

THE STATE PERSPECTIVE

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SALOMON BROTHERS, INC.  
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NEW YORK, NEW YORK 10004

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THE FORCES OF TECHNOLOGY HAVE REQUIRED A REEVALUATION AND REDEFINITION OF THE STRUCTURE OF TELECOMMUNICATIONS SERVICE MARKETS.

THE FEDERAL TREND TOWARDS DEREGULATION OF THE TELECOMMUNICATIONS INDUSTRY HAS PLACED SUBSTANTIAL POLITICAL PRESSURE ON THE STATE COMMISSIONS WHERE PRIMARY CONCERN HAS BEEN THE CONTINUATION OF AFFORDABLE RATES FOR RESIDENTIAL AND SMALL BUSINESS CUSTOMERS. MANY OBSERVERS HAD SPECULATED THAT TECHNOLOGICAL, ECONOMIC AND POLICY DEVELOPMENTS WOULD COMPEL MORE STATE OFFICIALS TO PERMIT SOME FORM OF TELECOMMUNICATIONS FLEXIBILITY.

#### STATE INITIATIVES

IT WOULD APPEAR THAT THOSE OBSERVATIONS WERE CORRECT. SINCE 1983, ALMOST HALF OF THE STATES HAVE ENACTED MAJOR LEGISLATION PROVIDING FOR REDUCED REGULATION OR DEREGULATION OF COMPETITIVE TELEPHONE SERVICES. AS OF SEPTEMBER 1, 1987, TWENTY-TWO STATES HAVE ENACTED TWENTY-FIVE DEREGULATION STATUTES. WITH THE NOTABLE EXCEPTION OF NEBRASKA, THESE STATUTES HAVE LEFT THE ACTUAL

DECISION ON WHETHER AND HOW MUCH TO DEREGULATE IN THE HANDS OF THE STATE REGULATORY COMMISSION. 1/

IN JUNE OF 1987 THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION GRANTED THE PETITION OF AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST OF (ATTCOM-PACIFIC) FOR CLASSIFICATION AS A COMPETITIVE CARRIER AND WAIVED VARIOUS STATUTES AND RULES CONCERNING BUDGETS, EXCESSIVE EARNINGS, AND SERVICE OFFERINGS. A 1986 LAW REQUIRES THE PUC TO CLASSIFY A TELECOMMUNICATIONS PROVIDER AS COMPETITIVE IF IT FINDS, AFTER NOTICE AND HEARINGS, THAT THE COMPANY'S SERVICES ARE SUBJECT TO "EFFECTIVE COMPETITION" WHICH MEANS THAT CUSTOMERS HAVE REASONABLY AVAILABLE SERVICE ALTERNATIVES AND THAT THE COMPANY DOES NOT HAVE A SIGNIFICANT CAPTIVE CUSTOMER BASE.

HOWEVER, THE PUC FOUND THAT ATTCOM-PACIFIC RETAINED VESTIGES OF MARKET POWER IN CERTAIN LOCATIONS AND MADE ITS COMPETITIVE CLASSIFICATION CONDITIONAL. THESE CONDITIONS ARE THAT ATTCOM-PACIFIC SHALL 1) CONTINUE CHARGING GEOGRAPHICALLY UNIFORM RATES, 2) CONTINUE PROVIDING SERVICE IN ALL AREAS OF THE STATE, 3) BE RESTRICTED IN ITS ABILITY TO CHANGE PRICES CHARGED TO CUSTOMERS USING ONE HOUR OF LONG-DISTANCE SERVICE PER MONTH RELATIVE TO THE PRICES CHARGED TO CUSTOMERS USING TEN HOURS OF LONG-DISTANCE SERVICE PER MONTH, AND 4) BE RESTRICTED FROM PLACING PROHIBITIONS OR SURCHARGES FOR RESALE OR SHARED USE OF

ANY INTEREXCHANGE SERVICE OR FACILITY. THE CONDITIONS ARE TO REMAIN IN EFFECT UNTIL AT LEAST MARCH 1, 1990.

AS A RESULT OF ITS CLASSIFICATION AS A COMPETITIVE CARRIER, ATTCOM-PACIFIC IS PERMITTED TO FILE PRICE LISTS IN LIEU OF TARIFFS. IN DECLARING THE COMPANY COMPETITIVE, THE PUC FOUND THAT ATTCOM-PACIFIC HAD EXPERIENCED A SIGNIFICANT DECLINE IN MARKET SHARE, EASE OF MARKET ENTRY WAS SHOWN, CONSUMERS HAD SERVICE ALTERNATIVES, AND ATTCOM-PACIFIC DID NOT HAVE A SIGNIFICANT CAPTIVE CUSTOMER BASE. THE PUC CONSIDERED AND REJECTED VARIOUS PROPOSALS FOR THE REGULATION OF ATTCOM-PACIFIC SUCH AS THE IMPOSITION OF A RATE OF RETURN CAP, AND PRICE BOUNDARIES EITHER BECAUSE THEY WERE CONTRARY TO THE FLEXIBILITY STATUTE OR THEY WERE NOT WORKABLE IN A COMPETITIVE MARKET.

THE MARYLAND PSC HAS ALSO RELAXED ITS REGULATORY CONTROL OVER AT&T COMMUNICATIONS OF MARYLAND, INC. (ATTCOM-MARYLAND). IN 1984, THE PSC EXAMINED WHETHER MARKET FORCES WERE SUFFICIENT TO COUNTER A DOMINANT MARKET SHARE HELD BY ATTCOM-MARYLAND. THE COMMISSION CONCLUDED THAT MARKET FORCES WERE NOT SUFFICIENT, BUT THAT IT WAS NOT NECESSARY TO RETAIN TRADITIONAL RATE BASE, RATE OF RETURN REGULATION OVER THE COMPANY. THIS CONCLUSION WAS REACHED AFTER THE COMMISSION RECEIVED EVIDENCE CONCERNING ATTCOM-MARYLAND'S MARKET SHARE, EASE OF ENTRY, CAPITAL EXPANSION

) CAPACITY OF OCCS, AVAILABLE ALTERNATIVES AND THE AVAILABILITY OF EQUAL ACCESS.

THE PSC AUTHORIZED THE COMPANY TO FILE FOR EXPEDITED RATE CHANGES, SO LONG AS THE CHANGES WERE WITHIN A BAND RANGING FROM A MINIMUM OF 5% BELOW A PSC SET REVENUE REQUIREMENT TO A MAXIMUM OF 5% ABOVE THE REVENUE REQUIREMENT. HOWEVER, THE COMMISSION ALSO ORDERED THAT THE COMPANY'S FINANCIAL OPERATIONS BE MONITORED.

IN 1986, THE MARYLAND PSC DETERMINED THAT THE COMPANY SHOULD BE GIVEN GREATER PRICING DISCRETION. THUS, ATTCOM-MARYLAND WOULD NO LONGER BE REQUIRED TO FILE FOR EXPEDITED RATE CHANGES WITHIN THE PSC'S PARAMETERS. HOWEVER, THE COMMISSION WOULD CONTINUE TO REQUIRE FINANCIAL MONITORING, WOULD NOT ACCEPT GEOGRAPHICALLY DEAVERAGED RATES AND WOULD REQUIRE THAT ANY PROPOSED RATE DESIGN CHANGES OR NEW SERVICES BE DOCUMENTED AS TO THEIR REASONABLENESS PRIOR TO ACCEPTANCE.

MOST RECENTLY, THE MARYLAND COMMISSION IS CONSIDERING A REQUEST BY ITS BOC, C&P TELEPHONE, THAT BASIC SERVICE RATES BE FROZEN AND MARKET BASED PRICING BE APPLIED TO SERVICES WHICH ARE OPTIONAL OR WHICH FACE SIGNIFICANT COMPETITION. C&P ESTIMATED THAT SUCH MARKET-PRICED SERVICES WOULD REPRESENT 40% OF ITS REVENUES.

RATES TO BE "PROTECTED" INCLUDE BOTH DIAL TONE AND USAGE PORTIONS OF RESIDENTIAL SERVICE. FOR BUSINESS, DIAL TONE RATES WOULD BE FROZEN AND USAGE RATE INCREASES WOULD NOT EXCEED 2 CENTS PER MESSAGE OVER FOUR YEARS. MARKET PRICED SERVICES WOULD INCLUDE CENTREX, PUBLIC PHONES, CUSTOM CALLING FEATURES, WATS, PRIVATE LINE, SPECIAL AND SWITCHED ACCESS, BILLING AND COLLECTION, 976, YELLOW PAGES AND INSIDE WIRE INSTALLATION AND MAINTENANCE.

THE COMMISSION HAS ESTABLISHED A TASK FORCE TO REVIEW THE PROPOSAL. ITS REPORT IS DUE BY DECEMBER 31, 1987.

ALSO IN 1986, THE NEW JERSEY BOARD OF PUBLIC UTILITIES ADOPTED RULES PERMITTING INTRASTATE INTERLATA CARRIERS TO CHANGE RATES FOR COMPETITIVE SERVICES WITHOUT PRIOR APPROVAL. THE RULES ALLOW LONG DISTANCE COMPANIES TO ADJUST INDIVIDUAL RATES BY AS MUCH AS 25% SO LONG AS THE BOARD IS NOTIFIED. HOWEVER, THE BOARD RETAINED THE RIGHT TO SUSPEND ANY RATE CHANGE FINDING HEARINGS AND FORMAL FINDINGS.

THE MICHIGAN PUBLIC SERVICE COMMISSION ADOPTED A HYBRID FORM OF REGULATION UNDER WHICH ATTCOM-MICHIGAN HAS LESS REGULATORY FREEDOM THAN OTHER CERTIFICATED INTEREXCHANGE CARRIERS, BUT ENJOYS A SUBSTANTIAL AMOUNT OF RATE FLEXIBILITY. ATTCOM-MICHIGAN WAS AUTHORIZED TO EARN A RATE OF RETURN WITHIN A SPECIFIED RANGE,

) WAS PERMITTED TO ENGAGE IN LIMITED FLEXIBLE PRICING AND WAS ALLOWED TO CONDUCT MARKET TRIALS AND RATE EXPERIMENTS UNDER A STREAMLINED APPROVAL PROCESS.

IN JANUARY OF 1987 A TWO-PART DEREGULATION BILL BECAME LAW IN MICHIGAN. PART ONE ALLOWS FLEXIBILITY IN THE REGULATION OF CERTAIN SERVICES THAT FACE COMPETITION OR ARE CONSIDERED NEW, PROMOTIONAL OR EXPERIMENTAL. RATES WOULD TAKE EFFECT WITHIN 30 DAYS OF FILING WITHOUT A FORMAL PROCEEDING. PART TWO PERMITS THE TOTAL DEREGULATION OF COMPETITIVE SERVICES. THE MICHIGAN PUBLIC SERVICE COMMISSION WOULD DETERMINE WHETHER A SERVICE IS COMPETITIVE, BUT THE LAW ALSO PROVIDES THAT THE PSC WOULD LOSE ITS AUTHORITY TO REGULATE TELECOMMUNICATIONS ON JANUARY 1, 1992.

NORTHWESTERN BELL RECENTLY INITIATED THE INTRODUCTION OF A BILL IN SOUTH DAKOTA WHICH CALLS FOR THE IMMEDIATE DEREGULATION OF LOCAL SERVICES AND THE REMOVAL OF THE PUC'S OVERSIGHT OF LOCAL RATES. OF COURSE, THE PUC RESISTED AND THE LEGISLATION HAS BEEN REVISED SEVERAL TIMES. THE PUC IS NOT OPPOSED TO DEREGULATION PER SE, BUT BELIEVES THAT IT SHOULD BE DONE ON A GRADUAL BASIS AND SHOULD FOLLOW PROPER ADMINISTRATIVE PROCEDURES. THE PUC HAS RELUCTANTLY AGREED TO THE CLASSIFICATION OF SERVICES AS NON-COMPETITIVE, EMERGING COMPETITIVE AND FULLY COMPETITIVE FOR DEREGULATORY PURPOSES, BUT INSISTS THAT IT IS THE ONE TO CLASSIFY

THE SERVICES. NORTHWESTERN BELL HAS TAKEN THE POSITION THAT IT IS IN THE BEST POSITION TO KNOW THE STATUS OF ITS SERVICES.

THE LEGISLATION IS AT A STALEMATE PENDING A STUDY BY A LEGISLATIVE COMMITTEE. HOWEVER, THE PUC HAS STATED THAT IF THE FINAL VERSION OF THE BILL IS PASSED OVER ITS OBJECTION, IT WILL SEEK A REFERENDUM.

THE WEST VIRGINIA PUBLIC SERVICE COMMISSION ISSUED A GENERIC ORDER AUTHORIZING STREAMLINED REGULATION OF ALL INTRASTATE INTERLATA TELEPHONE CARRIERS ON AN EQUAL BASIS. THESE CARRIERS ARE NO LONGER SUBJECT TO RATE BASE, RATE OF RETURN REGULATORY OVERSIGHT. HOWEVER, THEY ARE GENERALLY PROHIBITED FROM ENGAGING IN ANTICOMPETITIVE BEHAVIOR, INCLUDING RATE DEAVERAGING. FURTHER, THE PSC DID NOT STREAMLINE ITS REGULATION OF SERVICE ABANDONMENTS.

FINALLY, THE ILLINOIS COMMERCE COMMISSION DETARIFFED CENTREX, BUT RULED THAT ILLINOIS BELL WOULD STILL BE REQUIRED TO KEEP CURRENT RATES ON FILE WITH THE COMMISSION.

THE DISTRICT OF COLUMBIA COMMISSION HAS ALSO INVESTIGATED THE FEASIBILITY OF DEREGULATING CENTREX SERVICE.



) CENTREX IS AN EXTREMELY IMPORTANT SERVICE IN THE DISTRICT OF COLUMBIA BECAUSE IT COMPRISES 42% OF OUR OPERATING COMPANY'S ACCESS LINES AND 42% OF ITS INTRASTATE REVENUES. THIS LARGE DEPENDENCE ON CENTREX REVENUES IS UNIQUE AMONG LOCAL EXCHANGE CARRIERS. 2/ ALSO UNIQUE IS THE COMPANY'S HEAVY RELIANCE ON THE FEDERAL GOVERNMENT AS A CENTREX CUSTOMER. GSA IS C&P LARGEST CUSTOMER, USING 34% OF THE CENTREX LINES IN SERVICE. THE FEDERAL GOVERNMENT AS A WHOLE USES 73% OF CENTREX LINES.

IN 1985, THE COMPANY PROPOSED NEW CENTREX RATES. IN THIS PROCEEDING THE OFFICE OF PEOPLE'S COUNSEL ARGUED THAT THE COMPETITIVE ENVIRONMENT REQUIRED THAT CENTREX BE TREATED AS A SPECIAL CATEGORY OF SERVICE, WITH AN IMPUTED REVENUE REQUIREMENT UNDER WHICH C&P WOULD HAVE BROAD FLEXIBILITY TO PRICE CENTREX AS IT SAW FIT. 3/

C&P OPPOSED THIS PROPOSAL. INSTEAD, THE COMPANY PROPOSED TO CONTINUE ITS PRESENT RATE STABILITY PLAN AND INSTITUTE A NEW PLAN, WHICH CONTAINED A THREE YEAR CONTRACT LIFE AND SUBSTANTIAL PRICING REVISIONS, RANGING FROM REDUCTIONS OF 10% TO 95%. C&P ALSO PROPOSED TO IMPLEMENT A FULL CALC CREDIT OF \$2.00 TO ENSURE CONTINUED COMPARABILITY WITH PBX SYSTEMS.

THE COMMISSION REJECTED THE PROPOSAL TO CREATE A SEPARATE CENTREX REVENUE REQUIREMENT CATEGORY. WE WERE NOT PREPARED TO

RELINQUISH REGULATORY AUTHORITY OVER A SERVICE WHICH UTILIZED SUCH A SUBSTANTIAL PORTION OF COMMON CENTRAL OFFICE FACILITIES AND OUTSIDE PLANT.

WHILE THE COMMISSION WAS ABSOLUTELY CONVINCED THAT CENTREX REQUIRED A SPECIAL REGULATORY RESPONSE, WE WERE NOT PERSUADED THAT THE C&P PROPOSAL WOULD PROVIDE THAT RESPONSE. WE REASONED THAT THE CUSTOMERS WITH 10,000 LINES OR MORE COULD NOT SOLICIT BIDS FROM VENDORS, AWARD A CONTRACT AND COMPLETELY INSTALL A PBX SYSTEM IN LESS THAN THREE YEARS. THEREFORE, THE PLAN AS PROPOSED BY THE COMPANY WOULD HAVE NO IMPACT UPON THE PROCUREMENT DECISIONS OF ITS LARGE CUSTOMERS - AND THUS FAILED IN PROVIDING THE INDUCEMENT TO RETAIN CENTREX SERVICE. WE THEREFORE, ORDERED THAT LARGE CUSTOMERS COULD ONLY ELECT THE NEW PLAN, WITH THE PROPOSED RATE REDUCTIONS, IF THE CUSTOMER SIGNED UP FOR A FIVE YEAR PERIOD. IN ORDER TO FURTHER INDUCE CUSTOMER COMMITMENT, WE AGREED THAT THE RATES FOR THE NEW SERVICE WOULD ONLY BE ADJUSTED UPWARD BY AN AMOUNT NOT TO EXCEED THE PERCENTAGE INCREASE IN THE CONSUMER PRICE INDEX DURING THE PREVIOUS TWELVE MONTHS. THE COMMISSION WAS SO CONCERNED WITH THE POTENTIAL REVENUE LOSSES ASSOCIATED WITH CENTREX THAT WE ALSO GRANTED C&P'S REQUEST FOR A FULL CALC CREDIT ON THE INTERCOM RATE.

THESE EXAMPLES ILLUSTRATE THAT STATE COMMISSIONS HAVE NOT BECOME ANACHRONISMS. RATHER, THEY ARE WILLING TO INVESTIGATE AND

) DEVELOP INNOVATIVE PRICING TECHNIQUES AND IMPLEMENT THEM WHERE AND WHEN THEY ARE APPROPRIATE. STATE REGULATORS ARE VERY MUCH AWARE THAT THE COMPANIES THEY REGULATE MUST BE ABLE TO ACT QUICKLY IN ORDER TO TAKE FULL ADVANTAGE OF THE NEW COMPETITIVE ENVIRONMENT.

FOR THIS REASON, SEVERAL STATES HAVE ESTABLISHED A RANGE OF ALLOWABLE RATES-OF-RETURN INSTEAD OF TARGETING A SPECIFIC RATE. IN CONNECTICUT, PRICES FOR SOUTHERN NEW ENGLAND TELEPHONE (SNET) ARE SET TO MEET A TARGET RATE-OF-RETURN OF 13%, EQUITY RETURNS OF 13% TO 13.5% ARE RETAINED BY SNET, BUT RETURNS BETWEEN 13.5% AND 14.3% ARE SPLIT BETWEEN SHAREHOLDERS AND RATEPAYERS. PROFITS IN EXCESS OF 14.3% ARE RETURNED IN FULL TO RATEPAYERS. SNET IS NOT PERMITTED TO FILE FOR A RATE INCREASE UNTIL AT LEAST 1989 UNLESS ITS RATE OF RETURN FALLS BELOW 11% FOR ONE YEAR.

WISCONSIN BELL'S TARGET RATE OF RETURN IS 13.5%, BUT IT CAN RETAIN ALL EARNINGS UP TO 14%. EARNINGS IN THE 14% TO 15.5% RANGES ARE SHARED BY RATEPAYERS AND SHAREHOLDERS. EARNINGS OVER 15.5% ARE RETURNED TO SHAREHOLDERS. WISCONSIN BELL HAS AGREED NOT TO FILE FOR A RATE INCREASE UNTIL 1989 AND THEN ONLY IF ITS RETURN ON EQUITY FALLS BELOW 12.5%.

IN THE STATE OF WASHINGTON, THE UTILITIES AND TRANSPORTATION COMMISSION HAS PROPOSED "INCENTIVE REGULATION" WHICH WOULD

ESTABLISH A RANGE FOR RATE OF RETURN AND DEVELOP INDICES TO MONITOR SERVICE QUALITY.

RATES WOULD BE SET TO RECOVER A RETURN IN THE MIDDLE OF THE RANGE. THE COMPANY WOULD AGREE NOT TO SEEK A RATE INCREASE UNLESS ITS RETURN FELL BELOW THE LOWER END OF THE RANGE. ALSO BEING CONSIDERED IS A "BONUS" RATE OF RETURN UNDER WHICH TELCOS WOULD KEEP SOME EARNINGS OVER THE AUTHORIZED RETURN AND THE REST WOULD GO TO THE RATEPAYERS.

SERVICE QUALITY INDICES SUGGESTED BY THE WUTC INCLUDE ENGINEERING FACTORS SUCH AS BLOCKAGE RATIOS, PLANT USE FACTORS AND QUALITY OF CONNECTIONS AND CUSTOMER SERVICE FACTORS, SUCH AS THE NUMBER OF JUSTIFIED COMPLAINTS. FINANCIAL INDICES ALSO MIGHT BE DEVELOPED.

THE DISTRICT OF COLUMBIA COMMISSION RECENTLY ORGANIZED A WORKING GROUP TO STUDY THE COMPETITIVE ENVIRONMENT FACING THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY. THE GROUP WILL RECOMMEND REGULATORY APPROACHES TO ADDRESS CURRENT AND FUTURE MARKET CONDITIONS. ITS REPORT IS DUE NO LATER THAN DECEMBER 30, 1988 AND COULD HAVE A DRAMATIC IMPACT ON THE MANNER IN WHICH C&P IS REGULATED. 4/

PRICE CAPS

) I WOULD BE REMISS IF I DID NOT AT LEAST MENTION THAT THE FCC IS CONTINUING ITS STEADY MARCH DOWN THE DEREGULATORY PATH WHICH WAS BEGUN BY FORMER FCC CHAIRMAN MARK FOWLER. THE ONLY DIFFERENCE IS THAT INSTEAD OF MARCHING "BACK TO THE FUTURE" WE ARE GOING FORWARD WITH PRICE CAPS.

ON AUGUST 21, 1987 THE FCC RELEASED A NOTICE OF PROPOSED RULEMAKING (NPRM) IN WHICH IT SOUGHT COMMENTS ON ITS PROPOSAL TO REGULATE DOMINATE CARRIERS THROUGH THE USE OF PRICE CAPS. 5/ THIS IDEA ORIGINATED IN 1984 WHEN GREAT BRITAIN APPLIED IT TO BRITISH TELECOM. THE FCC'S RATIONALE WAS THAT THE USE OF PRICE CAPS "WOULD ENCOURAGE GREATER EFFICIENCY AND INNOVATION... ESPECIALLY IN LESS COMPETITIVE MARKETS, WOULD DECREASE INCENTIVES TO SHIFT COSTS FROM MORE TO LESS COMPETITIVE SERVICE OFFERINGS AND COULD REDUCE, IF NOT ELIMINATE, ANY PERVERSE INCENTIVES TO INFLATE RATE BASES". 6/

I, AS A STATE REGULATOR, DO NOT BELIEVE THAT COMPETITION INCREASES AS REGULATION DECREASES. RATHER, I BELIEVE THAT THE INVERSE IS TRUE. THAT IS, TRUE COMPETITION WILL LEAD TO LESS REGULATION. I DISAGREE WITH THE FCC'S ALLEGATION THAT PRICE CAPS WILL ENCOURAGE EFFICIENCY AND INNOVATION. ALL THAT IT WILL ENCOURAGE IS ENORMOUS PROFITS FOR THE COMPANY AND NO BENEFITS FOR RATEPAYERS.

FOR EXAMPLE, THE FCC HAS PROPOSED THAT ADJUSTMENTS TO THE CAPS BE TIED TO EITHER THE CONSUMER PRICE INDEX (CPI) OR THE PRODUCER'S PRICE INDEX (PPI). THE AGENCY EXPRESSED A PREFERENCE FOR THE PPI BECAUSE THE FCC BELIEVED THAT IT WOULD MORE ACCURATELY REFLECT THE CARRIER'S COST OF PRODUCING ITS SERVICES. 7/

THE INDEXING OF CAP ADJUSTMENTS WAS ONE OF THE ISSUES DISCUSSED ON NOVEMBER 11, 1987 AT A HEARING HELD BY EDWARD J. MARKEY (D. MASS). DURING FIVE HOURS OF TESTIMONY, ONLY AT&T, THE FCC, AND REPUBLICAN CONGRESSMAN HAD ANYTHING GOOD TO SAY.

MR. MARKEY DISPLAYED A CHART OF A STEEPLY CLIMBING CPI, RISING 188.5% SINCE 1975 AND TELEPHONE PRICES THAT WENT UP ONLY 77.8%, ILLUSTRATING A DECLINING COST INDUSTRY. 8/

THE CONSUMER FEDERATION OF AMERICA (CFA) ESTIMATED THAT IF THE PRICE CAP PROPOSAL HAD BEEN IMPLEMENTED IN 1934, THE AVERAGE RESIDENTIAL TELEPHONE BILL WOULD BE \$80 PER MONTH NOW INSTEAD OF THE CURRENT \$35 PER MONTH. 9/

THE MARYLAND PEOPLE'S COUNSEL TESTIFIED THAT ONCE AT&T OBTAINED FLEXIBLE PRICING IN MARYLAND EXCESSIVE PROFITS WERE GENERATED. AT&T EARNED 67.97% IN 1985 AND 91.08% IN 1986. 10/

) FEARFUL OF INVESTORS REAPING SUPRACOMPETITIVE PROFITS, MARKEY ASKED CHAIRMAN PATRICK FOR ASSURANCE THAT CONSUMERS WOULD BENEFIT FROM PRICE CAP REGULATION. PATRICK PROMISED TO MANDATE PASS-THROUGH OF SAVINGS SO THAT CONSUMERS WILL BENEFIT AND DO BETTER THAN UNDER RATE OF RETURN REGULATION. HOWEVER, JIM COOPER (D. TENN) CHARACTERIZED SIMILAR ASSURANCES ON POOLING AND AVERAGED RATES AS MERE "LIP SERVICE". 11/

HOUSE ENERGY & COMMERCE COMMITTEE CHAIRMAN JOHN D. DINGELL (D. MICH) VOWED TO MONITOR THE FCC TO SEE IF IT WOULD: 1) PREVENT THE EMERGENCE OF A COZY LONG DISTANCE OLIGOPOLY, 12/ NOT SUBJECT TO COMPETITIVE CONSTRAINTS; 2) MONITOR PROFIT RATES; 3) PROVIDE THAT EXCESS PROFITS WOULD BE SHARED WITH CUSTOMERS; AND 4) SECURE BINDING COMMITMENTS FROM DEREGULATED FIRMS THAT PROFITS WOULD BE USED TO MAINTAIN THE SYSTEM. 13/

I DON'T KNOW HOW THE FCC WOULD ENFORCE THIS, BUT IF PRICE CAPS ARE IMPLEMENTED, IT SHOULD BE ADOPTED.

COMMISSIONER GAIL GARFIELD SCHWARTZ OF THE NEW YORK PUBLIC SERVICE COMMISSION URGED THE FCC TO EXPERIMENTALLY IMPLEMENT FOR AT&T A COST-BASED INCENTIVE REGULATION PROGRAM MODELLED ON THAT DEVELOPED IN NEW YORK WHICH PERMITS REGULATED SERVICE CHARGES TO BE CAPPED NOT ON THE BASIS OF CURRENT RATES, BUT ON THE BASIS OF CURRENT COSTS, AND ALLOWS AT&T TO RETAIN NO MORE THAN 50% OF ITS

EARNINGS OVER A COST-JUSTIFIED LEVEL. (THIS LEVEL IS CURRENTLY 14% AND REPRESENTS THE RATE OF RETURN THE PSC WOULD HAVE IMPOSED IN THE NEXT RATE CASE). THE EXPERIMENT SHOULD BE CLOSELY MONITORED AND ACTUAL RATES SHOULD BE COMPARED TO RATES THAT WOULD HAVE BEEN EARNED FOR EACH SERVICE UNDER TRADITIONAL REGULATION. AFTER A REASONABLE PERIOD OF TIME (PERHAPS TWO YEARS), THE FCC SHOULD INVITE COMMENTS. 14/

I WOULD AGREE WITH COMMISSIONER SCHWARTZ THAT THE FCC'S PRICE CAP PROPOSAL IS TOO MUCH, TOO SOON. IT IS COMPARABLE TO AMPUTATING AN ARM CURE A HANGNAIL. RATE OF RETURN REGULATION WORKS AND WILL CONTINUE TO WORK SO LONG AS REGULATORS ARE ALLOWED TO DETERMINE WHAT FORM IT SHOULD TAKE IN THEIR STATE. WE ARE READY, WILLING AND ABLE TO DO THIS. EVEN THE FCC ACKNOWLEDGED THAT THIRTY-ONE STATES HAVE MOVED AWAY FROM RATE OF RETURN REGULATION IN ITS STRICTEST SENSE. 15/ BEFORE THE FCC TOTALLY ABANDONS RATE OF RETURN AS A REGULATORY DEVICE, IT SHOULD RECALL THAT ITS DETERMINATION THAT A&T MUST REDUCE ITS RATES BY 34% WAS MADE BY USING RATE OF RETURN. 16/



### FOOTNOTES

1. See State Telephone Regulation Report, September 24, 1987
2. See Formal Case #828, Order #8230 April 15, 1985 at 32
3. Id. at 29
4. Formal Case #814, Order #8876, September 28, 1987
5. In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313; Released 8/21/87
6. Id. at 6
7. Id. at 11
8. Telecommunications Report, November 16, 1987
9. Id.
10. Id.
11. Id.
12. An oligopoly is a market situation in which each of a few producers affects, but does not control the market.
13. Telecommunications Report August 10, 1987
14. Testimony of Gail Garfield Schwartz before the U.S. House of Representatives Committee on Energy and Commerce, Subcommittee on Telecommunications and Finance, November 10, 1987.
15. Telecommunications Reports, November 16, 1987
16. Telecommunications Reports, August 10, 1987