REMARKS OF THE HONORABLE PATRICIA M. WORTHY,

CHAIRMAN, PUBLIC SERVICE COMMISSION

OF THE DISTRICT OF COLUMBIA

BEFORE THE

26TH ANNUAL WINTER CONVENTION

OF THE

ORGANIZATION FOR THE PROTECTION AND

ADVANCEMENT OF SMALL TELEPHONE COMPANIES

MAUI MARRIOTT RESORT

JANUARY 17, 1988 - 9 A.M.

THANK YOU VERY MUCH, I'M DELIGHTED TO BE HERE THIS MORNING. I WOULD LIKE TO FOCUS MY REMARKS ON WHAT SOME HAVE DEEMED THE "UNREGULATION" OF TELECOMMUNICATIONS IN AMERICA. I AM REFERRING, OF COURSE, TO THE RECENT EFFORTS TO DISMANTLE OVER HALF A CENTURY'S WORTH OF REGULATORY ACTIVITY DESIGNED TO ENSURE THAT CONSUMERS AND UTILITIES ENJOY THE BENEFITS EACH HAS TO OFFER, WITH CONSUMERS AFFORDED QUALITY SERVICE AT REASONABLE RATES AND UTILITIES ASSURED A PROTECTED MARKET AND THE OPPORTUNITY TO EARN A FAIR RETURN ON THEIR INVESTMENT. IT IS CLEAR TO ME THAT TO SOME EXTENT THESE REGULATORY REFORMS STEM FROM A POLITICAL

ENVIRONMENT THAT TOTALLY REJECTS THE IDEA OF ANY ROLE FOR GOVERNEMENT INTRUSION IN ECONOMIC AFFAIRS. AT LAST, AFTER LIVING IN WASHINGTON, D.C FOR MORE THAN TWENTY YEARS I HAVE HAD THE OPPORTUNITY TO OBSERVE A STATE OF TOTAL DEVASTATION AND CHAOS BROUGHT ABOUT, NOT BY MY COLLEAGUES, MEMBERS OF THE LEGAL PROFESSIONS, BUT INSTEAD BY A GROUP OF PENDANTIC ECONOMISTS.

IN RECENT TIMES, SEVERAL INTERRRELATED CONCEPTS WITHIN MAINSTREAM ECONOMICS GREW IN STRENGTH OF NUMBERS AND MERGED INTO A STATED REALITY. FIRST, THE CONDITIONS OF ECONOMIES OF SCALE THAT PRIMARILY HAD BEEN IDENTIFIED AS JUSTIFYING SOCIAL INTERVENTION WAS INTERPRETED EVEN MORE NARROWLY AND AS EVER, MORE OPEN TO EROSION THROUGH TECHNOLOGICAL CHANGES AND THE DEVELOPMENT OF SUBSTITUTE PRODUCTS AND SERVICES. CONCURRENTLY, THE ACCEPTED DEFINITION OF COMPETITION IS BEING RADICALLY CHANGED. A NEW THEORY OF COMPETITION, THAT OF "CONTESTABLE MARKETS", HAS BEEN DEVELOPED AND EMPLOYED TO DEMONSTRATE THAT MONOPOLY IS, AS A FORMER COLLEAGUE OF MINE EDYTHE MILLER CLEVERLY PUTS IT, "APPARENTLY ONLY COMPETITION IN DRAG " 1/ MOREOVER, AN

"ECONOMIC THEORY OF REGULATION" WAS DEVELOPED THAT QUESTIONED THE PUBLIC INTEREST IMPLICATIONS OF REGULATION BY DEPICTING WE REGULATORS AS PAWNS OF REGULATED INDUSTRY AND REGULATION AS AN ACTIVITY CONDUCTED IN PURSUIT OF A PRIVATE AS OPPOSED TO A PUBLIC INTEREST. THE CONSERVATIVES FOUND THE "CONTESTABLE MARKETS" APPROACH MERITORIOUS IN THAT IN FOSTERED ITS GOAL OF "GETTING GOVERNMENT OFF THE BACK OF BIG BUSINESS" AND THE DEPICTION OF REGULATORS AS PAWNS EXCITED THE POLITICAL LIBERALS WHO ARE ALWAYS MOTIVATED BY A HINT OF CORRUPTION IN HIGH PLACES. TOGETHER, THEY HAVE ALMOST SWEPT THE POLITICAL BOARD CLEAN OF RATE OF RETURN REGULATION AS WE KNOW IT TODAY.

IN MY HUMBLE OPINION THE OVERALL EFFECTS OF THESE REGULATORY CHANGES HAVE BEEN IN LARGE MEASURE QUITE DEBILITATING: CONSUMERS ARE CONFUSED, RATES FOR LOCAL SERVICES HAVE RISEN DRAMATICALLY AND WILL CONTINUE TO RISE, THE BELL OPERATING COMPANIES (BOCS) FACE GREATER FINANCIAL RISK DUE TO THEIR ACCELERATING DIVERSIFICATION, AND APPROXIMATELY SEVEN MILLION AMERICANS REMAIN WITHOUT TELEPHONE SERVICE. NEVERTHELESS, THE ZEAL OF THOSE

ADVOCATING REDUCED PUBLIC OVERSIGHT OF ESSENTIAL AND MONOPOLY SERVICES REMAINS UNFETTERED.

IN THE NEXT FEW MOMENTS, I WOULD LIKE TO ADDRESS THREE SPECIFIC AREAS WHICH IN MY VIEW, WILL ADD TO THE TELECOMMUNICATIONS INDUSTRY'S CONTINUED DISRUPTION: THE CONTINUING OVERSIGHT OF THE AT&T MODIFIED FINAL JUDGMENT BY JUDGE HAROLD GREENE OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA, THE FCC'S EFFORTS TO RELAX THE LONG-STANDING PROHIBITION AGAINST OWNERSHIP OF CABLE TELEVISION FACILITIES BY TELEPHONE COMPANIES OUTSIDE OF RURAL AREAS, AND THE FCC'S CONTINUING EFFORTS TO PUT IN PLACE A PRICE CAP REGIME. FIRST, HOWEVER, I WOULD LIKE YOU TO SIT BACK AND RELAX, BECAUSE I AM GOING TO TELL YOU A STORY.

ONCE UPON A TIME, THERE WAS A SMALL KINGDOM WITH A BIG PROBLEM. THE KINGDOM WAS GROWING, DEMAND FOR TELEPHONE SERVICE WAS HIGH, TECHNOLOGY HAD DEVELOPED RAPIDLY, AND INSTANTANEOUS VOICE COMMUNICATIONS AMONG LARGE NUMBERS OF ITS CITIZENS WAS APPROACHING REALITY. THE TELEPHONE COMPANY KNEW ALL THIS, OF

COURSE, AND IT ALSO KNEW THAT IT WAS THE ONLY OPTION FOR PEOPLE WANTING A TELEPHONE HOOK-UP. THERE WAS COMPETITION, OF SORTS. THE CITIZENS COULD STILL USE PUBLIC TELEGRAPH LINES TO RELAY MESSAGES, AND DISTANCES WERE SHORT, SO HAND DELIVERY OF WRITTEN MESSAGES WAS AN EFFECTIVE MEANS OF COMMUNICATIONS. NEVERTHELESS, THERE WAS ONLY ONE COMPANY THAT OWNED THE TELEPHONE WIRES RUNNING THROUGH TOWN, HAD THE SOLE RIGHT TO INSTALL MORE, AND THAT HAD THE CAPABILITY TO SWITCH CALLS FROM ONE SUBSCRIBERS' LINE TO ANOTHER.

BECAUSE THERE COULD BE NO OTHER TELEPHONE COMPANIES, THE COMPANY IN QUESTION WAS ABLE TO MAKE INTERNAL CORPORATE DECISIONS WITHOUT ANY EXTERNAL CORPORATE RESTRAINTS. THE COMPANY'S DECISIONS COULD BE SELF-SERVING AND DRIVEN SOLELY BY THE "BOTTOM-LINE". THE COMPANY HAD NO CONSTRAINTS ON ITS MONOPOLY POWER OF ANY KIND. THERE WERE NO OTHER TELEPHONE COMPANIES, NOR HAD THE GOVERNMENT PROVIDED ANY OVERSIGHT TO ENSURE THE PROVISION OF SERVICE AT A FAIR PRICE.

ONE OF THE COMPANY'S FAVORITE PASTIMES WAS RAISING TELEPHONE

RATES, WHICH IT DID FREQUENTLY. WHEN THE COMPANY FIRST STARTED BUSINESS, IT CHARGED $12 FOR A TELEPHONE HOOK-UP, AND TOLD CUSTOMERS THAT WHEN THE NUMBER OF SUBSCRIBERS REACHED 200 IT WOULD LOWER RATES. WHEN SUBSCRIBERSHIP EXCEEDED 200, HOWEVER, RATES ROSE TO $25. THE PROMISE OF RATE REDUCTION HAD BEEN IGNORED. PEOPLE OF THE KINGDOM COMPLAINED, OF COURSE, BUT THERE WAS NO ONE TO LISTEN WITH THE AUTHORITY OR INCLINATION TO BRING ABOUT CHANGE. SO, THE COMPANY RAISED ITS RATES AGAIN, THIS TIME TO $40, AND THEN TO $60. AND THEN, FINALLY, TO $125 A LINE FOR PREMIUM SERVICE. AT THE SAME TIME, THE COMPANY PLACED ONEROUS USE RESTRICTIONS ON SUBSCRIBERS' PHONES, AND ENFORCED THEN VIGOROUSLY. IT PROHIBITED ANYONE BUT THE ACTUAL SUBSCRIBER FROM USING A TELEPHONE UNLESS THE COMPANY RECEIVED A SPECIAL PAYMENT. IT CHARGED EXORBITANT RATES AT PAY PHONES. THE COMPANY ALSO ACTIVELY MONITORED EACH TELEPHONE CALL, DISCONNECTING CALLS AT WILL. FOR EXAMPLE, A SUBSCRIBER USING HIS BUSINESS LINE TO PLACE A PERSONAL CALL WOULD BE INTERRUPTED BY AN OPERATOR DEMANDING ADDITIONAL PAYMENT. IF PAYMENT WAS NOT AGREED TO, THE CALL WAS

TERMINATED. NATURALLY, THE OPERATORS MONITORING EACH CALL SOMETIMES HEARD MORE THAN THEY SHOULD HAVE, AND HAD NO COMPUNCTIONS ABOUT RELAYING THE IMPORTANT INFORMATION TO FELLOW EMPLOYEES. THIS PROBLEM WAS PARTICULARLY ACUTE IN THAT THE KING USED HIS TELEPHONE QUITE FREQUENTLY, AND DIDN'T WANT HIS CALLS OVERHEARD.

IN THE END, THE PEOPLE OF THE KINGDOM GOT FED UP, AND CREATED A SPECIAL GOVERNMENT AGENCY TO POLICE THE TELEPHONE COMPANY AND ENSURE THAT IT COULD NO LONGER USE ITS MONOPOLY POWER TO ABUSE THE PUBLIC TRUST. AS A RESULT, TELEPHONE RATES CAME DOWN, SERVICE IMPROVED, AND THE MONITORING OF CALLS STOPPED. ORDER HAD BEEN RESTORED. IT REMAINS TO BE SEEN HOWEVER, AS TO WHETHER OR NOT THEY LIVE HAPPILY EVER AFTER.

THE SMALL KINGDOM IN MY STORY, IS OF COURSE, THE DISTRICT OF COLUMBIA, AND THE TELEPHONE COMPANY, OUR OWN C&P. THE STORY IS TRUE. ALL THESE INCIDENTS CAN BE FOUND IN THE TRANSCRIPT OF HEARINGS BEFORE CONGRESS HELD IN 1898, IN THE DAYS BEFORE PUBLIC UTILITY REGULATION. AS A RESULT OF THESE HEARINGS, IN 1913,

CONGRESS CREATED THE PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA. AT ABOUT THE SAME TIME, STATES THROUGHOUT THE NATION CREATED SIMILAR COMMISSIONS, WHICH CONTINUE, IN MY OPINION, TO SERVE THE PUBLIC WELL.

HOWEVER, IN SPITE OF OUR LONG RECORD OF PUBLIC SERVICE, THE PENDULUM IS NOW CLEARLY SWINGING AWAY FROM REGULATION TO A LAISSEZ-FAIRE CAPITALISM IN WHICH ESSENTIALLY MONOPOLY FIRMS ARE FREE TO PURSUE THEIR OBJECTIVES WITHOUT THE DISCOMFORTING INTRUSION OF GOVERNMENT OVERSIGHT.

THERE ARE MANY EXAMPLES TODAY OF THE IMPACT ASSOCIATED WITH THE FEDERAL GOVERMENT'S INFATUATION WITH THE "FREE MARKET" CONCEPT.

TELEPHONE\CABLE CROSS-OWNERSHIP

IN 1987, THE FEDERAL COMMUNICATIONS COMMISSION INSTITUTED AN INQUIRY TO REVIEW THE TELEPHONE COMPANY\CABLE TELEVISION CROSS-OWNERSHIP RESTRICTIONS ESTABLISHED BY ITS RULES, AND LATER CODIFIED IN THE CABLE COMMUNICATIONS POLICY ACT OF 1984. IN

GENERAL, THOSE RESTRICTIONS PROHIBIT TELEPHONE COMPANIES FROM PROVIDING VIDEO PROGRAMMING SERVICES WITHIN THEIR TELEPHONE SERVICE AREAS IF LOCATED IN NON-RURAL AREAS. THE FCC INITIALLY ESTABLISHED THESE RESTRICTIONS TO PREVENT TELEPHONE COMPANIES FROM IMPEDING THE EARLY DEVELOPMENT OF AN INDEPENDENT CABLE INDUSTRY. THIS OBJECTIVE HAD A TWO-FOLD PURPOSE: FIRST, IT WAS INTENDED TO PREVENT CROSS-SUBSIDIZATION OF NON-REGULATED TELEPHONE COMPANY CABLE TELEVISION ACTIVITIES WITH RESOURCES COMMITTED TO THE REGULATED SECTOR. THE EFFECT OF SUCH CROSS-SUBSIDIZATION WOULD HAVE BEEN THAT TELEPHONE RATEPAYERS WOULD, THROUGH ARTIFICIALLY HIGHER RATES, PAY SOME OF THE COSTS OF PROVIDING CABLE TELEVISION SERVICE. SECOND, THE PROHIBITION WAS IMPOSED TO PREVENT TELEPHONE COMPANIES FROM USING THEIR MONOPOLY POSITION IN THE BASIC EXCHANGE SERVICE MARKET AS LEVERAGE TO DOMINATE THE CABLE SERVICES MARKET PLACE AS WELL. FOR EXAMPLE, IT WAS FEARED THAT TELCOS COULD USE THEIR OWNERSHIP OF UTILITY POLES AND UNDERGROUND CONDUIT TO COMPEL OTHER CABLE COMPANIES TO PAY EXORBITANT ACCESS FEES, THEREBY AFFORDING THE TELCOS WITH A

SUBSTANTIAL COMPETITIVE ADVANTAGE.

IN ITS CABLE INQUIRY, HOWEVER, THE FCC HAS TENTATIVELY FOUND THAT THE CABLE INDUSTRY HAS HAD AN OPPORTUNITY TO OUTGROW THE LIKELIHOOD OF ABUSES FOUND AT THE INCEPTION OF THE CROSS-OWNERSHIP PROHIBITION. THE FCC NOW BELIEVES THAT THE MARKET LANDSCAPE COULD SUPPORT TELEPHONE COMPANY ENTRY INTO THE PROVISION OF CABLE CHANNEL SERVICES, EVEN OUTSIDE OF RURAL AREAS, AND IS NOW CONSIDERING SUBMITTING TO CONGRESS LEGISLATIVE RECOMMENDATIONS THAT WOULD DO AWAY WITH THE RESTRICTION. IN LARGE PART, THE FCC'S TENTATIVE RECOMMENDATION PLACES GREAT HOPE AND RELIANCE ON ITS VERSION OF NON-STRUCTURAL REGULATORY SAFEGUARDS, SUCH AS THOSE FORMULATED IN THE THIRD COMPUTER INQUIRY, AS THE PRIMARY PROTECTION AGAINST ABUSES. FOR A VARIETY OF REASONS, I BELIEVE THE FCC'S COURSE OF ACTION IS ILL-ADVISED.

FIRST, THE FCC'S RELIANCE ON ITS COMPUTER III NON-STRUCTURAL SAFEGUARDS IS WHOLLY INADEQUATE AND GROSSLY PREMATURE. THE FCC'S COMPUTER III FRAMEWORK HAS NOT BEEN TESTED OVER TIME, NOR HAS IT EVEN BEEN UPHELD AS LAWFUL BY THE COURTS. I AM ALSO CONCERNED

ABOUT THE EFFECTIVENESS OF NON-STRUCTURAL SAFEGUARDS GIVEN THE TREMENDOUS LEVEL OF HUMAN RESOURCES NECESSARY TO OVERSEE THEM, PARTICULARLY WITH RESPECT TO COST ACCOUNTING, WHICH MUST FORM THE FOUNDATION FOR RELAXED CROSS-OWNERSHIP REGULATIONS. FOR EXAMPLE, INCREASING THE AUDIT RESPONSIBILITIES OF STATE COMMISSIONS TO INCLUDE TRANSACTION-BY-TRANSACTION ANALYSIS OF BOC ENTERPRISES COULD REQUIRE ADDITIONAL RESOURCES AND FACILITIES AT GREATLY INCREASED REGULATORY COST. PUBLIC UTILITY ACCOUNTING IS REMARKABLY COMPLEX AND EXTREMELY INTRICATE IN ITS DETAIL. IT IS IMPOSSIBLE FOR EVEN THE MOST VIGILANT REGULATOR TO TRACK EVERY TRANSACTION AND BALANCE EVERY ACCOUNT. EVEN THE FCC HAS HAD TO DELEGATE THIS RESPONSIBILITY TO THE BIG ACCOUNTING FIRMS MINDFUL OF THEIR OWN LIMITED RESOURCES.

THE CONSEQUENCE OF INEFFECTIVE NON-STRUCTURAL SAFEGUARDS IS A FAR GREATER RISK OF CROSS-SUBSIDIZATION OF NON-REGULATED CABLE SERVICES USING REVENUES FROM REGULATED ACTIVITIES. THE ARTIFICIAL INCREASE IN TELEPHONE RATES CAUSED BY THIS SUBSIDY COULD BE ENOUGH TO DRIVE MANY SUBSCRIBERS OFF THE NETWORK. UNIVERSAL

TELEPHONE SERVICE IS A GOAL IN THE DISTRICT OF COLUMBIA, AND NOT A TERM OF ART BANTERED ABOUT BY THOSE ATTEMPTING TO STAVE OFF BLAME AND PUBLIC SCRUTINY.

IF THE FCC IS SUCCESSFUL IN RELAXING THE CROSS-OWNERSHIP PROHIBITION, THE TRADITIONAL ROLE OF STATE PUBLIC UTILITY COMMISSIONS IN REGULATING INTRASTATE TELECOMMUNICATIONS MUST BE PRESERVED. AT A MINIMUM, THIS REQUIRES THAT EACH STATE MUST HAVE THE DISCRETION TO DECIDE WHAT REGULATORY FRAMEWORK WOULD BEST PREVENT ANTICOMPETITIVE CONDUCT BY TELEPHONE COMPANIES IN THEIR RESPECTIVE JURISDICTIONS. IT IS MY PERSONAL BELIEF THAT CABLE CROSS-OWNERSHIP BY THE BOCS SHOULD ONLY BE ALLOWED, IF AT ALL, THROUGH ARMS LENGTH SUBSIDIARIES. WHILE THERE IS SOME DEBATE THAT THIS WOULD DIMINISH BENEFITS OF ECONOMIES OF SCALE, I REJECT THIS ARGUMENT IF IT IS AT THE COST OF RATEPAYERS AS A WHOLE.

THE MOST <u>EFFECTIVE</u> AND SIMPLISTIC MECHANISM TO PREVENT CROSS-SUBSIDY IS A RETENTION OF THE EXISTING PROHIBITION. AS ONE CABLE OPERATOR PUT IT IN TESTIMONY TO CONGRESS BEFORE PASSAGE OF

THE 1984 CABLE ACT:

> IT WOULD BE IMPOSSIBLE TO TOTALLY STOP THE UTILITY FROM CROSS SUBSIDIZING THE CABLE TV OPERATIONS FROM THEIR TELCO CUSTOMER REVENUES. THIS IS TRUE BECAUSE CABLE TV USES THE SAME HARDWARE -- STRAND, ANCHORS, PEDESTALS, BOLTS, CLAMPS -- THE SAME TYPE OF CONSTRUCTION PERSONNEL AND TECHNIQUES, SAME TYPE OF SERVICE, VEHICLES, AND THE SAME CONDUIT, POLES AND TRENCHES....ONLY CABLE AND ELECTRONIC DEVICES DIFFER BETWEEN THESE OPERATIONS, AND THIS REPRESENTS LESS THAN 20 PERCENT OF THE INVESTMENT REQUIRED TO BUILD A CABLE SYSTEM. 2/

THE FCC'S CABLE CROSS-OWNERSHIP INQUIRY HAS ALSO FOCUSED ATTENTION ON WHETHER FURTHER PREEMPTION OF STATE REGULATORY AUTHORITY IS NECESSARY IN ORDER TO PROMOTE USE OF CABLE SYSTEMS FOR PROVISION OF CHANNEL AND DATA SERVICES CURRENTLY PROVIDED, PRIMARILY, BY REGULATED TELEPHONE COMPANIES. THIS PROPOSAL "SMACKS" IN THE FACE OF LONG-STANDING PRECEDENT AND COMMON SENSE. THE COMMUNICATIONS ACT OF 1934 AND THE SUPREME COURT OF THE UNITED STATES RECOGNIZE THAT STATES HAVE A SPECIAL INTEREST IN

REGULATING LOCAL TELECOMMUNICATIONS SERVICE.

THE INTENT OF CONGRESS WAS, CLEARLY, TO ALLOW FOR THE CROSS-OWNERSHIP OF CABLE SYSTEMS BY TELEPHONE COMPANIES IN RURAL AREAS ONLY, WITH THE INTENTION BEING TO BRING CABLE SERVICE TO SPARSELY POPULATED REGIONS THAT INDEPENDENT CABLE PROVIDERS WOULD FIND UNPROFITABLE. THERE WAS ALSO EXPLICIT CONGRESSIONAL RECOGNITION THAT AT&T AND ITS THEN AFFILIATES MUST BE BARRED FROM CROSS-OWNERSHIP IN POPULOUS AREAS, WITH THIS ADDED REQUIREMENT THAT ALL UNREGULATED SERVICES OFFERED BY TELEPHONE COMPANY SUBSIDIARIES MUST BE CARRIED OUT THROUGH A SEPARATE SUBSIDIARY. I SEE NO CHANGED CIRCUMSTANCES THAT WOULD SUGGEST THAT A BASIS EXISTS FOR CHANGING THIS FEDERAL POLICY.

MODIFIED FINAL JUDGMENT

WE ARE ALL, BY NOW, WELL VERSED IN THE HIGHLY PUBLICIZED OUTCOME OF THE FIRST TRIENNIAL REVIEW OF THE AT&T CONSENT DECREE REGARDING THE LINE OF BUSINESS RESTRICTIONS IMPOSED ON THE BELL OPERATING COMPANIES AT THEIR DIVESTITURE FROM AT&T.

IT IS MY BELIEF THAT THE CONDITIONS WHICH THE COURT FOUND

WARRANTED THE IMPOSITION OF RESTRICTIONS STILL CLEARLY EXIST. NEVERTHELESS, IN LIGHT OF THE RECORD OF THE FIRST TRIENNIAL REVIEW, JUDGE GREENE, IN SEPTEMBER 1987, DEEMED CIRCUMSTANCES TO BE SUFFICIENTLY CHANGED TO WARRANT ELIMINATION OF THE RESTRICTIONS CONCERNING NON-TELECOMMUNICATIONS LINES OF BUSINESS AND INFORMATION TRANSMISSION SERVICES. WITH RESPECT TO NON-TELECOMMUNICATIONS LINES OF BUSINESS, JUDGE GREENE BASED HIS DECISION ON: (1) THE GENERAL AGREEMENT AMONG COMMENTERS THAT THE COMPANIES COULD NOT USE LOCAL EXCHANGE FACILITIES TO INHIBIT COMPETITION IN NON-TELECOMMUNICATIONS VENTURES; (2) HIS BELIEF IN THE LIMITED OPPORTUNITIES AVAILABLE TO BOCS FOR CROSS-SUBSIDIZATION; AND (3) THE TREMENDOUS RESOURCES NECESSARY FOR THE COURT TO PROVIDE CONTINUING OVERSIGHT.

IT IS MY BELIEF THAT THE COURT EXRCISED FLAWED REASONING AND I ATTRIBUTE THE COURT'S ACTION IN GREAT PART TO THE CONTINUED EMPHASIS AT THE FEDERAL LEVEL THAT REGULATORY RESTRAINTS MUST BE LESSENED. THE DISTRICT OF COLUMBIA PUBLIC SERVICE COMMISSION IS ATTEMPTING TO APPEAL CERTAIN PORTIONS OF THE SEPTEMBER DECISION

TO THE UNITED STATE COURT OF APPEALS. THAT PROCEEDING, AS WELL AS APPEALS BROUGHT BY THE BOCS THEMSELVES IN ORDER TO SEEK FURTHER RELAXATION OF THE RESTRICTIONS, REMAIN PENDING.

PERHAPS THE MOST FAR-REACHING OF JUDGE GREENE'S CHANGES TO THE MFJ CONCERN HIS INFORMATION SERVICES ORDERS ALLOWING THE BOCS TO PROVIDE INFORMATION GATEWAYS THROUGH WHICH CONSUMERS COULD OFFER A MULTITUDE OF VIDEO AND AUDIOTEX SERVICES. WHILE JUDGE GREENE NO DOUBT BELIEVES THAT HIS DECISION WILL CREATE A NEW COMPETITIVE INDUSTRY, MANY STATE REGULATORY COMMISSIONERS ARE CONCERNED ABOUT HIS INEXPLICABLE ABOUT-FACE IN ONLY THREE YEARS. AREN'T THESE THE SAME NOTORIOUS MONOPOLISTS AT THE CONTROLS WHICH LEAD TO THE INITIAL BELL BREAK-UP.

IN ORDER TO UNDERSTAND OUR CONCERNS ONE MUST UNDERSTAND THAT THE ROLE OF A FEDERAL JUDGE ENFORCING THE ANTITRUST LAWS IS OFTEN IN CONFLICT WITH THE ROLE OF STATE REGULATORS. JUDGE GREENE STATED IN HIS SEPTEMBER 10, 1987 ORDER THAT THE "COURT'S DECISIONS ON THE CORE RESTRICTIONS DO NOT TURN ON THE FACTORS OF PROTECTION OF RATEPAYERS FROM PRICE GOUGING OR THAT OF UNIVERSAL

SERVICE". JUDGE GREENE FURTHER NOTED THAT "UNIVERSAL SERVICE HAS BEEN EXPLICITLY DECLARED BY THE CONGRESS TO BE A PARAMOUNT NATIONAL OBJECTIVE, AND THE COURTS MAY BE EXPECTED TO AVOID TAKING ACTIONS, IF THAT CAN LEGITIMATELY BE DONE, THAT ARE INCONSISTENT WITH THIS OBJECTIVE". 3/ UNLIKE THE ROLE DESCRIBED BY JUDGE GREENE FOR HIS COURT, THE PRIMARY ROLE OF STATE REGULATORS IS TO ENSURE UNIVERSAL SERVICE, THROUGH AFFORDABLE, REASONABLE AND NONDISCRIMINATORY RATES. TO ACHIEVE THESE GOALS, STATE REGULATORS MUST HAVE THE TOOLS NECESSARY TO PROTECT AGAINST DISCRIMINATION AND CROSS-SUBSIDIZATION BY THE BOC'S AND THEIR OPERATING COMPANIES. THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS'(NARUC) POLICY REGARDING THE JUSTICE DEPARTMENT'S FIRST TRIENNIAL REVIEW OF THE MFJ AND MOTIONS TO REVISE IT, DATING BACK TO FEBRUARY OF 1987, REFLECTS THOSE CONCERNS.

NARUC'S EXECUTIVE COMMITTEE ADOPTED A RESOLUTION WHICH LISTS FOUR CONDITIONS FOR NARUC SUPPORT OF LIFTING ANY OF THE ORIGINAL LINE-OF-BUSINESS RESTRICTIONS. THEREFORE, IN EVALUATING JUDGE

GREENE'S INFORMATION SERVICES DECISIONS, WE MUST LOOK TO SEE IF THOSE CONDITIONS--THOUGH NOT NECESSARILY WITHIN JUDGE GREENE'S POWER TO SATISFY--HAVE, IN SOME WAY, BEEN MET. WHILE INDUSTRY CAN CLAIM THAT JUDGE GREENE HAS SHARED OUR CONCERN IN THE FIRST OF THESE CONDITIONS, THAT "EACH SERVICE OR FUNCTION SHOULD BE VIEWED AND EVALUATED IN TERMS OF HOW IT CONTRIBUTES TO THE ENHANCEMENT OF A 'FULL SERVICE' NETWORK," WE FIND REGULATORY PROTECTION ADDRESSING OUR OTHER CONCERNS SORELY LACKING.

FOR INSTANCE, AS I HAVE NOTED, THE ORGANIZATIONAL FORMAT UTILIZED IN OFFERING ANY NEW INTRASTATE SERVICE IS, FIRST AND FOREMOST, A STATE REGULATORY DECISION. STATES MUST BE FREE, AS STATED IN THE SECOND CONDITION, TO TREAT THESE SERVICES AS `ABOVE THE LINE' OR `BELOW THE LINE' ITEMS, AND TO REQUIRE ACCOUNTING SEPARATION PROCEDURES OR SEPARATE SUBSIDIARY REQUIREMENTS TO PROTECT FULLY THE INTERESTS OF CAPTIVE RATEPAYERS OF THE REGULATED COMPANY OR REGIONAL HOLDING COMPANY. HOWEVER, WHEN THE FCC BACKED AWAY FROM THE STRUCTURAL SEPARATIONS REQUIREMENT IN ITS COMPUTER III DECISION, 4/ IT ALSO PREEMPTED

STATE REGULATORS FROM USING THAT METHOD TO PROTECT RATEPAYERS. THE NARUC AND THE STATES HAVE APPEALED THE COMPUTER III DECISION. ORAL ARGUMENT WAS HEARD LAST WEEK, AND A DECISION WILL LIKELY BE FORTHCOMING MID-YEAR.

NOR HAVE NARUC'S THIRD AND FOURTH CONDITIONS BEEN MET. THE THIRD CONDITION STATES THAT "IN THE EVENT THAT AN AFFILIATE OF THE REGIONAL HOLDING COMPANY IS UTILIZED, THE STATE COMMISSION MUST HAVE THE AUTHORITY TO ENFORCE CONDITIONS DEEMED BY IT TO BE ESSENTIAL TO ASSURE THAT THE SWITCHED NETWORK WOULD BE ENHANCED OR PROTECTED FROM POSSIBLE EROSION OF ITS COST-EFFECTIVE INVESTMENT BASE." THE FOURTH CONDITION HOLDS THAT "THE STATE REGULATORY COMMISSIONS SHALL HAVE FULL ACCESS TO ALL BOOKS, RECORDS, FACILITIES AND PREMISES OF THE BOCS AND ALL AFFILIATED COMPANIES". THE DISTRICT COURT'S ORDER FAILS TO IMPOSE EITHER OF THESE REQUIREMENTS ON THE BOC'S OR CONDITION BOC INFORMATION SERVICES ON ADOPTION BY STATES OF RULES PROVIDING FOR THESE PROTECTION. BY ALLOWING THE BOCS' GREATER MARKET PRESENCE WHILE REJECTING THE OPPORTUNITY TO IMPOSE ADDITIONAL REGULATORY

PROTECTION, 5/ JUDGE GREENE'S INFORMATION SERVICES DECISION ONLY EXACERBATES AN ALREADY DIFFICULT PROBLEM CAUSED BY THE FCC'S COMPUTER III DECISION. THE GREATEST THREAT TO CAPTIVE RATEPAYERS FROM BOC PROVISION OF COMPETITIVE SERVICE IS THE INCENTIVE FOR THE COMPANIES TO USE RATEPAYERS' DOLLARS TO SUBSIDIZE THEIR COMPETITIVE ACTIVITIES. EFFORTS UNDERTAKEN BY THE STATES IN 1984, 1985 AND 1986 TO AUDIT THE BOCS WERE COMPLICATED AND AT TIMES HINDERED BY PROBLEMS IN GAINING FULL ACCESS TO ALL CORPORATE BOOKS AND RECORDS, OF THE BOCS AND THEIR UNREGULATED AFFILIATES. THE STATES LACK ASSURANCES FROM THE COURT, CONGRESS OR THE FCC THAT FUTURE EFFORTS WILL NOT FACE THE SAME BARRIERS.

AS I MENTIONED, THESE WERE THE CONCERNS OF OUR COMMITTEE SOME TIME AGO. TODAY, I FEEL QUITE COMFORTABLE IN SAYING THAT THE CURRENT COMPOSITION OF OUR COMMITTEE INDICATES AN EVEN MORE CAUTIOUS AND SKEPTICAL APPROACH TO BOC FREEDOM. AND I AM SURE THAT OUR CONCERNS WILL BE EXPRESSED IF AND WHEN CONGRESS CONDUCTS HEARINGS ON THIS ISSUE.

PRICE CAPS

LET ME NOW FOCUS ON THE CLEAREST EVIDENCE OF THIS TREND TOWARD REGULATORY REFORM AND THAT IS THE FEDERAL COMMUNICATIONS COMMISSION'S PROPOSAL TO EMPLOY PRICE CAPS TO SET RATES FOR AT&T'S INTERSTATE SERVICE AND THE BELL OPERATING COMPANIES' PROVISION OF INTERSTATE EXCHANGE ACCESS SERVICE. ON MAY 23, 1988, THE FEDERAL COMMUNICATIONS COMMISSION RELEASED ITS FURTHER NOTICE OF PROPOSED RULEMAKING IN CC DOCKET NO. 87-313 (FURTHER NOTICE). THE FURTHER NOTICE WAS FAR MORE DETAILED AND REPRESENTED, IN MY OPINION, A SIGNIFICANT EFFORT BY THE FCC TO ADDRESS THE CONCERNS RAISED IN LIGHT OF ITS AUGUST 21, 1987 ORIGINAL NOTICE. AS COMMENTERS, INCLUDING THE PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA, POINTED OUT, HOWEVER, THE FCC'S PRICE CAP PROPOSAL STILL CONTAINED CERTAIN FLAWS AND WEAKNESSES WHICH NEEDED TO BE ADDRESSED PRIOR TO A DECISION AS TO WHETHER A PRICE CAPS REGIME SERVED THE PUBLIC INTEREST.

AS WE ARE ALL NOW AWARE, THE PRIMARY FOCUS OF THE FCC'S PRICE CAP PROPOSAL IS THE PRICE CAP INDEX OR PCI. THE PCI, IN

TURN, IS COMPOSED OF THREE SEGMENTS -- AN INFLATION FACTOR, A CARRIER PRODUCTIVELY OFFSET, AND THE SO-CALLED CONSUMER PRODUCTIVITY DIVIDEND, OR CPD. THE INFLATION FACTOR IS THE U.S. DEPARTMENT OF COMMERCE'S GROSS NATIONAL PRODUCT PRICE INDEX (GNP-PI) WHICH "UTILIZES AN HISTORICAL BASE PERIOD (CURRENTLY 1982), AND SUMMARIZES PRICE CHANGES IN ALL SECTORS OF THE ECONOMY, NOT JUST CONSUMER GOODS." 6/ THE FCC'S INDUSTRY DERIVED-PRODUCTIVITY OFFSET IS 2.5%, A NUMBER WHICH THE FCC ARGUES REPRESENTS "A REASONABLE ESTIMATE OF POTENTIAL FUTURE PRODUCTIVITY GAINS IF EXISTING REGULATORY METHODS REMAIN IN PLACE." 7/ FINALLY, THE PCI CONTEMPLATES THE USE OF THE CPD, WHICH IS AN ADDITIONAL .05% OFFSET. ACCORDING TO THE FCC, THE CPD WAS USED SO THAT "RATEPAYERS WILL BE BETTER OFF UNDER PRICE CAPS THAN THEY WOULD HAVE BEEN UNDER RATE-OF-RETURN REGULATION." 8/

IN ADDITION TO THE PCI, LET ME TOUCH ON TWO OTHER CONSTRUCTS PROPOSED BY THE FCC TO GOVERN PRICE CAPS. FIRST, THE FCC PROPOSES THAT A CARRIER SUBJECT TO PRICE CAPS MAY PRICE SUCH SERVICES WITHIN A PLUS OR MINUS 5% BAND. CARRIERS PRICING THEIR

SERVICES WITHIN THIS BAND WOULD FIND SUCH PRICING PRESUMPTIVELY LAWFUL SO LONG AS THE RESULTING ACTUAL PRICE INDEX DOES NOT EXCEED THE PCI. 9/ FINALLY, THE FCC PROPOSES THAT NEW SERVICES WOULD NOT INITIALLY BE SUBJECT TO THE PRICE CAPS, BUT WOULD COME WITHIN THE PRICE CAP WITHIN ONE YEAR.

IT IS NO SECRET THAT STATE REGULATORS HAVE MADE KNOWN THEIR POSITIONS CONCERNING PRICE CAPS. LED BY NARUC, OUR CONCERNS REGARDING PRICE CAPS HAVE BEEN MADE CLEAR TO THE FCC AND TO CONGRESS. OF PARAMOUNT CONCERN TO ME IS THE QUESTION OF WHETHER PRICE CAPS WILL PRESERVE THE HIGH-LEVEL OF QUALITY WHICH WE, AS NETWORK USERS, ENJOY TODAY. LET ME FIRST SAY, THAT SERVICE QUALITY IS NOT A JURISDICTIONAL ISSUE. THEREFORE, PRIOR TO ANY IMPLEMENTATION OF PRICE CAP, IT IS MY FIRM OPINION THAT STATE AND FEDERAL REGULATORS SHOULD WORK TOGETHER TO DEVELOP AND PUT IN PLACE A SYSTEM FOR EFFECTIVELY ADDRESSING AND MONITORING SERVICE QUALITY ISSUES. I WOULD SUGGEST TO YOU THAT A GOOD STARTING POINT WOULD BE THE MODEL SERVICE QUALITY RULES ADOPTED BY NARUC IN 1987.

BUT WHY, YOU MAY ASK, WOULD PRICE CAPS UNDERMINE LEVELS OF SERVICE QUALITY? THE CONCERN IS SIMPLY THAT THE PRICE CAP PROPOSAL, IF IMPLEMENTED, MAY CREATE INCENTIVES TO FORSAKE NETWORK INVESTMENT AND THEREFORE QUALITY, IN ORDER TO INCREASE PROFITS. LET ME REMIND YOU OF THE BELL SYSTEM SERVICE QUALITY CRISIS IN THE LATE 1960'S WHICH RESULTED FROM AT&T'S EFFORTS TO INCREASE NET EARNINGS. THE COMPANY REFUSED TO INCREASE CAPITAL OUTLAYS AT A TIME WHEN DEMAND GROWTH IN SEVERAL AREAS EXCEEDED SWITCHING CAPACITY. THE RESULTING CAPACITY SHORTAGES CAUSED SERIOUS DECLINES IN SERVICE QUALITY, WITH SERVICE INTERRUPTIONS IN MAJOR EAST COAST CITIES DURING 1967-1968. BY 1969, SERVICE THROUGHOUT THE URBAN REGIONS OF THE EASTERN PART OF THE COUNTRY WAS BESET BY DELAYS IN DIAL TONE, REPAIRS, AND INSTALLATION OF NEW EQUIPMENT. 10/

IN ADDITION TO SERVICE QUALITY I'D LIKE TO TOUCH ON THREE OTHER CONCERNS I HAVE WITH THE CURRENT PRICE CAP PROPOSAL. FIRST, I HAVE CONCERN OVER THE USE OF THE GNP-PI AS THE GENERAL INFLATION INDEX. THE D.C. COMMISSION ARGUED THAT THE

DEVELOPMENT OF A TELECOMMUNICATIONS-SPECIFIC INDEX SHOULD BE ATTEMPTED. WHILE ITS DEVELOPMENT COULD BE TIME CONSUMING AND PROBABLY CONTENTIOUS, DIFFICULTY ALONE SHOULD NOT THWART ITS DEVELOPMENT. SECOND, I HAVE CONCERNS REGARDING NOT ONLY THE 5% BANDING PROPOSAL AND THE EMPIRICAL EVIDENCE SUPPORTING THAT PROPOSAL, BUT ALSO THE VAGUE STANDARDS WHICH THE FCC PROPOSES TO USE TO ADMINISTER OUT-OF-BAND PRICING PROPOSALS. FINALLY, I NOTE THAT THE FCC'S DEFINITION OF "NEW SERVICES" IS LOOSELY DEFINED. MY CONCERN IS THAT BECAUSE NEW SERVICES ARE ORIGINALLY KEPT OUT OF THE PRICE CAP FOR ONE YEAR, CARRIERS SUBJECT TO PRICE CAPS MAY BE ABLE TO PRICE OUTSIDE THEIR RESPECTIVE CAPS BY MEANS OF MINIMAL RESTRUCTURING OF CURRENT SERVICE OFFERINGS.

LET ME NOW TOUCH ON A FEW POINTS RAISED BY OTHER STATE REGULATORS CONCERNING PRICE CAPS. THESE ISSUES HIGHLIGHT ADDITIONAL CONCERNS WHICH I LIKEWISE SHARE. THE FIRST ISSUE WAS STATED QUITE CLEARLY IN TESTIMONY BEFORE THE UNITED STATES SENATE PRESENTED ON BEHALF OF NARUC BY MY COLLEAGUE, DEPUTY CHAIRMAN GAIL GARFIELD SCHWARTZ OF THE NEW YORK PUBLIC SERVICE COMMISSION.

IN THAT TESTIMONY SHE RAISES A VERY VALID CONCERN REGARDING THE FCC'S PRODUCTIVITY FACTOR. SHE NOTES THE IRONY THAT THE FCC STRONGLY CRITICIZES THE EFFICIENCY OF RATE OF RETURN REGULATION, YET IT IS THIS MODE OF REGULATION WHICH FORMS THE FOUNDATION FOR THE HISTORICAL PRODUCTIVITY ANALYSIS UPON WHICH THE FCC RELIES TO BASE ITS PRODUCTIVITY FACTOR. SHE CONCLUDES, AND I AGREE, THAT "[I]F THE INEFFICIENCIES IN THE FORMER REGIME WERE AS GREAT AS CLAIMED, SURELY THE THEORETICALLY MORE EFFICIENT REGIME OF PRICE CAPS SHOULD RESULT IN A HIGHER-THAN-HISTORIC PRODUCTIVITY INCREASE." 11/ SHE ALSO NOTES THAT BECAUSE OF THE POTENTIAL 20% INCREASE IN PRICES OVER THE 4-YEAR TRIAL PERIOD (5% PER YEAR FOR 4 YEARS) AND THE DEGREE OF DISCRETION WHICH THE FCC'S PROPOSAL WOULD PERMIT THE CARRIER TO HAVE OVER THESE INCREASES, THERE IS THE CONCERN THAT CUSTOMERS OF THE LESS ELASTIC SERVICES WILL NOT BE PROTECTED "FROM PRICES FAR ABOVE COST BY THE CONSTRAINTS OF THE COMPETITIVE MARKET." 12/ UNDER THIS SCENARIO, I LIKEWISE AGREE WITH COMMISSIONER SCHWARTZ THAT THERE IS AN INCENTIVE TO DECREASE PRICES FOR THE COMPETITIVE ELASTIC SERVICES WHILE

OFFSETTING THESE DECREASES WITH HIGHER PRICES FOR THE LESS ELASTIC SERVICES. 13/

FINALLY, I NOTE THE CONCERNS EXPRESSED BY THE STAFF OF THE MICHIGAN PUBLIC SERVICE COMMISSION IN ITS JULY 26, 1988 COMMENTS ON THE PRICE CAP PROPOSAL. IN THOSE COMMENTS, ONE OF THE CONCERNS EXPRESSED WAS THAT THE PROPOSAL WOULD PRESENT INCENTIVES FOR COMPANIES UNDER INTERSTATE PRICE CAPS TO ALLOCATE MORE COSTS TO THE INTRASTATE ACTIVITIES WHICH ARE NOT UNDER A PRICE CAP REGIME. 14/ THE MICHIGAN STAFF'S CONCLUSION THAT SAFEGUARDS NEED TO BE DEVELOPED TO PREVENT THE POTENTIAL FOR COST SHIFTING SHOULD THE FCC ADOPT PRICE CAPS FOR INTRASTATE SERVICES SHOULD LIKEWISE BE FOLLOWED.

WHILE I HAVE NOT TOUCHED ON ALL CONCERNS RAISED BY COMMENTERS ON THE FCC'S FURTHER NOTICE. I DO HOPE THAT MY COMMENTS HAVE SUGGESTED WHAT ARE, IN MY OPINION, SOME OF THE MORE CRITICAL CONCERNS PRESENTED BY THE FCC'S PRICE CAP PROPOSAL. ON BALANCE AND IN LIGHT OF THE LIMITED RISKS ASSOCIATED WITH THE PRICE CAP PROPOSAL TO CARRIERS WHICH ELECT THAT ALTERNATIVE, AND