

REMARKS OF CHAIRMAN PATRICIA WORTHY,  
PUBLIC SERVICE COMMISSION OF THE DISTRICT  
OF COLUMBIA, CONCERNING REGULATORY  
REFORM IN TELECOMMUNICATIONS

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PRESENTED TO THE MARYLAND-DISTRICT OF  
COLUMBIA UTILITIES ASSOCIATION

APRIL 19, 1988

4:30 P.M.

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I'M DELIGHTED TO BE HERE THIS AFTERNOON. THE TOPIC OF TODAY'S DISCUSSION IS THE STATE OF REGULATION OF UTILITY SERVICE (IN THIS INSTANCE TELECOMMUNICATIONS) AND THE TREND TOWARD ADOPTING ALTERNATIVES TO RATE OF RETURN REGULATION. IT HAS BECOME FASHIONABLE DURING THE REAGAN ADMINISTRATION TO ATTACK ESTABLISHED INSTITUTIONS, TO DRIVE TOWARD LESS AND LESS GOVERNMENT OVERSIGHT, AND TO PROMOTE COMPETITION IN INDUSTRIES LONG CONSIDERED NATURAL MONOPOLIES. I THINK IN LARGE PART THIS SHOW OF DEREGULATORY ZEAL IS THE PRODUCT OF THE "FAST-FIX" AND A FAILURE ON THE PART OF THE LEGISLATIVE AND EXECUTIVE BRANCHES OF OUR FEDERAL GOVERNMENT TO PROPERLY ANALYZE, DEVELOP, COORDINATE AND IMPLEMENT A NATIONAL COMMUNICATIONS POLICY. HOWEVER, FOR OUR

PURPOSES THIS AFTERNOON, I WILL SHARE WITH YOU MY VIEWS ON REGULATORY REFORM BY STARTING WITH A STORY.

ONCE UPON A TIME, THERE WAS A LITTLE SOUTHERN TOWN WITH A VERY BIG PROBLEM. THE TOWN 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 HAVING RECENTLY PURCHASED THE EXCLUSIVE FRANCHISE THAT IT WAS THE ONLY COMPANY AVAILABLE TO PEOPLE WANTING TELEPHONE SERVICE. 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.

THERE COULD BE NO OTHER TELEPHONE COMPANIES AS A RESULT THE

COMPANY WAS ABLE TO MAKE INTERNAL CORPORATE DECISIONS WITHOUT ANY EXTERNAL CORPORATE RESTRAINTS. THE COMPANY'S DECISION 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 QUALITY SERVICE AT A FAIR PRICE.

ONE OF THE COMPANY'S FAVORITE PASSTIMES 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. THIS MARKETING STRATEGY ATTRACTED ADDITIONAL CUSTOMERS QUICKLY, HOWEVER, WHEN CUSTOMER SUBSCRIBERSHIP EXCEEDED 200 RATES ROSE TO \$25. THE PROMISE OF RATE REDUCTION HAD BEEN VIOLATED. CUSTOMERS COMPLAINED, OF COURSE, BUT THERE EXISTED NO GOVERNMENT BODY WITH THE AUTHORITY OR INCLINATION TO RESPOND TO THE CONCERNS EXPRESSED. 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 THEM VIGOROUSLY. IT PROHIBITED ANYONE BUT THE ACTUAL SUBSCRIBER FROM USING A TELEPHONE, FOR EXAMPLE ONLY THE FATHER IN THE HOUSEHOLD COULD USE THE TELEPHONE. ANY ADDITIONAL FAMILY MEMBER WHO WANTED TO UTILIZE THE TELEPHONE HAD TO PAY A SPECIAL PREMIUM. THE TELEPHONE COMPANY ALSO CHARGED EXORBITANT RATES AT PAY PHONES. THE COMPANY ALSO ACTIVELY MONITORED EACH TELEPHONE CALL, DISCONNECTING CALLS IT DIDN'T LIKE. FOR EXAMPLE, A SUBSCRIBER USING HIS BUSINESS LINE PLACING 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 COMPUNCTION ABOUT RELAYING IMPORTANT INFORMATION OVERHEARD TO HIGHER RANKED TELEPHONE EMPLOYEES. THIS PROBLEM WAS PARTICULARLY ACUTE IN THIS TOWN, SINCE IT WAS HERE THAT MANY HIGH RANKING GOVERNMENT OFFICIALS BOTH WORKED AND LIVED.

FINALLY, THE PEOPLE OF THE TOWN OVERWHELMED WITH ABUSIVE AND UNETHICAL PRACTICES CREATED A SPECIAL GOVERNMENT AGENCY TO POLICE THE TELEPHONE COMPANY AND ENSURE THAT IT COULD NO LONGER USE ITS MONOPOLY POSITION TO VIOLATE THE PUBLIC TRUST. AS A RESULT, RATES CAME DOWN, SERVICE IMPROVED, AND THE MONITORING OF TELEPHONE CALLS CEASED. ORDER HAD BEEN RESTORED. IT REMAINS TO BE SEEN HOWEVER, WHETHER, EVERYONE WILL LIVE HAPPILY EVER AFTER.

THE SOUTHERN TOWN IN OUR STORY, OF COURSE, WAS THE DISTRICT OF COLUMBIA, AND THE COMPANY, OUR OWN CHESAPEAKE AND POTOMAC TELEPHONE COMPANY. THE STORY IS IN FACT TRUE. ALL THESE INCIDENTS CAN BE FOUND IN THE TRANSCRIPT OF HEARINGS BEFORE CONGRESS HELD IN 1898, IN THE DAYS BEFORE PUBLIC UTILITY REGULATION CAME TO THE DISTRICT OR WAS WIDESPREAD THROUGHOUT OUR NATION. 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 COUNTRY WERE CREATING SIMILAR COMMISSIONS, ALL OF WHICH IN MY OPINION CONTINUE TO SERVE THE PUBLIC WELL.

THE PENDULUM HOWEVER IS NOW SWINGING AWAY FROM REGULATION TO THE "FREE MARKET" APPROACH THAT ALL OF US HAVE READ ABOUT IN ECONOMY 101. THAT IS TO SAY, THAT ESSENTIALLY MONOPOLY FIRMS ARE FREE TO PURSUE THEIR OBJECTIVES WITHOUT THE DISCOMFORT AND INEFFICIENCY OF GOVERNMENT INTRUSION. I BELIEVE THAT IN LARGE PART THIS TREND IS SHORT-SIGHTED, LACKING ADEQUATE JUSTIFICATION, AND POLITICALLY MOTIVATED. WHILE RATE OF RETURN REGULATION HAS NEVER BEEN CONSTRUED AS A PANACEA, AND DOES BURDEN UTILITIES AND RATEPAYERS ALIKE WITH SIGNIFICANT REGULATORY COSTS, I HAVE YET TO SEE AN ALTERNATIVE REGULATORY PROPOSAL THAT HAS BEEN PROVEN AS EFFECTIVE AS TRADITIONAL COST OF SERVICE REGULATION AT CURBING INCENTIVES TO EXERCISE ABUSIVE MONOPOLY POWER. I AM HOWEVER COMMITTED TO MAINTAINING AN OPEN MIND.

IT IS SAID THAT THE STATES ARE LABORATORIES FOR TESTING GOVERNMENTAL POLICIES. THOSE POLICIES SUCCESSFUL AT THE STATE LEVEL OFTEN FIND THEIR WAY INTO FEDERAL REGULATION AND LAW. THE TREND TOWARD COMMUNICATIONS REFORM IS A PERFECT EXAMPLE. WHILE THE INITIAL IMPETUS FOR INTRODUCING COMPETITION INTO THE

TELEPHONE INDUSTRY RESULTED FROM AN INDUSTRY RESTRUCTURING EFFECTED BY THE REAGAN ADMINISTRATION; BY WAY OF THE AT&T CONSENT DECREE AND THE FCC, REVISIONS TO THE METHODS OF REGULATING THE TELEPHONE COMPANIES THEMSELVES HAVE LARGELY BEEN SPEARHEADED BY THE STATES. THESE ACTIONS HAVE RESULTED FROM LEGISLATIVE INITIATIVES, AND REGULATORY PROCEEDINGS, OR BOTH. WHILE TIME DOES NOT PERMIT A DISCUSSION OF EACH STATE'S APPROACH TO REGULATORY REFORM, I THOUGHT IT WOULD BE USEFUL TO OUTLINE BRIEFLY THE EFFORTS BEING TAKEN IN A FEW OF THE MID-ATLANTIC JURISDICTIONS.

THE D.C. PSC IS PRESENTLY INVESTIGATING THE COMPETITIVE ENVIRONMENT FACING THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY, AS WELL AS ALTERNATIVES TO RATE OF RETURN REGULATION, IN FORMAL CASE NO. 814, WHICH COMMENCED IN SEPTEMBER OF 1987. THE COMMISSION HAS FORMED A WORKING GROUP WHICH IS COMPRISED OF REPRESENTATIVES OF THE COMMISSION STAFF, THE OFFICE OF THE PEOPLE'S COUNSEL, AND OTHER INTERESTED PARTIES WITH C&P SERVING AS A PARTICIPANT AND PROVIDER OF TECHNICAL INFORMATION. THE

WORKING GROUP IS TO FORWARD RECOMMENDATIONS TO THE COMMISSION IN  
A REPORT DUE AT THE END OF 1988. AMONG THE QUESTIONS THE GROUP  
MUST ADDRESS ARE:

WHAT IS THE NATURE AND SCOPE OF CURRENT AND  
ANTICIPATED COMPETITION FACING C&P?

WHAT IS THE NATURE AND EXTENT OF BYPASS OF  
C&P FACILITIES BY LARGE USERS AND  
INTEREXCHANGE CARRIERS?

WHAT IS THE NATURE AND EXTENT OF THE USE OF  
FIBER OPTIC TECHNOLOGY TO FACILITATE BYPASS  
AND PROVIDE ALTERNATIVES TO C&P SERVICES?

WHAT IMPACT DOES RATE OF RETURN REGULATION  
HAVE ON C&P'S COMPETITIVENESS?

DOES RATE OF RETURN PROVIDE ADEQUATE  
INCENTIVES TO REGULATED TELEPHONE COMPANIES  
TO IMPROVE AND MODERNIZE THEIR SERVICES?

WHAT ARE THE ALTERNATIVES TO RATE OF RETURN  
REGULATION, THEIR BENEFITS AND DRAWBACKS?

VIRGINIA HAS ADOPTED A VARIETY OF DEREGULATORY INITIATIVES.  
IN 1984, IN LIGHT OF NEW LEGISLATION, THE VIRGINIA CORPORATION  
COMMISSION DEREGULATED INTER-LATA LONG DISTANCE AND CERTIFICATED  
FIVE NEW INTER-LATA CARRIERS.

WITH RESPECT TO LOCAL EXCHANGE CARRIERS, THE VIRGINIA  
GENERAL ASSEMBLY HAS ALREADY DEREGULATED TELEPHONE COMPANIES WITH  
REVENUES OF \$20 MILLION OR LESS. THESE COMPANIES MAY CHARGE  
RATES WITHOUT COMMISSION HEARINGS UNLESS 5% OF THE CUSTOMERS



PROTEST, OR IF THE COMMISSION ITSELF CHOOSES TO INVESTIGATE.

WITH RESPECT TO THE LARGE LECS, IN NOVEMBER OF 1987, A VIRGINIA COMMISSION TASK FORCE RECOMMENDED IN AN INTERIM REPORT THAT RATE OF RETURN REGULATION AS APPLIED TO LECS IS NO LONGER ADEQUATE TO MEET THE NEEDS OF A COMPETITIVE MARKETPLACE. IT RECOMMENDED ADOPTION OF LEGISLATION EMPOWERING THE COMMISSION TO APPLY NON-TRADITIONAL REGULATORY MEASURES TO EXCHANGE CARRIERS AND "TO PROVIDE GREATER DISCRETION [TO THE COMMISSION] TO DEAL WITH CHANGES IN THE TELECOMMUNICATIONS INDUSTRY." THE TASK FORCE ALSO RECOMMENDED THAT IF THE LEGISLATION IS PASSED, THE COMMISSION "PROPOSE FORMAL RULES PERMITTING LECS TO APPLY TO HAVE THEIR RATES GOVERNED BY THE FORCES OF COMPETITION FOR THOSE SERVICES THE COMMISSION DEEMS APPROPRIATE."

IN PENNSYLVANIA, THERE HAVE ALSO BEEN CALLS FOR LEGISLATIVE REVISION COMING DIRECTLY FROM THE INDUSTRY. AFTER AN ABORTIVE ATTEMPT AT DEREGULATORY LEGISLATION BY BELL OF PENNSYLVANIA EARLY IN 1987, THE PENNSYLVANIA TELEPHONE ASSOCIATION PROPOSED DRAFT LEGISLATION SEEKING SWEEPING DEREGULATORY CHANGES. THE BILL WOULD

IMMEDIATELY DEREGULATE BILLING AND COLLECTION, YELLOW PAGES DIRECTORY ADVERTISING, WHITE PAGES DIRECTORY SERVICES, MOBILE TELEPHONE AND PAGING, AND OPERATOR SERVICES. MOREOVER, ALL NEW NON-BASIC SERVICES INTRODUCED AFTER THE EFFECTIVE DATE OF THE LEGISLATION WOULD NOT BE REGULATED. THE COMPANIES WOULD BE REQUIRED TO REPORT CERTAIN FINANCIAL AND OTHER DATA TO THE PENNSYLVANIA COMMISSION, AND TO COMPLY WITH NEW ACCOUNTING AND AUDIT RULES. THE BILL WOULD COMPLETELY DEREGULATE CARRIERS WITH FEWER THAN FIFTY THOUSAND ACCESS LINES, ALTHOUGH RATE PROCEEDINGS WOULD BE HELD FOR INCREASES OF MORE THAN TEN PER CENT.

ON THE FEDERAL LEVEL, THE FCC HAS, OF COURSE, PROPOSED ADOPTING PRICE CAP REGULATION FOR AT&T'S REGULATED OPERATIONS AND THE INTERSTATE ACCESS SERVICES PROVIDED BY THE BELL OPERATING COMPANIES. THE FCC HAS NOT YET ADOPTED A SPECIFIC PLAN, BUT THE PLANS FILED IN COMMENTS GENERALLY CALL FOR INITIAL CAPS AT CURRENT TARIFFED RATES, WITH REGULAR ADJUSTMENTS BASED ON ONE FEDERAL PRICE INDEX OR ANOTHER MODIFIED WITH A PRODUCTIVITY FACTOR TO REWARD INCREASED CARRIER EFFICIENCIES. THIS PROPOSAL,

AS YOU KNOW, HAS MET WITH STIFF CONGRESSIONAL OPPOSITION.

IN MY OPINION, PRICE CAP REGULATION AS PROPOSED FAILS TO PROTECT ADEQUATELY THE PUBLIC INTEREST. ITS BENEFITS APPEAR TO BE ONE-SIDED: IT PROMOTES THE INTERESTS OF CARRIERS AND THEIR SHAREHOLDERS TO THE DETRIMENT OF THE RATEPAYING PUBLIC. THERE ARE A NUMBER OF DRAWBACKS TO THE PRICE CAP APPROACH: IT CREATES INVESTMENT DISINCENTIVES FOR CARRIERS; EXISTING TARIFFED RATES ARE TOO HIGH TO BE USED AS INITIAL CAPPED RATES; THERE REMAINS NO ADEQUATE RATE ADJUSTMENT MECHANISM; AND THERE IS NO ADEQUATE MECHANISM TO ENSURE THAT CARRIER COST SAVINGS FLOW THROUGH TO RATE PAYERS.

THERE ARE ALSO UNRESOLVED FLAWS IN THE MECHANICS OF PRICE CAP REGULATION. MOST PRICE CAP PROPOSALS RECOMMEND USE OF THE CONSUMER PRICE INDEX AS THE FOUNDATION OF FUTURE CAP ADJUSTMENTS. ALTHOUGH USEFUL WITH RESPECT TO LABOR COSTS, THE CPI WOULD NOT REFLECT CHANGES IN THE EMBEDDED COST OF NET PLANT AND ITS RELATED DEPRECIATION EXPENSE, THE COST OF NEW PLANT, OR THE COST OF CAPITAL SPECIFIC TO THE TELEPHONE INDUSTRY.

ANOTHER RATE ADJUSTMENT PROBLEM CONCERNS THE PRODUCTIVITY FACTOR, BY WHICH IMPROVEMENTS IN CARRIER PRODUCTIVITY ARE PASSED ON TO RATE PAYERS. ANY PRODUCTIVITY ADJUSTMENT MUST BE CRAFTED CAREFULLY SO THAT PRODUCTIVITY IMPROVEMENTS REFLECT IMPROVED MANAGEMENT AND LABOR PRACTICES OCCURRING SUBSEQUENT TO THE IMPLEMENTATION OF PRICE CAPS, RATHER THAN PRODUCTIVITY IMPROVEMENTS GAINED FROM TECHNOLOGICAL INNOVATION AND INVESTMENT OCCURRING PRIOR TO IMPLEMENTATION OF PRICE CAPS. OTHERWISE, THE REAL MEASURE OF THE EFFECTIVENESS OF PRICE CAPS WILL BE DISTORTED, AND ITS ALLEGED BENEFITS OVEREMPHASIZED.

IN LIGHT OF MY REMARKS OF THE PAST FEW MINUTES, IT MAY SURPRISE YOU TO KNOW THAT I AM NOT OPPOSED TO DEREGULATION. I BELIEVE, HOWEVER, THAT DEREGULATION FOR ITS OWN SAKE IS NOT PROGRESS: IT IS MERELY THE REPLACEMENT OF ONE FORM OF REGULATION FOR ANOTHER. BEFORE I WILL SUBSCRIBE TO A PARTICULAR DEREGULATORY APPROACH, IT MUST BE PROVEN THAT THE CHOSEN METHOD OF RE-REGULATION WILL IMPROVE THE OVERALL STATE OF TELECOMMUNICATIONS,

THAT IT WILL INCREASE EFFICIENCIES, YIELD TECHNOLOGICAL INNOVATIONS, CREATE SUSTAINED PRICE REDUCTIONS, AND THAT BENEFITS WILL APPRECIABLY EXCEED RISKS. I ALSO BELIEVE THAT DEREGULATION SHOULD PROCEED SLOWLY, CAUTIOUSLY, ON A SERVICE-BY-SERVICE BASIS, AND ONLY AFTER A CONVINCING SHOWING THAT IT IS IN THE BEST INTEREST OF CUSTOMERS AND COMPANY ALIKE.

THANK YOU.