about coming in are going to have their effect. If you say there are going to be more than the withholding on dividends and interest, and in the case of my particular office, that would mean exceeding 107,000. In that case it was pretty definite how people felt. I had, out of that 107,000-plus letters on that issue, I had 12 people who were for it. Would it be that this would be just as crystal clear, I would doubt that.

Thank you very much. We will now have a 10-minute recess and reconvene at that time.

Senator JEPSEN. This meeting will now convene and I thank the panel for getting into place. I was the one that was dragging my feet, and that is not the first time. We will start with the order as we are seated from left to right, beginning with Mr. Bill Stauffer, vice president of Northwestern Bell of Des Moines, Iowa. I would again remind this panel that any written statements you have will be entered into the record as if read and therefore you may proceed in any manner you may desire.

STATEMENT OF WILLIAM STAUFFER, VICE PRESIDENT, NORTHWESTERN BELL, DES MOINES, IOWA

Mr. STAUFFER. Senator Jepsen, thank you. It is a pleasure to be here and have the opportunity to visit with you and talk about some of the things that are happening in our industry and hopefully maybe try to clear up some misinformation and give some information to the people here. As I listened to some of the people on the prior panels I was prompted occasionally to want to step up and ask a question or make a comment but I did not think it was appropriate and I am not going to try to comment about things that other panel members have said before me.

I think today the purpose of my statement is basically threefold: I want to summarize my assessment of the primary issues facing the changing telecommunications industry. And two, I want to offer my views on appropriate responses to those issues in the public policy arena. And third, I would like to state my opposition to the proposed congressional legislation, namely Senate bill 1660 and House bill 4102.

I have been the chief executive officer for Northwestern Bell in Iowa since 1974. Prior to that I served the company as chief executive officer in North Dakota. I was the secretary-treasurer and in several other capacities. My concerns as a CO are to keep phone service available and affordable to our 760,000 Iowa customers and to meet the service needs of new customers connecting to our network. Insuring that our Iowa customers have access to affordable telephone service is one of our commitments. We want to, and we are determined to keep universal service a reality. It is Northwestern Bell's best interest to do so. The value of the telephone service that we provide depends on everybody having the ability to use the telephone.

Now the technological revolution in communications has led to extensive competition in our industry. The competition that exists and is flourishing today is an economic reality that must be acknowledged and accommodate in our industry. The driving force in telecommunications over the last 25 years has been technological change. However, the impact of technological change has not been uniform. Technology has driven down costs primarily in the long-distance portion of the business. The line that connects every customer to one of our switching offices has not experienced anywhere near the degree of technological change that has occurred at long distance. In relative terms, the price of local service has actually been decreasing. The result is the problem that now confronts the entire telecommunications industry, the flow of large subsidies from long-distance to local telephone service. These subsidies cause a huge distortion in the relationship between costs and prices. Competition has entered those parts of the market which are overpriced. We do not have any competition coming in and wanting to provide local exchange telecommunications services, all of the competition has been in those areas that have been very highy priced and very profitable. These subsidies cause a huge distortion in the relationship between cost and prices. Given the degree of overpricing, we have only seen the modest beginnings of competition, which has a significant effect on revenue growth.

The response of the Federal Communications Commission to the current situation is to reprice the way users pay for the fixed cost of telephone service. We are moving, as we must move in my opinion, in the direction of repricing services so that the cost causer bears the cost. The recent FCC order in Docket 78–72 in my opinion is a rational and well-balanced effort to deal with the problem of current pricing distortions. The FCC realized that the collection of local service costs through AT&T and the other long-distance companies through their rates encourages bypassing of the local telephone company and bypassing will ultimately lead to higher than necessary prices and poorer service.

Now let us discuss bypass for a minute. Bypass is simply the origination or the termination of a call without the use of the local telephone company facilities. In a bypass configuration, calls, both local and long distance and the resulting revenue, are diverted from the local telephone company. Lost revenues mean the remaining subscribers must pay more to maintain the local exchange network. Much of the local telephone plant investment is what we call nontraffic sensitive, that is the costs are fixed between the customer or the subscribers and the switching office and they do not vary at all. Those costs do not vary at all with the amount of usage, whether that usage is local or whether that usage is long distance. That is a fixed investment for that local plant. That pair of copper wires from your home to the switching office do not vary at all. When revenue is lost without recovering the fixed cost of plant, the result is lower operating income which reduces the company's rate of return and its ability to raise the capital.

The risk of revenue loss is increased because of the concentration of telephone company revenues among a relatively few large customers. Nationwide 95 percent of all customers generate 50 percent of the total revenue. That means that the remaining 5 percent of our customers generate 50 percent of the total revenues. Now of that 5 percent that generate 50 percent of the revenues, 1 percent generates 30 percent of all telephone communication revenues, 1 percent of the customers generate 30 percent of all the revenues. Two percent generate 40 percent of all telephone communication revenues. Those customers that generate that kind of total money are obvious targets for bypass. If the portion of these revenues which flows to Northwestern Bell to support local service were lost because these companies bypassed us it would place a considerable burden on the remaining customers to replace those revenues.

Bypass is attractive today, we have it in Iowa today. One of the former panel members indicated they have their own microwave system, that is a form of bypass. The most important factor for a bypasser to consider is the long-term impact. Now the FCC order makes it clear that in the long run bypass will not be attractive because prices will follow costs. The FCC transition plan which moves toward the elimination of long-distance subsidy accomplishes this and clearly sends this signal to people who might be potential bypassers of the local network. If, on the other hand, Congress passes legislation as proposed, this could lead to the belief that the FCC goal of cost-based pricing may never be reached. This will lead to uneconomic bypass of unprecedented magnitude that could virtually destroy the telephone network as we know it today and universal service in the process. Now some bypass in my opinion is economically sound. This is the case where an alternative can be provided at cost below what the telephone company's cost of service actually is for that customer. We do not oppose economic bypass, we do oppose uneconomic bypass.

The key to the FCC access charge plan is the gradual and planned removal of the present long-distance subsidy. The plan calls for the subsidy which covers the local cable costs to be gradually shifted to the residential and business users who cause those costs. The plan calls for the price of residential service to increase by $2 in 1984, another $1 increase in 1985, and another $1 increase on top of that in 1986. The impact of these price increases on residential services and residential customer's ability to pay for local telephone service seems to be the main concern of Congress.

The goal of universal service is a goal that really has been reached for all practical purposes. Everyone who wants a telephone line can afford one. It is our opinion that the doom-sayers who are predicting massive disconnection due to the $2 per month increase in rates, that they are simply wrong in that kind of attitude. These people completely ignore the fact that long-distance rates are going to be coming down, which could affect any increase in local service. Both AT&T and MCI recently announced plans to lower long-distance rates.

I realize that Congress, especially in the Senate bill, deals with the bypass issue. I would suggest, however, that their solutions may cause more problems than they purport to solve. Proposals in the Senate bill raise a number of constitutional issues. Efforts to tax bypassers may well be unlawful and discriminatory. The Senate bill would limit a proposed high-cost subsidy to telephone companies with less than 50,000 customers. That would effectively exclude the 77,000 rural customers. I am responsible for in the State of Iowa, the majority of rural customers in our State in fact, from benefiting from the subsidy. And by the way, as the bill is written, our 77,000 rural customers would be paying higher rates to subsidize rural customers served by smaller telephone companies in the State and that just does not seem fair to me.

In addition, Northwestern Bell, like nearly all telephone companies, is designing services specifically targeted to low-income groups. Last month we filed with the Iowa State Commerce Commission to expand our local measured service offering to other areas served by all-electronic offices. We hope that the commerce commission will work with us in developing alternative local service pricing options based upon the desire to maintain universal service.

In closing I would like to emphasize that Senate bill 1660 and House bill 4102 are not, in my opinion, the solution to concerns for continued universal service. In fact, they contribute to its demise. My company is in the closing months of a massive divestiture undertaking that was not our idea. The implementation of the ordered FCC access charging is an extensive effort and well underway and it has taken the FCC 5 years to come up with this plan. This is not the proper time for the U.S. Congress to consider action, particularly action as it is being discussed. My request to Congress is simple: Let us move ahead with the steps we must take, let the change take place and then with the FCC, with the State commerce commission, with the Justice Department and the judicial branch, observe and monitor the impacts and consider alternatives if the need becomes apparent.

Remember, the overall goal is to maintain universal service and to introduce competition in the telephone industry. Handcuffing the court and the FCC method would have disastrous results. We have the best, as Senator Jepsen pointed out, we have the best, the least expensive telephone service in the world. We intend to manage ourselves through this transition to keep it that way.

Thank you very much.

Senator JEPSEN. Mr. Stauffer, just for a little background before we proceed; I would like a little more information that is meaningful to Iowa. How much phone user units, if that is the way to describe it, are there in Iowa. You say you have 760,000 customers?

Mr. STAUFFER. Yes.

Senator JEPSEN. Is that all the phone customers in Iowa, are there more?

Mr. STAUFFER. We serve about two-thirds to three-fourths of the telephone customers; of the customers in Iowa who have telephone service, Northwestern Bell serves approximately two-thirds.

Senator JEPSEN. So there are approximately 1 million telephone customers in Iowa?

Mr. STAUFFER. Yes.

Senator JEPSEN. You serve approximately three-fourths of them?

Mr. STAUFFER. Yes.

Senator JEPSEN. Of those three-fourths that you serve, about one-tenth, or 77,000 are rural?

Mr. STAUFFER. That is correct. And about, of that 760,000 customers, about 60,000 are business customers and the business customers generate about 50 percent of our total revenues.

Senator JEPSEN. About 50 percent?

Mr. STAUFFER. Yes.

Senator JEPSEN. So one-tenth, less than one-tenth, or as you indicated in your remarks, about 5 percent of the customers generate 95 percent of the revenue?

Mr. STAUFFER. No. 95 percent of the customers generate between 5 and—those figures were nationwide. Nationwide 5 percent of the customers generate 50 percent of total revenue.

Senator JEPSEN. That holds true pretty much for Iowa, also?

Mr. STAUFFER. Iowa is a little different. We have roughly—yes, that would be true in Iowa, too because 10 percent of the customers are business customers and that includes all the business customers, yeah.

Senator JEPSEN. So the business generates the majority of revenue?

Mr. STAUFFER. It generates 50 percent of the revenue.

Senator JEPSEN. Fifty percent of revenues?

Mr. STAUFFER. Yes.

Senator JEPSEN. I thank you. James Harpham, president, General Telephone of Midwest, Grinnell, Iowa.

STATEMENT OF JAMES HARPHAM, PRESIDENT, GENERAL TELEPHONE OF MIDWEST, GRENNELL, IOWA

Mr. HARPHAM. Thank you, Senator. I want to applaud you for having such a session. I think it is very valuable for not only you but the people in this audience to hear several sides say of this issue. I have kind of thrown away my prepared text because I have heard an awful lot said here in previous panels and some of those statements and some of the items I would like to really address. The first one being that imposing question for all of you in the audience, are you happy with airline deregulation, banking deregulation, railroad deregulation, trucking deregulation. I am sure each of you have your own answer to that.

Our industry, the telephone industry, has been built upon subsidy. Bill Stauffer said that, I will repeat it and I am sure everybody at this table. I think what we are going through at the moment is a dislocation as a result of changing a highly cross subsidized and regulated business and taking it back to where competition is, let us say before you, bringing it to the point where you as a customer have a choice. I heard the business panel up here talking about having a choice and I can remember I have had 28 years in this business, and I can remember being told you work for a monopoly, I have to deal with you. No longer is that true, particularly the big business has many alternatives today in buying their telephone, their telephone system, in their network. We are going through what the trucking industry, the banking industry, other industries, other industry has been highly cross subsidized.

There has been talk today that you do not know your costs. For many years that was true, we had no reason to know our exact costs of every item for when any unit went before a public service commission all of those costs were lumped into the overall cost of running the company. Now that we are in a competitive market we know a great deal more about our costs. But any of you that are in the costing business know one thing, and that is no cost is pure. There is some subsidy and some cost to some customers. And what the FCC is attempting to do is relieve the major subsidy. The $6 access charge that business is being asked to pay is the actual nontraffic cost that is being transferred from the long-distance network over for local customers to pay. The FCC did not want to put the entire $6 upon the customer, therefore they put a $2 charge and that would be transitioned up say in the next few years until $2 becomes $6.

So let no one kid you, the real cost is $6. I would like to point out that the telephone industry has fought most of these issues, fought the Carter phone decision, fought the courts. I think the Bell System has spent some $400 million defending themselves from the antitrust case. There was talk earlier that there was a line drawn down the middle of a switching center between what is AT&T and what is Bill Stauffer with Northwestern Bell. Bill Stauffer did not draw that line, Judge Green drew the line, Bill Stauffer had nothing to do with that line. The idea of drawing the line was so that there was no cross subsidy from the long-distance business over into the local business. Let us say that this will be a clearcut line of demarcation so there was nothing. Let us say that was done, yes, it can be done by accounting. In fact, General Telephone and Electronic, being a smaller company than all the other independent companies, are allowed to draw that line if you will from an accounting standpoint and not from a physical standpoint. The telephone industry did not choose this method. This method grew from 1968 in the Carter phone decision and it grew through the courts, through the antitrust suits against the Bell System, and it was nothing that was planned. I heard Mark Fowler, the chairman of the FCC, say recently we did pretty well with what we had to work with. And what he had to work with were court decisions and previous rules that were handed to him when he became chairman. And like it or not, ladies and gentlemen, that is what we have. We have a set of circumstances that are being handed to us today.

Next Thursday morning at 7 o'clock I will be addressing the Rotary group in Logan, Iowa. And I think their question to me will be, Mr. Harpham, when are you going to give us a new switch, we want to be in the new age, we want the new digital switch, we have heard so much about it. My answer to them, ladies and gentlemen, is you have not paid for the one you have. Now that may be a shock to a lot of you but you have not paid for the switch that you are presently using. Any public utility, and that goes for Iowa Electric, that goes for any water company, any telephone company, we are mortgaged. Your telephone is mortgaged, your switch is mortgaged, your monthly rental is a mortgage payment, it has not been paid off. If technology replaces that switch earlier than we anticipated or earlier than the Iowa Public Service Commission, let us say, would permit us necessary rates, you have not paid for the switch. It would be as though the house was destroyed and you have not paid the mortgage and you are going to go out and buy a new house. We do not plan to have AT&T stockholders go out to replace the house when the old one has not been paid for. Now that is talking very directly to all of you but that is not truely the way the utility business, right or wrong, has been run. Long-distance lines depreciated out over 30 years and keep the rates low, that is a social program, I think a very good social program and I share what Bill Stauffer said. Our business is to see that you continue to have telephone service universally available to all of you at a reasonable price. The question is what is reasonable.

Very recently, let us say because of all the deregulation, our company went through quite a massive study and some of you wrote and asked why did you not do it before. And I guess the answer would be I did not have to because I saw no purpose in having this information.

The average General Telephone of Iowa customer, of which I have 102,000 and I serve 239 communities throughout the State, pay $6.25 basic monthly rates. Their toll within Iowa is $11.50 on the average. This interstate toll is $8.75. They pay $4 a month for miscellaneous equipment and $1.75 in taxes, or a $32.25, that is the average. And believe me, that is a numerical average. Now what is going to happen in 1984 let us say as the FCC places the access charges into effect through me. The $2 a month goes on to the bill for the interstate portion. AT&T, as you all know, has announced a 10½-percent decrease let us say in the rate, that would reduce that bill by 90 cents so you have a net increase of $1.10. The Iowa Commerce Commission also placed a mirror charge for the FCC that is a $2 residential charge. But they did some more things, allowing the telephone companies to charge the other carriers. As I get done with that calculation, it means that the $2 I collect will be reducing your basic bill somewhere in the neighborhood of $2. That is a wash. So the first year now, this is only the first year, the first year there would be no effect from the intrastate. That is only your company. I do not think that will necessarily meet the same requirements of these other companies. So the net effect after the first year will be a $1.10 increase. I do not believe that is a severe impact upon the residential customer. Again that is the beginning. In the future years those costs will be transferred from toll over to your local and ultimately you will be paying $6.

In previous discussions there was a discussion regarding higher bills, and I am speaking for Mr. Stauffer in this case, I think some of the bills that are being quoted by some of the large businesses were bills that probably Northwestern Bell is billing far beyond. If you read the papers, they are subject to some refund so that all of that net billing is not going to be billed probably and that would be up to Bill Stauffer and his people to, let us say, to determine that. But the fact remains that the cost of telephones are going from a subsidized system to as close as possible system where the user of the service pays the cost.

I do not believe that there is any way that we can go backward. I think technology is here. The changes that are being brought about by technology, if you go to K mart, if you go to any store, you will see in the store today the new throwaway telephone. Our concern, my and Bill's and the rest of these gentlemen here, maintaining a network that is available to the public at the lowest possible cost the more people are going to use it. These are economies of scale. We want people to utilize that network. Pricing people out of the market for basic telephone service does not serve any interest, either the telephone company or the customer. The entire process of transferring, transferring access charges over to the local and lowering of long-distance rates, believe me, ladies and gentlemen, your local telephone company, we do not get any more revenue than we were getting under the previous system. All it is is simply a transfer of dollars. Certain customers will not believe that for their costs are going to go up. Other customers' costs are going to remain the same and others are going down depending say on their usage. But believe me, the telephone industry did not think up this whole idea. It was a very well-run industry, a very efficient industry. I think probably our productivity increased in the neighborhood of 3½ percent per year, year in and year out. Probably no other industry could make that statement, frankly, and I think you are the beneficiaries of that efficiency for telephone rates.

I am going to speak, as I said before at the Logan Rotary next Thursday. Their rates were $5.75 for residential telephones in 1970 and they are $4.21 now and I would like to see anybody in this room match that from other businesses. Now they were highly subsidized, absolutely no question about that. But the fact remains they are paying $4.21 for a basic one-party residential phone today. That is because we had a subsidized system.

Well I have tried to, let us say, answer an awful lot of different questions. That is the items that came up in previous discussions. Please believe our industry did not invent deregulation. We fought it. Please believe that the changing of the subsidy does not bring us any more net money, we are going to get the same dollars although we may get it in a different manner. We are going to get the same money let us say that we had gotten under a totally regulated business.

I think the one thing that is confusing to everybody is the amount of choice you have today. I know the elderly regard the wiring charges and the deregulation of wiring. Let us say within Iowa, they are very concerned about their telephone saying I want you to handle it, I do not want to have to worry about my telephone. They are a different segment of the customer base, they have to be dealt with I think separately. I think somewhere there may be a perception that all elderly are poor. That is not true, all elderly are not poor. And therefore, if subsidies are provided, lifeline service and universal service funds, they should be provided to only those telephone companies that require assistance, or to only those customers who show a demonstrated need for assistance. We are not out to run a welfare program. We are trying to provide telephone service and we should keep that foremost before us. We are proud to provide telephone service to the general public at a reasonable rate and General Telephone will keep working toward that purpose.

I want to thank you for this time, I appreciate it.

Senator JEPSEN. Thank you, Mr. Harpham. Curt Olson from Cascade Telephone Co., Curt.

STATEMENT OF CURT OLSON, GENERAL MANAGER, CASCADE TELEPHONE CO., CASCADE, IOWA

Mr. OLSON. My name is Curt Olson and I work for the Cascade Telephone Co. Our headquarters is in the town of Cascade, Iowa, and my job title is general manager. My duties consist of management, bookkeeping, collections and sometimes troubleshooting, janitorial work, lawn mowing and snow shoveling.

Cascade Telephone Co. provides all single-party telephone service to our exchanges located in Cascade and Otter Creek. The Cascade exchange encompasses an area 14 miles long and 11 miles wide and the Otter Creek exchange encompasses an area 7 miles long and 6 miles wide. The company sends telephone bills to 1,225 customers in the Cascade exchange and telephone bills to 146 customers in the Otter Creek exchange.

I have worked in the telephone business for 33 years and I have seen telephone service progress from poles and aerial wire to the present buried stormproof telephone cables. I am sure from the information given everyone can see that we serve a rural area. Having my home in a rural area gives me a chance to know almost 100 percent of my customers, at least on a hello, how are you basis. Some of the statements our customers have made about telephone rates since the newspaper, radio, and TV have carried that coverage are as follows: how can I afford telephone service, why did they change something that worked so well, at my age I need a phone in case I get sick or hurt, all those changes sound crazy to me.

I would like to submit to this hearing the following observations, these are my own and not necessarily the views of the Cascade Telephone Co. We need reasonable rates to rural business and residential customers. A telephone is a necessity in rural Iowa in case of fire, sickness, injury and for communications with schools, neighbors and so on. The senior citizen will be hard pressed to continue telephone service if monthly rates are raised out of sight. Cheaper toll rates between large cities will have little benefit to rural Iowa customers.

I submit the following as suggestions to this hearing. All companies in the toll business continue to pool part of their revenues to assure universal service in rural Iowa. Also revenues generated by toll companies should not be used to subsidize other businesses. Local telephone companies should be protected from bypass. We have many dollars invested per customer in our rural areas and we cannot afford to lose the big users. The telephone network should be required to continue to allow independent telephone companies access to the basic telephone network. The lawmakers in Washington could lessen the impact of the increase in telephone rates to rural America by removing the Federal excise taxes on Federal service.

In conclusion I would like to thank you for allowing me to express my views in this hearing. Thank you.

Senator JEPSEN. Thank you, Curt. Bill Wallace of the Citizen Mutual Telephone Co. of Bloomfield.

STATEMENT OF WILLIAM WALLACE, MANAGER, CITIZEN MUTUAL TELEPHONE CO., BLOOMFIELD, IOWA

Mr. WALLACE. Thank you, Senator. My name is William Wallace, I am the manager of the Citizen Mutual Telephone Co. in Bloomfield, Iowa. As the Senator well knows by now, we are famous for two things in Bloomfield, one is a disaster in 1983 which put all of our farmers out of business, the second is the infamous Exchange Bank which put all the rest of us out of business, that took care of anything that the drought did not get. I manage, like Curt, a small telephone company in southeast Iowa. We serve around 3,000 customers. I have mixed emotions of sitting here this morning, Senator. I feel like I ought to be out in the audience. I think I am on the wrong panel. Our company is a co-op and as such all of my customers are also owners and also users of the service. So I look at this with very mixed emotions in that I can see from my 3,000 customers a very, very deep need from my farm community, from my elderly, from my small business people for me to be able to continue to give them excellent telephone service at a rate they can afford.

Unlike some other panelists here today I can totally support Senate bill 1660. I have been in close contact with our national organization, which we are members of, and I will say, Senator, there are things in Senate bill 1660 that we do not totally agree with, but I think there is nothing there that cannot be worked out and I feel beyond a doubt that we can totally support it.

Unlike other companies we do not have subsidies to segment our rates. The only subsidy we have received has been through telephone revenue and I openly admit that to some point this is a subsidy, but is it? I put in a local telephone for one of my customers, and our rates are not inexpensive. Our residential rate for instance is $8.50 a month and it is not subsidized because everybody in my exchange pays that same rate. Our average toll bill for my customers will run $17 to $18 a month. Now we sit here and say well, we have a subsidy from tolls, granted, I received a payment from the toll company for the use of my local facilities, but I question as to whether or not that is a subsidy because I built adequate equipment into my office to handle that toll use that I would not have had to have in that office, at a great expense to my customers, if we did not carry that portion of the toll for which we are being paid a fair share for carrying.

I have a written text, which as you can see I am not using. I will turn it in, it is rather lengthy. But I guess the whole point I would like to make today is that we have a vested interest in keeping the rural rates at an affordable point. This must be done. I sit here today and I have heard some of the other panelists all talk about deregulation, talk about access charges and several of these points, and I do not disagree in total with anything that has been said, but I think we must go back and take an overall look. Deregulation had absolutely nothing to do with the access charges. In fact, when the FCC set up this access charge, Judge Green went back and admonished them for their action. Judge Green's position was that no change need be made in the 50-year-old way that we were handling the separation of tolls. Now think about that. We are talking about lowering long-distance rates, we are talking about a $2 and eventually a $6 access charge, but that is only half the story, that is the Federal portion that the Senator is interested in, without a doubt. But there is also the State portion that is going to add automatically, January 1, another $2.

So we are sitting here telling you today that your bill is going to go up $2, it is going up $4, like it or not. You are going to pay in the State of Iowa, $2 to the Federal pool. I just want to make that quite clear that the $6 is not the top of this pyramid. I guess I am too old. Everybody says, well, we need to deregulate that so that everybody can own their own telephone. Unfortunately I am old enough, like a lot of you in the room and like you, Senator, that I can remember when we had magneto telephone service and everybody owned their own telephone and I do not think I want to go back to that.

Senator JEPSEN. We put up our own poles.

Mr. WALLACE. Right, Senator. I remember very well, believe me. I guess in closing I would like to read a paragraph from my prepared statement.

Rural Americans face 100 to 300 percent local rate increases and probably much higher long-distance rates in the near future. The reason is that the FCC has bought the argument of big business users, the Fortune 500 companies, AT&T, and other large telephone companies that what is good for their profit picture is good for Americans. Plain and simple, it is a ripoff, and the majority of the Americans are going to pick up the tab so that big corporations can have cheaper telephone service. It is the biggest scam since the Dutch bought Manhatten Island for $24. There is no proven reason for the charge, just some gobbledygook statistics by AT&T and other big companies that they cannot compete for the Fortune 500 telephone business if Joe American does not help pay the tab. Rural America produces the food and fiber for urban America and much of the world, but it cannot continue to do so without modern telephone service. The telephone is not a luxury, but rather a necessity in rural America, we need it to reach doctors, hospitals, friends, and loved ones, and yes once in a while our Congressmen and Senators. While most of America sleeps, the FCC has allowed corporate America to steal the cookie jar. We can and will support S. 1660. For we in rural America realize our dependence on adequate communication at a price we can afford.

Thank you, Senator.

Senator JEPSEN. Thank you, Mr. Wallace. You started out your remarks by saying you had mixed emotions, I was trying to find that mix. Thank you for your remarks.

Francis Kahle, is that how you pronounce it, from South Slope Co-op Telephone Co. of Norway, Iowa.

STATEMENT OF FRANCIS KAHLE, MANAGER, SOUTH SLOPE CO-OP TELEPHONE CO., NORWAY, IOWA

Mr. KAHLE. Being last on the panel, I am quite certain that what I have to say might be somewhat dry and most of it will have already been said but I will attempt to make my views known. I am the manager of South Slope Telephone Co. headquartered in Norway, Iowa. We serve 4,500 customers in four counties here in east-central Iowa. These 4,500 customers represent nearly 95 percent of the customer base. As I stated earlier this afternoon, with the introduction of regulated competition on one hand and the deregulation of the telephone industry on the other, coupled with the divestiture of AT&T, we are beginning to see a potential for the erosion of the universal telephone service concept.

And I might go back for just a second. When you posed a hypothetical case earlier of what would happen if there would be 75 percent of the people would have a telephone, if I want to call you and you happened to be one of the 25 percent that did not have a telephone, at that particular moment my telephone would be useless to me. It would be absolutely useless if I wanted to call you on the telephone.

Two particular items that have been introduced while attempting to make this transition and at the same time maintain the integrity of the universal telephone service concept are the ideas that all subsidies are bad and the idea that the cost causer is to be the cost payer. All subsidies are not bad. In fact, we see them all around us in nearly every day of our lives. The idea of having the cost causer being the cost payer in itself is not a bad idea but it needs to be applied with reasonableness. In fact, in some areas of our life it just plain would not work. An extreme example of this is in the area of law enforcement. Cost causers being the cost payer would result in instant chaos.

Replacing toll settlement revenues with access charges supposedly would be offset by a lower toll charge, could turn out to be a gigantic hoax especially for the customers in the small exchanges with low toll volume. I am not certain just how long-distance charges are going to shake out, but I have reason to believe that the average end user will benefit little, if in fact at all, from the proposed long-distance rate decreases.

In the past, in the area of settlement, which I think are generally perceived as a subsidy to the majority of users, we have allocated our costs more heavily toward the toll and less toward local. We did that because it seemed to be in the best interest of the public, not to mention the fact that it worked.

But now that we are being told that competition will be good for us, I see a hard push to develop one common plan for settling with toll carriers when in fact we have been settling under at least a half a dozen different plans nationwide for many years.

In any event, if the deregulation of the telephone industry goes the route of the airline deregulation whereby the longer and more loaded the route, the lower the rate, our people are going to be in a world of hurt. Of the total minutes of toll usage the Iowa independent average is 25 percent of toll minutes are interstate, 75 percent of toll minutes are intrastate. Of the 75 percent of intrastate toll minutes of use, 20 percent are inter-LATA and 80 percent are intra-LATA. So you can see most of our customer's calling area is fairly close to home.

Now I realize that the large toll user feels that he is being put upon to subsidize the end user through the settlement process. A compromise solution is to have all common carriers, including any arrangement to bypass and contribute to a universal service fund to subsidize end user charges. I also feel a plan needs to be worked out to allow large toll users a volume discount regardless of where they are located, not because they happen to be located in an area that carries a lot of traffic between two certain cities. You could have a large phone user in a small exchange and he would benefit nothing from lower rates because the volume would be low coming into our exchange.

Thank you for the opportunity of appearing before the panel.

Senator JEPSEN. I thank you. First of all, I would like to say again—it has been said here several times—and we are all familiar with the phrase: why fix it if it is not broken. And again I would like to probe this just a wee bit. I would like to raise it and get a response from all of you gentlemen. First of all, is the telephone industry broke, or was it broken? After all, our phone network, I think all of us agree, is the best in the world. How did we get to where we are, and what makes the FCC and the Justice Department think it needs fixing? And secondly, if any of you think it is broke, how would you recommend we fit it? Mr. Stauffer, you do not think it is broke, do you?

Mr. STAUFFER. Senator, about 6 years ago we saw the potential consequences of what was happening in the telephone communication industry. We saw that if the subsidy started shifting and if competition was allowed to come in, that it would force the change and the subsidy program. And we said then here are the ultimate consequences, here is what is going to happen. And we got no one, not a single person to pay a bit of attention to us. And we finally said maybe, at the end, maybe society wants a change, maybe they want competition.

The thing that I think is really driving the change that is taking place is technology. Those business, those 10 percent of our business customers that are paying us 50 percent of our revenues, they say why should I pay Bell or MCI a dollar for a long-distance call when I can get that same call through my own system for $0.60. And those customers that are paying millions of dollars for long distance are not going to continue to pay 60 percent higher rates than they know they could if they did it themselves. And technology has allowed that to happen. And technology will allow those business customers to go to a satellite, from one plant to a satellite to their home office, to go anywhere they want to go, and it is the technology that is driving this.

And as far as I am concerned there are two things that I think have made the economy in the country. One is we have not tried to corral technology, we have tried to let it flourish. And if we really believe that technology should flourish then we should not hamper it with a bunch of subsidies based on prices. And if we believe that free enterprise will encourage more technology and the development of more technology and the benefits of that technology go to the general public, then I think what the FCC is saying is let us let that happen, let us let that develop.

No, the system is not broke. And if we let it take its natural economic course I do not think we will be broke in the future, either.

Mr. HARPHAM. As I would share what Bill said, I do not think the system is at all broken. I think it has got some dings and dents now. Let us say over the past 13 to 15 years that we have been fighting this issue. I think it is time, let us say that the Senate in their bill, if they chose to look at it further, a moratorium on residential part is not a catastrophe say to the industry at all, that time needs to be taken at some juncture to determine where we are, what has happened as far as the elderly, the poor, and big business, small business, rural business. I have said this to several of the people in Washington, and I think as an overall view of deregulation, if you take airlines, trucking, banking, telephone and you deregulate all of these items, my concern is that in 1990 rural America is going to be a very expensive place to live. And if we dislocate rural America and end up with people living in the large cities because they cannot afford rural America, I am not so sure, ladies and gentlemen, that the large cities can take the people that they have today and I do not believe that our Congress looks at all of these issues as one issue and they rarely are one issue. Deregulation, should the cost causer pay the cost, that is what the Senator, that is what his colleagues really have to determine, who should pay the cost, the cost causer or someone else.

No, it is not broken. It has got problems. It has got so many unknowns before us. We do not know the answer. As we said earlier, if you ask a telephone person the answer, they do not know, and that is exactly true. We do not know the answer, we do not know the effects of all of these things. Maybe we ought to hold it for a while, let a certain part of it go and then stand back and look at it and then see where we want to make the next step.

Senator JEPSEN. Mr. Olson.

Mr. OLSON. Let me quote from a magazine that I just got yesterday. I will not read the name of the company, it is a long-distance company and it is not AT&T. In 1982 got a 47-percent return on equity. AT&T, according to the article, had a 12-percent return on equity because AT&T had to subsidize the local customer.

I can see why everybody wants to get into the toll business.

Mr. WALLACE. Senator, I would have to agree with what has been said by prior panelists. I do not feel our system is broken. I think it is bent to some extent. I do not think it is anything that we cannot recover from. As you know, Bill Stauffer and myself and others for the past 6 years have been coming to Washington at various times and addressing these problems as we could see them coming. It is beyond me to understand how we can take 15 years to have an antitrust suit against AT&T and then in less than 12 months basically say, well, we are going to forget that and here is what we are going to do. I think, as was voiced previously, we need some time possibly to stop, assess our position and see which way to move.

Mr. KAHLE. As Bill Stauffer said, the system is probably not broke. I think he probably would have been the first one to see it. But I think the person is broke when you let people come in and skim off the cream and do nothing about it. To me that is broken. Earlier a comment was made about, Curt mentioned about, the rate of return for this company. An earlier comment was made about our guaranteed rate of return from the regulated company. It might be well to point out that for the ability to have a guaranteed rate of return, we sacrifice that ability to go out and charge whatever we want. Also I think that if your car goes in a ditch, it doesn't serve much of a purpose to get out and stand out there and figure out how you got in the ditch, you want to figure out how to get out of the ditch.

Senator JEPSEN. Very good. At the hearing we had in Washington, some of the information brought out said that about 1 out of every 6 residential customers do not make long-distance calls. I do not know whether that figure is correct or not. I have heard over and over again the pros and cons about the decision that was made by the FCC. Are we going to have a pay-as-you-go or a pay-for-what-you-get plan or are we going to have a form of subsidy someway or another? So I would ask the question, as it stands now as recommended by the FCC, if I understand it correctly, these 1 out of 6 residential customers that do not make any long-distance calls, are still going to be required to pay access as I understand it to that service anyway, is that not true?

Mr. HARPHAM. I think that figure of maybe 1 out of 6, I am sure that that is a national average. I think the question should be how many of those people, let us say they receive a call long distance but they are connected not only to the network to make a call but there is a certain value in receiving that call. So I do not think, Senator, that anybody really knows the exact figure, that 1 out of 6 I am sure, let us see within my company. I do not know the, you know, the exact figure. I know that 65 percent of our customers place less than $20 a month in long-distance calling. There is another figure for you and I am sure Bill and sure that some of these other gentlemen can give you more figures.

Mr. STAUFFER. Senator, the figure you have given applies to residential customers. There may be 20 percent of the customers who make long-distance calls in a month, as Jim mentioned. They might receive a long-distance call. Now the next month it would not be the same 20 percent, it might be another 20 percent. They may have been, the one that did not make the call in October, might make one in November and December. So in any given month there might be 20 percent of the residential customers that do not make long-distance calls but it is not the same 20 percent of the customers.

Secondly, the access charge, this is a misnomer about what it does. It is not access to the long-distance network, it is access to the local network that includes the ability to lock into the long-distance network. Some people think that this is only for those people that use long-distance service. The access charge is to help pay for the cost of local service and that local service is also used then to gain access to the long-distance network.

Mr. OLSON. Let me simplify that if I may. What we do not get in toll today, we are going to charge the customer tomorrow. You can call it access charge, call that peanuts, but what we do not get on toll we are going to have to charge the customer because we have a revenue requirement. So simply what we lose from toll we make up from our local customer.

Senator JEPSEN. Somebody has got to pay the bill.

Mr. OLSON. That is right.

Senator JEPSEN. I might point out that the figure I gave you was, and I am glad we had your responses to it. One of the responses was "It is just not that simple." When you say you just pay for access, you are not just paying for access. When you think of making a long-distance call you also have the capability of receiving an incoming long-distance call. That figure that I gave you is taken from figures used by Congressmen Dingell and Wirth and their staff, who are the key House Commerce Committee members. According to their research, 62 percent of all long-distance billings go to the top 4 percent of the users, the major corporations of America. About 1 in every 6 residential customers each month makes no long-distance calls but soon would be forced to pay for access to that service anyway.

And then the article goes on to discuss the topic we need to air. From their perspective, the FCC decision was an inequitable transfer of billions of dollars from the poor and middle-income local ratepayers to wealthy industries, a transfer that would threaten the concept of universal service.

And so that was the source.

Mr. HARPHAM. You are familiar with the Iowa Commerce Commission which has proposed rules in passing now that customers who do not wish to make a long-distance call can be quote, blocked from that. Industry, and at least my company, the cost of doing that, ladies and gentlemen, is, I think, going to be prohibitive because it is going to cost a lot of money to block just a very, very few people from making or receiving a long-distance call. It is not impossible. You have to have a certain kind of switching where that can be done. But I am sure that that is an uneconomical way to go. It is certainly a worthwhile effort to explore it, but I doubt frankly that the cost, and many of our customers have to use long distance to simply call law enforcement, so they are going to have to have some kind of long distance.

Senator JEPSEN. If I may, I would like to approach this panel from a little different angle. I would like to ask a simple question that I think maybe is a little difficult to answer directly, but anyway here goes. Just what changes in the communication industry are a threat to basic telephone service and reasonable prices?

Mr. OLSON. I will start with that, Senator. I think the word is bypass. The fact that people were allowed to get into the telephone business without providing a subsidy if you will to the local company. In other words, they were allowed access in and out of local companies without paying for it is where this whole thing came from, in my opinion.

Senator JEPSEN. Does anyone else wish to comment on that?

Mr. HARPHAM. No, I would not disagree. I think if you go back to the original application that MCI, as they went into business, and those hearings were held in the late 1960's and early 1970's, their original purpose was not to go into the long distance at all. Their original purpose was to provide private line service between Chicago and St. Louis and then subsequently went into the business, long-distance business. Could not make any money doing it so subsequently was permitted to go into the general toll business and that is what we have today. And subsequent to that then many companies leaped into that business. My guess is there are probably several hundred long-distance companies today.

Senator JEPSEN. Without being critical, but trying to be descriptive or analytical, they were sort of hitchhikers.

Mr. HARPHAM. They saw the opportunity to beat the average cost. AT&T, in placing long-distance rates before the FCC, took all the costs nationally of running the long-distance network, lumped them in and divided them up and said we need so much money and you would pay the same quotes from Pocatello, Idaho, to San Francisco, as you would have with the same distance from Dallas to San Francisco if the differences were the same.

Senator JEPSEN. Do they come under the same regulations?

Mr. HARPHAM. They applied to the FCC. They got a license to build and were regulated by the FCC.

Senator JEPSEN. None of their revenue goes toward basic phone service anywhere?

Mr. HARPHAM. They pay an in-fee charge to buy services because they do drop the call off to a local telephone company and they pay a charge for that. So, yes, they do pay the local telephone company some revenue for using the local switching. There has been a debate as to whether they pay the total cost or not.

Senator JEPSEN. But not as much as AT&T, I am told.

Mr. HARPHAM. Well, that is what AT&T says.

Mr. STAUFFER. Senator, I think a lot of it goes back to technology. The technology was available and when you have technology available and you find a situation where some customers are paying more for the service than what the new technology can provide, you are going to have in our country, thank goodness, you are going to have people take advantage of that and that is what happened. Whether it was good or bad or right or wrong they took advantage of some technology and said we can provide these services cheaper than under a regulated monopoly that is artificially keeping prices high on certain services to subsidize other services.

Senator JEPSEN. OK. Well, in keeping with Mr. Kahle's remarks, when your car is in the ditch, rather than stand on the road and try to figure out why you got there, you ought to start thinking about how you are going to get out. On that basis would anyone want to address or try to describe a relationship between Bell and non-Bell telephone companies which can improve service, or can any changes be made in a relationship which would promote universal service?

Mr. STAUFFER. I would like to try to answer that if I might. I think the FCC order should be allowed to go into effect. That would send the strongest signal that could be sent to bypassers that it is not going to be economically viable in the future, and would probably prompt most large companies from expending millions of dollars to get into bypass. Then I think we ought to take a good hard look at how many of our customers are priced out of having telephone service. We want universal service. We would propose if people cannot afford telephone service that there should be a subsidy for those customers who cannot afford basic telephone service.

Senator JEPSEN. Where from?

Mr. STAUFFER. And it could come from three places as far as I see it. It could be State commissions or Congress would mandate a lifeline service at $6 or $8 a month or something like that. We have got our local measured service that right today provides our customers service for $2 less per month than our flat rate. That is an option that customers can have if they want to take it.

I feel so strongly about universal service that if those are possible, I would suggest that there be a tax on all communication services of 1 penny or 1 percent or 2 percent. I do not think it would take over 1 or 2 percent. That could go back to the States and could contribute to those people, those families who cannot afford telephone service. It could be very similar to the energy assistance program. From what I hear that seems to be working very, very well. It is a program that could be financed through a 1-percent tax on communication services and it would give those people who really cannot afford to pay for telephone service the opportunity to pay for it. It would not subsidize the millionaire who can afford to pay for telephone service, who would be subsidized under the provisions of the Senate bill. Everyone, under the provisions of the Senate bill in a given location, would be subsidized and I do not think everyone should be subsidized. I think those people who cannot afford basic telephone service should be subsidized so we can continue universal service.

Senator JEPSEN. Can any changes be made in the relationship which will promote universal service? That was the general thrust of the question.

Mr. OLSON. Well it sounds like we are getting back into the subsidy business. The feeling that it works so well, why did we ruin it, how are we going to get back. And I think that is the feeling that I have is it going ot be in such a shape that we cannot get back to some sort of reasonable service. And I think that one of the main things that has to be done is that anyone that is in the toll business, I do not care who it is, should have to pay into the pool to get back to the local companies that have spent a tremendous amount of dollars to provide good telephone service. An example, we have an investment of about $600, excuse me, $1,650 per customer to provide telephone service. I will match that with any of the big companies here.

Mr. WALLACE. I would have to agree with the comments by Curt, Senator. We are sitting here saying we are going to get back in the subsidy business. Well this is what the access charge is supposedly getting us out of. And if that is the case, why have two wrongs to make a right. When we were on our regular settlements we had no need for this. We have almost accomplished universal service in the United States. A lot of this has been done through the REA-financed telephone program. The last figures I saw, I think roughly 95 percent of all the people that are served in an REA-financed area have telephone service and over 95 percent of those people have one-party service at a price they can afford. So again, and back to your question, if it is not broke why do we need to fix it?

Senator JEPSEN. Speaking of Rural Electrification, they have played a key role in pursuing a congressional directive to establish and maintain an extensive national phone network. How can it improve its activity and role, in light of the many changes taking place in the telephone industry? Do you have any comments on that, Bill?

Mr. WALLACE. In the last 3 to 5 years the agency has undergone vast changes, Senator. It has, as you know, they have cut back dramatically on their personnel. They have made the telephone companies more adept at handling some of our problems that they were handling for us. We will have to, in some instances, continue adequate funding for REA because there are areas that still need low-interest loans. As you have heard me say for a number of years, the average of the REA borrowers like ourselves are willing to pay an adequate rate of interest. We established years ago the telephone bank, similar to the land bank, to get ourselves, more or less wean ourselves from government-type of financing. It is a necessity though that that program be funded. Basically I think the program is doing a good job as it goes today. I think they are being very, very cost conscious with the loans they are making and I totally support this effort.

Senator JEPSEN. Are there any closing comments? I want to say at this point in time, Mr. Wallace, I have been advised that you were planning to fly up here. You went a long distance, as I understand it and your plan didn't work out so you drove. It is rather hard to get here and you are going to turn around and drive back. I thank you for the effort, and I thank all of you for the effort that you have put in bringing information to this hearing, which has been candid and fair. We certainly covered the bases, so to speak. In summary, I think I find a unanimous agreement that the senior citizens and the elderly should be provided for by some form of special arrangements. Is that generally the agreement? And we generally have unanswered questions about how small business or nonregulated private business will be affected by costs that they are concerned about. Further, we need a good relationship between Bell and non-Bell telephone companies to maintain universal service during the upcoming change. But beyond universal service, we move around nearly full circle and do a sort of U-turn from that concept—and that is free and wide-open, unregulated competition. And we say we want that to make sure that high technology moves forward unfettered. In fact we want to encourage it.

Speaking of high technology, I believe Carl Sandburg tells this story. When he was standing outside of the National Archives Building in Washington, D.C., just off Pennsylvania Avenue, a number of years back, a busload of senior citizens stopped and were going into the building. On the side of the stairway as you go into the building there is an inscription that says the past is prologue. And one of the senior citzen ladies read that and she looked around and she saw Carl Sandburg standing there and asked what "the past is prolog" meant. Carl Sandburg scratched his head and he said, "I am not sure, lady, but I think it means you ain't seen nothing yet."

I think that is true with technology and the future of this country—we have not seen nothing yet—whether it be in the area of communications, medicine, or whatever it may be. So to foster and promote that, I think we have to have a climate that certainly will do that. Technology is one of the things, although it has been touched on here, that I think is probably going to advance as a result of the changes that are happening in the telephone industry. Tremendous research is taking place. As I indicated in my opening remarks, the research and development laboratories of Bell Telephone are noted and recognized worldwide as being the very best.

Before I turn this forum over to any of you for final remarks, I would like to announce that in keeping with our efforts to get more information, we are having a regional field hearing on this same subject next Monday, October 17, at the Marriott Hotel in Des Moines beginning at 9:30. At that time we are going to expand outside of Iowa and have witnesses from Minnesota, Iowa, Nebraska, North and South Dakota, representing government, industry, business, and consumers of telephone services. If any of you who would like to appear a second time, you are invited and you are welcome.

And now, Mr. Stauffer, do you have any closing comments?

Mr. STAUFFER. No, sir; nothing other than to express our appreciation to you for conducting the hearings and giving us the opportunity to explain some of the things that are happening and some of the concerns that we have with what is going on in Washington. Thank you.

Mr. HARPHAM. I thank you too, Senator. I think it has been very worthwhile and I hope the people sitting in the audience have gotten some benefit.

Senator JEPSEN. Mr. Olson from Cascade.

Mr. OLSON. Thank you. One point that I would like to make that may not have been too evident up here, we of the small telephone companies, servicewise, get along very well with the big telephone companies and I think this is how we provide and have provided good telephone service to our customers. This has worked because we knew where to go when we had to get something fixed or to talk to somebody to get something fixed. I hope that people can recognize the problems that are coming if we have some 200 long-distance companies. We are going to lose, I think, part of the good service that we provided the people in the past.

And with that, thank you, Senator, for allowing me to appear.

Senator JEPSEN. Mr. Wallace.

Mr. WALLACE. Just to say thank you, Senator. We appreciate your efforts and the efforts of the entire Iowa congressional group. And I know you have in the past been at least able to lend an ear to our needs and we hope you will do the same in the future. Thank you very much.

Senator JEPSEN. Well, I wish you a safe trip back to Bloomfield, and as you know, I did share in some of your disaster down there.

Mr. WALLACE. Senator, I was aware of that.

Senator JEPSEN. Mr. Kahle.

Mr. KAHLE. Thank you, Senator.

Senator JEPSEN. And thank you, all of the participants and all in the audience for coming here today. I now declare this meeting adjourned.

[Whereupon, at 4 p.m., the committee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record:]

1247 Melrose Ave
Iowa City, Iowa, 52240
11 October 1983

Honorable Roger Jepson, U.S. Senator
Committee on Impact of Telephone changes
Cornell College Campus,
Mt. Vernon, Ia.

Dear Senator Jepson:

During these committee hearings, you will hear in some detail about the devastating impact on many elderly people of the proposed rate increases in telephone service. It is urgent that some policy be instituted that will avoid these harmful effects on so many elderly people. However, I would raise a more general question as to whether any increase in customer rates need be allowed.

I am proposing that Congress and the regulatory agencies move at once to establish a moratorium on rate increases by the phone companies for at least a five year period. This would provide a period of time for the reorganized companies to experience the changes, and develop a data base concerning the new operations to show whether there is need for increased rates.

There are tremendous resources in the companies at national, regional and local levels, both in real property and in current income from customers. There may be a need to allocate these resources differently, but no need to "soak the customer" again. If notice is given to all companies that they will not be allowed to get additional funds from the customers (public), then they can turn to the courts or regulatory agencies for help in dividing up the already available resources.

Sincerely,

Stanley Good

Rachel S. Dennis
320 East Washington # 9 D
Iowa City, Iowa 52240

Re: General Telephone Use

The telephone is basic to the interweaving fabric of our communities. The value of my own telephone to myself and to my community is diminished to the extent that any member of the community is not able to afford its basic cost and is thus not a participant in the community"s information exchange.

Re: Telephone Reassurance Programs

Various telephone reassurance networks, gradually being developed, that assist elderly or handicapped people in maintaining independent living depend upon an affordable base for the telephone service.

William M. Dennis
320 East Washington # 9 D
Iowa City, Iowa 52240

It will probably be necessary to process a certain amount of preliminary information before this presentation arrives at a point. I hope that you will bear with me and that this information will prove valuable.

At the advent of the Carter administration, I collected data which showed that the total of salaried jobs in the United States formed only 58 % of the country's mainstream population. Today, almost all job holders are salaried, either by the employer or by one'sself if one is self-employed.

A conclusion derived from the above data is that this nation could continue with hardly a noticeable hitch if forty percent, roughly, of the population (selectively) disappeared into thin air.

It is one of the functions of Congress to care for that forty (roughly) per cent which does not participate in the economy of this country.

The economic activity of this nation is normally interpreted in "gross national product". The present circumstances are such that productivity, which once was a measure of a quantity of job slots, no longer depends upon the numerical significance of employment. The telephone industry, in particular, has substituted electronic procedure with an accompanying heavy fall-out of human employment. The ongoing introduction of robotics will doubtless further diminish human participation in productivity.

If the human element of our country merits attention by Congress, it is time that productivity be interpreted in terms of a quantity of labor performed by human beings. The average amount of productivity representing the labor of one person may be called the "productivity unit" and all economic activity, in services as well as in industries should be "read" in terms of "productivity units".

With reference to the telephone industry, then, its values in services and products should be rated in "productivity units". Where productivity is the end-product of electronic "man hours", in the telephone (and other) industry, or of "robotic man hours" in other industries, those industries employing non-human means should be taxed and treated in other respects in the terms of the human equivalent represented.

It is my considered opinion that hearings of this nature (as we are today having) are dealing with only the pustules of a malaise which actually affects the economic life blood of this country.

My specific request of this hearing, than, is that time, energy, and concern at least equal to that represented by this hearing be devoted toward the consideration of ongoing industry and economics in "human terms".

THE ECONOMIC ISSUES OF A CHANGING TELECOMMUNICATIONS INDUSTRY

FRIDAY, OCTOBER 14, 1983

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON AGRICULTURE AND TRANSPORTATION
OF THE JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in the Town House Convention Center, Sioux Falls, S. Dak., Hon. James Abdnor (chairman of the subcommittee) presiding.

Present: Senator Abdnor.

Also present: Dale Jahr, professional staff member.

[Due to the unavailability of a stenographic service, the following information was supplied for the record. It includes the opening statement of Senator Abdnor, a list of the participants, statements of the various participants, and questions and answers with State regulators, consumer and social groups, and telephone companies.]

OPENING STATEMENT OF SENATOR ABDNOR

This meeting will now come to order. It is my privilege to welcome our witnesses, members of the news media and the ladies and gentlemen of our audience. We are here today to discuss the complex and sometimes confusing issues of a rapidly changing telephone industry. Foremost in my mind is finding out how my fellow citizens of South Dakota are going to be affected by those changes, and determining what I can do in Washington to ensure that South Dakotans are treated fairly.

The Congress, federal and state regulators, the telephone industry and telephone customers have divided and conflicting views on what changes are necessary to keep our telephone service high in quality yet affordable in price. I'd have to admit that I'm a little confused about all these changes myself, and for that reason ~~I called~~ for a hearing on telephone issues on the Joint Economic Committee. Less than two weeks ago, I chaired a hearing at which four so-called "expert witnesses" represented the views of consumers, economists and industry consultants. One of the more colorful and insightful witnesses is familiar to you -- Dr. Alfred Kahn, who you remember was head of the Civil Aeronautics Board when airline deregulation occurred in 1979, and before that was President Carter's "inflation czar."

Certainly Washington doesn't have all the answers or the final word, and that's why I'm holding this forum today. In addition, the Joint Economic Committee will be holding a regional field hearing in Des Moines next Monday. Some of our invited witnesses here ~~also~~ have been invited to participate at that hearing, and ~~it~~ is my hope that they carry with them the thoughts and ideas of this group.

Many of our witnesses here are members of the South Dakota Telephone Users Panel. These people have volunteered a considerable amount of their time becoming familiar with the telephone industry and how customers rely on telephone service and how they are affected by changes. I sincerely appreciate the willingness of this panel to share their insights with us. A special word of thanks goes to Sandy Watson, who helped with all the arrangements.

Before we begin with the statements of our witnesses, I would like to give an overview of some of the changes taking place and some of my concerns about these changes:

- By federal court order, AT&T will be divesting itself of the Bell Operating Companies. Here in South Dakota that means Northwestern Bell will no longer have strings tied to New York and New Jersey. Instead, it will become part of a regional holding company known as U.S.West. U.S.West has 14 states which make up almost one-third of the land area of the U.S.

- The Federal Communications Commission has allowed competition in the long distance market in response to changes in technology. That has allowed new firms such as Sprint and MCI to offer services. Both are now in South Dakota, and WATS resellers are also here now, such as Midco-Tel here in Sioux-Falls. I might add that these new firms do not have to serve all persons in the state, and will probably offer services in just a few cities. Other residents in the state will not benefit from this new competition.

- Bell Operating Companies across the U.S. have filed for the largest rate increases in history for 1984. Some of the rate increases no doubt stem from the great uncertainty that exists in the industry.

- AT&T, which will be the interstate long distance carrier next year, has filed for a $1.75 billion <u>decrease</u> in long distance rates. This is in response to an FCC-ordered Access Charge, which I'll discuss shortly. Under AT&T's rate request, shorter distance calls will drop about 5% in price, and longer routes

10 to 15%. AT&T is positioning itself for a "price war" of sorts with its new competition.

- o The FCC is phasing out its current cross-subsidy system where profits from long distance calls were used to support local service. It is replacing the old system with a new Access Charge system, which will be imposed on all customers. If this system goes into effect, starting this January 1st, a \$2 per month charge on residents and a \$6 monthly charge on business for each phone line will be added to your phone bill. Congress is considering legislation which would put a moratorium on the residential access charge and on businesses that have just one phone line. I'd have to admit, I don't see a tremendous amount of harm in a \$2 increase, but what I fear is that it is just the tip of an iceberg where all costs associated with the local phone network are imposed on the customers. In South Dakota, it costs about \$26 to \$35 per month to keep a phone in service, yet customers pay just \$10 or \$12 for that service.

- o Phone usage and revenues are very concentrated in South Dakota. It is my understanding that just 30 customers generate about 20% of all revenue, ~~in~~ the state, and 2% of business customers generate a large share of the total. These heavy users are likely targets for new technology which allows them to bypass the local phone exchange. If even a portion of these big users leave the public network, I worry about the consequences it will have on the rest of the customers.

SENATOR JAMES ABDNOR

Information Forum

"THE CONDITION OF THE SOUTH DAKOTA TELECOMMUNICATIONS INDUSTRY"

Friday, October 14, 1983
10:00 AM to 3:00 PM

Town House Convention Center
Sioux Falls, South Dakota

*** LIST OF PARTICIPANTS ***

Panel I: The Government's Role

1. South Dakota Public Utilities Commission
   Ken Stofferahn, Jeff Solem, Dennis Eisnach

2. Peter Pitsch, Chief, Office of Plans and Policy
   Federal Communications Commission

Panel II: The Business and Community Perspective

1. Dave McNeil, SD Chamber of Commerce
2. Clair Hurd, SD Retailers Association
3. Ertis Osterberg, SD Municipal League
4. Oscar Austad, The Austad Company

Panel III: Social and Consumer Considerations

1. Owen Halleen, Sioux Falls College
2. Marv Noteboom American Association of Retired Persons
3. Ben Radcliffe, Farmers Union
4. Margaret McKinney, South Dakota ACORN

Panel IV: The Telephone Industry Perspective

1. Ken Detweiler, NW Bell
2. Jeff Miller, Midco Tel
3. Claude Kraft, SD Cable Television Association
4. Lee Larscheid, SD Independent Telephone Coalition
5. Homer Lyon, Dakota Answering and Paging Service
6. Pat McHale, AT&T

Public Utilities Commission
State of South Dakota

Commissioners:
Kenneth Stofferahn
Jeff Solem
Dennis Eisnach

500 East Capitol
Pierre, South Dakota
57501
(605) 773-3201

In Reply Please Refer to:
William Robert Stevens
Executive Secretary

TESTIMONY OF THE SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

Ken Stofferahn, Chairman
Jeff Solem, Vice-Chairman
Dennis Eisnach, Commissioner

Before the

Joint Economic Committee
Sioux Falls, South Dakota
October 14, 1983

The South Dakota Public Utilities Commission is particularly pleased and appreciative of the opportunity to participate actively in the hearings of the Joint Economic Committee, with respect to the "Condition of the South Dakota Telecommunications Industry".

We are submitting for your consideration today, the policy statement which was forwarded to the Federal Communications Commission in FCC Docket No. 83-788, and which elicits our concerns on the impact of divestiture and the latest FCC decisions relating to the telecommunication's industry.

We are pleased that the Congress is now taking an active interest in addressing some of the problems that have been troubling state commissions for the past two years, and it affords state commissions--such as ours--the opportunity to present additional views of enhanced concern.

This Commission has a long standing tradition of commitment to the preservation of universal telephone service at affordable rates. Since well over 95% of all households now have a telephone, we can make the assumption that universal telephone service is in place and that rates are affordable.

Over the past year or so, AT&T has, in our opinion, implemented an intense media campaign to condition the American public to the fact that telephone rates will at least double in the very near future. They have based this assumption, in part, on the fact that subsidies flowing from interstate separation will no longer be available. This is not surprising, since the effect of the Modified Final Judgement issued by Judge Greene will place AT&T into the competitive, non-regulated, interstate market at a decided advantage, if the present decisions of the FCC are allowed to stand.

It would be a decided advantage for AT&T to shed as much of their presently owned investment in local exchange facilities, as possible, to the regulated monopoly or BOC.

Under the current system of jurisdiction cost separations, a portion of local exchange facility costs is allocated to interstate toll service. However, the methodology does not fully allocate costs between interstate and intrastate services or between local and toll services. Rather, it is used only to allocate certain costs to the interstate jurisdiction. All residual costs are assumed to be intrastate.

In most states, local exchange rates traditionally have been determined by the basic service philosophy. Under this approach, rates are set for all intrastate services except local service, at levels desired by the telephone company. All residual revenue requirement needs then are allocated to Basic Local Service. Under what the Bell system has called the "Statewide Theory of Rate-Making", cost of service studies are not normally done for individual service categories. Rather, prices are set with particular reference to the value of service. Thus, the rates for basic local service are not based upon out independent determination of local service costs. They are determined by the residual intrastate revenue requirement needs, which in turn are the residual costs eminating from the jurisdictional cost separations process.

This process is far from being cost based, and in light of the divestiture, will prove that the last thing you will want to be in the reorganization is the residual or local rate payer.

The FCC, in their latest decision, has decided to impose end user access charges to all telephone subscribers for the privilege of accessing the interstate, long distance network, whether they use it or not. This action, not surprisingly, is strongly supported by the interstate long distance carriers, such as AT&T, because it offers the opportunity for AT&T to shed investment costs in jointly used local exchange facilities, by permitting the undefended residual ratepayers to pay in the form of access charges.

This Commission believes that the FCC has abdicated their responsibility to the public interest on this issue and that their decision was apparently more arbitrary than evidence based. The result is that they have failed the American public miserably. The FCC, in its own case history, investigated the interservice subsidy flow issue and required AT&T to undertake a seven-way cost study in 1964. Although the details of the cost study methodology were determined by AT&T, <u>the results clearly showed that the competitive services (private line and Telpak) were being subsidized by the basic monopoly toll service</u>. After discovering this apparent subsidy flow, AT&T did not propose to change it's pricing policy or reverse it. Rather, it changed its cost standards for judging subsidy, adopting incremental cost and allocating all residual costs to the monopoly message toll service under the basic service philosophy. The subsidy has continued, and has even been extended, as AT&T has introduced more reduced tariffs in an attempt to fend off competitors, while at the same time casting a greedy eye toward the residual local rate-payer to see if they can stand yet another "bump" by convincing them through the media that their local rates will have to double or triple because interstate subsidies have now come to an end. All of this has occurred under the very watchful and protective eye of the FCC.

This Commission, because of this, urges Congress to commission an independent, fully distributed, stand alone cost study to determine, 1) if local rates are in fact subsidized, which involves the allocation of investment costs of non-traffic sensitive (local loop) portion of the plant as well as other joint and commonly used portions of plant, and 2) the direction of subsidy flows, if at all, from competitive message toll tariffs.

This can take form through the support of S. 1660 and H. 3621, as marked and amended. We believe it is reasonable to have a moratorium placed on the access charge issue until some determination is made with respect to whether or not local telephone rates have to be raised because of divestiture.

This Commission can support most features of S. 1660, but we are inclined to more strongly support H. 3621, because it addresses more specifically the deep concerns that most state regulatory commissions have. We believe it imperative that Congress, in any legislation, take steps to reverse the access charge order, and take necessary steps to insure that state regulatory commissions maintain jurisdictional control over all intrastate inter-LATA regulation.

Rate base regulation of utilities, such as the telephone industry, is common throughout the 50 states. Under this type of regulation, the utility is entitled to recover their legitimate operating expenses, in addition to a reasonable return on their investment.

On January 1, 1984, implementation of divestiture will begin. The telecommunications environment will now consist of rate base regulation for the local exhange monopoly, and non-regulation for the interstate long distance network. Congress and state commissions must be fully aware of the pending impact of cost for local telephone service.

There is a strong tendency, at this time, for AT&T to shift unnecessary cost burdens to the BOC which would be placed in the rate base and be recovered, under law, in all states, to the detriment of local rate-payers, even though we believe the evidence would prove that more of the investment costs in local exchange facilities should be more appropriately borne by the interstate long distance carrier.

The South Dakota PUC has been fully aware of these looming possibilities, and has done everything possible to protect the public interest. The Commission, about a year ago, petitioned the Federal court to designate South Dakota as a single LATA state and we were successful in that effort.

Relatively speaking, we think that this will prove to be the single, most beneficial aspect to South Dakota in the entire reorganization of the telecommunications industry in the State. It eliminates the need for intrastate inter-LATA access charges, and Northwestern Bell will operate the intrastate network.

This network will make a net contribution of over 6 million dollars per year to the South Dakota BOC, and will lessen the burden on local telephone rates in the revenue requirement. Additionally, the designation of a single LATA state will save, in our opinion, as much as eight dollars per month, with the elimination of intrastate inter-LATA access charges.

These comments are respectfully submitted by the South Dakota Public Utilities Commission knowing that the Congress will recognize the gravity of the issue and with the hope that august body will respond positively to the concept of Universal Telephone Service at affordable rates for all Americans as embodied in H. 3621 and S. 1660.

Respectfully,

Ken Stofferahn, Chairman

Jeff Solem, Vice-Chairman

Dennis Eisnach, Commissioner

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

In the Matter of Petition of the State of Michigan Concerning the Effects of Certain Federal Decisions on Local Telephone Service.	)	CC Docket No. 83-788

ADDITIONAL COMMENTS OF THE
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

The South Dakota Public Utilities Commission ("SDPUC") files these Comments in response to the Notice of Inquiry entered in this case on August 1, 1983. The Notice of Inquiry originally set September 26, 1983 as the deadline for filing additional comments. However, on September 21, 1983, the Commission extended the deadline for filing comments until October 6, 1983.

I.

THE EFFECT OF PRICE ON TELEPHONE DEMAND

The full impact of the various telephone ratemaking issues which are the subject of review in this proceeding and other ratemaking issues associated with the American Telephone and Telegraph Company ("AT&T") divestiture have not yet been felt in South Dakota. The major local exchange carrier in South Dakota, Northwestern Bell Telephone Company

("NW Bell") has now pending before the SDPUC an application which would increase local exchange residential telephone rates by approximately 70%.

The NW Bell monthly average one-party residential recurring charge in South Dakota was $6.88 in 1970. 1/ As a result of a succession of rate increase applications filed by NW Bell, average residential one-party rates are now about $9.92 per month. Appendix I is a copy of the present South Dakota NW Bell local exchange tariff sheets in effect since November, 1982. Until recently, the relatively gradual residence rate adjustments paralleled the gradual elevation of household family income in South Dakota. As a consequence of the last rate increase, a noticeable decline in residence main stations has been reported by NW Bell. This reduction does not appear to be purely a definitional change due to the disposition of CPE on sale to patrons. The total number of network access lines shows a similar decline.

1/ Report of National Economic Research Associates, "Economic Determinants of Telephone Availability", Bell Exhibit 21, FCC Docket No. 20003, Appendix C.

TABLE I

COMPARISON OF NUMBER OF MAIN STATIONS

Northwestern Bell	Total Residence	Total Business	Total	Total-Terminals
April 1983	167,616	31,136	198,752	230,085
April 1982	174,909	32,114	207,023	229,851
April 1981	175,864	32,368	208,232	226,781

Golden West Telecommunications Cooperative, Inc.

	Total Residence	Total Business	Total
December 1982	8,264	1,687	9,951
December 1981	8,324	1,635	9,959
December 1980	8,313	1,629	9,942

City of Brookings, South Dakota

	Total Residence	Total Business	Total
December 1982	8,407	582	8,989
December 1981	no data	no data	8,149
December 1980	no data	no data	8,163

Bison State Telephone Company (Independent)

	Total Residence	Total Business	Total
December 1982	5,634	1,444	7,078
December 1981	5,788	993	6,781
December 1980	5,640	982	6,622

Dakota Cooperative Telecommunications, Inc.

	Total Residence	Total Business	Total
December 1982	4,828	505	5,333
December 1981	4,918	597	5,515
December 1980	4,909	589	5,498

Table I is a summation of residence mains and access lines reported by NW Bell for the corresponding months of April 1981, 1982 and 1983. As a basis for comparison, data is also shown for two telephone cooperatives, a municipal telephone utility and an independent commercial company showing telephone service changes in recent years. The cooperatives, who have also required upward rate adjustments in recent years also reflect some dimunition of service demand.

The effect of NW Bell's current rate application before the SDPUC would, if granted in full, increase one party residence rates for local exchange service from an average of $9.92 to an average of $16.67, an increase of approximately 68%.

The SDPUC does not have available at this time the results of any independent investigations of price demand elasticity for residence exchange telephone service in South Dakota. However, demand studies financed by AT&T and submitted by AT&T as evidence in the recent Department of Justice anti-trust action appear reasonable. Those results are shown in Table II. The AT&T study, commonly refered to as the "PERL Study" are somewhat now disavowed by AT&T as being based upon vintage data. The logic of the relationships shown in these results, together with the SDPUC's general knowledge of early telephone events, appears to be consistent with the statistical relationships shown by the PERL study.

TABLE II

ESTIMATED PERCENTAGE OF HOUSEHOLDS WITH BASIC TELEPHONE SERVICE

Demographic Characteristics	Base	Price Increase 50%	100%	200%
All	91.52	82.15	83.69	70.92
Young	85.39	80.12	73.54	56.92
Black	86.37	81.33	75.08	58.89
Rural	88.84	84.53	79.10	64.28
Moderately Poor	83.31	78.12	77.11	53.93
Young	72.18	64.14	55.22	38.97
Black	75.25	67.71	53.12	40.74
Rural	79.25	72.48	64.50	46.34
Very Poor				
Young	64.99	56.14	46.88	29.56
Black	69.21	60.78	51.66	33.89
Rural	73.35	66.07	57.31	38.96

Source:

AT&T Exhibit in Anti-Trust Suit of DOJ vs. AT&T cited in FCC Third Report and Order CC Docket No. 78-72 Phase I, page 233.

Logically, customer reaction to telephone price adjustments are, in part, a function of income of the using household. In terms of the demographic characteristics set out in Table II, South Dakota might be characterized as, on average, a rural, moderately low income state. This description appears to be borne out by the recent, unpublished Census Bureau data of South Dakota household income. This information is shown in Table III.

TABLE III

NUMBER AND DISTRIBUTION OF HOUSEHOLD INCOME
SOUTH DAKOTA, 1979

Household Income	All Families	Distribution
Less than $5,000	42,091	17.3%
$5,000 to $7,499	25,610	10.6%
$7,500 to $9,999	24,109	9.9%

Household Income	All Families	Distribution
$10,000 to $14,999	44,320	18.2%
$15,000 to $19,999	35,850	14.7%
$20,000 to $24,999	28,110	11.5%
$25,000 to $34,999	27,491	11.2%
$35,000 to $49,999	10,375	4.3%
$50,000 or more	5,492	2.3%
Median	13,156	
Mean	15,899	

Source:

Unpublished Data, 1980 Census of Population and Housing, Bureau of the Census, U.S. Dept. of Commerce.

It will be noted that over 1/3 of South Dakota families had income under $10,000 as reported in 1980. Median household income in South Dakota was in the neighborhood of $13,000, about 20% below the national average household income. 2/

The SDPUC has not yet ruled on the NW Bell application pending before it, and therefore has not made any judgments on the evidence formulated by NW Bell in support of its application. Therefore, it would be premature to express any view or forecast of residence telephone demand in response to future price changes. However, case histories in Commission archives are mindful of parallel events which took place not only in this jurisdiction, but throughout the

2/ As reported in the 1982 Statistical Abstract, Table No. 729.

country, during the period of major economic depression during the years 1929 through 1939. While history never quite repeats itself, certain events are reminiscent of what could occur. Initially, South Dakota and the country as a whole, were visted during that period by a vast decline in the level of agricultural income. This fall-off in farm income produced an initial decline in both farm and urban telephone development. The local exchange carriers, led by NW Bell, sought and successfully achieved upward adjustments in local exchange charges. The bases for these requests was the need to recover fixed charges from a diminished number of served customers. Today, the proportion of fixed costs as a proportion of total telephone utility costs is at least twice as high as was characterized by the manual magnetic and common battery apparatus typical of the earlier decade. All dial service has supplanted manual telephony; computers now substitute for many of the early commercial and revenue accounting functions of the 1930's. But it may be of some significance to the Commission that resistance to rate increases in the Depression Era took the form of large scale service discontinuance throughout the country.

TABLE IV

NUMBER OF TELEPHONES IN THE U.S. AT CLOSE OF YEAR 1929-1939

Year	No. of Telephones (000)	Index 1929=100
1929	20,233	100.0
1930	20,201	99.8
1931	19,707	97.4
1932	17,424	86.1
1933	16,968	83.8
1935	17,424	86.1
1936	18,433	91.1
1937	19,453	96.1
1938	19,953	98.6
1939	20,831	102.9

Source:

Statutes of Communications, FCC, 1981 Edition, Table 5, page 6

It was observed that the initial decline in telephony during the Depression Era in South Dakota was brought on by major reductions in family income accompanied by relatively minor increases in basic residence and business exchange rates. Further, the need and significance of rapid communications has been materially increased in the intervening 50 years. Nevertheless, economic barriers may be very formidable agents of change. South Dakota families have been subject to income adversity in recent years. All households are subject to multiple economic demands. Exchange telephone rate increases of the magnitude proposed by NW Bell, when magnified by additional increases mandated by the Commission, could build the dynamics of a parallel recession in telephone demand which characterize the industry during the Depression Era.

II.

FEDERAL REGULATORY POLICIES

As noted in previous filings, the SDPUC has sought to examine the Commission's decisions which have so materially affected the proposed level of local exchange rates in South Dakota. The examination was undertaken to determine what recognition was offered to the varied economic and social conditions of the different states and to the distinctive telephonic requirements of a moderately low income agricultural state such as South Dakota. For this purpose, the SDPUC carefully studied the Commission's positions on (1) access charges, (2) depreciation, and (3) removal of CPE from separations. The SDPUC offers the following views on each of these issues.

A. Access Charges

The views of the Commission with respect to imposition of end user access charges are contained in its Third Report and Order, CC Docket 78-72. Heretofore, the allocated portion of local exchange plant costs assigned to interstate message toll operations has been contained in the message usage rates. These allocated costs, termed non-traffic sensitive costs since January 1971 with introduction of the Ozark Separations Procedures, the Commission now maintains, should be borne by the end user and disaggregated from the message-mileage rates. Exclusion from the message charges has been justified on the grounds that the generation of these costs is independent of usage; they are a fixed function of the individual customer line.

The SDPUC is troubled by the foregoing rationalization. The SDPUC's concern arises from several scores. On the one hand, the Commission is disaggregating the allocated portion of non-traffic sensitive exchange plant costs and will be applying them as fixed monthly charges against the individual exchange ratepayer. The bulk of this same telephone exchange plant is borne by exchange ratepayers through recurring monthly exchange rates. On numerous occasions, the Commission has recommended improvements to local exchange ratemaking to state regulatory commission. 3/ A salient element of these recommendations has been to suggest that a "sounder" basis for levying exchange charges would be on a measured usage basis, rather than imposition of flat monthly recurring charges. The SDPUC cannot escape the fact that the identical local exchange tele-

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3/ These suggestions have been conveyed through the routine Commissioner and staff meetings of the NARUC Committee on Communications.

phone plant is employed jointly in rendition of interstate message toll as is used in the provision of local exchange service. The allocated interstate portion, the Commission now avers, can be properly billed only through flat end user (CALC) fees. The states have formal authority over the residual portion of these local exchange plant costs. The FCC appears to recognize no inconsistency in promoting the use of measured service to state commissions for recovery of the balance of these exchange plant costs.

A salient consideration underlying the numerous plans considered by these commissions in CC Docket 78-72 is the impact of each of the proposals on the major extant common carriers. These carriers have been confronted by active market competition by new interexchange suppliers such as EXECUNET, SPRINT, and others. The Commission prediction is that when non-traffic sensitive costs are disaggregated, usage rates of the principle carriers may drop substantially and enhance the market competitive position of the established carriers. Except for minor offerings in the City of Sioux Falls, the other common carriers ("OCC") have displayed little interest in extending their markets to rural South Dakota. The OCC's have stumbled on the limited business opportunities of the state, just as the conventional common carriers had largely bypassed exchange service opportunities in the years of exchange telephone development. Here, it would appear, the Commission has been responsive to the market requirements of the established carriers, as it has done throughout its history of separations charges. But the SDPUC has assumed that the statutory responsibility of the Commission is directed to meeting the public interest, not the commercial interest of primary interexchange vendors.

B. Accelerated Depreciation Recovery

The Commission has found it necessary to accelerate the recovery of capital through depreciation charges. The impetus for this modification of its practice has been the introduction of market competition, the advent of newer technology and shifts in requirements from voice-grade services to increasing proportions of data transmission. Thus, the use of straight line vintage group ("SLVG") principles is to be replaced by equal life group ("ELG") and remaining life depreciation methods. The Commission has exercised its jurisdiction to preempt state ratemaking control over depreciation matters in CC Docket No. 79-105.

The Commission's effort to speed recovery of telephone central office investment will have serious adverse financial impacts in South Dakota. A significant majority of local central offices in South Dakota are Strowger step by step community dial offices. They have been depreciated on the basis of an estimated 25 year average service life. On a remaining life basis, the Company has shortened future life expectations to about 5 or 6 years. A few urban communities in the state are now served by analogue electronic switching centers with a previous estimate of average service life of 37 to 39 years. The Company sees a future "Information Age" market in the digital world and has shortened ESS lives to 10 to 12 years. The future digital world envisioned by Northwestern Bell will exceed the requirements of most South Dakota residential telephone needs. The historic practice of depreciating plant on a straight-line vintage group basis assures the carrier that it will recover its complete investment and earn a return on the unamortized portion. Only a tiny segment of the business community will benefit by the planned premature retirement of the exchange analogue central office equipment. When the Commission adopts a nation-wide, uniform depreciation policy, it remains oblivious to the needs of the majority of residential and business telephone ratepayers in South Dakota.

C. Removal of CPE From Separations

The joint FCC-NARUC Board has been examining many of the underlying principles governing telephone separations in CC Docket No. 80-286. A major change which has been introduced (Order of November 10, 1982, Appendix page 45, Section 25.32 of Separations Manual) is to phase out the recorded investments in customer premises equipment (A/CS 231 and 234) from allocation to interstate message services. By January, 1988 CPE will be wholly assigned to intrastate operations. It was the United States Supreme Court that, in the 1930 decision of Smith v. Illinois Bell Telephone Company, 282 US 133, concluded that a portion of the investment and related expenses in the provision of certain telephone instruments should be borne by he interstate message services. Prior to that time interstate telephone rates were established on the "Board-to-Board" basis. Under the latter doctrine only the costs of inter exchange plant facilities and toll switchboard equipment had been included in the costing of long distance message toll service. The joint cost facilities including telephone handsets PBX equipment were borne solely by exchange rates. The latest revision to the separations proposals is essentially a reversion to the original board-to-board method of telephone ratemaking. While divestiture of the Bell System will realign operating responsibilities for provision of customer terminal equipment, the effective pricing standards under CC Docket 80-286, transfers ultimate cost responsibility wholly to the end user, or exchange ratepayer. Where the common carrier does not supply the terminal instrument and ownership is vested in the customer, obviously no additional costs are required for jurisdictional allocation. In South Dakota, Northwestern Bell, and after January 1, 1984 AT&T Communications, will furnish customer terminal equipment. Traditionally, separations has recognized the material effect on local plant of the need to effect compatibility and service requirements of the long distance network. That obligation should continue. The burdens imposed on local plant, including CPE, in accounting to interstate toll should be reflected by corresponding message charges.

III.

CONCLUSION

The purpose of these comments has been to outline the concern of the SDPUC over the possible impact which recent decisions of this Commission may have on local exchange rates in South Dakota. The rate impact of the decisions of this Commission, when considered in conjunction with NW Bell's proposed intrastate rate increase application now pending before the SDPUC, may threaten continued universal telephone service in South Dakota. The SDPUC urges the Commission to reassess the aggregate impact of its recent decisions in light of this possible result.

Dated at Pierre, South Dakota, this 4th day of October, 1983.

Respectfully submitted,

Walter Washington

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TESTIMONY OF

PETER K. PITSCH
CHIEF, OFFICE OF PLANS AND POLICY
FEDERAL COMMUNICATIONS COMMISSION

BEFORE

THE JOINT ECONOMIC COMMITTEE

REGIONAL FIELD HEARINGS

SIOUX FALLS, SOUTH DAKOTA	OCTOBER 14, 1983
DES MOINES, IOWA	OCTOBER 17, 1983

I WOULD LIKE TO THANK YOU FOR THIS OPPORTUNITY TO DISCUSS THE IMPORTANT CHANGES BEING MADE TO OUR NATION'S TELEPHONE SYSTEM. THE FEDERAL COMMUNICATIONS COMMISSION'S RECENT DECISION CONCERNING TELEPHONE ACCESS CHARGES HAS SPARKED CONSIDERABLE CONTROVERSY, AROUSING FEARS THAT THE WIDELY SHARED GOAL OF UNIVERSAL, AFFORDABLE TELEPHONE SERVICE MAY BE JEOPARDIZED. IT HAS ALSO BEEN SUGGESTED THAT THE DECISION IS UNFAIR BECAUSE IT PENALIZES THOSE CUSTOMERS WHO MAKE LONG DISTANCE CALLS INFREQUENTLY. I WOULD LIKE TO BEGIN MY TESTIMONY BY EXPLAINING WHY THE FEDERAL COMMUNICATIONS COMMISSION ADOPTED ITS ACCESS CHARGE DECISION. IN THE SECOND HALF OF MY TESTIMONY I WILL BRIEFLY ADDRESS THE EFFECTS OF THE ACCESS CHARGE DECISION ON THE CITIZENS OF THE STATES OF THIS REGION.

WHY THE ACCESS CHARGE DECISION

NO BRIEF TESTIMONY CAN ADEQUATELY EXPLAIN THE MANY COMPLEXITIES IN THIS AREA, BUT I WISH TO CLARIFY THE FOUR MOST IMPORTANT POINTS THAT UNDERGIRD THIS DECISION: (1) THE ACCESS CHARGE DECISION MORE FAIRLY ALLOCATES TELEPHONE COSTS TO THOSE USERS WHO CAUSE THEM; (2) IT CREATES SEVERAL SAFETY MECHANISMS TO ASSURE THAT ACCESS TO THE TELEPHONE NETWORK REMAINS AFFORDABLE FOR ALL; (3)

(3) IT FOSTERS FAR MORE EFFICIENT USE OF AMERICA'S INTERSTATE TELECOMMUNICATIONS NETWORK; AND (4) IT EFFECTIVELY STEMS THE FLIGHT OF LARGE USERS FROM THE NETWORK, WHICH WOULD ALMOST CERTAINLY OCCUR UNDER THE EXISTING PRICING SCHEME, AND WHICH CONSTITUTES A SERIOUS THREAT TO THE GOAL OF UNIVERSAL SERVICE.

THE FIRST POINT I WOULD LIKE TO MAKE IS THAT THE ACCESS CHARGE DECISION IS FAIR, BECAUSE IT PLACES THE FIXED COSTS OF OBTAINING ACCESS TO THE TELEPHONE NETWORK ON THE COST CAUSER. THE FIXED COSTS OF PROVIDING THIS ACCESS TO THE SINGLE UNIFIED INTERSTATE AND LOCAL NETWORK INCLUDE YOUR TELEPHONE, THE WIRING INSIDE YOUR HOUSE OR BUSINESS, AND THE COPPER WIRE AND POLES FROM THERE TO THE LOCAL TELEPHONE SWITCH. UNDER THE CURRENT SYSTEM PART OF THESE COSTS HAVE BEEN CHARGED TO LONG DISTANCE USERS ON A PER MINUTE BASIS. THIS IS UNFAIR AND INEFFICIENT BECAUSE ALL TELEPHONE CUSTOMERS IMPOSE THESE COSTS ON THE NETWORK IRRESPECTIVE OF HOW MANY LONG DISTANCE OR LOCAL CALLS THEY MAKE. IN 1983 ROUGHLY ONE-QUARTER, OR NEARLY 11 BILLION DOLLARS, OF THOSE FIXED COSTS WERE PAID FOR BY LONG DISTANCE USERS -- INCREASING LONG DISTANCE RATES BY APPROXIMATELY 15 CENTS A MINUTE!

NEXT JANUARY A PORTION OF THOSE FIXED COSTS WILL BE SHIFTED TO THE RESIDENTIAL AND BUSINESS USERS WHO ENJOY ACCESS. AT FIRST, RESIDENTIAL USERS WILL BE CHARGED $2.00 A MONTH. THAT FIGURE WILL RISE TO $3.00 IN 1985 AND $4.00 IN 1986. THESE INCREASES ARE A FAR CRY FROM THE DOUBLING AND TRIPLING OF RATES WE HAVE BEEN SEEING IN NEWSPAPER HEADLINES. THEREAFTER, NECESSARY INCREASES WILL BE PHASED IN ONLY IF OUR MONITORING EFFORTS ASSURE US THE NATION'S UNIVERSAL SERVICE GOALS ARE NOT IN JEOPARDY. THESE FLAT MONTHLY CHARGES SPELL THE BEGINNING OF THE END OF THE HEAVY TAX ON FREQUENT LONG DISTANCE CALLERS AND OF THE COMPLICATED FLOW OF SUBSIDIES TO OTHERS, MOST OF WHOM CAN READILY PAY THEIR SHARE OF ACCESS COSTS. IN GENERAL, IT IS ONLY FAIR THAT THOSE WHO IMPOSE COSTS PAY FOR THEM. INDEED, 55 PERCENT OF THE RESPONDENTS IN A RECENT NEW YORK TIMES/CBS NEWS POLL SAID THEY DID NOT FAVOR SUBSIDIZING LOCAL TELEPHONE RATES.*

THE SECOND POINT I WOULD LIKE TO MAKE IS THAT THE ACCESS CHARGE DECISION PROTECTS UNIVERSAL SERVICE GOALS. AS WE HAVE REPEATEDLY EMPHASIZED, THE COMMISSION WANTS TO KEEP ACCESS TO OUR TELEPHONE NETWORK AFFORDABLE TO ALL RESIDENTIAL USERS. SEVERAL ACTIONS WITHIN OUR JURISDICTION WERE TAKEN TO

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* NEW YORK TIMES, OCTOBER 4, 1983 AT D1.

ASSURE THIS GOAL. THE MONTHLY FLAT CHARGES START LOW, INCREASE SLOWLY OVER A SIX YEAR PERIOD, AND ALL THE WHILE THE COMMISSION WILL BE MONITORING THE NETWORK FOR POSSIBLE ADVERSE EFFECTS. FURTHERMORE, STATE REGULATORS MAY REQUEST WAIVERS OF THESE CHARGES IN ORDER TO PROVIDE "LIFELINE" SERVICE OFFERINGS TO THOSE USERS WHO MAY FIND THESE COSTS UNAFFORDABLE. THE ORDER ALSO CREATES A UNIVERSAL SERVICE FUND THAT DIRECTS SUBSIDIES TO SPARSELY SETTLED, RURAL AREAS WHERE THE COSTS OF ACCESSING THE LOCAL SWITCH ARE HIGHER. I WILL LATER DISCUSS THIS FUND'S EFFECT ON THESE REGIONS IN MORE DETAIL. BUT FOR NOW SUFFICE IT TO SAY THAT TOGETHER THESE PROVISIONS SHOULD KEEP LOW INCOME AND RURAL CUSTOMERS ON THE NETWORK WITHOUT DISTORTING THE PRICE OF LONG DISTANCE SERVICE TO EVERYONE.

THE THIRD POINT I WOULD LIKE TO MAKE IS THAT THE ACCESS CHARGE DECISION IS EFFICIENT. THE BENEFITS OF COST-BASED PRICING FOR LONG DISTANCE SERVICE WILL BE DRAMATIC. TODAY LONG DISTANCE CHARGES MAY BE AS MUCH AS 60% HIGHER THAN THE COST OF PROVIDING THE SERVICE.* THIS METHOD OF PAYING FOR ACCESS HAS EXCESSIVELY DISCOURAGED LONG DISTANCE CALLING. THE COLLECTIVE WASTE FROM SUCH UNDERUTILIZATION OF LONG DISTANCE SERVICE HAS BEEN ESTIMATED TO BE AS MUCH AS

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* SEE <u>COMMENTS</u> OF AT&T IN RESPONSE TO 4TH SUPPLEMENTAL NOTICE IN DOCKET 78-72.

A BILLION DOLLARS A YEAR.* BY THIS I MEAN THAT IF LONG DISTANCE RATES WERE COST-BASED THE BENEFIT TO CUSTOMERS FROM MAKING ADDITIONAL CALLS WOULD EXCEED THE COST OF PROVIDING THE EXTRA SERVICE BY ABOUT A BILLION DOLLARS A YEAR.

IN RESPONSE TO THE FIRST PHASE OF THE ACCESS CHARGE PLAN, AT&T HAS ANNOUNCED 10 TO 15 PERCENT CUTS IN LONG DISTANCE RATES. FOR EXAMPLE, A FIVE MINUTE DIRECT DIALED DAY CALL FROM SIOUX FALLS OR DES MOINES TO CHICAGO WOULD COST $1.98 RATHER THAN $2.27 OR 12.8 PERCENT LESS.** MORE LONG DISTANCE RATE CUTS WILL FOLLOW AS THE DECISION IS PHASED IN. AS THESE COSTS COME DOWN, PEOPLE WILL CALL MORE, MAKE LONGER CALLS AND RECEIVE MORE CALLS. WE HAVE ALREADY SEEN THIS HAPPEN WHEN SUBSCRIBERS CHOOSE LOWER-COST ALTERNATIVE NETWORKS SUCH AS MCI. THE SHORT OF IT IS THAT ALL LONG DISTANCE USERS -- AND THAT INCLUDES MANY LOW INCOME PERSONS -- WILL BENEFIT.

THE INDIRECT EFFECTS FROM MORE INTENSIVE USE BY BUSINESS WILL ALSO TRANSLATE INTO ENORMOUS GAINS TO ALL AMERICANS WHEN THE INNUMERABLE ENTREPRENEURS IN OUR THREE TRILLION DOLLAR ECONOMY BEGIN TO ADJUST TO THESE

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* JAMES M. GRIFFEN, "THE WELFARE IMPLICATIONS OF EXTERNALITIES AND PRICE ELASTICITIES FOR TELECOMMUNICATIONS PRICING" 64 REVIEW OF ECONOMICS AND STATISTICS 59 (1982).

** BASED ON ATTACHMENTS TO LETTER TO MARK S. FOWLER, CHAIRMAN OF FCC, FROM JAMES R. BILLINGSLEY, VICE PRESIDENT OF AT&T, OCTOBER 3, 1983.

ENORMOUS PRICE REDUCTIONS BY FINDING INNOVATIVE WAYS TO USE LONG DISTANCE SERVICE.

FOR EXAMPLE, BUSINESSES, GOVERNMENT AND EDUCATIONAL INSTITUTIONS INCREASINGLY RELY UPON LOW COST TELECOMMUNICATIONS TO DO THEIR WORK. TELECONFERENCING IS INCREASINGLY USED IN PLACE OF ACTUAL MEETING FOR TRAINING PURPOSES. IT SAVES TIME AND MONEY AND THUS KEEPS COSTS AND PRICES DOWN. INFORMATION NETWORKS HAVE BECOME THE BACKBONES OF BUSINESS AND GOVERNMENT. FURTHERMORE, PROFESSIONALS IN MANY FIELDS NOW RELY EXTENSIVELY UPON INFORMATION MADE AVAILABLE BY LOW COST LONG DISTANCE TELECOMMUNICATIONS. MEDICAL DOCTORS CAN CALL UP SERVICES SUCH AS "MEDLINE" AND "COLLEAGUE" TO GET ACCESS TO STATE-OF-THE-ART DIAGNOSTIC INFORMATION AND THE MOST RECENT RESEARCH. THAT MEANS HIGHER QUALITY MEDICAL CARE. LAWYERS, ENGINEERS AND PROFESSIONALS OF ALL KINDS ARE USING LONG DISTANCE COMMUNICATIONS TO ACQUIRE INFORMATION THAT ENABLES THEM TO SUPPLY BETTER SERVICES AT LOWER COSTS. AS THE COSTS OF ELECTRONIC COMMUNICAITON FALL, THESE SERVICE BENEFITS CAN BE MADE AVAILABLE ON AN INCREASINGLY WIDESPREAD BASIS. WHAT THIS MEANS FOR THE AMERICAN PEOPLE IS BETTER SERVICES OF ALL KINDS AT LOWER COSTS NO MATTER WHERE YOU LIVE. ALSO, RURAL STATES WILL BECOME EVEN MORE ATTRACTIVE SITES FOR

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LOCATING NEW BUSINESSES. GIVEN THEIR EXPERIENCE WITH COMPANIES SUCH AS CITIBANK, THE PEOPLE OF SOUTH DAKOTA KNOW HOW SIGNIFICANT SUCH AN INFLUX CAN BE.

THE FOURTH POINT I WOULD LIKE TO MAKE IS THAT THE ACCESS CHARGE DECISION WILL ALSO REDUCE THE UNECONOMIC BYPASS OF THE TELEPHONE NETWORK AND DIVERSION OF REVENUES THAT THE PRESENT SYSTEM IS CAUSING. BECAUSE LARGE LONG DISTANCE USERS PAY THEIR SHARE OF ACCESS COSTS MANY TIMES OVER, THEY HAVE AN ENORMOUS INCENTIVE TO TURN TO CHEAPER ALTERNATIVES. WE SIMPLY CANNOT AFFORD TO GIVE LARGE TELEPHONE USERS AN ARTIFICAL INCENTIVE TO JUMP SHIP. IF THEY DO, THE COSTS WILL STILL BE THERE, AND THE REMAINING USERS WILL BE SOCKED EVEN HARDER. OUR DECISION MAKES IT ATTRACTIVE FOR BIG USERS TO LEAVE THE NETWORK ONLY IF BYPASSING IT IS MORE EFFICIENT. THE ALTERNATIVE OF TAXING SUCH BYPASS FACILITIES, PROPOSED BY SOME IN CONGRESS, IS NEITHER FEASIBLE NOR DESIRABLE. DEFINING AND THEN FINDING BYPASSERS WOULD BE NO EASY TASK. EVEN IF FEASIBLE, BYPASS TAXES COULD KILL EFFICIENT NEW TECHNOLOGIES. FOR EXAMPLE, THE TEXT OF THE WALL STREET JOURNAL IS TRANSMITTED TO PRINTING PLANTS BY SATELLITE. THIS SERVICE, ALBEIT AT HIGHER COSTS, COULD BE PROVIDED BY THE TELEPHONE NETWORK. IS THAT PAPER'S DISTRIBUTION NETWORK UNECONOMIC BYPASS? WE CAN'T REALLY TELL

UNDER THE PRESENT SYSTEM. THE MOST PRUDENT SOLUTION TO UNECONOMIC BYPASS IS TO PRICE SERVICES AT COST, REMOVING THE INCENTIVE TO TURN TO INEFFICIENT ALTERNATIVES.

THE EFFECTS ON IOWA, MINNESOTA, NEBRASKA, NORTH DAKOTA AND SOUTH DAKOTA

NOW I WOULD LIKE TO TAKE A MOMENT TO DISCUSS THE EFFECT OF THE ACCESS CHARGE DECISION ON THE CITIZENS OF THE STATES IN THIS REGION. SOME FEAR THAT UNDER THE ACCESS CHARGE DECISION RATES IN LESS DENSELY POPULATED STATES WILL RISE MORE THAN IN OTHER REGIONS, BECAUSE SUCH STATES HAVE HIGHER LOOP COSTS PER CUSTOMER. HIGHER RATES, IT IS ARGUED, WILL JEOPARDIZE UNIVERSAL SERVICE IN RURAL AREAS. THIS CRITICISM OF THE ACCESS CHARGE IS MISPLACED FOR SEVERAL REASONS.

FIRST, IT SHOULD BE NOTED THAT SOME RURAL STATES -- INCLUDING IOWA, MINNESOTA, AND NEBRASKA -- HAVE LOOP COSTS THAT ARE AT OR UNDER THE NATIONAL AVERAGE.* AFTER ONE FACTORS IN WHAT LONG DISTANCE CUSTOMERS WILL BE PAYING INTO THE UNIVERSAL SERVICE FUND, THE PEOPLE OF THOSE THREE STATES ARE NET

* SEE ATTACHMENT C OF LETTER TO JOYCE I. BUTLER, CHIEF, DOCKETS BRANCH FROM JACK D. SMITH, CHIEF, COMMON CARRIER BUREAU, OCTOBER 6, 1983.

LOSERS UNDER THE SENATE BILL. IOWANS PAY OUT FOUR TIMES MORE THAN THEY RECEIVE. MINNESOTANS PAY OUT ALMOST TWICE AS MUCH AS THEY RECEIVE AND NEBRASKANS PAY OUT 20 PERCENT MORE THAN THEY RECEIVE.*

SECOND, AS I HAVE ALREADY NOTED, THE COMMISSION'S DECISION CREATES A UNIVERSAL SERVICE FUND ESPECIALLY DESIGNED TO ADDRESS THIS PROBLEM. INDEED, OF THE FIVE STATES OF PARTICULAR CONCERN IN THESE HEARINGS, FOUR WILL RECEIVE MORE FROM THE FCC/JOINT BOARD UNIVERSAL SERVICE FUND THAN THEY WOULD UNDER THE MOST RECENT SENATE BILL. MINNESOTA WOULD RECEIVE MORE THAN NINE TIMES AS MUCH. THE PRECISE AMOUNTS FOR EACH STATE ARE CONTAINED IN TABLE 1 APPENDED TO MY TESTIMONY. OF COURSE, TO THE EXTENT A STATE RECEIVES LESS MONEY UNDER THE PROPOSED LEGISLATION, ITS LOCAL TELEPHONE RATES WOULD HAVE TO BE HIGHER TO COVER THE SHORTFALL. WHILE END USERS WOULD NOT HAVE TO PAY MONTHLY FLAT FEES UNDER THE SENATE BILL, THEY WOULD LIKELY HAVE HIGHER LOCAL TELEPHONE RATES. ALSO, THE SENATE BILL INTRODUCES AN ADDITIONAL DISTORTION BY DIRECTING HIGH COST ASSISTANCE TO ONLY THOSE TELEPHONE COMPANIES WITH 50,000 OR FEWER LOOPS AND WHICH ARE NOT AFFILIATED WITH A HOLDING COMPANY WITH REVENUES OF 100

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* TABLE III A TO LETTER TO CONGRESSMAN JOHN DINGELL FROM CHARLES BROWN, CHAIRMAN OF THE BOARD OF AT&T, SEPTEMBER 1, 1983. SEE TABLE 2 APPENDED TO THIS TESTIMONY FOR THE INFORMATION RELEVANT TO THESE FIVE STATES.

MILLION DOLLARS OR MORE. IT IS EASY TO IMAGINE HOLDING COMPANIES DIVESTING LOCAL EXCHANGES SO THAT BOTH MAY QUALIFY FOR ASSISTANCE. EVEN IF THEY DON'T DO THIS THERE MAY BE WASTEFUL NEW ENTRY BY SMALL FIRMS. IN EITHER EVENT INEFFICIENT BUSINESS ORGANIZATION WILL BE ENCOURAGED -- TO THE ULTIMATE DETRIMENT OF CONSUMERS.

I AM NOT ARGUING FOR SUBSIDIES FOR ANY PARTICULAR STATE. TO THE CONTRARY, I THINK THAT BROAD BASED, UNFOCUSED SUBSIDIES SHOULD BE THE EXCEPTION NOT THE RULE. MY POINT IN CITING THESE STATISTICS IS TO EMPHASIZE THAT THE FCC MADE A CONSIDERED DECISION TO ADDRESS THE PLIGHT OF HIGH COST STATES AND THIS DECISION CONTINUES TO BE REFINED. THE PROPOSED LEGISLATION, ON THE OTHER HAND, IS BASED ON A HURRIED REVIEW OF THE PROBLEM, INTRODUCES NEW DISTORTIONS, AND WILL BE FAR MORE DIFFICULT TO MODIFY AS CHANGING CIRCUMSTANCES WARRANT. THE COMMISSION WILL BE CONTINUOUSLY MONITORING THE PHASE-IN OVER THE NEXT THREE YEARS AS THE FLAT FEE RISES TO FOUR DOLLARS. IF A SIGNIFICANT NUMBER OF DISCONNECTS OCCUR OR EVEN APPEAR LIKELY, THE COMMISSION COULD RECOMMEND SPECIFIC ACTION. FOR EXAMPLE, CONGRESS AND THE STATES COULD ACT TO TARGET ASSISTANCE TO THOSE CITIZENS WHO NEED IT. THIS APPROACH WOULD PRESERVE THE SUBSTANTIAL EFFICIENCY GAINS FROM COST BASED

PRICING OF LONG DISTANCE SERVICE AND BE MUCH FAIRER AND CHEAPER THAN GIVING SUBSIDIES TO ALL PEOPLE REGARDLESS OF WHETHER THEY NEED THEM.

FINALLY, WE CAN EXPECT TELEPHONE COMPANIES, IF THEY ARE GIVEN THE FLEXIBILITY, TO MAKE IT EASIER FOR MANY CUSTOMERS TO STAY ON THE NETWORK. MANY CRITICS OF THE ACCESS CHARGE PLAN ARGUE THAT THE NETWORK IS WORTH MORE TO EVERYONE IF THE PENETRATION RATE REMAINS HIGH, THAT IS, NEARLY UNIVERSAL. TO THE EXTENT THIS EXTERNALITY IS IMPORTANT, HOWEVER, THE TELEPHONE COMPANIES WILL HAVE A STRONG INCENTIVE TO KEEP CUSTOMERS ON THE SYSTEM. THEY CAN DO THIS BY OFFERING A RANGE OF OPTIONS TO CUSTOMERS THAT ALLOWS USERS TO PAY ONLY FOR WHAT THEY GET. FOR EXAMPLE, NORTHWESTERN BELL OFFERS OR IS PROPOSING SUCH OPTIONS IN THIS AREA TODAY:

- IOWA HAS A $9.55 FLAT RATE FOR UNMEASURED SERVICE AND PROPOSES TO OFFER A $6.05 LOW COST OPTION THAT PROVIDES ACCESS PLUS $2.00 WORTH OF CALLS.

- MINNESOTA HAS "IN METRO" AND "OUTSTATE" FLAT RATES OF $12.35 AND $10.72 AND OFFERS AN IN METRO OPTION OF $7.02 WITH A $3.15 CALL ALLOWANCE AND AN OUTSTATE OPTION OF $5.96 WITH A $2.40 ALLOWANCE.

- NEBRASKA HAS FLAT RATES BETWEEN $6.37 AND $9.86 BUT OFFERS A LOW COST OPTION OF $6.25 WITH A ONE DOLLAR CALL ALLOWANCE.

- NORTH DAKOTA HAS A $12.05 FLAT RATE AND A LOW COST OPTION OF $6.50.

- SOUTH DAKOTA HAS A $11.40 FLAT RATE AND A LOW COST OPTION OF $5.00 WITH 40 FREE CALLS.

IT IS MY UNDERSTANDING THAT NORTHWEST BELL ESTIMATES THAT BY 1986 80% OF THEIR CUSTOMERS IN THESE FIVE STATES WILL HAVE THESE LOW COST OPTIONS AVAILABLE TO THEM.

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IN CLOSING IT IS IMPORTANT TO PLACE THESE RECENT DEVELOPMENTS INTO THE CONTEXT OF THE RECENT PAST. TELECOMMUNICATIONS TECHNOLOGICAL BREAKTHROUGHS HAVE CAUSED A REVOLUTION IN THE REGULATION OF THIS INDUSTRY. INNOVATION AND

THE COMPETITIVE FORCES IT UNLEASHED WERE THE IMPETUS FOR FASTER DEPRECIATION OF TELEPHONE PLANT AND EQUIPMENT, PRICE DEREGULATION OF RESIDENTIAL AND BUSINESS TELEPHONES, AND DEVELOPMENT OF VIBRANT COMPETITION IN LONG DISTANCE TELEPHONE SERVICE. WE KNOW THESE CHANGES HAVE BEEN BENEFICIAL. BECAUSE OF COMPETITION, TODAY YOU CAN BUY A PHONE, WITH FEATURES UNAVAILABLE ONLY FIVE YEARS AGO, FROM NEW SUPPLIERS FOR THE SAME PRICE IT COSTS TO LEASE A STANDARD PHONE FROM THE PHONE COMPANY FOR JUST ONE YEAR. THE COMMISSION'S ACCESS CHARGE DECISION IS THE NEXT LOGICAL STEP IN ENSURING THAT AMERICAN CONSUMERS AND BUSINESSES REAP THE FULL BENEFITS OF THE GROWING COMPETITION AND REMARKABLE NEW TECHNOLOGIES APPEARING IN THE LONG DISTANCE MARKETPLACE. IN ESSENCE, THE COMMISSION IS EXTENDING THE FREE ENTREPRISE SYSTEM TO ANOTHER SECTOR OF THE ECONOMY. IT WILL BE BOTH FAIRER AND MORE EFFICIENT THAN THE EXISTING SYSTEM BECAUSE IT MOVES PRICES TO REFLECT COSTS AND ALLOWS FOR SUBSIDIES, IF THEY NEED TO EXIST, THAT WILL BE OPEN AND TARGETED TO ONLY THOSE CONSUMERS WHO NEED THEM.

THANK YOU.

TABLE 1

STATEWIDE PER LOOP AND TOTAL ANNUAL SUBSIDIES
FOR SELECTED STATES BASED ON 1980 DATA

STATE	PACKWOOD PLAN 1/		FCC/JOINT BOARD PLAN 2/	
	HCRR 3/	THCRR 4/	HCRR 3/	THCRR 4/
IOWA	.57	635,127	.79	883,478
MINNESOTA	.19	327,239	1.79	3,025,652
NEBRASKA	3.66	2,486,129	2.97	2,021,077
NORTH DAKOTA	24.94	6,550,144	28.88	7,584,535
SOUTH DAKOTA	12.07	2,942,736	15.64	3,812,992

1/ THE PACKWOOD PLAN PAYS 90% OF THOSE COMPANY LOOP COSTS BETWEEN 110 AND 250% OF NATIONAL AVERAGE LOOP COSTS AND 100% OF THOSE COSTS ABOVE 250% OF THAT AVERAGE. HOWEVER, TO BE ELIGIBLE FOR THIS ASSISTANCE A COMPANY MUST HAVE 50,000 OR FEWER LOOPS AND NOT BE AFFILIATED WITH A HOLDING COMPANY WITH REVENUES OF 100 MILLION DOLLARS OR MORE. THESE FIGURES ARE TAKEN FROM AN ANALYSIS BY THE FCC COMMON CARRIER BUREAU BASED ON A SAMPLE OF OVER 600 TELEPHONE COMPANIES WITH 98% OF ALL LOOPS. SEE ATTACHMENT D OF LETTER TO WARD WHITE, SENIOR COUNSEL TO SENATE COMMERCE COMMITTEE, FROM JACK D. SMITH, CHIEF, COMMON CARRIER BUREAU, SEPTEMBER 19, 1983.

2/ THE FCC/JOINT BOARD PLAN PAYS 50% OF THOSE COMPANY LOOP COSTS BETWEEN 115 AND 160% OF THE NATIONAL AVERAGE LOOP COSTS, 60% OF THOSE COSTS BETWEEN 160 AND 200%, 95% OF THOSE COSTS BETWEEN 200 AND 250%, AND 100% OF THOSE COSTS OVER 250%. THERE ARE NO ADDITIONAL ELIGIBILITY REQUIREMENTS. THESE FIGURES ARE TAKEN FROM AN ANALYSIS BY THE FCC COMMON CARRIER BUREAU BASED ON A SAMPLE OF OVER 600 TELEPHONE COMPANIES WITH 98% OF THE LOOPS. SEE ATTACHMENT C OF LETTER TO JOYCE C. BUTLER, CHIEF, DOCKETS BRANCH FROM JACK D. SMITH, CHIEF, COMMON CARRIER BUREAU, OCTOBER 6, 1983.

3/ HCRR IS THE ANNUAL HIGH COSTS REVENUE REQUIREMENT OR SUBSIDY PER LOOP.

4/ THCRR IS THE TOTAL ANNUAL HIGH COST REVENUE REQUIREMENT OR SUBSIDY.

TABLE 2

UNIVERSAL SERVICE FUND COMPONENT OF JOINT BOARD PROPOSAL (DOCKET 80-286)
TELEPHONE INDUSTRY - 1984 LEVEL (ESTIMATED)*

(DOLLARS - MILLIONS)

STATE	USF PAYMENTS (A)	CUSTOMER PAYMENTS TO FUND USFØ (B)	RATIO (A÷B)
IOWA	2	9	.22
MINNESOTA	7	11	.64
NEBRASKA	5	6	.83
NORTH DAKOTA	17	3	5.67
SOUTH DAKOTA	9	3	3.00
TOTAL	900	900	XX

* ASSUMING USF WERE IN EFFECT IN 1984.

Ø BASED ON CARRIER CHARGES DISTRIBUTED ON ORIGINATING MINUTES.

"THE CONDITION OF THE
SOUTH DAKOTA TELECOMMUNICATIONS INDUSTRY"

Statement of Dave McNeil
Representing South Dakota State Chamber of Commerce

Senator Abdnor:

As a representative of the South Dakota General Business Community, I appreciate the opportunity to address this forum. My comments will be on the impacts of telephone deregulation, the FCC rule to allow access charges and the overall question of universal telephone service as it affects Business in South Dakota.

Just let me say that it is our opinion that the deregulation of the national telephone system is not in the best interest of a rural state such as South Dakota. In the past few years we have seen rail deregulation, truck, banking, airline and, in our state, the price of milk deregulation. In all these cases, the overall long range results have not been proven to be beneficial.

In the deregulation approach to competitive pricing of controlled utilities such as transportation and communication, the main ingredient to price efficiencies is mass markets. This means population bases. Consequently, it is our belief that, as in the airline situation, our sparse population will prove to be a negative factor in achieving the cost savings of deregulation.

In our estimation the entire benefit of telephone deregulation was designed for major metropolitan markets. We feel our rural population will be pushed to the bottom of the list by those providing low cost long distance service. We have felt that over the years the goal of the telephone industry was universal service. That policy and its implementation worked well, giving South Dakotans the most reliable, affordable telephone service to business and residential users. Moreover, we felt telephone rates were structured properly so that revenues from more profitable service were used to insure local universal service.

I would like to switch to the discussion of systems "by-pass." A state such as ours needs all phone users in the system. With so few major business phone users, every one that opts for private systems or by-passes the telephone company places a considerable burden on the remaining consumer. These by-pass actions in our state will have major impact on any savings, however slight, other phone users may achieve.

We know there is absolutely no way to stop the major phone users from making straight forward economic decisions that will lead to by-passing the traditional phone system.

Another factor is the torrid pace of technology advances. We may be only a few short years away from technology that will allow smaller commercial phone users to by-pass the system. A graphic example of this technological syndrome is the satellite T.V. dish. Only a few years ago they were considered absolute luxuries. Today dishes can be seen across our state. The deepening of the by-pass capabilities to smaller and smaller firms will only further the revenue deterioration of our local system.

In our estimation, one of the ways to offset the revenue losses brought about by competitive long distance service and by by-pass would be to implement the Federal Communication Commission access charge plan in Docket 78-72.

Under the access charge plan adopted by the Federal Communications Commission, AT&T and the other companies which sell long distance service will pay the full costs for their connections to and use of the local exchange. Moreover, for a period of several years the long distance users will continue to pay additional charges to help support local service.

The idea behind this plan, of course, is to bring telephone rates into line with the actual costs of providing each type of service. Artificial subsidies cannot continue for long because they encourage long distance suppliers and large users to bypass the local network, using alternative technologies that have become available. This loss of revenues would lead to drastically higher local rates for remaining customers - and truly endanger universal service.

Some in Congress -- concerned about the fact that one of the features of the FCC's Access Charge Plan is to impose end user charges on local residential and business customers -- introduced legislation to overturn this plan. The plan was modified by the FCC so that the residential end user charge was reduced from $.400 to $2.00 per month, but some in Congress were still not satisfied and have persisted in their legislative effort.

Passage of that legislation would mean that the average local customer eventually would have to pay more for local service. The bills would, in one way or another, push much of the costs of local access facilities back on the long distance customer. The larger long distance users -- and a small percentage of them produce significant amounts of revenues -- would be likely to find it more economic to set up their own private systems bypassing not only the long distance but the local portion of the public network.

When these revenues are lost, the local customer will have to pick up substantially more of the fixed costs of local facilities. Thus that customer's local rates will go up.

In summary:

...We feel deregulation will not prove beneficial to South Dakota phone users -- residential or business.

...All business communication decisions will be made on a purely economic basis.

...Without some transition mechanism like access charges to help move greadually to users assuming a greater share of actual costs, any competitive benefits will be lost.

...We would support FCC 78-72 access charge approach over the proposed Congressional remedies.

TO: The Honorable Senator James Abnor

DATE: October 14, 1983

FORUM: The Condition of the South Dakota Telecommunications Industry

The South Dakota Municipal League has not considered at length, the divestiture of A. T. & T. and the subsequent ramifications. However, on October 7, at our annual convention in Mitchell, the membership did address the Cable TV aspect of telecommunications and unanimously adopted the following policy statements:

1. The SDML opposes any further Federal or State restrictions on the municipalities right to control and regulate Cable TV.

2. The SDML will oppose any attempt by the South Dakota Public Utilities Commission to regulate services provided by cable television systems.

On October 6, Mr. Larry Toll spoke to the convention presenting Northwestern Bell's views and local concerns regarding the telephone systems in South Dakota. Considering the complexity of subject, it was well presented. The time allotted did not allow for any lengthy discussions. The obvious concern among those present was the "access charge."

Through conversation, and inquiries received over the past few months by the League office from municipalities of various sizes, it is apparent that there is a general fear of the unknown. The problem seems to be that of education, or the lack of it. Most communities across the state are only aware that their phone bill is going up. There is little understanding of why an access charge is necessary or what the alternatives are should legislation be passed to disallow the proposed access charge.

Most municipalities do not have a sufficient tax base to procure alternate communication systems and must rely on the local telephone companies.

At a time when additional fiscal burdens are being placed on our cities and towns, it is not palatable, though perhaps inevitable, to be assessed increase communications costs which obviously affect their tax levy and utility rates.

In consideration of the complexities involved in the telecommunications industry, the South Dakota Municipal League is anxious to cooperate with you and the local telephone companies in an educational effort through it's monthly member publication.

Thank you for the opportunity to participate in this forum.

Ertis Osterberg
For the South Dakota Municipal League

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My name is Ben Radcliffe. I am past president of the South Dakota Farmers Union, our state's largest farm organization and represent that organization on the state Telephone Users Panel. The South Dakota Farmers Union sincerely appreciates the opportunity to participate in this information forum.

As an organization of concerned South Dakota citizens, the Farmers Union is anxious that all telephone consumers in our state be dealt with in a fair and reasonable manner. However, as a rural organization, we are particularly concerned with the welfare of our more than 37,000 family farmers and ranchers. While it is true that a substantial proportion of rural people are currently served by Rural Telephone Cooperatives and other independent companies, a large number are also served by Northwestern Bell Company which will first absorb the full impact of the telecommunications deregulation.

The primary concern of the South Dakota Farmers Union is to preserve the concept of universal telephone service and to assure that all telephone customers, no matter how remotely located, continue to receive adequate service at affordable prices.

The Public Utilities Commission is currently considering the $11.3 million in proposed "business as usual" rate increase requested by Northwestern Bell and will soon begin holding hearings on the $7.5 million rate increase sought as a result of the divestiture of the American Telephone and Telegraph Company (AT&T) and the question of access charges. We believe that the national implications with regard to preservation of universal service involved in the divestiture and in decisions by the Federal Communications Commission (FCC) is a major issue in contention and cannot be ignored. If state public utilities commissions accede to huge rate increases by Bell Companies, either as a result of divestiture or for reasons of enhanced profits, the nationwide effect could be disastrous.

The FCC has developed a program of access charges which it wants to impose on companies (including rural telphone cooperatives) who use AT&T's facilities. I would like to suggest that the planners at the FCC have made a grave mistake. The access fee should, in fact, be paid by the long distance company for the privilege of accessing the telephone company's network, with its thousands of potential users of long distance services. The Congress should carefully review the whole concept of access charges and enact legislation that places the burden of accessing the homes of telephone users on the commercial entity that will profit from that connection, which inevitably will be the long distance company. To do otherwise would fly in the face of logic, as well as justice.

Provisions have also been made to establish a Universal Service Fund which would be used to assist high cost companies, but the level of that assistance has not yet been established.

In addition national universal service legislation is being considered in Congress. A number of such bills have been introduced and most contain a provision guaranteeing that no telephone customer would be assessed service charges beyond a specified per cent of the national average. (110 per cent for example). The net result of approval of huge rate increases granted at the state level would be to dramatically increase the national average charge and, thus pave the way for huge rate increases for all South Dakotans including those served by independent telephone companies.

According to AT&T, 92 per cent of American households now have phone service. It has been estimated that a doubling of rates could reduce that to 84 per cent and 65 per cent for the poor. In rural areas, telephone co-op managers have estimated that rates could go up by as much as 400 per cent. About 89 per cent of rural households now have phone service. That figure could be dramatically reduced by projected rate increases.

The Farmers Union is deeply concerned because many of those in greatest jeopardy of losing telephone service would be the poor and the rural elderly. In their cases, loss of telephone service could lead directly to life-threatening situations. It is not uncommon for rural people in sparsely settled areas of South Dakota to reside as much as 50 miles from the nearest doctor or hospital. With the loss of telephone service, these individuals might as well be living on the moon in the event of a medical emergency. In many instances, the time lost in driving to the nearest telephone would prove fatal.

We feel it is crucially important to keep these facts in mind as regulation commissions and Congress move toward decisions with regard to future telephone cost and services, particulary in rural and semi-rural areas.

In conclusion, we ~~also~~ recognize the massive problems created by the upcoming divestiture of the American Telephone and Telegraph Company. The potentially mammoth rate increases ensuing from divestiture pose an issue that is nationwide in scope. What is at stake here is the very survival of the universal telephone service concept. We believe that Congress has a national responsibility to deal with this issue and to assure that all Americans have continued access to reasonably priced telephone service.

For additional insight into the position of the South Dakota Farmers Union on this issue, I am attaching to this testimony for your use and review, a copy of recent testimony of the South Dakota Farmers Union before the South Dakota Public Utilities Commission.

Thank you.

Attachment

Docket No. F-3442
Filed 8-3-83

SOUTH DAKOTA FARMERS UNION

SOUTH DAKOTA FARMERS UNION

TESTIMONY

OF

CHUCK GROTH

My name is Chuck Groth. I am communications director and editor for the South Dakota Farmers Union -- our state's largest farm and ranch organization. The South Dakota Farmers Union sincerely appreciates the opportunity to present testimony as an intervenor in the current rate increase application by Northwestern Bell Telephone Company.

As an organization of concerned South Dakota citizens, the Farmers Union is anxious that all telephone consumers in our state be dealt with in a fair and reasonable manner. However, as a rural organization, we are particularly concerned with the welfare of our more than 37,000 family farmers and ranchers. While it is true that a substantial proportion of rural people are currently served by Rural Telephone Cooperatives and other independent companies, a large number are also served by Northwestern Bell Company and are thus directly concerned with the ultimate decision of the Public Utilities Commission in this case.

The primary concern of the South Dakota Farmers Union is to preserve the concept of universal telephone service and to assure that all telephone customers, no matter how remotely located, continue to receive adequate service at affordable prices.

Although the Public Utilities Commission has determined that the $11.3 million in proposed "business as usual" rate increase will be dealt with separately from the $7.5 million rate increase sought as a result of the divestiture of the American Telephone and Telegraph Company (AT&T) and the question of access charges, we believe that the national implications with regard to preservation of universal service involved in the divestiture and in decisions by the Federal Communication Commission (FCC) cannot be ignored. If state public utilities commission accede to huge rate increases by Bell Companies, either as a result of divestiture or for reasons of enhanced profits, the nationwide effect could be disastrous. As the Commission is aware, the FCC is in the process of developing a program of access charges which it wants to impose on companies (including rural telephone cooperatives) who use AT&T's facilities. Provisions have also been made to establish a Universal Service Fund which would be used to assist high cost companies, but the level of that assistance has not yet been established. In addition national universal service legislation is being considered in Congress. A number of such bills have been introduced and most contain a provision guaranteeing that no telephone customer would be assessed service charges beyond a specified per cent of the national average. (110 per cent for example). The net result of approval of huge rate increases granted at the state level would be to dramatically increase the national average charge and, thus pave the way for huge rate increases for all South Dakotans including those served by independent telephone companies.

According to AT&T, 92 per cent of American households now have phone service. It has been estimated that a doubling of rates could reduce that to 84 per cent and 65 per cent for the poor. In rural areas, telephone co-op managers have estimated that rates could go up by as much as 400 per cent. About 89 per cent of rural households now have phone service. That figure could be dramatically reduced by projected rate increases.

The Farmers Union is deeply concerned because many of those in greatest jeopardy of losing telephone service would be the poor and the rural elderly. In their cases, loss of telephone service could lead directly to life-threatening situations. It is not uncommon for rural people in sparsely settled areas of South Dakota to reside as much as 50 miles from the nearest doctor or hospital. With the loss of telephone service, these individuals might as well be living on the moon in the event of a medical emergency. In many instances, the time lost in driving to the nearest telephone would prove fatal.

We feel it is crucially important for the Commission to keep these facts in mind as you move toward your decision with regard to the Northwestern Bell application.

In the May 12, 1983 application to the Public Utilities Commission, Northwestern Bell officials contended that their request for an $11.3 million increase in local service rates was "reasonable." They also contended that their request was based upon the fact that "inflation has continued at a high rate" since the granting of their last increase.

The Farmers Union believes that both of these assertions must be challenged. We do not believe that a rate increase ranging up to 108% in local service charges can be viewed as "reasonable." Nor do we believe that the current national inflation rate of just over 2 per cent can accurately be described as a "high rate."

If Bell customers feel that they cannot afford the proposed $8.70 increase in monthly local service charges, will they be offered any alternatives?

Yes, Bell does offer a Service Basic Pac. But this combination of a lower service rate and metered charges for individuals making more than 40 local calls per month is only available on a limited basis in South Dakota. It is not available at all for most rural customers, Bell says that it is "planning to make measured service options available to most...customers over the next few years." But they offer the Commission no projected time frame for completion of this program. Even if consumers were to view this as an attractive option, proposed changes requested in the current application would make it much more expensive. These changes include almost doubling the base charge ($4.00 to $7.50) and reduction of the number of monthly "free" local calls (from 40 to 20).

In previous rate cases before the Public Utilities Commission the Farmers Union has also questioned the inclusion of "charitable contributions" and "memberships" in service organizations and advertising as legitimate items in the rate base. We congratulate Bell for its professed commitment to local communities and charities, however, we feel that these contributions should be paid out of company profits. The public should not be forced to pay the bill for Bell's generosity through higher rates. If Bell employees wish to join public service organizations, the dues for these organizations should be their own responsibility. We also question the use of advertising in the rate base, to the extent that Bell holds a local service mononpoly. Advertising can only be justified as a legitimate rate base item when it involves a service where competition actually exists.

These are all important questions. Another important question which must be addressed by the PUC is whether or not Northwestern Bell is currently receiving a fair rate of return on investment. Bell witnesses have gone to considerable effort to demonstrate that the company is not presently earning profits at a level equal to certain other industries in the United States. Despite this testimony, the Farmers Union believes that the rate of return granted by the Public Utilities Commission in 1982 was more than fair. As we have previously stated, Northwestern Bell has had and will continue to maintain a virtual monopoly in much of the areas in which it does business in South Dakota. We do not feel that it is the responsibility of the Public Utilities Commission to guarantee that Northwestern Bell will be one of the most profitable companies in the United States. At a time when much of the rest of the South Dakota economy, particularly agriculture, is in the midst of an economic depression, we feel that the magnitude of the rate increase requested by Northwestern Bell is unconscionable.

The South Dakota Farmers Union has great confidence that the staff and members of the Public Utilities Commission will do their utmost to protect the legitimate interests of South Dakota consumers. However, we also recognize the massive problems created by the upcoming divestiture of the American Telephone and Telegraph Company. The potentially mammoth rate increases ensuing from divestiture pose an issue that is nationwide in scope. What is at stake here is the very survival of the universal telephone service concept. We believe that Congress has a national responsibility to deal with this issue and to assure that all Americans have continued access to reasonably priced telephone service.

Thank you.

"THE CONDITION OF THE

SOUTH DAKOTA TELECOMMUNICATIONS INDUSTRY"

Statement of Margaret McKinney

Representing SOUTH DAKOTA ACORN

My name is Margaret McKinney. I live at 330 Beach SE, Huron, SD. I am a member of the Northwestern Bell Telephone Users Panel representing South Dakota ACORN. I regret that I am unable to be here personally today.

ACORN stands for Association of Community Organizations For Reform Now. We are a grassroots membership organization of low and moderate income people with members in 25 states.

The changes that are taking place in the telephone industry are both confusing and frightening to telephone users. Consumers are going to be confused with dealing with the choice of several companies for buying telephones, the choice of long distance calls from AT&T, Midco-Tel, Sprint, MCI and others that may spring up; plus the possibility of as many as three bills a month for 1) local service from the Bell Company 2) AT&T for phone rental, and 3) a carrier for long distance service.

Since we as low and moderate income persons must spend a greater percentage of our income on basic telephone service the possibility of larger phone bills is especially threatening. It has been estimated that 90% of households now have telephones and that with the proposed increases 70% of households would still have phones but only 46% of the poor people in our country would have phones. If income is the determining factor in whether a person has a phone this does more to establish class lines. I am concerned about the social ramifications of this issue. Higher phone rates will be one more step in the direction of making us a nation of the haves and the have nots.

Low income people do not make many long distance calls so we will not benefit from the promised lower long distance rates. The access charge telephone users will be charged whether long distance calls are made or not seems very unfair.

There has been some discussion about the possibility of a government subsidy for low income persons such as the energy assistance plan now used for utilities. This is not the answer.

The continuation of basic telephone service at affordable prices is a necessity for all citizens. I urge Congress to do whatever possible to keep telephone rates down and to make the deregulation transition as easy as possible the companies involved should be directed to put on a well planned educational program so telephone users will understand the changes that are taking place.

Thank you.

Statement of K. L. Detweiler

Submitted to: Information Forum

"The Condition of the South Dakota Telecommunications Industry"

October 14, 1983

Sioux Falls, South Dakota

I appreciate the invitation by Senator Abdnor to share my assessment of the primary economic and legislative issues facing the telecommunications industry in South Dakota.

As Chief Executive Officer for Northwestern Bell in South Dakota, my concerns are to keep phone service available and affordable to all our customers, and to meet service needs of customers connecting to our network. Our determination is to keep universal service a reality. It makes very good business sense for us to work toward this objective. Obviously, we want to sell our service to as many customers as possible, for the value of our service to a large extent is directly related to the ability to call anyone, anywhere.

The technological revolution in communications, coupled with industry and regulatory inclination to subsidize local service, has led to competition in the provision of long distance services. The competition that exists and is flourishing today is an economic reality that must be acknowledged and accommodated in our industry. (I have provided in Exhibit 1 a list of present and future competitors in South Dakota.) The driving force in the whole telecommunications industry over the past 25 years has been technological change. However, the impact of technological change has not been uniform. Technology has driven down costs primarily in the long distance portion of our business. Microwave and satellite technologies, along with improved multiplexing of channels, have greatly reduced the cost of providing long distance.

Similar technological change has not occurred in the local loop or subscriber access portion of our business. The line which connects every customer to one of our central offices has not experienced anywhere near the degree of technological change that has occurred in long distance. In fact, inflation has more than offset any cost reductions for the local access line.

Pricing of services in the industry has been inconsistent with the course of this technological change. In fact, the growth in toll volumes and application of the separations process produced just the opposite effect. The result, of course, is the problem that now confronts the entire telecommunications industry -- the shifting of huge subsidies from long distance to local telephone service.

These subsidies have caused a huge distortion in the relationship between costs and prices, which in turn has caused the problem we are faced with today. Competition has entered those parts of the market which are over-priced. Given the degree of over-pricing, we have only seen the modest beginnings of competition. The recent Order by the FCC, in Docket 78-72, is a rational and well-balanced effort to deal with the problem of the current pricing distortions. The FCC realized that the current subsidization of local service costs by AT&T and the future subsidization of other long distance companies through toll usage prices encourages bypass of the local telephone company.

The FCC's proposal to phase in a customer access line charge recognizes the very real and serious dangers of bypass. Let me briefly explain what "bypass" means in the context of long distance service and access charging, and, more importantly, why we all need to be concerned about the real and negative consequences uneconomic bypass can cause.

First, I'll briefly define the two forms of bypass: Economic bypass and uneconomic bypass. Economic bypass is in the public interest and is a natural condition in a competitive market. It occurs when differences in price are based on actual cost differences. On the other hand, uneconomic bypass occurs when differences in price are artificial because they are not -- for whatever reason -- directly related to actual costs. This situation ultimately is not in the public's best interest.

Customers who bypass -- principally businesses -- build a separate and alternative communications network which circumvents entirely the public long distance network and, in some cases, the local network too. Some of these firms also have the capacity to resell the use of their network to others. If the price of using the public network becomes an unattractive economic option for this type of customer, bypass becomes a viable alternative.

With bypass, access revenues are lost, forcing increased upward pressure on the rates for all other customers. Ultimately, this situation creates a "death spiral" phenomenon because as prices escalate upward -- due to large users leaving the public network and loss of that revenue -- more and more customers opt for some form of bypass putting yet more of a support burden on those remaining.

Lost traffic and lost revenue means the remaining subscribers must pay more to maintain the local exchange network. Lost traffic does not lower operating costs since much of the local telephone plant investment is non-traffic sensitive -- that is, the costs are fixed between the subscriber and the central office and do not vary with the amount of usage. When revenue is lost without recovering the fixed costs of the plant, the result is lower operating income which reduces the company's rate of return and its ability to raise capital.

Further complicating this problem is the fact that a high concentration of our long distance revenue comes from a very few business customers in a few locations.

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We serve about 22,000 business locations in South Dakota alone. If only about 2% of those customer locations chose to bypass -- and they will if access charges are not levied on the cost causers fairly and phased in sensibly -- we would lose about 50% of our business interstate long distance revenues. This loss alone would equate to an immediate burden on the monthly rate for all our customers of about $6 to compensate for that lost contribution. That is simply not acceptable. A gradual phased in schedule which removes the existing subsidies over a number of years makes good sense and will minimize the bypass threat.

To our local telephone users, the recipients of the subsidies over the past several decades, the economic reality should be clear. The subsidization through long distance traffic sensitive pricing must end, the conditions allowing it are being removed, and to try to delay the inevitable will only make it more difficult, burdensome, and "uneconomic" for society in the near future.

Today's technologies provide the ready means to achieve the bypass invited by the telephone rate structure I have discussed. Technologies already available or currently being used to bypass the local telephone network include coaxial cable, microwave radio, satellite, cellular radio, Digital Termination Service, as well as ordinary copper pairs in ducts leased from the telephone company.

Several technologies can be used for bypass. While no technology is right for every bypass situation, each technology will eventually find its market niche.

Cable TV is a medium for bypassing local telephone company facilities. Cable TV companies are beginning to construct two-way systems with voice capability. Many CATV franchise agreements now provide for two-way institutional network that provide voice, data and video telecommunications links between all government offices in the franchise area. In addition, CATV companies are actively working with interexchange carriers (IC's) to provide local access over the CATV facilities to the ICs. This potential for bypass is a reality. At the recent National Cable Television Association's annual trade show in Houston, June 12-15, 1983, MCI demonstrated what they call the CABLEPHONE concept. CABLEPHONE is a regional voice network which uses CATV coaxial cable to interconnect with MCI's long distance service, thus bypassing the local telephone company. Israel Switzer, an MCI engineering consultant was quoted in the April, 1983 issue of Telephone Bypass News on this subject. Mr. Switzer said:

> "We're talking about the transfer of existing functions from expensive local telephone lines, bypassing those, and using two-way cable instead. It is probably the most important, earliest, non-television revenue source (for cable) again, because it is a known service, with nothing 'blue sky' or speculative about whether the public will use the service or not."

Private microwave is a common form of local bypass in use today. It is used primarily in the formation of private networks by government agencies, educational systems, utilities, and large corporations. Spectrum congestion at the lower frequencies has recently resulted in the development of higher frequency systems targeted specifically at providing local bypass.

Satellite transmission, still another form of radio, utilizes geostationary satellite transponders to relay signals between earth stations (or dishes). With satellite technology, signals transmitted from one point may be received by numerous points, making satellite very attractive for broadcast type services. High speed data transfer or signals requiring large bandwidth are also well suited for satellite service. Citibank in Sioux Falls is currently using this type of satellite communication.

Cellular radio is another potential bypass technology. This technology is a sophisticated mobile radio system that utilizes multiple transmission nodes (each forming a cell) such that as the customer moves from one cell to another, the transmission responsibility is handed-off between the adjacent nodes. This procedure permits low power transmission and radio frequency re-use, thus increasing the number of subscribers possible. Cellular systems, like the traditional local exchange service, will be interconnected to the interexchange carriers. It has been estimated that several hundred thousand customers can be served in a metropolitan area. As cellular radio grows, an ever increasing number of bypass connections will be possible.

Bypassers also have the alternative of leasing duct space or some other right-of-way and placing their own cables. Light fiber, copper, or coaxial cable would all be possibilities. Moreover, bypassers can also build networks by interconnecting various technologies.

The incentive for a customer or carrier to bypass is dependent only upon the spread between the customer's rates and the cost of bypass facilities. Therefore, large users located in exchanges served by small independent telephone companies are also bypass candidates. In fact, the impact on a small telephone company of losing one or two of its largest customers could be very serious indeed. Both customers and interexchange carriers may decide to bypass Northwestern Bell's access facilities. In the case of private microwave networks, the decision appears to be completely on the part of the customer. In other cases, interexchange carriers may decide to bypass Northwestern Bell's access facilities in providing interexchange service to their customers. An end-user of an interexchange service very possibly might not know if the access were provided on NWB's facility or on a bypass facility.

I have been asked several times how much additional bypass will occur if the pending legislation is enacted -- thus thwarting the FCC's Order. The answer to that question is not simple, but it is very important. The answer does not hinge on whether or not $2 of the subsidy is removed in 1984 and transferred to the end-user where it belongs. Bypass is attractive today and it will be attractive in 1984. The most important factor for a potential bypasser to consider is the long-term impact. The FCC's Order makes it clear that in the long-run bypass will not be attractive, because prices will follow costs. The transition plan which moves toward elimination of the toll subsidy accomplished this and clearly sends this signal. If, on the other hand, Congress passes legislation as proposed, this could lead to the belief that the FCC's goal of cost-based pricing may never be reached. This will lead to bypass of unprecedented magnitude that could virtually destroy the telephone network as we know it today, and universal service in the process.

Large customers will bypass if they aren't given an acceptable alternative. The FCC's Access Charge Order is such an acceptable alternative. From a potential bypasser's prospective, a highlight of that order is the transition plan which gradually phases out the subsidy. This transition plan sends the all-important signal to potential bypassers, that any benefits they might derive from constructing bypass facilities will be short-lived. If Congress demonstrates that the FCC's plan is not going to stand up, then bypassers will be quick to react. Bypass plans will be made and construction of facilities will start.

The key to the FCC's access charge plan is the gradual and planned removal of the present toll subsidy. The plan calls for the subsidy, which covers local loop costs, to be gradually shifted to the residential and business users who, in fact, cause these costs to be incurred. The plan calls for the price of residential service to increase by $2 in 1984, $3 in 1985 and $4 in 1986. The impact of these price increases on residential customers ability to pay for telephone service seems to be the main concern of Congress.

The goal of universal service is a goal that has been reached. For all practical purposes, everyone who wants a telephone line can afford one. Industry studies show that the price of local telephone service is very inelastic. That means that very few people will disconnect service even if the price goes up significantly. I believe that the doom-sayers who are predicting massive disconnection due to a $2 increase in rates are simply wrong.

In our discussion of universal service, I feel it is important to keep telephone rates, and any future increases in prices, in reasonable perspective. By any measure of comparison, the increase in the price of phone service has lagged far behind virtually every other product and service people use and consume. While the Consumer Price Index increased about 130% (1972 to 1982), residence local service rates in South Dakota have increased only about 50%.

Price increases on intercity services during recent years have, of course, been minimal, many customers are already benefiting from the lower long distance rates available from a number of companies. These benefits will be available to even more customers under AT&T's proposed $1.75 billion price reduction in interstate long distance.

Congress, however, should not be ambivalent about those people for whom any increase may be a hardship. I assure Congress, though, that the industry is not ignoring these people. The FCC's Order includes mechanisms for offsetting costs in those areas where costs are unusually high.

In addition, Northwestern Bell in South Dakota, like nearly all telephone companies, offers service options to help customers offset the rising price of flat-rate unlimited service. Our usage-sensitive measured service is a reasonably priced alternative for people who are able to limit the use of the telephone. In exchanges where measured servcie is not provided, two-party residence flat-rate service will be offered as the lower-cost alternative. We are aggressively working on new and innovative programs and rate plans to make sure phone service remains affordable in the future.

We realize that some customers may not be able to afford even the very lowest priced optional service. If it is determined that some additional degree of support is needed to cover the difference between the price of a given specific grade of service and what it costs to provide that same service, we strongly encourage a direct and targeted subsidy to the individual customer based on need as opposed to one that is dispersed in a general or geographically related fashion.

If relief which may be necessary for some is not targeted, the truly deserving may not receive an adequate level of support. We must assure that assistance is given directly to those who really need it and not administered broad brush in a manner leading to unfairness, misuse and waste. I include here as example those who by some geographical criteria are considered rural customers. It is erroneous to conclude that all rural customers need a subsidy.

The FCC's Order provides for the logical and planned expansion of competition in the telecommunications industry. Planned and controlled expansion of competition can provide benefits to all. On the other hand, the uncontrolled, helter-skelter advances of bypass competition provide short-term benefits to only a few large users, and in the long-run don't benefit anyone.

This industry is in a transition period. The marks of that transition are rapidly evolving technology, competition, divestiture of the Bell System, and regulatory response.

It is my view that our most critical task is to manage this transition by taking the advantages in society that open-market competition brings without losing universal service.

In closing, I want to emphasize that Senate Bill 1660 and House Bill 4102 are not the solution to concerns for continued universal service. In fact, they could contribute to its demise. My Company is in the closing months of a massive divestiture undertaking. The implementation of the ordered FCC access charging is an extensive effort and well underway. This is not the proper time for the U. S. Congress to consider taking action, particularly action as it is being discussed.

My request to Congress is this -- let us move ahead with the steps we must take, let the changes take place, and then, with the FCC and the Justice Department and the judicial branch, observe and monitor the impacts and consider alternatives if the need becomes apparent.

We have the best, least expensive telephone service in the world. We intend to manage through this transition to keep it that way.

Thank you.

Exhibit 1

The list of potential competitors will depend significantly on the rate levels of our service. The higher our rates - the higher the window of opportunity becomes for other vendors. The list of present and potential competitors that we are aware of at this time in South Dakota is as follows:

Present Competitors
Mid Co. Tel. (R.C. & S.F.) - WATS Reseller
Pat Co. Tel. (Aberdeen) - WATS Reseller
Citibank (S.F.) - Bypass
State Radio - Microwave Bypass
U.S. Department of Energy - Microwave Bypass
Western Union - Satellite Bypass
Equatorial Communications - Satellite Bypass to UPI
Associated Press - Satellite Bypass
Northern Border Pipe Line Co. - Private Line Bypass
Basin Electric Power Coop. - Private Line Bypass
East River Electric Power - Private Line Bypass
Fox Ridge Water - Private Line Bypass
Ottertail Power Company - Private Line Bypass
Iowa Beef Processors - Private Line Bypass
Burlington Northern Railroad - Private Line Bypass
SPRINT - Microwave Bypass
Telenet - GTE]
UNI-Net - United Tel.] Data Network
TYM-Net]
USA Today

Future Potential Competitors
Resellers
  Telemarketing Communications, Inc.
  Executone of South Dakota

Bypass
HY-Net Communications
RCA American Communications, Inc.
MCI
SBS
ITT
AT&T
City Sat. Com.
American Business Communications
Midcontinent Cable TV
South Dakota Cable TV
Thomaston Cable TV
KOTA Cable TV
Public Broadcasting Service
Rosebud Community TV
WI-DAK, Inc.
Valley Cable Vision
Community TV - Madison
Satt Cable Services
Corusn Tele-Comm., Inc.
Sioux Falls Cable TV
Mobridge Cable TV
LAKOTA Communications
Sisseton Cable TV
Watertown Cable TV
Yankton Cable TV

PREPARED TESTIMONY OF LEE E. LARSCHEID
ON BEHALF OF THE SOUTH DAKOTA INDEPENDENT TELEPHONE COALITION, INC.

I WANT TO THANK SENATOR ABNOR AND HIS STAFF FOR PROVIDING THIS OPPORTUNITY FOR ME TO EXPRESS THE THOUGHTS OF INDEPENDENT TELEPHONE COMPANIES OF SOUTH DAKOTA. CURRENTLY, ONE OUT EVERY FOUR TELEPHONE SUBSCRIBERS IN SOUTH DAKOTA IS BEING SERVED BY AN INDEPENDENT TELEPHONE COMPANY. TO PROTECT THE INTERESTS OF THEIR TELEPHONE SUBSCRIBERS, THE SOUTH DAKOTA INDEPENDENT TELEPHONE COALITION WAS FORMED AND IT IS ON BEHALF OF THIS GROUP THAT I SPEAK TODAY.

FROM EDGEMONT TO ROSHOLT AND FROM CAMP CROOK TO JEFFERSON, INDEPENDENT TELEPHONE COMPANIES CRISS-CROSS THE STATE SERVING OVER 140 TELEPHONE EXCHANGES. THE SIZE OF THESE EXCHANGES RANGE FROM 7,100 SUBSCRIBERS DOWN TO JUST OVER 50. WHILE ONE OUT OF FOUR SUBSCRIBERS ARE SERVED BY INDEPENDENT TELEPHONE COMPANIES, OVER HALF OF THE GEOGRAPHICAL LAND AREA IN SOUTH DAKOTA IS SERVED BY INDEPENDENT TELEPHONE COMPANIES. MUCH OF THIS AREA IS IN WESTERN SOUTH DAKOTA, WHICH IS SPARCELY POPULATED AND TREMENDOUSLY EXPENSIVE TO SERVE. IF UNIVERSAL TELEPHONE SERVICE IS TO BE PRESERVED, THEN THOSE HIGH COST AREAS OF SOUTH DAKOTA MUST HAVE SOME SOURCE OF ASSISTANCE RATHER THAN PLACING THE FULL BURDEN OF TELEPHONE COSTS ON THE TELEPHONE USER.

THROUGH FCC RULES AND SPECTRUM ALLOCATION, COMPETITION IN THE LONG DISTANCE NETWORK HAS BECOME A REALITY. HOWEVER, FOR RURAL AREAS LIKE THOSE SERVED BY THE INDEPENDENT TELEPHONE COMPANIES IT'S DOUBTFUL THAT COMPETITION WILL PROVIDE ANY

BENEFIT TO THE AVERAGE TELEPHONE CUSTOMER. IN FACT, UNDER THE FCC'S CURRENT ACCESS CHARGE SCHEME, THE INDEPENDENT TELEPHONE USER, COULD SEE SUBSTANTIAL INCREASES IN HIS LOCAL TELEPHONE BILL.

I HAVE PREPARED AN EXHIBIT THAT SHOWS WHAT THE POTENTIAL AFFECT IS ON LOCAL RATES IF 100% OF ACCESS COSTS ARE TO BE PAID BY THE TELEPHONE SUBSCRIBER. THE FIRST TWO COLUMNS OF NUMBERS SHOW THE COSTS BY COMPANY TO ACCESS THE STATE TOLL NETWORK AND INTERSTATE TOLL NETWORK. THE NEXT TWO COLUMNS SHOW THE COST PER LOOP OR PER SUBSCRIBER PER MONTH TO PAY FOR ACCESS CHARGES. THE LAST COLUMNS GIVES THE TOTAL COST TO THE SUBSCRIBER TO ACCESS BOTH STATE AND INTERSTATE TOLL NETWORKS. AS CAN BE SEEN THE INCREASE IN RATES TO THE LOCAL SUBSCRIBERS RANGES FROM A LOW OF $3.96 TO A HIGH OF $26.57. INCREASES OF $23.00 TO $ 26.00 PER CUSTOMER WOULD TRIPLE OR EVEN QUADRUPLE SOME CUSTOMER'S BILLS. INCREASES OF THIS MAGNITUDE CANNOT BE ALLOWED TO OCCUR. LEGISLATION SHOULD BE ADOPTED WHEREBY THREE KEY POINTS ARE ESTABLISHED.

1. LOCAL SUBSCRIBERS SHOULD NOT BE FORCED TO PAY 100% OF THE LOOP COSTS. TOLL CARRIERS AND OTHER TOLL CONNECTING COMPANIES (E.G., RESELLERS, ETC.) SHOULD PAY A FAIR SHARE OF THE LOOP COSTS.

2. A UNIVERSAL SERVICE FUND HAS TO BE ESTABLISHED TO AID THOSE COMPANIES WHOSE RATES WOULD BE SEVERLY IMPACTED. EVEN WITH TOLL CARRIERS PAYING A PORTION OF THE ACCESS COSTS SOME LOCAL RATES FOR INDEPENDENT TELEPHONE CUSTOMERS COULD BE EXCESSIVE.

3. AT&T SHOULD BE ALLOWED TO DEAVERAGE RATES ON A VOLUME DISCOUNT BASIS. IF AT&T WERE ALLOWED TO COMPETE EQUALLY FOR HIGH VOLUME TRAFFIC, LONG DISTANCE RATES FOR LOW VOLUME USERS COULD REMAIN ESSENTIALLY AT THE SAME LEVEL AS TODAY'S RATES.

THE SOUTH DAKOTA INDEPENDENT TELEPHONE COALITION BELIEVES THAT IF THE 3 ITEMS PREVIOUSLY MENTIONED WOULD BE ADOPTED BY CONGRESS ALL USERS AND PROVIDERS OF TELEPHONE SERVICE WOULD BE CONTRIBUTING HIS FAIR SHARE.

A CLOSER LOOK AT EACH OF THE 3 PROPOSALS WILL SHOW WHY WE FEEL THIS WAY. TELEPHONE SERVICE IS AN END TO END TYPE SERVICE. IF ONE END OF THE SERVICE IS PRICED TOO EXCESSIVELY AND SUBSCRIBERS DROP OFF OF THE NETWORK, THIS MAKES THE SERVICE LESS VALUABLE FOR THOSE REMAINING ON THE NETWORK. IT IS IN THE BEST INTEREST OF BOTH TELEPHONE USER AND PROVIDER OF TELEPHONE SERVICE, BOTH TOLL AND LOCAL, TO HAVE AS MANY SUBSCRIBERS AS POSSIBLE CONNECTED TO THE NETWORK. Senior Citizens Example

UNDER THE FCC'S PLAN, COSTS TO THE SUBSCRIBERS WILL CONTINUE TO GO UP WHILE COST TO THE TOLL PROVIDER WILL CONTINUE TO GO DOWN. UNDER RULES ADOPTED BY THE IOWA COMMERCE COMMISSION, THE SUBSCRIBER'S BILL WILL INCREASE TO $2.00 PER MONTH AND CHARGES TO THE TOLL CARRIER ARE SET AT 3 CENTS PER MINUTE OF USE TO DEFRAY COSTS ASSOCIATED WITH THE LOOP COSTS. THESE ARE FIXED AMOUNTS AND IT APPEARS TO BE A FAIR ATTEMPT TO SPREAD THE COSTS ASSOCIATED WITH TOLL ACCESS. THE APPROACH BY THE IOWA COMMERCE COMMISSION IS MUCH MORE PREFERABLE BY THE COALITION MEMBERS THAN THE FCC'S PLAN.

BASED UPON OUR STUDIES, EVEN A $2.00 PER SUBSCRIBER INCREASE AND 3 CENTS PER MINUTE OF USE CHARGE TO THE TOLL CARRIER WILL NOT COVER THE LOOP COSTS OF ALL INDEPENDENT TELEPHONE COMPANIES. THEREFORE, A UNIVERSAL SERVICE FUND IS NECESSARY TO ASSIST THOSE HIGH COST COMPANIES IN NEED OF PRESERVING AFFORDABLE TELEPHONE SERVICE. IF CONGRESS WAS TO MANDATE A CONTINUOUS $2.00 CUSTOMER CHARGE AND 3 CENTS PER MINUTE OF USE CARRIER CHARGE, A .4 OF A CENT PER MINUTE OF USE CHARGE IS ALL THAT WOULD BE NECESSARY TO FUND A UNIVERSAL SERVICE FUND BASED UPON THE NEEDS OF SOUTH DAKOTA INDEPENDENT TELEPHONE COMPANIES. THIS .4 OF A CENT COULD BE LEVIED AGAINST THE TOLL CARRIER OR AS A 2% SURCHARGE ON TOLL BILLS.

FINALLY, THE COALITION BELIEVES THAT BY ALLOWING AT&T TO DEAVERAGE RATES ON A VOLUME DISCOUNT BASIS, THIS WOULD SOLVE THE "BYPASS" PROBLEM AND ALLOW AT&T TO MEET THE PRESSURES OF COMPETITION WITHOUT FORCING EVERYONE'S LOCAL RATES TO GO UP. RECENTLY, AT&T ANNOUNCED A GENERAL RATE DECREASE OF 10% SCHEDULED TO TAKE AFFECT ON JANUARY 1, 1984, WHICH IS THE SAME DATE THAT THE FCC'S ENACTS ITS $2 AND $6 ACCESS CHARGE PROPOSAL. FOR THOSE THAT MAKE NO INTERSTATE CALLS, WHICH IS ABOUT 30% TO 35% OF INDEPENDENT TELEPHONE USERS, THE 10% REDUCTION WILL NOT HELP THEM, BUT THEY STILL MUST PAY THE $2.00 ACCESS CHARGE ANYWAY. AT&T WOULD HAVE BEEN BETTER OFF TO REDUCE RATES MORE THAN 10% HIGHER LEVEL TO HIGH VOLUME USERS LEAVING THE LOW VOLUME RATES AT THE CURRENT LEVEL. A 10% REDUCTION WILL PROBABLY HAVE A MINIMAL EFFECT ON A BYPASSER AND WILL PROBABLY NOT SOLVE THE PROBLEM.

IN SUMMARY, MEMBERS OF THE COALITION DON'T NECESSARILY OBJECT TO AN ACCESS CHARGE METHOD OF COMPENSATION FOR TOLL INVESTMENT AND EXPENSES, BUT TOLL CARRIERS HAVE TO PAY THEIR FAIR SHARE AND TELEPHONE SUBSCRIBERS SHOULD NOT BE SUBJECTED TO ENORMOUS LOCAL RATE INCREASES. IF CONGRESS WERE TO ADOPT LEGISLATION ALONG THE LINES I HAVE PRESENTED TODAY, THE COALITION FEELS THE INTERESTS OF ALL PARTIES WILL BE EFFECTIVELY COMPROMISED.

COMMENTS

OF

PATRICK H. McHALE

DIRECTOR - REGULATORY MATTERS

AT&T - COMMUNICATIONS, INC.

AT

SENATOR JAMES ABDNOR

INFORMATION FORUM ON

SOUTH DAKOTA TELECOMMUNICATIONS INDUSTRY

Townhouse Convention Center

Sioux Falls, South Dakota

October 14, 1983

Good afternoon. I appreciate the invitation to come and share some timely and important information with you today. The purpose of my statement is two-fold:

One, to give you my assessment of the economic changes in the telecommunication industry...

And to state my opposition to proposed congressional legislation, namely the Senate Bill 1660 and the House Bill 4102.

I have been through the major changes of the telecommnications industry these past few years. I have been with Northwestern Bell, AT&T, and most recently with AT&T Communications. Through these changes one goal constantly being repeated: Universal service is a reality and we want to keep universal service a reality.

There exists another reality today. This reality is the technological revolution in communications that has brought about extensive competition in our industry. This was recognized as a reality by introduction of the Carterphone decision in 1967. Again it was recognized when MCI connected their first channel between Chicago and St. Louis.

The driving force in telecommunications over the past 25 years has been technological change. However, the impact of this change has not been uniform. Long distance costs have decreased because of this technology; but similar technological change has not occurred in the local portion of the industry. Therefore, long distance prices have been artificially kept high to pay for the higher cost of local service.

The telecommunications industry task force in the document stated, that the top 4 percent of business customers in terms of individual demands generated 62 percent of business interstate traffic in 1976. Similarly, the top 4 percent of household consumers generated 30 percent of all household interstate telephone traffic in 1976. This concentration of traffic has two important consequences for consumer switching. First, only a small proportion of all consumers need switch suppliers in order to have a major impact on AT&T's sales. Second, this concentration implies that some consumers have relatively large demands for interLata services and they will have strong incentives to search for better suppliers.

This was 1976. Today a large portion of those interstate users have gone to other carriers of long distance. This has taken many of the dollars away from AT&T to subsidize local callers. In the sort run this does not appear to be of any consequence; however, if AT&T is forced to subsidize local service through anticompetitive legislation that would impose "unworkable and unnecessary subsidies", there will begin enormous uncertainty at a very crucial time for the entire industry. This could extend beyond the foundation of the telecommunications industry and affect the money recommendations of those in the financial world.

The telecommunications industry has been extensively regulated in the past, and is today. As competition occurs, regulation must respond accordingly, with a move to deregulate and allow all parties to compete on an equal basis in the open marketplace. This economic reality has been addressed by the FCC in the deregulation of telephone equipment. Now the FCC must be allowed to continue to respond to fundamental changes in the industry.

The FCC is responding to the current situation, which is to reprice the way users pay for the fixed cost of telephone service. Today, in reality every customer who calls interstate long distance in effect subsidizes those who use MCI or any other carrier. The FCC is responding to that situation by ultimately repricing services so the cost-causer, either carrier or local user, bears the cost.

The recent FCC order, Docket 78-72, is a rational and well-balanced effort to deal with today's problem of subsidies. The position is:

1. Universal service is not in jeopardy. There is no reason for Congress to enact anticompetitive legislation that would reimpose "unworkable and unnecessary subsidies which cannot be sustained in a competitive environment."
2. Legislation would change the ground rules and introduce

enormous uncertainty at a crucial time for the industry.

3. It will deprive customers of savings coming to them as a result of competition by legislating away the proposed largest long distance rate reduction in history.
4. Although purported to "preserve" universal service and "protect" local ratepayers, even in the sort term, it would keep long distance rates artificially high, encouraging high volume users to bypass the network leaving behind higher and higher fixed costs to be borne by remaining local ratepayers.
5. In "protecting" local residence customers from access charges - of only two or three dollars a month on an average 30 to 40 dollar total monthly telephone bill - legislation would almost certainly impose far higher eventual costs on local ratepayers than it "saves" them in access charges. Bypass will reduce revenue but not investment of the carriers.

Telephone rates should be kept in proper perspective:

- In South Dakota the average residential customer spends a little under $37 each month for telephone service.
- The interstate access charge will add only $2 to this bill, or an increase of approximately 2% when you consider the off-setting long distance interstate rate reduction applied to the average of $12.59 per month that is spent on interstate toll charges.

Consequences of not aligning prices with costs should be put in proper perspective:

- Bypass of the local network is a reality anywhere there is a concentration of business or residence revenues. Examples of bypass are Citicorp in Sioux Falls and MCI and Cox Cable in Omaha. As South Dakota attracts more financial businesses, the means and knowledge to bypass will be used to control costs by these communications intensive businesses.

- If Congress passes legislation as proposed, this could lead to the belief that the FCC's goal of cost-based pricing may never be reached. This will lead to uneconomic bypass of a magnitude that could so change the industry and the telephone network as we know it today, and truly jeopardize universal service in the process.

Universal service should be put in proper perspective:

- It is not in jeopardy now.
- The bills in Congress change the eligibility of local carriers for special high-cost area funds. In so doing, rural customers served by Bell and the larger independents will be excluded from any subsidies, even though Bell serves approximately half the rural population and will be paying more to subsidize rural service.
- Both bills create a federal telephone subsidy for lifeline service. The concept of lifeline or budget service is in itself not bad, just the provision to subsidize a service which is already offered in 30 states with rate differentials already absorbed into the current pricing structure.

Other facts should be put in proper perspective:

- Even when you add in the intrastate access charge of $2, the increase is still less than 11%.
- Claims about escalating rates have been exaggerated and taken out of context. Past history in South Dakota helps to support this -- the last rate award was made in November of 1982 and resulted in an increase of revenues of only 5.6%.
- The facts indicate that there will not be a doubling or tripling of rates.

Remember the overall goal is to maintain universal service and to introduce competition in the telephone industry. This is not the proper time for the U.S. Congress to consider taking action,

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particularly action as it is being discussed. Hasty legislative proposals are not only unnecessary, but they will make matters worse.

Allow the FCC, a creature of Congress, to do what it has been charged by Congress to do. It has been over 5 years in reaching its current order. Give it a chance. Have Congress perform a stringent oversight or the FCC review the results. Propose changes as a result of thoughtful legislation based upon fact not emotional response. It's too late to change the competitive world we live in. Guide it through legislation. Don't try to stop it.

A hasty legislative reaction bears the seeds of more long-range trouble than it attempts to prevent.

Thank you.

RESPONSE OF STATE REGULATORS TO QUESTIONS POSED BY SENATOR ABDNOR

SENATOR ABDNOR: Thank you Commissioner. I appreciate all your input because it's very important. Let's stop for a moment. Let me understand this better, this "shedding" subject you were talking about. Doyou mean, in the splitting up of the business, that AT&T is not taking on all the responsibility they should in this?

ANSWER: That's our position. For example, I mentioned the local loop, that's telephone wires leading from the telephones to a local exchange. That's a nontraffic sensitive portion of the revenue requirements. In South Dakota that amounts to about $160 million. That's joint and commonly used for long distance and local. And under the present Ozark Separations Plan, that accounts for some of that investment over there. That's considered arbitrary as well, but it doesn't indicate that there is an excessive subsidy flow from the interestate to local exchange and we think that there's room at least, formative evidence and case history already will show that there's room for investigation of how you allocate these costs. For example, with the break-up I mentioned briefly and AT&T -- and, incidentally, this is also in the best interest of the new Bell operating company -- to allocate it properly. So there's no adversarial position there, between us and the new operating company. It's very necessary to allocate these costs properly, because if AT&T is doing what I think they're doing so well, that is, they're getting ready to be nonregulated and competitive in the interstate long distance market, they want to be in a position to underprice or, at least, be very competitive with their long distance toll, and I think this shows now with the application for a tariff before the FCC to lower their rates beginning in January. Because now they've gotten the FCC to come out with a decision in order to place the access charge onto the end user and, more appropriately, it ought to be borne by the interstate carrier because they're accessing these markets out here. It's truly in their best interests to shed as much of that investment on that local loop which they presently own and get rid of it and let it remain with the regulated Bell operating company, because it can be recovered through law in local rates, and I think they've conditioned the American public to accept that.

SENATOR ABDNOR: I don't know the answer, but who is responsible for the way they are divided? Judge Green? The FCC? Or was it taken upon by AT&T at all? I mean, I think they were pretty well directed, were they not, by the ruling?

ANSWER: Now, Judge Green, in my opinion, did as much as he possibly could as a Federal judge to protect the public interest. He looked at such things and he was very concerned about this. He looked at such things as reorganization, new capital structure, how we'd look in the holding companies and so on to make sure the Bell operating companies could operate properly. And even in his most specific words, which I don't have in front of me, but in his decision and order said, that because of divestiture, it does not mean nor should it be interpreted to mean thatlocal rates have to increase at all, just because there's competition in the long distance calls.

SENATOR ABDNOR: I have no quarrel. I'm sure Judge Green did exactly what he had to do. I was always hoping it didn't have to be a monopoly issue, which called for the division. I believe in that old saying that if something is working right, don't try to fix it. I don't know that anyone could say they were overcharging for corporate profiteering. We still have the cheapest rates of anywhere in the world, and the best system. But this change was forced; I don't profess to know enough about it yet to know how that division came about. Do you think it possible that this was done arbitrarily by the AT&T then? I mean, who was behind this?

ANSWER: Let me say I just received a copy of the Washington Post. There's an article on the 6th of October where it pretty well laid bare what was going on a year ago in Congress and the lobbying activities of AT&T against the present bill that was in front of Congress at that time. I think that showed pretty specifically what AT&T's position was and how they wanted the access charge to be placed as it is now decided by the FCC, because to protect their own best interests and leave everything else to be recovered through residual rate paid out there and local rates.

SENATOR ABDNOR: Interestingly enough, in front of my Joint Economic Committee that I chaired last Monday, October 3rd, we had a four witnesses -- two of them were consultants for telecommunications -- not just telephones, per se, and as a matter of fact, one of the gentlemen did considerable work for a telephone co-op here in South Dakota. I know that co-op held this consulting firm in high esteem and so was the other consulting firm. And you all remember Dr. Alfred Kahn who is supposed to be very knowledgeable. One gentleman, the fourth one, is Vice President for the Consumer Confederation of America. As I recall -- Mr. Dale Jahr on my left, he is with the Joint Economic staff, formerly with my staff, and he's doing a fine job on the telephone issue. The report you see wasput together by Dale. It's a good background of where we're going and we've had many fine comments on it. Three of those people in front of that panel all said we should not tamper with the fee decision.I don't know who they are representing. We hoped that we were getting a very independent view by the experts. And all three of them were very much for the FCC plan, and urged us not to foul it up now with what's taking place in Congress. Let is go into effect for a year and see what happens. The fourth gentleman was very much opposed to it, Dr. Richardson. And that's left me with a lot of questions after that hearing. I said immediately I would like to have a hearing out here and we are really interested in the input you've giving us because you gentlemen work with this all the time.

But, again, going back -- do you think AT&T controlled the way they got divided up or was that done by someone higher than they were?

But, again, going back -- do you think AT&T controlled the way they got divided up or was that done by someone higher than they were?

ANSWER: I think Judge Green made some important modifications after he initially made the agreement between AT&T and Justice. Yes, I think they had a lot to do with the design initially. He changed some of it. then I think they saw their most success in getting the FCC to place all of the burden on the local loop. But the biggest thing you've got to look at, I think, and that is whether the public interest issue here because you've got to remember that this rate base regulation, as a law by which these legitimate expenses and rate of return on rate base can be recovered by law and our Commission is somewhat limited in that. We have some discretion. But, surely, if we're dominated by the FCC's decision which ties our hands and we can't say anything about it. Local rates are sure to increase. They've just got to go up. And the whole question is whether or not they should or should not because of evidence is not plainly shown.

SENATOR ABDNOR: Dale Jahr's research called for the figures and they haven't been questioned by the consultants at all -- it costs about $28 to $32 -- are those the range of cost to operate the hook-up on local levels. Do you think there could be enough of a reconsideration here in the division that to be able to say that it doesn't cost this $28 on the average that we could bring it back more like half -- $14, which is still higher than any one is paying in monthly charges. I mean, if you're right and it could be redivided, do you think we could pick up that much of a discrepancy this thing so we could say it really only costs $15 and not $28 on the average?

ANSWER: I think there's room for that, and I say that simply because of this. Everyone has accepted that figure -- and I've heard it a lot here -- that it costs that much to provide, every month, the telephone. But you've got to remember, that in establishing that figure, we have and everyone has, over the years, because almost everything was going along smoothly. But we have always accepted only the Bell Company, AT&T's figures, on what they call the embedded direct analysis, of what they thought their costs were. Nobody has ever challenged that. The FCC did at one time and they went dry -- turned their head away as to determine what those actual costs were. And I think there's clear indication that that ought to be done to see exactly what those costs are. Here's another thing, we've been -- I think the American public has been convinced over the years -- and we've had a lot of pressure on the commission to establish rates at cost base. In other words, get your rates established on what the actual costs are. There is a real dichotomy going here, because, on one hand, the tariffs that are in place in South Dakota do reflect that. You have the rural areas that are zoned.

The further out you are from the local exchange, the higher cost of the service is. And we have been moving in that area of cost basing those rates. But on the other hand, someone mentioned, I think, in your opening remarks, Senator, that 20 percent of the customers generate most of the revenue. Now we're getting ready for competition and I want to show you where the dichotomy is here. If we want to go cost base rates all the way and get ready for bypass and competition and all this, then should we then place the cost on the 20 percent customers who are going to use that in the form of new and more expensive and more technical local exchange facilities. But yet cost-base rates are being passed by the wayside here because Bell operating company does not want to see that. Obviously, it could encourage bypass. So what they are saying is that we want to impose all of the costs of investment in local exchange facilities on a more technical nature and spread that entirely around all of the customers i South Dakota whether they use that or not. So there's a dichotomy there, there is a definite conflict on how we establish cost-base rates on the one hand, the telephone company tells us let's establish them this way and yet they're saying, we want to spread them around for everybody else in the ivestment of local exchange facilities. How do you reconcile that, I don't know, but I think through good, fully distributed cost study in determining as closely as possible where the allocation of investment ought to go is the best way, I think, and the most accurate, in determinig what local exchange rates ought to be and what message toll service tariffs ought to be.

SENATOR ABDNOR: What you're saying is one of my greatest concerns, too. More and more are going to skim the cream off the top and they're going to go to the new concepts, new companies that are forming, whether Sprint or MCI, or new ones yet to come. And, of course, no one's going to apparently be able to stop that. Do you think it is possible that some kind of a charge could be placed on those and then shared with rural telephone companies where the costs are higher. I don't know if that can be done. That's what we've been doing with the system we have now. We pass on profit from one level to another group, but its all within the same corporation. Could we take completely separate corporations and put a charge on those users to give to another group? Is that what you had in mind?

ANSWER: I think if I understand you correctly, what we're talking about is an establishing of a high cost factor fund, probably. Now that is -- I think it is -- a part of a legislation and if the FCC's decision and order on establishing end-user access charges are allowed to stand, then surely, I think, that has to be a part of it. We have always endorsed a high cost factor fund, at least, if we have to live with the FCC's decision and order. But we think that surely there's room to investigate whether or not that ought to be an end user charge and, if not, there possibly can be a different formula by which you could eliminate the high cost factor fund, I'm not sure.

ANSWER: Senator, one other comment on that particular question. One of the things that you start to do, in my opinion, when you do that, you begin to regulate an industry that has just been deregulated. And the other thing I think you have to be careful of is that you don't stand in the way of advancing technology. And that might tend to do that. So there is a balance on the other side of that issue also.

SENATOR ABDNOR: We have nothing to go by on past history about telephone issues. However, I do look at airline deregulation and I was talking the same way you were talking. I strongly opposed that legislation. I was on the subcommittee where it was taken up, and I was the only member of the subcommittee to veto against it. But I've seen nothing being done to make our rates more in line with rates in other parts of the country. They have more people using the plane going from New York to Los Angeles and they can fly round trip for way less that I can fly for round trip coming into South Dakota. I don't see any movement on the part of Congress to change that. I don't know how successful it might be in this sort of thing here. But it wuld make a good point. But it's going to take a lot of support, it's going to take a lot of work to get it done, I think. Somehow we always get ourselves pitted against the rural versus the urban. Now, these new communications firms go to the people in the cities and offer access and availability to some of those new concepts coming in in telecommunications, but it's not very likely to happen out here in South Dakota except for the few that use it the most. Maybe a few areas of the state will see this.. There is this hearing I spoke of in Des Moines Monday, I think the invitations have been sent. I know it's a long way to go, but that's in front of the full Joint Economic Committee. I'm the subcommittee chairman that began the work, but Senator Jepsen has called that and is going to bring in witnesses from all around the mid-west. I hope it's possible. I know this travelling is expensive, but this is a pretty big issue and you gentlemen are certainly very knowledgeable in it and what it is going to do to us. If it is possible, it would be good if you could take that meeting in, too.

Thank you very much for your appearance here today.

RESPONSE OF CONSUMER AND SOCIAL GROUPS TO QUESTIONS POSED BY SENATOR ABDNOR

SENATOR ABDNOR: Let's talk for a second about that category, that group of people, the senior citizens. Dr. Halleene, would you speculate as to how many people in that category group would have to give up the telephone if their rates were to double, like next month, or January 1. Let's say rates suddenly doubled, do you think it would be a big loss in numbers?

ANSWER: I can't even speculate on a number. I know that many of my friends who are in that category live very marginally and they watch every penny they spend each month. As utilities go up, as rents or other things go up, if suddenly the telephone goes up, too, they would have to make choices on what they were going to give up.

SENATOR ABDNOR: Something would have to give?

ANSWER: The telephone is probably one of those things that they would have to give up before heat, before rent, and before food.

SENATOR ABDNOR: Yet, the telephone offers a great deal of security, doesn't it?

ANSWER: And yet the telephone is very, very important.

SENATOR ABDNOR: I'll bet even Mr. Noteboom could be even more specific, visiting with these people all of the time. Do you have some thoughts on that? You kind of touched on that in your remarks.

ANSWER: With my little bit of work that I have done so far, I haven't been into it too long. But my wife and I are both getting involved in it. I would say a great percentage of them -- we have an art meeting of the board of directors of which I am a member of of our local group here. And we have a meeting Wednesday afternoon and in talking with the rest of the board members, I would say over 35 percent, at least, maybe more, would have to give up the telephone. And they can't afford to give up the telephone because, like I say, it's their means of communication. They do nothing else but talk on the telephone. They don't have any way of getting around and I don't think we can afford to let these people go because, after all, they've been the backbone of the country for many years and we're all getting old, but we have to support these people.

SENATOR ABDNOR: That's what we're trying to do to get to some solution. Mr. Radcliffe, through his organization, has worked with the senior citizens and I'll ask you that question and I'll add to it: how many farmers do you think will have to give up the telephone if the rates double on them?

ANSWER: Obviously, farms and ranches that are located miles apart -- the people who live in these farms and ranches do have unique needs for telecommunications. We haven't done any definitive survey to determine what the drop off would be and farmers and ranchers might be forced to sacrifice food and heat. They have to have a telephone. And anything that threatens that service gets them pretty concerned, believe me. At our meetings that we're holding around the state, that's the number one topic of discussion, quite often, is what is going to happen to the telephone. Senator, I would hope that you would support the one-year suspension of the $2 levy against all telephone users -- all residential users -- to give us a chance to evaluate really what's going to be happening in the event that the sequence of $2, $4 and $6 finally hit the consumers' bill.

SENATOR ABDNOR: If the study were carried through and we do find that the figures mentioned by Dr. Halleen are somewhat accurate, that might mean that the government might have to step in and in some way, somehow, help carry that cost of that telephone to those who can't afford it, and who absolutely need it. I don't know what kind of an appropriation that would require. The only reason that I'm throwing this out, is that the budget is stretched to the hilt now. We just finished a $195 billion deficit, we've got that much staring us in the face again. As a matter of fact, Dr. Martin Feldstein recently set up his own change -- make some cuts somewhere, something like a $1.2 billion additional deficit. Now, I know you can't measure people's needs in dollars entirely, but do you think the answer to it is to try to create a fund necessary to ensure phone service to users of the telephone, businesses, large businesses, small businesses?

That's kind of what we're doing today. With the separation system, it's simply a matter of -- I don't know all of the details -- but I know that the money's coming back from the AT&T to the Bell System, then to independents, long distance usage carries much of the burden of the cost of users' telephone. Do you think we should try to devise that type of a system, even though the courts have caused a separation, to help subsidize those who need it the most?

ANSWER: I know that is a better system that the government becoming the main subsidizer. But what I'm afraid of is there will be enough political pressure put on right now so that the access fee will be taken care of and the universal service fund will not be funded adequately and there won't be any money left to subsidize the poverty, or the lifeline system and I guess at that point if all else fails, then I guess I'm asking for the government help.

SENATOR ABDNOR: Marv, do you think that the way we've gone in the past --where those who use it the most and generate a large part of profits for the telephone industry to help the other users -- should be continued in the future to help carry the load of more costly areas of telephone service?

ANSWER: I have nothing prepared when I came, but I think something should be frozen here. We just can't keep escalating.

SENATOR ABDNOR: The only thing definite eas with that the courtshave come up with now, through the demands of someone starting years ago with antitrust suits. Some group, along with the government, had brought this case against AT&T and the courts broke it up and we now find ourselves in this mess. And we've got to work ourselves out of it, too. I guess, to some degree, you can persuade industry into doing certain things, but when we get down to the legislation I just mentioned to Mr. Radcliffe, one thing we've got to think about is going to taking the vote of the Congress. I think their rates will be cheaper. Their representatives are not going to be anxious to vote for something that's going to raise rates on their people to help another area. I mean, I'm finding out, as you said earlier, with the airline deregulation legislation. I don't think it's quite right that we're paying twice as much for air travel in South Dakota then on the East Coast, even going twice as far. To change that, it is going to require legislation, but it is something that is going to take a lot of work and I guess the best thing we've got to have is the figures to back up our arguments and our case for what we believe in.

ANSWER: Senator, I've seen the results of surveys that show that 50 percent of the residents, the telephone users, in our country, make one or less long distance calls a month -- one or less --

and many, a larger percentage of this group, make no long distance calls during the month and probably never plan to. And yet, we're talking about charging them $2 per month for the privilege of making a long distance call they have no intention of making. I think this is a gross error on the part of the FCC planners. And I want to commend our public utility comission for the in-depth studies that they've made and for the comments they've made this morning. It seems to me that they have a better grasp of what's happening in this telecommunications deregulation process than anyone that I've heard and probably a better grasp than the average congressman has because, obviously, they've had more time to study it and I urge you to listen to their views very carefully and somehow a system should be devised whereby the long distance companies, which are the ones that are going to come in here and really make the profit out of this whole break-up, they should be required to continue to bear the cost of accessing our local lines. I don't see anything that would be logical other than to go that route. Now, I would also like to comment as some of the other people have here this morning, about the conserver's service the Bell telephone has developed with cooperation from the telephone user's panel. It is somewhat unique in our state, although other states have similar plans and it does provide that any resident user in the state can maintain a telephone in his or her home for a flat rate of $5.00 a month. That's all the charge is, $5.00 a month to have access to a telephone. Then they're allowed to make a given number of phone calls out of the home before a time use rate begins to be charged. But I want to emphasize that the phone there is available for in-coming calls at all times for a reasonable rate of $5.00. I think this is terribly important that we remain in that kind of access to our low income people and, in any event, whatever happens in the boosting of rates of modifying rates, I would hope that we would be able to maintain some kind of a low-cost for low-income people who need the telephone in their homes, but would never pay the higher price rates that we see coming down the pike.

SENATOR ABDNOR: That's certainly our goal and we know the importance of what the telephone means to everyone's every day life. In particular, certain groups even more so than others.

And with that, gentlemen, unless someone else has anything else to add here, I thank you for appearing and being with us here today.

RESPONSE OF TELEPHONE COMPANIES TO QUESTIONS POSED BY SENATOR ABDNOR

LETTER READ BY DALE JAHR AT THE REQUEST OF SENATOR ABDNOR AFTER WHICH COMMENTS WERE MADE BY THE WITNESSES.

. . .

Mr. Ken Detweiler

I agree 100 percent with Charlie Brown's letter. Let me just give you a little bit of background. On January 8, 1982, when the agreement was reached with the Department of Justice, we have since that day been inventoring all of the assets of the Bell System -- all $150 billion. We have brought you all of our buildings, we have brought you all of our circuits, we have gone through our employees, we are right now within 80 days, as Mr. Brown indicated, of separating the world's largest company. I don't believe that with this legislation -- if it is passed -- I believe there are enough constitutional issues associated with either one of the House or Senate bills, that it would delay divestiture. And I think we are talking about millions and millions of dollars that would be lost as a result of delaying divestitures. Secondly, I think that one point that hasn't come up today that is mentioned in Charlie Brown's letter that I think is very important, is the fact that you are aware that the financing of the Bell System is very heavily through investors. Investors are watching the divestiture of the Bell System at this point in time. U.S. West on January 1, 1984 will acquire three million shareowners and we will be on our own; we will be one of the largest independent telephone companies in this country, along with the other independents that have been created as a result of the divestiture. For example, just yesterday in looking through my mail, two pieces came across my desk which kind of indicate what's happening in terms of change. Let me just give you an excerpt from the first one. It's called the Merrill-Lynch Investment News. It starts out by saying something like 13 bills have been introduced in Congress. It goes on to say the bills range in impact from temporizing to extremely impractical. Andfinally winds up by saying even the passage of the simplest bill would require us to rethink all ratings. That is one of Charlie Brown's major concerns is the fact that in 40 days three million shareowners of U.S. West have to decide what kind of investment they have in their telephone company and what kind of investment they have in their telephone company in South Dakota. A change in the FCC docket 7872 in the way we are heading right now could have serious implications on divestiture, being able to meet that day and will certainly have serious impacts on Wall Street and the way we raise money to create capital to invest in the telephone company.

I might add that's only 40 days away -- in approximately 40 days, U.S. West stock will start trading on a one-issue basis. I agree with his letter, I agree with his concern about delay and I am particularly concerned about the impact on investors and the uncertainty that's going to create in their minds.

Mr. Jeff Miller

I guess I, too, would agree with the letter from Mr. Brown. AT&T has spent a lot of time in coordinating and orchestrating the change that is about to take place. The one concern I do have is the public's involvement and the public understanding something that is finally coming to bear now. It is unfortunate that it had to be so complicated that people are just starting to come to understand, starting to question and are starting to get the answers. I believe it has to be pushed ahead as quickly as possible because of the investments made, because of the decisions -- business decisions that have been made on everyone's part. However, some of the recent decisions should bear some investigation and the public input -- not for the initial change -- but for the fine-tuning into next year, should carry a lot of weight.

Mr. Lee Larscheid

Yes, I certainly can appreciate the contents of Mr. Brown's letter and also the comments by Ken ~~and~~ Jeff both. I think any delay would certainly be probably destructive at this point. I guess probably any comments that I may have would certainly not be of any importance at this point because of lack of knowledge where the divestitures is concerned and I would imagine I am probably in the same position as the average person on the street is. So, based on that, I really don't have any additional comment.

Mr. Claude Kraft

Again, speaking from the independent point of view, I found interesting that you brought out the stockholders and employees and the majority of independent phone companies in South Dakota are either cooperative or family owned and have no stockholders and as such I think our concerns lie with the end user. The person that is going to be picking up the tab. Obviously, if the users pay the tab, the stockholders and employees are going to benefit. And I think we are trying to switch and say here's what the telephone user feels about the legislation and the prime concern that we see is the shifting of the costs from the toll provider to the end user. This 100 percent shift -- we don't feel that the competition at this time should dictate that type of a long-term commitment. That may be something in the order of locking in a fair share, where a consumer will know what his share is and continue on that fair basis. And that other alternatives are available to attack this still unknown bypass. We've got a lot of threats -- future technology, future things are going to happen here and if we don't do this we're going to severely harm. And a lot of it is still idle threats yet and we look in South Dakota and this thing could be postponed in terms of the access, in terms of carrier's charges and it would impact us hardly at all. Both from a South Dakota perspective and from an independent telephone company perspective, we don't see the great hurry or urgency to leap forward to these long-term commitments which in the end will increase subscriber's telephone bills, double, triple, or quadruple. That would be my comment.

Mr. Homer Lyon

My comment would be that twice in my life I have had experience with decisions in Washington which drastically affected the organization I was involved with. In neither case was I in a high enough level to challenge it or change it, but the affect on the organizations -- both of them -- were so drastic that I just felt that people from Washington didn't believe what was happening. And so based on that, I would say that we ought to let it go and try to make the adjustments in the future when we see what the result is. Because at this point, it's really too late for the -- and I'm talking from a guy that has been through it. One was an FCC problem with the company and the other was where I was involved in the reserve unit, where the Pentagon put out some orders that really -- the end of the whip really cracked.

Mr. Pat McHale

I would only like to place some perspective on this divestiture process as it affects people and as a manager of some thirty years service, I probably have more experience with that than anything else. This divestiture -- people don't realize how far it's one that are outside of the business. And I happen to be in AT&T communications for care and supervision. That's where I belong. However, I'm still a member of Northwestern Bell until the first of the year. Even though I have titles and positions in an AT&T organization, the first of October, following the plan of reorganization, we began to pull the infrastate business out of Northwestern Bell. To this extent we had to move out of the corporate headquarters in Omaha and take new quarters out in the outskirts of town. We began to split up any possible availability of files or advisory knowledge that we might have gotten in the Northwestern company and had to begin providing our own. So that we really are starting to operate the intrastate company separate from Northwestern Bell. So the moment a stock transfer -- which is the first of January of next year -- it's really only a technicality. The company, the business, in effect, will have been in existence for 90 days, will have started to have a form and a substance to it and the people will be directed in the ways in which they are going to perform within the new corporation.

And this is going on not only Northwestern Bell, but throughout the Bell system. Other companies like ourselves, are beginning to pull off the embedded base company, the people who handle the installation and maintenance of current customer premise equipment, they are also in the same position -- reorganized, ready to pull out. It's not clearly understood, I'm sure, by many people how far this thing has really gone and I'm not real sure that even if we were told to stop, that we have enough managers and a strong enough system to be able to withstand that. I don't think we could do it.

QUESTION AND ANSWER PERIOD

SENATOR ABDNOR: Thank you. Let me ask you this. Suppose Congress does nothing, and the FCC rulings and regulations are implemented on January 1, and by the end of the year we see that all of it is not well for the telephone consumers users in this country. Is it going to be even more difficult at that point to shift back to something else?

ANSWER: I think that at the end of one year's experience, that you will have enough facts to know what legislation should be enacted in order to guide, not to stop, or to channel, but to guide what really is a national resource. And I think you ought to be looking at it from a personal feeling in terms of a national resource and not necessarily just a business. But I do think that you need that experience and I do think you need at least a year's history so that you would be able to do the right thing where legislation is concerned. To my way of thinking, the FCC is your agency, you fund it, operate under a law passed by congress and I think you can hold them responsible for those developmental acts and reporting acts that are necessary for you to really arrive at what is truly going on and what the effect of this big change is. I think that at the end of a year you'd be in a much better position to do what really is right in the long term and perhaps not what appears to be right, but only a short-term solution.

SENATOR ABDNOR: Thank you. How about you, Mr. Larscheid. How would you review that? Any chance of correcting it or is it clear off base -- coming up with a different plan or modifying it?

MR: LARSCHEID: I think -- like I said before -- that the independents have no problem with shifting to an access environment for settlement purposes. What we are saying here is that currently all telephone revenues go into a pool and the independents receive a part of that pool based on their expenses or based on their average schedule. We're going to shift from that over to a method where now they receive compensation on a minute of use. They're selling minutes of use to a toll carrier and as calls terminate in their exchange or originate, they will charge the toll carrier a minute of use rate based on how many minutes come in and come out. Under the FCC's proposal, that minute of rate that they receive will keep going down and the end user charge will keep going up and what we are basically saying is that at this time it doesn't appear that enough evidence is there to support that type of a continued transition. So that if we were to go to a $2 charge in '84, maybe we should look at continuing that in '85 or '86, as opposed to their continued increases in the customer charges and continued decreases in subscriber. They are doing that because they say that will get the rates down to cost and that will prevent the bypassers -- uneconomic bypass.

And I don't think enough information is available to determine when do you reach that economic point and I don't think it will eliminate all bypassers anyway, for either economic reasons or for security reasons for whatever, we still may have bypassers and they still may lose customers to their own private network. It was the FCC's own rules that allowed that to come in place to begin with. And so I think we are looking at the long term effects, the availability of outside source of finances from a universal service fund for some of these high cost companies I have identified.

Obviously, there are some that are low cost that wouldn't need any assistance. But we are talking about $20 on top of your local bill today. That would be awfully hard to tell a consumer that this is in their best interest to pay this because it's so good for the country.

SENATOR ABDNOR: In addition, Mr. Larscheid, to the $2 access charge in that first year, how much do you think the rates are going to be going up in some of these independents? They are going to have to have a substantial raise, are they not? I mean, $2 isn't going to offset all the factors and costs, is it?

MR. LARSCHEID: The one thing that we have to keep in mind here is what we're talking about is interstate and interLADA when we go to the access charges. A large percent of our revenue comes from the in-state toll network or the intraLATA toll network and I have been a part of a negotiating team of other independents that have negotiated with Bell for a proposed two-year settlement for '84 and '85 revenues and I might say that at this time it appears that the settlement that we have reached would keep the independents and Bell healthy enough where they wouldn't need to go in for any increase for local service to make up lost toll revenue. So at this time, we are sitting quite well, but again, it was the idea of let's not jump into something so hurriedly that it's going, in the long term, get the ball rolling, let's say, for continued rate increases. I might add that I read in a newsletter that the State of Washington -- that commission has mirrored the FCC plan where they will charge a $2 state access for residents and a $6 access for business. So now we're looking at $4 and if the FCC goes up to $3, then they go $3 instate, so it just keeps doubling and at the end of '86 or '87, you know, they may be locked into a plan of $8-$10 rates over and above what they are paying today. And it is those types of things that we -- maybe we should look at it now and before we make these long term commitments, say a one year plan, get some facts and figures, get the bypass, look at the competition and another thing, look at the way rates are set. Again, I want to point out that AT&T has average schedules throughout the country. They really haven't been allowed to go in and compete, I don't think, on a fair basis. If they could meet the competition head to head, then we wouldn't have to make everybody chip in on a local basis so that we're all paying the same rates. It's kind of like -- if we're going to deregulate -- let's pay a little bit more -- and sure, it won't benefit us maybe everybody, but this thing isn't looking to benefit everybody. It's just the high business that's going to benefit anyway.

SENATOR ABDNOR: If we commence in the next two months, --we had less than two months to try to take some action -- what would we be looking at? Is there going to be complete turmoil?

MR. LARSCHEID: Okay, the thing is we're talking about divestiture on one hand and access charges on another. Divestiture is going through. They're going to split up, they're going to have their access. What we're looking at in 1984 and beyond is how are the local companies going to receive their compensation for toll. There will be no more pooling of this, we're going to access charges.

SENATOR ABDNOR: If we don't, we've got nothing, right?

MR. LARSCHEID: Right. And what Bell is saying is that right now because we are going to charge everybody $2, we're going to dock rates down 10 percent. That's a trade-off. Customers pay more and because Bell's costs have suddenly gone down, then they can drop rates 10 percent. If we were to say hold it -- let's keep the prices we've got today, off goes the rate decrease, but then off goes the $2. That's what the trade-off is -- is that Bell's saying, "Wait a minute, we can't reduce our rates." And they may say, "Well, that looks like a bypass opportunity is even more available because now a bypass has suddenly gained 10 percent in which his savings would be at the current rate level."

SENATOR ABDNOR: But how would small independent telephone company that uses -- I mean, in a smaller area, I suppose the less long distane calls you make, isn't that right?

MR. LARSCHEID: There is a suppression that as long distance rates go up, the costs in general goes up, the use tends to go down and I think that as I stated before and we have the facts and figures to back it up, that if this thing were to go into place in '84, because of the mix of state and single LATA, by the way, we want to preserve that, that's one of the best things South Dakota's got going for it, is that the independent telephone user will not be severely impacted other than the $2 increase on his local bill. These are the long term numbers that I have given you here, Senator. The one hundred percent phase out of non traffic sensitive plan onto the user under the proposal here, I think the estimate is that maybe the end user is contributing possibly 25-30 percent. The carrier is still paying the 70-75 percent. And I think what we are saying is maybe a 50/50 or 60/40 or something other than complete removal of the non traffic _sensitive cost or the long cost on to the end user.

SENATOR ABDNOR: You've brought up something, Mr. Larscheid. I've seen the House legislation dealing with disallowing single-LATA states. What's behind that? I assume you caught everyone by surprise by new legislation to eliminate that, to do away with it. Who would be the one pushing for that?

MR. LARSCHEID: The main push would be from those companies right now who would have to spend lots more money in the future to meet the access charge requirements. Right now, nearly 90 percent of the independent phone companies joined the Exchange Carrier Association, the ECA, and as such, there is a pulley mechanism where they put their access charges in from the carrier, the carrier will pay them on a per minute of use. That goes into a pool. They submit what their costs are and get those back out of the pool. Well, one of the problems that exist is that that exists only for interstate traffic. When you start getting into state traffic, most states are looking at using the same rates as the rates that the ECA has. Only there's no pool on a state level to get their money from. So there are states like Minnesota, and North Dakota and Nebraska and Iowa where they've got multiple LATAs, where they're charging the carrier less than what their costs are. And as such they have to go back to the customers for more money. So that the marks that I'm talking about today refer only to South Dakota with a single LATA. Other studies have shown that for Minnesota and for North

Dakota and Nebraska, customers for independents will be impacting because there will be unavailability to charge their full costs on the carrier because of the mirroring effect of the ECA rates. The only way they can get from that is to file their own rates. So if they file their own rates, and file their own charges, then they get the cost of coverage. But they can't do that until starting 1985. So it is those people who are saying, hey, let's postpone this thing because we will then have to go back for a rate increase in '84, because they're not getting enough money from the state side to meet our obligations and if you let us go in '85, then we can set up our own tariffs, do our own cost studies, and charge for our costs.

Senator Abdnor: Would anyone like to add to that?

THE ECONOMIC ISSUES OF A CHANGING TELECOMMUNICATIONS INDUSTRY

MONDAY, OCTOBER 17, 1983

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The committee met, pursuant to notice, at 9:30 a.m., in the Davenport Room, Marriott Hotel, Des Moines, Iowa, Hon. Roger W. Jepsen (chairman of the committee) presiding.

Present: Senator Jepsen.

Also present: John Conrad, legislative assistant to Senator Jepsen; and Dale Jahr, professional staff member.

OPENING STATEMENT OF SENATOR JEPSEN, CHAIRMAN

Senator JEPSEN. This meeting will come to order.

It is my privilege this morning to welcome our witnesses and interested citizens in our audience to this hearing. We are here today to discuss the complex and sometimes confusing issues of the rapidly changing telephone industry.

Foremost in our mind is to find out how the citizens of Iowa and the residents of the upper Midwest are going to be affected by these proposed changes, in determining what, if anything, can be done in Washington to insure that telephone users are treated fairly.

The Congress, Federal and State regulators, the telephone industry, and the telephone customers have divided and conflicting views on what changes are necessary to keep our telephone service high in quality and yet affordable in price.

I have to admit that I find all these changes a bit complicated myself, and for that reason, the Joint Economic Committee, under my chairmanship, has become involved in this issue. Just 2 weeks ago, at a Joint Economic Committee hearing, four so-called expert witnesses represented the views of consumers, economists, and industry consultants.

Certainly, Washington does not have all the answers or the final word. I am not sure but that Will Rogers' admonition that he made at one time some years ago, when he said the farther he got away from Washington, the more hope he had for the country, maybe has some thread of truth today yet.

We are holding this forum here today to listen and to receive additional information from everyone affected by the proposed changes in the industry.

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Last week, two other hearings—telephone hearings were conducted. One was in Mt. Vernon, which I chaired last Tuesday, and there was one in Sioux Falls, S. Dak., chaired by Senator Abdnor.

It is my hope and desire that all these hearings will produce thoughts, ideas, and recommendations which we can take back to our colleagues in Washington. Our witnesses here today represent the Federal and State Governments, business and industry, consumers, and the telecommunications industry itself, and we will be hearing from people from Minnesota, Iowa, Nebraska, and South Dakota.

Before we begin with the statements, I would like to give an overview of some of the changes taking place and some of the concerns we have about these things.

First, by way of a background, by Federal court order, AT&T will be divesting itself of Bell operating companies. Here in Iowa, that means that Northwestern Bell will no longer have strings tied to New York and New Jersey. Instead, it will become part of a regional holding company known as the U.S. West, and U.S. West has 14 States which make up almost one-third of the land area of the United States.

Second, the Federal Communications Commission has allowed competition in the long-distance market and responses to change in technologies. That has allowed new firms, such as Sprint and MCI, to offer services. Both are established in this region. WATS resellers also are here now, such as Teleconnect here in Iowa. I might add, that those new firms do not have to serve all persons in the State, and probably will provide services in just a few cities. Other residents will not benefit from this new competition.

Another item. Bell operating companies across the United States have filed for the largest rate increases in history for 1984. Some of the rate increases, no doubt, stem from the great uncertainty that exists in the industry.

Another item. AT&T, which will be the interstate long-distance carrier next year, has filed for a $1.75 billion increase in long-distance rates. This is in response to an FCC order on access charges, which I will discuss shortly. Under AT&T's rate request, shorter distance calls will drop about 5 percent in price, and longer routes will drop 10 to 15 percent. AT&T maybe is posturing itself for a possible price war of sorts with its new competition.

Another item. The FCC is phasing out its current cross-subsidy system, where profits from long-distance calls were used to support the local service. It is replacing the old system with a new access charge system which will be imposed on all customers. This system goes into effect starting this January 1. A $2 per month charge on residents, and a $6 per month charge on business for each phone line will be added to the phone bill.

Congress is considering legislation which, among its provisions, would place a moratorium on the residential access charge and on businesses that have just one phone line. In Iowa it costs about $25 per month to keep a phone in service, yet customers pay somewhere in the neighborhood of $10 to $12 for that service.

Another item. Phone usage revenues are very concentrated in the United States, and it is my understanding that just 10 percent of the business customers generate about 70 percent of all business revenue.

In Iowa, just 6 percent of business customers generate about 24 percent of total business revenue. These heavy users are likely targets for the new technology which allows it to bypass the local phone service exchange. If even a fraction of these big users leave the public network, I have some concern about the consequences that it will have on the rest of the customers.

Now, these points provide a background so that we can illustrate some of the concerns about the future of the telephone service in the rural States, such as the five States invited to participate in this hearing. I am grateful these witnesses have agreed to share their insights with this committee, and the audience. I look forward to this discussion.

Again, I welcome you all. With the growing concern that has moved across the country in all the regulatory areas, whether it be the deregulation of airlines, the deregulation of the trucking industry, the deregulation of natural gas, the deregulation of the telephone industry, an awful lot of people are also asking themselves today, "Why fix it if it isn't broken?" with the thought in mind that there is a lot of bewilderment and confusion and apprehension as to what may be coming.

A democracy functions best when we do get opinions, input and assistance from those on the firing line. Our whole system of Government works on the basis we derive our powers from the bottom up, and Washington does not have the only word nor is it—the seat of all wisdom, and we have a great need for making sure that we sit down and talk about these matters. In this forum, we can listen while we are talking, and then join hands and do what we all want done, as what is best for the country. In this particular instance, our concern is about universal telephone service which now covers, depending on who you talk to, somewhere between 92 and 96 percent of all people in this country.

At this time I would like to ask the first panel to come forward, which deals with the Government's role, Mr. Peter Pitsch.

Mr. PITSCH. Yes, sir.

Senator JEPSEN. Is that how you pronounce it?

Mr. PITSCH. Yes, Senator.

Senator JEPSEN. OK. My first "pitch" was correct.

Mr. Peter Pitsch, Chief, Office of Plans and Policy, Federal Communications Commission, and also the representatives from the State public service commissions, please come forward. We have not ascertained who all is here, and we will start off, once we identify the people on the panel along with Peter Pitsch, and proceed from there.

One person who has been a longtime personal friend of mine, who I can start out with introducing with complete confidence, is Andy Varley, former colleague of mine in the State legislature. We served together. Andy has served Iowa for many years in all areas very admirably, and he is from the Iowa Commerce Commission and is to my right and to your left.

Andy, thank you for coming.

Mr. Stofferahn.

Mr. STOFFERAHN. Right.

Senator JEPSEN. Mr. Stofferahn, I believe, is from South Dakota Public Utilities Commission, and Mr. Eisnach, your far right, my far left, also from South Dakota. And S-o-l-e-m, Solem. And are you also from South Dakota?

Mr. SOLEM. South Dakota.

Senator JEPSEN. All right. Then we have Mr. Simpson from Nebraska. Any relation to the Senator's family, Senator Simpson?

Mr. SIMPSON. I think way back there has to be a slight relation.

Senator JEPSEN. Good company. His dad was a Senator prior to him, and they have a long family history of service to country and State.

Gentlemen, welcome and thank you for coming, and with no further ado we will begin with Peter Pitsch, Chief, Office of Plans and Policy, Federal Communications Commission. I would advise the panel that any statements that you may have that is in writing will be entered into the record as if read. So you may summarize, or you may proceed in any manner you so desire.

Mr. Pitsch, welcome, and you may proceed.

STATEMENT OF PETER K. PITSCH, CHIEF, OFFICE OF PLANS AND POLICY, FEDERAL COMMUNICATIONS COMMISSION

Mr. PITSCH. Thank you Senator.

I appreciate this opportunity to discuss the important changes being made to our Nation's telephone system, in particular, the Federal Communications Commission's recent decision concerning telephone access charges which has sparked considerable controversy, arousing fears that the widely shared goal of universal service may be jeopardized. It has also been suggested that that decision is unfair because it penalizes those customers who make long-distance calls infrequently.

I would like to begin my testimony by explaining why the Federal Communications Commission adopted the access-charge decision, and then briefly address the effects of that access-charge decision on the citizens of the States of this region.

No brief testimony can adequately explain the many complexities in this area, but I wish to clarify the four most important points that undergird this decision:

First, the access charge decision more fairly allocates telephone costs to those users who cause them.

Second, it creates several safety mechanisms to assure that access to the telephone network remains affordable for all.

Third, it fosters far more efficient use of America's interstate telecommunications network.

Fourth, it effectively stems the flight of large users from the network, which would almost certainly occur under the existing pricing scheme, and which constitutes a serious threat to the goal of universal service.

The first point I would like to make is that the access-charge decision is fair, because it places fixed costs of obtaining access to the telephone network on the cost causer.

The fixed costs of providing this access to the single unified interstate and local network include your telephone, the wiring inside your house or business, the copper wire and poles from that to the local switch. Under the current system, part of these costs have been charged to long-distance users on a per minute basis. This is unfair and inefficient because all telephone customers impose these costs on the network irrespective of how many long-distance or local calls they make.

In 1983, roughly one-quarter, or nearly $11 billion, of those fixed costs were paid by long-distance users, increasing long-distance rates by approximately 15 cents a minute. Next January, a portion of those fixed costs will be shifted to the residential and business users who enjoy access.

At first, residential users will be charged $2 a month. That figure will rise to $3 in 1985, and $4 in 1986. These increases are a far cry from the doubling and tripling of rates we have been seeing in newspaper headlines.

Thereafter, necessary increases will be phased in only if our monitoring efforts assure us that the Nation's universal service goals are not in jeopardy. These flat monthly charges spell the beginning of the end of the heavy tax on frequent long-distance callers, and complicated flow of subsidies to others, many of whom can readily pay their share of access costs.

In general, it is only fair that those who impose costs pay for them. Indeed, 55 percent of the respondents in a recent New York Times/CBS news poll said they did not favor subsidizing local telephone rates.

The second point I would like to make is that the access-charge decision protects universal service goals. As we have repeatedly emphasized, the Commission wants to keep access to our telephone network affordable to all residential users. Several actions within our jurisdiction were taken to assure this goal.

The monthly flat charges start low, increase slowly over a 6-year period, and all the while the Commission will be monitoring the network for possible adverse affects. Furthermore, State regulators may request waivers of these charges in order to provide lifeline service offerings for these users who find these costs unaffordable.

The order also creates a universal service fund that directs subsidies to sparsely settled, rural areas where the costs of accessing the local switch are higher. I will later discuss the fund's effect on these regions in more detail, but for now, suffice it to say that, together, these provisions should keep low income and rural customers on the network without distorting the price of long-distance service to everyone.

The third point I would like to make is that the access-charge decision is efficient. The benefits of cost-based pricing for long-distance service will be dramatic. Today long-distance service may be as much as 60 percent higher than the cost of providing that service.

This method of paying for access has excessively discouraged long-distance calling. The collective waste from such underutilization of long-distance service has been estimated to be as much as $1 billion a year. By this I mean if long-distance rates were cost based, the benefit to customers from making additonal calls would exceed the cost of providing the extra service by about $1 billion a year. In response to the first phase of the access charge plan, AT&T has announced a

10 to 15 percent cut in long-distance rates. For example, a 5-minute direct-dial day call from Sioux Falls or Des Moines to Chicago would cost $1.98 rather than $2.27, or 12.8 percent less.

More long-distance cuts will follow as the decision is phased in. These lower prices will cause people to call more, make longer calls, and receive more calls. We have already seen this happen when subscribers choose lower cost alternative networks, such as MCI.

The short of it is that all long-distance users, and that includes many low-income persons, will benefit. The indirect effects for more intensive use by business will also translate into enormous gains to all Americans when the innumerable entrepreneurs in our $3 billion economy begin to adjust to these enormous price reductions by finding innovative ways to use long-distance service.

For example, businesses, Government, and educational institutions increasingly rely upon low-cost telecommunications to do their work. Teleconferencing is increasingly used in place of actual meeting for training purposes. Medical doctors can call up services such as medline and colleague to get access to the state-of-the-art diagnostic information and the most recent research. That means higher quality medical care for everyone.

Lawyers, engineers, and professionals of all kinds are using long-distance communication to acquire information that enables them to supply better services at lower costs.

As the costs of electronic communication fall, these service benefits can be made available on an increasingly widespread basis. What this means for the American people is better services of all kinds at lower costs no matter where you live.

Also, rural States will become even more attractive sites for locating new businesses. Given their experience with companies such as Citibank, the people of South Dakota know how significant an influx like this can be.

The fourth point I would like to make is that the access-charge decision will also reduce the uneconomic bypass of the telephone network and diversion of revenues that the present system is causing. Because large long-distance users pay their share of access costs many times over, they have an enormous incentive to turn to cheaper alternatives. We simply cannot afford to give large users an artificial incentive to jump ship. If they do, the cost of service will still be there, and the remaining users will be socked even harder.

Our decision makes it attractive for big users to leave the network only if bypassing it is more efficient.

The alternative to taxing such bypass facilities proposed by some in Congress is neither feasible nor desirable. Defining and then finding bypassers would be no easy task. Even if feasible, bypass taxes could kill efficient new technologies.

For example, the text of the Wall Street Journal is transmitted to printing plants by satellite. This service, albeit at higher costs, could be provided by the telephone network. Is that paper's distribution network uneconomic bypass? We cannot really tell under the present system. The most prudent solution to economic bypass is to price services at cost, removing the incentive to turn to inefficient alternatives.

Now, I would like to take a moment to discuss the effects of the access-charge decision on the citizens of the States in this region.

Some fear that under the access-charge decision, rates is less densely populated States will raise more than in other regions because such States have higher loop costs per customer.

Higher rates, it is argued, will jeopardize universal service in rural areas. This criticism of the access-charge decision is misplaced for several reasons. First, it should be noted that some rural States, including Iowa, Minnesota, and Nebraska, have loop costs that are at or under the national average.

After one factors in what long-distance customers will be paying into the universal service fund, the people of those three States are net losers under the Senate bill. Iowans pay out four times more than they receive. Minnesotans pay out almost twice as much as what they receive. Nebraskans, 20 percent more than they receive.

Second, as I have already noted, the Commission's decision creates a universal service fund designed to address this problem. Indeed, of the five States of particular concern in these hearings, four will receive more from the FCC/joint board universal service fund than they would under the most recent Senate bill.

The Minnesotans would receive more than nine times as much. South Dakota would receive about 30 percent more, or an additional $1 million. Iowans would receive about $250,000 more. The precise amounts of each of these States are contained in a table appended to my testimony.

Of course, to the extent a State receives less money under the proposed legislation, its local telephone rates would have to be higher to cover the shortfall. While end users would not have to pay monthly flat fees under the Senate bill, they would likely have higher local telephone rates.

Also, the Senate bill introduces an additional distortion by directing high-cost assistance to only those telephone companies with 50,000 or fewer loops and which are not affiliated with a holding company with revenues of $100 million or more.

It is easy to imagine holding companies divesting 9 local exchanges so both may qualify for assistance. Even if they do not do this, there may be wasteful new entry by small firms who could. In either event, inefficient business organization will be encouraged, to the ultimate detriment of consumers.

I am not arguing for subsidies for any particular State. To the contrary, I think that broad based, unfocused subsidies should be the exception, not the rule.

My point in citing these statistics is to emphasize that the FCC made a considered decision to address the plight of high-cost States, and this decision continues to be refined.

The proposed legislation, on the other hand, is based on a hurried review of the problem, introduces new distortions and will be far more difficult to modify as changing circumstances warrant. The Commission will be continually monitoring the phasein over the next 3 years as the flat fee rises to $4. If a significant number of disconnects occur or even appear likely, the Commission could recommend specific action.

For example, Congress and the States could target assistance to those citizens who need it. This approach would preserve the efficiency gains from cost-based pricing of long-distance service, and be much fairer and cheaper than giving subsidies to all people regardless of whether they need them.

Finally, we can expect telephone companies, if they are given the flexibility, to make it easier for many customers to stay on the network. Many critics of the access-charge plan argue that the network is worth more to everyone if the penetration rate remains high, that is, nearly universal.

To the extent this externality is important, however, the telephone companies themselves will have a strong incentive to keep customers on the system. They can do this by offering a range of options to customers that allow users to pay only for what they get.

For example, Northwestern Bell offers, or is proposing, such options in this area today. Iowa has a $9.55 flat rate for unmeasured service, and proposes to offer a $6.05 low-cost option that provides access, plus $2 worth of calls.

I have in my testimony the other States. I will just mention South Dakota. South Dakota has $11.40 flat rate and a low-cost option of $5 with 40 free calls.

It is my understanding that Northwestern Bell estimates that by 1986, 80 percent of their customers in these five States will have these low-cost options available to them.

In closing, it is important to place these recent developments in the context of the recent past. Telecommunications technological breakthroughs have caused a revolution in the regulation of the industry. Innovation and the competitive forces it unleased were the impetus for faster depreciation of telephone plant and equipment, price deregulation of residential and business telephones, and development of vibrant competition in long-distance telephone service.

We know these changes have been beneficial. Because of competition, today you can buy a phone with features unavailable only 5 years ago, from new suppliers for the same price it costs to lease a standard phone from the phone company for just 1 year.

The Commission's access-charge decision is the next logical step in insuring that American consumers and businesses reap the full benefits of growing competition and the remarkable new technologies appearing in the long-distance marketplace.

In essence, the Commission is extending the free-enterprise system to another sector of the economy. It will be both fairer and more efficient than the existing system because it moves prices to reflect costs and allows for subsidies, if they need to exist, that will be open and targeted to only those consumers who need them.

Thank you very much.

[The prepared statement of Mr. Pitsch, together with the attached tables, follows:]

PREPARED STATEMENT OF PETER K. PITSCH

I WOULD LIKE TO THANK YOU FOR THIS OPPORTUNITY TO DISCUSS THE IMPORTANT CHANGES BEING MADE TO OUR NATION'S TELEPHONE SYSTEM. THE FEDERAL COMMUNICATIONS COMMISSION'S RECENT DECISION CONCERNING TELEPHONE ACCESS CHARGES HAS SPARKED CONSIDERABLE CONTROVERSY, AROUSING FEARS THAT THE WIDELY SHARED GOAL OF UNIVERSAL, AFFORDABLE TELEPHONE SERVICE MAY BE JEOPARDIZED. IT HAS ALSO BEEN SUGGESTED THAT THE DECISION IS UNFAIR BECAUSE IT PENALIZES THOSE CUSTOMERS WHO MAKE LONG DISTANCE CALLS INFREQUENTLY. I WOULD LIKE TO BEGIN MY TESTIMONY BY EXPLAINING WHY THE FEDERAL COMMUNICATIONS COMMISSION ADOPTED ITS ACCESS CHARGE DECISION. IN THE SECOND HALF OF MY TESTIMONY I WILL BRIEFLY ADDRESS THE EFFECTS OF THE ACCESS CHARGE DECISION ON THE CITIZENS OF THE STATES OF THIS REGION.

WHY THE ACCESS CHARGE DECISION

NO BRIEF TESTIMONY CAN ADEQUATELY EXPLAIN THE MANY COMPLEXITIES IN THIS AREA, BUT I WISH TO CLARIFY THE FOUR MOST IMPORTANT POINTS THAT UNDERGIRD THIS DECISION: (1) THE ACCESS CHARGE DECISION MORE FAIRLY ALLOCATES TELEPHONE COSTS TO THOSE USERS WHO CAUSE THEM; (2) IT CREATES SEVERAL SAFETY MECHANISMS TO ASSURE THAT ACCESS TO THE TELEPHONE NETWORK REMAINS AFFORDABLE FOR ALL; (3)

(3) IT FOSTERS FAR MORE EFFICIENT USE OF AMERICA'S INTERSTATE TELECOMMUNICATIONS NETWORK; AND (4) IT EFFECTIVELY STEMS THE FLIGHT OF LARGE USERS FROM THE NETWORK, WHICH WOULD ALMOST CERTAINLY OCCUR UNDER THE EXISTING PRICING SCHEME, AND WHICH CONSTITUTES A SERIOUS THREAT TO THE GOAL OF UNIVERSAL SERVICE.

THE FIRST POINT I WOULD LIKE TO MAKE IS THAT THE ACCESS CHARGE DECISION IS FAIR, BECAUSE IT PLACES THE FIXED COSTS OF OBTAINING ACCESS TO THE TELEPHONE NETWORK ON THE COST CAUSER. THE <u>FIXED</u> COSTS OF PROVIDING THIS ACCESS TO THE SINGLE UNIFIED INTERSTATE <u>AND</u> LOCAL NETWORK INCLUDE YOUR TELEPHONE, THE WIRING INSIDE YOUR HOUSE OR BUSINESS, AND THE COPPER WIRE AND POLES FROM THERE TO THE LOCAL TELEPHONE SWITCH. UNDER THE CURRENT SYSTEM PART OF THESE COSTS HAVE BEEN CHARGED TO LONG DISTANCE USERS ON A PER MINUTE BASIS. THIS IS UNFAIR AND INEFFICIENT BECAUSE ALL TELEPHONE CUSTOMERS IMPOSE THESE COSTS ON THE NETWORK IRRESPECTIVE OF HOW MANY LONG DISTANCE OR LOCAL CALLS THEY MAKE. IN 1983 ROUGHLY ONE-QUARTER, OR NEARLY 11 BILLION DOLLARS, OF THOSE FIXED COSTS WERE PAID FOR BY LONG DISTANCE USERS -- INCREASING LONG DISTANCE RATES BY APPROXIMATELY 15 CENTS A MINUTE!

NEXT JANUARY A PORTION OF THOSE FIXED COSTS WILL BE SHIFTED TO THE RESIDENTIAL AND BUSINESS USERS WHO ENJOY ACCESS. AT FIRST, RESIDENTIAL USERS WILL BE CHARGED $2.00 A MONTH. THAT FIGURE WILL RISE TO $3.00 IN 1985 AND $4.00 IN 1986. THESE INCREASES ARE A FAR CRY FROM THE DOUBLING AND TRIPLING OF RATES WE HAVE BEEN SEEING IN NEWSPAPER HEADLINES. THEREAFTER, NECESSARY INCREASES WILL BE PHASED IN ONLY IF OUR MONITORING EFFORTS ASSURE US THE NATION'S UNIVERSAL SERVICE GOALS ARE NOT IN JEOPARDY. THESE FLAT MONTHLY CHARGES SPELL THE BEGINNING OF THE END OF THE HEAVY TAX ON FREQUENT LONG DISTANCE CALLERS AND OF THE COMPLICATED FLOW OF SUBSIDIES TO OTHERS, MOST OF WHOM CAN READILY PAY THEIR SHARE OF ACCESS COSTS. IN GENERAL, IT IS ONLY FAIR THAT THOSE WHO IMPOSE COSTS PAY FOR THEM. INDEED, 55 PERCENT OF THE RESPONDENTS IN A RECENT NEW YORK TIMES/CBS NEWS POLL SAID THEY DID NOT FAVOR SUBSIDIZING LOCAL TELEPHONE RATES.*

THE SECOND POINT I WOULD LIKE TO MAKE IS THAT THE ACCESS CHARGE DECISION PROTECTS UNIVERSAL SERVICE GOALS. AS WE HAVE REPEATEDLY EMPHASIZED, THE COMMISSION WANTS TO KEEP ACCESS TO OUR TELEPHONE NETWORK AFFORDABLE TO ALL RESIDENTIAL USERS. SEVERAL ACTIONS WITHIN OUR JURISDICTION WERE TAKEN TO

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* NEW YORK TIMES, OCTOBER 4, 1983 AT D1.

ASSURE THIS GOAL. THE MONTHLY FLAT CHARGES START LOW, INCREASE SLOWLY OVER A SIX YEAR PERIOD, AND ALL THE WHILE THE COMMISSION WILL BE MONITORING THE NETWORK FOR POSSIBLE ADVERSE EFFECTS. FURTHERMORE, STATE REGULATORS MAY REQUEST WAIVERS OF THESE CHARGES IN ORDER TO PROVIDE "LIFELINE" SERVICE OFFERINGS TO THOSE USERS WHO MAY FIND THESE COSTS UNAFFORDABLE. THE ORDER ALSO CREATES A UNIVERSAL SERVICE FUND THAT DIRECTS SUBSIDIES TO SPARSELY SETTLED, RURAL AREAS WHERE THE COSTS OF ACCESSING THE LOCAL SWITCH ARE HIGHER. I WILL LATER DISCUSS THIS FUND'S EFFECT ON THESE REGIONS IN MORE DETAIL. BUT FOR NOW SUFFICE IT TO SAY THAT TOGETHER THESE PROVISIONS SHOULD KEEP LOW INCOME AND RURAL CUSTOMERS ON THE NETWORK WITHOUT DISTORTING THE PRICE OF LONG DISTANCE SERVICE TO EVERYONE.

THE THIRD POINT I WOULD LIKE TO MAKE IS THAT THE ACCESS CHARGE DECISION IS EFFICIENT. THE BENEFITS OF COST-BASED PRICING FOR LONG DISTANCE SERVICE WILL BE DRAMATIC. TODAY LONG DISTANCE CHARGES MAY BE AS MUCH AS 60% HIGHER THAN THE COST OF PROVIDING THE SERVICE.* THIS METHOD OF PAYING FOR ACCESS HAS EXCESSIVELY DISCOURAGED LONG DISTANCE CALLING. THE COLLECTIVE WASTE FROM SUCH UNDERUTILIZATION OF LONG DISTANCE SERVICE HAS BEEN ESTIMATED TO BE AS MUCH AS

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* SEE <u>COMMENTS</u> OF AT&T IN RESPONSE TO 4TH SUPPLEMENTAL NOTICE IN DOCKET 78-72.

A BILLION DOLLARS A YEAR.* BY THIS I MEAN THAT IF LONG DISTANCE RATES WERE COST-BASED THE BENEFIT TO CUSTOMERS FROM MAKING ADDITIONAL CALLS WOULD EXCEED THE COST OF PROVIDING THE EXTRA SERVICE BY ABOUT A BILLION DOLLARS A YEAR.

IN RESPONSE TO THE FIRST PHASE OF THE ACCESS CHARGE PLAN, AT&T HAS ANNOUNCED 10 TO 15 PERCENT CUTS IN LONG DISTANCE RATES. FOR EXAMPLE, A FIVE MINUTE DIRECT DIALED DAY CALL FROM SIOUX FALLS OR DES MOINES TO CHICAGO WOULD COST $1.98 RATHER THAN $2.27 OR 12.8 PERCENT LESS.** MORE LONG DISTANCE RATE CUTS WILL FOLLOW AS THE DECISION IS PHASED IN. AS THESE COSTS COME DOWN, PEOPLE WILL CALL MORE, MAKE LONGER CALLS AND RECEIVE MORE CALLS. WE HAVE ALREADY SEEN THIS HAPPEN WHEN SUBSCRIBERS CHOOSE LOWER-COST ALTERNATIVE NETWORKS SUCH AS MCI. THE SHORT OF IT IS THAT ALL LONG DISTANCE USERS -- AND THAT INCLUDES MANY LOW INCOME PERSONS -- WILL BENEFIT.

THE INDIRECT EFFECTS FROM MORE INTENSIVE USE BY BUSINESS WILL ALSO TRANSLATE INTO ENORMOUS GAINS TO ALL AMERICANS WHEN THE INNUMERABLE ENTREPRENEURS IN OUR THREE TRILLION DOLLAR ECONOMY BEGIN TO ADJUST TO THESE

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* JAMES M. GRIFFEN, "THE WELFARE IMPLICATIONS OF EXTERNALITIES AND PRICE ELASTICITIES FOR TELECOMMUNICATIONS PRICING" 64 <u>REVIEW OF ECONOMICS AND STATISTICS</u> 59 (1982).

** BASED ON ATTACHMENTS TO LETTER TO MARK S. FOWLER, CHAIRMAN OF FCC, FROM JAMES R. BILLINGSLEY, VICE PRESIDENT OF AT&T, OCTOBER 3, 1983.

ENORMOUS PRICE REDUCTIONS BY FINDING INNOVATIVE WAYS TO USE LONG DISTANCE SERVICE.

FOR EXAMPLE, BUSINESSES, GOVERNMENT AND EDUCATIONAL INSTITUTIONS INCREASINGLY RELY UPON LOW COST TELECOMMUNICATIONS TO DO THEIR WORK. TELECONFERENCING IS INCREASINGLY USED IN PLACE OF ACTUAL MEETING FOR TRAINING PURPOSES. IT SAVES TIME AND MONEY AND THUS KEEPS COSTS AND PRICES DOWN. INFORMATION NETWORKS HAVE BECOME THE BACKBONES OF BUSINESS AND GOVERNMENT. FURTHERMORE, PROFESSIONALS IN MANY FIELDS NOW RELY EXTENSIVELY UPON INFORMATION MADE AVAILABLE BY LOW COST LONG DISTANCE TELECOMMUNICATIONS. MEDICAL DOCTORS CAN CALL UP SERVICES SUCH AS "MEDLINE" AND "COLLEAGUE" TO GET ACCESS TO STATE-OF-THE-ART DIAGNOSTIC INFORMATION AND THE MOST RECENT RESEARCH. THAT MEANS HIGHER QUALITY MEDICAL CARE. LAWYERS, ENGINEERS AND PROFESSIONALS OF ALL KINDS ARE USING LONG DISTANCE COMMUNICATIONS TO ACQUIRE INFORMATION THAT ENABLES THEM TO SUPPLY BETTER SERVICES AT LOWER COSTS. AS THE COSTS OF ELECTRONIC COMMUNICAITON FALL, THESE SERVICE BENEFITS CAN BE MADE AVAILABLE ON AN INCREASINGLY WIDESPREAD BASIS. WHAT THIS MEANS FOR THE AMERICAN PEOPLE IS BETTER SERVICES OF ALL KINDS AT LOWER COSTS NO MATTER WHERE YOU LIVE. ALSO, RURAL STATES WILL BECOME EVEN MORE ATTRACTIVE SITES FOR

LOCATING NEW BUSINESSES. GIVEN THEIR EXPERIENCE WITH COMPANIES SUCH AS CITIBANK, THE PEOPLE OF SOUTH DAKOTA KNOW HOW SIGNIFICANT SUCH AN INFLUX CAN BE.

THE FOURTH POINT I WOULD LIKE TO MAKE IS THAT THE ACCESS CHARGE DECISION WILL ALSO REDUCE THE UNECONOMIC BYPASS OF THE TELEPHONE NETWORK AND DIVERSION OF REVENUES THAT THE PRESENT SYSTEM IS CAUSING. BECAUSE LARGE LONG DISTANCE USERS PAY THEIR SHARE OF ACCESS COSTS MANY TIMES OVER, THEY HAVE AN ENORMOUS INCENTIVE TO TURN TO CHEAPER ALTERNATIVES. WE SIMPLY CANNOT AFFORD TO GIVE LARGE TELEPHONE USERS AN ARTIFICAL INCENTIVE TO JUMP SHIP. IF THEY DO, THE COSTS WILL STILL BE THERE, AND THE REMAINING USERS WILL BE SOCKED EVEN HARDER. OUR DECISION MAKES IT ATTRACTIVE FOR BIG USERS TO LEAVE THE NETWORK ONLY IF BYPASSING IT IS MORE EFFICIENT. THE ALTERNATIVE OF TAXING SUCH BYPASS FACILITIES, PROPOSED BY SOME IN CONGRESS, IS NEITHER FEASIBLE NOR DESIRABLE. DEFINING AND THEN FINDING BYPASSERS WOULD BE NO EASY TASK. EVEN IF FEASIBLE, BYPASS TAXES COULD KILL EFFICIENT NEW TECHNOLOGIES. FOR EXAMPLE, THE TEXT OF THE WALL STREET JOURNAL IS TRANSMITTED TO PRINTING PLANTS BY SATELLITE. THIS SERVICE, ALBEIT AT HIGHER COSTS, COULD BE PROVIDED BY THE TELEPHONE NETWORK. IS THAT PAPER'S DISTRIBUTION NETWORK UNECONOMIC BYPASS? WE CAN'T REALLY TELL

UNDER THE PRESENT SYSTEM. THE MOST PRUDENT SOLUTION TO UNECONOMIC BYPASS IS TO PRICE SERVICES AT COST, REMOVING THE INCENTIVE TO TURN TO INEFFICIENT ALTERNATIVES.

THE EFFECTS ON IOWA, MINNESOTA, NEBRASKA, NORTH DAKOTA AND SOUTH DAKOTA

NOW I WOULD LIKE TO TAKE A MOMENT TO DISCUSS THE EFFECT OF THE ACCESS CHARGE DECISION ON THE CITIZENS OF THE STATES IN THIS REGION. SOME FEAR THAT UNDER THE ACCESS CHARGE DECISION RATES IN LESS DENSELY POPULATED STATES WILL RISE MORE THAN IN OTHER REGIONS, BECAUSE SUCH STATES HAVE HIGHER LOOP COSTS PER CUSTOMER. HIGHER RATES, IT IS ARGUED, WILL JEOPARDIZE UNIVERSAL SERVICE IN RURAL AREAS. THIS CRITICISM OF THE ACCESS CHARGE IS MISPLACED FOR SEVERAL REASONS.

FIRST, IT SHOULD BE NOTED THAT SOME RURAL STATES -- INCLUDING IOWA, MINNESOTA, AND NEBRASKA -- HAVE LOOP COSTS THAT ARE AT OR UNDER THE NATIONAL AVERAGE.* AFTER ONE FACTORS IN WHAT LONG DISTANCE CUSTOMERS WILL BE PAYING INTO THE UNIVERSAL SERVICE FUND, THE PEOPLE OF THOSE THREE STATES ARE NET

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* SEE ATTACHMENT C OF LETTER TO JOYCE I. BUTLER, CHIEF, DOCKETS BRANCH FROM JACK D. SMITH, CHIEF, COMMON CARRIER BUREAU, OCTOBER 6, 1983.

LOSERS UNDER THE SENATE BILL. IOWANS PAY OUT FOUR TIMES MORE THAN THEY RECEIVE. MINNESOTANS PAY OUT ALMOST TWICE AS MUCH AS THEY RECEIVE AND NEBRASKANS PAY OUT 20 PERCENT MORE THAN THEY RECEIVE.*

SECOND, AS I HAVE ALREADY NOTED, THE COMMISSION'S DECISION CREATES A UNIVERSAL SERVICE FUND ESPECIALLY DESIGNED TO ADDRESS THIS PROBLEM. INDEED, OF THE FIVE STATES OF PARTICULAR CONCERN IN THESE HEARINGS, FOUR WILL RECEIVE MORE FROM THE FCC/JOINT BOARD UNIVERSAL SERVICE FUND THAN THEY WOULD UNDER THE MOST RECENT SENATE BILL. MINNESOTA WOULD RECEIVE MORE THAN NINE TIMES AS MUCH. THE PRECISE AMOUNTS FOR EACH STATE ARE CONTAINED IN TABLE 1 APPENDED TO MY TESTIMONY. OF COURSE, TO THE EXTENT A STATE RECEIVES LESS MONEY UNDER THE PROPOSED LEGISLATION, ITS LOCAL TELEPHONE RATES WOULD HAVE TO BE HIGHER TO COVER THE SHORTFALL. WHILE END USERS WOULD NOT HAVE TO PAY MONTHLY FLAT FEES UNDER THE SENATE BILL, THEY WOULD LIKELY HAVE HIGHER LOCAL TELEPHONE RATES. ALSO, THE SENATE BILL INTRODUCES AN ADDITIONAL DISTORTION BY DIRECTING HIGH COST ASSISTANCE TO ONLY THOSE TELEPHONE COMPANIES WITH 50,000 OR FEWER LOOPS AND WHICH ARE NOT AFFILIATED WITH A HOLDING COMPANY WITH REVENUES OF 100

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* TABLE III A TO LETTER TO CONGRESSMAN JOHN DINGELL FROM CHARLES BROWN, CHAIRMAN OF THE BOARD OF AT&T, SEPTEMBER 1, 1983. SEE TABLE 2 APPENDED TO THIS TESTIMONY FOR THE INFORMATION RELEVANT TO THESE FIVE STATES.

MILLION DOLLARS OR MORE. IT IS EASY TO IMAGINE HOLDING COMPANIES DIVESTING LOCAL EXCHANGES SO THAT BOTH MAY QUALIFY FOR ASSISTANCE. EVEN IF THEY DON'T DO THIS THERE MAY BE WASTEFUL NEW ENTRY BY SMALL FIRMS. IN EITHER EVENT INEFFICIENT BUSINESS ORGANIZATION WILL BE ENCOURAGED -- TO THE ULTIMATE DETRIMENT OF CONSUMERS.

I AM NOT ARGUING FOR SUBSIDIES FOR ANY PARTICULAR STATE. TO THE CONTRARY, I THINK THAT BROAD BASED, UNFOCUSED SUBSIDIES SHOULD BE THE EXCEPTION NOT THE RULE. MY POINT IN CITING THESE STATISTICS IS TO EMPHASIZE THAT THE FCC MADE A CONSIDERED DECISION TO ADDRESS THE PLIGHT OF HIGH COST STATES AND THIS DECISION CONTINUES TO BE REFINED. THE PROPOSED LEGISLATION, ON THE OTHER HAND, IS BASED ON A HURRIED REVIEW OF THE PROBLEM, INTRODUCES NEW DISTORTIONS, AND WILL BE FAR MORE DIFFICULT TO MODIFY AS CHANGING CIRCUMSTANCES WARRANT. THE COMMISSION WILL BE CONTINUOUSLY MONITORING THE PHASE-IN OVER THE NEXT THREE YEARS AS THE FLAT FEE RISES TO FOUR DOLLARS. IF A SIGNIFICANT NUMBER OF DISCONNECTS OCCUR OR EVEN APPEAR LIKELY, THE COMMISSION COULD RECOMMEND SPECIFIC ACTION. FOR EXAMPLE, CONGRESS AND THE STATES COULD ACT TO TARGET ASSISTANCE TO THOSE CITIZENS WHO NEED IT. THIS APPROACH WOULD PRESERVE THE SUBSTANTIAL EFFICIENCY GAINS FROM COST BASED

PRICING OF LONG DISTANCE SERVICE AND BE MUCH FAIRER AND CHEAPER THAN GIVING SUBSIDIES TO ALL PEOPLE REGARDLESS OF WHETHER THEY NEED THEM.

FINALLY, WE CAN EXPECT TELEPHONE COMPANIES, IF THEY ARE GIVEN THE FLEXIBILITY, TO MAKE IT EASIER FOR MANY CUSTOMERS TO STAY ON THE NETWORK. MANY CRITICS OF THE ACCESS CHARGE PLAN ARGUE THAT THE NETWORK IS WORTH MORE TO EVERYONE IF THE PENETRATION RATE REMAINS HIGH, THAT IS, NEARLY UNIVERSAL. TO THE EXTENT THIS EXTERNALITY IS IMPORTANT, HOWEVER, THE TELEPHONE COMPANIES WILL HAVE A STRONG INCENTIVE TO KEEP CUSTOMERS ON THE SYSTEM. THEY CAN DO THIS BY OFFERING A RANGE OF OPTIONS TO CUSTOMERS THAT ALLOWS USERS TO PAY ONLY FOR WHAT THEY GET. FOR EXAMPLE, NORTHWESTERN BELL OFFERS OR IS PROPOSING SUCH OPTIONS IN THIS AREA TODAY:

- IOWA HAS A $9.55 FLAT RATE FOR UNMEASURED SERVICE AND PROPOSES TO OFFER A $6.05 LOW COST OPTION THAT PROVIDES ACCESS PLUS $2.00 WORTH OF CALLS.

- MINNESOTA HAS "IN METRO" AND "OUTSTATE" FLAT RATES OF $12.35 AND $10.72 AND OFFERS AN IN METRO OPTION OF $7.02 WITH A $3.15 CALL ALLOWANCE AND AN OUTSTATE OPTION OF $5.96 WITH A $2.40 ALLOWANCE.

- Nebraska has flat rates between \$6.37 and \$9.86 but offers a low cost option of \$6.25 with a one dollar call allowance.

- North Dakota has a \$12.05 flat rate and a low cost option of \$6.50.

- South Dakota has a \$11.40 flat rate and a low cost option of \$5.00 with 40 free calls.

It is my understanding that Northwest Bell estimates that by 1986 80% of their customers in these five states will have these low cost options available to them.

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In closing it is important to place these recent developments into the context of the recent past. Telecommunications technological breakthroughs have caused a revolution in the regulation of this industry. Innovation and

THE COMPETITIVE FORCES IT UNLEASHED WERE THE IMPETUS FOR FASTER DEPRECIATION OF TELEPHONE PLANT AND EQUIPMENT, PRICE DEREGULATION OF RESIDENTIAL AND BUSINESS TELEPHONES, AND DEVELOPMENT OF VIBRANT COMPETITION IN LONG DISTANCE TELEPHONE SERVICE. WE KNOW THESE CHANGES HAVE BEEN BENEFICIAL. BECAUSE OF COMPETITION, TODAY YOU CAN BUY A PHONE, WITH FEATURES UNAVAILABLE ONLY FIVE YEARS AGO, FROM NEW SUPPLIERS FOR THE SAME PRICE IT COSTS TO LEASE A STANDARD PHONE FROM THE PHONE COMPANY FOR JUST ONE YEAR. THE COMMISSION'S ACCESS CHARGE DECISION IS THE NEXT LOGICAL STEP IN ENSURING THAT AMERICAN CONSUMERS AND BUSINESSES REAP THE FULL BENEFITS OF THE GROWING COMPETITION AND REMARKABLE NEW TECHNOLOGIES APPEARING IN THE LONG DISTANCE MARKETPLACE. IN ESSENCE, THE COMMISSION IS EXTENDING THE FREE ENTREPRISE SYSTEM TO ANOTHER SECTOR OF THE ECONOMY. IT WILL BE BOTH FAIRER AND MORE EFFICIENT THAN THE EXISTING SYSTEM BECAUSE IT MOVES PRICES TO REFLECT COSTS AND ALLOWS FOR SUBSIDIES, IF THEY NEED TO EXIST, THAT WILL BE OPEN AND TARGETED TO ONLY THOSE CONSUMERS WHO NEED THEM.

THANK YOU.

TABLE 1

STATEWIDE PER LOOP AND TOTAL ANNUAL SUBSIDIES
FOR SELECTED STATES BASED ON 1980 DATA

STATE	PACKWOOD PLAN 1/		FCC/JOINT BOARD PLAN 2/	
	HCRR 3/	THCRR 4/	HCRR 3/	THCRR 4/
IOWA	.57	635,127	.79	883,478
MINNESOTA	.19	327,239	1.79	3,025,652
NEBRASKA	3.66	2,486,129	2.97	2,021,077
NORTH DAKOTA	24.94	6,550,144	28.88	7,584,535
SOUTH DAKOTA	12.07	2,942,736	15.64	3,812,992

1/ THE PACKWOOD PLAN PAYS 90% OF THOSE COMPANY LOOP COSTS BETWEEN 110 AND 250% OF NATIONAL AVERAGE LOOP COSTS AND 100% OF THOSE COSTS ABOVE 250% OF THAT AVERAGE. HOWEVER, TO BE ELIGIBLE FOR THIS ASSISTANCE A COMPANY MUST HAVE 50,000 OR FEWER LOOPS AND NOT BE AFFILIATED WITH A HOLDING COMPANY WITH REVENUES OF 100 MILLION DOLLARS OR MORE. THESE FIGURES ARE TAKEN FROM AN ANALYSIS BY THE FCC COMMON CARRIER BUREAU BASED ON A SAMPLE OF OVER 600 TELEPHONE COMPANIES WITH 98% OF ALL LOOPS. SEE ATTACHMENT D OF LETTER TO WARD WHITE, SENIOR COUNSEL TO SENATE COMMERCE COMMITTEE, FROM JACK D. SMITH, CHIEF, COMMON CARRIER BUREAU, SEPTEMBER 19, 1983.

2/ THE FCC/JOINT BOARD PLAN PAYS 50% OF THOSE COMPANY LOOP COSTS BETWEEN 115 AND 160% OF THE NATIONAL AVERAGE LOOP COSTS, 60% OF THOSE COSTS BETWEEN 160 AND 200%, 95% OF THOSE COSTS BETWEEN 200 AND 250%, AND 100% OF THOSE COSTS OVER 250%. THERE ARE NO ADDITIONAL ELIGIBILITY REQUIREMENTS. THESE FIGURES ARE TAKEN FROM AN ANALYSIS BY THE FCC COMMON CARRIER BUREAU BASED ON A SAMPLE OF OVER 600 TELEPHONE COMPANIES WITH 98% OF THE LOOPS. SEE ATTACHMENT C OF LETTER TO JOYCE C. BUTLER, CHIEF, DOCKETS BRANCH FROM JACK D. SMITH, CHIEF, COMMON CARRIER BUREAU, OCTOBER 6, 1983.

3/ HCRR IS THE ANNUAL HIGH COSTS REVENUE REQUIREMENT OR SUBSIDY PER LOOP.

4/ THCRR IS THE TOTAL ANNUAL HIGH COST REVENUE REQUIREMENT OR SUBSIDY.

TABLE 2

UNIVERSAL SERVICE FUND COMPONENT OF JOINT BOARD PROPOSAL (DOCKET 80-286)
TELEPHONE INDUSTRY - 1984 LEVEL (ESTIMATED)*

(DOLLARS - MILLIONS)

STATE	USF PAYMENTS (A)	CUSTOMER PAYMENTS TO FUND USFØ (B)	RATIO (A÷B)
IOWA	2	9	.22
MINNESOTA	7	11	.64
NEBRASKA	5	6	.83
NORTH DAKOTA	17	3	5.67
SOUTH DAKOTA	9	3	3.00
TOTAL	900	900	XX

* ASSUMING USF WERE IN EFFECT IN 1984.

Ø BASED ON CARRIER CHARGES DISTRIBUTED ON ORIGINATING MINUTES.

Senator JEPSEN. Before going to the representatives from the various States, let us set the stage for some of the remarks, or to pose some questions to which you may respond when you make your remarks. Mr. Pitsch, is there any segment of our society that may be affected by any downside to this at all, this divestiture, this proposal, of which I assume, from your remarks, you are in complete agreement, and are supporting and promoting, and, I guess you should?

Mr. PITSCH. Since I had a hand in making the decision, that is correct.

Senator JEPSEN. Did not the Judge make it?

Mr. PITSCH. I would point out that my remarks are confined to the Commission's access-charge decision. I think the Commission, in comments before Judge Greene, supported the consent decree, which AT&T and the Department of Justice also supported, for different reasons, obviously.

In terms of the access-charge decision, I think that—first off, I think it is the only way we are going to get there. If we do not do something like this, bypass is going to really cause problems down the road. And once people put in new technologies, new systems in place, they are not going to come back until that is amortized over several years; and, second, I think that there are enormous efficiency gains. That is not to say that some people now will not pay higher rates, but I think many of those people can afford those rates, and they are causing those costs—they are imposing those costs on the system. I think it is fair that they pay them.

Now, for those people who cannot afford it, I think, in a civilized society, we try to help them, and I think there are measures in place that can do that. So I am supportive of the Commission's decision.

Senator JEPSEN. You quote a New York Times poll which said that the majority of Americans say the phone system should not be subsidized. Now, I can understand that.

Now, tell me, realistically, if phone customer rates went from $10 or $12, the current monthly rate to an actual cost of, say, $25 or $30, and then we ran the same poll, what do you think it would be?

Mr. PITSCH. It is always treacherous to cite opinion surveys. I think that the point I would make is that generally, people think it is fair for people to pay for the costs of the service they are provided.

Now, you might be right in inferring that many people who currently enjoy local service and who make no long-distance calls, do not realize that they are subsidized, and that might affect their reaction to whether or not we ought to go to this system.

But my point in citing it is that, generally, in our private system, in our free-enterprise system, we realize that enormous efficiencies are gained from pricing services at cost. That is one of the great advantages of competition as opposed to monopolies. It drives prices to cost and allocates resources to their most efficient ends.

Senator JEPSEN. As you understand this access charge, what would a small business in Iowa that had, say, 25 phone lines and this divestiture took place, and so on, what would they pay for access charge?

Mr. PITSCH. I cannot be sure until we know what those tariffs—what the final costs are in Iowa. It is possible that the business line access charge would fall below $6, but assuming that it did not, assuming that it was $6——

Senator JEPSEN. Is that per line?

Mr. PITSCH. That is per line per month. Now, the reason I give you that caveat is that, for example, I believe Michigan, that charge would be $3 per line per month even for businesses. One of the States has that $3. But, the point is that, right now, as you would expect, when those costs are lower, people might be using lines in an inefficient way, and, perhaps, when that business sees that the full cost to society of providing that service is $6, they will adjust and reduce the number of lines.

Obviously, people can accommodate to new changes in their circumstances, but under your scenario, 25 times $6, or $150 per month. On the other hand, for many businesses that is going to be far different than a residential customer, and the cost of business, and a cost that ought to be paid by the people who benefit from that particular business service or good.

Senator JEPSEN. A utility company the other day at the hearing said that it was going to cost some several hundred thousand dollars for them. Now, they can put this added cost in their rates. And I am not debating this with you, but just to make sure that we have some perspective on this, because most businesses—large and small—do not have that ability. Do you have any comment on how they might plan for those things?

Mr. PITSCH. Again, I think that if that business is efficiently run and providing a service that people really want, it will be able to pass those costs along in higher prices. However, I think it is important to note, and this is an important point of my efficiency argument, is that when you balance those higher prices to consumers by the lower prices they get from more efficient use of our interstate network—people now are using inferior substitutes—they are not making telephone calls that they otherwise would be if the rates were as much as 40 percent lower than they are now, and that means that all of us, including the poorer people of this country who buy, spend a disproportionate amount of their income on goods and services, who do not invest and save a lot of their money, will be disproportionally benefited although indirectly—of course, if they buy a product in a drugstore, they are not going to see that it cost them a couple pennies less because the providers and warehouses of that service have lower costs, but they will be there, and I think that the Commission felt that that was a very telling argument.

We have a magnificent telephone network that has enjoyed enormous technology improvements in the last several decades.

Senator JEPSEN. You say we have one now?

Mr. PITSCH. That is correct. In long-distance service, in particular, with the microwave, satellite, and coaxial cable, those prices should have fallen dramatically since World War II, and we have only seen part of those lower prices because of the current subsidy programs.

If a business like AT&T, who invented the transistor, warehoused that transistor, in order to protect their investment or protect current labor arrangements, we, as a country, would be outraged that they had warehoused an innovation.

I think the primary reason for the enormous prosperity this country has enjoyed has been exploiting that kind of innovation in improving efficiency. Well, unfortunately, the current regulatory system has warehoused these improvements in our interstate network, and, consequently, we, as a society, are shooting ourselves in the foot to the tune of about $1 billion a year in higher prices, eventually, for goods and services.

Senator JEPSEN. One last thing before we move on and I will recognize the Iowa State Representative Varley. Uniformly or unanimously, I should say, the other day when I asked of everyone that testified, certainly from the industries, businesses, and so on, setting the senior citizen folks into a separate category, is there one thing that concerns people most, and everyone said that the bypass problem was the greatest concern. As it is proposed, does this change allow or compensate for some of the dangers that they seem to feel that is inherent in being able to bypass the local phone exchange?

Mr. PITSCH. I think so, Senator. If you are a large user right now and the cost of access to you is, say, $6 a month per line, but because you make several hundreds of calls a month, your telephone bill may be several thousands of dollars, and you might well be paying $200 or $300 per line per month because the charges are being picked up in a usage way, and, obviously, if you add up 15 cents for every minute, it can generate $200 or $300 figure.

Now, if you have the alternative of using microwave technology to tie into an interstate competitor, now, that could be AT&T Long Lines after the divestiture, but, say that technology cost you $80 a month per line, well, if the choice is paying $200 or $300, or $80, you will go to $80. But if you price things closer to cost, that means $80 or $7 a month per line, obviously you are not going to use that technology, and we will not get the uneconomic, inefficient bypass that I am afraid is already existing.

We have teleport facilities being set up in several cities. We have got private microwave networks already in place that could be used more and more for this purpose. We have got cable technology that might be used for this purpose. We have got corporations like Martin-Marietta and Boeing using these technologies already. We have hotels in Las Vegas doing this.

I think it is a very real concern that has to be addressed.

Senator JEPSEN. The Rockwell Corp. has it in our State. We are familiar with that.

Thank you.

Mr. Varley.

STATEMENT OF ANDREW VARLEY, CHAIRMAN, IOWA STATE COMMERCE COMMISSION, DES MOINES, IOWA

Mr. VARLEY. Thank you, Senator Jepsen.

It is a pleasure for me to be here and testify before your committee. I would like to make some comments that are primarily directed to Senate bill 1660, but then I would like to respond to a few of the statements made by Mr. Pitsch's program.

Senator JEPSEN. Please go ahead.

Mr. VARLEY. It is most appropriate that Congress should be taking action to establish telecommunications policy for this country. We are going through a complete revolution in the pricing of telephone service as a result of decisions in the courts and decisions by the Federal Communications Commission but in the absence of any direction by Congress, the appropriate policymaking body.

Senate bill 1660 is a move in the right direction in that it delays implementation of the interstate access charge and establishes a universal service fund to maintain some semblance of universal service but I do not believe it goes far enough.

The policy statement says in part:

[F]or the purpose of assuring that any inter-exchange carrier or other persons that use the service of exchange companies through direct or indirect connection or that offers, owns, operates, or controls any transmission facilities or service used as a substitute for voice grade or equivalent transmission facilities or services offered by exchange carriers shall bear an equitable share of the cost of universal telephone service.

That philosophy is correct and should be expanded.

The FCC's position that long-line service should contribute only usage sensitive cost to the local exchange ignores the necessity of access to the local exchange for the long-line service to have any value. While the long-line service may have contributed too much to the shared fixed cost in the local exchange in the past, that is no argument for them not sharing any of those costs. The threat of uneconomic bypass is more imagined than real if all long-line carriers are treated the same. Shifts to other common carriers [OCC] take place because the OCC's do not pay all of the cost that is currently charged to AT&T. When all long-line carriers share the same cost, that bypass will no longer be a threat.

That is no reason to conclude that no long-line carriers should share any fixed cost in the local exchange. Independent networks to carry dedicated lines represent the other significant form of bypass. In most cases dedicated lines should bypass the local switch. If they only pay usage sensitive cost they can only add to the cost for other customers by going through the local switch and should not be subsidized to remain there.

The FCC's solution to avoid what they perceive as uneconomic bypass achieves the end result of uneconomic bypass for the local customer; that is, that long-line service contributes nothing to the shared fixed cost in the local exchange.

I believe that Senate bill 1660, consistent with their earlier policy statement on universal telephone service, should further state that any inter-exchange carrier or other person that uses the service of exchange companies through direct or indirect connection should contribute to the joint fixed cost of that local exchange.

While the universal service fund with its limited application is a major step toward insuring that isolated exchanges will not have rates many times higher than the national average, it does not solve the problem that the national average may double or triple. It attempts to further alleviate that high-cost problem through the lifeline provision that may set an impossible standard. Only 50 percent of the total lifeline costs are to come from the universal service fund implying that the other 50 percent of the costs are to be made up in the local rates. It further suggests that the lifeline rates are "such rates as are necessary and sufficient to insure that access to telephone service remains available to the same percentage of households served by the exchange carrier on January 1, 1983."

If local exchange costs go up as much as we expect, we would assume there would be some loss of customers from all income classes where individuals perceive their telephone usage as being too small to justify the much higher rates.

Using the lifeline rates to keep local exchange service at the 1983 price for low-income individuals would not result in the exchange carrier serving the same percentage of households.

Delaying the interstate access charge until January 1, 1986, only delays the shift of cost from toll revenues to the local exchange to a later date.

Asking for policy recommendations from a board that is dominated by FCC members is unlikely to produce recommendations significantly different than the policies they have proposed up to the present time.

I believe Congress should direct the FCC to revise their policy on giving inter-exchange carriers access to the local switch without sharing in those fixed costs.

I believe that the design and financing of lifeline rates should be left to the individual States to be solved in a manner consistent with their individual circumstances. Time, of course, is important because the major changes in telephone pricing are scheduled to start taking place January 1, 1984. It is unclear under Senate bill 1660 exactly what will take place between January 1, 1984, and January 1, 1986, in that the separations and settlement system of the past will no longer be in place after that date, with the separation of AT&T and the Bell operating companies.

Congress should take this opportunity to formulate meaningful telecommunication policy rather than pass a bill that simply cushions the impact of policies established in the absence of congressional direction.

I would like to respond to several of the statements made by Mr. Pitsch. His first item that he stated was in reference to the FCC's access charge as a fair way of allocating those costs.

I think that is similar to looking at a situation, if you had one grocery store in a community and you made a decision that you were going to allocate all of the fixed cost to people who were customers in the meat market in that store, and then make the further assumption that those fixed costs should be shared equally by all of the customers without regard to the amount of meat that they purchased. I simply do not think their pricing policy does have solid foundation based on the fair method of allocated costs.

I think it is a result of a concern about unequal pricing policies for long-line service from AT&T, or other common carriers, and there obviously is always going to be some incentive for bypass, if one of the long-line carriers has to pay costs different from the other carriers.

The suggestion that the increase in local rates are exaggerated, that the access charge is only $4 to $6 per month, and that is a far cry from doubling or tripling, ignores the impact of their overall decision. Certainly there is a great deal of pressure on the State to price intrastate calls the same way that the FCC is pricing interstate calls, and there is a very significant loss in revenue coming back to the local exchange.

It is not just the amount that is being made up for by that $4 to $6. In fact, they start out with the charge per minute based on usage. That is phased out over time, as that access charge increases.

If States do the same thing, price their services in the same way—and they are almost forced to in order for intrastate calls to be competitive with interstate, the doubling or tripling of rates is not out of line. I think if you doubt that, all you have to do is look at the United Telephone's recent filing with Iowa Commission where they are asking for an increase in rates of 93 to 97 percent. That is just for starters.

When you say "we are not looking at dramatic increases in local rates," that is simply to ignore what is happening right before our eyes. The suggestion that this solves the problem of universal service, again, I think ignores the fact—the statement that by phasing the charge in over 6 years, people probably will not notice it, I think is a little naive. I believe they are going to notice it in a—very shortly.

The fact that State regulators can ask for waivers is true, but all that does is shift the responsibility back on the States. Not only do you not have to pay the access charge, you have to make up the loss of revenues somewhere else. It has to come from somewhere, and the FCC is solving their problem simply by shifting that issue back to the States.

The universal service fund that is proposed by the FCC is a much larger pool than the universal service fund proposed in Senate bill 1660, as I understand it.

In suggesting that some States are gainers or losers ignores the amount of money that people are kicking into that fund from their local exchange, and I much prefer the Senate bill to the FCC's policy, primarily because of the volume of dollars that go into that fund to begin with.

I completely agree with Mr. Pitsch that as total rates go down, you would expect there to be more toll usage. I do not argue with that at all. The suggestion of reducing uneconomic bypass I addressed in my earlier remarks.

We have heard several examples from Mr. Pitsch and other representatives from the FCC about cases of bypass. Certainly the Wall Street Journal should bypass the local exchange system. There is absolutely no reason why transmitting the copy for the Wall Street Journal should go through a local exchange at either end of the transmission. I think the satellite is the perfect mechanism for doing that.

We have heard about airline companies, hotel companies that have dedicated lines, bypassing the system, and they should. Having those dedicated lines go through a local exchange can only add cost to the local exchange. There is every reason for them to bypass.

One of the problems with the FCC's policy is that they are not having them share any of those local costs. Those local fixed costs provide a real incentive for uneconomic remainder with the system. If you are getting a service that you are not paying for, then there is every reason for certain users with the telephone system to go through the local switch when they should not go through the local switch at all.

Finally, the suggestion that the problem can be solved by Congress and the States appropriating money to subsidize low-income people so they can afford to use telephone service, I think is regrettable. Here we have what has been a very prosperous industry that has provided excellent service, and now, suddenly, we are saying that by changing our pricing policy, we are going to develop a situation where, in order for people to have access to it, it is going to require a substantial subsidy from either Federal or State government. I think that is tragic, and I think it is also unnecessary. I think if Congress establishes a proper pricing policy, that can be avoided.

Thank you very much, Senator.

Senator JEPSEN. I thank you, and I think we will move now to our guest from South Dakota, Ken Stofferahn; is that correct? And I see Mr. Pitsch gave you access to his microphone. [Laughter.]

Mr. STOFFERAHN. I reached out and touched it. [Laughter.]

STATEMENT OF KEN STOFFERAHN, CHAIRMAN, PUBLIC UTILITIES COMMISSION, STATE OF SOUTH DAKOTA

Mr. STOFFERAHN. Senator and members of the committee and staff, it is a pleasure for all commissioners from South Dakota to be present here today.

The remarks that I am going to give you were jointly prepared by all three of us, and they will be available, and my colleagues will be available for any questioning or additional remarks that they may have.

The South Dakota Public Utilities Commission is particularly pleased and appreciative of the opportunity to participate actively in the hearings of the Joint Economic Committee, with respect to the impact of the divestiture of AT&T upon the South Dakota telecommunications industry.

We are submitting for your consideration today, the policy statement which was forwarded to the FCC's previous docket which elicits our concerns on the impact of the divestiture and the latest FCC decisions relating to the telecommunications industry.

We are pleased that the Congress is now taking an active interest in addressing some of the problems that have been troubling State commissions for the past 2 years, and it affords State commissions—such as ours—the opportunity to present additional views of enhanced concern.

This commission has a longstanding tradition of commitment to the preservation of universal telephone service at affordable rates. Since well over 95 percent of all households now have a telephone, we can make the assumption that universal service is in place and that rates are now affordable.

Over the past year or so, AT&T has, in our opinion at least, implemented an intense media campaign to condition the American public to the fact that telephone rates will at least double in the very near future as a result of the divestiture. They have based this assumption, in part, on the fact that subsidies flowing from interstate separation will no longer be available. This is not surprising, since the effect of the modified final judgment issued by Judge Greene will place AT&T into the competitive, nonregulated, interstate market at a decided advantage, if the present decisions of the FCC are allowed to stand.

During the October 14 hearing of this committee in Sioux Falls, the BOC of South Dakota endorsed the access charges as proposed by the

FCC. We would hasten to point out, that if the public interest is to be served, it is of monumental importance that we proceed from the proper benchmark. We believe that Members of Congress should be fully apprised of the consequences to the public interest if unnecessary cost burdens are placed in the BOC's regulated rate base or allowed to remain.

At issue here is the proper allocation of the huge investment in the local loop, which is referred to as the non-traffic-sensitive portion of the telephone plant. Simply, it is the pair of copper wires leading from the telephone to the local exchange facility or local switch. If a call is made by a local subscriber, it proceeds to the local exchange and is either completed as a local call or is switched beyond as an intrastate or interstate long-distance call.

From this brief description, it is obvious that this huge investment in this local loop wire is used jointly and commonly by both local and long-distance service. The local loop is necessary for both functions and as a result, a portion of the local loop investment should be shared by the interstate long-distance carriers because they too, share in the benefits and generated revenues. However, in the FCC decision, this is not the case.

It is important also for Congress to consider what is really necessary, in terms of investment in local exchange facilities, to provide basic local voice communication. While this commission does not necessarily question the investment in such things as electronic switching system we do recognize that this type of facility is not at all necessary for basic, local voice communication. In a recent MacNeil-Lehrer report, Chairman Fowler of the FCC seemed to place the major emphasis of the implementation of the end user access charge on the fact that "Mother is going to get more calls from her kids, it is going to bring the Nation closer together."

We can rest assured that mother, or for that matter grandmother, does not need an elaborate switching system to make or receive calls from her children. Logic and reasoning does not permit anyone with a sound mind to let mother and grandmother inherit the total investment in the local loop in the form of end user access charges when that investment is obviously going to be used primarily for other purposes such as data transmission and other highly technical services.

If this was the intention of the FCC in determining who should pay the access charge, then obviously they have been drinking from the wrong fountain and the American public will suffer the consequences.

We are not surprised that the BOC's are endorsing the end user access charge but we are extremely concerned that they are not adopting a responsible position as to what is logically acceptable in their rate base and what is not. It is becoming very clear that although AT&T and the BOC's are going to be divorced on January 1, 1984, they are obviously still deeply in love.

We must bear in mind that what we are doing in relation to the divestiture or greater yet, what we are not doing, will establish the benchmark of how telephone rates are to be set over the next 50 years. It is critically important that they be manifested properly from the standpoint of what is fair and in the public interest and not what is fair from the viewpoint of AT&T and the other long-distance carriers.

AT&T currently has 98 percent of the long-distance market and the other carriers comprise the remaining 2 percent. If AT&T is able to "shed" its investment in the local loop to "mother and the kids" and to local businesses, the large carrier will be at a decided advantage to underprice long-distance rates; which incidentally they have filed for to take effect on January 1, 1984. Additionally, it will allow them to eventually underprice all competitors and remain for all practical purposes the only carrier. However, this time they will be nonregulated, while "mother and the kids" pay the bill for time and distance measured intrastate and interstate calls with an end user access charge added for the privilege of being able to use the network. This amounts to double billing.

Once again, simple logic says that if the local loop is jointly and commonly used for local calling as well as long distance, the investment must be shared jointly and commonly between the local user and the long distance carriers and it must not be solely placed upon the end user as the FCC has implied.

It would be a decided advantage for AT&T to shed as much of their presently owned investment in local exchange facilities as possible, to the regulated monopoly on the BOC. This is strategically desirable because under residual rate base regulation, all revenue requirement needs can be recovered under State law and allocated to basic local service. Congress must examine carefully the vast implications of the access charge issue because all costs not recovered from competitive services will most assuredly be recovered through the revenue requirements of the regulated monopoly. Basic local service will then climb higher and higher, with State commissions such as ours powerless to deal with it in any effective manner.

Under the current system of jurisdictional cost separations, a portion of local exchange facility costs are allocated to interstate toll. However, the methodology does not fully allocate costs between interstate and intrastate services or between local and toll services. Rather, it is used only to allocate certain costs to the interstate jurisdiction. All residual costs are assumed to be intrastate.

In most States, local exchange rates traditionally have been determined by the basic service philosophy. Under this approach, rates are set for all intrastate services except local service, at levels desired by the telephone company. All residual revenue requirement needs then are allocated to basic local service. Under what the Bell System has called the "Statewide Theory of Rate Making," cost of service studies are not normally done for individual service categories. Rather, prices are set with particular reference to the value of service. Thus, rates for basic local service are not based upon an independent determination of local service costs. They are determined by the residual intrastate revenue requirement needs, which in turn are the residual costs emanating from the jurisdictional cost separations process. Residual costs in other words are all basic local service costs left over after the telephone company establishes desired rates for interstate and intrastate services.

This process is far from being cost based, and in light of the divestiture, will prove that the last thing you will want to be in the reorganization is the residual or the local ratepayer.

At the October 14 hearing, testimony by the FCC, BOC and AT&T all concluded that rates must be cost based, subsidies must end and that local services must pay its own way. We must point out, that what appears to them to be actual costs of providing service is the result of AT&T's methodology and what they call "Embedded Direct Analysis." No State commission that we are aware of has completed any in-depth cost study to determine what the actual cost of providing telephone service really is. A study of this type must be completed by Congress, State commissions or by the National Association of Regulatory Commissioners. At the very least, AT&T's "Embedded Direct Analysis" must be examined in light of the entire subsidy issue. We believe that a moratorium on the access charge would allow the time necessary to complete such a study.

It would appear that the FCC, BOC's and AT&T are only advocating cost based rates when it is convenient to add it on to the local subscriber and then looking the other way when it is not.

A case in point is the State of South Dakota where 20 percent of the customers generate 80 percent of the revenues. This situation over the years has no doubt caused an increase in investment in local exchange facilities and switching technologies. Should we then allocate these costs to those who caused them? The FCC, BOC's and AT&T say no, it should be spread over all of the users. The least they can be is consistent.

At the October 14 hearing we also heard the threat of large customers bypassing the system if the access charges are not allowed to remain on the end user. Bypass of the system may occur. Most businesses that have had such plans however, have made their decision based upon considerations quite independent of the access charge issue. They probably did not even know it was around. The point is, we should establish rates on experience and not on what some people may think will happen.

This Commission believes that the FCC has abdicated their responsibility to the public interest on this issue and that their decision was apparently more arbitrary than evidence based. The result is that they have failed the American public miserably. The FCC, in its own case history, investigated the subsidy flow issue and required AT&T to undertake a seven-way cost study in 1964. Although the details of the cost methodology were determined by AT&T, the results clearly showed that the competitive services—private line and Telpak—were being subsidized by the basic monopoly toll service. After discovering this apparent subsidy flow, AT&T did not propose to change its pricing policy or reverse it. Rather, it changed its cost standards for judging subsidy and allocated all residual costs to the monopoly message toll service under the basic service philosophy.

We conclude then by asking Congress to commission an independent, fully distributed, stand alone cost study to determine, (1) if local rates are in fact subsidized, which has been claimed by the FCC, and (2) the direction of the subsidy flows, if any at all, from competitive toll service.

We believe that it is imperative that Congress, in any legislation, take steps to reverse the access charge order, and take necessary steps to insure that State regulatory commissions maintain jurisdictional control over all intrastate inter-LATA regulation.

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On January 1, 1984, implementation of divestiture will begin. Congress and State commissions must be fully aware of the pending impact of cost for local telephone service.

The South Dakota PUC is doing everything in its power to protect the public interest. Through our efforts, we were able to petition the Federal court to designate South Dakota as a single LATA State. Relatively speaking, we think that this will prove to be the single most beneficial aspect to our State in the entire reorganization of the telecommunication industry. It will make a net contribution of over $6 million per year to the South Dakota BOC, and will lessen the burden on local telephone rates in the revenue requirement. Additionally, the designation of a single LATA State will save, in our opinion, as much as $8 per month, with the elimination of intrastate inter-LATA access charges.

However, it is our understanding that as a local exchange area is defined by House bill 4102, a single LATA State is prohibited. This would have an extreme negative effect on our efforts to protect our ratepayers thus far and we would hope that Congress would take some type of action to correct this section of the legislation.

These comments are respectfully submitted by the South Dakota Public Utilities Commission knowing that Congress will recognize the gravity of the issue and with the hope that that august body will respond positively to the concept of universal telephone service at affordable rates for all Americans embodied by House bill 4102 and Senate bill 1660 with proper amendments. Thank you very much.

[The policy statement referred to in Mr. Stofferahn's statement follows:]

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

In the Matter of Petition of the State of Michigan Concerning the Effects of Certain Federal Decisions on Local Telephone Service.	)	CC Docket No. 83-788

ADDITIONAL COMMENTS OF THE
SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

The South Dakota Public Utilities Commission ("SDPUC") files these Comments in response to the Notice of Inquiry entered in this case on August 1, 1983. The Notice of Inquiry originally set September 26, 1983 as the deadline for filing additional comments. However, on September 21, 1983, the Commission extended the deadline for filing comments until October 6, 1983.

I.

THE EFFECT OF PRICE ON TELEPHONE DEMAND

The full impact of the various telephone ratemaking issues which are the subject of review in this proceeding and other ratemaking issues associated with the American Telephone and Telegraph Company ("AT&T") divestiture have not yet been felt in South Dakota. The major local exchange carrier in South Dakota, Northwestern Bell Telephone Company

("NW Bell") has now pending before the SDPUC an application which would increase local exchange residential telephone rates by approximately 70%.

The NW Bell monthly average one-party residential recurring charge in South Dakota was $6.88 in 1970. 1/ As a result of a succession of rate increase applications filed by NW Bell, average residential one-party rates are now about $9.92 per month. Appendix I is a copy of the present South Dakota NW Bell local exchange tariff sheets in effect since November, 1982. Until recently, the relatively gradual residence rate adjustments paralleled the gradual elevation of household family income in South Dakota. As a consequence of the last rate increase, a noticeable decline in residence main stations has been reported by NW Bell. This reduction does not appear to be purely a definitional change due to the disposition of CPE on sale to patrons. The total number of network access lines shows a similar decline.

1/ Report of National Economic Research Associates, "Economic Determinants of Telephone Availability", Bell Exhibit 21, FCC Docket No. 20003, Appendix C.

TABLE I

COMPARISON OF NUMBER OF MAIN STATIONS

Northwestern Bell	Total Residence	Total Business	Total	Total-Terminals
April 1983	167,616	31,136	198,752	230,085
April 1982	174,909	32,114	207,023	229,851
April 1981	175,864	32,368	208,232	226,781

Golden West Telecommunications Cooperative, Inc.

	Total Residence	Total Business	Total
December 1982	8,264	1,687	9,951
December 1981	8,324	1,635	9,959
December 1980	8,313	1,629	9,942

City of Brookings, South Dakota

	Total Residence	Total Business	Total
December 1982	8,407	582	8,989
December 1981	no data	no data	8,149
December 1980	no data	no data	8,163

Bison State Telephone Company (Independent)

	Total Residence	Total Business	Total
December 1982	5,634	1,444	7,078
December 1981	5,788	993	6,781
December 1980	5,640	982	6,622

Dakota Cooperative Telecommunications, Inc.

	Total Residence	Total Business	Total
December 1982	4,828	505	5,333
December 1981	4,918	597	5,515
December 1980	4,909	589	5,498

Table I is a summation of residence mains and access lines reported by NW Bell for the corresponding months of April 1981, 1982 and 1983. As a basis for comparison, data is also shown for two telephone cooperatives, a municipal telephone utility and an independent commercial company showing telephone service changes in recent years. The cooperatives, who have also required upward rate adjustments in recent years also reflect some dimunition of service demand.

The effect of NW Bell's current rate application before the SDPUC would, if granted in full, increase one party residence rates for local exchange service from an average of $9.92 to an average of $16.67, an increase of approximately 68%.

The SDPUC does not have available at this time the results of any independent investigations of price demand elasticity for residence exchange telephone service in South Dakota. However, demand studies financed by AT&T and submitted by AT&T as evidence in the recent Department of Justice anti-trust action appear reasonable. Those results are shown in Table II. The AT&T study, commonly refered to as the "PERL Study" are somewhat now disavowed by AT&T as being based upon vintage data. The logic of the relationships shown in these results, together with the SDPUC's general knowledge of early telephone events, appears to be consistent with the statistical relationships shown by the PERL study.

TABLE II

ESTIMATED PERCENTAGE OF HOUSEHOLDS WITH BASIC TELEPHONE SERVICE

Demographic Characteristics	Base	Price Increase 50%	100%	200%
All	91.52	82.15	83.69	70.92
Young	85.39	80.12	73.54	56.92
Black	86.37	81.33	75.08	58.89
Rural	88.84	84.53	79.10	64.28
Moderately Poor	83.31	78.12	77.11	53.93
Young	72.18	64.14	55.22	38.97
Black	75.25	67.71	53.12	40.74
Rural	79.25	72.48	64.50	46.34
Very Poor				
Young	64.99	56.14	46.88	29.56
Black	69.21	60.78	51.66	33.89
Rural	73.35	66.07	57.31	38.96

Source:

AT&T Exhibit in Anti-Trust Suit of DOJ vs. AT&T cited in FCC Third Report and Order CC Docket No. 78-72 Phase I, page 233.

Logically, customer reaction to telephone price adjustments are, in part, a function of income of the using household. In terms of the demographic characteristics set out in Table II, South Dakota might be characterized as, on average, a rural, moderately low income state. This description appears to be borne out by the recent, unpublished Census Bureau data of South Dakota household income. This information is shown in Table III.

TABLE III

NUMBER AND DISTRIBUTION OF HOUSEHOLD INCOME
SOUTH DAKOTA, 1979

Household Income	All Families	Distribution
Less than $5,000	42,091	17.3%
$5,000 to $7,499	25,610	10.6%
$7,500 to $9,999	24,109	9.9%

Household Income	All Families	Distribution
$10,000 to $14,999	44,320	18.2%
$15,000 to $19,999	35,850	14.7%
$20,000 to $24,999	28,110	11.5%
$25,000 to $34,999	27,491	11.2%
$35,000 to $49,999	10,375	4.3%
$50,000 or more	5,492	2.3%
Median	13,156	
Mean	15,899	

Source:

Unpublished Data, 1980 Census of Population and Housing, Bureau of the Census, U.S. Dept. of Commerce.

It will be noted that over 1/3 of South Dakota families had income under $10,000 as reported in 1980. Median household income in South Dakota was in the neighborhood of $13,000, about 20% below the national average household income. 2/

The SDPUC has not yet ruled on the NW Bell application pending before it, and therefore has not made any judgments on the evidence formulated by NW Bell in support of its application. Therefore, it would be premature to express any view or forecast of residence telephone demand in response to future price changes. However, case histories in Commission archives are mindful of parallel events which took place not only in this jurisdiction, but throughout the

2/ As reported in the 1982 Statistical Abstract, Table No. 729.

country, during the period of major economic depression during the years 1929 through 1939. While history never quite repeats itself, certain events are reminiscent of what could occur. Initially, South Dakota and the country as a whole, were visted during that period by a vast decline in the level of agricultural income. This fall-off in farm income produced an initial decline in both farm and urban telephone development. The local exchange carriers, led by NW Bell, sought and successfully achieved upward adjustments in local exchange charges. The bases for these requests was the need to recover fixed charges from a diminished number of served customers. Today, the proportion of fixed costs as a proportion of total telephone utility costs is at least twice as high as was characterized by the manual magnetic and common battery apparatus typical of the earlier decade. All dial service has supplanted manual telephony; computers now substitute for many of the early commercial and revenue accounting functions of the 1930's. But it may be of some significance to the Commission that resistance to rate increases in the Depression Era took the form of large scale service discontinuance throughout the country.

TABLE IV

NUMBER OF TELEPHONES IN THE U.S. AT CLOSE OF YEAR 1929-1939

Year	No. of Telephones (000)	Index 1929=100
1929	20,233	100.0
1930	20,201	99.8
1931	19,707	97.4
1932	17,424	86.1
1933	16,968	83.8
1935	17,424	86.1
1936	18,433	91.1
1937	19,453	96.1
1938	19,953	98.6
1939	20,831	102.9

Source:

Statutes of Communications, FCC, 1981 Edition, Table 5, page 6

It was observed that the initial decline in telephony during the Depression Era in South Dakota was brought on by major reductions in family income accompanied by relatively minor increases in basic residence and business exchange rates. Further, the need and significance of rapid communications has been materially increased in the intervening 50 years. Nevertheless, economic barriers may be very formidable agents of change. South Dakota families have been subject to income adversity in recent years. All households are subject to multiple economic demands. Exchange telephone rate increases of the magnitude proposed by NW Bell, when magnified by additional increases mandated by the Commission, could build the dynamics of a parallel recession in telephone demand which characterize the industry during the Depression Era.

II.

FEDERAL REGULATORY POLICIES

As noted in previous filings, the SDPUC has sought to examine the Commission's decisions which have so materially affected the proposed level of local exchange rates in South Dakota. The examination was undertaken to determine what recognition was offered to the varied economic and social conditions of the different states and to the distinctive telephonic requirements of a moderately low income agricultural state such as South Dakota. For this purpose, the SDPUC carefully studied the Commission's positions on (1) access charges, (2) depreciation, and (3) removal of CPE from separations. The SDPUC offers the following views on each of these issues.

A. Access Charges

The views of the Commission with respect to imposition of end user access charges are contained in its Third Report and Order, CC Docket 78-72. Heretofore, the allocated portion of local exchange plant costs assigned to interstate message toll operations has been contained in the message usage rates. These allocated costs, termed non-traffic sensitive costs since January 1971 with introduction of the Ozark Separations Procedures, the Commission now maintains, should be borne by the end user and disaggregated from the message-mileage rates. Exclusion from the message charges has been justified on the grounds that the generation of these costs is independent of usage; they are a fixed function of the individual customer line.

The SDPUC is troubled by the foregoing rationalization. The SDPUC's concern arises from several scores. On the one hand, the Commission is disaggregating the allocated portion of non-traffic sensitive exchange plant costs and will be applying them as fixed monthly charges against the individual exchange ratepayer. The bulk of this same telephone exchange plant is borne by exchange ratepayers through recurring monthly exchange rates. On numerous occasions, the Commission has recommended improvements to local exchange ratemaking to state regulatory commission. 3/ A salient element of these recommendations has been to suggest that a "sounder" basis for levying exchange charges would be on a measured usage basis, rather than imposition of flat monthly recurring charges. The SDPUC cannot escape the fact that the identical local exchange tele-

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3/ These suggestions have been conveyed through the routine Commissioner and staff meetings of the NARUC Committee on Communications.

phone plant is employed jointly in rendition of interstate message toll as is used in the provision of local exchange service. The allocated interstate portion, the Commission now avers, can be properly billed only through flat end user (CALC) fees. The states have formal authority over the residual portion of these local exchange plant costs. The FCC appears to recognize no inconsistency in promoting the use of measured service to state commissions for recovery of the balance of these exchange plant costs.

A salient consideration underlying the numerous plans considered by these commissions in CC Docket 78-72 is the impact of each of the proposals on the major extant common carriers. These carriers have been confronted by active market competition by new interexchange suppliers such as EXECUNET, SPRINT, and others. The Commission prediction is that when non-traffic sensitive costs are disaggregated, usage rates of the principle carriers may drop substantially and enhance the market competitive position of the established carriers. Except for minor offerings in the City of Sioux Falls, the other common carriers ("OCC") have displayed little interest in extending their markets to rural South Dakota. The OCC's have stumbled on the limited business opportunities of the state, just as the conventional common carriers had largely bypassed exchange service opportunities in the years of exchange telephone development. Here, it would appear, the Commission has been responsive to the market requirements of the established carriers, as it has done throughout its history of separations charges. But the SDPUC has assumed that the statutory responsibility of the Commission is directed to meeting the public interest, not the commercial interest of primary interexchange vendors.

B. Accelerated Depreciation Recovery

The Commission has found it necessary to accelerate the recovery of capital through depreciation charges. The impetus for this modification of its practice has been the introduction of market competition, the advent of newer technology and shifts in requirements from voice-grade services to increasing proportions of data transmission. Thus, the use of straight line vintage group ("SLVG") principles is to be replaced by equal life group ("ELG") and remaining life depreciation methods. The Commission has exercised its jurisdiction to preempt state ratemaking control over depreciation matters in CC Docket No. 79-105.

The Commission's effort to speed recovery of telephone central office investment will have serious adverse financial impacts in South Dakota. A significant majority of local central offices in South Dakota are Strowger step by step community dial offices. They have been depreciated on the basis of an estimated 25 year average service life. On a remaining life basis, the Company has shortened future life expectations to about 5 or 6 years. A few urban communities in the state are now served by analogue electronic switching centers with a previous estimate of average service life of 37 to 39 years. The Company sees a future "Information Age" market in the digital world and has shortened ESS lives to 10 to 12 years. The future digital world envisioned by Northwestern Bell will exceed the requirements of most South Dakota residential telephone needs. The historic practice of depreciating plant on a straight-line vintage group basis assures the carrier that it will recover its complete investment and earn a return on the unamortized portion. Only a tiny segment of the business community will benefit by the planned premature retirement of the exchange analogue central office equipment. When the Commission adopts a nation-wide, uniform depreciation policy, it remains oblivious to the needs of the majority of residential and business telephone ratepayers in South Dakota.

C. Removal of CPE From Separations

The joint FCC-NARUC Board has been examining many of the underlying principles governing telephone separations in CC Docket No. 80-286. A major change which has been introduced (Order of November 10, 1982, Appendix page 45, Section 25.32 of Separations Manual) is to phase out the recorded investments in customer premises equipment (A/CS 231 and 234) from allocation to interstate message services. By January, 1988 CPE will be wholly assigned to intrastate operations. It was the United States Supreme Court that, in the 1930 decision of Smith v. Illinois Bell Telephone Company, 282 US 133, concluded that a portion of the investment and related expenses in the provision of certain telephone instruments should be borne by he interstate message services. Prior to that time interstate telephone rates were established on the "Board-to-Board" basis. Under the latter doctrine only the costs of inter exchange plant facilities and toll switchboard equipment had been included in the costing of long distance message toll service. The joint cost facilities including telephone handsets PBX equipment were borne solely by exchange rates. The latest revision to the separations proposals is essentially a reversion to the original board-to-board method of telephone ratemaking. While divestiture of the Bell System will realign operating responsibilities for provision of customer terminal equipment, the effective pricing standards under CC Docket 80-286, transfers ultimate cost responsibility wholly to the end user, or exchange ratepayer. Where the common carrier does not supply the terminal instrument and ownership is vested in the customer, obviously no additional costs are required for jurisdictional allocation. In South Dakota, Northwestern Bell, and after January 1, 1984 AT&T Communications, will furnish customer terminal equipment. Traditionally, separations has recognized the material effect on local plant of the need to effect compatibility and service requirements of the long distance network. That obligation should continue. The burdens imposed on local plant, including CPE, in accounting to interstate toll should be reflected by corresponding message charges.

III.

CONCLUSION

The purpose of these comments has been to outline the concern of the SDPUC over the possible impact which recent decisions of this Commission may have on local exchange rates in South Dakota. The rate impact of the decisions of this Commission, when considered in conjunction with NW Bell's proposed intrastate rate increase application now pending before the SDPUC, may threaten continued universal telephone service in South Dakota. The SDPUC urges the Commission to reassess the aggregate impact of its recent decisions in light of this possible result.

Dated at Pierre, South Dakota, this 4th day of October, 1983.

Respectfully submitted,

Walter Washington

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Thirteen

August 11, 1983
Transcript #2054

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THE MACNEIL-LEHRER REPORT

CWA Strike

In New York

ROBERT MacNEIL .... Executive Editor
KENNETH J. WHALEN .... AT&T

In Washington

JIM LEHRER .... Associate Editor
GLENN E. WATTS .... President, Communications Workers of America
MARK S. FOWLER .... FCC Chairman

In San Francisco (Facilities: KQED-TV)

Rep. AL SWIFT .... Democrat, Washington

Producer .... KENNETH WITTY
Reporter .... WILLIAM SHEBAR
Researcher .... DAVID HONICKY

Funding for this program has been provided by this station and other Public Television Stations and by grants from Exxon Corporation and American Telephone & Telegraph Company and the Bell System Companies.

A co-production of MacNeil-Lehrer-Gannett Productions and WETA Show #8291

cations and computers. We are going to be able to help the smokestack industries rescue themselves by making them more efficent. Good example: a company's able to keep its inventory absolutely accurate by using computers tying its different plants together.

LEHRER: Sounds great, Mr. Chairman, but the fact is that the local telephone user is going to have to pay two or three dollars more or four dollars a month as it goes up, plus the local increase that is coming throughout the country, even though a lot of these increases haven't yet been granted — there have only been applications. But for the local user of a telephone, there's going to be a lot more money they're going to have to pay, right?

Chmn. FOWLER: Over the long term the local bill, in one sense, will go up; but the long distance rates will come way down. And generally speaking, if you've made six or more long distance calls, roughly, you're going to be much better off than you are now, because your long distance rates are down. But the more important point is, mother is going to get more calls from her kids, it's going to bring the nation closer together. Small businesses for the first time will be able to use computers to do their inventory, to reduce their costs. This can make Detroit much more competitive on the international scene as to automobiles, as to steel: the local businessman can do lots of things that he can't do now — for example, use a telephone to make sales calls. A California firm which is small can sell something to somebody in New York because long distance rates are cheaper and you can pick up the phone and use it more. And the economists calculate that this will add billions of dollars of new wealth — we're going to create new wealth for all citizens in our society. What Congress wants to do—

LEHRER: Well, we're going to find out right now.

Chmn. FOWLER: —is to turn that backwards.

LEHRER: That's what we're going to find out right now. Robin?

MacNEIL: Yes. The prospect of higher local phone rates has provoked 13 separate bills in Congress, all aimed at keeping the service affordable for everyone. Democratic Congressman Al Swift of Washington State helped draft the leading bill in the House. He's with us tonight at public station KQED, San Francisco. Congressman Swift, first of all, how do you like the FCC's decision on this access charge?

Rep. AL SWIFT: I don't like it very much. What they did is they turned everything upside down from the way it should have been. Essentially what they have done is said that the end users, they call them, the local customer, is going to have to pick up all the charges, and that virtually free, the long distance companies are going to be able to use that local system. That's not right. There's no reason in the world that the long distance companies shouldn't pay for a right to access the local loop, rather than the local customer, at the end of it, having to pay to access long distance whether they want to use the long distance or not. And our bill essentially reverses that.

MacNEIL: I'm going to ask you about your bill in a moment. Before I go into that, what do you see as the effect on private subscribers of the access charge and the likely increases in local rates?

Rep. SWIFT: Well, first point, the $2 figure gets used a lot, but that $2 is the first year, and then, as you said, there's another charge next year and the year after. But that keeps going 'til 1989, and it's going to be on a national average an $8 increase because of the FCC-mandated charges, plus whatever the states add for intrastate long distance charges. In my state of Washington it's going to be somewhere around 12 bucks when this is finally all worked out.

MacNEIL: You mean there's going to be a state access long distance charge as well as a federal one?

Rep. SWIFT: Sure. Sure, because all the FCC's doing is the interstate charge, and then each state is going to have to do something similar — in my state of Washington, did virtually identically the same thing — by adding another charge onto that for intrastate long distance.

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Senator JEPSEN. Thank you. Mr. Simpson from Nebraska.

STATEMENT OF HAROLD SIMPSON, PUBLIC SERVICE COMMISSIONER, STATE OF NEBRASKA

Mr. SIMPSON. This is a party line. We do not each have one, our own private line here. [Laughter.]

I think to start, Senator Jepsen, you said the whole thing, and the deregulation syndrome is, even if it is not broke, why, we better fix it. We have done that in too many areas already which have adversely affected Midwest States. I guess I found a good example yesterday when I paid for two airline tickets, one to come to Des Moines, and one to go to Detroit. It only cost me $66 more to go to Detroit than to come to Des Moines, 161 miles, and the reason for that is they do not have much competition here. So in the free competition area, they stick it to you where you have to take that service.

Now, we do have, in this country, up-to-date, the best communication system in the world, and we are making it better all the time. Now, our decisions coming out of the FCC—and we are divesting AT&T, and these are threatening to break down that communication system and to eliminate universal service as we know it today.

The National Association of Regulatory Utility Commissioners, the national organization of all us State people, through their communications committee, and specifically the subcommittee of that who are overlooking—or looking over, not overlooking—looking over the divestiture came up with a set of 12 principles which should be in legislation to insure the continuation of universal service.

I am sure that you, as every other Member of Congress, have received those principles, and as a member of that committee, I agree 100 percent that that is the way it should be. We need the legislation. The large telephone companies, AT&T and the Bell operating companies are opposing any legislation, and we understand why. They are happy to milk the person on the end. We do not think that is really necessary.

Now, we talked about some of the answers of what we could really do even under the increases to save the public from losing their telephone service, and we have talked about the panacea of measured service. Sounds great, but today, and in the very near future, in Omaha, Nebr., 70 percent would be the maximum amount of people that could be involved in that. They do not have the technology in their central offices to even allow measured service.

The end of this year, they will be close to 70 percent. Now, how can we say that everybody has an alternative when they do not even have the technology there to get it?

I feel that the issue of bypass is basically in the same category. Telephone companies have not upgraded their equipment to where they can give bypass what they really want. They want high-speed data transmission that is reliable, and they cannot get it today from the telephone companies, so they are going to alternatives. These are the people who are the concern of bypass. It has become a scare word, that everyone is going to get out.

Well, if we are worried about that, why do we not just encompass into the access charge that all users of communication services will pay, not only the inter-exchange carriers, but also the bypassers, and those with the private systems. That is not out of the realm of doing, and if we do this, we are talking about practically eliminating the end user's charge.

I just saw a television program last night, and a man from AT&T was saying, "Listen to all the scares going on about how high those end users' charges are. I hear people complaining about double and triple, and do you realize the average phone bill today is $35 to $40, and what would $2 be on that?"

That would hardly seem reasonable what these people are saying, but, the cost, first of all, of that home user's phone is the basic charge, and it runs most places in the area of $10. The rest of that is toll or added services, which you can get or you do not have to. I decide every day whether I am going to make a toll call, or whether I am going to write a letter, or how I am going to get in contact with people, or just forget about them, and, as things were more expensive, the people are too. But let us not confuse this with what the local phone bill is for the average user.

They have that $10 now. They are going to put a $2 interstate access charge on it, very possibly a $2 intrastate. That is the first year, put on top of that what the Bell operating companies and other independent companies are now asking for in local money to make up for their loss of revenue, what the FCC has just put on, a represcription on depreciation rates which they have mandated that we give to Northwestern Bell, Nebraska, $1.65 a month, everybody's phone bill, two bucks for the—keep adding them up. Pretty soon you are going to be there.

It is not going to take 5 years. They are going to double and it is going to triple. People cannot afford it. There is an alternative. Congress needs to act.

My reliability on the FCC would be as it was in another issue under divestiture. I sat in their offices in Washington with the FCC and the DOJ. We talked about what should happen to the Bell name and the Bell logo, and both the FCC and the DOJ said it belongs to the stockholders of AT&T, and AT&T should get to keep it.

Now, that was the most asinine thing I could see when the people who had to pay for it are out here all over the country. They are the patrons of the telephone company paying that bill, and the companies remaining need that recognition in order to be a viable company. AT&T have no need for that logo or that name.

With the help of a lot of other people, that decision was made by Judge Greene, that it would be given where it rightfully belonged, to Bell operating companies. That was terribly important.

Remember out of all of this, who is the one that is really smiling? That is AT&T on the way to the bank.

When you talk about $11 billion revenue, they are going to give $4½ billion or so to the access charges they are going to pay, and they are going to give another billion and a half in revenue in rates. Mathematic says that only figures up to about $6 billion, so they have got $5 billion in their pockets. Pretty nice.

I think that we should look, and Congress should act. We should take care of the people who really need the phone, and the phone no longer is a luxury. It is a necessity to everyone out there.

I think I am ending. I am going to give you one little story. I will take western Nebraska. There is a farmer out here—or a rancher. He lives 17 miles from his local exchange. Everybody said, "Boy. It is really something. The telphone company gives him service. They had to run a line 17 miles out there for him to have a phone."

You know when he needs that phone? When one of his buildings catches on fire or he has an accident. Otherwise he does not need that phone, because he is a good enough businessman that he can line up in one trip, those 17 miles to town, he can go to the courthouse, he goes to the bank, to his feed dealer, seed dealer, he goes sees everybody he has to see in one trip. But who needs the phone? All of those dealers in town. They need to contact him when they have something to sell. But if he does not have the phone, then they can each make a trip out there and hope they catch him home, maybe two or three trips to catch him home, each individual one.

Now, who should be subsidizing that phone? I think it is only reasonable the people who want to call somebody should have to pay part of the cost, and I think that is the thing with our total system now. It is no good if only the big users have to have the phone. They have to call somebody. It is no good if just the small people have the phone. Everyone needs the phone. We need to continue a good universal service.

The only way to view it is to slow down this process and eliminate at some point the added cost to the basic service.

Thank you.

[The 12 principles referred to in Mr. Simpson's statement follow:]

TWELVE PRINCIPLES WHICH MUST BE EMBODIED IN EFFECTIVE UNIVERSAL SERVICE LEGISLATION

1. OVERTURN F.C.C. ACCESS DECISION AND GIVE STATE COMMISSIONS FLEXIBILITY TO SET ACCESS CHARGES UNDER UNIFORM NATIONAL GUIDELINES WITH A UNIVERSAL SERVICE BOARD REVIEW.

2. REQUIRE INTEREXCHANGE CARRIERS, INCLUDING BYPASSERS AND PRIVATE SYSTEMS, TO PAY ACCESS CHARGES OR SURCHARGERS FOR THE USE AND UPKEEP OF THE LOCAL EXCHANGE.

3. PROVIDE FOR AN ORDERLY TRANSITION FROM THE PRESENT SYSTEM OF JURISDICTIONAL SEPARATIONS TO AN ACCESS CHARGE STRUCTURE, GO SLOW!

4. REQUIRE STATE COMMISSIONS TO GENERATE SUFFICIENT FUNDS WITHIN EACH STATE TO PRESERVE UNIVERSAL SERVICE.

5. PROVIDE LIMITED INTERSTATE REVENUE SHARING FOR EXCHANGE CARRIERS WHOSE STATES CANNOT INTERNALLY GENERATE THE NECESSARY REVENUE WITHOUT JEOPARDIZING UNIVERSAL SERVICE.

6. CREATE A NINE MEMBER, ADMINISTRATIVELY FINAL UNIVERSAL SERVICE BOARD, CONSISTING OF 5 FEDERAL AND 4 STATE MEMBERS, FOR THE PURPOSE OF ESTABLISHING UNIFORM NATIONWIDE PROCEDURES AND ADMINISTERING A UNIVERSAL SERVICE FUND.

7. RETAIN STATE COMMISSION AUTHORITY TO PRESCRIBE THE METHODS BY WHICH EXCHANGE CARRIERS RECOVER INVESTMENT TO PROMOTE ECONOMIC VIABILITY AND RECOVER THE INVESTMENT OVER ITS USEFUL SERVICE LIFE, STATES SET DEPRECIATION RATES.

8. ALLOW STATE COMMISSIONS TO MAKE AVAILABLE A BASIC TELEPHONE INSTRUMENT FROM THE EXCHANGE CARRIER ON A FULLY COMPENSATORY BASIS.

9. PERMIT STATE COMMISSIONS TO ESTABLISH BASIC LIFE LINE TELEPHONE RATES DESIGNED TO ENCOURAGE UNIVERSAL SERVICE.

10. PREVENT CROSS SUBSIDIZATION BETWEEN REGULATED TELECOMMUNICATIONS SERVICES AND UNREGULATED COMMERCIAL ACTIVITIES OF CARRIERS.

11. PERMIT STATE COMMISSIONS TO DESIGNATE ONE OR MORE INTEREXCHANGE PROVIDERS OF LAST RESORT WITHIN EACH STATE.

12. RESERVE 911 AS A NATIONWIDE ACCESS NUMBER.

Senator JEPSEN. Thank you. Do either one of the members from South Dakota's Commission desire to be heard?

Mr. Solem.

STATEMENT OF JEFF SOLEM, VICE CHAIRMAN, PUBLIC UTILITIES COMMISSION, STATE OF SOUTH DAKOTA

Mr. SOLEM. There are a couple brief comments, Senator. I too am appreciative of the opportunity to appear and become a part of your record here today.

I would simply echo, I think, the need for the moratorium that is being discussed, simply on the basis of the gigantic magnitude of the effects of this whole operation we are talking about, the corporate structure that was 107 years in the making, and we are now looking at cutting an umbilical cord in about 18 months, and we are using jargon to explain jargon, and I am beginning to understand what the jargon means. And it seems to me that the people, like yourself, Senator, and your many colleagues on Capitol Hill, need to take some more time if you want to understand what a lot of this jargon is really about and the effect and the end result.

The ratepayers in South Dakota are asking us—I know there are philosophical differences in certain parts of the country, from one part to another, but they are asking us about the access charge, wanting to know why, in their bailiwick, they should be charged to get out of it instead of the system that is going to bring them the calls from the outside. Perhaps they should be charged to access the neighborhood of South Dakota. I have no logical response for them.

Numbers, actual numbers of usage, in South Dakota, as apart from surveys that have been made, the New York Times and CBS, and whomever, but actual numbers and provable numbers from the records in South Dakota indicate something over 40 percent of the ratepayers in South Dakota, the residential nonbusiness type, make one or none—one or no—better English—long distance telephone calls even in intrastate in South Dakota in the course of a month, month after month after month, and they have a little difficulty understanding why, simply in the event that they may some day want to make a long distance phone call, should that month by month by month $2, $3, $4, $5, up to $6 should be tacked on their bill simply for the privilege that some day they may want to use it. Hard to answer these people's questions.

Finally, the reference made by Chairman Stofferahn, the single LATA status of the State of South Dakota, and this was another one of those surprises that came on about 10:05 last Friday morning up in Sioux Falls, when, in the addendum, apparenty, to the definition of proposed House bill 4102, the single LATA in a single State is to be outlawed.

We simply say in the State of South Dakota, we saw the—we heard the whistle before the train went by. We applied and petitioned to Judge Harold Greene in Washington, because of our structure in South Dakota, to permit us to have the single LATA arrangement, saving us some $6 million to the ratepayers of the State, ultimately $6 to $8 to $10 a month per bill. We were granted by Judge Greene the single LATA status, and now somebody—and we cannot find out whom—in their intellect has decided that we should no longer be entitled to that in the future, and we would certainly like somebody somewhere to find out where it originated, find out and explain to us why, but most preferably, see that we remain that status.

What other numbers of States are in the Union that enjoy—probably less than a half a dozen, I do not know—that enjoy the single LATA structure, we would like to retain that.

Thank you for your time.

Senator JEPSEN. Mr. Eisnach.

STATEMENT OF DENNIS EISNACH, COMMISSIONER, PUBLIC UTILITIES COMMISSION, STATE OF SOUTH DAKOTA

Mr. EISNACH. Just a couple of points, and I will not be redundant. Being at the end of the table, most everything has been said.

One thing that is happening in South Dakota, we have a rate application before us, and it has been split into two parts; one that deals with business as usual, as we are calling it, and the other one that deals on the divestiture issues.

We recently held seven hearings around the State to get the public input as far as this issue is concerned, and one of the reasons that three commissioners are here from South Dakota this morning is we want to demonstrate to you, and to your committee, the concern that the South Dakota people are feeling about this issue of the increased charges on their telephones. They really are concerned. This issue has probably generated more correspondence, telephone calls, personal visits by the people in South Dakota than anything that this Commission has faced before.

One thing became very apparent to us, that those people on the low end of the economic scale in South Dakota probably have the greatest need for telephone communications for their own social well-being. They have to call for rides, they have to call for Meals on Wheels, they have to have a telephone for emergencies. That message was given to us over and over and over again.

The other things that I would like to emphasize that Commissioner Varley and Commissioner Simpson touched on is that we are not dealing just with the access charge. Most of the discussion this morning has been about the access charge, but when you add up the various things that are happening with the divestiture and various things in South Dakota, we find if the rate application before us is granted, we would have a 68-percent increase in our rates. It would go from $9.92 to $16.67, and I can guarantee that if we have an increase like that, we are going to have a lot of people who are going to find it necessary to fall off of the system. They are just not going to be able to pay that.

We are not only dealing with access charge, but we are dealing with the removal of the customer premise equipment, the CPE, from the base. We are dealing with accelerated depreciation schedules. We are dealing with the access charge and just the general cost of depreciation. So please, do not be misled by just the access charge. There are other charges that are going with this that are going to increase the cost to those consumers out there.

One of the other things that I think is necessary for Congress to keep in mind is to make sure that the States have the flexibility to continue to deal with some of the problems that are unique to each one of the States. Those have been pointed out to you, and I ask that you please keep that in mind when you are considering a legislation that is going to affect the country as a whole.

Again, I appreciate being here and being able to represent South Dakota.

I thank you very much for your time, Senator.

Senator JEPSEN. We have five panels today, and "The Government's Role" is the title of the first panel subject area. It is taking a little longer, and understandably so.

All right. We will take whatever break time is necessary for the reporter to change the tape.

[A short break was taken.]

Senator JEPSEN. We will be going next to panel No. 2, the business and industry perspective, but before this panel leaves, gentlemen, I would ask the State commissioner, there seeems to be much confusion existing in the industry right now. Divestiture is taking place, the FCC access charges have been proposed for interstate calls. You, as State commissioners, are working on intrastate fees. Do you feel that you have the necessary information and resources to make the decision—difficult decision I might add—on the proposals before you on the basis of what is happening at this point in time?

Mr. STOFFERAHN. Mr. Chairman, the thing that I think worries us the most, and that is that we seem to have no control over the larger issues, and that is why I have mentioned in my remarks that I thought, at least, that the access charges proposed by the FCC is manifested from the wrong premise.

Surely within the several States, and also it is very important for State commissions to have intrastate inter-LATA total jurisdiction so at least they have some discretion in their States between the LATA's.

Now, if we are able to maintain a single LATA state in South Dakota, that would be no problem for us. We can handle that. But in terms of having the necessary information to do what we are given the discretion to do, I guess that we probably have except that we feel that we just do not have the control over the larger issues in terms of the interstate access charge.

Senator JEPSEN. Mr. Simpson, do you have any comment?

Mr. SIMPSON. I think I would echo that. First of all, things are coming too fast, there is too much to be done in too short a time, plus the fact that too many of the decisions are coming from someplace else besides Nebraska, for us.

If we could do this in an orderly fashion, we have all the tools we need to do it. We cannot push them all into this short of a period, and that is why I would like to see legislation that would slow that down.

Senator JEPSEN. Mr. Pitsch, you have heard some testimony now since you have testified. Do you have any comments that you would like to make before I have a question for you?

Mr. PITSCH. I would like to make two overall points. The first is that in terms of what we know now about the effects of the access charge decision, although we will not know until we put these in place and we see how consumers react, I think it is important to give some context.

First, in the last 10 years, the real prices of telephones have fallen. Prices have gone up 30 percent compared to a national average of about 95 percent. Of course, many other essential commodities have gone up more rapidly than that, 400 and 500 percent in the case of natural gas and coal and such commodities.

But, more importantly, real income has also increased at that same time, and then together with our phasein which is going to phase this in over a 6-year period, it is quite possible that that and the low cost options are going to keep everyone on the system, and, indeed, the evidence of reaction to large rate increases in at least five or six instances that I am aware of, of 27 to 47 percent, indicate that people have not dropped off the network.

The other point, and this is so crucial because I do not want to be perceived as arguing for abstract efficiency, is that the decision is fair, and we have joint costs here. That is right. We have joint costs. They have been paid in a traffic sensitive way in the long-distance area, 8 percent of the minutes have been picking up 26 percent of the cost. But we can avoid the problems of paying for joint costs by putting those directly on the cost causer.

In many instances, consumers are familiar with this kind of pricing mechanism. If you join a club and there are fixed costs to join that club, you will have to pay a membership fee. Well, the membership fee in this case is to the unified interstate local access.

After you incur special traffic sensitive costs, then you are going to pay for those on an incremental basis. And, finally, in terms of fairness, I do not think that it is very fair that we target subsidies to those people who need them.

There is no reason why a rich rancher in Wyoming ought to be subsidized by a poor man in south Bronx. Right now the system does that. I think that subsidy ought to be targeted to those people who need them. They ought to be out in the open, they ought to be accountable so people can see these things and not hidden, as has been the practice in the last 20 years.

Senator JEPSEN. Rural areas, small business, residential customers, that is all typical of the people that are appearing on the panel here for these States.

Did you have some special research that assessed the impact of phone deregulation on the rural, small business, and residential customers?

Mr. PITSCH. The research that I am referring to—there are no detailed studies of how people are going to react to the various——

Senator JEPSEN. Not react. I do not know how you can study how they are going to react.

Mr. PITSCH. Because they are not here yet.

Senator JEPSEN. If you study how it is going to affect them, then you might know how they are going to react. Do you have any research in how it affects them?

Mr. PITSCH. I am aware of research of how people have reacted to price increases in local rates in the last few years.

For example, there are five instances, as I mentioned, where prices have increased from 27 to 49 percent, and there was little or no decrease in penetration rates. Indeed, they went up in some instances.

Now, I am not saying they went up because prices went up, but I am saying that price increases need not drive people off, and those States included, I believe, some States in the South and some States in the North.

The Michigan cases that were cited in their petition to the Commission, the Hickory Telephone Co. was one instance where they said there was a 14-percent dropoff.

But in that particular case, the rate went up 100 percent in 1 year, where the company went from a four-party system to a single party, and consumers were given the chance of paying $8 to $16, and a number of them dropped off.

However, there was no phase in. There were no low-cost options available. The other instance that Michigan cited—I do not know how to pronounce the company's name for sure—but, in fact, there was some dropoff. But the rates went back up to comparable penetration rates. So on the basis of evidence I have, I think that the predictions of enormous dropoffs are off the mark.

Senator JEPSEN. In targeting for subsidies, the overwhelming agreement in feeling from the last hearing was that the senior citizen should have some special attention and allowances made for them, and it was also pointed out, and this is as you have pointed out, too. You feel that those who cannot pay should be subsidized. Some type of lifeline service should be provided to senior citizens, our elderly, because a phone, on the basis of that hearing, was a necessary of those folks, a matter of both a necessity for the protection of life, as well as one for good health care and others.

Pinpointing this special attention, I ask this: Rather than creating a universal service fund that they are talking about, would it be more practical to increase social security or welfare payments, or at least use those as a conduit by the amount of access charge, and thereby eliminating any new bureaucracies to be established, as long as we are doing this? Have you looked into that?

Mr. PITSCH. I am not very expert in how to set up welfare mechanisms. I think the ones you mentioned are logical candidates.

I think that my point is simply that that would be the preferable way of assisting those people who cannot afford it, and who we want to make sure stay on the network. That would be my reaction.

Senator JEPSEN. I have just one question, and then I would like to close this panel. You can answer yes or no, if you could.

Do you believe that the phone system should be subsidized, or that there should be a subsidy for phone customers?

Mr. PITSCH. I think there may be for low income and high-cost areas, and I think the Commission's plan allows for—addresses the high-cost area problem, and, obviously, leaves to the Congress the ability to tax and target.

Mr. STOFFERAHN. Well, Senator, I am expressing my own personal opinion here now, but I think there is sufficient information that exists these days to question, just outright question the whole subsidy issue.

I have mentioned briefly in my remarks that at least there is some area by which somebody ought to question, whether or not there is real subsidy flow, and how much.

Senator JEPSEN. I appreciate that. In other words, we get into the semantics of whether in fact the system, as it is set up, is really subsidizing, or whether it is in fact fair and equitable system since it is essentially a product of the regulatory agencies, and the Government, and Ma Bell—I do not know whether that is the correct—how do you address Ma Bell? AT&T?

Mr. PITSCH. AT&T, and, of course, each of the——

Senator JEPSEN. Anyway, everybody that has been involved has agreed to what has been going on for years, which is essentially—call it whatever you may. It is a sharing, a subsidy, whatever it is, the regulators, and the telephone system, and so on have agreed that they will take some of the long distance—because the bottom line is, very simply, what we are talking about here, long-distance rates have provided for a subsidy for local telephone service; is that right or wrong?

Mr. PITSCH. Well, I think the State commissions would say it has provided some costs to help keep lower rates.

Senator JEPSEN. But there have been some moneys directed from long-distance revenues. Instead of putting it somewhere else, it has been diverted without giving consideration to the rightness or wrongness of it, to local telephone companies. Is that correct or not correct?

Mr. PITSCH. Not correct.

Senator JEPSEN. Well, I guess I better come in and start over again.

Mr. PITSCH. You are correct.

Senator JEPSEN. Am I now correct?

Mr. PITSCH. You are correct. I thought you meant is it prudent.

Senator JEPSEN. I did not ask about the rightness or wrongness.

Mr. SOLEM. I think your statement is absolutely correct, Senator. It is provable in all the records that AT&T's long distance has historically funneled money back to the local systems, right or wrong.

Mr. PITSCH. That is right.

Mr. SIMPSON. But, not as a subsidy.

Senator JEPSEN. Is not the FCC phasing out its current cost-subsidy system, or whatever you want to call it, sharing, where long-distance users paid most of the subsidy, and is phasing in an access-charge system which is imposed on all customers; is that a correct statement?

Mr. PITSCH. That is a correct statement. I misspoke before. I misunderstood what you said.

Senator JEPSEN. OK. You do not like that statement?

Mr. SIMPSON. No.

Senator JEPSEN. I never had a panel quite like this before. I am having a difficult time.

Mr. SIMPSON. It is a little difficult when you have people from both sides of the fence here, the ones that work with the Federal Government, and the ones who are down where the people are. I think if we have—and that is not a knock at you——

Mr. PITSCH. It is not?

Mr. SIMPSON [continuing]. But I think that there has been money from the long distance which has been used on the local to insure that the long-distance callers have someone to call, and you can call that a subsidy or whatever you want, but when I have a company who wishes to call people all over the country as prospective customers, and they do this out of large companies out of New York and all over, they want these people to have a phone, and they understand that part of the cost of calling them is to assure that there is a phone on the other end when they make that call.

And in no way can you call this a subsidization of the local people. I think that it is a necessity for universal service for the people who wish to make all of these calls to have someone there to call.

Senator JEPSEN. I thank you. Your testimony has been very educational, and it will help to provide for complete records and information to assist, hopefully, in intelligent handling and working in the area of any congressional activity, if any is coming. Thank you very much.

I now call to the witness table the business and industry representatives for the business and industry perspective, Mr. Jim Collison, Iowa Small Business Employers Association, and Mr. Bill Cleveland, Iowa Telephone Users Group.

While they are coming forward, we will just take a 3-minute recess.

[A short recess was taken.]

Senator JEPSEN. Mr. Collison and Mr. Cleveland, if they are here, they would please come forward. Be sure to speak right into the microphone. Mr. Bill Cleveland, the Iowa Telephone Users Group.

Again, I would advise you if you have a written statement, it will be entered into the record as if read, and you may proceed in any manner in which you so desire.

STATEMENT OF BILL CLEVELAND, PRESIDENT, IOWA TELECOMMUNICATIONS USERS GROUP

Mr. CLEVELAND. Thank you, Senator. I appear before you today in my capacity as president of the Iowa Telecommunications Users Group. The Iowa Telecommunications Users Group was founded in 1980. The purpose of this association, as outlined in its constitution, is to provide a means whereby users of telecommunications facilities and services can exchange information, experience, and concepts for mutual benefits to the individual members and their companies; to encourage technological research and development in the field of telecommunications. That means seminars, conferences, newsletters, and any special reports.

Our membership consists of approximately 100 companies in the State of Iowa, grossing over $12 million in sales annually, with expenditures of approximately $35 million annually on telecommunications.

The companies employ approximately 80,000 employees within the State of Iowa. Because the Iowa Telecommunications Users Group represents a broad spectrum of business in the State of Iowa, the issues at hand are looked at in many different ways. Regarding access fees, some of our companies want to see the existing structure and regulations move forward as planned, to get on with deregulation with the break up of the Bell System.

The feeling is, delay will serve no purpose other than to continue to cloud an already murky area which, right now, is impeding national forecasting relating to budgets and capital programs. Such limitations are not conducive to a growing company or economy. This is not to say that these companies are in full agreement with the charges and their applications. To the contrary.

The belief is credibility regarding these charges, their amount and reason for has been stretched far beyond the point any reasonable person could believe. It has been alleged that some services have subsidized others for years, principally residential.

Now, we are told all services will stand on their own. However, as far as we can determine, the rate increases in the October 3, 1983, filing far outweigh the reductions offered on interstate toll.

Others of our companies can find no reason for justification for the access charges, and feel we have a telephone company crying wolf and using the same rhetoric as in years past. Without the additional money, the phone service, as we know it, will cease to exist, or if we do not get these charges, we will have to raise our rates even more.

The recommendation here is that a moratorium on the access fees should be put in place for a period of at least 1 year. The break up in deregulation of the Bell System, however, should continue on schedule. and the results monitored to determine the financial needs of the BOC's and independent companies.

The past indicates once the rates are installed and being collected, the chance of getting them rescinded is very, very remote.

It seems no matter what the rates being collected, the phone company can always find ways to match it with expenses, while at the same time getting their allowed rate of return.

With regard to deregulation. Basically we find the deregulation of the final judgment decree disturbing in that it appears we will have to become much more knowledgeable about our own communications system, as well as our communication needs. We are concerned that the cavalier attitude of the telephone company in that a lot of rhetoric sounds so familiar, "everything will be done for you if we just let them alone," or " we will only change what it costs plus a profit designed to bring us within the guidelines of the allowed rate of return." We then find out about immigration strategy where the cost, in reality, has nothing to do with the amount being charged.

Senator, during the last week I have learned my private line costs are going to increase 30 percent, at a minimum. I have talked to other companies throughout the country who are expecting over 50 percent increases. The circuits are the same, nothing is changed except who is being paid.

Senator, we constantly hear of the impact of these increases being less than 10 percent for the average customer. I have never met the average customer, nor has anyone else, I am aware of.

We have seen 20 to 50 percent increases result from these rate increases. As rates continue to increase, the economic viability of bypass increases. And while this term is being vilified, it still remains the objective of business to produce results on the bottom line, and that has always meant to explore all alternatives consistent with the company's goals and objectives, and to employ those procedures and goods most economical to the company.

In closing, let me say that the Iowa Telecommunications Users Group feel the State of Iowa, and its people, could best be served in using restraint in applying the forces of deregulation in the coming months. No blank checks should be given, and at the same time, we should move forward with all aspects being closed monitored, without reservation to reverse any decision should it prove to be in error, and we would like to have nothing to impede this process.

Thank you for allowing us to appear before you.

Senator JEPSEN. Mr. Cleveland, in Iowa, how does the business benefit from having a universal phone network, in your opinion? You represent a lot of companies, a lot of employers. What if only 75 percent of the households had phones? How would that affect the banks, the main street stores, mail order companies, utilities, and other commercial businesses?

Mr. CLEVELAND. Well, Senator, there are a lot of different angles to approach that question. One of them is, if in fact we would lose a portion of the people on our now universal telephone services through this process, who will they be? Will they be, as we heard earlier, the rancher out in Wyoming, or will it be the last economic—or the economic disadvantaged people, or poor people, elderly people?

When it comes to businesses in Iowa, yes, it has a profound effect, and we lose universal phone service.

We would not, by any means, advocate that, nor would we like to see that happen. Basically, in business, in downtown main street, they use those phones. They use phones to call their customers, their customers need them to call them. I cannot say what effect it will be because nobody has been able to tell us exactly what will happen.

Senator JEPSEN. Well, just on the basis of what we do know, on the small business, the FCC's access charge on business would be $6 per month per line if it is implemented; is that correct?

Mr. CLEVELAND. The FCC's, yes. Now, couple that with the States, as Mr. Varley was mentioning and one of the other participants, we are really talking access fees—we are talking maybe $12.

Senator JEPSEN. Maybe double that; 2 and 2 is 4; 6 and 6, 12?

Mr. CLEVELAND. Correct.

Senator JEPSEN. On the basis of just the FCC's fee now, I am concerned on the impact that that access charge may have on small business, a lot of main street stores in the State of Iowa that are going to pay $72 more per year for each phone line if a business had just four phone lines. I know a lot of businesses that have at least 25 phone lines.

But, if they just have four phone lines, that means the increase will be $288 per year, and that is going to probably be double that?

Mr. CLEVELAND. Yes.

Senator JEPSEN. How might that affect the businesses that you, in your representative work, have been connected with, or have been able to view firsthand? Are there a lot of businesses in Iowa that will be able to take on another $500, $600, $1,500, or whatever it may be?

Mr. CLEVELAND. I think it was brought out a little while back, one of the participants did very well, that we are not talking about just the access fees. We're talking about the impact on business. We are talking not the $200 a month for the access fees, we are talking about the whole gamet of his phone bill, which is going to increase considerably more than just for the access fees; the new tariffs that have been filed recently, the new costs that are coming into play as far as private services is concerned.

We are talking about companies that have private service, private wire service used through the phone company. We are not talking about another 10 or 15 percent. It is going to be tough on the small businessman. He is, already, after—the recession that we have been in, you have seen a lot of small companies, you have seen a lot of big companies who have failed.

Now, he is being squeezed very hard on his, if you will, his slim margins at the present time.

Now, this is going to add one more to it. How long will it be before it breaks his back? I cannot answer it. I know there is a great deal of concern as to who is going to pay for the costs. The end consumer does, but if the end consumer decides not to pay for the products that the individual is manufacturing or he is selling, then he no longer is viable and has no business. So it is another cost.

Senator JEPSEN. If you could isolate—this is the last question—one problem area in what all is being proposed and discussed today, what would it be? What would be the most serious problem area, in your opinion?

Mr. CLEVELAND. I guess, Senator, I would address this problem of bypass that has been talked about.

We have heard from the FCC, continuing uneconomical bypass, bypass is uneconomical. Business today, shareholders are not going to sit still for a decrease in earnings based on sloppy management.

Management must look at all alternatives to keep expenses low. It is completely foreign to me to understand how a company can set up a private network, and it be cheaper than the public network, and, yet, it has happened. We know of companies who have already done it, as you mentioned, in our State. We know of them throughout the United States.

I cannot impress enough that business is going to do whatever it has to do in order to maintain its costs, to keep it down. I do not see why bypass should be so inexpensive. However, it appears that there are other suppliers and other methods of communication service that either do not have the overhead the telephone company does, or have somehow been able to operate much more efficiently to be able to offer it, and that being the satellite services, private network services, or microwave, even to the point of fiber optics.

So this is one of our main concerns, is the costs, as they continue to go up. In my own company's bills, you know, we have to continue to look at other alternatives. Is there another way to do the same job and cut the costs, or keep it the same?

Senator JEPSEN. OK. I thank you very much.

Mr. CLEVELAND. Thank you, Senator.

Senator JEPSEN. I will now call panel No. 3, from the consumer's perspective, to the witness table.

Karen Tynes, executive director, Iowa Commission on Aging. I saw her here. Yes. Welcome, Karen.

Mr. Jim M-a-r-e-t. Is that Maret?

Mr. MARET. Maret.

Senator JEPSEN. Mr. Maret is consumer advocate of the State of Iowa. Mr. Merle Wilson, American Association of Retired Persons, and Wayne Pos. He is here representing the senior citizens. Wayne has served in Washington before representing the senior citizens, retired folks.

Welcome to the panel, and we will start with the executive director for the Iowa Commission on Aging, Ms. Tynes, and Karen Tynes, I would again advise you and the panel that your statements will be entered into the record as if read if you have them in writing, and you may abbreviate or proceed in any way you so desire. Thank you.

STATEMENT OF KAREN L. TYNES, EXECUTIVE DIRECTOR, IOWA COMMISSION ON THE AGING

Ms. TYNES. Thank you, Senator.

I am extremely pleased and consider it an honor to appear before you today to speak on telephone deregulation and its impact on the elderly in Iowa. Thank you for inviting the views of the Iowa Commission on the Aging.

Allow me to state first of all from our Commission mission statement:

> It is the mission of the Iowa Commission on the Aging to encourage and assist state and local agencies in the development of comprehensive and coordinated service systems to secure and maintain independence and dignity in living for all older Iowans. * * * The Iowa Commission on the Aging will serve as an effective and visible advocate for the elderly in all matters relating to the mission of the agency * * *.

Having read this simple statement, let me add that we take our responsibility seriously and as advocates for Iowa's 520,665 citizens age 60 years or older, we come before you to express our concern over the sharp escalation in the cost of local telephone service precipitated by the forced divestiture of the telephone companies from AT&T.

Dorcas Hardy, assistant secretary of human development services under the Department of Health and Human Services is reported to have said at the 1981 White House Conference on Aging:

> While serious problems do exist, the great majority of elderly Americans are the wealthiest, best fed, best housed, healthiest, most self-reliant older population in our history.

This is, of course, a relative statement, but what is ignored is the fact that with the fast growing population of elderly in the country because of our technological advances, the sheer numbers of elderly at every economic level have forced a completely different scenario upon us. The fact is that large numbers of seniors fall below the poverty line each year. We are reaching the point where the size of the below poverty class of seniors exceeds the total population of elderly in the country two generations ago. We are talking about a greater number of seniors saddled with a greater number of problems than endured by their forebears.

In Iowa, according to the 1980 Census Bureau report, 17.31 percent of those 60 years of age or older live below the poverty level. The hard fact is that the cost of goods and services considered essential by the elderly has continued to rise beyond their ability to cope with their fixed incomes. Consider the cost of food, medicine, medical care, energy, and housing. These are essentials which are being priced beyond the limits which fixed incomes allow. The consequence is that large numbers of elderly lose their economic independence every day. We, who work with the elderly, hear repeatedly the complaint that seniors must choose between eating, and heating, buying medicine, or paying utilities. And although the elderly have largely been a silent minority, as added injustices are heaped upon them, they are forced to become more vocal.

Regarding the increased telephone service costs, it is still too early to know the full impact of these increases. The elderly are a diligent and resourceful people. If at all possible, they will find some way around these new hurdles to survival. But, although we do not have firm statistical data to adequately answer the questions this hearing poses, there are a few questions that need to be asked regarding which we do have some answers.

No. 1. Is owning a telephone a luxury? Some, who point to the days when few families owned phones, are saying it is. But many things have changed in the past century. In terms of today's society, we have learned from experience that for many older persons the telephone is more than a social convenience. The telephone stands as the connector to information, services, business needs, and family contacts. Especially for the frail elderly, the telephone is the one social convenience that stands between them and total social isolation. And, from the service provider's perspective, the telephone is a critical access tool to these otherwise isolated persons.

The frail elderly who remain in their own homes must also depend on an informal support network comprised of family neighbors and friends to maintain their independent lifestyle. The telephone provides the vital link in that informal support network.

No. 2. How poor must one be before the telephone becomes an unaffordable necessity? In light of what has already been said, many low-income elderly will find some way to keep this lifeline in place. Turning again to the 1980 census, we find that of 1,012,728 occupied housing units, in Iowa, 40,305 or 3.9 percent were without phones. We surmise, but cannot say with certainty, that most of these households were without phones for economic reasons. Again, we do not know how many of these phoneless homes were headed by senior citizens. But given the fact that 17.3 of Iowa's senior citizens have income below the poverty level, we suspect approximately 10,000 of these phoneless homes are inhabited by seniors surviving on subsistence level incomes or less.

No. 3. Will the end result of divestiture be that many more elderly will be forced to give up their phones? We suspect this will be the case. We do know, however, that to forestall such an event, we must give thought to programs which will assist the lower income households in their efforts to keep this social connector in place within their homes. Some subsidy program for the truly needy families of our Nation must be devised and given high priority.

Senator Jepsen. Thank you. Mr. Maret, consumer advocate for the State of Iowa.

STATEMENT OF JAMES R. MARET, OFFICE OF CONSUMER ADVOCATE, STATE OF IOWA

Mr. MARET. Thank you, Senator. It is a pleasure to be here this morning and present some comments from the point of view of the public.

There have been significant changes in the telephone industry in the past few years. These changes were brought about by a combination of actions taken by both the Federal Communications Commission and the courts which introduced competition in the telephone industry.

The telephone industry is now in the process of implementing these decisions and the public is being bombarded with announcements of these changes, leaving the public thoroughly confused. However, telephone ratepayers do know that beginning January 1, 1984, the residential user will be required to pay a $2 a month charge in order to have access to the interstate toll system and that this charge will increase by $1 in both 1985 and 1986. I might add that the Iowa State Commerce Commission has recently passed rules which would also implement a $2 charge for intrastate calls beginning January 1, 1984. This is true even if no long-distance calls are made. This charge has been mandated by the Federal Communications Commission to foster competition among long-distance carriers; the result is that the local customer will be required over time to pick up all the fixed cost of the local loop.

It appears to the Office of Consumer Advocate that the proper allocation of cost would require the toll carriers to pay the full cost of the toll portion of the local loop and associated costs, as a condition of having access to a local telephone exchange. This is appropriate because it is obviously the toll carrier who stands to gain increased revenue by having access to a local exchange, thereby allowing customers of that exchange to place toll calls over its system. The toll carrier should provide the local telephone company with revenues to cover its costs of providing access to the exchange to the toll carrier as one of the costs of doing business.

Also, it is less sensible to require captive monopoly local exchange ratepayers to compensate local telephone companies for providing access than to require compensation by entities operating in a competitive arena. If access costs are placed upon monopoly ratepayers, the ratepayers have no choice but to pay the access charges, or do without toll service, or do without a telephone altogether. However, if access costs are charged back to the carriers providing toll service, those carriers may compete with each other, providing ratepayers with various choices of rate design and rate levels in the best manner of competition. As long as access charges are imposed upon the carriers on a nondiscriminatory basis, there will be no interference with the competitive market forces. Therefore, legislation is requiring toll carriers to pay the full toll portion of the costs of the local loop and associated costs of having access to a local telephone exchange should be adopted.

As mentioned previously, one of the concerns with placing the access charges on the local exchange customer is that the resulting monthly charge may be more than the customer can afford to pay and his or her only option is to discontinue service. Our telephone service today provides universal service at reasonable prices and for many elderly and shut-ins, the telephone is their main source of communication with the outside world. We should move with extreme caution before making drastic changes to the pricing system that may jeopardize that end result. I do not believe that anyone can say with any degree of certainty what the total dollar impact of changes in the pricing system and deregulation will be within the next year. It would appear that, at a minimum, Congress should slow down the process by passing legislation which would delay the implementation of access charges for 1 year and continue the existing toll settlement agreements until Congress has had time to study all the ramifications of the proposed changes and can adopt legislation which will be in the best interest of the public.

In conclusion I would urge Congress to:

One. Adopt legislation which would force the Federal Communications Commission to require toll carrier to pay the full toll portion of the costs of the local loop and associated costs of having access to a local telephone exchange. In the alternative, equity and commonsense would dictate that the toll carrier be required to pick up a high percentage of those costs.

Two. If insufficient time remains for Congress to deal with the substantive issues, consideration should be given to legislation which would delay the implementation of access charges for at least 1 year and to continue the existing toll settlement agreements between AT&T and the independent telephone companies.

Thank you.

Senator JEPSEN. Thank you, Mr. Merle Wilson, American Association of Retired Persons. Proceed.

STATEMENT OF MERLE A. WILSON, CHAIRMAN, IOWA STATE LEGISLATIVE COMMITTEE, AMERICAN ASSOCIATION OF RETIRED PERSONS, DES MOINES, IOWA

Mr. WILSON. Thank you, Senator. I appreciate the opportunity to present our views on this issue.

At the outset, Senator, I would like to applaud you for holding this hearing on the issues as seen by diverse groups, and to then execute a plan that will help the telephone consumer out of the dilemma we face.

The AT&T divestiture case is so complicated and complex that I do not pretend to understand the intricacies of the financial or legal matters. I do know what increase and local rates will mean to a large number of elderly.

We support the notion that the Federal Communications Commission be given the responsibility to establish, as a national policy, procedures to issue the universal availability of basic telephone services at a reasonable rate.

This report is divided into three sections. I want to talk a little bit about the elderly in Iowa, importance of the telephone for the elderly consumer, and our opposition to escalating rates.

Recently William Petroski for the Des Moines Register had a series of articles from a study he made on "The Graying of America." He reported beginning September 25, 1983. He points out that one in six Iowans are over the age of 60.

I checked also on the States that were involved here, and South Dakota, North Dakota, Nebraska, Minnesota, and Iowa all have between 16 and 18 percent of the population, in the area between 60 and over. This number means more than 530,000 persons in Iowa who exceed this age. It would be more than the total population of the cities of Des Moines, Cedar Rapids, Davenport, and Sioux City.

We think there are 387,000 over the age of 65 in Iowa. Iowa, as you know, ranks about third in the States in the percentage of older population.

The fastest growing population in Iowa is what we term the "frail elderly," those over 75 years. It is projected by the year 2000, that this number will be about 232,000 persons.

In Iowa, the poverty rate of 65 plus has dropped from 26 percent in 1970 to around 12 percent in 1980. This is a dramatic decline. However, considering the 12 percent in Iowa, that means that there are about 46,000—almost 47,000 elderly in the poverty range.

As Charles Meyer from the Iowa State University, Economist, has pointed out, these statistics do not mean that the vast majority of elderly are living high on the hog. A lot of the elderly are living in poverty and not very far above the poverty level.

Iowa's elderly are not highly mobile. They are the ones that stay in the community. I will not report about Wayne County, which has the most—it is in the written report.

In 1980, a survey was made by Louis Harris and Associates that found that 30 percent of the elderly people indicated loneliness was a personal problem. Thirty percent of our elderly. This means mental health conditions can sometimes be alleviated by use of a telephone.

One study estimates that one-fourth, about 70,500 of the 30,000 Iowans now living in nursing homes, could be at home if they had proper services, and we believe that proper services would include the use of a telephone.

Senator Grassley has said that Iowans have a special character that, because of the rural nature of the character, its large number of small towns and its cold northern climate and long tradition of strong family ties and personal responsibilities, those are all reasons why everyone should have a telephone.

Now, I am going to use my mother as—the way she uses the telephone. She lived first on a farm, and then in a small community, Guthrie Center, as a matter of fact, and is now deceased.

She used the phone for business. She called the local bank, she called the elevator, she called the county offices concerning taxes and other matters. She called the local grocery store, who, in a small town, they had somebody who would come by and deliver the groceries.

She would call her attorney. For medical reasons, she called her doctor, she called the health clinic, she called the dentist. For drugs she would call Jim Dowd and ask for the prescription to be delivered, and someone would deliver it later in the afternoon.

Telephone use as an emergency. She used it for illness, in case of an accident, emergency, and at one time she was up on a stool—and we cautioned her not to get up on the stool—in the kitchen, to see something on the top shelf, but she did anyway. She broke her hip. She was able to get to the telephone and call her sister—call her daughter, and get the medical needs taken care of.

In case of fire, disaster, police, water and heat and plumbing, and to arrange for transportation.

Use of the telephone for social reasons. She called friends and relatives, committee work with the church, and with her card club. She used the telephone to—her daughter used it to check to see how she was daily.

Use of the phone for church. She would call the pastor, the circle group, and to call a friend to arrange for transportation.

As we get older, we become aware of the needs of the telephone, and we use it more and more to contact our friends and relatives.

Now, the third part of the report I want to discuss is the opposition to the escalating rates.

Well, the AARP has concern for all elderly. There are two groups about which we have special concern. Those groups are the frail elderly that I have mentioned, and these groups—and the other group is the low income elderly.

Financing retirement is a major concern for all Iowans, but, particularly to women and minorities, and it is also a rural problem.

Poverty among the elderly in the countryside is more prevalent that it is in the urban areas. Telephone service at a reasonable rate is important to all of these groups.

While the thrust of my remarks relate to the elderly, we are concerned about the disabled, the handicapped and the low income individuals and families. Increased local telephone rates would have an impact on the lifestyle of these people.

We are mindful of the fair number of Iowans who are AT&T shareholders, and depend in part on the dividends to supplement their income. However, the weight of the issue is with the over 46,000 Iowans aged 65 and over who live at the poverty level, or very close to it, who do not have the benefit of these investments.

Telephone service must be available and affordable to all of us. In today's world, the telephone is no luxury. It is a life link to the outside for all of us.

As reported in U.S. News and World Report, there are pending before a number of States and local authorities a number of requests of phone companies for very substantial rate increases. We know that on September 14, the Iowa Commerce Commission slashed major portions of Northwestern Bell Telephone Co. request for increases.

The Register carried on Wednesday, September 15, a report that "It is considered likely that the firm, Northwestern Bell, soon will ask the Commission for higher rates to cushion the blow of losing interstate long distance revenue and other businesses to AT&T under the split-up."

This fear and uncertainty has the older population worried, and I would like to make three remarks that are not in the prepared statement that came out of the Commission—or the hearing this morning.

What does lifeline service constitute? We feel that the access charges need to have further study, and we want to close by saying that the best next thing to being there is being able to reach out and touch a loved one, and that means by telephone.

Thank you, Senator.

[The prepared statement of Mr. Wilson follows:]

Prepared Statement of Merle A. Wilson

Senator Jepsen, my name is Merle Wilson, and I am chairman of the Iowa State Legislative Committee of the American Association of Retired Persons (AARP). Our AARP membership in Iowa is over 180,000 persons over the age of 50. I appreciate this opportunity to present our views on, "The Economic Issues of a Changing Telecommunications Industry."

At the outset, Senator Jepsen, I want to applaud you and your committee for holding this hearing in an effort to hear the issues as seen by diverse groups and then to execute a plan that will help the telephone consumer out of the dilemma we now face.

The AT&T divestiture case is so complicated and complex that I do not pretend to understand the intricacies of the financial and legal matters. I do know that increased local rates will mean to a large number of the elderly. We support the notion that the Federal Communications Commission be given responsibility to establish, as a national policy, procedures to insure the universal availability of basic telephone service at reasonable rates.

This report is in three sections:

1. A look at the elderly in Iowa.
2. Importance of the telephone to elderly consumers.
3. Opposition to escalating rates.

1. A LOOK AT THE ELDERLY IN IOWA

Recently William Petroski conducted a study of, "The Graying of America", and reported in the Register in a series of articles beginning September 25, 1983. He points out that:

(1) One of six Iowans make up the over 60 generation.

(2) This numbers more than 530,000 persons (exceeding the combined population of Des Moines, Cedar Rapids, Davenport, and Sioux City (387,000 are age 65 and over).

(3) Iowa is one of the grayest places in the Nation. Only Florida and Arkansas rank higher than Iowa's 13.8 percent of persons 65 and older.

(4) It is expected that by the year 2000 Iowa's over 60 population will reach 568,000 and by 2025 one in four Iowans will be age 60 or older.

(5) The fastest growing segment of Iowa's population is its oldest and most frail.

(6) Iowa is second only to Florida in its percentage of elderly who are 75 and older.

(7) In 1980 there were 172,000 Iowans or 5.9 percent of the State's population in the 75 and older category. (It is projected that by the year 2000 the number will increase to 232,000.)

(8) In Iowa the poverty rate among the 65 plus age group has dropped from 26.4 percent in 1970 to 12.1 percent in 1980. This is a dramatic decline, however, considering the 12.1 percent means Iowa still has 46,821 elderly in the poverty range. (Current level is $4,626 for a single senior and $5,836 for a senior couple.)

(9) An Iowa State University economist, Charles Meyer cautions us that. "These statistics do not mean that the vast majority of the elderly are living high on the hog. A lot of older people not living in poverty are not very far above poverty. So they are still experiencing a modest standard of living."

(10) Iowa elderly are not highly mobile. They tend to stay in their local areas. A federal study of 1978 debunks the notion that seniors are a migratory group. "The fact is that the older population is the least migratory of any age group" the report said.

(11) Wayne County has the highest percentage of old folks of any other county in the State (22.9 percent are 65 and older and 30 percent are 60 and older.) Since the Wayne County population has dropped more than 16 percent and it is the younger set that is leaving—the older ones remain behind. This is a trend throughout the State.

(12) Because of the exodus of youth from rural to urban areas the sons and daughters are not physically at hand to lend close emotional support to their elderly family.

(13) In a 1981 survey Louis Harris and Associates found that 30 percent of the elderly polled indicated loneliness was a personal problem.

(14) One study estimates that up to one-fourth (7,500) of the 30,000 Iowans now living in nursing homes could be at home if they had adequate services. Our philosophy is to encourage home care and keep individuals in their homes as long as possible.

(15) Senator Grassley says issues involving older Iowans have a special character. That is because of the State's rural character, its large number of small towns, its cold northern climate and its long tradition of strong family ties and personal responsibilities.

2. IMPORTANCE OF THE TELEPHONE TO ELDERLY CONSUMERS

(1) Use of the phone for business: Calls to the local bank; calls to the local elevator; calls to the county offices (taxes, et cetera); calls to local grocery; calls to attorney.

(2) Use of the phone for medical: Calls to the doctor—dentist—health clinic—nurse; calls to the druggist for prescriptions.

(3) Use of the phone for emergencies: Illness; accidents (falling, et cetera)—ambulance—funeral director; fire and other disasters; police; failure of utilities and appliances; plumbing and heating; water problems; to arrange transportation.

(4) Use of the phone for social reasons: Calls to friends; calls to relatives; committee work for groups; telephone checks.

(5) Use of the phone for church: Calls to pastor; calls to Circle members; call to a friend to arrange transportation.

(6) As we get older the telephone becomes a means of maintaining contact with family and friends and to summon assistance in an emergency.

(7) We are concerned about the farmers eighty-year-old ailing mother who lives in the old farmstead down the road two or three miles. The blizzard is raging, the roads are blocked. Anxiety is high in both homes. The telephone can relieve the tension.

(8) For the age 75 plus Iowans the telephone is often the only link with the outside world. They have been referred to as the "invisible elderly." Without a phone they could become "out-of-sight, out-of-mind and lost forever."

3. OPPOSITION TO ESCALATING RATES

(1) While AARP has concern for all elderly there are two groups about which we have special concern relative to the increase in telephone rates. These groups are those in the poverty and just above poverty level; the other group the frail elderly (age 75 plus). These groups have the least flexibility with income and would be the most adversely affected by the proposed rate service increases.

(2) Financing retirement is a major concern for all Iowans, but particularly for women and minorities. It is also a rural problem. Poverty among the elderly is more prevalent in the countryside. Telephone service at reasonable rates is very important for these groups.

(3) While the thrust of my remarks relate to the elderly we are concerned also about the disabled, the handicapped, and low income individuals and families of any age. Increased local telephone rates would have an impact on the life style of these people.

(4) We are mindful of a fair number of retired Iowans who are AT&T shareholders and depend, in part, on the dividends to supplement their income. However, the weight of the issue is with the over 46,000 Iowans age 65 and over who live at the poverty level without benefit of such investments.

(5) Telephone service must be available and affordable to all of us. In today's world the telephone is no luxury, it is the life link to the outside for many.

(6) As reported in U.S. News and World Report, August 30, 1982 there are pending before state and local regulatory authorities a number of requests by phone companies for very substantial rate increases. We know that on September 14, 1983 the Iowa Commerce Commission slashed major portions of the Northwestern Bell Telephone Company's $68.7 million rate increase request. The Regis-

ter, September 15, 1983 reported that "—it is considered likely that the firm (Northwestern Bell) soon will ask the Commission for higher rates to cushion the blow of losing interstate long-distance revenue and other business to AT&T under the split-up."

This fear and uncertainty has the older population worried.

Senator JEPSEN. Thank you. Mr. Pos.

STATEMENT OF WAYNE POS, CHAIRMAN, IOWA AGING COALITION

Mr. POS. Senator Jepsen, I feel honored and grateful to be able to be here.

In listening to the testimony of my friends here at the table, the testimony given this morning, I felt almost like an island in a sea of information.

Senator JEPSEN. Hold that a little closer.

Mr. POS. I felt almost like an island in a sea of information. However, on that island, I am not alone. There are over 387,000 Iowans 65 and older in Iowa.

As chairman of the Iowa Aging Coalition, whose membership consists of over 250,000 senior citizens, I feel quite strongly regarding the increase in rates recently requested by Northwestern Bell Telephone Co. There are 387,000 senior citizens living in Iowa who are 65 or over.

The primary purpose of a telephone in an elderly person's home is not for business reasons. The majority of the elderly find the telephone a lifeline for them so they may keep in touch with their friends or relatives, letting them know if they are feeling well or not feeling well, or to be used in the case of an emergency, to call a doctor, ambulance, fire, police, and any other emergency situation which could arise. In 1980, 7.1 million of all noninstitutionalized older persons lived alone.

It is interesting to note, in the United States in 1980, there were 7$\frac{1}{10}$ million of all noninstitutionalized older persons lived alone. Loneliness can be a terrible thing.

For the vast majority of elderly, the telephone is used for local calls, and it probably would be proper at this time to state that we feel it is quite feasible that long-distance rates help subsidize the cost of local calls.

The proposed fee of $2 per month with this stated objective as printed in the Des Moines Register of raising this in succeeding years to 5, 6, and even 7 percent, will make the telephone not a necessity, but a luxury which no longer can be afforded by many elderly persons.

Over 50 percent of the retired headed households throughout the United States have income below the $10,000 level, and the substandard level, the number is tremendous. And by increasing two, three, five, six, and where are we going to stop, and having the feeling you are on the island and crying for help, yes, a hardship is created for them.

We would like to recommend a national policy that the Federal Communications System insure that basic telephone service be universally available at reasonable rates. This could be administered by the local State commerce commission.

Thank you, very much.

Senator JEPSEN. I thank you.

Many States are offering lifeline telephone service for the elderly and disadvantaged. This lifeline rate is typically about $4 or $5 a month for the first 30 phone calls plus a small charge per call for any additional phone use.

What is your opinion of this type of approach to making phone service affordable? We just might go from my right to left. Mr. Maret?

Mr. MARET. Well, I think it is essential that all Iowans have access to a telephone, and I think it goes beyond the need for emergency services.

And as I guess as has been pointed out by the other speakers here, it has become such a social tool, that it is a surce of communicating with the outside world.

I would prefer to see some method adopted which would not require some type of subsidization by one class over another by the Federal Government. However, on the other hand, if it boils down to a situation where economics would dictate that a number of Iowans were unable to receive basic service, I would certainly support some type of subsidy, either from the Federal or State Government, in order to provide the type of service that you explained.

Senator JEPSEN. Ms. Tynes.

Ms. TYNES. I think the lifeline service can serve a purpose, but I do not believe it can fulfill the need.

If we talk about 30 calls a month, that may be one a day, and consider talking to one individual per day yourself. For someone who is isolated, that is hardly realistic.

And if the telephone is used as a means to touch base on a regular basis with an individual who is homebound, that usually entails more than one call a day. That might be a call in the morning to make sure the person is OK, a call later in the day to make sure the person is still doing well. So 30 calls a day—30 calls a month just begins to scratch the surface.

Senator JEPSEN. Mr. Pos.

Mr. POS. We would support a subsidy for those elderly who need it, but Ms. Tynes pointed out very graphically and quite capably that that, in itself, the number of 30, would not be sufficient.

Mr. WILSON. We would be concerned about, I think, the measured service.

My wife, for instance, is on a telephone committee that makes calls for the retired teachers, and I do not see that we could work with that kind of an arrangement. So we would be concerned about that.

We are also concerned about a means test. We believe that the local call—or the local rates are reasonable at this point, and we would prefer to have them continued about the same rate.

Senator JEPSEN. Well, one thing that has not been mentioned so far today is that reliability that we have on our phone system in this country, and when you talk about needing the phone, you really do. You want to be able to count on it. That takes some service and some upkeep and some repair immediately available, and this type of thing.

We only have to go to some other country to appreciate the phone service that we have in this country. The phones work, the service has been available, and if consumers are going to receive better service and a greater variety of services because of charges in the industry, let us pretend for a minute that if that should be the case, is there any circumstances when, for the senior citizens, which is primarily what we have represented in this panel, with the exception of Mr. Maret, is there any circumstances where there would be any reasonable increase that would be acceptable?

Mr. WILSON. I would think that as the economy improves, and, hopefully, social security and cost-of-living adjustments continue to improve, that the telephone rates also would improve at about the same rate.

I think that we have talked this morning about long-distance calls, maybe subsidizing local calls, and I do not know whether they do or whether they do not.

Senator JEPSEN. They do.

Mr. WILSON. OK. Why that could not continue under some fashion. I believe Judge Greene's divestiture did not talk to that particular point.

Senator JEPSEN. Anyone else?

Mr. POS. We are also now paying—those of us who chose to do so—50 cents a month to have the line within our home worked upon in the event something happens. So we are helping pay for that.

Senator JEPSEN. Anything else?

Ms. TYNES. Well, I think your question was, was there a time when an increase in rates would be acceptable to the elderly, and I am afraid that rates—or everything increases at about the same pace as the social security benefits do, and what we are seeing beginning in January is a slight increase in social security, but also an increase in their medicare payment as well as probably an increase in subsidized housing, and most of the people whom we are talking about today would be eligible for subsidized housing.

So there is probably never a good time when an increase in the cost of living in anything to enable one to live independently would be acceptable.

Senator JEPSEN. Do you have any comment on that, Mr. Maret?

Mr. MARET. Not specifically, but if I may, I would like to make a comment on another matter which came to my mind as a result of your earlier comment about the universal service and adequate service.

I think, in talking to a number of Iowans who are aware what is going to transpire on January 1, 1984, and, basically, what they're aware of is their local service bill is going to go up like $4 a month, is that they look at the service they are receiving right now and say:

> Gee, this is great. We got a problem. We call the telephone company, they take care of it. Service is good, and, as of January 1, all of a sudden I am going to have to start paying $4 a month more? What am I getting for that additional $4 a month?

It is very hard for the general public to understand that all of a sudden their rates are going to be increased, whether they pick up the phone and use it for a long-distance call or not. It is not material. They are still going to have to pay for that cost, and there is a great deal of concern in the public about that.

Senator JEPSEN. Let the record show, does anyone here know of any limit in any telephone system or arrangement that places any limit on incoming calls?

[No response.]

Senator JEPSEN. OK. A question for the three panel members who are concerned primarily with the senior citizens. What is more important, in your opinion, to the elderly? A local or long-distance call? Which would they use the most? What would you say?

Ms. TYNES. I believe senior citizens would make more local outgoing calls. However, because of the extended family situation, may receive a number of long-distance incoming calls.

Senator JEPSEN. And there is no limit on those?

Ms. TYNES. No.

Senator JEPSEN. Mr. Pos?

Mr. POS. I would like to have you repeat your question again. I am not sure I understand.

Senator JEPSEN. What is most important to the elderly, long-distance or local calls, and what do you think they use the most?

Mr. POS. No question but what the local calls would be the most important, and I would agree also that—to be able to use it to call out is of vital importance. They are not alone.

Dr. WILSON. I agree. There is no question but what the local calls are far more important than long-distance calls, although I do recall what one of the commissioners from South Dakota said this morning, that it is important to have a phone on the other end when you do make a long-distance call, and I think that is important for us to keep in mind.

Senator JEPSEN. Anybody have a final statement they would like to make? Mr. Maret.

Mr. MARET. I would like to make a comment on your last question. I think the Iowa State Commerce Commission has addressed the issue of—as a matter of fact, has adopted rules which would permit customers to receive only local service and not take or have access to the toll service.

There are some problems from a technical standpoint. Many of the telephone companies indicated that they did not have facilities in order to implement this, and the other problem was the question of whether or not it was economically feasible to provide such a system.

But assuming both of those criteria can be met, it is possible for Iowans to receive only local service in the future, and not be hooked up at all with the toll network.

Senator JEPSEN. OK. I thank you for coming. As we say in the jargon of Washington, the Capitol area, thank you for taking time out of your busy schedule to be with us today.

We have two panels left. One is for the alternatives to traditional telephone service, and the other panel, the last one, from the telephone company's perspective.

We will have these two panels start immediately after a break for the noon hour.

We will take just an hour, so at 1:25, we will reconvene here, and at that time, start with panel No. 4, which is alternatives to traditional telephone service.

[Whereupon, at 12:25 p.m., the committee recessed, to reconvene at 1:25 p.m., the same day.]

AFTERNOON SESSION

Senator JEPSEN. This hearing will please come to order.

We will now invite to the witness table Mr. Clark McLeod, Teleconnect, Cedar Rapids; Mr. Joseph Reed, AT&T Communications, Chicago; Mr. Craig Welch, GTE Sprint, Washington; Mr. Bob Patrick, Cox Cable in Omaha.

We will proceed in alphabetical order, which is as good a way and as safe a way to proceed as any. I will then recognize now Mr. Clark McLeod, and I would advise all the panel that any written statements you have will be entered into the record as if read, and therefore you may summarize if you choose, or proceed in any manner you so desire. Mr. McLeod from Teleconnect in Cedar Rapids.

STATEMENT OF CLARK McLEOD, PRESIDENT, TELECONNECT CO., CEDAR RAPIDS, IOWA

Mr. McLEOD. I hate to start right off on a different issue, but I am afraid the situation that I represent is considerably different than any of the situations that have been talked about so far.

So in my testimony today, I have gone very slowly to explain—I have moved very slowly to explain our position, and explain a little bit of background about Teleconnect.

I am the president of Teleconnect Co., a privately held Iowa-based corporation. We began business 4 years ago with four employees.

Today, Teleconnect provides jobs for more than 350 Iowans. We project doubling that employment in the coming year, if we can continue at our present rate of progress.

Let me provide some background. Teleconnect's first business activity was selling and installing telephone systems for businesses. We are still in that business; however, starting with the first of these equipment installations, it was apparent that long distance telephone service costs were a major concern of the commercial customer.

As a part of our service, we began counseling customers on ways to save money through the proper use of AT&T and MCI's long distance calling services. This counseling did not generate revenue for Teleconnect, but was viewed as an integral part of our service function. It was difficult, however, to get employees from these businesses to always use these long distance lines in the manner in which we had directed them.

So Teleconnect began offering a new service in July of 1982. The same long-distance lines which were misused when purchased directly from AT&T, or the other Iowa carrier, MCI—and excuse me, but Sprint, I do not believe, was providing services at that time—were first routed through Teleconnect's computer, and our customers were allowed to access our computer through dialing a secure access code.

This method of control allows us to make available the best quality line, the best cost, and provide an itemized detail of the transaction back to the business owner. In November of 1982 we opened up this long-distance service to residential customers as well.

Let me repeat how Teleconnect provides long-distance service. We lease lines from AT&T and the present Bell company at the same rates that large business users do. We then allow our customers to access our system by dialing into our switching computer. They are charged for this service at a discount from Bell direct dial rates.

We can do this, not by any special price break, but by efficient coordination of the calls and high volume use of the lines. We use the same lines which make large business customers minimize their communications expense, but we can use them to provide lower costs to small businesses and residential customers.

In June of 1981, the FCC provided the legal framework for Teleconnect's long distance service, which is now referred to as resale. Resale means to take service from one or more of the interexchange common carrier, such as AT&T, MCI and GTE, and combine them for a select group of users.

In June of 1982, the Iowa Commerce Commission was one of the first State commissions to accept tariffs from Northwestern Bell, which legalized reselling Iowa WATS services. We started using those tariffs to provide our service the following month.

Teleconnect now serves 50,000 residential customers and 3,000 business customers. By the end of 1984, we will be serving 175,000 residential customers, and 15,000 business customers. The reason for this tremendous success is that customers that use as little as $5 a month in long distance subscribe to our service.

Now for the serious issues. I felt you needed some background on the resale industry since that has not been brought up so far.

Teleconnect Co. is concerned about the FCC's modified access charge plan and its scheduled effective date, January 1, 1984. We feel that this plan will cause chaos if implemented without major revision.

There are three areas which require change: The residential access charge; charges which apply to interexchange carriers; and resellers being classified as interexchange carriers, not as users.

Allow me to expand on each of these areas. The residential access charge—everyone has been talking about it; I will talk about it very briefly—the $2 per month interstate plus a $2 per month intrastate plus other rate increases requested by the operating companies will cause many people in need of phone service to go without, and those are the people that we are concerned with.

We are not necessarily concerned with everyone having phone service. We are definitely concerned with people in need of phone service. There may be a difference there.

Residential access charges should be delayed until an adequate lifeline-type service is available. We have heard people talk about that it is 70 percent available in Omaha, and it is available in 30 States. But it is not available nationwide. It certainly is not available in a lot of the cities in Iowa. Why should the access charge be delayed?

Let us examine the low-income elderly. Already strapped to pay for food, medicine, shelter, and electricity, many of these persons find the phone a luxury they cannot afford. There is no group in society more in need of phone service for their well-being and safety.

The fact is that many older citizens even now are without phone service, let alone once the rates go up. We at Teleconnect have recognized this by joining with the Linn County Council on Aging to provide at least some of our most needy elderly Iowans with free phone service under a program called silver thread.

Teleconnect provides the phones and is soliciting voluntary donations to pay for phone service. This program is not a small undertaking for Teleconnect. We expect to spend $50,000 in 1984 to insure this program's success.

Even once a lifeline service is available, it cannot be provided free of charge. For that reason, we expect silver thread, or some other similar program, to be required in every State in 1984 and years to come.

Our second area of concern is the increased access charge to small interexchange carriers. Interexchange carriers, in this case, I am referring to the MCI's, and the GTE's. Their charges will increase dramatically on January 1 while AT&T's payments will decrease.

At the same time, AT&T's rates to users will be lowered by 10 percent. This would put AT&T's competitors at a disadvantage; in fact, it will put them out of business.

Tom Brophy, the chairman of GTE, has been quoted as saying recently: "Five years from now there will be only one carrier."

How does this concern Teleconnect? Teleconnect needs the option of choosing from a number of carriers, not just AT&T.

The third area which requires modification is that resellers were classified by the FCC as inter-exchange carriers instead of users. This is absurd.

Long distance communication involves three parties—the interexchange carrier, the exchange carrier, and the ratepayers or user. Within the first category, there is a dominant interexchange carrier, AT&T, and nondominant interexchange carriers such as MCI and GTE. These people actually own the lines or microwave circuits which provide for long distance communication between cities.

The second element is called an exchange carrier, and the exchange carrier owns the lines within the city that connects with the interexchange carrier lines.

The third element is the ratepayer or the user. The ratepayer is made up of residential and business customers which subscribe to carrier services. Resellers also subscribe to carrier services. Resellers do not own or maintain local or long-distance telephone lines. In fact, resellers lease these lines from the carriers.

Teleconnect is the largest user of Bell lines, exchange lines, and AT&T's lines, interexchange lines, within the State of Iowa. I do not have positive fact about that, but I think that is pretty close to being true. We are spending about a million dollars a month on those services.

These access charges become part of what the interexchange carrier charges their user. We are saying when carriers are to be charged, those charges should be put into their circut charges and applied back to the end user, resellers, the large businesses and the small businesses.

In summary, I must emphasize that Congress needs to act on the FCC's access plan to modify its implementation.

Gentlemen, the FCC, as I understand it, October 3 received 500,000 pages of tariffs. If we stack 500,000 pages of tariffs outside this building, it is about 18 stories high.

They received those tariffs on October 3, as I understand it. I assume they are going to go through those tariffs, but the FCC does not have that kind of manpower to go through all those tariffs.

We buy services from most of these people providing those tariffs. We certainly cannot read through 500,000 pages of tariffs between now and January 1, when this access plan goes into effect.

In order for Congress to act on this issue, Senator Jepsen, Congressman Tauke, other people in Washington, D.C., must have the confidence that they are acting on behalf of the people that have elected them. I must ask the public to support Senator Jepsen and all the other legislators in Washington, D.C., on these matters which are coming before them now.

I ask our legislators to, one, delay the residential access charge; two, freeze the present carrier charges; and, three, redefine the resellers as users.

Thank you for letting me provide this information on behalf of Teleconnect, its strand of 50 employees, and its 53,000 customers.

Senator JEPSEN. Thank you, Mr. McLeod.

Mr. Bob Patrick of Cox Cable of Omaha will be next.

STATEMENT OF G. ROBERT PATRICK, COX CABLE COMMUNICATIONS, OMAHA, NEBR.

Mr. PATRICK. Good afternoon, Senator Jepsen and members of the committee. Let me introduce myself as one of those feared bypassers. It is a measure of respect to the sensibilities of ladies present I decided to leave my horns and my pitchfork and my forked tail downstairs in the checked baggage before I came to testify.

On a more serious note, though, I am grateful to be here. I am grateful to be allowed to talk to you about our small part in the communications industry, and to share in the opinions of other concerned parties in the progress of divestiture and unregulation.

My contributions today will be limited to these spoken remarks and participation in question and answer. We will furnish written remarks as soon as possible.

I represent Cox Cable Communications, which is a major cable television operator doing business in 23 States with about 1½ million subscribers. Cox Cable Communications is a subsidiary of Cox Communications, which owns major television and radio broadcasting stations, and is involved in programing and satellite transmissions services.

Cox is also involved in two developmental services, INDAX and COMMLINE, which place the company squarely in the path of the events of the divestiture, unregulation proceedings.

INDAX furnishes two-way communication. It services to homes for the purpose of in-home video text banking, shopping, and information retrieval.

COMMLINE provides two-way video and data communications services to businesses, municipal and government agencies. Both services represent a potential boon to those whom they are intended to serve, and represent exactly the kind of new innovative services that the divestiture and control on regulation were intended to stimulate.

Let me talk about the COMMLINE service for a moment because that service more closely alines with the conditional concept of telecommunications, and will be the most immediately affected by the outcome of the current divestiture proceedings, and access charge decisions.

Initially, COMMLINE service was introduced just to the west of here, in Omaha, which also gives it a regional flavor, a matter of regional interest. I will describe what is being done in Omaha today by way of explaining the service as a whole.

COMMLINE uses coaxial cable to carry data to video services in Omaha. These data services are primarily a high speed service and a large multipoint data service.

The video services are one- and two-way, full color, and are sold by the month, and, interestingly enough, sold by the hour. Clients can use the services to transfer information between the locations inside the Omaha city limits.

Cox views these services as serving to broaden the spectrum of communication choices available to Omaha businesses, not as services to replace the telephone company's business communication services. Indeed, the majority of use of the COMMLINE coaxial cable network is in the realm of new and innovative services like linking high speed local area networks with equipment speed circuits, carrying video programing for local newspapers to enable them to broadcast hourly local news programs to Omaha residents, creating extensive networks for computer education, forming links between buildings for one- and two-way video conferencing, and linking buildings with very high speed data circuits for the bulk of transfer of information.

Well over two-thirds of these business service applications did not even exist before COMMLINE came to town.

That tells us two things. No. 1, the COMMLINE is stimulating significant new communication use for the benefit of Omaha organizations, and indirectly for the benefit of Omaha citizens; and,

No. 2, this "bypass business," is not taking appreciable amounts of revenue from the local telephone company. In fact, the total system revenue of the COMMLINE system at maturity is projected to be less than one-fifth of Northwestern Bell's Nebraska current annual revenue increases—not gross revenue, but annual revenue increases.

What is happening is that both COMMLINE and Northwestern Bell in Omaha are taking pieces out of a rapidly growing communication services pie. Northwestern Bell local service revenues will never be less than they are today.

The effect of the presence of COMMLINE in the market, or COMMLINE in any market, would be, as much as anything else, to stimulate the use of communications and increase the total size of the market for all communication providers.

The Federal regulatory and legal climate has been generally favorable to growth and divestitation of communications including these new cable services. We view the existing divestiture proceedings and the continuing of that generally helpful trend, the recent State and Federal legislation has given us pause, or caused us to fear these competitive climates may be truly short lived.

We view with alarm the vague wording in the House Resolution 4102 and its companion amendments; that is, those amendments that we have been able to see. Some of these provisions would call for return to absolute regulation of communication services, including two-way cable services like COMMLINE and INDAX.

Other provisions would place a user tax on all the services that COMMLINE and INDAX provide; in some cases, the tax being equal to as much as 200 percent of the basic service price.

The result of these restrictions, if enacted into law, would be devastating. COMMLINE, INDAX, and other services like it would cease to exist almost before their promise was known.

It would be ironic if legislation hastily enacted to achieve the truly worthwhile goal, to assure a universal service, also achieves the destruction of these promising new services. That may very well be the result, and may well happen in the next few weeks in Congress.

There is an answer, and that answer is to give the current divestiture arrangements, including FCC companion decisions, a chance to work. This carefully crafted and well-considered plan, the product of full public input, and over the course of 1¾ years' deliberation, will probably not prove to be perfect, but it will probably prove to be workable.

This country, with its money system, will not abruptly totter off or topple off in catastrophe January 1. The local divestiture Bell-operated companies will remain viable with or without enormous rate increases, and will benefit from increased competition in the long-distance industry, and, indeed, from the introduction of new unregulated services.

Any minor dislocation or inefficiency discovered over time could then be remedied by specifically targeted legislation or regulatory decree. This would be preferable to omnibus legislation hastily enacted at this time, legislation which is trying to cure ills that may not even exist, and legislation that may prove to be as enduring as the Communications Act of 1934.

In summary, the recommendation is to proceed with great caution in enacting communications legislation, although it may ultimately be necessary. Give the current blueprint for deregulation a chance to accomplish its intended purposes, and then make fine adjustments as needed. Any attempts at comprehensive legislation, especially when enacted without due deliberation, could be catastrophic, causing major dislocations in services and revenues and effectively forbidding the development of new services both over coaxial cable and other media.

Thank you for my chance to be heard, sir. Gentlemen, this concludes my remarks.

Senator JEPSEN. Thank you, Mr. Patrick.

Mr. Joseph Reed, AT&T Communications of Chicago.

STATEMENT OF JOSEPH D. REED, REGIONAL VICE PRESIDENT, AT&T COMMUNICATIONS, CHICAGO, ILL.

Mr. REED. Thank you, Senator Jepsen. I am indeed based in Chicago in the new structure of AT&T, but will be visiting and will be responsible generally for a 10-State area for AT&T, which encompasses Iowa and the States of the—represented by some of the people who spoke this morning.

I appreciate the opportunity to be here today, for, among other reasons, the interest and concern that this whole issue has attracted, and the desire on the part of you and your colleagues to shed light on what is a very complex subject.

Despite my instinct to offer some rebuttal to things that have gone before today, I will restrain myself and address myself to the comments that I have prepared to make.

I have been through the major changes that this telecommunications industry has been going through in the past few years. You might say I am a veteran.

I spent most of my career in Ohio Bell. Recently, I however, last year, participated in the establishment of the Information Systems Division of AT&T, and now have moved over to the AT&T Communications organization with entirely new problems and circumstances in which the divestiture is taking place.

All of this experience has made it abundantly clear to me that a whole new reality exists today, and that reality, of course, is the technological revolution that has brought about extensive competition in our industry.

Competition came to be a reality first with a decision with regard to the radio spectrum back in the early sixties by the FCC, and later, of course, with the Carter fund decision, and then more rapidly here in the seventies with a series of decisions which led to the connection of the first intercity long-distance channel by a supplier other than AT&T, when MCI connected its first long-distance channel between Chicago and St. Louis. But the driving force over the last 25 years in my industry has clearly been technological changes, but the change has not been uniform.

Long-distance costs have decreased because of the introduction of technology into that portion of the business but similar technological advances have simply not occured in the local exchange portion of the industry. As a result, local exchange rates have tended to go up as long-distance rates have tended to remain the same, or gone down.

Therefore, the reality is that long-distance prices have simply artifically been kept higher to pay for the higher cost of local service, and that, of course, in essence, is what we are all talking about here today.

Before I go on, I would just like to make one other comment with regard to my qualifications in order to give you an idea where I am coming from. I represent the enterprise that, if it did not invent it, it certainly developed the concept of universal telephone service, and I think it should be made clear here today that I, and the entire organization that I represent, give the concept of universal service no less priority today than we have over the 107 years of our existence.

It is important to every AT&T and Bell operating company manager I know that this unique bit of Americana, which we call universal telephone service, is sustained, and my dedication is not only because of the historical relevance of this, it clearly is, in reference to what I mentioned earlier, that is, I represent the entity that will, after divestiture, provide the bridge between the service areas of local telephone companies.

I think it is now clear, without universal telephone service, I do not have anyone to sell my services to. So that, in itself, is an added incentive for my dedication to continuing universal telephone service.

I think this meeting bodes well for further understanding of the issues, and there is a need for greater understanding. Studies prove that. Excepting the informed people who have been here today, only about one in three—in our studies of the public, only about one in three really have any understanding of the effects of the changes that are taking place in my industry upon them as individuals, and on the industry in the long run. Probably the reason for this lack of understanding is the fact that so much focus has been placed on the issues in terms of the industry and not so much in concern—or in connection with the concern of the individual members of the public, and I think these hearings will help eliminate that, and will change, perhaps, the focus. But to do it effectively, I think these issues, the presentation of these issues, must include a presentation of all the facts, not just those that benefit me as one presenter, but all of the presenters then. It is in this spirit then that I offer my remarks.

As I said, I am not here really to talk much about competition. The subject is closed. The ship has sailed, the telecommunications industry, as represented by all of us at this table, has been irrevocably changed. The break-up of the Bell System is at the end of the sequence of events, just as it is at the beginning of a new adventure with new risks, and no amount of wishing can reconstruct the industry as it was. No amount of wishing can recapture the time window when constructive legislation might have been fashioned to satisfy everyone, if, indeed, that ever could have been done. And because telecommunications is simply the most innovative industry in the U.S. economy, any attempt to ignore these facts could be disastrous, not only for the telecommunications industry, but for the economy as a whole.

In my opinion, the Universal Telephone Service Preservation Act of 1983 is a direct denial of the principle of competition that we have come to accept as a role in the break-up of the Bell System. It would undermine the fundamental concept of the competition provision provided in the Federal Communications access charge plan which is designed to implement the concept of competition, and I do not believe that institutional rules can control a process so profoundly influenced by technology and driven by technology.

In keeping with the realities of telecommunications technology and today's marketplace, the FCC plan does recognize that long-distance services cannot carry the same burden of subsidizing local exchange services as they have in the past. That plan implements the concept of competition in the telecommunications industry by moving toward cost-based pricing for telephone service and communication services.

In attempting to undermine the FCC plan, the Universal Telephone Service Preservation Act would undermine the most basic building blocks of economic competition, and penalize the very people it proposes to help. The act not only introduces major changes in the access charge order, but it attempts to defeat the necessary restructuring of rates to accommodate the divestiture and transition to a competitive environment.

By postponing or prohibiting portions of direct user charges, the proposed legislation would, in effect, disregard the years of intensive study and scrutiny that went into the FCC order and into their decision. I would like to use a couple of examples of the problem of going back to a system of general subsidization.

I think the issue of whether or not there should be a subsidy is part of what has been debated here, but more profoundly, it seems to me the question of whether or not that subsidy should come internally or in the form of some sort of a hidden tax within the structure of the telecommunication pricing plan that would tax one customer for the benefit—presumed benefit of another customer.

Take an example of local exchange usage. We have talked a lot about elderly, we have talked a lot about poor and deprived people, but, in fact, one of the largest subgroups of users of telecommunication services are teenagers. They talk for hours, often, on local calls. A neighbor, on the other hand, next door making a long-distance call across the country to an aged parent, subsidizes that lengthy local call, and therefore causes that price of that long-distance call, even for users of services other than AT&T, to be unnecessarily higher, for one 10-minute call, somewhere in the neighborhood of $1.50 higher, to be exact, because that amount goes to support local service.

I think all of the schemes that would suggest that a subscriber, because of their age, are unable—or, per se, unable to pay for the service that they use are wrong because, in many cases, those individuals are very able to pay, and are not paying for the true cost of this service, but are being subsidized by people who are even less privileged and less capable than they are. The result is that local exchange rates often encourage overuse, if not abuse, of the exchange network.

There is no intention in development of the approach that is—that has unfolded, and as a result of the competition and the technological change that has occurred in our business, there is no intention here to deny anyone service. There is no intention to cut off a whole segment of the population from the availability of their telephone service.

The issue is simply whether there is not a way to target subsidies, if those subsidies are needed, in much the way other subsidies are targeted to individuals who are in need. Of course, that is the basic concern that we have.

Bypass has been mentioned a couple of times this morning, and I would like to return to that for just a moment and take you back to the comments that Mr. Cleveland made representing his business perspective on this entire issue. He made the point, in connection with bypass, better than I ever could have. He said, and I think I am quoting him with a fair degree of accuracy, "Business will do what they need to do to hold costs down," and that's quite right. I translate this to say that a businessman using telecommunications must, in fact, look out for himself in the interest of his business. And he suggested furthermore, however, that the cost that drives prices so high that private systems become economical is somehow traceable to overhead. He is right, but it is not the kind of overhead he envisions. It is overhead imposed by arbitrary assignment of cost in order to continue a general subsidy and, of course, that is our fundamental concern. Business people will certainly look elsewhere when their telephone costs are bearing a hidden tax.

Just to attempt to sum up this very complicated subject, in my judgment, the Universal Telephone Preservation Act of 1983 defeats the very principle its title proposes. It will not preserve telephone service. The act attempts to throw out marketplace economics and replace it with a continuation of the type of utility economics and monopoly pricing of a bygone era.

I submit, you cannot have it both ways. Competition and monopoly are simply totally incompatible institutions. Today's economic climate cannot support any continuation of the adding of arbitrary costs to the pricing of long-distance calls.

Again, I submit subsidies through this method cannot survive. Today's advances in telecommunication technology make it totally unrealistic to impose on the business customers the additional cost to long-distance service they have traditionally borne.

Furthermore, I believe it is unethical to expect industry to carry a burden of cost so far out of proportion to the actual cost of servicing them.

It is no time to attempt to turn back the clock, and at this moment, time is a crucial factor. The last minute introduction of legislation is interjecting damaging uncertainty in the divestiture process, uncertainty, I am certain, was never intended, but damaging, nevertheless.

The current and potential implications of these delays to investors, the financial community at large are incalculable, and the uncertainties that exist by the introduction of diseconomic subsidies that vary from State to State are certain to have adverse affects on investor confidence, and, in turn, financial markets, and possibly world trade.

To each of us as individuals, I submit that we have and are acting in good faith. As managers, we have accepted the idea of breaking up the Bell System, the very institution we and our predecessors worked for 107 years to build for the benefit of untold millions. Each of us echoes the sentiments of the chief executive officer of AT&T, and I quote, "All of us in the Bell family are accommodating ourselves to the job of dismantling what we built because new telecommunications policy has been established. We are determined to make it work. We are not looking back, and we are not second guessing."

Please, let us get on with it.

Thank you very much.

[The prepared statement of Mr. Reed follows:]

PREPARED STATEMENT OF JOSEPH D. REED

My name is Joseph D. Reed. I am Regional Vice President of External Affairs for the prospective interexchange organization, AT&T Communications. This is the entity which after divestiture will provide such services as interstate long distance communication services and the intrastate interLATA long distance services formerly provided by the Bell Operating Companies.

I am here today, at your invitation, to state my views on the proposed congressional legislation, Senate bill 1660 and House bill 4102.

I certainly appreciate the opportunity to appear before you today. And I welcome the interest and concern which this subject has finally attracted.

I have been through the major changes of the telecommunications industry these past few years. You might say I'm a veteran. I have been with Ohio Bell, and before coming to AT&T Communications, was in Marketing -- and responsible for establishing the midwestern sales facilities for AT&T Information Systems -- the spin off AT&T marketing equipment company.

I was a witness to the changes that impel us to meet today. I can testify that those changes did not come easily. Universal service had been all but achieved by the time I entered the business. The focus of technological innovation then was on cutting costs and keeping rates both low and stable. The changes upset that scenario.

As many will recall, AT&T opposed these changes. We argued that subsidies could not be maintained in a competitive environment, while others argued for the economic efficiency said to be fostered by competition.

It was a lengthy debate but the ultimate outcome is now clear. Competition is to be valued above regulated monopoly. The consensus in favor of competition emerged from a confluence of forces; regulatory bodies, the courts, the halls of Congress, and from the Antitrust Division of the Department of Justice. And furthermore, the rapid pace of technological change made such a shift in public policy more urgent as the line between telecommunications and data processing became ever more blurred.

And so we acquiesced.

We adjusted to the new realities by agreeing to the massive reorganization that is now proceeding under Judge Greene's supervision and in accordance with both state and federal regulatory requirements.

As we predicted, competition has begun to drive prices toward costs. The process commenced in the early 1970s and is accelerating today. It must continue because of the burgeoning new technologies which make bypass of the network both feasible and economically attractive in the eyes of large users.

My experience has made it abundantly clear to me that a new reality exists today. That reality is the technological revolution that has brought about extensive competition in our industry.

Competition came to be a reality, first, with the "above 890" decision, and then later with the Carterphone decision in 1967. Again, it was recognized when MCI connected its first long distance channel between Chicago and St. Louis.

The driving force in telecommunications over the past 25 years has been technological change. However, the impact of this change has not been uniform. Long distance costs have decreased because of technological change. But similar technological advancements have not occurred in the local exchange portion of the industry. As a result, local exchange rates have not been reduced.

Therefore, the reality is that long distance prices have been artificially kept higher to pay for the higher cost of local service. And that, in essence, is the issue that brings us here today.

Before going on, I must again further state my qualifications -- on two grounds -- in order to give you a clearer idea of where I am "coming from."

I represent the enterprise that "invented," if you will, developed ... and implemented the concept of universal telephone service. And I want each of you to know that I, and the entire organization I represent give that concept of universal telephone service the same priority today that we have through the 107 years of our existence.

I won't promise not to make another reference to that later. It's that important to me. It's that important to every AT&T and Bell Operating Company manager I know. And we believe we still have the most workable plan to continue, even in today's economy, that unique bit of Americana -- universal telephone service.

I'd like to qualify further my dedication to universal telephone service in yet another way -- by referring to what I mentioned earlier. I represent the entity that will, after divestiture, provide the "bridge" between the service areas of the local telephone companies. I think it's now clear, without universal telephone service, I wouldn't have anyone to sell my services. So that in itself is an added incentive for my dedication to continuing universal telephone service.

Our meeting today bodes well for a fuller understanding of the issues. And there is a need for a greater understanding of the issues. Studies prove that. The public is still in the dark. Only one in three has any understanding of the effects of these changes on them as individuals -- and on the industry, long term.

Probably, the reason for this lack of understanding is that the issues have been interpreted as industry issues, and not as the concern of individual members of the public. That misinterpretation of the facts must be changed. These hearings will help illuminate understanding of the issues.

In order to do this effectively, though, the presentation of these issues must include all of the facts, not just those that serve the particular purpose of the presentor. It is in this spirit that I offer my remarks.

I am not here to talk about competition. That subject is closed. The ship has sailed. The telecommunications industry has been irrevocably changed.

The breakup of the Bell System is at the end of a sequence of events, just as it is beginning a new adventure -- with new risks. No amount of wishing can reconstruct the industry as it was. No amount of wishing can recapture the time window when constructive legislation might have been fashioned to satisfy everyone. If indeed, that ever could have been done. And because telecommunications represents the high-tech revolution, any attempt to ignore those facts could be disasterous not only for the telecommunications industry, but for the economy as a whole.

I am here to comment on legislation that would effectively negate the very basis of agreement that started us down the road to divestiture -- the public policy that switched us from regulation to competition.

In my opinion, the "Universal Telephone Service Preservation Act of 1983" is a direct denial of the principle of competition that we have come to accept as our role in the breakup of the Bell System. It would undermine the fundamental concept of competition envisioned in the Federal Communication Commission's access-charge plan -- the only plan we have which is designed to <u>implement</u> the concept of competition.

In keeping with the realities of telecommunications technology and today's marketplace, the FCC plan recognizes that long distance services cannot carry the same burdern of subsidizing local exchange services as in the past. That plan implements the concept of competition in the telecommunications industry by moving toward cost-based pricing for telephone service and communications services.

It is a fact that the industry and its regulators historically pursued universal service through a policy of broad subsidies. Through the first seventy years of the business, when telephone service was a monopoly and our record of innovation made us the envy of the world, that policy seemed to work just fine. But it won't -- and can't -- work any longer. The practice of setting some prices artificially high so that others can be kept artificially low is fundamentally inconsistent with the free and open competition that has been mandated for our industry.

Let me explain. Competition inevitably drives prices toward cost, a process that will undoubtedly lead to higher local rates. The local user today pays far less than the actual cost of access to the telephone network. On average, the cost of linking an end-user's telephone to the switched network is about $26 a month. This cost is non-traffic sensitive - that is, it represents dedicated facilities with a fixed cost regardless of how much a customer uses the telephone, or even if the telephone is not used at all. Yet, the average bill today for local residence exchange service is only about $11. So, the rest of those fixed costs, the difference between $26 and $11, are being recovered through usage sensitive charges, principally those included in long distance prices. Indeed, about 40 cents of every interstate long distance dollar is really earmarked to recover the fixed costs of access.

What this means is that the low user or non-user of long distance service contributes very little toward the access costs of his service, while heavy users pay again and again, far in excess of their actual costs.

In a competitive market, heavy users can and will seek to avoid such overpayments by moving to alternative forms of service. Bypass is the result and this is what makes the perpetuation of a policy of subsidization untenable.

In attempting to undermine the FCC plan, the Universal Telephone Service Preservation Act would undermine the most basic building blocks of economic competition and penalize the very people it proposes to help.

The Act not only introduces major changes in the FCC Access Charge order, it attempts to defeat the necessary restructuring of rates to accommodate the divestiture and the transition to competitive environment.

By postponing or prohibiting portions of direct-user charges, the proposed legislation would, in effect, disregard the years of intensive scrutiny that went into the FCC study.

The FCC's access charge order goes a long way toward mitigating the effects of the shift from usage to fixed charges for customer access by establishing a gradual and orderly transition period. As I mentioned, the average residence customer today pays about $11 a month for local service. Even presuming that prices were to double, the increase would amount to about 35 cents a day. And the FCC has provided for a transition period of seven years to accomplish the shift from usage to fixed based charges for access.

I would not represent to you that the FCC's transition plan is a cureall or that it will be painless. But given the new realities of a competitive marketplace, I would be hard-pressed to conceive a better solution.

Further, the Act works against the interests of the consumer by attempting to push much of the cost of local access back onto the long distance customer and thereby maintain artificially low local rates. It's really a case of one caller subsidizing another, without determining whether the receiving party needs the subsidy. Here's how this comes about.

Take the example of - a teenager talking for hours on a local call. A neighbor's long distance call -- across country to an aged parent -- subsidizes that lengthy local call -- and therefore is unnecessarily higher. For one 10-minute call, a dollar and 50 cents higher, to be exact, because that amount goes to support local service.

The result is that local exchange rates encourage overuse, if not abuse, of the exchange network. At the same time, concerned individuals who need to call long distance across country to inquire about loved ones would be restricted -- because of unnecessary and arbitrary pricing of long distance calling.

We all can predict the end of that scenario. Long distance calling volumes would be reduced -- because of arbitrary and unnecessary subsidy. And because of falling calling volumes, the cost of maintaining the network would be disproportionately higher per call. Rates would need to be increased to support the cost of running the network. The pattern would repeat itself, falling call volumes, increased long distance rates. Higher long distance costs would give high-volume long distance customers the incentive to develop their own long distance systems and bypass the local public network.

Perhaps a word or two on bypass would be appropriate here. When a local exchange telephone company speaks of "bypass," it's referring to an alternate, competing, substitute for its facilities by some customer or competing company. The result is a loss of revenue for the telephone company.

There can be two forms of bypass -- economic and uneconomic. Economic bypass occurs, as you might imagine, when the cost of providing alternate facilities is less than the cost the local exchange telephone company incurs to equal the competing facilities. In effect, the bypass facilities are more economically attractive. Of course, it is the telephone company's responsibility to defend itself against that.

Uneconomic bypass occurs when the price of telephone company facilities is set above its cost of providing the service. The result is that a competing service can use more expensive bypass facilities and still beat the telephone company's price. In effect, the bypass facilities are less economically efficient. Uneconomic bypass is likely to occur when the charges Commissions place on interexchange carriers and the local exchange charges placed on end users simply are not competitive.

I submit that it's just plain economics. The results are inescapable. You cannot hope to abuse the national resource that is this nation's switched network -- and have this nation go unscathed, The effect on the economy -- on communications itself -- would be disasterous. In the final analysis, affordable service for both classes of customer -- residence and business -- would be jeopardized.

You already know my dedication, and the dedication of AT&T, to universal telephone service. And, so, you know we understand the fear some have that telephone service will no longer be affordable for everyone when access charges are introduced and long distance subsidies eliminated. Those fears are unfounded.

To use just one example, in Iowa the average residential customer spends a little over $30 each month for telephone service. The interstate access charge will add only $2 to this bill, or an increase of approximately 5% when you consider the offsetting that will result from the long distance interstate rate reductions proposed by AT&T to the average of $4.66 per month that is spent on interstate toll charges.

And as for the low-income residence customers who may not be able to afford telephone service -- or any number of other daily needs, for that matter -- they can be protected with "Lifeline" rates. Already about 30 state have filed for this type of rate. State regulatory commissions have ample authority and resources to put such pricing into place.

I would urge you to consider that universal service can best be protected by targetting assistance to the groups which may truly need help --those low-income customers who cannot afford the cost of basic telephone service. For them, I submit that lifeline rates administered by the states are the best vehicle currently available for achieving that end.

As the burden of uneconomic costs is lifted from interexchange services over the years ahead, long distance prices will come down. Customers will find new ways to take advantage of existing services, not to mention the innovative services which are sure to be offered with increasing frequency. Technological advance will be stimulated, not retarded. And the resources of local telephone company exchange carriers and the long distance carriers will be optimized for the benefit of all customers.

Even so, interexchange carriers will continue to make substantial contributions to the costs of local service. This point is not well enough understood, but under the FCC's order interexchange carriers will be paying some $3 billion a year in non-traffic sensitive costs even after the transition period ends.

In addition, the very individuals we all are looking to protect -- the economically disadvantaged -- would benefit. Lower long distance rates would give them greater access to the public network. Lower rates would also give others concerned with their welfare greater access to the network to inquire about them.

Just to attempt to sum up a very complicated subject ... The "Universal Telephone Service Preservation Act of 1983" defeats the very principle its title proposes. It will not preserve telephone service.

The Act attempts to throw out marketplace economics and to replace it with a continuation of the type of utility economics and monopoly pricing of a bygone era. I submit, you cannot have it both ways.

Today's economic climate cannot support any continuation of the adding of arbitrary costs to the pricing of long distance calls. Again, I submit, subsidies are a thing of the past.

Today's advances in telecommunications technology make it totally unrealistic to impose on the business customer the additional costs to long distance service they have traditionally borne. It is also unethical to expect industry to carry a burden of cost so far out of proportion to the actual cost of serving them.

This is no time to attempt to turn back the clock. And at this moment, time is an important factor.

This last-minute introduction of hasty legislation is interjecting damaging uncertainty to the divestiture process. I am certain this was never intended. But damaging it is.

To paraphrase what has been said by C. L. Brown, Chairman of AT&T -- we are now within 76 days of the moment the Bell System will cease to exist. We are within 38 days of the date on which we must provide prospective 1984 financial data to the SEC and to our investors. "Please let's get on with it."

The current and potential implications of these delays to investors and the financial community-at-large are incalculable. The uncertainties that exist by the introduction of diseconomic subsidies that vary from state to state are certain to have adverse effects on investor confidence, and in turn, financial markets, and possibly world trade.

To each of you, as individuals, I submit that we have and are acting in good faith. As managers, we have accepted the idea of breaking up the Bell System -- the very institution we and our predecessors worked 107 years to build for the benefit of untold millions. Each of us echos the sentiments of the chief executive officer of AT&T, and I quote, "All of us in the Bell family are accommodating ourselves to the job of dismantling what we have built because new telecommunications policy has been established. We are determined to make it work. We are not looking back and we are not second-guessing."

"Please, let's get on with it."

Senator JEPSEN. Thank you, Mr. Reed.

And, now, finally, Mr. Craig Welch from GTE Sprint from Washington. I wish to welcome you, Mr. Welch, to Iowa.

STATEMENT OF CRAIG WELCH, DIRECTOR, CORPORATE COMMUNICATIONS, GTE SPRINT COMMUNICATIONS, WASHINGTON, D.C.

Mr. WELCH. Thank you, very much. My name is Craig Welch. I am director of Corporate Communications for GTE Sprint Communications Corp.

Thank you for inviting Sprint to participate Senator Jepsen, in this very worthwhile and constructive hearing.

Sprint is one of several long-distance telecommunications companies that provides services to the public in competition with AT&T. Sprint owns and operates a terrestrial microwave network which serves over 835,000 business and residential customers in over 350 cities across the country. Here in Iowa, we now service Cedar Rapids, Davenport, Des Moines, and Sioux City. We rely upon the local telephone companies to provide call origination and termination service over their local networks and we pay them about $250 per line per month for this service.

We plan to expand our transmission capacity substantially when Spacenet, an affiliate of Sprint, launches two satellites in 1984 and another in 1985. Today our network handles nearly 1.5 million calls each day. We employ close to 4,000 people.

My testimony today focuses on three principles that Sprint believes should be included in telecommunications policy developed by the Congress. I will then briefly discuss certain unique problems of the long-distance carriers.

One, first and foremost, Sprint believes that our national telecommunications policy should include a strong procompetitive statement. We believe the statement of policy contained in S. 898 which passed the Senate in 1981 is an excellent model. The first line reads:

> It is the policy of the United States to rely wherever and whenever possible on marketplace competition and on the private sector to provide all telecommunications services, and thereby to reduce and eliminate unnecessary regulation including the regulation of telecommunications facilities to the extent there is effective competition with respect to such facilities.

Attachment A of my prepared statement is a copy of the entire statement of policy. The House Telecommunications bill last year, H.R. 5158, contained similar procompetitive policy.

Sprint was formed less than 10 years ago, based on the conviction that competition in the domestic common carrier industry in America is and will continue to be good for the residential ratepayers, business users, and the Government. This conviction has been the basis underlying the regulatory and divestiture decisions which have brought us to the threshold of a competitive telecommunications industry. Sprint does not want to see Congress "Put Humpty Dumpty back together again." We do not want Congress to turn back the clock by preserving the predivestiture, monopoly system.

Competition means benefits in terms of increased employment, productivity, new services, and lower prices for consumers. Our own company is a case in point. There are some statistics in my prepared statement which illustrate our growth, and I believe it has been mirrored by other testifiers. The long-distance market itself is growing, and I think that is something that really needs to be focused on. In 1979 it was $16 billion, in long-distance calls; 1983—this is a 1982 figure—approximately $41 billion. We are drastically and dramatically increasing the market, in spite of competition, or maybe because of competition.

Item No. 2, cost-based pricing is another key principle that should be included in telecommunications policy. This principle follows from the first. Sprint believes that service should be priced to reflect the cost of providing that service. The concept that users of the telephone network should be responsible for the costs they actually cause is sound from an economic and from a public policy perspective. It is also a matter of fundamental fairness. Also, cost-based pricing will promote efficient use of the nationwide telecommunications network. This is not to say that we support a "flash cut" to cost-based pricing in an industry that has traditionally priced with little regard to cost. To the contrary, Sprint has supported a gradual phase in to cost-based user charges.

Item No. 3, universal service: Another important principle that should be included in telecommunications policy. Sprint supports this goal. Universally affordable telephone service need not be threatened simply because rates are aligned more closely with the costs of providing phone service. As I stated earlier, a transition is essential to minimize adverse effects on telephone users during this period of change. In order to preserve universal service, Sprint believes that a targeted means-tested entitlement program would be the most equitable method of providing basic residential service to truly needy individuals. As a means-tested program, it should be funded from general revenues. A means-tested program would avoid the economic dislocations that might be created by legislation designed to maintain the present subsidy scheme.

Much of the legislative debate these days is whether to support local service by taxing consumers who use long-distance service. Long-distance is not a luxury. Congress should avoid taxing one category of telephone user to subsidize another category.

Finally let me close with just 1 minute of comments on the unique problems that face companies, like ours, for new long-distance carriers.

One of the most serious problems facing the new long-distance carriers is that we are denied the same kind of access to local telephone company facilities that AT&T receives. This unequal and inferior type of access means that our customers must push at least 23 digits to complete a long-distance call while AT&T customers dial 10 or 11 digits. Sprint service cannot be used with a rotary dial phone unless adaptor equipment is added. Since about 50 percent of the phones in the United States today are rotary dial, we automatically cannot serve many customers that AT&T can serve.

Sprint is supporting a provision now in H.R. 4102 that would modify an FCC decision so that new long-distance carriers would have a 1½ year transition to the new system of access charges.

Without this provision, Sprint's access charge payments for interconnection to the local telephone company exchanges would more than double after January 1, 1984. At the same time, the access charges paid by AT&T would decrease by about $4 billion. This would cause an immediate and devastating impact on the future of the competitive long-distance marketplace.

Competition in the long-distance market is not as well developed as many people believe it to be. Attachment B to my prepared statement is a chart that shows 1982 long-distance revenues. Sprint had less than 1 percent of the market. Although Sprint is a healthy company that is growing rapidly, our market share is small and our company is very young compared to AT&T.

We believe that competition will bring benefits to all telephone users if it is allowed to develop, but we also share concerns that you have about the transition period that is ahead.

We commend you in your efforts to find the facts regarding this complex industry and look forward to working with you in arriving at satisfactory solutions to the challenges of a new, competitive telecommunications industry. Thank you very much.

[The prepared statement of Mr. Welch, together with the attachments, follows:]

PREPARED STATEMENT OF CRAIG WELCH

MY NAME IS CRAIG WELCH. I AM DIRECTOR OF CORPORATE COMMUNICATIONS FOR GTE SPRINT COMMUNICATIONS CORPORATION.

THANK YOU FOR INVITING SPRINT TO PARTICIPATE IN THIS HEARING.

SPRINT IS ONE OF SEVERAL LONG DISTANCE TELECOMMUNICATIONS COMPANIES THAT PROVIDES SERVICES TO THE PUBLIC IN COMPETITION WITH AT&T. SPRINT OWNS AND OPERATES A TERRESTRIAL MICROWAVE NETWORK WHICH SERVES OVER 835,000 BUSINESS AND RESIDENTIAL CUSTOMERS IN OVER 350 CITIES ACROSS THE COUNTRY. WE RELY UPON THE LOCAL TELEPHONE COMPANY TO PROVIDE CALL ORIGINATION AND TERMINATION SERVICE OVER THEIR LOCAL NETWORKS AND WE PAY THEM ABOUT $250 PER LINE PER MONTH FOR THIS SERVICE. WE PLAN TO EXPAND OUR TRANSMISSION CAPACITY SUBSTANTIALLY WHEN SPACENET, AN AFFILIATE OF SPRINT, LAUNCHES TWO SATELLITES IN 1984 AND ANOTHER IN 1985. TODAY OUR NETWORK HANDLES NEARLY 1.5 MILLION CALLS EACH DAY. WE EMPLOY CLOSE TO 4,000 PEOPLE. HERE IN THE STATE OF IOWA WE NOW SERVE CEDAR RAPIDS, DAVENPORT, DES MOINES AND SIOUX CITY.

MY TESTIMONY TODAY FOCUSES ON THREE PRINCIPLES THAT SPRINT BELIEVES SHOULD BE INCLUDED IN TELECOMMUNICATIONS POLICY DEVELOPED BY THE CONGRESS. I WILL THEN BRIEFLY DISCUSS CERTAIN UNIQUE PROBLEMS OF THE LONG DISTANCE CARRIERS.

1) FIRST AND FOREMOST, SPRINT BELIEVES THAT OUR NATIONAL TELECOMMUNICATIONS POLICY SHOULD INCLUDE A <u>STRONG PROCOMPETITIVE STATEMENT</u>. WE BELIEVE THE STATEMENT OF POLICY CONTAINED IN S. 898 WHICH PASSED THE SENATE IN 1981 IS AN EXCELLENT MODEL. THE FIRST LINE READS:

> IT IS THE POLICY OF THE UNITED STATES TO RELY WHEREVER AND WHENEVER POSSIBLE ON MARKETPLACE COMPETITION AND ON THE PRIVATE SECTOR TO PROVIDE ALL TELECOMMUNICATIONS SERVICES, AND THEREBY TO REDUCE AND ELIMINATE UNNECESSARY REGULATION INCLUDING THE REGULATION OF TELECOMMUNICATIONS FACILITIES TO THE EXTENT THERE IS EFFECTIVE COMPETITION WITH RESPECT TO SUCH FACILITIES.

ATTACHMENT A IS A COPY OF THE ENTIRE STATEMENT OF POLICY. THE HOUSE TELECOMMUNICATIONS BILL LAST YEAR, H.R. 5158, CONTAINED SIMILAR PRO-COMPETITIVE POLICY.

SPRINT WAS FORMED LESS THAN TEN YEARS AGO, BASED ON THE CONVICTION THAT COMPETITION IN THE DOMESTIC COMMON CARRIER INDUSTRY IN AMERICA IS AND WILL CONTINUE TO BE GOOD FOR THE RESIDENTIAL RATEPAYERS, BUSINESS USERS, AND THE GOVERNMENT. THIS CONVICTION HAS BEEN THE BASIS UNDERLYING THE REGULATORY AND DIVESTITURE DECISIONS WHICH HAVE BROUGHT US TO THE THRESHOLD OF A COMPETITIVE TELECOMMUNICATIONS INDUSTRY. SPRINT DOES NOT WANT TO SEE CONGRESS "PUT HUMPTY DUMPTY BACK TOGETHER AGAIN." WE DO NOT WANT CONGRESS TO TURN BACK THE CLOCK BY PRESERVING THE PRE-DIVESTITURE, MONOPOLY SYSTEM.

COMPETITION MEANS BENEFITS IN TERMS OF INCREASED EMPLOYMENT, PRODUCTIVITY, NEW SERVICES, AND LOWER PRICES FOR CONSUMERS. THE FOLLOWING SPRINT STATISTICS ILLUSTRATE THIS POINT:

	1979	1983 (AUGUST)
EMPLOYEES	1,250	3,860
CUSTOMERS	47,000	835,000
CITIES SERVED	53	343
ANNUAL REVENUES (IN MILLIONS)	$99	$393 (1982)
U.S. LONG DISTANCE MARKET (IN BILLIONS)	$16	$41 (1982)

2) <u>COST-BASED PRICING</u> IS ANOTHER KEY PRINCIPLE THAT SHOULD BE INCLUDED IN TELECOMMUNICATIONS POLICY. THIS PRINCIPLE FOLLOWS FROM THE FIRST. SPRINT BELIEVES THAT SERVICE SHOULD BE PRICED TO REFLECT THE COST OF PROVIDING THAT SERVICE. THE CONCEPT THAT USERS OF THE TELEPHONE NETWORK SHOULD BE RESPONSIBLE FOR THE COSTS THEY ACTUALLY CAUSE IS SOUND FROM AN ECONOMIC AND FROM A PUBLIC POLICY PERSPECTIVE. IT IS ALSO A MATTER OF FUNDAMENTAL

FAIRNESS. ALSO, COST BASED PRICING WILL PROMOTE EFFICIENT USE OF THE NATIONWIDE TELECOMMUNICATIONS NETWORK. THIS IS NOT TO SAY THAT WE SUPPORT A "FLASH CUT" TO COST BASED PRICING IN AN INDUSTRY THAT HAS TRADITIONALLY PRICED WITH LITTLE REGARD TO COST. TO THE CONTRARY, SPRINT HAS SUPPORTED A GRADUAL PHASE IN TO COST BASED USER CHARGES.

3) UNIVERSAL SERVICE IS ANOTHER IMPORTANT PRINCIPLE THAT SHOULD BE INCLUDED IN TELECOMMUNICATIONS POLICY. SPRINT SUPPORTS THIS GOAL. UNIVERSALLY AFFORDABLE TELEPHONE SERVICE NEED NOT BE THREATENED SIMPLY BECAUSE RATES ARE ALLIGNED MORE CLOSELY WITH THE COSTS OF PROVIDING PHONE SERVICE. AS I STATED EARLIER, A TRANSITION IS ESSENTIAL TO MINIMIZE ADVERSE AFFECTS ON TELEPHONE USERS DURING THIS PERIOD OF CHANGE. IN ORDER TO PRESERVE UNIVERSAL SERVICE SPRINT BELIEVES THAT A TARGETED MEANS-TESTED ENTITLEMENT PROGRAM WOULD BE THE MOST EQUITABLE METHOD OF PROVIDING BASIC RESIDENTIAL SERVICE TO TRULY NEEDY INDIVIDUALS. AS A MEANS-TESTED PROGRAM, IT SHOULD BE FUNDED FROM GENERAL REVENUES. A MEANS-TESTED PROGRAM WOULD AVOID THE ECONOMIC DISLOCATIONS THAT MIGHT BE CREATED BY LEGISLATION DESIGNED TO MAINTAIN THE PRESENT SUBSIDY SCHEME.

MUCH OF THE LEGISLATIVE DEBATE THESE DAYS IS WHETHER TO SUPPORT LOCAL SERVICE BY TAXING CONSUMERS WHO USE LONG DISTANCE SERVICE. LONG DISTANCE SERVICE IS NOT A LUXURY. CONGRESS SHOULD AVOID TAXING ONE CATEGORY OF TELEPHONE USER TO SUBSIDIZE ANOTHER CATEGORY.

UNIQUE PROBLEMS FOR NEW LONG DISTANCE CARRIERS

ONE OF THE MOST SERIOUS PROBLEMS FACING THE NEW LONG DISTANCE CARRIERS IS THAT WE ARE DENIED THE SAME KIND OF ACCESS TO LOCAL TELEPHONE COMPANY FACILITIES THAT AT&T RECEIVES. THIS UNEQUAL AND INFERIOR TYPE OF ACCESS MEANS THAT OUR CUSTOMERS MUST PUSH AT LEAST TWENTY-THREE DIGITS TO COMPLETE A LONG DISTANCE CALL

WHILE AT&T CUSTOMERS DIAL TEN OR ELEVEN DIGITS. SPRINT SERVICE CANNOT BE USED WITH A ROTARY DIAL PHONE UNLESS EXPENSIVE ADAPTOR EQUIPMENT IS ADDED. SINCE ABOUT 50 PERCENT OF THE PHONES IN THE UNITED STATES TODAY ARE ROTARY DIAL, WE CANNOT AUTOMATICALLY SERVE MANY CUSTOMERS THAT AT&T CAN SERVE.

SPRINT IS SUPPORTING A PROVISION NOW IN H.R. 4102 THAT WOULD MODIFY AN FCC DECISION SO THAT NEW LONG DISTANCE CARRIERS WOULD HAVE A ONE AND ONE-HALF YEAR TRANSITION TO THE NEW SYSTEM OF ACCESS CHARGES.

WITHOUT THIS PROVISION, SPRINT'S ACCESS CHARGE PAYMENTS FOR INTERCONNECTION TO THE LOCAL TELEPHONE COMPANY EXCHANGES WOULD MORE THAN DOUBLE AFTER JANUARY 1, 1984. AT THE SAME TIME, THE ACCESS CHARGES PAID BY AT&T WOULD DECREASE BY ABOUT $4 BILLION. THIS WOULD CAUSE AN IMMEDIATE AND DEVASTATING IMPACT ON THE FUTURE OF THE COMPETITIVE LONG DISTANCE MARKETPLACE.

COMPETITION IN THE LONG DISTANCE MARKET IS NOT AS WELL DEVELOPED AS MANY PEOPLE BELIEVE IT TO BE. ATTACHMENT B IS A CHART THAT SHOWS 1982 LONG DISTANCE REVENUES. SPRINT HAD LESS THAN ONE PERCENT OF THE MARKET. ALTHOUGH SPRINT IS A HEALTHY COMPANY THAT IS GROWING RAPIDLY, OUR MARKET SHARE IS SMALL AND OUR COMPANY IS YOUNG COMPARED TO AT&T.

WE BELIEVE THAT COMPETITION WILL BRING BENEFITS TO ALL TELEPHONE USERS IF IT IS ALLOWED TO DEVELOP, BUT WE ALSO SHARE CONCERNS THAT YOU HAVE ABOUT THE TRANSITION PERIOD THAT IS AHEAD.

WE COMMEND YOU IN YOUR EFFORTS TO FIND THE FACTS REGARDING THIS COMPLEX INDUSTRY AND LOOK FORWARD TO WORKING WITH YOU IN ARRIVING AT SATISFACTORY SOLUTIONS TO THE CHALLENGES OF A NEW COMPETITIVE TELECOMMUNICATIONS INUDSTRY.

ATTACHMENT A

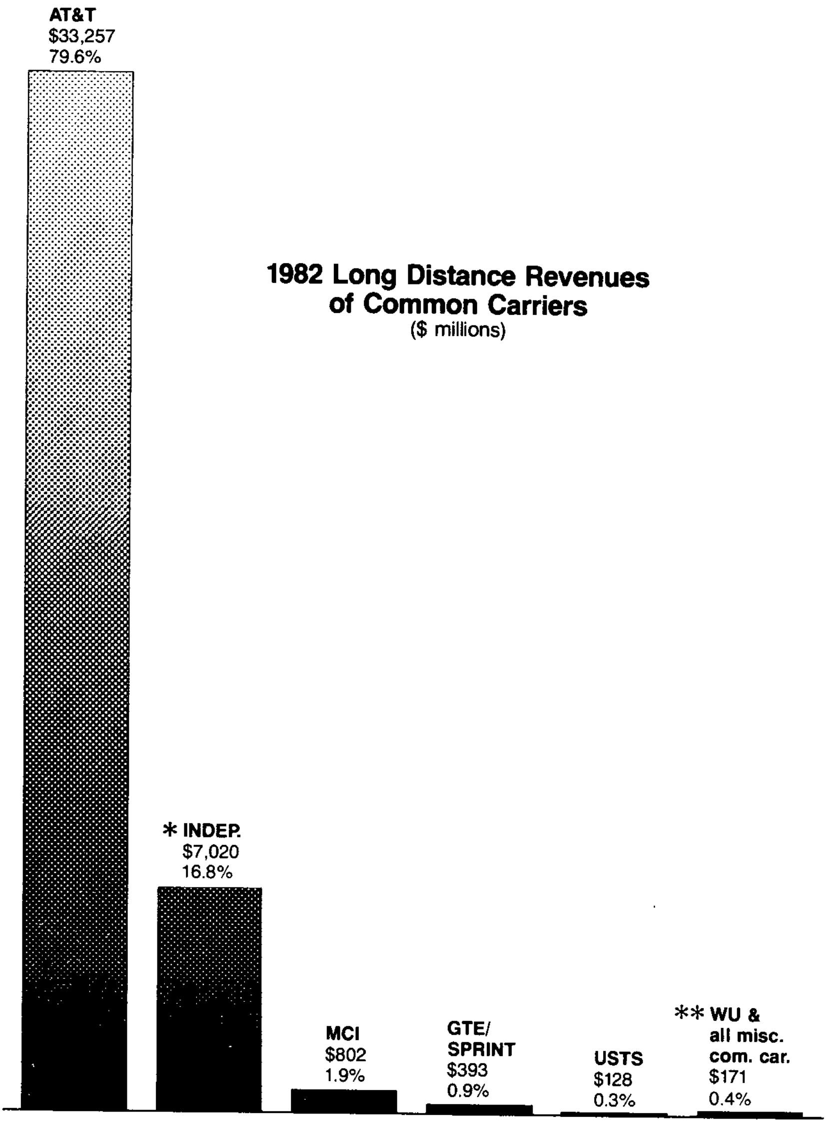
S. 898 Telecommunications Competition and Deregulation Act of 1981, Report, July 27, 1981. Pages 94 and 95

TITLE II—DOMESTIC TELECOMMUNICATIONS

STATEMENT OF POLICY

SEC. 201. It is the policy of the United States to rely wherever and whenever possible on marketplace competition and on the private sector to provide all telecommunications services, and thereby to reduce and eliminate unnecessary regulation including the regulation of telecommunications facilities to the extent there is effective competition with respect to such facilities. Marketplace competition will result in technological innovation, operating efficiencies, and availability of a wide variety of telecommunications technologies that are now or may become available in the future, and will promote the equitable and efficient use of such technologies to provide services to all geographical areas of the United States. Where effective competition does not now exist, it is the policy of the United States to encourage the development of such competition, and pursuant to an appropriate transition in accordance with this Act, to deregulate telecommunications services while establishing appropriate safeguards to prevent anticompetitive practices, or adverse impact upon the national defense and security or emergency preparedness. Whenever the Commission finds it necessary to regulate the provision of basic telephone or basic telephone or basic telecommunications service in order to ensure their universal and reasonable availability, or to regulate telecommunications services or facilities which are not subject to effective competition, such regulation shall be minimal and strictly in accordance with this Act. Prior to the deregulation of basic telephone or basic telecommunications service in any particular geographic area or market, the Commission must find that such basic telephone or basic telecommunications service are subject to effective competition and will continue to be universally and reasonably available. Unless the Commission in any particular case shall find otherwise, it shall be presumed that there are no basic technological, operational, or economic factors which would necessarily preclude the provision of any telecommunications service under conditions of competition. Competition in the provision of telecommunications from foreign persons and their United States affiliates is welcome to the extent that United States persons are permitted reciprocal rights of access to and the right of establishment in the markets of those foreign persons who seek access to the United States market.

ATTACHMENT B



1982 Long Distance Revenues of Common Carriers

Revenues (000,000)	Carrier	% Total	Source
$33,257	AT&T	79.6	1982 AT&T Annual Report
$ 7,020	* Independents	16.8	1982 Phonefacts USITA
$ 802	MCI	1.9	1982 Form P
$ 393	GTE Sprint	0.9	1982 Form P
$ 128	USTS	0.3	1982 Form P
$ 60	** All Miscellaneous Common Carriers	0.1	FCC Summary of Form P
$ 4	Western Union-Metro	—	Estimate
$ 20	Satellite Business System	—	Estimate
$ 80.3	U.S. Tel	0.2	Standard & Poor
$ 7.1	Telesphere	—	Standard & Poor
$41,771.4	**Total**		

* Independents receive payments from AT&T via settlements process.

** There are over 150 resellers who are not included in this chart because they do not file information with the FCC.

Senator JEPSEN. Thank you. Before we proceed further, I would advise the panel that the questions I ask are not necessarily in the order of importance, and I emphasize, they do not reflect any opinion or preference that I may have. I am trying to put a disclaimer on what I am about to do, which is just to ask questions for the record. I think there will be enough to go around so everybody will feel that I am not picking out any one group or individual, because my job here today and responsibility is to hold a hearing, and in doing so, to get everything into the record that might be shared with those who will be making, we hope, studies for reasons of review, and possible action on this.

First of all, we might start, Mr. Welch, with you since you have just finished.

New long-distance companies have the privilege to serve localities and customers of their choice, and they have no obligation to serve the public at large. Do you believe it is fair that a large portion of the population will not benefit from this new competition, as you practice it? What will Sprint and others do to promote reasonable long-distance rates to all telephone customers?

Mr. WELCH. I think, Senator, the strongest argument that can be given to that is to reflect historically on the development of the telephone industry in its very, very origin. That, in an industry like this, does not develop overnight, and from the very beginning, all areas of the United States were not able to have telephone service at all, in fact. But, in time, they did, and that pattern again will be followed in this case.

Senator JEPSEN. Do cable TV companies who enter the communications industry in ways other than broadcasting intend to provide universal service to the public, or just the customers they prefer?

Mr. PATRICK. We are almost always required to provide service to anyone in our area who requires it—or desires it. So within our specific service areas, we do indeed pass every home, whether it be economic or not to do so.

There are perhaps some examples to—or exceptions to that, but I am not really aware how many there are.

Senator JEPSEN. Do you feel that cable companies are or should be regulated like other common carriers?

Mr. PATRICK. I take a slight exception to the phrase "other common carriers." That would seem to insinuate that cable television companies are common carriers, which hitherto, they are not.

I do not think it is necessary, sir, nor does my industry because there are a number of effective competitive measures out there to provide not only things like two-way services data transmission, but also any video services.

Senator JEPSEN. Mr. Reed, you refer to your chairman, I believe, Charlie Brown?

Mr. REED. Yes, sir.

Senator JEPSEN. He wrote a letter to me and all other Senators and Congressmen, and in the letter he expressed support for the FCC's access charge, and his opposition to congressional legislation to change it.

The letter also laments that charges may adversely affect the AT&T employees, and the AT&T shareholders. It does not say anything about the tens of millions of customers.

Is there any reservation in your mind, whatsoever, that this will do anything except also affect, if it proceeds, the tens of millions of customers in a very positive way?

Mr. REED. Senator, there is no way you can fundamentally alter the industry, a company of our size, and not affect, everyone that is in any of its constituencies. That is clear.

The issue is that, it seems to me, the transition of some years has been worked out in the FCC's plan to lessen the impact of profound change in the method of costing and pricing for telecommunication services, and that that transition period is very gradual.

The transition period for share owners and employees is abrupt. It is a flash cut, so to speak. I am sure that all of us are concerned about the impact on customers, and that is why the FCC's effort to minimize that impact is applauded.

Senator JEPSEN. Again, Mr. Reed, does AT&T intend to de-average long-distance rates? I mean, today I can place calls from Pella, Iowa, to another small town, let us say, in Montana, 1,000 miles away, for about the same price I can place a call from St. Louis to Washington, D.C. That is because we have averaged rates.

Now, if we de-average, however—and I understand there has been talk about that—I am wondering what the rural rates will do. It seems to me they might—to use an Iowan expression—go through the roof. What assurances can you give that rural areas will have an affordable long-distance phone rate?

Mr. REED. I have no knowledge of any plan at the moment to de-average long-distance rates. However, logic would suggest that over a period of time, that as the competition enters by choice, those rates that have the heaviest usage and the lowest costs, the ability to sustain average rates would be in jeopardy. By the same token, I think contrary to some comments that were made this morning, that our record of technological innovations and cost reductions in long-distance services is exemplary, and we will again, in the interest of serving the customers, all of them that we can retain on AT&T's service, we will continue to deliver service at the lowest possible cost to all of our customers, including the rural customers. And I can visualize technologies that would make that possible in the face of competitive pressures.

Senator JEPSEN. Well, one more question for you, and then I will move on to someone else.

Will AT&T cancel its current long-distance rate decrease if the legislation does postpone the access charge?

Mr. REED. Senator Jepsen, I would say it would certainly be in jeopardy, but I am not in a position to commit to outright cancellation of it.

Clearly, if any scheme is developed in the form of legislation which puts a moratorium on the access charge plan, it would tend to freeze in place the current methods of doing business, which would mean that none of the cost shifts would have been permitted, and the result is that, it would appear to me, that we would be in serious jeopardy with the interstate reduction.

Senator JEPSEN. Would not competition kind of force you to keep that scheduled rate decrease, with everything else I have heard today? I am not trying to corner you——

Mr. REED. No, sir. I understand, and a question of when you can reduce rates in a regulated situation to recognize competition which is delivering service at substantially lower prices than you are, I think hinges on a number of questions. And as much as we would like to be able to reduce those rates, as long as they are arbitrary, and in our judgment, capricious costs that are loaded on to our prices that are significantly different from those that are in the price of our competitors, we have no alternative but to keep the prices where they are. The natural action of competition would permit us to begin to bring our prices in some sensible relationship with competitors.

I have to bring this to your attention. I have an ad here by one of our competitors, MCI, that I think must have gone to upward of 10 or 12 million customers in the United States yesterday, which offers free 30 minutes of long-distance calls as an introductory offer to hook into the MCI network.

Now, I think that is first-class competitive behavior on their part. There is no way, under current circumstances, or if the situation is frozen into its current state, there is no way that AT&T can respond to this either by offering a trial opportunity like this, or by adjusting our prices to accommodate the pressures from our competitors.

Senator JEPSEN. What I hear you saying is that AT&T is not afraid of the competition, but if everybody starts at the same blocks, you would be permitted to do it?

Mr. REED. That is correct, sir, and we would not even suggest that you could flash cut to a situation where we are all on the same level playing field. We understand there is a transition period with regard to that as well as there is a transition period with regard to the impact on the ultimate user.

Nobody is suggesting a flash cut, and for that reason, we understand the need for transition, but I am concerned with what I have heard here today, and what I hear in the rhetoric in connection with this whole issue, is I hear repeal rhetoric. I do not hear moratorium. I hear moratorium, but what I really hear is repeal, and that is what I have got a problem with, and that is what we have got a problem with. You cannot repeal reality.

Senator JEPSEN. If you are saying—and if you are not, please say so—that you have some understanding that a moratorium—a temporary delay for reflecting and analyzing and making sure we are making the right decision is one thing, and to repeal is something different—is that right?

Mr. REED. Yes, sir; that is correct.

Senator JEPSEN. You do understand, possibly, the former is being considered by some——

Mr. REED. Yes; we do understand that.

Senator JEPSEN. You are not for it, but you do understand it?

Mr. REED. Our position is that that transition is contained in the FCC's 7872 order.

Senator JEPSEN. Mr. McLeod, you know deregulation in the AT&T divestiture is occurring in order to promote competition. That is what we hear, and I think that is what people believe. Once AT&T turns its attention from divestiture, how long do you think that competition will last?

Mr. McLeod. Under the present FCC access plan?

Senator Jepsen. Yes.

Mr. McLeod. And in long-distance service?

Senator Jepsen. Let me ask you this more specifically: How will your WATS reselling firm do financially if AT&T starts a price war on long-distance services?

Mr. McLeod. We buy all of our services from AT&T, and so, as they lower their prices, our costs go down, we will offer our service at a lower rate too.

Senator Jepsen. How about you, Mr. Welch?

Mr. Welch. We intend to compete in every way, and that is one element of it.

Mr. McLeod. Can I add something more, Senator?

Senator Jepsen. Sure. I did not mean to cut you off. I wanted to make sure Mr. Welch had a chance.

Mr. McLeod. Let me speak for him on this issue.

Senator Jepsen. No; it is not all right with him. [Laughter.]

Mr. McLeod. I think we will survive January 1 access plan. There is no doubt that our margins will shrink under the new plan, but in the case of GTE and MCI, their access charges are going to double, and they are going to double January 1.

That is not a gradual transition when someone has access charges double overnight when they have the same microwave facilities running between cities, and their competition, although we are competition to them as well, but their main competition, AT&T, has lowered their price 10 percent.

Now, I do not know if GTE Sprint is ready to jump up and down on the table, but I would be jumping up and down on the table one hell of a lot more if I were in their position. Our position, as a reseller, is we want to be able to buy services from AT&T, from GTE, from MCI, from RCA, from satellite business services, and any other carrier that can provide quality service at a good price.

We are a retailer of long-distance services, and because these issues have gotten so complicated, we act on behalf of our users to select the best price, best quality facilities from Sprint, from AT&T, and from whomever. We want more than one carrier left after January 1. We will be here. There is no doubt about that, and we want Sprint and MCI to be here with us.

Senator Jepsen. And AT&T?

Mr. McLeod. And definitely AT&T. Realize one thing, Teleconnect is buying all of their services from AT&T. OK? And we might still continue to buy all our services from AT&T. After GTE finds out I am buying all my services from AT&T, they may be knocking on my door tomorrow. I want that. That is important to the industry. It is important to Iowa because, in this particular marketplace, you are concerned about whether people are providing these competitive services to lots of people.

Now, that is exactly what we are doing. We are not just in Des Moines or Cedar Rapids or the Quad Cities, but we are in Clinton and we are in Muscatine and we are in Iowa City and we are in Mason City and we are in Ames and on and on and on, and we plan on spreading those facilities to small business users and residential customers, and we will do it if we are allowed to purchase from several interexchange business carriers.

Senator JEPSEN. Are you not allowed to now?

Mr. McLEOD. We are allowed to now, and we could tomorrow purchase from GTE. I do not think GTE can exist under the new access plan.

Senator JEPSEN. In other words, in your opinion, they may not be there to purchase from. Is that what you are saying? You did authorize him to speak for you? I want the record to show that. [Laughter.]

Mr. McLEOD. I have read a letter from the president of GTE, and I made a quote from him today, but that letter went from the president of GTE to MCI and six other real carriers, interexchange carriers, the people who have the circuits between the cities. Their losses in 1984 under the new access plan, cumulative losses, will be $500 million. Their gross revenues will be $4 billion.

The text of that letter was in the Wall Street Journal a week ago, and I believe it. It does not take much more than a seventh grade algebra—seventh grade arithmetic problem to decide if their access charge is double, and their competition lowers their price by 10 percent causing them to lower theirs by 10 percent, if they are not working under 10 to 20 percent bottom line profit or more, they are in trouble.

Well, they are not working above 20 percent, and there may be some disparities between what those people are able to work at, and what AT&T can work at.

All I am saying is, the FCC access plan—and I am not talking about repealing it, I am talking about a moratorium too. I am saying, let us look at it, make sure that we do not end up playing Russian roulette with what we have as competitive services already.

I think the access issue will load the cylinder right now with six bullets. I would just as soon you remove a couple of bullets, or pull them out for a while, and spin them 6 months or a year down the line after we get a chance to look at it.

When we got into this resale business, I looked at the business for a year and a half before I got into it. Now, come October 3, all of a sudden, everyone has new tariffs. The FCC has a new access plan, and Teleconnect has $8 million in equipment in Iowa; $8 million invested in equipment in Iowa, and we are supposed to react to this by January 1? Well, we will. We will react, but I tell you, it is going to be awfully hard on the inter-exchange carrier.

Senator JEPSEN. OK. I would recognize Mr. Reed in just a second, if I may.

Mr. Welch, if you care to say something at this time, do so, otherwise I will go on.

Mr. WELCH. Yes. I appreciate Mr. McLeod's advocacy and support sincerely, and there is a large, large measure of substance and truth in what he says. And I think, in my prepared remarks, that the case was made quite clearly that we feel competition is in the country's best interest, and Iowa's best interest, and it is not altogether set in cement yet; that it is, indeed, quite a delicate proposition, and needs the strong support from every concern.

Senator JEPSEN. Mr. Reed.

Mr. REED. Thank you, Senator Jepsen. Let me just be specific for the record, that with all of this disastrous talk about after January 1, 1984, the other common carriers by FCC order in the 7872 reconsideration, will go in January 1, 1984, with the 35-percent discount in access charges that they pay to the exchange carriers, and that it is true that over a period of some 2 years and 9 months, during the process of providing the equal access to the other common carriers, that discount will begin to erode. But 35-percent discount is a pretty healthy discount, it seems to me, in the payment of access charges.

The second point I would make is that I have been anguished over this divestiture and in the process of preparing to carry it off, as most of my colleagues have, but when I hear, as I have heard today, the appeal that this entire—that this pot of money that is left over, when the cost of long-distance services have been paid, must continue to be used to subsidize service for poor people, elderly people, small businesses, other common carriers. I will not argue with the merits of either because I think each has to be taken on its own basis.

I would only suggest to you that the fact that all of these people somehow can be supported through this pot of money that is left over suggests that this is a very sizeable amount of money, and in dealing with it—and it has, indeed, distorted the economic use of the facilities, when the price is so high that you have all these people that presume that some sort of a subsidy can continue to be paid out of it, out of the difference, it suggests something ought to be done to bring the price more into line with the economic use of the services.

Thank you.

Senator JEPSEN. Is this an accurate statement that, "62 percent of all long-distance billings go to about the top 4 percent of the users"?

Mr. REED. I would find it hard to dispute that. There are concentrations of usage across the user groups.

Senator JEPSEN. I think that is a national figure. And, "One out of six residential users make no long-distance calls," that keeps cropping up?

Mr. REED. That is an average, Senator, that I suspect is wrong almost by definition. I would say that in—interestingly enough, some of the very people who have been represented here are very intensive users of long-distance services.

I think most of our carriers would agree that that varies so widely, that it is very difficult to agree to a generalized statement like that.

Senator JEPSEN. Well, leaving out the last, "One out of six residential users make no long-distance calls," just disregarding that, but keeping the "62 percent of all long-distance billings go to the top 4 percent of users," then who benefits most from reduced long-distance rates? I am not talking about the rightness or wrongness of it.

Mr. REED. Those users.

Senator JEPSEN. The 4 percent?

Mr. REED. The 4 percent, but the 4 percent are the focus of our discussion of what I would call uneconomic bypass, because they are the very people who have the capability of buying bypass capability, which causes them, ultimately, to be lost to the network completely.

One of the arguments, it seems to me, that makes sense here is the reality that a generalized benefit to those 4 percent of users that use 62 percent, which is very hard to find, but all the time that we were discussing during the seventies holding—somebody said Humpty Dumpty—Humpty Dumpty together, we argued that the indirect benefits of the ability to reduce long-distance services would show up in literally a host of ways in the pockets of consumers, and I think that is so hard to find, but nevertheless, I think, intuitively, is true.

Senator JEPSEN. Do you have any comments on this, Mr. Patrick? You have not had an opportunity to get a lick in here. Do you have anything that you want to get in?

Mr. PATRICK. I am just sort of riding the storm out here, without being directly involved in any of this, other than to say, perhaps, in support of this gentlemen's argument, I can see one formula, and that is reduced long-distance rates increase long-distance service, which thereby increases the number of access lines sold by a local telephone operating company, which therefore increases revenues, which therefore decreases the necessity to request rate increases, the residential subscribers to make target rate of return. That might be a possible benefit of decreased long-time services.

Senator JEPSEN. Mr. McLeod, your Silver Thread, that is unique for your organization, in your industry?

Mr. MELEOD. Yes; it is.

Senator JEPSEN. What do you do with that? Do you trademark it? Is it something that is exclusively yours?

Mr. MCLEOD. Well, we trademark it in this case, but what we wanted to do with it—first of all, when the universal service issue came up, we went to the Council on Aging to find out how many people—how many of the frail elderly people, low income, were actually without service today. We were not even thinking about 1984, although that prompted the concern. And in the process, we found that there were a number of people that the Council on Aging could not work with effectively because they could not communicate with them.

And so in this procedure, we decided that there is no way that Teleconnect itself could fund this project completely. Since we had so many of the people that are using long-distance that are supposedly going to be taking advantage of the lower rates, we felt that these people should be willing to contribute to a fund of this sort. We did not know whether or not a universal fund would be enacted, or social security would take over, or whatever, but we felt if we put together a project like this, that the dollars would be required, whether or not social security and other funds were involved in it.

So we are willing to invest the manpower in the issue because we think it is an important issue. We think phone service for the people in need is something that everyone wants.

Senator JEPSEN. And this is something that you include in your public relations program, and does everyone that avails themselves of your service, are they aware of this Silver Thread, and how has it been doing? Has it been a successful program?

Mr. MCLEOD. The program was initiated, I believe now, about

3 weeks ago, and what we are doing is—we are actually doing a telephone solicitation on all of our present users. However, in the future, we will actually be asking for the duration at the time we sell the service.

Senator JEPSEN. It is too new at this time yet to show?

Mr. McLEOD. The people we are soliciting by telephone, the business users, our response has been about 20 percent.

Senator JEPSEN. I am very anxious to hear how that goes.

If a moratorium does go into effect, and as it stands now, the proposed moratorium covers only the residential and single-line business user; is that fair? I mean, should it cover everybody, or if it should go in effect, should it just be limited to what it is now? Anyone have any opinion or advice on that?

Mr. McLEOD. You want me to comment? I believe a moratorium should also be placed on the other common carrier—or carrier charges. Those charges are going to replace the present ENFIA charges, which are roughly $200 per circuit per month.

Those charges will double or triple, depending on the amount of usage on those lines, and as I say, I think the other common carriers will be hit very hard by that particular situation. We can be hit very hard by that as well if, in fact, resellers are continued to be looked at as exchange carriers.

This is really of dire importance to us. We want to buy services from carriers, interexchange carriers. If there is going to be carrier charges, let us place those carrier charges on the carrier.

We are a user of long-distance service, and we will pay user charges, and we are not asking for business-access charges to be delayed, the $6 charge, ta-da-ta-da-ta-da, that charge, although it maybe should be until we can look at the whole situation.

But we do feel that carrier charges, other carriers, who are trying to compete with AT&T, will be put at a tremendous disadvantage. Mr. Reed just indicated that a 35-percent discount was in order, and I cannot disagree with that. There is a 35-percent differential between the premium access that Bell has with 10-digit dialing versus the 23-digit dialing that we have.

The point is, these access charges for these fragile carriers will double or triple, while their competition goes down 10 percent, and I do not care if it is at a 35-percent disadvantage or not.

If you want competition in the long-distance marketplace, you cannot allow the access charge to go into effect as it is, period, end of statement.

Senator JEPSEN. Are there any other comments? Yes.

Mr. WELCH. I would just like to reiterate along that line, that is why we are supporting the provision of H.R. 4102 to modify the FCC's provision to give us a year and a half transition toward these access charges.

Senator JEPSEN. Are there any other statements, comments anyone would like to offer before we dismiss this very distinguished and very efficient panel? There is someone from the audience. Would you want to identify yourself?

Mr. PITSCH. I am Mr. Pitsch from this morning from the FCC.

Senator JEPSEN. OK. Without my glasses on, it is hard to recognize you.

Mr. PITSCH. I would like very much to speak to the premium that the OCC's—that AT&T has to pay, because we set that. That has been discussed quite a bit.

Senator JEPSEN. Please. We are here to hear all views.

Mr. PITSCH. In quite a bit of the discussion, one of the most important issues that was addressed by the Commission was what surcharge, if any, should AT&T pay above what the so-called OCC's pay.

In the past, that was the result of a negotiated agreement between the carriers, supervised by the Commission. In the proceeding, we looked at the record and tried to identify what in fact the costs imposed on the OCC's would be because they had this lower grade of interconnection. And in doing that, we came up with a figure that—of about $2 billion, or it works out to 35 percent, and I would emphasize to you, Senator, that that is the appropriate way to deal with this.

The fact that the OCC's may—their rates are going up dramatically in January 1, 1984, and the fact that they may be—may suffer a loss of profits, or the revenues may not grow as rapidly as they would like, is not telling.

The Commission tried to strike a balance, and then let the chips fall where they may. We are not interested in subsidizing competition for the sake of subsidizing competition. The fact that if ENFIA was frozen for 2 years, would put AT&T at a very big disadvantage, I am not interested in that. I am interested in the fact that MTS and WATS customers, many of whom do not have access to the OCC service, would be paying higher rates because of that.

I do not think the Commission—this is not a counterrevolution. We are very much in favor of competition, but we are interested in striking a balance in terms of what that inferior grade of interconnection is worth to the OCC's, and then giving them the appropriate discount. I do not think we should be in the business of handicapping the OCC's for some period of time until they feel they can compete with AT&T.

Thank you.

Senator JEPSEN. Any other comments? Mr. McLeod.

Mr. MCLEOD. I think that is a nice attitude for the FCC to take, and I think if they really actually do want the OCC's to disappear, that is what they should do.

They tried to strike a balance. They said that the premium access was worth 35 percent, and that is where it stands. But I think at the same time, the FCC and Congress should take a look at MCI's P&L and see if, in fact, what they are saying is true. If they will lose money next year under the plan, at least realize that that is the case, and play some what if games.

What if MCI lowers their rates? Right now, they are about 15 to 20 percent different—forget what they advertise—15 to 20 percent different from what Bell direct-dial rates are. Now, they could lower those rates, but, realize, they have got to dial and do some extra work, and I am not saying that the FCC should sit here and hold AT&T at a disadvantage forever. I am just saying that, realize that you will put them out of business January 1 if, in fact, you do what you plan on doing.

If that is what the FCC wants to do—not wants to do—if the FCC wants to allow that to happen, that is fine.

May I ask the gentleman from the FCC why a reseller who buys circuits from the carriers are classified as OCC's under the FCC's access plan?

Senator JEPSEN. Go ahead.

Mr. PITSCH. The gentleman's testimony, Mr. McLeod's testimony, I think is a little misleading in characterizing himself as a user, because the fact is, in many instances, resellers use local facilities.

Mr. McLEOD. Their own facilities you mean? We do not use anyone's but AT&T's facilities.

Mr. PITSCH. Except for hotels, most resellers have their customers access the local switch in order to get to them. And if you are a competitor of AT&T, or the OCC's, and in the meantime, during this transition, we are imposing a tax on your competitors but not on you, then you are going to be receiving an unfair advantage.

Now, the fact of the matter is, in the transition, we gave you a very good transition in terms of not really imposing all of those costs on you at the outset. In fact, except where resellers paid ENFIA in the past, they do not pay a carrier carrier's charge in the future.

So I think that we did give you a transition, but I also think that the equitable thing is for those people who use local loop, they are in a sense providing inter-exchange competition, they ought to be paying for it.

Mr. McLEOD. I will be quiet.

Senator JEPSEN. I thank you very much.

I would like to, just before I dismiss this committee, introduce—I should have done that earlier today—the two gentlemen with me here. The one on my left is Mr. Jahr, who is an economist. He is an economist with the Joint Economic Committee. He serves not only in this area of communications and rural communications, but also in the area of development of agricultural policy.

Mr. Conrad from Conrad, Iowa, on my immediate right is a man who serves on my senatorial staff, and he serves in all areas, in dealing with special projects in Iowa, as well as some special interests, and contributes in helping set up the hearings for the Joint Economic Committee in my home State.

Mr. Jahr just came from an economic hearing in South Dakota, as was mentioned this morning. He was in Mt. Vernon just prior to that. So I just want the record to show, contrary to any local media effort to distort the administrative procedures and precedence of the Senate committee chairman, which I am, of the Joint Economic Committee, I have in the best interest of my constituents in Iowa, the comingling of both to pay a responsibility in order to serve not only the national constituency, as well as individual State constituency, as well as any other subjects. It just made good business sense to do that, as most good business people would understand. I thank you.

We will take just a 5-minute break, but before we do, I will announce that the next and the last panel will present the telephone companies' perspective. It will include Mr. Dick McCormick of Northwestern Bell of Omaha; Mr. John Hoffman, United Telephone Co., of Monticello, Minn.; Mr. Larry Ware, Garden Valley Telephone Cooperative of Erskine, Minn.

We will now have a 5-minute recess.

[A 5-minute recess was taken.]

Senator JEPSEN. Will the hearing please come to order.

We now welcome Mr. Dick McCormick of Northwestern Bell from Omaha; Mr. John Hoffman, the United Telephone Co. of Kansas City; Mr. Bob Rierson, Bridge Water Telephone Co. of Monticello, Minn., and Mr. Larry Ware of the Garden Valley Telephone Coperative of Erskine, Minn.

I have been advised that Mr. Rierson does have a plane schedule to keep, so in the event—he is No. 3 if we went alphabetically here, and should his schedule require that he leave, with the rest of the panel's agreement, in the parlance of the Senate, we would recognize Mr. Rierson first.

You may proceed.

Mr. RIERSON. Thank you, Senator. May I suggest that we——

Senator JEPSEN. Excuse me. I am remiss in that I was asked by Mr. Reed, from the last panel, if he could, for the record, make a statement, and at this time I ask him to please do so.

Mr. REED. I will come forward.

Senator, thank you very much. I was told by my colleagues at the break that I had either misspoken or not spoken clearly enough on the question of a moratorium, which you had asked, and I believe that you and I both understand that we oppose a moratorium as provided for in the current legislation; that my answer to that question was intended to be that the transition period was appropriately cared for under the 78–72 order of the FCC.

I believe you and I understood that, but I was not sure the rest of them understood.

Senator JEPSEN. The way it came out, I think it is good that you corrected it. It is corrected.

Mr. REED. Thank you.

Senator JEPSEN. Mr. Rierson.

STATEMENT OF BOB RIERSON, MANAGER, BRIDGE WATER TELEPHONE CO., MONTICELLO, MINN.

Mr. RIERSON. Senator, my name is Bob Rierson. I am pleased to offer this statement on behalf of Bridge Water Telephone Co. and the Organization for the Protection and Advancement of Small Telephone Companies on the preservation of universal telephone service in this country.

I am the manager of Bridge Water Telephone Co. of Monticello, Minn. We serve 3,200 customer access lines in two exchanges. I might add to that, that with that 3,200 customers, we have in excess of $5 million invested in less than a 100-square-mile area.

I fully support the effort of your committee to learn more about the issues regarding universal service. For many years, as the industry has moved inexorably toward a fully competitive environment, we have expressed our concern about the impact of the changes in the telephone industry on our subscribers in rural America. The goals of preserving universal telephone service and moving toward a competitive telecommunications industry are often in conflict. I believe that only Congress can resolve these issues and enact sufficient protections to assure continued availability of telephone service. I do not urge you to turn back the clock. I fully recognize that technological advances, the AT&T divestiture, and FCC and court decisions have made clear that the telecommunications industry of tomorrow will exist in the competitive marketplace and will not be characterized by monopoly provision of any service.

Our customers in rural America also want to be part of this technological revolution. We, too, want to participate in the information age. We are concerned that telephone service may be priced beyond the reach of many of our subscribers if modifications are not made to recent FCC decisions. We believe that those in rural America, indeed all Americans, should continue to have high quality telephone service at rates which are affordable.

Maintaining universal service at reasonable rates as the industry becomes fully competitive is no easy task. Congress has been struggling with these competing goals for over 7 years. The issues are now clearly focused, the solutions are at hand. We cannot afford to wait and see how many subscribers are left without telephone service when we have the ability to prevent such a consequence now.

I believe that legislation to preserve universal telephone service should address the following principles:

One. All providers of telecommunications services, including bypassers of local facilities, should contribute equitably to the costs of providing local telephone service;

Two. A universal service fund to deal adequately with telephone service in high-cost areas must be developed;

Three. Consistent and uniform regulatory policies between Federal and State jurisdictions should be implemented;

Four. End users should not pay directly for the costs of the local telephone lines; and

Five. Toll connecting links whose costs are significantly higher than the national average should be compensated for by the universal service fund.

To expand on those:

One. All telecommunications providers should contribute equitably to the costs of universal telephone service.

I believe that all providers of telecommunications services should contribute fairly to the costs of providing universal service. Providers of telecommunications services which bypass the local distribution facilities of exchange carriers should also share the cost of these local facilities, Although competition has increased and alternative technologies have been developed, we have not seen a stampede of carriers wishing to serve high-cost rural areas or residential subscribers. Competitors have naturally entered markets which are profitable and have not chosen to serve the high cost and lower density markets. Yet all telecommunications service providers benefit from the universality of telephone service, all providers benefit from using existing facilities as a back-up or to expand their own networks. Thus their profitability is increased by universally available telephone service. I believe they should all contribute to the cost of preserving these universal local facilities.

Two. Legislation should insure that a universal service fund is created that will adequately protect exchange carriers that serve high-cost areas. I believe that exchange carriers whose costs exceed the national average by more than 110 percent should be eligible to receive funds from the USF. I also believe that these eligible carriers should recover all of their costs from the USF which exceed the national average in order to insure that they are able to continue providing service in high-cost areas and that their customers are able to afford telephone service.

Three. In recent years, as competition in telecommunications has been sanctioned by the Federal courts and the FCC, there has been increasing conflict between the Federal and State regulatory bodies. I believe that consistent regulatory policy is essential to the continued financial viability of our telephone companies. As Congress acts to set out their clear goals for national telecommunications policy, it should act to insure consistent regulatory policy at the Federal and State level. As telephone companies try to provide high quality service to our customers and take advantage of new technology to reduce costs, we are the ones that suffer from the constant confrontations between Federal and State regulatory policies. We believe that Congress can eliminate these needless and costly regulatory battles by setting clear national policy direction. The economic health of our companies and thus our ability to serve our customers depend on it.

Four. End users should not pay directly for the costs of subscriber lines. As you are all aware, the FCC's decision in docket 78–72 would transfer, over a transitional period, most costs of the customer's access line to the interstate telephone network directly to subscribers or end users at a flat rate. This would be true whether or not these customers ever made a long-distance call. I might add here, that in our company in response to an earlier question, in our company, in a given month, approximately 10 percent of our customers make no long-distance calls whatsoever.

The essential rationale for the FCC's decision was to prevent the uneconomic bypass of local facilities by heavy users of telecommunications services who pay a disproportionate share of the fixed cost of local facilities through usage-based rates. We believe the Commission went too far. By attempting to cure one problem, they have created another. The transfer of all of these fixed costs to end users places an excessive burden on residential customers, particularly in high cost rural areas. If these costs are charged directly to our customers, many will simply not be able to continue to have basic telephone service. Furthermore, if end users must pay all local loop costs on a flat rate basis, there is no incentive for exchange carriers to make investments in new modern facilities. Interexchange carriers depend on these facilities and benefit from continued upgrading and introduction of new technology. I believe that Congress should change this portion of the FCC decision and modify end user charges.

And five. High-cost toll connecting links should be supported by the Universal Service Fund and probably, in my mind, one of the most important, in low-density rural areas, the costs of providing service between the local telephone company central office and the toll network are exceedingly high. These toll connecting links or class 4 to class 5 links, as they are often called, constitute the part of the telephone network where there is the greatest variance in cost. If exchange carriers are forced to charge interexchange carriers directly for the costs of these toll connecting links, the pressure to de-average toll rates for calls in and out of rural areas will be severe. I believe that the universal service fund should provide a contribution to the cost of these high-cost toll connecting links in order to prevent excessively high toll rates for rural areas.

In summary, I believe that Congress must act now to preserve universal telephone service. I believe that any legislation which is enacted should include the following points:

One. All providers of telecommunications services should contribute to the cost of providing universal telephone service.

Two. An adequate universal service fund should be developed. Exchange carriers whose costs exceed 110 percent of the national average should recover all costs from the universal service fund.

Three. Uniform and consistent Federal and State regulatory policy should be implemented.

Four. End users should not pay directly for the costs of customer lines.

Five. High-cost toll connecting links should receive a contribution from the universal service fund.

I thank you, and we would be happy to furnish you with any further information you need as your Commission develops a position on these issues.

Senator JEPSEN. Thank you, Mr. Rierson. Just one quick question. How would you finance a universal service fund?

Mr. RIERSON. I believe it should be financed in the form of a premium access charge on the interexchange carriers.

Senator JEPSEN. Premium access charge? Who would pay that?

Mr. RIERSON. The inter-exchange carriers.

Senator JEPSEN. Would you give an example of who that might be?

Mr. RIERSON. Sprint, MCI, AT&T.

Senator JEPSEN. What about private telephone carriers like John Deere, Rockwell?

Mr. RIERSON. They would also pay, as I indicated in my testimony. A private system which bypasses a network, whenever it has the ability to directly or indirectly connect with the network, should also pay—contribute to the universal service fund.

Senator JEPSEN. Now, then, Mr. Hoffman, we will go back alphabetically here. The United Telephone Co. of Kansas City. You may proceed.

STATEMENT OF JOHN R. HOFFMAN, VICE PRESIDENT-GENERAL COUNSEL, UNITED TELEPHONE SYSTEM, INC., KANSAS CITY, MO.

Mr. HOFFMAN. Thank you, Senator Jepsen, for the opportunity to be here today. I have prepared a written statement which I submitted to Mr. Conrad, and I understand will be submitted in the record.

Senator JEPSEN. It will be entered into the record as if read, as will all statements from this panel.

Mr. HOFFMAN. It more thoroughly describes the telephone system and gives our view on the staff study produced by this committee that has the same title as this hearing, and that is "The Economic Issues of a Changing Telecommunications Industry."

That study has not received much attention today, so I would like to focus most of my comments on its observations and conclusions.

First, very briefly, let me describe the United Telephone System. The United Telephone System is the second largest independent, or non-Bell, telephone system in the United States. It is comprised of 22 operating telephone companies, which provide local exchange and related services to almost 3 million access lines in over 3,000 communities throughout 20 States.

We employ a little over 25,000 people. In Iowa, we serve 62,000 access lines, with 356 employees, in primarily rural areas. We also operate in the States of Nebraska and Minnesota, that are within this region.

I mentioned our size only to give you an indication of the stake we have in the future of the telecommunications industry. But our size is somewhat deceiving. We are not comparable to, say, a Bell operating company in terms of operating area. Rather, we are an accumulation of relatively small companies that serve predominantly rural areas.

In that respect, we feel very close to all of our subscribers. Indeed, the needs and desires of our customers permeate the reasoning behind all of our management decisions. When a customer can no longer afford service, we lose not only as a business enterprise, but as a concerned member of the communities we serve.

That is the reason why we were so encouraged to read the staff study prepared for this committee. That study is, in my opinion, very well done.

I quoted to Mr. Jahr this morning when I first met him, that that is the first intelligent infusion of sound economic theory in the discussion before Congress and telecommunications legislation that I have seen in recent months.

Now, I will get to my exceptions. I do have a few exceptions to some of the conclusions drawn on that policy, and I listed and tried to explain most of them in the written statement that I submitted for the record.

What is important, though, from our perspective, is that the facts as supported by that study are that the FCC's access charge plan is based on sound economic theory, and that implementation of that plan without legislative modification is the best hope for preserving universal telephone service in this country.

Consider, in that regard, about 10 principles, real quickly, that I have excerpted from that study:

First. A desirable congressional policy is to allow the free market to do what it does best: Allocate resources optimally with accurate price signals;

Second. About 90 percent of all residential customers do not pay the average cost of having phone service;

Third. In a competitive environment, the cost causer should be the cost payer;

Fourth. Bold regulatory and judicial action has introduced the benefits of competition into the telecommunications industry;

Fifth. The case for traditional cross-subsidies between local and long-distance telephone services has become more complex with the advent of competition in the long-distance market, and with the potential bypass of the local exchanges;

Sixth. The FCC's access charge plan is an appropriate replacement for the established cross-subsidy practice, and access charges should be considered a compensable fee for having long distance services available in addition to local service;

Seventh. The overwhelming amount of the subsidy to local service comes not from urban areas, but from the relatively few high volume users of long distance service, wherever they may be located;

Eighth. Bypass of the network by high volume users, to avoid the inordinate burden of subsidizing local service, is the biggest threat of universal telephone service;

Ninth. In addition to access charges, universal service can be promoted by implementing variable charges, instead of flat fees, for local service; and

Tenth. Regulatory agencies need to abandon old, impractical and uneconomic depreciation schedules and, instead, appropriately recognize the impact of technoolgical change on the "economic life" of telephone equipment.

Now, those are the principles in the study I fully endorse.

I did mention that I have some reservations about the study. The most important of those reservations is the recommended congressional action to the threat of uneconomic bypass that is contained in that study.

The study recommends assessing a fee on bypassers to elicit from them a contribution to local service in order to satisfy "a compelling public interest." I respectfully submit that a greater public need can be served by Congress forbearing from placing an arbitrary penalty on the use of alternate means of communication, the choice of which was motivated primarily by desires to take advantage of economic efficiency and technological advances.

Such a fee would unproductively and unwisely tax, and therefore curtail, innovation. Instead, Congress should allow telephone companies to operate and price their services so efficiently that the uneconomic incentive to bypass will be minimized, which efficiency, we believe, can largely be achieved under the FCC's access charge plan.

Finally, I would like to make one more gratuitous observation. The current impetus for Federal telecommunications legislation seems to be the rather large local rate increase requests recently filed with a number of State commissions by several telephone companies. I do not question the genuine concern that these rate cases have raised among regulators and the public, but it should be recognized that the bulk of these rate increases requests are not generated by the implementation of access charges.

My examination of some of the largest of these filings indicate that most of the increases stem from the Bell System diverstiture, updated capital recovery or depreciation needs, and/or higher rate of return requirements.

Now, earlier this morning Chairman Varley mentioned that rate case filed by the United Telephone Co. of Iowa. That case requests $6.3 million dollars rate increase.

Let me break down the elements of that case very briefly for you, to make my point: $1.2 million of that case is simply to make whole, simple to bring our company up to the earning level last approved for Northwestern Bell in this state, which, by the way, is lower than the authorized return approved us in our last case; $2 million of that case is based on rate of return requirements, to improve our return on equity; $2 million of that case is based on—or results from the deregulation by the Iowa Commission of Customer premises equipment, or terminal equipment. And the remaining $1.1 million in that case is based on the depreciation needs.

None of that revenue requirement results from the implementation of access charges, and if the access charge was reversed, it would have no impact on that case. In fact, the Iowa Commission has recently adopted an order for intrastate access charges. And our earlier calculations indicate that if that order is implemented, which is a $2 flat rate end-user charge on residential customers, $6 on business customers, and a 3-cent per minute charge on carriers, if that plan is implemented, we will be able to reduce the amount we are requesting in our rate case.

My point is that Federal legislation modifying the FCC's access charge plan will not—will have little or no impact on these cases. In that regard, it is misdirected. It is the wrong solution for the wrong problem.

Thus, I urge this Joint Economic Committee to use its considerable influence to enlighten Congress as to the economic benefits of the FCC's access charge plan, and the absence of any need for legislation at this time.

If real threats to the universality of telephone service do develop subsequent to the implementation of the plan—and they will be readily detected by the extensive monitoring procedure currently being put in place by the FCC—I can assure you that the United Telephone System will be among the first to see corrective legislation.

Thank you, Senator.

[The prepared statement of Mr. Hoffman follows:]

PREPARED STATEMENT OF JOHN R. HOFFMAN

Thank you, Senator Jepsen, for the opportunity to participate in this regional hearing. The important national issues being addressed by your Joint Congressional Committee are critical to the future of telecommunications, and my Company is both pleased and honored to contribute to the discussion.

My name is John R. Hoffman. I am and have been employed by the United Telephone System since I graduated from college, sixteen years ago. I have been since March 1980, the Vice President-General Counsel of United Telephone System, Inc., which company provides management, technical and professional services to the twenty operating telephone subsidiaries of United Telecommunications, Inc., that comprise the United Telephone System ("UTS"). UTS is the second largest Independent (non-Bell) telephone system in the United States.

UTS Companies provide local exchange telephone service to almost three million access lines in over three thousand communities in twenty states. At year-end 1982, UTS Companies had over $5.3 billion invested in operating telephone plant, generated over $1.8 billion in revenues, and employed over 25,000 people. In this State, the United Telephone Company of Iowa served 61,793 access lines, with $82.9 million invested in telephone plant and 356 employees, in 1982. Accordingly, our stake in the future of the telecommunications industry is significant.

It is for that reason that I read with great interest the study entitled "The Economic Issues of a Changing Telecommunications Industry," written by staff economist Dale Jahr, and submitted to the Joint Economic Committee on September 27, 1983, by Senator James Abdnor, Chairman of the Subcommittee on Agriculture and Transportation (hereinafter sometimes referred to as the "Study"). The Study is, in my opinion, very well done; it concisely, understandably and generally correctly identifies and explains the economic forces currently at work in the changing telecommunications industry, and for the most part rationally defines the consequences if certain actions are or are not taken by regulators and legislators. Staff economist Dale Jahr should be congratulated for developing this highly useful Study which, hopefully, will be used to correct much of the misinformation and misunderstandings that presently seem to pervade the discussion in Congress regarding the need for federal telecommunications legislation.

I am not an economist, and I am admittedly not qualified to either challenge or endorse the economic theories espoused in the Study; nevertheless, there are some factual assumptions therein which I submit require closer examination and correction. Thus, I'd like to direct most of my remarks to the text of the Study.

Universal Service. The Study defines universal service by reference to the "current level of penetration" of telephones nationwide (pg. 2 of the Joint Committee Print dated October 3, 1983). I have to disagree with that definition, because it would appear to impose on telephone companies the obligation to maintain a certain percentage of availability of service regardless of more influential factors beyond their control; such as inflation, unemployment, population shifts, disasters, or even customer choice. In that regard, I don't believe that universal service can be objectively defined according to numerical criteria. Instead, it should mean that telephone service should be reasonably available and relatively affordable to all persons who desire, request and pay for it.

Tripling Rates. The Study refers to the recently popular threat of "doubling or tripling of residential rates" as a result of ineffective regulatory practices (pg. 1). The Study goes on to very articulately explain that rate increases to replace subsidies that could only have been justified in the monopoly era, are necessary if the benefits of competition are to be realized. I would make two additional observations. First, the transitional mechanisms and other safeguards (such as, the

Universal Service Fund contained in the FCC's Access Charge Plan) will prevent dramatic, immediate rate increases. Second, current telephone rate levels are comparatively low; to put it in more perspective, a 100% increase in the average local telephone bill would equate to less dollars than a 10% increase in the average monthly residential energy bill in most States. In the United Telephone System, current average monthly residential rates range from $3.65 in the State of New Jersey to $20.25 in Ohio; even if the average of these rates were doubled, it would still be less than what many subscribers pay monthly for, say, CATV services.

High Cost. The Study skillfully explains how the "separations and settlements" process provided subsidies from long distance revenues to support local service, but assumes that areas which receive large subsidies correlate with high cost areas (pg. 13). That is not necessarily so. Telephone companies currently receive separations revenues according to their respective Subscriber Plant Factors (or SPFs), which is a Separations Manual (Part 67 of the FCC's Rules) formula that heavily weighs factors such as the length-of-haul (distance) and holding-time (duration) of toll traffic. The revenues depicted on Table 6 of the Study (pgs. 13-14) do not translate to total costs, but represent the amount of Non-Traffic Sensitive (NTS) or local loop costs allocated to the interstate jurisdiction by SPF. In that regard, SPF often produces distorted results. Consider, for instance, two UTS Companies with the same costs but different SPFs; the United Telephone Company of Ohio has NTS revenue requirements per access line per month of about $30 and an SPF of 21.7%, which allows a recovery of only $6 per access line per month from the interstate jurisdictional business; whereas the New Jersey Telephone Company also has monthly NTS revenue requirements per access line of $30 but a SPF of 43.7%, which affords a recovery of $13 per line per month from interstate settlements. Such disparities cannot be justified, especially in a competitive environment.

Access Charges. The Study describes the thrust of the FCC's Access Charge Plan (CC Docket No. 78-72) as relieving long distance competitors of the SPF "burden of supporting local service and shift it onto the subscriber directly" (pg. 14). This statement is not entirely true. The FCC's Plan does appropriately recover most fixed NTS local loop costs from end-users on a flat rate basis; but, some of those costs remain permanently assigned to be recovered from carriers on a usage basis to support a Universal Service Fund, which will provide targeted subsidies to needy high cost areas. Indeed, the High Cost Factor recommended by the Federal-State Joint Board (Docket No. 80-286) to define the recipients of the FCC's Universal Service Fund, as released on September 26, 1983, provides that no telephone company will have to assess to end-users allocated NTS costs in excess of 156% of the nationwide average level of such costs. Thus, the so-called "burden" does not entirely shift directly to subscribers.

Competitive Benefits. The Study opines that because competition will likely be focused in urban, profitable areas, "many Americans will not see the rewards of a changing market structure" (pg. 15). The fact is that the so-called "little guy" is already enjoying significant benefits from the advent of competition in the telecommunications industry. The deregulation of Customer Premises Equipment (CPE, or the telephone instrument) has enabled customers to purchase new, modern telephones with a variety of features for as little as $10 ($7.50 with the purchase of groceries, in some stores), to replace the basic set theretofore rented from the Telephone Company at a rate of $2.50 per month. Reduced long distance rates are also almost ubiquitously available, regardless of population density, via a variety of resellers, as well as the larger long distance competitors.

Rural Costs. The Study concludes that "(c)osts on a per telephone basis are higher in rural areas" for certain stated reasons (pg. 18). The facts extant in the United Telephone System do not substantiate that conclusion. Although UTS serves both some very rural and relatively suburban areas, our studies clearly show that population density alone is not necessarily a controlling factor in determining costs. Instead, factors such as the inflated replacement cost of new equipment in high growth areas, as well as the average length-of-haul of toll traffic, tend to at least equate the cost of providing service in those generally more populous areas with truly rural, less dense areas.

In other words, generalizations about rural vs. urban telephone service costs, especially based on population density, are at least suspect.

Rural Toll Rates. The Study also concludes that nationwide toll rates will likely be deaveraged, and consequently long distance rates "probably will increase in rural areas," analogizing airline deregulation (pg. 19). Nationwide toll rate deaveraging may occur, but only if and as approved by the appropriate regulatory authority. The fact is, though, that AT&T recently filed tariffs with the FCC to reduce nationwide long distance MTS (message telephone service) and WATS (wide-area telephone service) rates by approximately $2 billion, or more than 10%; which reductions apply in all areas, urban and rural alike.

Postage Rates. On the same subject of nationwide average long distance rates, the Study proffers "uniform first class postage rates" as an example to be emulated (pg. 20). The example must fail as a result of the obvious difference between the provision of telephone service on a profitable basis by private enterprise and the government subsidized postal service. Surely the Study does not advocate the nationalization and deficit operation of telephone service.

Bypass Fee. Finally, the Study recommends "assessing a fee on bypassers" to satisfy "a compelling public interest" (pg. 21). I respectfully submit that a greater public need can be served by

Congress forbearing from placing an arbitrary penalty on the use of alternate means of communication, that was motivated primarily by desires to take advantage of economic efficiency and technological advances. Such a fee would unproductively and unwisely tax, and therefore curtail, innovation. Instead, Congress should allow telephone companies to operate and price their services so efficiently that the uneconomic incentive to bypass will be minimized; which efficiency can largely be achieved under the FCC's Access Charge Plan.

Now, having itemized those few parts of the Study with which I didn't necessarily agree, I must again emphasize that I consider the Study to be a most enlightening and generally accurate analysis of the economic challenges facing the telephone industry. In particular, we at UTS wholeheartedly agree with and accept the Study's principle observations and conclusions regarding:

- the four public policy goals for Congressional consideration in defining telecommunications issues, to-wit:

  (1) establish an economic environment that allows telephone companies to satisfy customer wants efficiently;

  (2) monitor the public interest and identify the strengths and weaknesses of the market structure;

(3) allow technology to progress unimpeded, except by economic feasibility; and

(4) preserve the national telephone network (pg. 1); and

- the desirability of a policy to allow the free market to allocate resources optimally with accurate price and profit signals (pg. 2); and

- the undisputable fact that the "overwhelming contribution" to local service rates presently comes from a relatively few high volume, highly profitable customers (pg. 15); who are most likely to bypass the network to avoid those high costs and thereby become more competitive in their own businesses; and

- the conclusion that bypass is the biggest threat to universal service and the economic feasibility of the public telephone network (pg. 17); and

- the observation that below-cost, flat rate pricing of local telephone service has tended to cause the service to be overused and undervalued by the consuming public (pg. 20); and

- the belief that a "strong case for universal service still exists" (pg. 20); and, that the application of sound economic principles will enable the industry to achieve and maintain that desirable goal; and

- the firm conviction that the two goals of universal service and competition in telecommunications need not be mutually exclusive, if price and profit signals are free to operate without artificial distortion (pg. 21); and

- the need to "temper" the flat charge for local service with a variable charge based on usage, in order to optimize utilization of the local network (pg. 22); which is generally referred to in the industry as Local Measured Service (LMS); and

- the need for regulatory agencies to abandon old, impracticable and uneconomic depreciation schedules and, instead, appropriately recognize the impact of technological change on the "economic life" of telephone equipment (pg. 22).

All of these points argue in favor of the FCC's Access Charge Plan. The FCC spent five years studying all of these issues in depth, and considering the input of all interested parties. UTS actively participated in that process and, admittedly, thereby learned and expanded its perception of the future of telecommunications in this Nation. We are convinced that the FCC has devised an economically sound plan to both best price local exchange access services in a competitive long distance market, and preserve and protect the valued concept of universal service. The FCC's Plan not only equitably recovers costs from the cost causers, but also fairly targets needed subsidies to high cost areas and establishes an effective monitoring mechanism to give advance warning of and fashion corrective action to any developing threat to universal service. The FCC's Access Charge Plan should be given an opportunity to work; Congress should not impose any last-minute modifications, especially as a result of misunderstandings of the facts and applicable economic principles.

I earlier disclaimed personal economic credentials; so, I'll defer to the considerable expertise of the Chairman of the FCC. The Honorable Mark S. Fowler, in an editorial published in the October 4, 1983 edition of the Wall Street Journal, very convincingly explained that:

> "The Commission's access charge decision is part of a wave of regulatory reforms: faster depreciation of telephone plant and equipment, price deregulation of residential and business phones and competition in long-distance services. The result is a fairer, more efficient system. It is a system that rewards innovation, moves prices to reflect costs and allows for subsidies only to those consumers who need them.

Those who would undo the FCC's decision should realize if this happens, our phone system will face greater upheaval down the road. It is unavoidable. And we will have missed the chance to promote the efficiency and innovation promised by the access charge rule, create new jobs and wealth, and expand our international trade."

I respectfully suggest that it is within the professional purview of this Joint Economic Committee to adopt and recommend those principles to the Congress. Thank you very much.

Senator JEPSEN. Thank you.

Now, Mr. Dick McCormick of the Northwestern Bell of Omaha.

STATEMENT OF RICHARD P. McCORMICK, PRESIDENT, NORTHWESTERN BELL TELEPHONE CO., OMAHA, NEBR.

Mr. McCORMICK. Thank you, Senator. We are here today because each of us cares very much about the quality and availability of telephone service in the upper Midwest.

The question that you are asking is, "Will telephone users be well served by the currently proposed legislation?" I submit that they will not be well served.

While proponents say that this legislation would continue to assure a phone in every home, I am convinced that it would actually threaten universal service. I believe the support for the legislation can be traced to three motivations from its proponents.

First, there are those who frankly would like to get AT&T;

Second, there are those who did not want the Bell System broken up in the first place, they wanted to turn back the clock, they wanted to bring back the telephone system the way it used to be; and

Third, there are those who want to take the populist position by supporting what appears to be a $2 reduction in phone bills. That is a great political position.

As to the first point, AT&T has already been gotten. It was subjected to cream-skimming competition in the 1970's, and was finally broken to pieces in the 1980's.

Come January, Northwestern Bell will no longer be a part of AT&T with or without the legislation. That job is done.

Regarding the second point, it is simply too late to turn back the clock. Competition is firmly entrenched in our industry. There are over 4,000 providers of telephone equipment in this country. There are more than 400 long distance companies either in the form of owning their own facilities, or being resellers of that service.

The days are long gone when Ma Bell was the only game in town. And to the third point, both Congress and our customers need to realize that blocking the disputed $2 would only be a phantom savings. The pocketbook truth is that while the legislation would appear to save customers money, in reality, it will cost them.

In a competitive environment, prices have to reflect actual costs. That statement has been made by 15 other people today.

To continue to price long distance substantially above cost and local service below cost simply will no longer work. If we try it, business customers will continue to buy or build their own long distance facilities. They are already doing so in large numbers.

I call this uneconomic bypass. They will bypass the local network altogether to avoid paying the local subsidy. We will lose more money, and our customers that are left with us will have their phone bills raised to cover more costs.

If we lose the revenues of just 150 customers in our company, if they choose to bypass us, every residence customer in Northwestern Bell would have to pay an extra $3.25 a month to make up for those lost revenues from just 150 customers. If we expanded that number to 521 customers, the number is $5.13, and we will lose them if Congress gives them the incentive to bypass.

That is what I mean when I call the $2 a phantom savings. That is what I mean when I say "universal service is safer with access charges than without."

$2 a month is 7 cents a day; 14 cents a day if the full $4 is assessed 2 years from now. I think that is a rather small amount for such a sudden concern by Congress. It is not enough to price many households out of telephone service.

So I strongly urge the Congress not to vote for this phantom $2 savings, which would actually penalize local telephone users. Congress has had this issue for 7 years and has never been able to pass legislation that would be appropriate. Instead, Congress has allowed the Federal Communications Commission and the courts to write a new national policy for telecommunications. Now it must allow that policy to work.

The FCC has developed a fair and reasonable way to gradually transfer the full costs of local service to those who use it. This, I might add, after 5 years of testimony from all interested parties, 5 years of study. I believe it will work.

Congress must not legislate a bandage in hopes of covering up the major surgery that has taken place in the past decade. That would not work.

I would also like to read a resolution passed by an organization that represents over 900 independent telephone companies in this country. Not one member of this organization is any Bell Co. or AT&T person, and this is from the U.S. Independent Telephone Association. This was passed at their board meeting yesterday in Boston.

Whereas the United States Independent Telephone Industry has traditionally supported universal service;

Whereas the FCC has approved access charges effective January 1st, 1984;

Whereas the public policy of competition and advances in technology will drive long distance charges to cost, and thereby reduce, over a period of time, the support for long distance revenue to local service costs;

And whereas this will increase local service rates;

Whereas the FCC access charge plan places an end-user charge of $4, 1984, $3, 1985 on residential customers;

And whereas the telephone industry and members of Congress are concerned about sustaining universal service in the future, particularly after application of flat rate end-user charges to customers which adds to the total impact of rate increases and the possibility of customers discontinuing service;

And whereas there is also a question of fairness of some inter-exchange carriers not paying appropriate levels of charges for usage of local facilities;

Whereas modification of the FCC access charge order at this late date would jeopardize revenue flows to exchange carriers, thus throwing the exchange carrier into economic chaos.

Therefore, be it resolved, in view of the short time remaining until access charge implementation of January 1st, 1984, USITA supports:

1. The implementation of FCC's access charge plan in 1984 and 1985, including the mandatory monitoring program. The FCC should report in 1985 and thereafter a comprehensive analysis to the effects of access charges on universal service.
2. Modification as needed on the access charge plan to provide for inter-exchange carriers to pay their fair share of local exchange facility costs.
3. Lifeline service should be developed where needed in each State by telephone companies and state regulatory commissions.
4. Maintaining the universal service fund to support high cost areas as part of this monitoring process, identify areas with legitimate high cost problems, and target the systems appropriately.

Thank you.

[The prepared statement of Mr. McCormick follows:]

PREPARED STATEMENT OF RICHARD P. McCORMICK

My name is Dick McCormick and I'm President of Northwestern Bell, a position I've held since October 1982. Prior to assuming my present responsibilities, I was senior vice president and chief operating officer. And I've held a variety of other positions in my 22 years with the Bell System, including 3 years as vice president and chief executive officer for Northwestern Bell in North Dakota.

I'd like to begin my remarks by thanking Senator Jepsen for the opportunity to participate in this hearing. I'm a native of Fort Dodge, Iowa, and a graduate of Iowa State University, so I jump at the chance to come to Iowa.

More importantly, these are critical times for the telephone industry and the issues facing us should be thoroughly discussed. I'm convinced that proposals in Congress---however well-intentioned---could threaten the economic viability of my company. I'm convinced that Congressional attempts to preserve universal service actually threaten it. I'm convinced that what the telephone industry needs is not a moratorium on access charges, but rather a moratorium on anyone issuing new ground rules for the communications industry. We have too long been in turmoil as the courts, commissions and Congress have bandied about ways to shape our industry. If we are to continue to provide this country with the best and lowest-priced telephone service in the world, we need some certainty as to the rules we are to play by. So I welcome this opportunity to tell that story.

For the record, Northwestern Bell, at present, is a wholly-owned subsidiary of AT&T and provides telephone service in Iowa, Minnesota, Nebraska, North Dakota and South Dakota. Under the Modified Final Judgment entered into by AT&T and the Department of Justice, Northwestern Bell will be divested from AT&T, with ownership transferred to U S West, a holding company which will also own Mountain Bell and Pacific Northwest Bell. This separation of my company from AT&T is scheduled to take place on January 1, 1984.

While our ownership will change January 1, our commitment to providing high-quality, affordable telephone service will not. We currently provide such service to 2,790,000 customers, serving 65 percent of the total telephone customers in the five states. 2.36 million or 85 percent of our customers are residence customers, 425,000 (15 percent) are business. We provide telephone service to approximately 300,000 rural customers, representing one-third percent of the rural telephone customers in the five states. Universal service today means that 96 percent of the households have telephone service. Our goal is to serve the same percentage of households at the end of 1984 as we do today. I'm confident that we can.

What we cannot do, however, is to continue to price local telephone service at only a fraction of its cost. As I've been telling employees of late, the big news is not that local rates are going up, the big news is that the price local telephone service has been as low as it has for as long as it has.

Historically, in the telephone business, residence service has been a loss leader. The rate for basic residence service was kept substantially below the cost, with the difference between the price charged and the cost incurred made up by revenues from such things as equipment rentals and extension services, and especially intrastate and interstate long distance revenues. That was a pricing policy that was right for the times. And one that enabled us to achieve a desired social policy of placing a telephone in virtually every home. But it was a pricing policy made possible only by allowing the telephone company a monopoly franchise in its service area. As the sole provider of sets and services, we, along with the regulatory commissions, could determine which of our service offerings would be priced below cost, which would be priced above cost. There are those in this business who look upon those times as the "good old days." Whether they were or not is mostly immaterial, because those days are gone forever.

While Northwestern Bell remains extensively regulated at both the federal and state levels, the marketplace, to a large extent, now must determine the price of our services. That's what happens in a competitive environment. And technological advancement, followed by regulatory and judicial decisions beginning in the late 1960s have dragged the telephone industry, albeit kicking and screaming, into the competitive world. We fought competition in the courts, before the Commission and in Congress. We lost in all three arenas. And so now we embrace competition. We really have no alternative.

To get some idea of how competitive our business has become, walk into any Radio Shack or department store and see the variety of telephone equipment for sale. Turn on the television set and be assaulted by commercials for the long distance services of MCI, Allnet, Sprint and, yes, AT&T. Ask the office manager of any medium- to large-sized business how many vendors are selling telephone systems. Open the Yellow Pages and note the number of companies offering pocket pagers.

One area, however, where there has yet to be any competitive inroads, is in the provision of local telephone service. For obvious reasons, competitors have yet to go after that market where a customer is asked to pay $10 for a service that costs $30 to provide. And so the local telephone company has effectively been left with a monopoly on the provision of local telephone service. What we haven't been left with is the ability to continue to provide that service at only a fraction of its cost.

Beginning the 1st of January, 40 percent of Northwestern Bell's revenues will be derived from a system of access charges devised by the Federal Communications Commission. After five years of looking at how AT&T priced and packaged its long distance offerings, the FCC, with input from the industry and consumers, arrived at a system for gradually transferring the cost of local telephone service to the end user. The Commission ruling means that beginning in 1984, residence customers will lose $2 of the monthly interstate long distance subsidy, $3 in 1985 and $4 in 1986. And residence customers will be asked to begin paying a larger portion of the actual cost of providing their service. I submit that even after those so-called "access charges" reach $4 per month, local residence telephone service will still be among the best bargains in the family budget.

There's been some confusion as to what a customer will be paying to "access" with those charges. The Iowa commission has ordered a system whereby a customer wishing neither to place nor receive long distance calls will not have to pay access charges. But, in fact, it is part of the cost of accessing the local network that those costs are designed to recover. Today's cost of running cable from a customer's residence to the nearest local switching office averages about $30. That's a fixed cost and does not vary with the amount of traffic, whether it be local or long distance, that is carried over that cable. The cost of connecting a long distance carrier with the local switching office has historically been recovered and will continue to be recovered by charges to that carrier on a per minutes of use basis. Of the 40 percent of revenues I mentioned my company estimates will come from access charges in 1984, 88 percent will come from carrier charges. Long distance will continue to cover its full costs and will additionally continue to make a contribution to local residence service.

The FCC access charge system, then, moves the telephone industry in the direction of pricing its services so that the costs are borne by the cost-causer. The competitive marketplace will tolerate no other approach to pricing. It is because certain services were priced artificially high that competitors became interested in portions of the telephone business in the first place. Entrepreneurs saw that they could serve select customers over select long distance routes at prices---not necessarily costs, but prices---lower than the telephone company's. And so was begun the era of "cream skimming," and of competition in most parts of our business.

I'm not here to argue the merit or lack of merit in a competitive telecommunications industry. As I said, we fought those battles and lost. But I think it is worth noting that the benefits of competition are there for all to enjoy. While those benefits are distributed somewhat unevenly---I know, for example, that there aren't a lot of long distance companies competing for the traffic of our rural customers----nonetheless, anyone can purchase a telephone set, and there are scores to choose from. And if, indeed, medium- to large-size companies are the big winners, still those winnings are shared by the customers of those companies, because ultimately the costs of doing business, and the cost savings, are passed along to the customer.

Residence customers are being ask to begin covering an additional $2 of the cost of providing their local telephone service next year, and there's been something of a public outcry. Congress is considering legislation and many appear in favor of a moratorium on access charges "so customer's aren't forced to give up their telephones." Respectfully, senator, I question how many of my customers will be "plowed under" by having to pay an additional seven-cents per day for their telephone service. As we have argued in rate case after rate case, percent increases in local telephone service in the last 15 years have been only about one-third of the level of increase in the Consumer Price Index, one-fifth as high as the level of increase in per capita income, and one-sixth the percent increase in the average monthly social security payment. The average rate for basic residence telephone service in my company is $11.22. If that average rate were to double tomorrow, it would take 2.6 hours of labor for the average worker to pay the monthly telephone bill, compared to 2.49 hours in 1965. It would take 2.9 percent of the average monthly social security payment, compared to 6 percent in 1965.

Telephone service is a bargain today. It will continue to be a bargain tomorrow. And for those customers who are moderate to light users of our service, we have begun introducing alternative service that will help them control their monthly telephone bill. We have local measured service in exchanges in each of our five states. And we are expanding our measured service offerings just as rapidly as we can get commission approval to do so. Today, under our measured service offering, a customer in Marshalltown, Iowa can have telephone service for $6.05 per month, and that includes $2.00 of usage.

I realize that there are customers for whom even that poses a hardship. For those customers, I would support a government subsidy, along the lines of the Food Stamp program or the Energy Assistance Fund. I side with those who argue the telephone is a necessity, not a luxury. And I think it is government's role to ensure that those unable to pay for telephone service can still have it.

For me, one of the more frustrating aspects of the legislative proposals before Congress, is that under the guise of preserving universal service, the aim is really to preserve the status quo---the present pricing scheme that has been made obsolete by technological advancements and by regulatory and judicial decisions. I've yet to see a Congressional proposal advanced that would rescind or place a moratorium on access charges only for those people unable to afford them. The FCC decision, so much under attack, does provide for a selective waiver of access charges for those unable to pay. But Congress would require an across the board rescission, regardless of need. Congress, plain and simple, would continue the historical subsidy, even though the source of that subsidy is no longer assured.

If the FCC decision is allowed to go forward, Northwestern Bell will realize not a penny more from access charge revenues than we would if the present system of separations and settlements were continued. For us, it's a wash. Why, then, do we oppose a Congressional mandate to preserve the status quo? Our fear is that if Congress requires long distance carriers who use our local facilities to continue to shoulder a large share of the cost of local service, those carriers will stop using our network. Technological advancements have made it possible for large business customers to bypass the local telephone network in disseminating both voice and data communications. A microwave system at four John Deere Company locations in Waterloo, Iowa eliminates the need to use the local telephone network for communications between those locations. And microwave is but one of several technologies that can be used for bypass. Others include satellite, digital transmission service, cellular radio and cable television.

Bypass---the origination or termination of a telephone call without using the local telephone company facilities---is a reality today. And those large users who construct bypass facilities or purchase them from carriers or resellers do not contribute to the support of the local network. To continue to price long distance rates artificially high is to encourage more and more large customers to consider the alternative of bypass. For large users, there comes a point when the cost of constructing a bypass system---even though higher than the telephone company's cost for such a facility---becomes economically attractive because the price the telephone company charges is so out of line with the actual cost.

The FCC access charge decision sent a signal to those who were considering bypass that they'd better be able to construct facilities at a cost below the telephone company's because in the long run, telephone prices will follow costs. Now Congress appears ready to reverse that message, to tell large customers that their services will continue to be priced way above cost. For large customers, bypass becomes an alternative, in many cases the lesser of evils.

Currently in our five states we have 159 business customers---that's .04 percent of our total business customers---who are buying in excess of $25,000 per month of telephone service from Northwestern Bell. We project those customers will generate $91 million in revenue in 1984. Were we to lose those customers to bypass---and we will if access charges are not levied on the cost-causers---we would have to increase the monthly bill of each of our 2.4 million residence customers by $3.24 per month. Were we to lose the $144.4 million in revenue generated by our 521 largest customers (customers with monthly billing in excess of $10,000---.12 percent of total NWB business customers) residence rates would have to be increased $5.13 per month.

As I've mentioned, bypass is a reality today and it poses even more of a threat for the future if telephone companies are required to continue to price services without regard to cost. As the industry is presently structured, there is no incentive for AT&T to bypass the Bell Operating Companies. That will not be the case after January 1. The biggest potential bypasser of the local telephone network will be AT&T if Congress sends a signal that it will be economically attractive for them to do so.

For those who would propose to continue the subsidy of local telephone service by combining the artificially high long distance rates with a tax on bypassers, I question the workability of any such bypass tax scheme. I'm skeptical of the ability to measure the volume of bypass traffic or even identify the existence of some bypassers. However, at a bare minimum, any Congressional action to delay or prohibit customer access charges should include an attempt to retrieve some of that lost revenue from bypassers, if at all possible.

In summary, universal service is not jeopardized by access charges, but is threatened by proposed legislation to rescind the FCC order. Northwestern Bell opposes S. 1660 and H.R. 4102. Enactment of either bill will only provide more incentive to bypass, which would lead to higher rates, which would in turn lead to additional bypass. If any Congressional action is needed at this time, it is to provide funds to subsidize the cost of providing telephone service to people of demonstrated need. Telephone service is a bargain today. It will still be a bargain tomorrow.

Thank you.

Senator JEPSEN. And the financing for the universal fund should come from where, in your opinion?

Mr. McCORMICK. I think it should come wherever it was provided for in the FCC access charge order.

Senator JEPSEN. Mr. Ware, Larry Ware, Garden Valley Telephone Cooperative of Erskine, Minn. You may proceed.

STATEMENT OF LAWRENCE C. WARE, MANAGER, GARDEN VALLEY TELEPHONE CO., ERSKINE, MINN.

Mr. WARE. Thank you. Mr. Chairman, my name is Lawrence Ware, or Larry Ware, and I am the general manager of the Garden Valley Telephone Co. located in Erskine, Minn. Today I also represent the National Telephone Cooperative Association, NTCA.

Senator JEPSEN. Would you mind pointing the microphone a little more directly? Thank you.

Mr. WARE. The NTCA is a national trade association comprised of approximately 400 locally owned and operated small telephone systems providing service in rural areas in more than 40 States.

Garden Valley Telephone Co. is a subscriber-owned cooperative serving 12,000 subscribers in 24 small communities throughout a 37-square-mile rural area in northwestern Minnesota. These small exchanges vary in size from 120 subscribers to 1,500 subscribers, with less than 3 subscribers per route mile of facilities.

Mr. Chairman, I appreciate the opportunity to appear before you today to testify in support of the legislative effort to preserve universal telephone service. I would like to comment briefly on several issues which need to be addressed in legislation to preserve universal service at reasonable rates. I will submit a more detailed written statement for the record.

I would like to comment, first, on the preservation of universal service. This goal is clearly stated in the Communications Act, and, again, clearly acknowledged by the FCC in its access charge decision, third report and order. However, NTCA believes this public policy goal has been threatened by the Commission's access charge decision.

Although the FCC has faithfully recited its intention to preserve universal service, it is my belief, in trying to avoid uneconomic bypass, which is the rationale for the FCC access charge mechanism, has gone too far. The transfer of most fixed costs to the end user places an excessive burden on residential and limited income subscribers without requiring interexchange carriers to pay for the facilities used to complete their calls.

The NTCA supports the elimination of the end-user access charges, and supports the continuation of a carrier's charge in a manner that is fair and reasonable to all.

Access charges have been ordered without the benefit of a quantitative analysis to demonstrate that subscriber rate increases resulting from bypass would be as great as the increases its plan will unquestionably impose. Also it has not been adequately demonstrated that access charges will eliminate or substantially reduce bypass.

Local measured service has been offered as an alternative for the local exchange subscriber. It is not a viable alternative for small exchanges. It would add to the costs of the exchange service without enough subscribers in the exchange over which to spread the costs from the discounted service.

The second issue is the adoption of an adequate high-cost factor. The FCC's high-cost factor appears to be completely inadequate to protect universal service as it provides very limited support under a sharply tapered formula.

Both Senate bill S. 1660 and House bill, H.R. 4102 provide much improved high-cost formulas for the support of universal service. Also both bills repudiate the FCC's requirement that a company's actual cost of debt be used in the cost calculation. That requirement would effectively penalize REA borrowers who serve the sparsely populated high cost areas.

Competition does not find areas like ours attractive. That is why our cooperatives were started in the first place.

Another issue is a need for a system which would provide for contribution to the support of universal telephone service by telecommunications services that allow big volume business customers to bypass local facilities. Bypass services connect to the public network on the receiving end. Even totally private systems rely on the public network for backup and overflow.

In many cases, the local telephone company has already constructed facilities to serve the large user. When such a user decides to leave the network for a competitive carrier, the remaining local subscribers pay for facilities and capacity built to accommodate the large user.

State and Federal regulators should have at their disposal the tools to regulate alternative technologies as they do telephone systems if it is necessary to do so to maintain universal service.

Both S. 1660 and H.R. 4102 provide for bypassers to contribute their fair share to maintain universal telephone service.

NTCA believes that nationwide average toll rates have benefited all Americans, particularly those in high-cost rural areas. We are concerned that the transition toward full competition and interexchange services will create irresistible pressures to deaverage toll rates.

We believe that there may be several approaches to continuing toll rate averages. Specifically, we believe that legislation should address the higher cost of connecting rural telephone central offices into the toll network. These higher costs should be included in the nationwide toll support mechanism. Otherwise, higher costs may discouraged alternative interexchange carriers from serving rural areas.

Rural users throughout the country are more dependent on long-distance services because of the small calling areas. The NTCA urges Congress to support the provision in H.R. 4102, which supports continued averaging of toll rates nationwide.

In conclusion, I would state the effects of the FCC's access charge decision will cause monthly bills to increase substantially, and could cause a significant number of subscribers to drop off the network. The rural and urban poor will be isolated without adequate transportation or communication.

We do not believe the public interest is being served by the FCC's access charge system.

We appreciate your concern, Mr. Chairman, and the concern of all the members of the committee, and we thank you for this opportunity to testify.

[The prepared statement of Mr. Ware, together with the attached appendixes, follows:]

PREPARED STATEMENT OF LAWRENCE C. WARE

Good Morning, Mr. Chairman and Members of the Subcommittee. My name is Lawrence Ware, and I am the Manager of the Garden Valley Telephone Company in Erskine, Minnesota. Today I also represent the National Telephone Cooperative Association, NTCA.

NTCA is a national trade association comprised of approximately 400 locally owned and operated small telephone systems providing service in rural areas in more than 40 states. Most of these systems have obtained capital financing under the loan programs of the Rural Electrification Administration (REA).

Garden Valley Telephone Company is a subscriber-owned cooperative providing telephone service to about 12,000 customers in rural Northern Minnesota.

I appreciate the opportunity to appear before you today to testify. I support the effort to preserve universal telephone service. As the manager of a small independent telephone system, I am well aware that we will need this kind of support if small telephone systems are to survive and the rural consumer reap the benefits of improved telecommunications under the new access charge system that the FCC has designed.

We have developed the best telephone system in the world because of the congressionally mandated goal of universal telephone service. The goal is stated in the Communications Act: "to make available, so far as possible, to all the people of the United States a rapid, efficient, Nationwide, and world-wide wire and radio communication service with adequate facilities at reasonable charges...." This mandate was clearly interpreted by the FCC in its access charge decision Third Report & Order. The Commission stated, "We have concluded that the "available... to all" language does contemplate that telephone exchange service should be made available at reasonable rates."[1] However, I believe the public policy goal of universal service at reasonable rates has been shaken by the Commission's Access Charge decision.

Today, I would like to focus on the impact of the FCC decision on Garden Valley and other small companies. Much of the available data comes from estimates compiled by the Rural Electrification Administration, or REA.

As a rule, the over 940 REA borrowers provide service to rural, high-cost areas. Since serving sparsely-settled areas requires more plant (cable, poles, etc.) to serve each subscriber, REA borrowers typically must invest much more on a per subscriber basis than does the Bell system. REA borrowers have invested an average of $1,836.36 per subscriber. For Garden Valley the amount is $2,022.22 per subscriber. Many rural telephone systems have as much as 90% of their investment in non-traffic sensitive (NTS) plant, while the average Bell Company, as of 1981, had about 50%.

1/ MTS/WATS Market Structure, CC Docket 78-72, Third Report & Order, December 22, 1982, p. 28. (hereinafter Third Report & Order).

REA borrowers have an average of 5.43 subscribers per route mile of line (1981 statistics) while Garden Valley has 2.91 subscribers per route mile. REA borrowers have an average local area calling scope of about 2,000 people. Garden Valley has many subscribers who can reach only 500 to 600 others, while half reach about 1,300 on a local call. Most urban local calling scope reaches hundreds of thousands and even millions.

Today, a significant portion of the expense of local facilities which are used by both long distance and local services is allocated to and considered a cost of long-distance service. Traditionally, these costs have been recovered from a pool of interstate long distance revenues. The costs of these local facilities are allocated between long distance and local service on the basis of a formula found in the NARUC-FCC Separations Manual.

NTCA recognizes that there is a need to revise the present system of compensation of local exchange carriers for origination and termination of intercity traffic. The present system of settlements contracts and the ENFIA tariffs for OCCs are filled with inconsistencies which create constant conflict. However, I believe that the allocation of non-traffic sensitive costs were made in a monopoly environment when it did not matter what was assigned to toll or local. A thorough study of the engineering requirements of wires and trunking is necessary to determine what is needed for local and what is needed for interstate calling. This study was not done by the FCC in the Access Charge Docket, nor by the Joint Board in the allocation of cost proceeding.

FCC Access Charge Decision

In its access charge decision, the FCC recognized the problems of high cost telephone systems. The FCC affirmed its congressionally mandated goal of universal telephone service, and admitted this goal would be jeopardized if subscribers were forced to pay high access charges. Therefore, the FCC included in its access charge plan a Universal Service Fund (USF) to be used to assist high cost local companies in keeping access charges reasonable. The Federal/State Joint Board was directed to recommend the details of the USF.

The impact of the access charge plan depends in large part on how the USF is implemented. In April, 1983, the Joint Board agreed to recommend a formula for designating those NTS costs which were eligible for recovery from the USF. The Joint Board provides for eligible costs to be limited to those above 115% of the national average of such costs. Only a percentage of those costs above 115% can be recovered from the USF. Under the Joint Board formula, interstate access charges in rural areas would be allowed to rise to as high as 156% of the national average charge. In addition, the Joint Board has proposed that the calculation of the high cost factor be based on the cost of debt of the individual company. This proposal would penalize rural companies who borrow from REA and would increase the eligibility of large companies. The USF is to be phased in over three years, beginning in 1986.

Critique of FCC Decision:

In arriving at its decision, the FCC attempted to balance the conflicting concerns of subscriber drop-off due to high access charges and the loss of high volume users through uneconomic bypass. However, the FCC decision does not contain quantitative analyses sufficient to justify its premises.

The FCC based its decision on the hypothesis that the demand for local service, including access charges, was relatively inelastic. However, in reaching this conclusion, the FCC used a very limited record. Studies available and in the FCC record, however, indicate that a substantial drop-off of local subscribers could result from high access charges, particularly where combined with similarly determined intrastate access charges.

In particular, the FCC itself referred to a study performed by Dr. Lewis J. Perl of NERA[2/] which AT&T had introduced in its antitrust trial. It indicated significant elasticity of demand for telephone service, especially among rural poor. The Perl study found that a 100% increase in basic telephone rates would result in a drop-off of subscribers to 83.69% and a 200% rate increase would lead to a 70.92% subscriber level. Whereas Perl concluded that 88.84% of rural persons currently had telephone service, with 100% rate increases, this percentage declined to 79.10%.[3/] For moderately poor rural persons, a 100% increase in the price of telephone service resulted in a decline to 64.50%.

It should be noted that Appendix G of the Commission's access charge decision[4/] includes another paper by the National Economic Research Associates, Inc., that was not subjected to public comment. This paper purports to recalculate the impacts of the access charge plan described in the Perl study, using increases of $2 and $7 on the assumption that these charges were in the range contemplated by the Commission. This assumption is invalid for two reasons. First, the $7 price is based on the Bell national average non-traffic sensitive per subscriber line cost. The Commission's order, however, effectively eliminated national averaging except for a then-undetermined high cost factor. Rather than Bell nationwide averages, the relevant range of costs, and hence prices, was shown to be up to $27 for individual companies and much higher for some independents. Second, the $7 figure is misleading because it does not reflect the fact that the states are

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2/ "Economic and Demographic Determinants of Residential Demand for Basic Telephone Service," Dr. Lewis J. Perl of National Economic Research Associates, Inc., for FCC Docket No. 20003, on behalf of AT&T. Presented in AT&T/DOJ Antitrust case as Defendant's Exhibit D-4-518. Table attached as Appendix I.

3/ Appendix I.

4/ Third Report and Order, Supra note 1, at appendix G urged to adopt the same formula on intrastate access charges. Therefore, even the average figure must be at least doubled if the effect on the consumer is to be measured.

It is therefore apparent that the Commission had good reason to believe that rather than demand for service being inelastic, a decrease of almost 8 percentage points in national telephone penetration, or approximately 7 million households (assuming 80 million residential subscribers) could be expected.

Some cases which have received public attention suggest a strong correlation between telephone rate increases and subscriber drop-off. While other factors may be operative in these cases, they deserve examination as an indication of subscriber reaction to increases of a magnitude anticipated under the FCC access charge plan. One such case is that of Hickory Telephone Company, described in testimony presented before the House Telecommunications Subcommittee on March 22, 1983. Hickory raised its local rates in 1975 from $10.66 to $16.35, a 54% increase. Consequently, 14% of the customers discontinued their basic telephone service.[5/] In another case, the Big Run Telephone Company in Pennsylvania requested and received approval for a substantial local rate increase to cover the costs of purchasing some used switching equipment. Approved in April, 1981, the new rate was an increase of about 40%, to a total of $21.75. Within several months, 22%, or 204 of the system's 924 subscribers dropped service. Although some have reconnected since that time, as of the end of 1982, most had not.

Several studies have been performed in an effort to quantify the impact of access charges on rural telephone rates. I have attached as Appendix II a preliminary survey of the impact on Minnesota independent telephone systems of the recent FCC and Joint Board decisions. This survey includes estimates of the interstate access charges and the full price of continued access to the telephone network which subscribers of these systems will pay if the state patterns its new cost recovery system on the FCC model.

According to the survey, interstate access charges will range from $4.70 to $21.48 per subscriber line per month. Garden Valley's customers will pay interstate access charges of $6.31. Intrastate access charges will range from $4.43 to $20.94; Garden Valley's will be $8.90. Implementing the FCC's High Cost Factor will benefit only eight companies, with the highest cost companies receiving $11.83 per subscriber line per month and the lowest eligible company receiving only 50¢ per subscriber line per month. Most Minnesota independent companies including Garden Valley, will receive virtually nothing.

5/ Testimony of Michigan Public Service Commission, Chairman Eric J. Schneidewind before the House Subcommittee on Telecommunication, Consumer Protection and Finance of the Energy and Commerce Committee, March 22, 1983.

A study by REA (Attached as Appendix III.) was based on a post-transition era, and assumed deregulation of CPE and inside wiring, as well as on the High Cost Factor (CC Docket 80-286) as announced in the Joint Board's press release of April 16, 1983. According to the REA study, 650 REA borrowers would have average monthly subscriber rates, including projected interestate and intrastate access charges, 100% or more increased over the 1981 local rate. For over two-thirds of REA borrowers, interstate access charges will at least double local rates.

Another example of the impact of the access charge and Joint Board decisions is provided by Golden West Telecommunications Cooperative, Inc. (Appendix IV). The cooperative serves 5,531 subscribers in Western South Dakota. If the FCC plan is implemented for both interstate and intrastate access, Golden West will have increased local rates from $5.80 to $22.50, a 288% increase. It would have a combined interstate and intrastate rate of $16.76. In rural areas where distances to schools and hospitals are great, more intrastate toll calls are made, so the increase would be considerable.

Finally, I would like to share with you the study done of the projected access charges and rate increases among the members of the Texas Statewide Telephone Cooperative, Inc. (Texas Statewide)(Appendix V). This study also includes estimates of access charges for intrastate service which would result from implementation of an FCC-type plan by the Texas Public Utility Commission.

The average basic monthly rate among these systems is $8.77. The number of subscribers they reach ranges from a few hundred to a few thousand. The interstate access charges as proposed by the FCC will range from $4.20 to $7.08 with an average high cost factor of $6.82. Intrastate access charges, if patterned after the FCC plan, would range from $6.72 to $21.47 and the total monthly rate at the end of the transition period would be increased from 83% to 488%, with the average of 193%.

Some access charges would be considerably more than would be others. Of the 21 companies studied, 14 would have monthly rates over $25 and 8 over $30.

In light of the Perl findings, it is clear that the implementation of the FCC access charge decision will have a serious impact on universal service in rural areas.

Another premise of the FCC access charge decision is that implementing end user charges would reduce uneconomic bypass. In the text of the decision, the Commission staff listed various instances of bypass. However, the staff failed to analyze whether such bypass would be reduced by any significant degree by the FCC decision. The FCC provided no quantitative analyses to demonstrate that it had considered the benefit of the public as a whole. For all that the FCC knows, the amount of customer rate increases avoided as a result of bypass deferred may be significantly less than the increases its plan will unquestionably impose.

NTCA Position

NTCA believes that there are several issues which need to be addressed in legislation to preserve universal service at reasonable rates.

I. Preservation of Universal Service at Reasonable Rates.

Although the FCC has faithfully recited its intentions to preserve universal service, it is my belief that it has thrown the balance too far in favor of the interexchange carriers and large users at the expense of local subscribers. In some cases this will be merely inequitable; in others it will seriously endanger universal service.

The FCC High Cost Factor appears to be inadequate to protect universal telephone service, especially since State public service commissions are under enormous pressure, both practical and political, to implement similar access charges for intrastate service. In many high cost areas, these intrastate charges will be substantially greater than the FCC charges.

In contrast, S.1660 provides that 90% of a qualified high cost exchanges' costs over 110% of the natural average will be recovered. H.R. 4102 provides a tapered formula which is an improvement on the Joint Board formula. Neither bill requires REA borrowers to compute their cost of capital.

A. Eliminate the End User Charge

NTCA supports the elimination of the end user access charge and supports the continuation of a carriers' charge in a manner that is fair and reasonable for all. It makes more sense for interexchange carriers to be charged the access fee. Through control of their pricing strategies they have the flexibility to distribute the costs among their users. Business users deduct the cost of telephone service as a business expense. Local exchange origination and termination functions and design are essential to the operations of interexchange carriers and are not otherwise available on a universal basis. It is the interexchange carrier which requires the use of the exchange carriers' facilities and not the other way around. Therefore, at a minimum, the costs of the local facilities should be shared between those who use them, including interexchange carriers.

National Universal Service policies and the REA policy of area coverage have encouraged extending service without regard to individual subscriber line costs. Some of these costs should be paid by the interexchange carrier. Moreover, as discussed above, a thorough review of NTS costs is required. Much overhead has been arbitrarily assigned to NTS which is not a cost of provision of local service.

B. Adopt a High Cost Factor

Some measures propose a Universal Service Fund for the recovery of NTS costs. If adopted, such a mechanism should allow recovery of 100% of the costs over 110% of the national average. Such a formula was in S. 898, the telecommunications bill which passed the Senate in 1981 and in H.R. 5158 which passed out of the House Subcommittee on Telecommunications in 1982. As stated above, both S.1660 and H.R. 4102 have improved High Cost Factors. Furthermore, NTCA recommends that the Congress repudiate the recommendation of the Joint Board that the individual company's actual cost of debt be used in its cost calculation. This requirement penalizes those telephone systems that borrow from the programs of the REA because it lowers their costs relative to those of non-REA borrowers. National average NTS costs are calculated using a national average cost of debt; for consistency the national average cost of debt should also be used to calculate the high cost factor.

II. Protection of Local Telephone Companies from Bypass

Any system adopted to protect local ratepayers should provide for contribution to the support of universal telephone service by telecommunications services that allow big-volume business customers to bypass local facilities. Many such services connect to the public network on the receiving end. Even totally private systems rely on the public network for back-up.

In many cases, the local telephone company has already constructed facilities to serve the large user. When such a user decides to leave the network for a competitive carrier, the remaining local subscribers must then pay for facilities and capacity built to accommodate the large user.

State and Federal regulators should have at their disposal the tools to regulate alternative technologies as they do telephone systems, if it is necessary to do so to maintain universal telephone service. Both S. 1660 and H.R. 4102 provide for bypassers to contribute their fair share to maintain universal telephone service.

III. Maintain Nationwide Toll Rate Averaging

All low-density toll routes, such as those in rural areas, benefit from our current national policy of toll rate averaging. Toll rate averaging is a pricing concept whereby a customer pays equally for interstate calls across equal distances, time of day and duration. However, it is not clear whether this policy will be continued. We believe that there may be several approaches to continuing toll rate averaging.

Specifically, we believe that legislation should address the higher cost of rural class four to class five toll connecting links.[6/] An REA

6/ Deaveraging of Interexchange Toll Rates Due to the Introduction of Competition - Preliminary Estimates, National Telecommunications and Information Administration, 1979.

study of Local Service Rates and Toll Bills for Subscribers in Rural Areas shows that the rural toll link costs seven times as much as an equivalent urban toll route.7/ These costs were considered part of the traffic sensitive elements in the FCC access charge decision and charged to interexchange carriers. These higher costs should be included in the nationwide toll support mechanism or in some pooling arrangement. Otherwise their higher costs may discourage alternative interexchange carriers from serving rural areas or will encourage toll rate deaveraging in service from high cost to high cost areas. As stated above, rural users throughout the country have local calling areas with fewer telephones to reach than urban users. Consequently, rural users are more dependent on long distance service to reach essential services such as doctors, hospitals, schools, etc. NTCA urges Congress to support the provision in H.R. 4102 which supports continued averaging of toll rates nationwide. Furthermore, if legislation is adopted to provide for carrier access charges, provisions should be made to protect deaveraging of toll rates in high cost areas.

IV. Minimize Regulation of Small Telephone Companies.

Under Section 2(b)(2) of Title II of the Communications Act, small exchange telephone companies, as intrastate carriers, are exempt from many of the FCC regulations and reporting requirements. Unless carefully designed, new mechanisms for recovering local costs may impose heavy new reporting and filing requirements on small companies. NTCA also supports the policy of equal interconnection. However, we urge that economically infeasible requirements for such interconnection not be imposed on small companies with electro-mechanical or older switches. At a minimum, implementation schedules should recognize the technical and financial constraints of small companies and allow flexibility in meeting these standards. NTCA urges Congress in considering common carrier legislation to continue the Section 2(b)(2) exemption for small local telephone companies. At this time, neither universal telephone service bills require equal interconnection and the matter is still in the rule-making stage at the FCC.

Conclusion

The ramifications of the FCC access charge decision are wide-ranging. If interstate and intrastate access fees increase by over 100%, as they will in high cost areas, a significant portion of subscribers will drop off the network. This will be detrimental to all users of the network.

The question that this Committee and eventually the Congress must ask themselves is how many people will disconnect from telephone service because of the rate increases before we have an end to universal service? Since agriculture is one of the linchpins of our economy as well

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7/ REA Study of Local Service Rates and Toll Bills for Subscribers in Rural Areas, Appendix to Comments of the Rural Electrification Administration in Docket 78-72, March 1980.

as our foreign trade, how much will rural telephone service and the nation be injured by the economic price experiment of shifting costs from the big businesses and other heavy toll users to the average residential American? How will higher telephone rates affect the continued development of the infrastructure of rural America? Those who drop off the network will not have rapid access to police, fire, and medical service. Businesses will not be able to contact their employees immediately. The rural and urban poor will be isolated without adequate transportation or communications. Is the benefit worth the risk? Is the public interest being served by the FCC access charge system? We in rural America do not believe it is, and share the concern with residential customers.

We appreciate your concern, Mr. Chairman and all the members of the Committee for your interest in preserving universal telephone service at reasonable rates. We look forward to working with you to preserve affordable telephone service. Thank you for this opportunity to testify.

APPENDIX I

ESTIMATED PERCENTAGE OF HOUSEHOLDS WITH BASIC TELEPHONE SERVICE[1]

DEMOGRAPHIC CHARACTERISTICS[3]	PRICE INCREASE[2]			
	BASE	50%	100%	200%
ALL	91.52	88.15	83.69	70.92
YOUNG	85.39	80.12	73.54	56.92
BLACK	86.37	81.38	75.08	58.89
RURAL	88.84	84.59	79.10	64.28
MODERATELY POOR	83.81	78.12	71.11	53.93
YOUNG	72.18	64.14	55.22	36.97
BLACK	75.25	67.71	59.12	40.74
RURAL	79.26	72.48	64.50	46.34
VERY POOR	79.28	72.52	64.53	46.38
YOUNG	64.59	56.14	46.88	29.56
BLACK	69.21	60.78	51.66	33.69
RURAL	73.85	66.07	57.31	38.96

SOURCE: HOUSEHOLD DEMOGRAPHIC AND ECONOMIC DATA: U.S. DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, MONEY INCOME OF HOUSEHOLDS IN THE UNITED STATES: 1979 (WASHINGTON, D.C. U.S. GOVERNMENT PRINTING OFFICE). U.S. DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, HOUSEHOLD AND FAMILY CHARACTERISTICS: MARCH 1980 (WASHINGTON, D.C.: U.S. GOVERNMENT PRINTING OFFICE).

TELEPHONE RATE INFORMATION: AMERICAN TELEPHONE AND TELEGRAPH COMPANY, MARKET AND SERVICE PLANS DEPARTMENT, RESEARCH SECTION, MARKET RESEARCH INFORMATION SYSTEMS (MRIS).

DEFENDANT'S EXHIBIT D-H-1518

APPENDIX II

INTRASTATE ACCESS CHARGES

INDEPENDENT TELEPHONE COMPANY GROUP

Telephone Company	Monthly End User Charges: Present (1)	Proposed: Interstate Total (2)	Proposed: HCF (Carrier) (3)	Proposed: Intrastate Total (4)	Proposed: Grand Total (5) (1)+(2)-(3)+(4)	Change: Amount (6) (5)-(1)	Change: Percent Increase (7) (6) vs. (1)
1	$ 7.24	$ 9.85	$ 5.25	$18.89	$30.73	$23.49	324%
2	6.58	6.88	1.29	11.30	23.47	16.89	257
3	7.64	8.21	1.96	10.39	24.28	16.64	218
4	6.85	6.02	-	9.97	22.84	15.99	233
5	8.36	5.20	-	6.65	20.21	11.85	142
6	5.67	4.70	-	9.37	19.74	14.07	248
7	9.45	9.67	2.13	9.32	26.31	16.86	178
8	10.66	5.88	-	6.63	23.17	12.51	117
9	9.04	6.59	-	12.32	27.95	18.91	209
Garden Valley Telephone Company	6.40	6.31	-	8.90	21.61	15.21	238
10	6.77	10.65	11.83	20.94	26.53	19.76	292
11	8.37	4.50	-	8.39	21.26	12.89	154
12	8.70	6.20	-	7.80	22.70	14.00	161
13	7.25	6.71	-	4.43	18.39	11.14	154
14	9.96	7.09	-	8.71	25.76	15.80	159
15	6.67	7.66	.50	9.55	23.38	16.71	291
16	7.39	5.65	-	6.95	19.99	12.60	171
17	7.09	7.29	.79	6.61	20.20	13.11	185
18	8.47	8.24	1.29	8.24	23.66	15.19	179
19	8.33	6.83	-	6.67	21.83	13.50	162
Average	$ 7.28	$ 6.30	$ .56	$ 8.53	$21.56	$14.28	196%

APPENDIX II

NOTES

1. The base year is 1981.

2. The chart reflects the expected monthly end user charges for exchange access following the transition period if the FCC access charge plan (Third Report and Order, Docket CC 78-72) were in effect during the base year and assuming the recommendations of the Federal/State Joint Board (CC Docket 80-286) are accepted by the FCC.

3. Column (1) is the weighted average local service rate.

4. Column (2) represents the interstate allocated NTS costs based on a 12.75% rate of return, including CPE but not including central office equipment costs.

5. Column (3) represents the application of the Joint Board recommendation following the transition period. The 1981 nationwide average NTS cost is assumed to be $162.00 per loop.

6. Column (4) represents the difference between the base year NTS costs allocated to toll per loop minus the interstate allocated costs.

EXPLANATORY NOTES ON REA ACCESS CHARGE STUDY

Purpose: REA needed to have some idea of how the new access charge system was going to affect local monthly flat rates and universal service. Areas of the country most affected needed to be identified. Also, the question of the effectiveness of the universal service fund needed to be answered.

Approach: The 1981 Annual Statistical Report of Rural Telephone Borrowers was used to obtain the basic financial data. The year 1982 was not available when the study was run. The following assumptions were made:

1. The full effect of the access charge system was in effect in 1981 and all the transitions were complete. This assumption was made since REA projects 5 years into the future for loan feasibility studies. Five years basically takes us past all the transitions.

2. All revenues and costs associated with terminal equipment and inside wiring have been deregulated. Therefore all revenues, expenses and investment for terminal equipment and inside wiring were removed before the study was made. This was done based on individual borrower investment in Accounts 231 - Station Equipment and 234 - Large PBX's and an estimated portion of Account 232 - Station Connections. The resulting total revenue requirement was projected in Column Q36.

3. Revenues were assumed to equal costs. For most of the borrowers, this assumption is reasonable. However, for those systems losing money or earning below their authorized rate of return the study will underestimate access charges and the monthly subscriber billing. If the system has a rate of return higher than authorized, then the monthly subscriber billing will be overestimated. In 1981, about 10% of REA borrowers had a negative rate of return.

4. The results were shown in dollars per month per subscriber.

Methods used to obtain results: The first column developed was Q34 - Traffic sensitive toll settlements from the toll carrier. The following basis was used:

1. Using the REA Annual Statistical Report and other data, traffic sensitive equipment was determined to be 36% of the total revenue requirement. Traffic sensitive equipment will now include: Switching equipment; line treatment equipment; toll identification equipment; toll lines; and other associated plant cost loaded on (such as land and buildings). The other 64% of the total revenue requirements is non traffic sensitive (NTS) equipment, which is basically the local loop.

2. State by state dial equipment minute (DEM) factors were developed from previous REA studies. These factors were applied to the traffic sensitive revenue requirement using a 12.75% rate of return in order to determine a traffic sensitive settlement. (12.75% is the authorized AT&T rate of return on interstate.)

The second column developed was Q35 - Universal Service Fund from ECA (Exchange Carrier Association). The revenues received from the Universal Service Fund were calculated according to the Federal/State Joint Board Formula. Total non-traffic sensitive costs of each REA borrower were compared to the national average (calculated to be $15 based on various AT&T FCC filings). After applying the formula, revenues from the high cost factor (universal service fund) resulted.

All other revenue requirements had to come from the subscriber in the form of monthly flat rates billed to the subscriber. This is shown in Column Q33.

Next, the interstate access charge was calculated using 25% as the allocation factor, and using the Federal/State Joint Board methods. This is Column Q31. Twenty-five percent was used since the Joint Board has determined that this will eventually replace the present subscriber plant factor (SPF) as the allocation factor.

Column Q32, the sum of local rates and the intrastate access charge, was calculated by subtracting Q31, interstate access charge, from Q33, monthly subscriber billing.

An easier way to look at the study is as follows:

Paid By Subscriber			Paid By Toll Carrier or ECA		Total Monthly Revenue Requirement
Q31 +	Q32 +	Q33	= + Q34	+ Q35	= Q36
Interstate Access Charge	+ Intrastate Access Charge & Local Rate	Total Monthly Subscriber Flat Rate Billing	Traffic Sensitive + from Toll Carrier	Universal Service Fund + from ECA	Total Monthly Revenue =Requirement

<u>Conclusions of and Uses for this Study</u>: First, the lack of a universal service fund for the local portion of traffic sensitive costs is what drives up monthly flat rate subscriber billing over the 156% limit imposed by the universal service fund for non-traffic sensitive equipment. There is a definite need for a traffic sensitive universal service fund. Second, there is a potential for a decrease in the level of universal service. This result is particularly evident in the western part of the United States.

These results can be discussed with borrowers by REA field personnel. It must be emphasized that these studies are no substitute for detailed studies done by separations costs consultants since they have far more precise data. For average schedule borrowers where no precise data exists, the REA results can be used as approximations. Even here, care must be used to look at all the individual characteristics of each borrower.

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STATE LISTING

OBS	STATE	Q31	Q32	Q33	Q34	Q35	Q36
1	ALABAMA	5.88471	19.4714	24.1581	3.5314	1.4986	29.1882
2	ALASKA	7.50000	34.8115	42.3115	14.3002	36.1960	92.8077
3	ARIZONA	7.50000	29.6169	37.1169	10.7562	20.4876	68.3608
4	ARKANSAS	5.61128	22.2122	27.8234	4.6024	3.3688	35.7946
5	CALIFORNIA	7.29761	23.4325	30.7301	12.9861	14.2803	58.0045
6	COLORADO	6.79796	23.5676	30.3656	9.6004	10.4244	50.3905
7	FLORIDA	6.81680	25.6241	32.4409	5.7880	7.4286	45.6575
8	GEORGIA	5.39945	21.5938	26.9932	4.3317	2.9580	34.2828
9	IDAHO	5.36372	23.0137	28.3774	6.1389	8.0841	42.6005
10	ILLINOIS	4.51484	18.3385	22.8534	4.4422	0.8343	28.1299
11	INDIANA	3.97502	17.3581	21.3331	3.0197	0.4137	24.7665
12	IOWA	4.44930	18.4207	22.8700	3.6684	1.1941	27.7325
13	KANSAS	5.86765	20.5445	26.4121	7.2871	3.8786	37.5778
14	KENTUCKY	4.15738	18.1382	22.2956	2.8420	0.7643	25.9027
15	LOUISIANA	5.44954	22.6708	28.1203	4.5717	4.6540	37.3460
16	MAINE	5.15757	19.6657	24.8233	5.3618	1.9493	32.1344
17	MARYLAND	4.60082	17.6160	22.2168	5.0721	0.5766	28.6655
18	MICHIGAN	4.40214	18.2687	22.6708	3.8396	1.0639	27.5743
19	MINNESOTA	4.85921	19.6698	24.5290	3.8902	1.8563	30.2754
20	MISSISSIPPI	4.34593	18.6889	23.0349	3.0831	0.9596	27.0775
21	MISSOURI	5.48543	20.1361	25.6215	5.8723	2.6833	34.1771
22	MONTANA	7.39576	26.3127	33.7085	11.7932	16.9471	62.4488
23	NEBRASKA	5.40342	20.9280	26.3314	4.9866	2.9554	34.2734
24	NEVADA	6.90879	26.9794	33.8802	14.4816	24.5519	72.9217
25	NEW HAMPSHIRE	6.50857	22.3089	28.8175	9.2244	8.2262	46.2680
26	NEW JERSEY	7.01201	19.6760	26.6880	11.3683	6.0721	44.1285
27	NEW MEXICO	7.34232	27.2877	34.6300	11.3868	18.1989	64.2158
28	NEW YORK	4.73106	19.0498	23.7809	4.2815	1.4581	29.5204
29	NORTH CAROLINA	4.01809	17.4176	21.4364	2.9167	0.6866	25.0398
30	NORTH DAKOTA	5.73509	22.4942	28.2301	4.6424	3.2273	36.0997
31	OHIO	3.68342	15.5593	19.2427	3.2000	0.4990	22.9496
32	OKLAHOMA	5.63129	20.3792	26.0104	6.5566	3.5635	36.1305
33	OREGON	6.32811	22.1887	28.5168	8.6025	7.7668	44.9661
34	PENNSYLVANIA	4.48800	19.1527	23.6407	3.6395	0.6824	27.9626
35	SOUTH CAROLINA	4.95142	20.4600	25.4115	4.0240	2.1040	31.5395
36	SOUTH DAKOTA	5.17442	20.3682	25.5426	4.6842	3.5303	33.7571
37	TENNESSEE	3.84709	16.9505	20.7976	2.8773	0.2945	23.9694
38	TEXAS	6.79348	25.2094	32.0029	7.0557	8.9238	47.9824
39	UTAH	5.45284	21.2508	26.7036	4.7347	2.5358	33.9741
40	VERMONT	6.34792	22.6429	28.9908	6.6956	5.1473	40.8337
41	VIRGINIA	4.14550	18.4386	22.5841	2.8388	0.4914	25.9143
42	WASHINGTON	6.35796	21.7154	28.0734	7.6096	5.4376	41.1206
43	WEST VIRGINIA	4.64969	19.5338	24.1835	3.5011	1.2855	28.9700
44	WISCONSIN	4.72269	19.4679	24.1906	3.8355	1.5257	29.5518
45	WYOMING	7.38981	25.8077	33.1975	10.6827	13.9656	57.8459
46	UNITED STATES	5.20107	20.6428	25.8439	4.9878	3.6899	34.5216

APPENDIX III

USDA/RURAL ELECTRIFICATION ADMINISTRATION

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
ALABAMA	501	5.271	21.679	26.950	3.973	1.917	32.840
ALABAMA	502	5.052	21.137	26.189	3.808	1.479	31.476
ALABAMA	504	4.440	19.621	24.061	3.347	0.254	27.662
ALABAMA	506	6.841	25.231	32.072	5.157	5.393	42.622
ALABAMA	508	3.513	15.726	19.239	2.648	0.000	21.887
ALABAMA	516	5.570	22.421	27.991	4.199	2.516	34.706
ALABAMA	519	3.129	14.008	17.137	2.359	0.000	19.496
ALABAMA	523	3.399	15.214	18.613	2.562	0.000	21.175
ALABAMA	524	3.226	14.443	17.669	2.432	0.000	20.101
ALABAMA	526	4.349	19.397	23.746	3.279	0.073	27.098
ALABAMA	528	3.473	15.549	19.022	2.618	0.000	21.640
ALABAMA	532	3.125	13.992	17.117	2.356	0.000	19.473
ALABAMA	534	3.372	15.098	18.470	2.542	0.000	21.012
ALABAMA	535	5.920	23.287	29.207	4.463	3.215	36.886
ALABAMA	536	4.646	20.133	24.779	3.503	0.668	28.950
ALABAMA	537	3.654	16.360	20.014	2.755	0.000	22.769
ALABAMA	539	5.647	22.610	28.257	4.257	2.668	35.181
ALABAMA	542	4.621	20.069	24.689	3.403	0.616	28.708
ALABAMA	546	5.022	21.062	26.084	3.785	1.410	31.280
ALABAMA	547	6.452	24.424	30.877	4.864	4.460	40.201
ALABAMA	549	3.815	17.081	20.896	2.076	0.000	22.972
ALABAMA	550	3.794	16.986	20.781	2.060	0.000	22.841
ALABAMA	553	5.643	22.602	28.245	4.254	2.661	35.160
ARIZONA	505	7.500	29.864	37.364	10.950	21.277	69.590
ARIZONA	506	7.500	28.436	35.936	9.830	16.709	62.474
ARIZONA	507	7.500	33.053	40.553	13.451	31.481	85.484
ARIZONA	508	7.500	30.486	37.986	11.438	23.268	72.692

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM ECA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
ARKANSAS	514	5.171	21.187	26.358	4.143	1.717	32.218
ARKANSAS	515	4.037	17.883	21.920	3.234	0.000	25.155
ARKANSAS	516	5.284	21.462	26.746	4.233	1.943	32.923
ARKANSAS	519	6.352	23.915	30.267	5.088	4.219	39.574
ARKANSAS	520	3.993	17.685	21.678	3.199	0.000	24.876
ARKANSAS	523	4.933	20.610	25.544	3.952	1.242	30.738
ARKANSAS	524	4.349	19.189	23.538	3.484	0.072	27.094
ARKANSAS	526	4.764	20.190	24.962	3.816	0.903	29.681
ARKANSAS	528	3.942	17.462	21.404	3.158	0.000	24.562
ARKANSAS	529	3.987	17.662	21.649	3.194	0.000	24.843
ARKANSAS	530	4.237	18.767	23.003	3.394	0.000	26.398
ARKANSAS	531	3.293	14.587	17.881	2.638	0.000	20.519
ARKANSAS	533	5.236	21.345	26.581	4.194	1.847	32.622
ARKANSAS	534	3.250	14.396	17.646	2.604	0.000	20.249
ARKANSAS	536	3.313	14.677	17.990	2.654	0.000	20.645
ARKANSAS	537	4.586	19.766	24.352	3.674	0.547	28.572
ARKANSAS	538	5.606	22.245	27.852	4.491	2.588	34.931
ARKANSAS	540	7.500	30.158	37.658	7.991	16.500	62.149
FLORIDA	502	7.500	28.126	35.626	6.789	11.136	51.551
FLORIDA	504	4.122	18.304	22.425	3.256	0.000	25.681
FLORIDA	506	6.549	24.389	30.938	5.172	4.692	40.802
FLORIDA	507	6.282	23.845	30.128	4.962	4.053	39.142
FLORIDA	509	7.500	27.198	34.698	6.342	8.984	50.024
FLORIDA	511	5.255	21.450	26.705	4.150	1.885	32.740
FLORIDA	516	7.500	30.560	38.060	8.037	17.304	63.402

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
GEORGIA	501	3.675	16.329	20.004	2.893	0.000	22.898
GEORGIA	503	3.316	14.736	18.051	2.611	0.000	20.663
GEORGIA	506	7.045	25.421	32.466	5.546	5.884	43.896
GEORGIA	510	5.520	22.112	27.631	4.345	2.415	34.392
GEORGIA	513	7.027	25.383	32.410	5.532	5.839	43.780
GEORGIA	515	4.737	20.198	24.935	3.729	0.849	29.513
GEORGIA	516	3.663	16.278	19.941	2.884	0.000	22.825
GEORGIA	517	3.578	15.900	19.478	2.817	0.000	22.296
GEORGIA	523	4.126	18.332	22.458	3.248	0.000	25.706
GEORGIA	526	3.496	15.533	19.029	2.752	0.000	21.781
GEORGIA	534	3.427	15.226	18.653	2.698	0.000	21.350
GEORGIA	536	3.527	15.670	19.197	2.776	0.000	21.973
GEORGIA	539	4.379	19.325	23.705	3.448	0.134	27.286
GEORGIA	541	3.928	17.453	21.380	3.092	0.000	24.473
GEORGIA	542	3.247	14.427	17.674	2.556	0.000	20.230
GEORGIA	543	7.500	29.084	36.584	7.214	13.297	57.095
GEORGIA	545	3.577	15.895	19.472	2.816	0.000	22.288
GEORGIA	547	4.288	19.053	23.341	3.376	0.000	26.717
GEORGIA	550	5.690	22.527	28.217	4.479	2.755	35.450
GEORGIA	551	5.852	22.924	28.777	4.607	3.000	36.463
GEORGIA	553	7.500	28.826	36.326	7.091	12.702	56.119
GEORGIA	554	4.304	19.122	23.426	3.388	0.000	26.814
GEORGIA	555	5.845	22.906	28.751	4.601	3.065	36.418
GEORGIA	559	3.259	14.482	17.742	2.566	0.000	20.307
GEORGIA	560	3.819	16.968	20.787	3.006	0.000	23.794
GEORGIA	562	3.994	17.747	21.742	3.144	0.000	24.886
GEORGIA	567	4.262	18.939	23.201	3.355	0.000	26.557
GEORGIA	568	4.176	18.556	22.732	3.288	0.000	26.019

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
ILLINOIS	510	3.698	15.702	19.400	3.638	0.000	23.038
ILLINOIS	511	4.053	17.213	21.267	3.988	0.000	25.255
ILLINOIS	513	3.776	16.036	19.813	3.715	0.000	23.528
ILLINOIS	516	3.586	15.228	18.814	3.528	0.000	22.342
ILLINOIS	517	5.382	20.717	26.100	5.296	2.140	33.535
ILLINOIS	518	3.736	15.866	19.602	3.676	0.000	23.278
ILLINOIS	522	3.909	16.600	20.509	3.846	0.000	24.355
ILLINOIS	523	3.623	15.386	19.010	3.565	0.000	22.575
ILLINOIS	526	4.401	18.511	22.912	4.310	0.176	27.410
ILLINOIS	538	3.581	15.208	18.789	3.524	0.000	22.313
ILLINOIS	547	4.819	19.452	24.271	4.742	1.014	30.027
ILLINOIS	549	4.112	17.460	21.572	4.045	0.000	25.618
ILLINOIS	551	4.299	18.255	22.554	4.230	0.000	26.783
ILLINOIS	552	6.060	22.230	28.297	5.970	3.537	37.805
ILLINOIS	553	5.914	21.911	27.825	5.819	3.203	36.847
ILLINOIS	555	3.372	14.319	17.690	3.317	0.000	21.008
ILLINOIS	557	3.032	12.876	15.908	2.983	0.000	18.891
ILLINOIS	560	4.509	18.755	23.264	4.436	0.393	28.093
ILLINOIS	562	4.980	19.812	24.792	4.900	1.334	31.026
ILLINOIS	566	4.747	19.289	24.035	4.670	0.868	29.574
ILLINOIS	567	3.512	14.916	18.429	3.456	0.000	21.885
ILLINOIS	569	5.847	21.760	27.607	5.753	3.068	36.428
ILLINOIS	570	5.965	22.026	27.990	5.869	3.305	37.164
ILLINOIS	572	6.953	23.864	30.816	6.841	5.661	43.318

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
INDIANA	501	3.635	16.253	19.888	2.762	0.000	22.649
INDIANA	503	3.348	14.969	18.318	2.544	0.000	20.861
INDIANA	506	3.892	17.401	21.293	2.957	0.000	24.249
INDIANA	509	3.626	16.213	19.840	2.755	0.000	22.595
INDIANA	516	3.522	15.749	19.271	2.676	0.000	21.947
INDIANA	522	4.163	18.614	22.777	3.163	0.000	25.940
INDIANA	523	3.003	13.428	16.432	2.282	0.000	18.713
INDIANA	524	4.932	20.810	25.742	3.746	1.238	30.727
INDIANA	529	3.731	16.680	20.411	2.834	0.000	23.245
INDIANA	530	3.336	14.913	18.249	2.534	0.000	20.783
INDIANA	531	3.409	15.239	18.648	2.589	0.000	21.237
INDIANA	535	2.675	11.958	14.633	2.032	0.000	16.665
INDIANA	540	3.896	17.421	21.317	2.960	0.000	24.277
INDIANA	541	5.681	22.662	28.343	4.316	2.737	35.396
INDIANA	542	3.208	14.700	17.908	2.498	0.000	20.406
INDIANA	543	3.506	15.675	19.181	2.663	0.000	21.845
INDIANA	544	3.535	15.803	19.338	2.685	0.000	22.023
INDIANA	545	3.296	14.736	18.032	2.504	0.000	20.536
INDIANA	546	2.889	12.917	15.806	2.195	0.000	18.000
INDIANA	547	2.757	12.326	15.083	2.094	0.000	17.177
INDIANA	550	6.343	24.160	30.503	4.819	4.198	39.520
INDIANA	551	3.469	15.508	18.977	2.635	0.000	21.612
INDIANA	552	2.519	11.261	13.780	1.913	0.000	15.693
INDIANA	553	3.984	17.814	21.798	3.027	0.000	24.825
INDIANA	555	4.631	20.068	24.700	3.518	0.638	28.856
INDIANA	556	3.946	17.643	21.589	2.998	0.000	24.586
INDIANA	558	3.970	17.750	21.721	3.016	0.000	24.737
INDIANA	560	5.649	22.582	28.231	4.291	2.672	35.194

APPENDIX III

USDA/RURAL ELECTRIFICATION ADMINISTRATION

J3077 MAY 31, 1983

BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
IOWA	503	3.560	15.685	19.245	2.934	0.000	22.178
IOWA	506	3.617	15.940	19.557	2.981	0.000	22.538
IOWA	507	3.624	15.967	19.590	2.986	0.000	22.577
IOWA	508	2.918	12.857	15.775	2.405	0.000	18.180
IOWA	510	3.104	13.678	16.782	2.558	0.000	19.340
IOWA	511	2.849	12.552	15.401	2.348	0.000	17.749
IOWA	515	2.914	12.839	15.753	2.401	0.000	18.154
IOWA	519	3.063	13.499	16.562	2.525	0.000	19.087
IOWA	520	3.708	16.337	20.044	3.056	0.000	23.100
IOWA	521	2.839	12.510	15.348	2.340	0.000	17.688
IOWA	522	3.850	16.966	20.817	3.173	0.000	23.990
IOWA	523	3.318	14.622	17.941	2.735	0.000	20.676
IOWA	524	3.434	15.130	18.563	2.830	0.000	21.393
IOWA	528	4.337	19.061	23.398	3.574	0.049	27.022
IOWA	535	3.106	13.687	16.794	2.560	0.000	19.354
IOWA	536	3.019	13.304	16.324	2.488	0.000	18.812
IOWA	541	3.209	14.141	17.350	2.645	0.000	19.995
IOWA	542	3.563	15.698	19.260	2.936	0.000	22.197
IOWA	555	3.654	16.099	19.753	3.011	0.000	22.764
IOWA	556	5.579	22.049	27.628	4.598	2.532	34.758
IOWA	558	3.494	15.395	18.888	2.879	0.000	21.768
IOWA	560	3.588	15.809	19.397	2.957	0.000	22.354
IOWA	562	3.739	16.477	20.217	3.082	0.000	23.299
IOWA	563	3.325	14.652	17.977	2.740	0.000	20.718
IOWA	565	4.552	19.578	24.130	3.751	0.479	28.360
IOWA	566	3.443	15.173	18.616	2.838	0.000	21.454
IOWA	568	3.151	13.886	17.038	2.597	0.000	19.635
IOWA	570	2.962	13.051	16.013	2.441	0.000	18.454
IOWA	571	3.516	15.492	19.008	2.898	0.000	21.906
IOWA	574	3.546	15.627	19.173	2.923	0.000	22.096
IOWA	575	3.634	16.011	19.645	2.995	0.000	22.640
IOWA	578	3.613	15.921	19.534	2.978	0.000	22.512
IOWA	579	3.617	15.938	19.555	2.981	0.000	22.535
IOWA	582	3.326	14.655	17.981	2.741	0.000	20.722
IOWA	583	3.052	13.448	16.500	2.515	0.000	19.015
IOWA	584	3.192	14.065	17.258	2.631	0.000	19.888
IOWA	585	3.524	15.530	19.054	2.905	0.000	21.959
IOWA	586	4.122	18.165	22.288	3.398	0.000	25.685
IOWA	587	3.910	17.229	21.139	3.223	0.000	24.362
IOWA	589	2.370	10.443	12.813	1.953	0.000	14.766
IOWA	591	3.688	16.253	19.941	3.040	0.000	22.981
IOWA	592	3.209	14.139	17.[illegible]	2.645	0.000	19.993
IOWA	593	3.158	13.917	17.[illegible]	2.603	0.000	19.678
IOWA	594	2.946	12.980	15.926	2.428	0.000	18.354

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
IOWA	596	3.578	15.766	19.343	2.949	0.000	22.292
IOWA	597	3.276	14.436	17.712	2.700	0.000	20.412
IOWA	599	2.904	12.798	15.702	2.394	0.000	18.096
IOWA	601	2.950	13.001	15.951	2.432	0.000	18.383
IOWA	602	4.784	20.137	24.921	3.943	0.943	29.807
IOWA	603	3.363	14.819	18.182	2.772	0.000	20.954
IOWA	604	3.123	13.760	16.883	2.574	0.000	19.457
IOWA	605	4.054	17.863	21.917	3.341	0.000	25.258
IOWA	606	3.814	16.805	20.619	3.143	0.000	23.762
IOWA	607	3.362	14.813	18.175	2.771	0.000	20.946
IOWA	608	2.980	13.130	16.110	2.456	0.000	18.565
IOWA	609	3.463	15.260	18.723	2.854	0.000	21.577
IOWA	610	4.278	18.849	23.127	3.525	0.000	26.652
IOWA	611	3.219	14.186	17.405	2.653	0.000	20.058
IOWA	613	2.992	13.183	16.175	2.466	0.000	18.640
IOWA	614	3.571	15.733	19.304	2.943	0.000	22.246
IOWA	615	5.624	22.158	27.782	4.635	2.623	35.040
IOWA	616	4.067	17.922	21.990	3.352	0.000	25.342
IOWA	619	3.275	14.430	17.704	2.699	0.000	20.403
IOWA	620	7.500	27.063	34.563	6.689	9.317	50.569
IOWA	622	3.307	14.574	17.882	2.726	0.000	20.607
IOWA	623	3.232	14.243	17.475	2.664	0.000	20.139
IOWA	625	3.874	17.069	20.943	3.193	0.000	24.136
IOWA	626	3.994	17.598	21.592	3.291	0.000	24.883
IOWA	632	3.552	15.652	19.205	2.928	0.000	22.132
IOWA	633	4.011	17.675	21.686	3.306	0.000	24.991
IOWA	634	4.297	18.935	23.233	3.542	0.000	26.774
IOWA	635	3.258	14.356	17.614	2.685	0.000	20.299
IOWA	636	3.553	15.658	19.211	2.929	0.000	22.140
IOWA	637	4.528	19.522	24.051	3.732	0.432	28.215
IOWA	638	3.508	15.455	18.963	2.891	0.000	21.854
IOWA	640	3.239	14.271	17.510	2.669	0.000	20.179
IOWA	643	4.427	19.279	23.706	3.649	0.230	27.585
IOWA	644	4.321	19.024	23.345	3.562	0.018	26.925
IOWA	645	2.915	12.844	15.759	2.402	0.000	18.161
IOWA	647	3.466	15.271	18.737	2.856	0.000	21.593

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
KENTUCKY	505	3.685	16.755	20.441	2.520	0.000	22.960
KENTUCKY	506	3.193	14.517	17.710	2.183	0.000	19.894
KENTUCKY	514	3.205	14.571	17.776	2.191	0.000	19.968
KENTUCKY	515	3.053	13.883	16.936	2.088	0.000	19.024
KENTUCKY	522	3.264	14.841	18.105	2.232	0.000	20.337
KENTUCKY	524	3.757	17.080	20.837	2.569	0.000	23.406
KENTUCKY	525	3.515	15.981	19.496	2.403	0.000	21.900
KENTUCKY	528	5.430	22.454	27.884	3.713	2.235	33.832
KENTUCKY	530	3.228	14.679	17.907	2.208	0.000	20.115
KENTUCKY	531	3.849	17.502	21.352	2.632	0.000	23.984
KENTUCKY	532	3.565	16.208	19.773	2.438	0.000	22.210
KENTUCKY	534	3.451	15.692	19.144	2.360	0.000	21.504
KENTUCKY	536	3.633	16.518	20.151	2.484	0.000	22.635
KENTUCKY	540	3.074	13.978	17.052	2.102	0.000	19.154
KENTUCKY	541	3.041	13.825	16.866	2.079	0.000	18.945
KENTUCKY	542	4.365	19.743	24.108	2.985	0.106	27.199
LOUISIANA	501	5.797	22.932	28.729	4.422	2.970	36.120
LOUISIANA	502	4.590	19.951	24.541	3.501	0.554	28.596
LOUISIANA	503	5.546	22.311	27.856	4.230	2.466	34.552
LOUISIANA	506	7.500	30.890	38.390	7.789	17.449	63.628
LOUISIANA	507	7.500	26.546	34.046	5.726	7.004	46.777
LOUISIANA	509	4.214	18.829	23.044	3.214	0.000	26.258
LOUISIANA	510	5.934	23.270	29.204	4.526	3.244	36.974
LOUISIANA	511	3.968	17.727	21.695	3.026	0.000	24.721
LOUISIANA	513	4.165	18.609	22.775	3.177	0.000	25.951
LOUISIANA	514	3.938	17.594	21.532	3.003	0.000	24.535
LOUISIANA	515	7.500	31.133	38.633	7.916	18.113	64.661
LOUISIANA	518	3.417	15.265	18.682	2.606	0.000	21.288
LOUISIANA	521	4.951	20.844	25.795	3.776	1.277	30.848
LOUISIANA	522	5.788	22.908	28.696	4.414	2.951	36.062
LOUISIANA	525	6.825	25.139	31.964	5.206	5.356	42.526
LOUISIANA	526	6.221	23.889	30.110	4.745	3.905	38.760
LOUISIANA	527	4.943	20.824	25.767	3.770	1.261	30.798
LOUISIANA	529	4.297	19.200	23.497	3.278	0.000	26.775
LOUISIANA	530	4.674	20.160	24.835	3.565	0.724	29.123

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
MAINE	505	5.066	19.724	24.790	5.266	1.507	31.563
MAINE	506	6.049	21.858	27.907	6.200	3.492	37.600
MAINE	511	5.117	19.836	24.952	5.319	1.609	31.880
MAINE	512	3.763	15.772	19.536	3.912	0.000	23.448
MAINE	518	4.787	19.113	23.901	4.977	0.949	29.827
MAINE	524	7.283	24.068	31.351	7.571	6.454	45.377
MAINE	525	2.745	11.503	14.248	2.854	0.000	17.102
MAINE	526	4.132	17.317	21.450	4.296	0.000	25.745
MAINE	527	3.676	15.408	19.084	3.022	0.000	22.106
MAINE	528	4.093	17.155	21.248	4.255	0.000	25.504
MARYLAND	501	4.601	17.616	22.217	5.872	0.577	28.666

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
MICHIGAN	508	3.002	13.099	16.101	2.605	0.000	18.706
MICHIGAN	511	2.817	12.289	15.105	2.444	0.000	17.549
MICHIGAN	512	3.911	17.063	20.973	3.393	0.000	24.366
MICHIGAN	518	3.659	15.962	19.621	3.174	0.000	22.795
MICHIGAN	520	3.151	13.749	16.901	2.734	0.000	19.635
MICHIGAN	521	3.904	17.031	20.935	3.387	0.000	24.322
MICHIGAN	523	3.456	15.077	18.532	2.998	0.000	21.531
MICHIGAN	524	3.496	15.254	18.750	3.033	0.000	21.783
MICHIGAN	527	3.772	16.457	20.229	3.273	0.000	23.502
MICHIGAN	529	3.929	17.142	21.071	3.409	0.000	24.480
MICHIGAN	531	6.716	24.209	30.925	5.827	5.094	41.845
MICHIGAN	532	4.498	19.254	23.752	3.902	0.371	28.025
MICHIGAN	533	3.612	15.758	19.370	3.134	0.000	22.504
MICHIGAN	536	5.016	20.477	25.493	4.352	1.407	31.251
MICHIGAN	537	4.316	18.822	23.138	3.744	0.006	26.888
MICHIGAN	539	5.515	21.656	27.171	4.785	2.405	34.360
MICHIGAN	540	4.926	20.265	25.191	4.274	1.227	30.692
MICHIGAN	543	6.419	23.625	30.044	5.569	4.381	39.994
MICHIGAN	544	7.500	27.207	34.787	7.361	10.718	52.866
MICHIGAN	545	6.848	24.468	31.316	5.941	5.411	42.669
MICHIGAN	546	7.500	29.305	36.805	8.543	15.942	61.290
MICHIGAN	548	4.037	17.614	21.651	3.503	0.000	25.153
MICHIGAN	551	7.096	24.954	32.049	6.156	6.005	44.210
MICHIGAN	553	2.280	9.947	12.227	1.978	0.000	14.205
MICHIGAN	555	3.591	15.668	19.259	3.116	0.000	22.374
MICHIGAN	556	3.270	14.268	17.539	2.837	0.000	20.376
MICHIGAN	557	3.640	15.880	19.519	3.158	0.000	22.677
MICHIGAN	558	3.087	13.467	16.554	2.678	0.000	19.232

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM ECA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
MINNESOTA	501	3.513	15.562	19.075	2.812	0.000	21.887
MINNESOTA	505	4.764	20.201	24.965	3.814	0.903	29.681
MINNESOTA	508	2.899	12.844	15.743	2.321	0.000	18.064
MINNESOTA	512	2.720	12.051	14.771	2.178	0.000	16.949
MINNESOTA	513	4.456	19.453	23.909	3.567	0.287	27.763
MINNESOTA	515	3.259	14.437	17.696	2.609	0.000	20.305
MINNESOTA	516	3.432	15.202	18.634	2.747	0.000	21.382
MINNESOTA	520	4.605	19.814	24.418	3.686	0.584	28.689
MINNESOTA	525	4.956	20.667	25.623	3.967	1.287	30.877
MINNESOTA	526	6.461	24.141	30.602	5.173	4.482	40.256
MINNESOTA	537	4.196	18.588	22.784	3.359	0.000	26.143
MINNESOTA	540	3.397	15.049	18.447	2.720	0.000	21.166
MINNESOTA	541	4.213	18.664	22.877	3.373	0.000	26.250
MINNESOTA	542	5.323	21.560	26.883	4.262	2.021	33.166
MINNESOTA	547	3.046	13.494	16.541	2.439	0.000	18.979
MINNESOTA	549	6.387	23.991	30.379	5.114	4.305	39.797
MINNESOTA	552	2.620	11.608	14.229	2.098	0.000	16.326
MINNESOTA	555	4.245	18.805	23.051	3.399	0.000	26.449
MINNESOTA	558	2.769	12.265	15.034	2.217	0.000	17.250
MINNESOTA	559	3.679	16.299	19.978	2.946	0.000	22.924
MINNESOTA	561	5.354	21.634	26.988	4.286	2.082	33.356
MINNESOTA	562	3.590	15.904	19.494	2.874	0.000	22.368
MINNESOTA	563	4.259	18.865	23.123	3.409	0.000	26.533
MINNESOTA	564	2.922	12.942	15.864	2.339	0.000	18.203
MINNESOTA	565	3.511	15.554	19.065	2.811	0.000	21.876
MINNESOTA	571	3.052	13.520	16.572	2.443	0.000	19.015
MINNESOTA	573	4.877	20.475	25.352	3.904	1.128	30.385
MINNESOTA	575	3.178	14.076	17.254	2.544	0.000	19.798
MINNESOTA	577	5.588	22.204	27.792	4.474	2.551	34.816
MINNESOTA	582	3.124	13.839	16.963	2.501	0.000	19.464
MINNESOTA	583	3.636	16.109	19.746	2.911	0.000	22.657
MINNESOTA	585	3.030	13.424	16.454	2.426	0.000	18.880
MINNESOTA	586	2.539	11.248	13.787	2.033	0.000	15.820
MINNESOTA	589	3.093	13.704	16.797	2.476	0.000	19.273
MINNESOTA	591	3.356	14.868	18.224	2.687	0.000	20.911
MINNESOTA	592	2.569	11.380	13.949	2.057	0.000	16.006
MINNESOTA	594	4.693	20.028	24.720	3.757	0.760	29.238
MINNESOTA	595	3.455	15.306	18.761	2.766	0.000	21.527
MINNESOTA	597	3.320	14.706	18.026	2.658	0.000	20.684
MINNESOTA	598	3.907	17.307	21.213	3.128	0.000	24.341
MINNESOTA	599	3.106	13.761	16.867	2.487	0.000	19.354
MINNESOTA	600	3.921	17.370	21.[illegible]2	3.139	0.000	24.431
MINNESOTA	6[illegible]	2.970	13.191	16[illegible]9	2.364	0.000	18.554
MINNESOTA	602	1.990	8.815	10.[illegible]	1.593	0.000	12.[illegible]

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
MINNESOTA	603	2.692	11.923	14.615	2.155	0.000	16.770
MINNESOTA	604	3.040	13.466	16.506	2.434	0.000	18.940
MINNESOTA	605	3.203	14.189	17.392	2.564	0.000	19.957
MINNESOTA	606	2.841	12.584	15.425	2.274	0.000	17.699
MINNESOTA	608	5.999	23.203	29.203	4.003	3.374	37.380
MINNESOTA	610	3.766	16.684	20.451	3.015	0.000	23.466
MINNESOTA	611	5.064	20.931	25.996	4.054	1.504	31.554
MINNESOTA	612	4.382	19.274	23.657	3.509	0.140	27.305
MINNESOTA	613	4.153	18.399	22.552	3.325	0.000	25.877
MINNESOTA	614	3.597	15.935	19.532	2.880	0.000	22.411
MINNESOTA	615	3.700	16.390	20.089	2.962	0.000	23.051
MINNESOTA	616	5.805	22.731	28.537	4.648	2.985	36.170
MINNESOTA	617	3.761	16.660	20.421	3.011	0.000	23.432
MINNESOTA	618	6.035	23.275	29.310	4.031	3.458	37.600
MINNESOTA	619	2.664	11.801	14.465	2.133	0.000	16.598
MINNESOTA	620	6.329	23.873	30.202	5.067	4.165	39.433
MINNESOTA	621	3.817	16.909	20.726	3.056	0.000	23.782
MINNESOTA	622	4.602	19.808	24.410	3.684	0.579	28.673
MINNESOTA	623	3.083	13.655	16.738	2.468	0.000	19.206
MISSISSIPPI	501	3.746	16.935	20.681	2.657	0.000	23.338
MISSISSIPPI	503	3.726	16.845	20.570	2.643	0.000	23.213
MISSISSIPPI	504	3.692	16.692	20.384	2.619	0.000	23.003
MISSISSIPPI	505	5.377	22.180	27.557	3.014	2.129	32.700
MISSISSIPPI	506	4.817	20.769	25.586	3.417	1.009	30.012
MISSISSIPPI	508	3.696	16.708	20.403	2.622	0.000	23.025
MISSISSIPPI	510	4.578	20.168	24.746	3.248	0.532	28.526
MISSISSIPPI	516	3.300	14.922	18.222	2.341	0.000	20.564
MISSISSIPPI	518	3.545	16.027	19.571	2.515	0.000	22.086
MISSISSIPPI	519	5.424	22.299	27.722	3.848	2.222	33.792
MISSISSIPPI	521	2.979	13.469	16.448	2.113	0.000	18.561
MISSISSIPPI	529	2.477	11.197	13.674	1.757	0.000	15.431
MISSISSIPPI	530	3.376	15.264	18.640	2.395	0.000	21.035
MISSISSIPPI	531	5.073	21.414	26.487	3.599	1.521	31.606
MISSISSIPPI	532	5.830	23.324	29.154	4.136	3.036	36.326
MISSISSIPPI	533	4.454	19.853	24.307	3.159	0.282	27.749

APPENDIX III

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM ECA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
MISSOURI	505	4.245	17.659	21.904	4.544	0.000	26.448
MISSOURI	512	4.437	18.209	22.647	4.750	0.249	27.646
MISSOURI	521	4.922	19.256	24.178	5.269	1.219	30.667
MISSOURI	533	4.165	17.328	21.494	4.459	0.000	25.953
MISSOURI	534	3.889	16.180	20.070	4.164	0.000	24.234
MISSOURI	535	3.994	16.615	20.610	4.276	0.000	24.886
MISSOURI	536	3.443	14.321	17.763	3.685	0.000	21.449
MISSOURI	538	3.442	14.321	17.763	3.685	0.000	21.448
MISSOURI	545	3.468	14.427	17.895	3.713	0.000	21.608
MISSOURI	554	5.054	19.541	24.595	5.410	1.483	31.488
MISSOURI	556	4.312	17.938	22.249	4.616	0.000	26.865
MISSOURI	558	5.666	20.863	26.529	6.065	2.707	35.301
MISSOURI	568	3.735	15.538	19.273	3.999	0.000	23.272
MISSOURI	580	6.492	22.451	28.943	6.950	4.556	40.449
MISSOURI	583	4.175	17.369	21.544	4.470	0.000	26.014
MISSOURI	591	7.238	23.764	31.002	7.748	6.346	45.096
MISSOURI	592	4.759	18.905	23.664	5.095	0.893	29.652
MISSOURI	594	4.643	18.653	23.296	4.970	0.660	28.927
MISSOURI	596	4.802	18.997	23.798	5.140	0.978	29.917
MISSOURI	597	3.599	14.974	18.573	3.853	0.000	22.427
MISSOURI	598	5.845	21.251	27.097	6.250	3.066	36.420
MISSOURI	599	3.719	15.472	19.191	3.981	0.000	23.172
MISSOURI	602	3.872	16.106	19.978	4.145	0.000	24.122
NEW HAMPSHIRE	502	7.500	26.193	33.693	12.936	18.256	64.885
NEW HAMPSHIRE	503	4.000	15.986	19.994	4.979	0.000	24.972
NEW HAMPSHIRE	504	6.428	21.235	27.662	7.984	4.402	40.048
NEW HAMPSHIRE	505	5.949	20.454	26.403	7.390	3.273	37.065
NEW HAMPSHIRE	507	7.500	23.259	30.759	9.652	8.001	48.412
NEW JERSEY	501	7.500	20.376	27.876	12.350	7.713	47.939
NEW JERSEY	502	6.882	19.459	26.341	11.047	5.492	42.880
NEW JERSEY	503	6.521	19.016	25.537	10.467	4.625	40.628

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
NEW MEXICO	501	7.500	27.482	34.982	11.366	17.754	64.101
NEW MEXICO	502	7.500	26.032	33.532	10.806	12.092	56.431
NEW MEXICO	504	7.500	25.457	32.957	9.527	11.242	53.725
NEW MEXICO	512	7.500	31.957	39.457	15.759	33.656	88.872
NEW MEXICO	517	5.661	20.659	26.319	6.254	2.697	35.270
NEW MEXICO	519	7.500	25.618	33.118	9.661	11.704	54.482
NEW MEXICO	520	7.500	28.947	36.447	12.805	22.960	72.213
NEW MEXICO	521	7.500	35.490	42.990	19.226	46.210	108.426
NEW YORK	501	6.291	23.148	29.439	5.685	4.074	39.198
NEW YORK	506	2.193	9.490	11.683	1.982	0.000	13.665
NEW YORK	510	5.896	22.343	28.239	5.327	3.166	36.733
NEW YORK	511	5.407	21.206	26.613	4.886	2.189	33.687
NEW YORK	512	5.680	21.842	27.522	5.133	2.735	35.391
NEW YORK	521	4.280	18.519	22.798	3.867	0.000	26.666
NEW YORK	525	4.672	19.496	24.168	4.222	0.719	29.109
NEW YORK	527	5.830	22.190	28.020	5.268	3.034	36.322
NEW YORK	528	4.815	19.830	24.645	4.351	1.006	30.002
NEW YORK	529	5.140	20.584	25.724	4.644	1.654	32.023
NEW YORK	530	5.218	20.767	25.985	4.715	1.811	32.512
NEW YORK	531	3.457	14.956	18.413	3.123	0.000	21.536
NEW YORK	533	3.460	14.971	18.431	3.127	0.000	21.558
NEW YORK	534	5.131	20.563	25.694	4.636	1.636	31.966
NEW YORK	535	4.049	17.519	21.568	3.659	0.000	25.226
NEW YORK	536	4.867	19.951	24.818	4.398	1.110	30.326
NEW YORK	537	5.048	20.371	25.419	4.561	1.471	31.451
NEW YORK	538	3.483	15.069	18.552	3.147	0.000	21.699
NEW YORK	539	7.500	26.153	33.653	7.177	8.657	49.487
NEW YORK	540	6.357	23.275	29.632	5.745	4.233	39.610
NEW YORK	541	5.862	22.265	28.127	5.297	3.099	36.523
NEW YORK	543	6.294	23.152	29.446	5.687	4.080	39.214
NEW YORK	544	4.167	18.031	22.198	3.766	0.000	25.964
NEW YORK	545	4.908	20.046	24.954	4.435	1.191	30.580
NEW YORK	546	3.732	16.149	19.881	3.373	0.000	23.254
NEW YORK	548	2.938	12.713	15.651	2.655	0.000	18.306
NEW YORK	549	6.409	23.374	29.783	5.791	4.356	39.930
NEW YORK	550	4.696	19.551	24.246	4.243	0.766	29.256

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
NORTH CAROLINA	501	4.879	20.846	25.725	3.541	1.133	30.400
NORTH CAROLINA	508	4.108	18.504	22.612	2.981	0.000	25.593
NORTH CAROLINA	509	2.946	13.272	16.218	2.138	0.000	18.356
NORTH CAROLINA	510	4.017	18.097	22.114	2.916	0.000	25.030
NORTH CAROLINA	513	2.686	12.102	14.788	1.950	0.000	16.738
NORTH CAROLINA	518	2.792	12.578	15.371	2.026	0.000	17.397
NORTH CAROLINA	520	5.444	22.262	27.707	3.951	2.264	33.922
NORTH CAROLINA	521	2.924	13.174	16.098	2.122	0.000	18.221
NORTH CAROLINA	522	3.431	15.456	18.888	2.490	0.000	21.378
NORTH CAROLINA	523	2.948	13.279	16.226	2.139	0.000	18.365
NORTH CAROLINA	529	2.431	10.949	13.380	1.764	0.000	15.144
NORTH CAROLINA	531	3.005	13.537	16.542	2.181	0.000	18.723
NORTH CAROLINA	534	3.672	16.539	20.211	2.665	0.000	22.876
NORTH CAROLINA	535	3.289	14.818	18.107	2.387	0.000	20.495
NORTH CAROLINA	538	6.068	23.796	29.864	4.404	3.537	37.806
NORTH CAROLINA	539	4.182	18.837	23.019	3.035	0.000	26.053
NORTH CAROLINA	540	2.105	9.401	11.506	1.527	0.000	13.033
NORTH CAROLINA	543	4.961	21.051	26.011	3.600	1.297	30.908
NORTH CAROLINA	545	4.628	20.216	24.844	3.359	0.630	28.833
NORTH DAKOTA	515	7.500	30.930	38.430	8.426	18.663	65.519
NORTH DAKOTA	519	5.587	22.198	27.785	4.477	2.549	34.810
NORTH DAKOTA	521	7.192	25.620	32.812	5.763	6.237	44.812
NORTH DAKOTA	522	3.971	17.590	21.562	3.182	0.000	24.744
NORTH DAKOTA	524	5.824	22.774	28.599	4.667	3.024	36.288
NORTH DAKOTA	525	6.253	23.715	29.968	5.010	3.983	38.962
NORTH DAKOTA	526	4.944	20.636	25.581	3.962	1.264	30.806
NORTH DAKOTA	527	5.095	21.003	26.098	4.083	1.566	31.747
NORTH DAKOTA	528	5.097	21.008	26.106	4.084	1.570	31.760
NORTH DAKOTA	529	4.956	20.665	25.621	3.971	1.287	30.879
NORTH DAKOTA	533	7.336	25.912	33.248	5.878	6.581	45.707
NORTH DAKOTA	534	7.166	25.566	32.732	5.741	6.173	44.646
NORTH DAKOTA	535	6.583	24.385	30.968	5.275	4.775	41.018

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. L. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM ECA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
HIU	503	2.330	10.158	12.488	2.029	0.000	14.517
HIU	504	3.685	16.064	19.749	3.209	0.000	22.959
HIU	509	2.212	9.644	11.856	1.926	0.000	13.782
HIU	510	2.683	11.698	14.381	2.337	0.000	16.718
HIU	512	2.257	9.841	12.099	1.966	0.000	14.065
HIU	513	2.942	12.825	15.766	2.562	0.000	18.328
HIU	515	3.123	13.615	16.738	2.720	0.000	19.458
HIU	517	5.201	20.897	26.098	4.530	1.777	32.404
HIU	519	4.292	18.713	23.006	3.738	0.000	26.744
HIU	521	3.177	13.852	17.029	2.767	0.000	19.796
HIU	522	4.241	18.488	22.729	3.693	0.000	26.422
HIU	526	3.821	16.658	20.478	3.328	0.000	23.806
HIU	527	3.433	14.969	18.402	2.990	0.000	21.392
HIU	528	2.621	11.428	14.049	2.283	0.000	16.332

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APPENDIX III

USDA/RURAL ELECTRIFICATION ADMINISTRATION

J3077 MAY 31, 1983

BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM ECA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
OKLAHOMA	510	6.418	21.934	28.352	7.256	4.377	39.985
OKLAHOMA	517	5.986	21.196	27.182	6.769	3.148	37.099
OKLAHOMA	518	3.933	16.123	20.056	4.446	0.000	24.502
OKLAHOMA	530	7.500	28.347	35.847	12.795	21.866	70.508
OKLAHOMA	532	7.500	24.102	31.602	8.765	7.933	48.300
OKLAHOMA	533	6.377	21.864	28.241	7.210	4.279	39.730
OKLAHOMA	534	5.967	21.155	27.123	6.747	3.309	37.179
OKLAHOMA	535	4.961	19.043	24.004	5.609	1.297	30.910
OKLAHOMA	536	7.500	25.940	33.440	10.364	13.306	57.109
OKLAHOMA	538	5.318	19.792	25.109	6.013	2.010	33.132
OKLAHOMA	540	3.878	15.898	19.776	4.384	0.000	24.160
OKLAHOMA	541	7.500	24.046	31.546	8.717	7.770	48.033
OKLAHOMA	542	3.844	15.759	19.602	4.346	0.000	23.948
OKLAHOMA	543	4.975	19.073	24.048	5.626	1.326	31.000
OKLAHOMA	544	5.036	19.201	24.237	5.694	1.448	31.379
OKLAHOMA	545	6.443	21.978	28.421	7.285	4.439	40.145
OKLAHOMA	547	5.773	20.748	26.521	6.527	2.921	35.969
OKLAHOMA	548	4.298	17.619	21.917	4.859	0.000	26.776
OKLAHOMA	549	4.168	17.089	21.257	4.713	0.000	25.970
OKLAHOMA	550	4.334	17.726	22.061	4.901	0.044	27.005
OKLAHOMA	551	7.500	27.221	34.721	11.638	17.772	64.131
OKLAHOMA	553	3.339	13.688	17.027	3.775	0.000	20.802
OKLAHOMA	554	4.056	18.021	23.677	5.490	1.086	30.253
OKLAHOMA	555	3.906	16.014	19.920	4.416	0.000	24.317
OKLAHOMA	556	7.500	24.173	31.673	8.827	8.140	48.640
OKLAHOMA	557	4.272	17.515	21.788	4.830	0.000	26.618
OKLAHOMA	558	7.500	24.154	31.654	8.810	8.085	48.549
OKLAHOMA	559	5.417	20.000	25.417	6.125	2.209	33.750
OKLAHOMA	560	4.669	18.429	23.098	5.279	0.713	29.090
OKLAHOMA	561	5.971	21.163	27.134	6.751	3.317	37.202
OKLAHOMA	562	5.342	19.844	25.186	6.041	2.060	33.286
OKLAHOMA	563	5.572	20.326	25.899	6.300	2.520	34.719

APPENDIX III

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J3077 MAY 11, 1983

BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
PENNSYLVANIA	505	3.823	16.898	20.721	3.100	0.000	23.821
PENNSYLVANIA	510	2.910	12.863	15.773	2.360	0.000	18.134
PENNSYLVANIA	512	3.551	15.694	19.245	2.880	0.000	22.125
PENNSYLVANIA	516	4.121	18.214	22.335	3.342	0.000	25.677
PENNSYLVANIA	518	3.840	16.970	20.810	3.114	0.000	23.924
PENNSYLVANIA	519	4.150	18.340	22.489	3.365	0.000	25.855
PENNSYLVANIA	522	5.750	22.538	28.288	4.663	2.875	35.827
PENNSYLVANIA	523	2.906	12.842	15.748	2.356	0.000	18.104
PENNSYLVANIA	524	6.946	25.052	31.998	5.632	5.645	43.275
PENNSYLVANIA	525	4.484	19.474	23.958	3.636	0.343	27.937
PENNSYLVANIA	528	4.555	19.645	24.200	3.694	0.484	28.378
PENNSYLVANIA	529	3.835	16.948	20.783	3.110	0.000	23.893
PENNSYLVANIA	531	3.872	17.113	20.985	3.140	0.000	24.125
PENNSYLVANIA	534	3.460	15.291	18.751	2.806	0.000	21.557
PENNSYLVANIA	536	5.147	21.080	26.227	4.174	1.670	32.072
PENNSYLVANIA	539	3.750	16.575	20.326	3.041	0.000	23.367
PENNSYLVANIA	543	3.136	13.858	16.993	2.543	0.000	19.536
PENNSYLVANIA	544	4.523	19.568	24.091	3.660	0.420	28.171
PENNSYLVANIA	545	4.197	18.550	22.747	3.404	0.000	26.151
PENNSYLVANIA	546	5.324	21.507	26.831	4.318	2.023	33.172
PENNSYLVANIA	547	3.267	14.437	17.703	2.649	0.000	20.352
PENNSYLVANIA	549	3.339	14.757	18.096	2.708	0.000	20.804
PENNSYLVANIA	551	4.274	18.890	23.165	3.466	0.000	26.631
PENNSYLVANIA	552	3.645	16.107	19.752	2.956	0.000	22.708
PENNSYLVANIA	553	6.418	23.986	30.403	5.204	4.377	39.985
PENNSYLVANIA	554	4.420	19.320	23.740	3.584	0.215	27.540
PENNSYLVANIA	555	3.395	15.005	18.401	2.753	0.000	21.154

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
SOUTH CAROLINA	501	4.026	17.857	21.883	3.200	0.000	25.083
SOUTH CAROLINA	502	3.582	15.887	19.468	2.647	0.000	22.115
SOUTH CAROLINA	503	3.357	14.889	18.245	2.668	0.000	20.914
SOUTH CAROLINA	505	4.096	18.170	22.266	3.256	0.000	25.522
SOUTH CAROLINA	506	3.342	14.823	18.164	2.656	0.000	20.821
SOUTH CAROLINA	508	5.504	22.031	27.535	4.375	2.383	34.294
SOUTH CAROLINA	512	4.444	19.450	23.895	3.533	0.264	27.692
SOUTH CAROLINA	514	5.219	21.337	26.557	4.149	1.814	32.519
SOUTH CAROLINA	515	3.488	15.472	18.960	2.773	0.000	21.733
SOUTH CAROLINA	518	5.659	22.409	28.068	4.499	2.694	35.261
SOUTH CAROLINA	519	4.181	18.545	22.726	3.324	0.000	26.050
SOUTH CAROLINA	522	4.036	17.904	21.940	3.209	0.000	25.149
SOUTH CAROLINA	525	4.248	18.843	23.091	3.377	0.000	26.468
SOUTH CAROLINA	526	5.564	22.177	27.741	4.423	2.503	34.667
SOUTH CAROLINA	529	7.500	28.031	35.531	6.807	11.015	53.353
SOUTH CAROLINA	533	6.198	23.641	29.839	4.927	3.850	38.615
SOUTH CAROLINA	534	7.500	29.910	37.410	7.757	15.634	60.801
SOUTH CAROLINA	535	5.842	22.853	28.695	4.644	3.058	36.397
SOUTH CAROLINA	538	5.156	21.184	26.340	4.099	1.688	32.127
SOUTH DAKOTA	508	7.500	28.242	35.742	7.849	12.975	56.566
SOUTH DAKOTA	509	3.515	15.347	18.863	3.039	0.000	21.902
SOUTH DAKOTA	515	3.467	15.138	18.606	2.998	0.000	21.604
SOUTH DAKOTA	516	3.822	16.686	20.508	3.304	0.000	23.812
SOUTH DAKOTA	517	4.340	18.893	23.233	3.752	0.055	27.040
SOUTH DAKOTA	518	3.782	16.514	20.296	3.270	0.000	23.566
SOUTH DAKOTA	519	3.595	15.696	19.291	3.108	0.000	22.399
SOUTH DAKOTA	520	3.539	15.450	18.989	3.060	0.000	22.049
SOUTH DAKOTA	521	3.343	14.597	17.941	2.091	0.000	20.031
SOUTH DAKOTA	522	5.733	22.189	27.923	4.957	2.841	35.721
SOUTH DAKOTA	523	4.564	19.422	23.986	3.945	0.502	28.433
SOUTH DAKOTA	524	4.790	19.959	24.749	4.142	0.956	29.847
SOUTH DAKOTA	525	7.379	25.533	32.912	6.380	6.686	45.978
SOUTH DAKOTA	526	4.096	17.881	21.977	3.541	0.000	25.518
SOUTH DAKOTA	531	6.874	24.539	31.413	5.943	5.473	42.829
SOUTH DAKOTA	532	3.916	17.097	21.013	3.386	0.000	24.399
SOUTH DAKOTA	533	7.500	30.034	37.534	8.946	17.988	64.467
SOUTH DAKOTA	534	7.421	25.627	33.054	6.421	6.800	46.276
SOUTH DAKOTA	535	3.722	16.251	19.973	3.218	0.000	23.191
SOUTH DAKOTA	536	5.220	20.976	26.196	4.513	1.816	32.525
SOUTH DAKOTA	5[illegible]	3.876	16.923	20.800	3.351	0.000	24.151

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
TENNESSEE	501	3.185	14.275	17.460	2.382	0.000	19.842
TENNESSEE	502	3.594	16.112	19.707	2.688	0.000	22.395
TENNESSEE	503	3.311	14.841	18.152	2.476	0.000	20.628
TENNESSEE	510	4.368	19.469	23.837	3.267	0.111	27.216
TENNESSEE	513	2.952	13.231	16.182	2.208	0.000	18.390
TENNESSEE	514	3.631	16.275	19.905	2.715	0.000	22.621
TENNESSEE	517	2.991	13.408	16.400	2.237	0.000	18.637
TENNESSEE	521	3.659	16.404	20.063	2.737	0.000	22.800
TENNESSEE	525	5.246	21.649	26.895	3.924	1.867	32.686
TENNESSEE	528	3.351	15.023	18.374	2.506	0.000	20.880
TENNESSEE	530	5.616	22.566	28.182	4.200	2.606	34.988
TENNESSEE	544	3.892	17.445	21.337	2.911	0.000	24.247
TENNESSEE	545	3.263	14.628	17.892	2.441	0.000	20.332
TENNESSEE	547	3.598	16.127	19.725	2.691	0.000	22.416
TENNESSEE	548	3.820	17.124	20.944	2.857	0.000	23.801
TENNESSEE	550	2.577	11.550	14.126	1.927	0.000	16.053
TENNESSEE	554	3.369	15.102	18.471	2.520	0.000	20.991
TENNESSEE	555	2.432	10.900	13.331	1.819	0.000	15.150
TENNESSEE	557	3.532	15.833	19.365	2.642	0.000	22.007
TENNESSEE	560	3.399	15.237	18.636	2.542	0.000	21.178
TENNESSEE	561	4.993	21.020	26.013	3.734	1.361	31.108

APPENDIX III

USDA/RURAL ELECTRIFICATION ADMINISTRATION

J3077 MAY 31, 1983

BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
TEXAS	506	7.500	32.093	39.593	11.288	25.882	76.763
TEXAS	507	7.500	33.218	40.718	12.072	29.306	82.096
TEXAS	510	4.430	18.879	23.309	4.059	0.236	27.604
TEXAS	511	5.795	22.037	27.832	5.309	2.965	36.107
TEXAS	517	7.347	25.089	32.435	6.731	6.607	45.773
TEXAS	522	7.500	28.208	35.708	8.635	14.381	58.724
TEXAS	528	7.500	25.452	32.952	6.913	7.148	47.013
TEXAS	530	7.500	29.061	36.561	9.174	16.655	62.391
TEXAS	540	7.500	30.173	37.673	9.949	20.037	67.659
TEXAS	544	5.868	22.206	28.074	5.376	3.111	36.561
TEXAS	549	7.500	26.334	33.834	7.447	9.361	50.642
TEXAS	551	5.788	22.021	27.810	5.303	2.952	36.064
TEXAS	557	5.693	21.801	27.494	5.216	2.761	35.470
TEXAS	558	7.500	25.736	33.236	7.085	7.861	48.182
TEXAS	559	5.656	21.715	27.371	5.182	2.687	35.239
TEXAS	562	7.500	33.698	41.198	12.406	30.764	84.368
TEXAS	563	7.500	26.886	34.386	7.781	10.746	52.913
TEXAS	567	7.500	38.271	45.771	15.594	44.683	106.048
TEXAS	569	7.500	45.638	53.138	20.729	67.104	140.971
TEXAS	572	4.843	19.833	24.675	4.437	1.060	30.172
TEXAS	573	7.467	25.319	32.786	6.841	6.895	46.522
TEXAS	575	6.636	23.728	30.364	6.079	4.901	41.344
TEXAS	576	4.486	19.007	23.493	4.110	0.347	27.949
TEXAS	578	5.927	22.342	28.269	5.430	3.229	36.927
TEXAS	583	7.500	28.520	36.020	8.797	15.005	59.822
TEXAS	587	7.500	26.654	34.154	7.641	10.167	51.962
TEXAS	592	5.940	22.372	28.312	5.442	3.255	37.009
TEXAS	593	7.012	24.448	31.460	6.424	5.804	43.688
TEXAS	594	5.573	21.523	27.096	5.106	2.521	34.724
TEXAS	604	7.500	28.732	36.232	8.945	15.652	60.828
TEXAS	609	6.331	23.145	29.476	5.800	4.170	39.446
TEXAS	611	3.269	14.104	17.373	2.995	0.000	20.368
TEXAS	612	6.398	23.272	29.670	5.861	4.329	39.860
TEXAS	613	6.585	23.631	30.216	6.033	4.779	41.027
TEXAS	615	7.106	24.628	31.734	6.510	6.029	44.274
TEXAS	616	3.183	13.734	16.917	2.916	0.000	19.833
TEXAS	617	6.267	23.023	29.291	5.742	4.017	39.050
TEXAS	618	5.789	22.023	27.812	5.304	2.953	36.069
TEXAS	624	5.796	22.038	27.834	5.310	2.966	36.110
TEXAS	626	7.468	25.321	32.789	6.842	6.898	46.528
TEXAS	627	2.998	12.936	15.934	2.747	0.000	18.681
TEXAS	630	7.500	45.858	53.358	20.882	67.772	142.012
TEXAS	63[illegible]	7.500	29.917	37[illegible]	9.771	19.260	66.[illegible]
TEXAS	63[illegible]	4.150	17.919	22[illegible]	3.838	0.000	25.907

APPENDIX III

USDA/RURAL ELECTRIFICATION ADMINISTRATION

J3077 MAY 31, 1983

BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
TEXAS	634	5.056	20.325	25.381	6.632	1.486	33.499
TEXAS	635	7.500	28.563	36.063	8.827	15.136	60.025
TEXAS	636	7.500	26.499	33.999	7.547	9.776	51.322
TEXAS	637	3.223	13.903	17.126	2.952	0.000	20.078
TEXAS	638	3.566	15.384	18.949	3.267	0.000	22.216
TEXAS	640	7.500	27.019	34.519	7.861	11.081	53.462
TEXAS	642	4.778	19.683	24.462	4.378	0.931	29.771
TEXAS	643	7.500	30.709	38.209	10.323	21.669	70.201
TEXAS	644	7.500	30.937	38.437	10.402	22.363	71.202
TEXAS	647	7.500	27.884	35.384	8.385	13.253	57.022
VERMONT	502	5.219	20.154	25.373	5.332	1.814	32.519
VERMONT	503	7.500	25.184	32.684	8.091	8.571	49.347
VERMONT	504	5.521	20.821	26.342	5.641	2.417	34.400
VERMONT	505	5.169	20.043	25.212	5.281	1.713	32.206
VIRGINIA	503	3.883	17.659	21.542	2.650	0.000	24.192
VIRGINIA	507	4.440	19.938	24.378	3.030	0.255	27.663
VIRGINIA	510	3.947	17.952	21.899	2.694	0.000	24.593
VIRGINIA	511	4.080	18.555	22.635	2.785	0.000	25.419
VIRGINIA	517	4.213	19.162	23.375	2.876	0.000	26.251
VIRGINIA	521	2.931	13.329	16.260	2.000	0.000	18.261
VIRGINIA	522	2.743	12.473	15.216	1.872	0.000	17.088
VIRGINIA	523	2.954	13.435	16.390	2.016	0.000	18.406
VIRGINIA	524	7.500	28.521	36.021	5.660	9.989	51.671
VIRGINIA	525	5.321	22.183	27.504	3.632	2.017	33.153
VIRGINIA	526	4.797	20.848	25.645	3.274	0.969	29.889
WEST VIRGINIA	507	3.155	14.125	17.280	2.375	0.000	19.655
WEST VIRGINIA	513	3.523	15.775	19.298	2.653	0.000	21.951
WEST VIRGINIA	514	3.292	14.740	18.032	2.479	0.000	20.511
WEST VIRGINIA	517	5.099	21.258	26.357	3.839	1.573	31.769
WEST VIRGINIA	518	5.410	22.028	27.438	4.074	2.195	33.706
WEST VIRGINIA	519	3.273	14.657	17.930	2.465	0.000	20.395
WEST VIRGINIA	520	3.387	15.165	18.552	2.550	0.000	21.102
WEST VIRGINIA	522	3.624	16.228	19.853	2.729	0.000	22.582
WEST VIRGINIA	523	3.289	14.727	18.016	2.477	0.000	20.493
WEST VIRGINIA	524	3.936	17.622	21.558	2.963	0.000	24.521

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
WISCONSIN	501	3.683	16.285	19.968	2.978	0.000	22.946
WISCONSIN	502	3.916	17.316	21.232	3.167	0.000	24.399
WISCONSIN	503	4.359	19.181	23.540	3.525	0.093	27.158
WISCONSIN	505	4.195	18.549	22.744	3.392	0.000	26.136
WISCONSIN	507	4.821	20.301	25.122	3.899	1.017	30.038
WISCONSIN	510	3.586	15.857	19.443	2.900	0.000	22.343
WISCONSIN	513	6.064	23.285	29.340	4.903	3.528	37.780
WISCONSIN	519	3.068	13.565	16.633	2.481	0.000	19.113
WISCONSIN	522	4.531	19.597	24.128	3.664	0.436	28.228
WISCONSIN	523	3.183	14.073	17.256	2.574	0.000	19.829
WISCONSIN	525	3.519	15.560	19.079	2.846	0.000	21.924
WISCONSIN	526	5.123	21.032	26.156	4.143	1.621	31.920
WISCONSIN	529	5.109	20.998	26.107	4.131	1.593	31.831
WISCONSIN	531	2.818	12.460	15.278	2.279	0.000	17.557
WISCONSIN	532	3.270	14.460	17.731	2.644	0.000	20.375
WISCONSIN	533	1.942	8.589	10.531	1.571	0.000	12.102
WISCONSIN	534	4.037	17.852	21.889	3.265	0.000	25.154
WISCONSIN	535	3.928	17.368	21.295	3.176	0.000	24.471
WISCONSIN	536	6.916	25.009	31.925	5.593	5.574	43.092
WISCONSIN	538	3.509	15.516	19.025	2.837	0.000	21.862
WISCONSIN	539	3.321	14.684	18.005	2.685	0.000	20.691
WISCONSIN	540	3.243	14.342	17.585	2.623	0.000	20.208
WISCONSIN	545	4.703	20.015	24.718	3.803	0.781	29.302
WISCONSIN	549	4.122	18.225	22.347	3.333	0.000	25.680
WISCONSIN	555	6.324	23.812	30.136	5.114	4.153	39.403
WISCONSIN	558	4.064	17.970	22.034	3.286	0.000	25.320
WISCONSIN	562	3.243	14.341	17.584	2.623	0.000	20.207
WISCONSIN	566	3.982	17.608	21.591	3.220	0.000	24.811
WISCONSIN	567	3.852	17.035	20.887	3.115	0.000	24.003
WISCONSIN	568	3.240	14.326	17.566	2.620	0.000	20.185
WISCONSIN	569	4.293	18.981	23.274	3.471	0.000	26.745
WISCONSIN	570	2.966	13.115	16.081	2.398	0.000	18.479
WISCONSIN	571	4.292	18.980	23.272	3.471	0.000	26.743
WISCONSIN	572	5.924	22.972	28.896	4.791	3.223	36.910
WISCONSIN	573	3.439	15.206	18.645	2.781	0.000	21.425
WISCONSIN	574	3.971	17.557	21.528	3.211	0.000	24.738
WISCONSIN	575	4.035	17.841	21.876	3.263	0.000	25.139
WISCONSIN	576	6.792	24.757	31.548	5.492	5.275	42.315
WISCONSIN	577	3.140	13.886	17.026	2.539	0.000	19.566
WISCONSIN	578	4.378	19.227	23.605	3.540	0.130	27.276
WISCONSIN	579	4.345	19.147	23.492	3.513	0.064	27.070
WISCONSIN	[illegible]	4.770	20.177	[illegible]	3.857	0.915	29.719
WISCONSI[illegible]	[illegible]	3.804	16.820	[illegible]	3.076	0.000	[illegible]
WISCONSI[illegible]	502	5.622	22.241	[illegible]	4.546	2.619	[illegible]

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BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
WISCONSIN	583	3.587	15.860	19.447	2.900	0.000	22.348
WISCONSIN	584	5.850	22.792	28.642	4.730	3.074	36.446
WISCONSIN	586	4.203	18.584	22.787	3.399	0.000	26.185
WISCONSIN	587	7.500	26.440	33.940	6.190	7.563	47.693
WISCONSIN	588	4.194	18.546	22.740	3.392	0.000	26.132
WISCONSIN	589	4.685	19.970	24.655	3.788	0.744	29.187
WISCONSIN	590	3.296	14.572	17.868	2.665	0.000	20.533
WISCONSIN	591	4.256	18.819	23.075	3.442	0.000	26.517
WISCONSIN	592	3.113	13.765	16.878	2.517	0.000	19.395
WISCONSIN	594	4.631	19.840	24.470	3.745	0.636	28.851
WISCONSIN	595	3.361	14.862	18.223	2.718	0.000	20.941
WISCONSIN	596	3.486	15.416	18.902	2.819	0.000	21.721
WISCONSIN	597	4.398	19.276	23.674	3.556	0.171	27.402
WISCONSIN	598	4.081	18.047	22.128	3.300	0.000	25.428
WISCONSIN	600	2.457	10.863	13.320	1.987	0.000	15.307
WISCONSIN	601	5.206	21.232	26.438	4.210	1.786	32.434
WISCONSIN	602	3.524	15.581	19.104	2.849	0.000	21.954
WISCONSIN	603	3.229	14.276	17.505	2.611	0.000	20.115
WISCONSIN	604	2.971	13.140	16.111	2.403	0.000	18.514
WISCONSIN	605	6.763	24.700	31.463	5.469	5.207	42.139
WISCONSIN	606	2.613	11.556	14.169	2.113	0.000	16.282
WISCONSIN	607	5.002	20.739	25.741	4.045	1.379	31.165
WISCONSIN	608	3.283	14.518	17.801	2.655	0.000	20.456
WISCONSIN	609	4.532	19.602	24.134	3.665	0.440	28.239
WISCONSIN	610	5.125	21.036	26.161	4.144	1.624	31.929
WISCONSIN	611	3.781	16.719	20.500	3.058	0.000	23.558
WISCONSIN	612	4.189	18.521	22.710	3.387	0.000	26.097
WISCONSIN	613	3.772	16.680	20.452	3.050	0.000	23.502
WISCONSIN	614	3.774	16.687	20.461	3.052	0.000	23.513
WISCONSIN	615	3.733	16.505	20.238	3.018	0.000	23.256
WISCONSIN	616	3.491	15.438	18.929	2.823	0.000	21.752
WISCONSIN	617	4.178	18.473	22.650	3.378	0.000	26.028
WISCONSIN	619	3.476	15.373	18.849	2.811	0.000	21.660
WISCONSIN	620	5.416	21.741	27.157	4.379	2.206	33.743
WISCONSIN	621	5.071	20.906	25.976	4.100	1.516	31.591
WISCONSIN	622	4.697	20.000	24.697	3.798	0.768	29.263
WISCONSIN	624	4.000	17.688	21.688	3.235	0.000	24.923
WISCONSIN	625	3.967	17.542	21.510	3.208	0.000	24.718
WISCONSIN	626	4.147	18.338	22.485	3.354	0.000	25.838
WISCONSIN	628	7.500	27.879	35.379	6.908	10.934	53.221
WISCONSIN	630	3.546	15.681	19.227	2.868	0.000	22.094
WISCONSIN	631	4.280	18.924	23.2[illegible]	3.461	0.000	26.664
WISCONSIN	63[illegible]	4.134	18.282	22.[illegible]	3.343	0.000	[illegible]5.759
WISCONSIN	633	3.975	17.575	21.[illegible]	3.214	0.000	24.764

APPENDIX III

J3077

USDA/RURAL ELECTRIFICATION ADMINISTRATION

MAY 31, 198[illegible]

BORROWER		031 INTERSTATE ACCESS CHARGE	032 A. C. AND LOCAL RATE	033 MONTHLY SUBSCRIBER BILLING (031 + 032)	034 TRAFFIC SENSITIVE FROM TOLL CARRIER	035 HIGH COST FUND FROM FCA	036 TOTAL REVENUE REQUIREMENT (033+034+035)
WISCONSIN	634	4.696	19.999	24.696	3.798	0.768	29.261
WISCONSIN	636	4.184	18.499	22.683	3.383	0.000	26.066
WISCONSIN	637	4.744	20.114	24.857	3.836	0.862	29.556
WISCONSIN	640	3.804	16.821	20.625	3.076	0.000	23.701
WISCONSIN	641	4.837	20.339	25.175	3.911	1.048	30.135

Ernst & Whinney

1800 First Interstate Plaza
Tacoma, Washington 98402

206/597-7550

May 5, 1983

Mr. Earl Waterland
President
Board of Directors
Golden West Telecommunications
Cooperative, Inc.
P.O. Box 98
Wall, South Dakota 57790

Dear Mr. Waterland:

This letter will address the probable effects of the Joint Board's final recommendations in Docket 80-286 upon Golden West Telecommunications Cooperative, Inc. As the South Dakota Commission has not yet specified what the intrastate jurisdictional separations procedures will be, this letter will focus on the interstate side.

The Joint Board has recommended adoption of a flat 25 percent assignment of non-traffic sensitive costs to interstate, following a five year transition period beginning January 1, 1984. This 25 percent assignment will replace the frozen Subscriber Plant Factor (SPF) which, in Golden West's case, is approximately 42 percent. This means that instead of assigning 42 percent of NTS costs to the interstate jurisdiction, by 1988 only 25 percent of these costs will be considered "interstate."

Golden West's total NTS revenue requirement in 1982 will be approximately $4,126,000, or about $33.50 per line per month. In 1982, 42 percent or $1,732,900 will be assigned to the interstate jurisdiction, 33 percent or $1,358,900 to the intrastate jurisdiction, and the remaining 25 percent, or $1,034,200 will be assigned to local. By the end of the five year transition, the interstate allocation will decrease from $1,732,900 to $1,031,500 (42 percent to 25 percent). This will shift $701,400 in NTS costs away from the interstate jurisdiction. If we assume that the South Dakota Commission will follow the FCC's lead and mandate a flat 25 percent intrastate toll allocation, an additional shift of $327,400 away from the toll jurisdiction would occur.

In addition to specifying the new NTS allocator, the Joint Board has laid out the manner in which the High Cost Factor will operate. Under the proposed methodology, Golden West's NTS cost, after the access charge phase-in period, would be recovered as follows:

Interstate End User (Flat Rate) Monthly Charge	$ 8.38
Intrastate Jurisdiction	19.72
High Cost Factor	5.40
	$33.50

Golden West's current one party residence line access rate is $5.80. If we assume that on the state side, an additional $8.38 of the $19.72 intrastate NTS cost is assigned to the end user, the total NTS cost per month per line shifted to the end user would be $16.76 (Interstate - $8.38; State - $8.38). This would increase the residential single line access rate from $5.80 to approximately $22.50, or an increase of 288 percent. An additional increase could also be expectd as the current $5.80 local rate does not completely cover the portion of the NTS cost per line that is assigned to "local" in the separations process. Based upon AT&T's curtailment study, "Economic and Demographic Determinants of Residential Demand for Basic Telephone Service," a monthly rate increase greater than 200 percent would be expected to produce a decrease in Golden West's subscriber base of more than 24 percent, or more than 2,500 subscribers. However, as subscribers leave the network, the NTS costs would be spread over a shrinking base, necessitating further rate increases. Theoretically, a "worst case" situation would occur when the NTS cost per line per month reached 200 percent of the national average. At this level, no further NTS costs would be assigned to end users. This situation would come about only after Golden West's subscriber base has been reduced to less than 8,600 subscribers.

A decrease of more than 20 percent in Golden West's subscriber base, which according to our analysis is theoretically possible, along with a corresponding decrease in revenue, could have a serious negative impact upon the Cooperative's ability to maintain high quality service. The curtailment problem indicates that the long-term effect of the implementation of Dockets 78-72 and 80-286 may be more than simply a shifting of costs between the toll and local jurisdictions. While AT&T's curtailment estimates may be exaggerated to some degree, it is clear that local rate increases of the magnitude discussed previously will, certainly, convince a significant percentage of Golden West's subscribers to subscribe to a lower grade of service, engage in "shared" telephone service with other subscribers, or even to completely abandon telephone service.

Golden West's decisions regarding REA borrowing were made based upon operating conditions and revenue flows as defined by Ozark separations procedures. A change in conditions as profound as that contemplated by the access charge and Joint Board proceedings could not have been predicted when Golden West's financing decisions were being made. Therefore, a significant loss of subscribers and operating revenues could have serious effects on Golden West's ability to fund construction and repay outstanding loans.

It should be noted that costs which are currently assigned 100 percent to toll are not affected by the Joint Board's decision. Thus, the Golden West/Northwestern Bell microwave project costs will continue to be 100 percent recoverable through settlements. However, Northwestern Bell's intrastate rate of return may be expected to decrease to some degree over the next few years, which could limit the return on that portion of the costs which are assigned intrastate vs. interstate.

Per your request, this analysis has been prepared based on current interpretations of the FCC's access charge docket, and the Joint Board's recommendations in Docket 80-286. The potential effects upon Golden West as a result of these proceedings are estimates and, therefore, subject to change based upon the ultimate outcome of both proceedings.

I hope these comments prove helpful in relation to the potential effects of proposed Federal regulation upon Golden West Telecommunications Cooperative, Inc. It is imperative that the South Dakota Commission evaluate the effects of further local increases on the State's telephone subscribers before making a decision on future intrastate jurisdictional settlements.

Sincerely,

For Daniel A. Lynch

DAL:mds
Copy to Mr. Donald Paulsen

APPENDIX V Pg.1

Additional Monthly End User Charges For Exchange Access

Telephone Company	Present (1)	Proposed: Interstate: HCF (Carrier) (2)	Proposed: Interstate: End User (3)	Proposed: Intrastate Toll (4)	Proposed: Grand Total (5) (1)+(3)+(4)	Increase: Amount (6) (3)+(4)	Increase: Percent Increase (7) (6)vs(1)
Big Bend Telephone Company	$16.21	$49.28	$ 6.74	$ 6.72	$29.67	$13.46	83%
Brazos Telephone Cooperative	5.70	6.51	7.08	20.76	33.54	27.84	488%
Cap Rock Telephone Company	11.14	5.41	6.59	20.18	37.91	26.77	240%
Central Texas Telephone Cooperative	7.40	20.11	7.08	19.97	34.45	27.05	366%
Coleman County Telephone Cooperative	7.51	.38	4.27	11.02	22.80	15.29	204%
Comanche County Telephone Company	8.39	.25	4.20	7.78	20.37	11.98	143%
Eastex Telephone Cooperative	8.08	.41	4.28	9.45	21.81	13.73	170%
Etex Telephone Cooperative	8.46	1.26	4.70	7.88	21.04	12.58	149%
Guadalupe Valley Tel. Cooperative	8.79	5.89	6.74	10.58	26.11	17.32	198%
Hill Country Telephone Company	7.44	2.38	5.27	12.64	25.35	17.91	241%
Industry Telephone Company	10.08	12.50	7.08	17.09	34.25	24.17	343%
Panhandle Telephone Cooperative	8.83	18.67	6.74	11.83	27.40	18.57	210%
Peeples Telephone Company	6.22	8.38	6.74	16.25	29.21	22.99	370%
Peoples Telephone Cooperative	9.03	2.85	5.30	10.03	24.36	15.33	170%
Riviera Telephone Company	10.87	5.41	6.59	15.59	33.05	22.18	204%
Santa Rosa Telephone Cooperative	6.42	16.50	7.08	11.16	24.66	18.24	284%
South Plains Telephone Cooperative	10.76	4.77	6.12	8.13	25.01	14.25	132%

Additional Monthly End User Charges For Exchange Access

	Present	Proposed				Increase	
		Interstate					
		HCF (Carrier)	End User	Intrastate Toll	Grand Total	Amount	Percent Increase
'elephone Company	(1)	(2)	(3)	(4)	(5) (1)+(3)+(4)	(6) (3)+(4)	(7) (6)vs(1)
'aylor Telephone Cooperative	$ 8.73	$ 2.01	$ 5.08	$10.00	$23.81	$15.08	173%
'alley Telephone Cooperative	7.08	42.97	7.08	21.47	35.63	28.55	403%
'es-Tex Telephone Cooperative	11.45	4.39	6.17	13.76	31.38	19.93	174%
:IT Rural Telephone Cooperative	11.49	28.47	6.74	15.68	33.91	22.42	195%
Average	$ 8.77	$ 6.82	$ 5.55	$11.35	$25.67	$16.90	193%

.) The exhibit reflects the expected monthly end user charges for exhange access following the transition period if the FCC access charge plan (Third Report and Order Docket CC 78-82) were in effect during the base year without benefit of an Intrastate Universal Service Fund, and assuming the recommendations of the Jurisdictional Joint Board (FCC Docket CC 80-286) are accepted by the FCC.

!) The base year is the year for which current cost separation studies are available, mostly for years ending in 1982.

3) Column (1) represents the weighted average local service rate.

4) Columns (2) and (3) represent the application of the Jurisdictional Joint Board recommendation following the transitional period. For purposes of this Exhibit the 1982 nationwide average NTS cost is $170.00 per loop, and for 1981 it is $162.00.

5) Column (4) represents the difference between the base year NTS Toll settlement amounts per loop less the proposed interstate allocated amount (HCF and End User).

Senator JEPSEN. Thank you. Mr. Ware, you are a member of the Exchange Carriers Association?

Mr. WARE. Yes, sir.

Senator JEPSEN. Would you please describe this organization and the role that you will play as the rural advocate, and what attention will be given to universal telephone service.

Mr. WARE. Mr. Chairman, the ECA is the Exchange Carriers Association, soon to be called the National Exchange Carrier Association.

It is an association created under the direction of the FCC order, and its purpose is to administer the tariffs and pools established to carry out the access charge order. It will be governed by a board of directors of 15 members, of which I am one; and, of course, my role in that board will be to try to protect the interest of the small rural companies and the residential consumers to the extent that I am able.

Senator JEPSEN. Do you believe the REA should receive greater funding to help with their rural telephone program?

Mr. WARE. Their loan program and the support mechanism that has been available by requiring the interexchange carriers to pay a portion for the use of the local network is probably the only way the exchanges, such as ours, were established and maintained, and we believe very strongly that their funding should be continued and their programs maintained.

Senator JEPSEN. Do you think that long-distance rates will be deaveraged in the near future, and do you think they should be?

Mr. WARE. I do not see how you can avoid the averaging. Although Mr. Reed of AT&T attempted to address that question, I do not think he clearly stated that they would not deaverage toll rates as competition almost assuredly drives rates down.

And to address the second part of the question, no, I do not believe they should.

Senator JEPSEN. Mr. McCormick, do you want to address that question, please?

Mr. MCCORMICK. You cannot have regulation and competition in the same business, and that is what we have in the long distance business. I believe the courts have spoken. I believe the FCC has spoken that it wants competition. I believe long-distance rate costs throughout this system ought to cover their costs, be priced based on their costs, and if that means deaveraging, so be it.

Senator JEPSEN. Mr. Hoffman, do you have a comment on the question, "Do you think the long distance rates will be deaveraged; and do you think they should be?"

Mr. HOFFMAN. I have a comment, Senator. I probably should not, though. The reason I should not is our system is comprised of local exchange carriers. We are not an intercity carrier. We will not be in the intercity business in 1984, but as a matter of principle, it does not make sense to us, long term, to impose arbitrary restrictions on a competitive market; for instance, saying you shall not deaverage rates. That is not how competition works, and that is not how the public can benefit from competition.

Senator JEPSEN. I would like to ask everyone to respond to the next question. It might be difficult to answer directly, but please, do so as much as possible.

Just what changes in the communications industry are a threat to basic telephone service and reasonable prices?

Mr. HOFFMAN. Besides legislation? Senator, I am not sure that I see severe threats if the FCC's access-charge plan is allowed to be implemented.

I agree with Mr. Jahr's study that the biggest threat now is bypass. I think the threat of bypass—of uneconomic bypass is minimized under the FCC's access-charge plan. I think the Senate bill S. 1660 contains lifeline-service provisions. We do not endorse everything that is in there, but we endorse the concept of lifeline service.

I think lifeline service is necessary to protect those segments of the population that need it, but the balance of the population that can afford to pay for the costs of telephone service ought to pay for it. And I think if rational, reasonable pricing policies are allowed to be implemented, this country can continue to have the best service in the world for another 100 years.

Senator JEPSEN. Mr. McCormick.

Mr. MCCORMICK. The question was what is——

Senator JEPSEN. What changes, if any, in the communications industry are a threat to basic telephone service and reasonable prices?

Mr. MCCORMICK. I believe this legislation is a threat, Senator, I believe, because we are trying to put a Band-aid on the marketplace, and we cannot do that.

The average residential customer pays about $25 a month for local and long-distance service. We are talking about imposing a $2 charge on that basic rate for access—the access line here, raising it to $3 a year after, $4 a year after that. I do not think that is pricing the average consumer out of the marketplace.

At the same time, that $27 a month total bill has about $17 a month of long distance in it, which will come down, if they use the Bell facilities, by 10 percent on January 1. If the price decrease from AT&T is up to 15 percent, it will more than offset that price increase on the access charge.

I think perhaps the biggest misnomer in all of this discussion is the term "access charge," and what is being applied to the end user. It is access to what?

Those costs are there whether a person makes any long distance calls or not. And regardless of whether people say we ought to assess the carriers for that $30 loop, the carriers do not pay that fee. Customers pay that fee; business customers, residential customers, poor people and rich people pay those carrier access charges.

As far as I am concerned, universal telephone service is not being threatened by the orderly transition that the FCC has set up. They have given us 5 years of work, and I believe they have taken testimony from every conceivable segment of this population.

I think we ought to let it work.

Senator JEPSEN. Just by way of clarification to understand your figures—as a matter of record—we have been advised and have been quoting in our hearings that the cost of local service, which is currently subsidized, or whatever other word you want to use, per phone line averages about $26 per month while customers, on an average, are charged about $11. Is that statistic accurate?

Mr. McCormick. That is fairly accurate, yes.

Senator Jepsen. You were saying that——

Mr. McCormick. The average revenue that we get in a bill from the average residential customer has local and long distance charges on it, and that averages around $27 to $28 a month. If we put $2 on that, and then turn around and see the AT&T price cut, along with the price cuts from its competitors, the average residential bill will not go up at all.

Senator Jepsen. I will think about that.

Mr. Ware, just what changes in the communication industry are a threat to basic telephone service and reasonable prices, if anything?

Mr. Ware. First of all, I would like to say, Mr. Chairman, that I thought the panel was very well balanced to start with. Mr. Rierson is going to hear from me for leaving early. [Laughter.]

I do not agree with Mr. McCormick. He refers to the $2 access charge frequently, and the access charge cost for our subscribers allocated between interstate and intrastate will equal—are estimated to be more than $15 at the end of the transition period. So focusing on the $2 is a very misleading exercise.

To go directly to your question, I feel the shift of all of the nontraffic sensitive costs, all the loop costs to the end user, is a very serious hazard for universal service. The interexchange carriers use those facilities and should pay for them, and, as Mr. McCormick indicated, the interexchange carriers do not pay, necessarily. Their customers do, and I think that is appropriate.

But, that mechanism—or that traffic should pay its fair share of those local facilities that are used.

Second, I think the deaveraging of toll rates is a substantial risk to universal service. As the deaveraging occurs, initially in the very high density markets, Chicago, St. Louis, those areas, it may not have quite as great an impact as in our rural areas, but certainly as deaveraging continues, it will affect us very seriously.

Our costs will go even higher as the rural rates are raised to reflect the true cost.

Another irony that occurs in the discussion of the access charges is that one of the rationales behind shifting the nontraffic sensitive costs to the end user on a nontraffic sensitive basis provides a very great burden for those subscribers, and an alternative that has been proposed many times is to go to the local measured service, which is not a flat rate charge, it is a usage sensitive charge.

So we are suggesting going from one usage sensitive charge to another usage sensitive charge, which does not quite track, or is not consistent.

Mr. Hoffman. Senator, could I make just one brief point, and I do not mean to gang up on Mr. Ware.

Mr. Ware. That is all right. I am fast.

Senator Jepsen. He seems to be doing pretty good holding his own. [Laughter.]

Mr. Hoffman. I have been on panels with him before, and he can hold his own pretty well.

I just want to add a couple facts to the record, most of which are already in Mr. Jahr's study, by the way. Recently, as early as the

1950's, telephone penetration per household in this country was only about 60 percent. We are now at about 94, 95, 96 percent. What has caused that increase, as recognized in Mr. Jahr's study, was the rural telephone bank, the REA program.

The fact is that subsidies from long distance to local service was not what was primarily responsible for the level of universal service that we have in this country today. It was Government financed REA loans, and I should submit that the opposite side of that equation must be true also, and that is, if you give up some of the subsidies that exist today in order to have a more rational pricing structure, that does not, ipso facto, mean the end of universal service.

Senator JEPSEN. A question: Will local exchanges begin offering enhanced services such as computer information banks, electronic mail, consumer shopping services and the like; and how soon after urban areas receive new telecommunication services will rural areas receive it?

I guess the first question I am asking is whether those services are going to be available for everyone. Some are available now in some areas, but to what degree will they be available at large? Will they be increasingly avialable, and how far behind will rural areas be behind the trend, and so on, generally.

Mr. HOFFMAN. In our system, yes, they are being tested today. We have a number—two or three exchanges scattered throughout the United States where we are test marketing to see if we can provide it on a low cost enough basis so it is attractive to our customers.

We believe we are going to be successful. We believe it is going to be available wherever customers want it. It is, in large measure, driven by the technology of the switch. So to some degree, it is dependent on our ability to change out switches in the next 4 or 5 years.

As to the second part of your question, the fact is, we serve no urban areas now. We are primarily a rural server, and we expect to have it available in all of our areas where our customers want it, and we can afford to provide it.

Senator JEPSEN. Has it been available, Mr. McCormick, for some time in urban areas?

Mr. MCCORMICK. We have all kinds of information services available today to all of our subscribers. We have a service called Agnet in Nebraska, that the University of Nebraska created, and it is predominantly used by farmers throughout Nebraska and throughout the country.

We have a company in Nebraska called Belmont Industries, which has done a joint venture with IBM. Belmont Industries is distributing IBM's personal computers to farmers and ranchers throughout the country.

I think there is something like 8 percent of our homes now have a home computer of some kind. They do not all have the means of communicating with that home computer, but it is simply the matter of having a mode and associating with it.

It is that thrust of usage that is coming on to the network by computers, and I believe the telephone companies are ready for now. We are ready for it. United is getting ready for it, and has it to some degree right now on their network, and I do not think there will be any rural area deprived of those kinds of services.

Senator JEPSEN. Do you have any comment on that, Mr. Ware?

Mr. WARE. I would like to add that we would hope to provide those services as our subscribers have a need for them or request them to the extent that those enhanced services require the modern facilities that Mr. Hoffman mentioned, or the modern central offices.

The substantial loss of revenue that could occur as a result of the access charge decision, could affect our ability to receive REA loans.

REA loans, as you directed my attention to earlier, have been a substantial part of our development of the service in rural areas, and to the extent that the loans are not feasible in the future, because we have inadequate revenues, we will be unable to get those loans.

Senator JEPSEN. Now, let us go back full circle here with this panel and ask kind of a basic question.

Starting with you, Mr. Hoffman, local exchanges can exist without interexchange carriers; is that right? I am not through yet, but so far—you started to frown.

Mr. HOFFMAN. Certainly they can.

Senator JEPSEN. But long-distance carriers almost always require access to local exchanges to complete the call.

Mr. HOFFMAN. Agreed.

Senator JEPSEN. This demonstrates the interdependent relationship between the two. To have the access, what should those long-distance carriers contribute to local service in order to maintain that phone system?

Mr. HOFFMAN. Senator, I think they ought to contribute the amount necessary to cover the costs to provide them access to the exchange, and I believe that is what the FCC's access charge plan does.

The charges on carriers is twofold. One, it recovers the traffic sensitive elements of providing them service, the part of the switch that serves them, the part of the transport to get them to the switch. They pay the full costs, plus a rate of return, by the way, to the local exchange company for the use of those traffic sensitive facilities; and

Two, under the FCC's access charge plan, they pay, in effect, a surcharge. They pay an amount based on their use that funds the universal service fund under the FCC's access charge plan, that goes to contribute to providing local service in high cost areas.

So, under the FCC's access charge plan, they are, in fact, subsidizing local service. The latest numbers I have seen indicate that that universal service fund, if allowed to go in effect, will amount to about $900 million in 1984.

So, I would say they are contributing a substantial amount. What they are not paying for and what I do not think it is appropriate that they pay for, is those nontraffic sensitive facilities, that local loop between customer's house—or customer's premise and the local switch, which exists solely for the benefit of that one customer.

There has been a lot of discussion about that today. My position is it makes no more sense to charge carriers for the use of that local loop than it does to require airline companies to subsidize taxicabs who bring their customers to the airport in order for them to get on a plane to fly interstate.

And in that respect, I agree with Mr. Jahr's study.

Senator JEPSEN. Let us go to the other end, and since we have kind of a two and one relationship here, let us move right directly to Mr. Ware and then come to Mr. McCormick.

Local exchanges can exist without interexchange carriers. But long distance carriers almost always require access to local exchanges to complete the call. This demonstrates the interdependent relationship between the two.

To have that access, what should long-distance carriers contribute to local service in order to maintain the system, Mr. Ware?

Mr. WARE. As Mr. Rierson said earlier, we do not believe it is necessary to turn the clock back, but we think the interexchange carriers should pay a fair share for the use of the local exchange facilities, not just a portion of those facilities.

What I am saying is the present settlement formula maybe should be adjusted, but it should not be eliminated. The pendulum has swung from one end clear to the other extreme, and we feel that the interexchange carrier shuold pay a portion for those local exchange facilities, including the nontraffic sensitive or local loop facilities. That portion should be based on some allocation formula.

Senator JEPSEN. Mr. McCormick, do you want me to repeat that?

Mr. McCORMICK. I think I can remember it, Senator.

My position is that those local facilities ought to be paid for by the end user. Beginning January 1, 1984, the exchange carriers will be paying us 88 percent of our access charges; the end user, only 12 percent, to cover that nontraffic sensitive loop we keep talking about.

I believe that that loop has to exist, whether or not there are any long distance companies in town. The gentleman on my right charges his customers about $6 a month for basic telephone service. I do not believe it is appropriate that every customer in this country should contribute to keeping the rate of $6 a month in northwest Minnesota, when the costs for providing that telephone service are substantially above that.

I do not think that is fair to the poor people in Des Moines or South Bronx or other poor rural farmers elsewhere in this country. I believe the nontraffic sensitive part of that loop ought to be paid for by the end user.

I guess, in view of compromises, I would certainly compromise based on some usage down the road. I have a feeling we will never get there, but I think the FCC fellow today said that 8 percent of that loop is used for long-distance calls.

I would probably settle on 8 percent as a great compromise today, but today is very heavily subsidized by the interexchange carriers.

Senator JEPSEN. Mr. Ware, you get two for one. [Laughter.]

Mr. WARE. We have dealt with our local exchange rates. I would like to respond, if I could, Mr. Chairman. I would appreciate the opportunity.

It is true that our subscribers pay a one party residential rate in the range of $6.40 in weighted average. But it is also true that half of our subscribers—or nearly half—can only call 500 other subscribers, which is substantially different than the typical Northwestern Bell rate of $10 to $15 where they can call many thousands of subscribers, sometimes hundreds of thousands of subscribers.

So I think, as we examine these questions and their impact on the telephone consumer, who is the person we should be concerned about, we have to keep all of these things in mind.

Equal rates for equal service is not an objectionable thing to us who serve the rural areas.

Mr. McCormick. I will submit, you can also call 144 million other telephones in this country from those 500 telephones.

Mr. Ware. At ever-increasing toll rates.

Mr. McCormick. Subsidized by people all over this country.

Mr. Ware. I have a plane to catch, so I will not rebut.

Senator Jepsen. OK. We will wind this up in a minute.

I have asked, generally, this to every panel except the first one, I believe, this question about the rate rulers—or the commissions, the various State commissions. Do you feel that—Well, United, Mr. Hoffman, I believe is asking for a 97 percent rate increase. Is that correct or not?

Mr. Hoffman. There are a variety of percentages in that case. The largest increase is 97 percent; that is correct.

Senator Jepsen. Do you think that the various commissions have the expertise or the research and adequate information with all the things that are happening, to realistically rule on this fairly? Do you have confidence in that?

Mr. Hoffman. Yes, sir. I might point out that, as I said before, there is nothing in that case, in that 97-percent increase, that has to do with access charges.

Iowa, and I suppose I can say this because I am from Missouri, but Iowa is a very tough regulatory jurisdiction. This commission knows what they are doing. They have considerable resources, and they are very tough regulators. As a matter of fact, from my perspective, as a telephone lawyer, there are even times when I think they are a little unfair with telephone companies.

I think the bulk of our pending rate increase request bears that out because about half of that case is to give us an opportunity to earn what we were authorized in the last case to earn.

It has been so tough to do business in Iowa that we cannot even earn what we are authorized. We are playing catchup in Iowa.

Senator Jepsen. I do not mean to make this a "loaded" question for the telephone companies, but would any of you wish to comment on the agencies who approve your—or disapprove—your rate increases?

Mr. McCormick. It is kind of a no win situation.

Senator Jepsen. Anyone else want to comment, or do you want to leave well enough alone?

Mr. Ware. I would add just one comment for the record, Mr. Chairman. Garden Valley Telephone Co., as a cooperative, is not rate regulated by the Minnesota Public Utilities Commission.

One of the influences in helping to hold our rates low is the cooperative structure, and a lack of pressure for a substantial rate of return. I will just leave it at that.

Mr. McCormick. Senator, the commissions here and in the five States we serve have all the data, all the staff necessary to analyze all the complexities facing them today. They need only step up and decide.

Senator Jepsen. OK. Before I ask my final question, first of all, let me share with you an up-to-date report on where these bills that we have been referring to today are. I asked for one to be given to me while we have been in session today.

The bill, S. 1660, was introduced in July by Senator Packwood and Representative Dingell. They held joint hearings.

Now, the Packwood bill has been passed by the committee and is ready for the floor in the Senate. The full House committee meets this week, and is expected at that time that the bill in the full House committee will be voted on, and probably voted out.

The Senate majority leader—I should say the Senate majority leader's office expects S. 1660 to come up on or about November 1.

If there is one thing that you could give me by way of advice, that you would like me to carry back to Washington, Mr. Hoffman, what would it be?

Mr. HOFFMAN. I just get one?

Senator JEPSEN. You get one, and Mr. McCormick gets one, and Mr. Ware gets two. [Laughter.]

Mr. WARE. Thank you, sir.

Mr. HOFFMAN. I think that is an unfair subsidy to Mr. Ware.

If I am reduced to one piece of advice, Senator, I think, in all earnestness, I would tell you that I think Congress can better serve this industry and its subscribers in telecommunications in this country by waiting at least a year before acting to modify the FCC's access charge plan.

We are convinced—I think Mr. Jahr's study indicates—that it has every opportunity to be successful, to promote universal service in this country, to allow telephone companies to fairly and reasonably price their services. But I admit at the same time, that I do not have a crystal ball, and we may be wrong.

But, I think my best advice to you is to give it a chance to work, give it at least a year to work, and, like I said earlier, if it does not work, I can assure you that our company will be the first in line knocking on your door asking you to pass legislation to correct the problem. But we do not think it is needed at this time.

Senator JEPSEN. Thank you. Mr. Ware.

Mr. WARE. My response would be to urge the adoption of the pending legislation, and to do so as quickly as possible because we do need to have certainly, as we go forward, as to what we are expected to do.

And I urge the adoption of the legislation because I think it is unfair to our consumers, the American public, to create a problem for them, and then try to develop a cure.

I think we should give it additional study, and avoid the problem.

Senator JEPSEN. Mr. McCormick.

Mr. MCCORMICK. Senator, we are within about 8 days of being divested, the biggest corporate restructuring in the history of any civilized nation. We have our hands full. We have them full to the brim today.

The Senate introduced this bill in July. It has had 2 days of hearings. We are about to have it on the floor the 1st of November with 2 days of hearings. I hardly think that that represents a full and open analysis by all the constituency. I think it is time to leave this alone. Let this plan go in, take a look at it, and have all the hearings that you want to next year, just as my associate on the left has said, but let the plan go to work. Let us get on with restructuring this industry, and then come back and address the problems, if there are any. I think we will find out there will be amazingly few.

Senator JEPSEN. Is there any member of the panel that wishes to make any final statement before we conclude the panel? Is there any member in the audience who wishes to make a statement or has a question before we conclude this meeting?

If not, I thank you all for coming, and I thank all of you for your contribution, your constructive and positive sharing of your concerns and your ideas. I think it has been a highy productive and constructive hearing. Even though we pulled no punches, it has been.

I have held a number of hearings, and this is one of the better ones we have had by way of getting right at it, at the same time, keeping it on a very high level.

Do you have anything, Mr. Jahr, that you would like to say, comment on, ask, contribute?

Mr. JAHR. I do not think so.

Senator JEPSEN. Mr. Conrad from Conrad?

Mr. CONRAD. No.

Senator JEPSEN. Thank you all for coming. This committee is adjourned.

[Whereupon, at 4:35 p.m., the committee adjourned, subject to the call of the Chair.]

[The following information was subsequently supplied for the record:]

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November 11, 1983

VIA EXPRESS MAIL

The Honorable Roger Jepsen
United States Senate
120 Russell Building
Washington, DC 20510

RE: Joint Economic Committee Report on the Telephone Industry

Dear Senator Jepsen:

During various discussions with you and John Conrad, it was suggested that the forthcoming Joint Economic Committee report include a discussion of certain legislative issues arising out of proposed legislation (S.F. 1660). Accordingly, we have prepared and enclosed, for your review and inclusion in the report, our comments covering certain key, legislative issues.

If you so desire, either Mr. Conrad or Mr. Jarre could discuss our suggestions before their inclusion in the report, and they should contact me directly.

We appreciate the opportunity which you have provided our client, Northwestern Bell Telephone Company.

Respectfully yours,

Harlan D. Hockenberg

Harlan D. Hockenberg

/llh
enclosure

JOINT ECONOMIC COMMITTEE REPORT

Summary of Legal Issues Raised by the Packwood Bill (S. 1660) Which Should be Referred to the Judiciary Committee for Consideration.

1. A primary goal of Judge Greene's divestiture order was to encourage competition within the telephone industry. The Packwood Bill thwarts this goal by encouraging uneconomic bypass, which leads to less efficient service and higher rates. [See Attached Exhibit "A", (I)].

2. The Packwood Bill's proposal to impose access charges on bypassers constitutes a discriminatory and unlawful form of taxation on such bypassers. Such access charges also violate the 14th Amendment's guarantee of equal protection and the 5th Amendment's guarantee that property will not be taken without due process. [See Attached Exhibit "A" (II)].

3. The Judiciary Committee should examine the Packwood Bill to determine whether the Packwood Bill would require a waiver from Judge Greene. Such a waiver would be necessary if enough revenues were not generated under the Packwood Bill to adequately compensate local operating companies. In that case, a waiver would be needed in order for AT&T to continue its current "division of revenues" to local companies. [See Attached Exhibit "B" (I)].

4. The Packwood Bill hinders competition by making it too easy for carriers to qualify for high cost subsidies, thus providing a disincentive for telephone companies to keep costs low and efficiency high. Again, Judge Greene's intentions to promote competition through his divestiture order are thwarted. [See Attached Exhibit "B" (II); Exhibit "C", p. 3].

5. The Packwood Bill restricts eligibility for support from the Universal Service Fund to smaller companies. Thus, subscribers served by larger companies are likely to have higher phone bills than their neighbors served by smaller companies, although there is no difference in cost of services. Such an inequitable result is a clear violation of equal protection which the Judiciary Committee should investigate. [See Attached Exhibit "B" (III); Exhibit "C", p. 2].

6. The Packwood Bill creates a Joint Board which is given broad powers and may substantially interfere with state ratemaking functions. Such a broad grant of federal power over traditional state ratemaking activity raises questions under the 10th Amendment, which restricts the federal government's power to regulate state activities. [See Attached Exhibit "B" (IV); Exhibit "C", p. 3].

7. The charges imposed on bypassers are taxes, because they do not bear any relationship to use of exchange facilities. It is not clear whether Congress can legally delegate the authority

to impose charges on bypassers who do not use the local exchange companies through a user fee mechanism which does not employ the taxing power of Congress. [See Attached Exhibit "D", No. 36].

8. The Packwood Bill raises "void for vagueness" issues. For example, the bill provides no standards or guidelines as to the definition of a "bypasser" and leaves unanswered questions such as whether data transmission facilities recently put into operation by newspaper publishing enterprises are subject to bypass charges. As another example, the report states that radio common carriers are not subject to bypass charges, yet radio common carriers provide service which is quite similar to local exchange service provided by local carriers. [See Attached Exhibit "D", No. 39].

9. The Packwood Bill should be referred to the Judiciary Committee to determine whether the forfeiture penalties provided for bypassers who do not voluntarily pay are unlawful. [See Attached Exhibit "D", No. 43].

EXHIBIT "A"

MEMORANDUM

DATE: October 10, 1983

RE: Northwestern Bell/Lobbying

Legal Impact of the Packwood Bill on the Greene Divestiture Order.

I. Before adopting the Packwood bill concerning Universal Telephone Service (S. 1660), Congress should consider the legal effect these bills may have on Judge Greene's divestiture order. Judge Greene's opinion was carefully considered and finely-tuned for the purpose of increasing competition within the telephone industry. The Federal Communication Commission (FCC) has studied the issue of telephone deregulation for nearly five years. In the FCC's judgment, the most effective way to increase competition in the phone industry is to provide that common line costs be increasingly recovered from telephone customers rather than interexchange carriers. (See: FCC Order 78-72, August 22, 1983).

The possibility of "uneconomic bypass" was a major justification for the FCC decision to move toward cost-based customer access charges. Interexchange charges such as those proposed in the Packwood bill encourage bypass, and if by-pass continues, telephone rates will go up as fewer and fewer customers share the telephone company's fixed costs. As costs mount, local phone companies must necessarily provide less efficient service at higher rates. Thus the Packwood legislation, which purports to protect ratepayers, is actually destructive of competition.

Judge Greene considered the encouragement of competition within the phone industry to be a primary goal of divestiture. If Congress passes the Packwood bill in its current form, one of the primary goals of Judge Greene's divestiture order will be thwarted. In its current rush to adopt the Packwood bill, Congress is ignoring the need for careful study of how this bill will affect Judge Greene's divestiture order. Such a careful study can best be ensured by referring the Packwood bill to the Senate Judiciary Committee.

II. The Packwood Bill proposes to discourage bypass by requiring bypassers to pay access charges to the local exchange networks and fining violators up to $100,000. Other universal telephone service bills propose to charge bypassers for exchange access whether or not they actually access the local exchange. By discouraging bypass, the Packwood bill will stifle technological innovation and again discourage the competition Judge Greene's divestiture order was meant to engender. In its order of August 22, 1983, which was the cumulative result of a five-year study, the FCC stated that a prohibition on bypass would be undesirable because bypass can serve functions that are not adequately served by existing telephone company services. By discouraging bypass, Senator Packwood's bill would deprive customers of the opportunity to choose from among a variety of services provided by a number of different competitive telephone companies, including bypassers.

The proposal that access charges be imposed on bypassers regardless of their use of the local exchanges, raises a number of constitutional issues. The classification of bypassers within the same category as phone companies which actually use the local exchanges results in an unlawful and discriminatory tax on bypassers. Such an unreasonable and arbitrary classification of a corporation for tax purposes is not allowed under the U. S. Constitution. [See: e.g., Southwestern Bell Telephone Co. v. Middlekamp, 1 F.2d 563 (1921)]. The mantle of the equal protection laws extends also to corporations, and equal protection is violated by proposals to lump bypassers and non-bypassers into the same category for purposes of access charges. These universal service telephone bills also contain a potential violation of the 5th Amendment, which provides that property may not be taken without due process. Access charges which have no relation to the actual activities of the bypassers should not be extracted from them without notice and an opportunity for a hearing.

III. Finally, the Packwood legislation should not be adopted without considering whether to do so would permit the Bell Telephone Companies to evade divestiture entirely. The Packwood bill changes the sources of the phone companies' revenue and could allow for noncompetitive arrangements that the Greene divestiture order was meant to prohibit. Judge Greene's divestiture order was based on a balancing of the interests of the telephone companies and their customers. In its headlong rush to pass the Packwood bill, Congress may be upsetting this fine balance. Before passing any hasty legislation, which may later be regretted, Congress should refer the Packwood bill to the Judiciary Committee or the Senate Finance Committee for a more careful legal study. Such a study would better reveal the extent of the Packwood bill's impact on Judge Greene's divestiture order.

EXHIBIT "B"

LEGAL RATIONALES FOR REFERRING THE PACKWOOD BILL, S. 1660, TO THE JUDICIARY COMMITTEE

I. If the Packwood Bill is passed, a waiver might be needed from Judge Harold Greene before divestiture could go forward. The rates that long distance carriers were required to pay local operating companies were explicitly set forth in the FCC access charge decision approved in July, 1983. These charges included a $2 per month fee for consumers and a $6 per month fee for businesses to connect to long distance phone lines. In addition, the order established a charge schedule that long distance carriers would pay to interconnect with local telephone lines. Thus, the FCC access charge decision allocated costs equally between consumers and long distance carriers, whereas the Packwood bill places all interstate access costs on the carriers.

This placement of the entire burden of access charges on long distance carriers may result in total revenues which are much reduced from the revenues which would be generated under the FCC decision. Such reduced revenues are likely because of the possibility that many telecommunication corporations will decide to bypass the local exchange companies. Even if the bill is amended to impose surcharges on bypassers, the difficulty of enforcement makes it unlikely that the local exchange carriers' total revenue requirement will be collected from long distance carriers.

Thus, it could become necessary for AT&T to continue the current "division of revenues" within its own system to compensate the local companies and assure that these local companies remain financially viable. AT&T would be likely to need legal approval from Judge Greene in order to continue this current subsidy program. The Packwood bill should be submitted to the Judiciary Committee for further study as to its effects on total revenues, and as to whether a waiver from Judge Greene would be necessary, if this bill goes into effect.

II. One concept that permeates Judge Greene's divestiture order is the idea that competition should be increased within the telephone industry. The Packwood bill, however, actually stifles competition by making it too easy for carriers to qualify for high cost subsidies. For example, if an exchange company's costs exceed 110% of the average cost of providing comparable basic intra LATA phone service throughout the U.S., the Packwood bill provides that 90% of those costs will be reimbursed out of the Universal Service Fund. Consequently, telephone companies have very few incentives to keep costs low and efficiency high. In contrast, under the FCC decision, supports would be provided at less generous levels, and inefficient companies would stand to lose more than they gained. Thus, the Packwood bill should be referred to the Judiciary Committee for an examination of how it would affect telephone industry competition as promoted under Judge Greene's Order.

III. The Packwood bill restricts eligibility for support from the Universal Service Fund, making subscribers in high cost areas which are served by larger companies ineligible for support. Thus, subscribers served by larger companies are likely to have higher telephone bills than their neighbors served by smaller companies, although there are no differences in cost of services. Thus, members of the same telephone-user class will be treated differently, which is a clear violation of equal protection. The Packwood bill should be reviewed by the Judiciary Committee to eliminate this and other possible violations of equal protection.

IV. The Packwood bill provides for four state members of the Joint Board and five FCC commissioner members. This structure is inconsistent with the principle that interstate ratemaking is in the federal domain. Under the Packwood proposal, four states could combine on an issue and persuade just one FCC Commissioner to vote with them in order to reach agreements that would apply to all the states. Such a scenario could lead to unconstitutional discrimination against certain states or groups of states.

Under the Packwood bill, the Joint Board would also have the power to interfere with state ratemaking prerogatives in attempting to ensure that lifeline service is provided for those that need it. Ratemaking is a traditional state function, and the 10th Amendment precludes the federal government from regulating traditional state governmental activities. The FCC access charge decision, in contrast, preserves the ability of state regulators to conform lifeline service plans to their own individual state needs. The Packwood bill should be referred to the Judiciary Committee to examine whether it infringes on the state's exclusive rate-making prerogatives.

EXHIBIT "C"

FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

October 31, 1983

IN REPLY REFER TO

The Honorable Barry Goldwater
Chairman
Subcommittee on Communications
Committee on Commerce, Science and Transportation
508 Dirksen Building
United States Senate
Washington, D. C. 20510

Dear Senator Goldwater:

This is in response to your letter of October 13 inviting the Chairman to submit the Commission's views regarding S. 1660, as reported by the Senate Commerce Committee. Because of the obvious importance of this issue and because of our belief that the FCC has chosen a course in its access orders which most fully realizes the goals set out by Congress in the Communications Act of 1934, the Commission is pleased to submit these comments for your consideration.

We fully realize that this agency, the courts, and the Congress have been grappling with the difficult issues this bill addresses. It is our hope that the additional material we are submitting will dissuade the Committee from passing legislation which we believe to be counter-productive to the goals the Congress is trying to achieve, and that the Congress will give the agency the opportunity to complement its decision with Congress' rigorous and continued oversight.

We stand by our access charge decision. Legislation is unnecessary, and S. 1660 will disserve the public interest. Chairman Fowler has previously submitted testimony to the Committee as to the desirability of an access charge system that includes fixed monthly charges for non-traffic sensitive (NTS) costs. The proposed two-year moratorium on most end user access charges would delay the economic benefits that the access charge plan was designed to produce.

Uneconomic bypass would be encouraged while the moratorium is in effect. Large users who leave the network during such a moratorium would not return because they will have made a large investment in their bypass facilities in the interim. Therefore, the delay of two years, coupled with uncertainty afterwards, would have serious consequences for network preservation and universal service in an industry marked by rapid technological change.

As the Committee is no doubt aware, fears of doubled or tripled telephone rates because of the FCC's access charge decision are proving unfounded. The access charges could not, by themselves, cause such percentage increases; these could result only if rate increase requests pending before the various states were granted in their entirety. As we predicted, however, states are disallowing large parts of the rate hikes requested by telephone companies. As of October 13, 1983, the state commissions had disallowed 62 percent of the Bell System rate requests reviewed. For example, on August 31, 1983, Georgia disallowed almost 90 percent of the rate increase requested by Southern Bell; on September 7, 1983, New York disallowed 68 percent of the rate increase requested by New York Telephone; and, effective October 1, 1983, Michigan had disallowed 64 percent of the rate increase requested by Michigan Bell.

These developments confirm that action by Congress is unnecessary this year. As was stated by Chairman Fowler in his previous testimony, the $2.00 residential interstate access charge will not have any significant impact in 1984. Congress can afford to take the time to see how the Commission's plan works.

If Congress disagrees with this assessment and decides to go forward with legislation, we believe that substantial revisions are essential to S. 1660, especially in those provisions concerning the Universal Service Fund, lifeline subsidies, new joint board procedures, bypasser charges, and Alaska rate integration. Provisions of the bill relating to these areas contain serious flaws that should be corrected before S. 1660 is enacted into law. Once the bill is enacted, any deficiencies will be almost impossible to correct. For example, while the Commission now has flexibility to adjust eligibility requirements for the Universal Service Fund, the rigid requirements in the bill will quickly become outdated. The agency would be powerless to make corrections to the bill's immutable terms.

The major problem areas include the following:

- The bill restricts eligibility for support from the Universal Service Fund <u>to eliminate over three-fourths of the support that the Joint Board plan would provide</u> for local exchange rates in high cost areas. Millions of telephone subscribers will pay higher local telephone rates under the bill than under the Joint Board plan. <u>Thirty-eight states</u> (and Puerto Rico and the Virgin Islands) <u>receive less support under the bill than under the Joint Board plan</u>; six states and D.C. are unaffected under both plans; and even the remaining six states which do somewhat better under the bill individually receive less than $1 million more support. See Attachment 1.

- Because the bill makes subscribers in high cost areas which are served by larger companies ineligible for support, it will have the inequitable result of subjecting subscribers served by larger companies to higher telephone bills than their neighbors served by smaller telephone companies, even though there is no difference in the costs of service.

- The bill makes it too easy for carriers to qualify for very substantial high cost support, perverting incentives to keep costs low and efficiency high. In contrast, the Joint Board plan is specifically designed to provide supports at less generous levels. Under the Joint Board plan, inefficient companies would lose more than they gained by their inefficiencies, and only carriers with unavoidable high costs could avail themselves of subsidy funds.

- The bill attempts to control interstate reimbursement in high cost situations by requiring state regulators to certify that the high costs are reasonably incurred. Knowing that certification of high costs would entitle local exchange carriers to draw substantial subsidies from the federal pool, state regulators would have little incentive to disallow any costs the carriers submit. These unnecessary costs would become the burden of the entire nation.

- The bill assigns continuous and demanding functions to a new joint board of state and federal regulators. However, state regulators have full time duties of their own, regulating electric, gas and water utilities as well as telephone companies. Moreover, the distance of the state members from one another and from the FCC and its staff limits these members' involvement in the important matters to be decided. Travel will be such an imposition that meetings cannot be held with the regularity required. The substantial regulatory delay that would inevitably result would be to the detriment of both interstate and local ratepayers.

- The bill is inconsistent with a fundamental premise of the Communications Act of 1934 that interstate ratemaking is the province of a federal body. This premise ensures that decisions inure to the benefit of <u>all</u> ratepayers, not just to the benefit of one region or state. Under the bill, if the four state members of the new joint board can reach agreements that benefit their respective states and if just one FCC commissioner concurs, their decision will be the law of the land, regardless of its impact on the rest of the nation. The result would be the very kind of factionalism that the 1934 Act was enacted to avoid.

- The bill unnecessarily would have the new joint board intrude upon state ratemaking prerogatives in attempts to ensure that lifeline support flows to residential subscribers. The Joint Board plan and the FCC's access charge decision preserve the ability of state regulators to tailor lifeline service plans to meet their own individual state needs.

- The bill seeks to establish what appears to be a bypass tax. It is a tax even though it purports to be a "user fee", because there would be <u>no</u> use of services or facilities for which the so-called fee is imposed. It is unclear who is to collect this tax. Either the telephone companies are to do so (individually, or collectively through their Exchange Carriers Association), or the new joint board is to do so governmentally. Whichever it turns out to be, there will be mammoth problems concerning legal authority (e.g., unlawful delegation of the government's tax function), identification (e.g., difficulties in identifying those who are to be liable for the tax), and implementation (e.g., how does a carrier collect money from somebody not taking service from it pursuant to tariff or contract).

- The bypass charge may well prove unworkable or unlawful, particularly since unexplained, ambiguous and discriminatory exceptions are discussed in the Committee report. In such case, the net result of the suspension of end user access charges would be to create new bypass incentives and to frustrate universal service. Even if the bypass charge goes forward in some form, the desirable incentives for improvement of exchange service and technological improvement generally which are created by economic bypass systems would be lost, and the nation would pay the price of lost efficiency.

- The suspension of end user access charges would deny the public the benefits of reduced long distance charges, and "information age" services which will develop when long distance charges reflect true costs more closely.

We are enclosing two attachments with this letter. The first compares the economic impact on a state-by-state basis of the Joint Board plan with that of the bill. The second discusses in more detail the foregoing and other problems inherent in S. 1660. We understand the deep concerns reflected in the bill and the Minority Views. We hope that this letter is responsive to your request, and we stand ready to provide additional information should you require it.

BY DIRECTION OF THE COMMISSION

William J. Tricarico,
Secretary

Attachments.

EXHIBIT "D"

Attachment 2

Detailed Analysis of S. 1660

END USER ACCESS CHARGES

1. S. 1660 proposes to suspend most end user access charges for two years. Senator Goldwater's Minority Views included in the Committee report accompanying S. 1660 correctly state that the two-year "mortatorium" on residential and single-line business flat end user charges is unnecessary and may in fact have an adverse effect on telephone customers. The Minority Views are correct that local rates will not go down as a result of the Committee's action, that the $2.00 flat charge constitutes only a small portion of customers' monthly phone bills, and that anticipated reductions in interstate long distance rates will be lost or seriously eroded during the two-year period of the moratorium.

2. The Commission shares the concerns expressed in the Minority Views and endorses the argument that the Committee's proposed alteration of the Commission's access charge decision is unnecessary and potentially harmful to the interests of all telephone customers. Our action in the access charge proceeding is the product of five years of close examination of the issues we have sought to resolve. Our approach was devised after having the benefit of the views of a large number of interested parties representing a broad spectrum of governmental entities, the telephone industry, and telephone customers, and is thus a balanced solution to a complex set of problems.

3. The basic philosophy of the Commission's access charge plan is to cause usage-based long distance rates to fall by having subscribers directly cover the fixed or non-traffic sensitive local exchange plant costs with flat charges. This will decrease inefficiencies that result from recovering a large share of the non-traffic sensitive (or "NTS") cost through toll rates that are inflated by about 15 cents per minute of use. We recognize that this represents a change in the way telephone bills have been rendered, and we have carefully adopted transitional procedures to protect universal service. First, we have provided for a gradual transition to the new access charge environment so that consumers will have time to adjust to the new method of recovering the interstate allocation of local exchange costs. Residential subscribers will pay a fixed monthly charge of $2.00 in 1984, which will rise to $3.00 in 1985 and $4.00 in 1986. The remainder of the costs of their non-traffic sensitive facilities will continue to be covered in long distance carriers' usage-based charges. In 1986, the Commission will conduct a thorough review of the entire program. We believe that, as a practical matter, a $2.00 (or $4.00) charge will not materially affect the decisions by residential subscribers to retain telephone service. Next, state regulatory authorities have flexibility under the access charge plan to require telephone companies to offer low-cost lifeline services to

subscribers. The Commission will entertain waivers to exempt lifeline service subscribers from all or part of the end user charges. Third, the Commission has limited the amount of local exchange costs to be recovered from subscribers at the end of the transition period. The Commission has established a Universal Service Fund to be paid for by interexchange carriers, and currently is considering recommendations of the Joint Board in the Jurisdictional Separations Proceeding concerning the level of funding necessary to ensure the continued availability of telephone service in high cost areas. Finally, we have provided for careful monitoring of access charge implementation to ensure that the anticipated benefits are realized and that we have ample opportunity to make any adjustments necessary to avoid adverse effects.

UNIVERSAL SERVICE FUND

4. Most S. 1660 provisions that do not relate to end user access charges relate to the Universal Service Fund and the proposed lifeline subsidy. The Universal Service Fund provisions appear to be a modification of the plan for a Universal Service Fund that has been recommended by the Federal-State Joint Board in the exchange plant separations proceeding (CC Docket 80-286). The lifeline subsidy fund is a new idea that has apparently not been proposed or considered in the Joint Board proceeding.

5. Legislation is not required in order to establish the concept of a Universal Service Fund. The Commission adopted that concept in the access charge rules and will be considering the Joint Board plan to implement that concept in the near future.

6. If Congress prefers a formula for implementing that concept that differs from a formula the Commission adopts, Congress will have an adequate opportunity to enact its own formula at a later date. The Joint Board has proposed that its plan become effective in 1986. S. 1660 also specifies a 1986 effective date for Universal Service Fund surcharges. An earlier effective date is not practical because additional data must be collected to implement any plan for such a fund. In these circumstances, there does not appear to be any need for Congress to address this subject as part of a measure that is designed to affect the initial access charges.

7. If Congress does choose to address this subject at this time, the Commission would recommend expanding the eligibility requirements for receiving distributions from a Universal Service Fund. S. 1660 is far more restrictive than the Joint Board plan or the comparable provisions of H.R. 4102. Adoption of S. 1660 could in fact result in higher local exchange rates in many areas of the country by depriving telephone subscribers of benefits they would receive if the Commission adopts the Joint Board plan. Such a result would clearly conflict with the stated objectives of that bill.

8. The Joint Board plan was designed to enable telephone companies and state public utility commissions to maintain in all exchanges local exchange service rates that do not substantially exceed nationwide average local exchange rates. The Joint Board plan would

accomplish that objective by allocating a larger portion of a study area's costs to interstate operations if the study area costs significantly exceed the national average costs for all study areas. A study area normally means the operations of a particular telephone company in a particular state. Such high cost apportionments to interstate operations (and nationwide pooling and distribution of a Universal Service Fund) would tend to equalize intrastate revenue requirements that must be recovered in part through local exchange service rates. This aid will help to keep down exchange rates in the highest cost study areas.

9. Although the subscriber plant factor or SPF in the Ozark separations formula sometimes tended to produce larger interstate allocations in high cost study areas, the correlation between a high SPF and high cost is very poor. A long succession of proposals have been considered by Congress and the Joint Board which have been designed to replace any subsidy that may be contained in a high SPF with a subsidy that is targeted in a more exact manner. The Joint Board has recommended a new separations formula for most of the non-traffic sensitive plant that would combine a base factor allocation of 25% for all study areas with an additional high cost or universal service allocation in the high cost study areas as a replacement for current SPF procedures. The Joint Board plans to review its recommendations in this area, and is scheduling additional meetings for this purpose.

10. S. 1660 would not alter the base factor allocation, but it would apparently allocate slightly more costs to interstate operations in some study areas and it would deprive customers in many other study areas of high cost support. S. 1660 would preclude any additional interstate allocation in all study areas that have more than 50,000 loops. It would also preclude an additional interstate allocation in study areas with fewer than 50,000 loops if the telephone company that serves the area is not an REA loan recipient or is not a Section 2(b)(2) carrier, or is part of a company or affiliated group of companies that has annual revenues in excess of $100 million.

11. This combination of restrictions would produce a drastic reduction in the size of the Universal Service Fund. The Joint Board has estimated that its plan would have produced a Universal Service Fund of $396 million in 1980. If the same definition of costs were used for purposes of the S. 1660 formula, the S. 1660 formula would have produced a Universal Service Fund of $82 million in 1980.

12. Much of the additional intrastate rate burden that S. 1660 would create would be reflected in residential local exchange service rates. Some telephone companies would be able to shift some of that burden to intrastate toll rates or business local exchange services. Those results would have disadvantages that should be carefully weighed. Even if those results are acceptable to Congress, it would be unrealistic to expect that intrastate toll services or business services could absorb much of the burden in study areas that do have fewer than 50,000 loops. Retention of the S. 1660 restrictions upon Universal Service Fund distributions to companies that serve such areas

would be almost certain to produce high local exchange rates in those high cost areas.

13. That burden would be particularly great for customers of companies such as Glacier State Telephone Company in Alaska, which had an annual NTS revenue requirement of $799 per line in 1980. The national average was $153 per line in that year. Glacier would not receive any Universal Service Fund distributions under S. 1660 (even though it has fewer than 50,000 loops and has NTS cost that are more than five times the national average) because it is affiliated with Continental Telephone System. The Alaska Public Utility Commission could not compel Continental to use its intrastate revenues or profits in other states to subsidize local exchange service rates for Glacier customers without violating long-established Constitutional principles that have recently been reaffirmed by the Alaska Supreme Court. See United States v. RCA Alaska, 597 P. 2d 489 (1979). Glacier would probably be required to recover an intrastate revenue requirement of about $600 per line per year (or $50 per month) from local exchange rates if S. 1660 were enacted. That intrastate revenue requirement would be reduced to $22 per month under the Joint Board plan. S. 1660 should at least be amended to eliminate the eligibility requirements other than the loop restriction. Failure to do so could produce a significant threat to universal service in many parts of the country.

14. Glacier State is not unique. Continental also has subsidiaries in Arizona, Arkansas, Colorado, Idaho, Kansas, Kentucky, Missouri, New Mexico, New York, Pennsylvania, and Washington that had NTS loop costs in excess of $300 per loop in 1980. None of those companies would receive high cost assistance under S. 1660. Several unaffiliated small high cost companies, such as Bush Telephone Company in Alaska, with a 1980 revenue requirement of $725 per line, were not REA loan recipients at the time the Joint Board compiled high cost data. If such companies have not received REA loans (or do not do so in the future), their subscribers would also be deprived of high cost assistance if S. 1660 were enacted in its present form.

15. Similarly, it would probably be unwise to deny all high cost support in every study area with more than 50,000 loops. It would be extremely difficult to establish or maintain residential rates that do not significantly exceed the nationwide average in many such areas. For example, the Wyoming operations of the Mountain States Telephone and Telegraph Company had an annual NTS revenue requirement of $290 per loop, or just less than twice the national average, in 1980. S. 1660 would not provide any high cost support for Mountain Bell's Wyoming customers because Mountain Bell has more than 50,000 loops in Wyoming and the company has well over $100 million in revenues. Wyoming is not the only high cost state that would be disadvantaged by the enactment of S. 1660. The principal Bell companies that serve West Virginia, Kentucky, South Carolina, Florida, Alabama, Mississippi, Arkansas and Nevada had annual NTS costs in excess of $200 per loop in 1980. The S. 1660 formula would deprive their customers of high cost support which would be provided by the Joint Board plan.

16. The effects of alternative plans probably should not be measured upon a state-by-state basis because effects will vary in areas served by different companies within a state. Nevertheless, such comparisons do shed some light upon the possible effects of sustituting the S. 1660 plan for the Joint Board plan. Our calculations based on 1980 data indicate that subscribers in 38 states, Puerto Rico and the Virgin Islands would receive less high cost assistance under S. 1660. Subscribers in 6 states would receive more high cost assistance. Subscribers in 6 states and the District of Columbia would not be affected. Subscribers in Alabama, Arkansas, Florida, Kentucky, Louisiana, Mississippi and Wyoming would have lost more than $10 million in high cost assistance based on 1980 data. Subscribers in California, Georgia, Missouri, South Carolina, Texas and West Virginia would have lost $5-10 million. Subscribers in Arizona, Idaho, Michigan, Indiana, Kansas, Minnesota, Nevada, New Mexico, New York, North Carolina, North Dakota, Ohio, Vermont, Virginia, Washington, Wisconsin, Puerto Rico and the Virgina Islands would have lost $1-5 million. These effects would, of course, be substantially greater if 1986 data were used to measure probable increases in local exchange service rates that would result from the enactment of S. 1660.

17. Some clarification of the description of the costs to be reflected in a high cost formula is needed. The Joint Board's plan for the apportionment of high costs provides such details. For example, it does not include customer premises equipment, inside wiring or central office costs, but it does include depreciation and maintenance expense associated with subscriber lines and certain indirect expenses that are associated with subscriber lines for this purpose. The proposed Section 201(e)(4) in S. 1660 describes the costs to be compensated as "nontraffic sensitive costs". That term might or might not include a portion of local dial switches that are sometimes described as non-traffic sensitive. It presumably would include subscriber lines and inside wiring or customer premises equipment that is included in the rate base. It might or might not include Popenoe Plan surrogate CPE costs. The term "non-traffic sensitive costs" also might or might not include expenses that are directly or indirectly associated with non-traffic sensitive plant.

18. If S. 1660 were modified to clarify the costs that are to be considered for purposes of applying a statutory high cost formula, a further Joint Board proceeding to revise separations rules for NTS plant would be unnecessary. Such a clarification might be achieved by adopting the definition of relevant costs in the Joint Board's Recommended Decision.

JOINT BOARD ROLE

19. If the new Section 410(d) Joint Board will be recommending jurisdictional separations rules, the scope of its separations responsibilities should be clarified. S. 1660 does not purport to give that Joint Board authority to consider separations questions that do not involve NTS costs or even questions relating to base factor NTS apportionments. Future separations decisions could be challenged on the grounds that the initial decision should have been

made by a Section 410(c) Joint Board instead of a Section 410(d) Joint Board, or vice versa. Even if the Commission or the courts can find the line that separates 410(c) separations questions from 410(d) separations questions, it would be impossible for any Joint Board to address the interrelationship among separations rules in a coordinated fashion.

20. It is our view that the separations tasks assigned to the new Joint Board should be vested in a traditional Section 410(c) Joint Board. There is no need to establish the new procedures contemplated in S. 1660. It is important to maintain the concept that the Federal Government, and the FCC Commissioners appointed and confirmed by the Federal Government, will make interstate rate determinations. State regulators have an interest in the process, and their views should be heard and accommodated where possible. But, in the final analysis, state regulators cannot be expected to approve regional subsidization plans under which their own constituents will be paying more for telephone service than they might otherwise, merely to subsidize other states' residents. A decisional process on issues such as these with decisional control by the states inevitably will break down. Unlike a Section 410(c) proceeding, where the Commission ultimately makes such decisions (with strong input from state regulators), the proposed Section 410(d) procedures would probably place the state regulators in the position of having to make such determinations themselves — determinations which could cause their defeat subsequently if they must stand for re-election or reappointment. The net result may be no decisions at all.

21. Second, while Section 410(d) would vest ostensible decisionmaking in FCC Commissioners by creating a board with five FCC Commissioners and four state representives, if a single FCC Commissioner were to vote with the state representatives, federal prerogatives might be lost. Under the existing statutory scheme, it would take three FCC Comissioners siding with state representatives (during final adoption of a joint board recommendation under Section 410(c)) to cause federal prerogatives to be lost. The current statutory scheme is to vest such decisonmaking in a majority of those appointed by the President and confirmed by the Senate, not a single FCC Commissioner. In short, the present Joint Board structure established in Section 410(c) of the Communications Act has been carefully constructed by Congress to balance legitimate federal and state interests regarding communications matters which affect both jurisdictions. The Committee Report exhorts "the members of the Board [to] recognize that they would be making national decisions, not regional decisions." But, this desire may be doomed to frustration in view of the harsh political realities of decisionmaking.

22. S. 1660 describes procedures for recovering universal service costs as well as criteria for identifying the high or "universal service" costs that are to be apportioned to the interstate jurisdiction. The recovery of costs that are apportioned to interstate services is a ratemaking function that has traditionally been reserved to the Federal Communications Commission. The present Act would not require consultation with state commissions in establishing rates for services those commissions do not regulate, but S. 1660 would give the new Section 410(d) Joint Board a role in designing the interstate

surcharges. That Joint Board role is inappropriate and unnecessary.

23. The Section 201(f) requirement that universal service cost reimbursement be used to reduce local exchange service rates may represent an even greater intrusion upon the traditional ratemaking prerogatives of state commissions. Such decisions traditionally have been reserved to the public utility commission in each state. It would be impossible to ensure that universal cost disbursements are used to reduce local exchange service rates without intruding deeply into the intrastate ratemaking process or creating intrusive and overly regulatory new procedures.

ADMINISTRATION OF THE FUND AND SURCHARGES

24. It would be difficult to measure or to enforce compliance with the Section 201(f) requirement. There is no reason to suppose that Universal Service Fund distributions will lead to any reduction in local exchange service rates in many cases because those distributions will merely replace some or all of the settlements that high SPF companies received under the Ozark formula. Changes in total costs and periodic changes in the authorized rate of return will also make it difficult to determine the reduction, if any, that should be expected. Even if it would be possible to enforce this requirement, it would be very difficult to develop a consensus upon guidelines in a Joint Board proceeding. The state commission members would probably come from states with very different ratemaking philosophies and practices.

25. S. 1660 does not specify the remedy that is to be used if the company or the state commission adopts rates that do not conform with Congressional expectations. One can probably infer that the Joint Board will be permitted or required to withhold disbursements if that contingency arises. If this is the Congressional desire, it should be expressed in a more direct and unambiguous manner.

26. Some of the provisions relating to the computation of surcharges may also be difficult to administer. One might infer that the Joint Board's function is limited to determining the relative portions of the revenue requirement that are to be recovered from persons who use telephone company access services and persons who do not. Some S. 1660 provisions would, however, appear to require the Joint Board to establish surcharges at a level that exceeds projected universal service costs. It is, of course, impossible to compute rates that will produce revenues that are precisely equal to the revenue requirement. Targeting errors inevitably produce a surplus or a shortfall and telephone industry pooling procedures have traditionally been designed to produce a common achieved return for all pool participants. That procedure ensures that each pool participant will share in a shortfall or surplus on a pro rata basis. The proposed Section 201(e) says that qualifying companies are "entitled" to reimbursement for universal service costs. If those companies have an unqualified right to reimbursement, the surcharges would presumably have to be designed to produce a surplus in order to avoid the possibility of a shortfall.

27. S. 1660 does not specify how the surcharges will be collected or the revenues from surcharges will be disbursed. Under the Commission's analogous access charge rules, those functions would be performed by the National Exchange Carrier Association. S. 1660 may permit a continuation of that arrangement, but the proposed provisions conceivably could authorize or even require the Joint Board to perform such functions. For example, the statement in Section 210(e)(4) that a state commission will "certify costs of exchange carriers to the Joint Board" could lead to the inference that Congress expected the Joint Board to disburse the money. In either case, collection of bypass "fees" (tax) will be uncertain and problematical (see our discussion below of the bypass provisions of the bill).

28. A Joint Board role in the collection or disbursement of surcharge revenues would require the creation of a sizeable new bureaucracy to perform functions that should remain with the industry. We would recommend the inclusion of clarifying language that would be sufficient to ensure that neither the Joint Board nor a court would infer that Congress expected the Joint Board to perform that role.

29. The Joint Board's discretion in determining the portion of the universal service costs that will be recovered from a bypass tax also appears to be somewhat excessive. The criteria described in Section 201(c)(3) may not provide meaningful guidance. As is discussed further below, if Congress chooses to impose a bypass tax, it should establish reasonably clear guidelines for determining the nature and magnitude of any charges that are to be imposed upon the bypassers.

30. The Section 210(e)(4) requirement that state commissions certify costs of eligible carriers may impose a burden that some commissions will be unable to meet. Some states such as Iowa are served by a very large number of different telephone companies and the state commissions in such states may not be equipped to perform that task. An awkward problem would be presented if some state commissions refused to accept the responsibilities that this provision thrusts upon them. Furthermore, state commissions are elected or appointed to keep local rates down. A failure to certify costs as reasonable will have the effect of raising their constituents' local rates. Thus, they have little incentive to scrutinize costs that will be recovered through interstate charges, and in fact have strong incentives to certify whatever costs are presented to them.

LIFELINE SERVICES

31. The Section 201(e)(4) provisions relating to lifeline service subsidies even more explicitly limit the discretion of state commissions to determine what local exchange service rates shall be. This provision apparently contemplates a national standard for lifeline rates that all state commissions will be obliged to accept. Indeed the lifeline service subsidy, which has not been proposed or considered in the Joint Board proceeding or prior common carrier bills, would not appear to serve any purpose other than creating a benefit that can be withheld if a particular state commission chooses to depart from national guidelines. If the intrastate revenue requirements are

equalized or substantially equalized through the assignment of high costs to interstate services as is proposed in the Joint Board plan pending before the Commission, additional subsidies would not be required to enable a state commission to set special rates for the truly needy. In the absence of a lifeline subsidy state commissions could use existing regulatory tools to create classes of local exchange service that will make affordable service available to all.

32. The "lifeline costs" may be very difficult to identify in any event. Section 201(e)(4) says it means "the amount by which the cost of providing lifeline telephone service exceeds the rate actually charged for such service." There is no standard method for computing the cost of local exchange service; some state commissions do not even purport to relate local exchange service rates to the cost of that particular service; and there is variability in ratemaking approaches and methods in the various states. A Joint Board could attempt to establish some rules for developing local exchange service cost, but that task could require a long and difficult proceeding, and it could potentially be very intrusive on local ratemaking prerogatives.

BYPASS

33. The provisions of S. 1660 do not constitute a satisfactory solution to the bypass problem. As was noted in Chairman Fowler's written testimony submitted on July 28, 1983, bypass of local telephone exchange facilities is a real and present danger. Large users of interstate telecommunications services are bypassing local exchange facilities with growing frequency because of the inequities in interstate rates. The bypassers range from state and local governments to large companies such as Boeing and Westinghouse. Further, AT&T could become the largest bypasser after it divests its ownership of the Bell Operating Companies pursuant to the divestiture requirements in United States v. American Telephone and Telegraph Co., 552 F. Supp. 131 (D.D.C. 1982), aff'd mem. sub nom. Maryland v. United States, 103 S. Ct. 1240 (1983).

34. The Commission, in its access charge decisions (CC Docket No. 78-72), has sought to alleviate the bypass problem by removing incentives which currently are leading large users to construct bypass facilities or otherwise bypass local facilities. Those incentives are generated by the current rate structure, which uses a usage-based scheme to shift a disproportionate amount of charges to interstate traffic. The access charge decision, by replacing this distorted rate structure with an equitable, cost-based system, reduces the incentives for uneconomic bypass of the local network. This reduced incentive promotes universal service by benefiting everyone who uses the public switched telephone network, primarily because it stems the serious drain of revenues out of the system which results from bypass. As large users bypass the local system, pressures for local rate increases are generated because remaining users of the system must make up the shortfall in revenues caused by the departure of the large users.

35. S. 1660 attempts to deal with this problem by preserving, at least in part, the distorted and inequitable rate structure inherent

in the present system while at the same time seeking to impose charges on carriers and other persons who connect with local exchange facilities or who totally bypass these facilities. Carriers or other persons who seek to avoid paying these bypass charges are subject to a $100,000 forfeiture penalty.

36. There are a number of problems with the Committee proposal. First, there may not be a legal basis for structuring bypass charges in the manner proposed in S. 1660. Unlike charges which might be imposed for interconnection, the charges that are imposed upon total bypassers actually are taxes, in that they do not bear any relationship to use of exchange facilities. Under the bill total bypassers will be billed for services that are not rendered and facilities that they do not use. Any attempt to characterize the charges as "user fees" ignores the fact that nonusers would be required to pay the charges. It is not clear whether Congress has the power to delegate the authority to impose charges upon persons who are not actually using the local exchange system through a "user fee" mechanism which does not employ Congress's taxing power. Certainly, telephone companies could not collect such fees under their tariffs as a charge for service, as no service will be rendered.

37. Second, it will be difficult to determine the types of activities which will constitute bypass under the bill. S. 1660 provides that an interexchange carrier or other person will be liable for bypass charges if that carrier or other person "offers . . . any transmission facilities or services used as a substitute for voice grade or equivalent transmission facilities or services offered by exchange carriers." Record carriers are expressly excluded from coverage by the bill. The Committee Report indicates that systems having "unique service and reliability requirements" are not covered because they are not "close substitutes" for local exchange services; the report lists "broadcaster's program transmissions" and "systems used primarily for public safety purposes" as examples.

38. The language of the bill and the report is fraught with uncertainty and vagueness. Let us cite some examples. It is impossible to discern from the bill whether local, state, and federal governmental agencies are subject to the bypass provisions. Since government agencies have frequently been engaged in bypass activities, and charges imposed on these activities would constitute a substantial new expense at the local, state, and federal level, it obviously is important to be able to determine from the language of the bill whether these agencies are treated as bypassers. The bill and the report, however, leave this question unanswered.

39. Further, the bill and report give little guidance regarding the question of whether data transmission facilities recently put into operation by newspaper publishing enterprises such as the Wall Street Journal and USA Today are subject to the bypass charges. Are these facilities "equivalent" to voice grade transmission facilities offered by exchange carriers? Do these facilities have "unique service and reliability" requirements? Where is the line supposed to be drawn between those systems which pay the charge and those which do not?

Although the answer to this question presumably would have some importance to a large cross section of American industry, the bill does not appear to draw the line with any precision. As another example, the report indicates that systems which are not "close substitutes" for local basic telephone service are not treated as bypassers, and then lists radio common carriers (RCCs) offering exchange services as an example. The problem with this is that, in terms of the nature of service provided, RCCs provide service which is quite similar to local exchange service provided by local carriers, and which is explicitly characterized as exchange service in Section 221(h) of the current Act. It is difficult to determine why the Committee does not consider RCCs' services to be a close substitute for local exchange service, and the report offers no explanation of the reasons for the Committee's conclusions.

40. In addition, the status of systems operated by railroads and oil pipeline companies is unclear under the language of the bill and the report. Under the language of the bill, the conclusion could be ventured that these systems are covered since they are used as substitutes for voice grade or equivalent facilities or services offered by exchange carriers. But are these systems exempted from coverage as bypass systems because, under the terms of the report, they have "unique service and reliability requirements" or because they are used "primarily" for public safety purposes? Certain communications systems used by railroads, for example, monitor train movements as a means of verifying train locations and measuring the level of traffic at various points throughout the system for purposes of increasing operational efficiency. Is this also a "public safety" purpose? Again, a reading of the bill and report does not produce any concrete answer. This vagueness in the bill and report would pose obvious problems for the Commission in administering the legislation. Beyond that, however, we must note that S. 1660 attempts simply to avoid these critical public policy issues. The legislation cannot ignore the fact that the answers to these questions are crucial to businesses, government agencies, and other entities which would like to know whether the bill would require them to start paying millions of dollars in bypass taxes.

41. A third problem with the bypass provision in S. 1660 is that it would have the effect of stifling technological innovation. The bill makes no attempt to distinguish between technology which does not introduce any new efficiencies and other types of bypass which, as a result of technological innovations, constitute more economical and efficient means of communicating than that provided by the current local exchange facilities. All types of bypass are subject to the bypass tax. Even though the report states that the bill is intended to "encourage the development of new technologies", it is difficult to discern how the application of bypass charges to uses made of this new technology can be construed as encouragement. For example, cable operators would be permitted, under the terms of S. 66, as passed by the Senate, to make use of new technologies in order to provide data transmission services which bypass the local loop. Under S. 1660, however, these cable operators would be forced to pay charges under the bypass provisions if they choose to offer these services.

42. Moreover, S. 1660 apparently would apply to existing bypass systems. Businesses using these systems would be required to pay bypass charges even though no such charges were in place at the time these facilities became operational. If the goal of S. 1660 is to discourage bypass, it is difficult to see how this goal is furthered by taxing existing systems. Is the intent to force the abandonment of these existing systems, even though the report recognizes that bypass systems "are major investments" which "often [cost] millions of dollars and [are] constructed to last for many years"? If this is not the intent of the bill, what is the basis for applying the bypass tax to these present systems?

43. As was noted in the Chairman's prior testimony, it would be extremely difficult to enforce any charge or tax upon bypassers who do not use any telephone company facilities. The inclusion of a forfeiture penalty for bypassers who do not voluntarily pay may not be lawful, and in any event it will not be sufficient in and of itself to cause bypassers to come forward and identify themselves. The collection problem will probably be even greater if the statute is interpreted to mean that the new Joint Board is actually supposed to perform the collection function. If the Joint Board has the enforcement responsibility, it will need a very large staff. If such a staff is not provided, then the bypass tax may prove to be an illusory deterrent to any form of bypass.

FCC TRANSITIONAL AUTHORITY

44. S. 1660 includes provisions addressing the manner in which the Commission can take steps to ensure a successful transition to a new access charge system based on the requirements of the legislation. The bill provides that the Commission, in addition to its existing authority, shall have discretion to establish interim access charges and to require carriers to submit interim tariffs based on the Commission's interim action. S. 1660 also provides that the records established in CC Docket No. 78-72, Phase I, and related proceedings, will serve as a sufficient basis for interim Commission action, and that judicial review of any such action must focus on the question of whether the Commission has exceeded authority under the legislation.

45. While the FCC probably has such power under the existing Act, it is clear that adoption of interim procedures will likely prove controversial, and lead to much litigation. For this reason, it is critical that Congress manifest its intention that expeditious procedures be employed, to minimize confusion if Congress does decide to alter the access charge plan the Commission has adopted.

RATE INTEGRATION

46. Section 7(c) of S. 1660 contains an amendment to the Communications Act relating to the provision of service to noncontiguous points (defined in the Committee Report as Alaska, Hawaii, Puerto Rico, and the Virgin Islands). These provisions are unnecessary.

47. The bill language would require rates to be integrated for service between noncontiguous points and the contiguous states. This is already being accomplished. In the domestic satellite proceedings in the early 1970's, the Commission adopted a policy of fostering rate integration for MTS-WATS interstate communications. Establishment of Domestic Communications Satellite Facilities, 35 FCC 2d 844 (1972). Subsequent decisions concluded that rate integration should be achieved through phased reductions. Integration of Rates and Services, 61 FCC 2d 380 (1976). Rates are already integrated for Puerto Rico and the Virgin Islands. The final step in the rate integration process for Alaska and Hawaii, as the Committee Report notes, is included in the tariff revisions filed by the American Telephone and Telegraph Company on October 3, 1983. This will result in rates being integrated for these two states earlier than the January 1, 1985 date specified in the settlement agreement between carriers serving the states. The settlement agreement was approved by this Commission in Docket No. 21263, Integration of Rates and Services, 87 FCC 2d 18 (1981). Thus, legislation is not required to establish the integration policy and its implementation.

48. The amendment also provides that "the current telephone carrier settlement arrangements" shall be "maintained until modified or replaced in accordance with orders of the Commission in such proceedings." The existing settlement agreements provide that settlements between carriers will be based on the Separations Manual provisions. For 1984, the Alaskan and Hawaiian carriers involved are to receive a transitional supplement to moderate the effects of moving from prior settlement procedures to settling on the basis of the Separations Manual provisions. Although the transitional supplement will expire after 1984, the settlement agreement will not. Thus, this amendatory language is unnecessary to ensure that the settlement procedures remain in place for the noncontiguous states. There is no reason to believe that the implementation of access charges would require or warrant a change in the basic settlement formula that has been negotiated by the carriers and approved by the Commission. If changes are required in the future, the existing provisions of Section 201 can be invoked to prescribe a settlements formula.

49. The amendment also requires the initiation within 180 days of a proceeding relating to integration of rates. However, as the preceding paragraphs reflect, the initiation of additional formal proceedings to develop rate integration policies is unnecessary. Moreover, it would be redundant with the proceedings that were recently concluded in Docket No. 21263, supra, which will lead to the completion of the rate integration policy for Alaska and Hawaii.

50. In addition to believing that legislative action is unnecessary with respect to noncontiguous states, we are concerned with the language of the Committee report. If legislation is to be adopted, unnecessary limitations should not be imposed on Commission discretion. Additionally, some of the report language is not related to integration.

51. The report states that "[i]t is the intent of the Committee that any change in the prescriptions of separations and settlements methodologies for the noncontiguous states necessary to implement rate integration not result in a shifting of a greater percentage of the cost of providing long distance facilities from the federal to the state jurisdictions than is now the case." The recent proceedings relating to separations have found that allocations between federal and state jurisdictions should be based on the same principles for all states to insure equity and to avoid discrimination. The cited language could be interpreted as reducing the flexibility of a future Joint Board established pursuant to Section 410(c) of the Act to follow such a principle if changes were recommended to the Commission in the future.

52. We believe such a limitation upon Joint Board and Commission discretion would be unwise and cannot reasonably be inferred from the language of the provision. If Section 7(c) is retained, it should be amended to preclude such a construction. Language should also be included to avoid any inference that the Commission proceeding that is initiated must include all subjects listed in the report. Such a legislative intent cannot be inferred from the language of the provision and the report language would create unnecessary confusion.

The Economic Issues of a Changing Telecommunications Industry.

STATEMENT OF

BRUCE HAGEN, PRESIDENT

NORTH DAKOTA PUBLIC SERVICE COMMISSION

Presented to

JOINT ECONOMIC COMMITTEE

of the

CONGRESS OF THE UNITED STATES

THE HONORABLE ROGER JEPSEN, CHAIRMAN

Hearing held on October 17, 1983

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I appreciate this opportunity to participate by written statement in your Joint Economic Committee field hearing to discuss how the residents of North Dakota and other states of the upper Midwest will be affected by changes in the telephone industry.

There appears to be a change taking place in the attitude of many about the national goal to provide universal telephone service at an affordable cost to all Americans. The Communications Act of 1934 envisioned that this new technology, the telephone, would be of greater economic and social value to the nation if more and more users were added to an expanding telephone network extending to the most rural areas of America. Perhaps the rural areas would not enjoy the more sophisticated forms of telephone service that the large urban area would, but a basic form of telephone service to everyone would be in the national interest.

To achieve this goal, the Communications Act of 1934 established the Federal Communications Commission (FCC). The REA program, which has been in place for approximately 34 years, has provided low cost funds to telephone companies in rural high cost areas. It would probably be safe to say that, at the national level, it was not intended that all users of telephone service pay the exact costs they impose on the system.

In the past monopoly environment, the universal service goal worked because certain telephone users were required to pay more than their actual costs if they wanted to continue using the national network. However, as we continued toward our goal of universal telephone service, certain technologies advanced and those customers who were paying more than costs objected. They petitioned to the FCC and the courts and, as a result, a competitive environment is being allowed to become a reality.

A new problem arose. The goal of universal service was able to continue as long as certain big customers were paying more than their costs. In a competitive environment where prices are cost based, customers generally pay the costs they impose on the system. If those costs are higher, as they appear to be in rural areas, some customers who were afforded service under a monopoly environment will not be able to afford service under a competitive environment. At first glance, it would appear universal service cannot exist in a competitive environment because the price of local service will increase dramatically, and the drop in the price of long distance calls to toll users, especially in rural areas such as North Dakota, may not offset the increased costs for local service.

For discussion purposes only, assume that competition in the telecommunications industry is the new national goal and that we are in a transition from a monopolistic industry to a competitive one. However, let us also require that our national goal is to continue universal service as we know it today. With this policy in mind, we must conclude that the cost of providing basic telecommunications service to rural areas and to low income users must be reduced. This must be done through technological advancement in the provision of telephone service at the local exchange level. And technologies in this area may very well advance if they are promoted.

It has often been said that "necessity is the mother of invention." If the cost of service to rural areas continues to increase, eventually we might conclude that someone will find it profitable to invent a cheaper way to provide that service, and that technology will be implemented if such service is open to competition.

If new technology does not reduce the cost of providing basic service, or if this new technology takes many years to develop, and if we hold fast to our goal of continued universal service at affordable rates, then we must consider other alternatives. Those alternatives might include increased amounts of federal dollars for low interest REA loans, federal funding to welfare programs, or revised ratemaking designed to charge certain local telephone customers to subsidize others. It is apparent the most unlikely short-term possibility will be to return the telecommunications industry to more regulation. However, we do hope Congress acts in this session to guarantee our goal of universal telephone service.

Therefore, perhaps the best combination of alternatives is increased federal dollars for REA loans, permitting some subsidization through ratemaking, and a period of transition from present ratemaking based averages to that based on costs, that period of transition being long enough to allow for development of new technologies to reduce the costs of providing basic local service. Congressional actions in this session could, through universal service fund legislation, help solve our problems.

The task at hand is great, and the discussions to be made will affect every user of telephone service. The North Dakota Public Service Commission remains committed to a national goal of universal service at an affordable cost to all Americans.

Bruce Hagen

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