

REMARKS OF
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PRESENTED TO
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FOR OVER HALF A CENTURY, THE NATION'S TELECOMMUNICATIONS POLICY HAS BEEN GUIDED BY THE PRINCIPLE THAT BASIC TELEPHONE SERVICE SHOULD BE UNIVERSALLY AVAILABLE, AND THAT CITIZENS OF EVEN THE MOST MODEST MEANS SHOULD HAVE TELEPHONE SERVICE IN THEIR HOMES. IN LARGE PART, REGULATORS AND TELEPHONE COMPANIES HAVE SUCCEEDED IN THIS QUEST. RECENT FCC FIGURES SHOW THAT IN NOVEMBER 1987, 92.3% OF AMERICAN HOUSEHOLDS HAD ACCESS TO A TELEPHONE. NEVERTHELESS, THE FCC'S FIGURES ALSO REVEAL AN ALARMING TREND: THE PERCENTAGE OF HOUSEHOLDS WITHOUT TELEPHONES, AFTER MANY YEARS OF STEADY DECLINE, MAY BE RISING AGAIN. BETWEEN MARCH AND NOVEMBER 1987, THE NUMBER OF HOUSEHOLDS WITHOUT TELEPHONES GREW BY TWO HUNDRED THOUSAND, AN AVERAGE OF FOUR THOUSAND PER STATE. IN TOTAL, SEVEN MILLION AMERICAN HOUSEHOLDS REMAINED WITHOUT

TELEPHONE SERVICE AT THE END OF 1987. FOR THESE CITIZENS, A TELEPHONE REMAINS A LUXURY.

IN ORDER TO BRING TELEPHONE SERVICE TO THE NEARLY EIGHT PERCENT OF AMERICANS REMAINING OFF THE NETWORK, IT IS NECESSARY TO EXAMINE SOME OF THE MAJOR THREATS TO UNIVERSAL TELEPHONE SERVICE, AND DEVELOP METHODS TO MODERATE OR ELIMINATE THOSE THREATS. ALMOST WITHOUT EXCEPTION, THE POLICIES THAT THREATEN UNIVERSAL SERVICE BY INCREASING BASIC LOCAL TELEPHONE SERVICE RATES ARE THE RESULT OF ACTIONS BY THE FEDERAL COMMUNICATIONS COMMISSION. IN THE NEXT FEW MINUTES, I WOULD LIKE TO TOUCH UPON SOME OF THE MAJOR ISSUES RELATING TO UNIVERSAL SERVICE, AND DISCUSS THE FCC'S INVOLVEMENT.

CROSS-SUBSIDIZATION

ONE OF THE MOST SIGNIFICANT THREATS TO UNIVERSAL SERVICE DERIVES FROM INCREASED DIVERSIFICATION BY TELEPHONE COMPANIES INTO NON-REGULATED ACTIVITIES IN THE ABSENCE OF EFFECTIVE SAFEGUARDS AGAINST CROSS-SUBSIDIZATION. MANY STATE REGULATORS FEAR THAT AS THE BELL OPERATING COMPANIES (BOCS) INCREASE THEIR

ACTIVITIES IN THE PROVISION OF INFORMATION SERVICES, EQUIPMENT, AND NON-TELECOMMUNICATIONS MARKETS, INCENTIVES FOR USING REGULATED REVENUES TO SUBSIDIZE UNREGULATED VENTURES INCREASE SUBSTANTIALLY. THE PROBLEM BECOMES EVEN MORE ACUTE IN LIGHT OF THE GENERALLY LACKLUSTER PERFORMANCE OF THE BOCS' UNREGULATED ENTERPRISES. IF BOCS UNLAWFULLY USE CAPTIVE REVENUES TO BOLSTER SAGGING NON-TELEPHONE ENTERPRISES, RATEPAYERS WILL BE FACED WITH RISING RATES WITHOUT ACCOMPANYING IMPROVEMENTS IN SERVICE. CAPTIVE RATEPAYERS WILL BE LINING THE POCKETS OF BOC SHAREHOLDERS BY ASSUMING THEIR RISKS.

NOTWITHSTANDING THE IMPORTANCE OF MEASURES TO PREVENT CROSS-SUBSIDY, RECENT FCC ORDERS HAVE DENIED STATES THE TOOLS NECESSARY TO GUARD AGAINST IT EFFECTIVELY. SPECIFICALLY, THE FCC, IN ITS COMPUTER III PROCEEDING, HAS PREEMPTED THE STATES FROM REGULATING THE MANNER IN WHICH BOCS MAY OFFER COMPUTER ENHANCED SERVICES, AS WELL AS FROM REGULATING THE SERVICES THEMSELVES. FOR EXAMPLE, THE FCC HAS PROHIBITED THE STATES FROM REQUIRING THAT BOCS PROVIDE THESE ENHANCED SERVICES THROUGH AN

ARMS-LENGTH SUBSIDIARY, EVEN THOUGH YEARS OF REGULATORY EXPERIENCE PROVE THAT STRUCTURAL SEPARATION IS THE MOST EFFECTIVE PREVENTION AGAINST UNLAWFUL CROSS-SUBSIDY. MOREOVER, EVEN THOUGH THE FCC HAS PREEMPTED STATES FROM REGULATING THE BOCS' ENHANCED SERVICES, IT NONETHELESS ADMITS THAT IT LACKS THE MANPOWER TO ENFORCE ITS OWN NEWLY ESTABLISHED COST ALLOCATION RULES. IN MANY STATES' VIEW, THE BOCS SHOULD BE RESTRICTED FROM PROVIDING UNREGULATED ENHANCED SERVICES UNTIL THE POTENTIAL FOR ABUSE HAS BEEN CURBED BY THE INTRODUCTION OF EFFECTIVE REGULATORY SAFEGUARDS PROMULGATED ON THE STATE LEVEL. ONLY THROUGH STATE ACTION CAN THERE BE ASSURANCES THAT CREATION OF A VIGOROUS, COMPETITIVE, INFORMATION MARKETPLACE DOES NOT COME AT THE EXPENSE OF UNIVERSAL SERVICE OBJECTIVES. UNFORTUNATELY, THE FCC'S PREEMPTION OF STATE REGULATION OF BOC-PROVIDED ENHANCED SERVICES HAS MADE THIS GOAL DIFFICULT, IF NOT IMPOSSIBLE. ACCORDINGLY, A NUMBER OF STATES HAVE JOINED TO CHALLENGE THE FCC'S UNLAWFUL PREEMPTION IN AN APPEAL TO THE FEDERAL APPEALS COURT IN SAN FRANCISCO. THE PARTIES IN THAT CASE ARE NOW PRESENTING THEIR

WRITTEN ARGUMENTS TO THE COURT, AND A DECISION MAY BE RELEASED BY
THE END OF THE YEAR,

THE COMPUTER III DEBATE UNDERSCORES FUNDAMENTAL TENSIONS
BETWEEN STATE COMMISSIONS AND THE FCC. THE FCC HAS FOR A NUMBER
OF YEARS AGGRESSIVELY ASSERTED ITS CLAIM OF PREEMPTIVE AUTHORITY.
USING A LABORED INTERPRETATION OF THE FEDERAL COMMUNICATIONS ACT
OF 1934, THE FCC HAS SOUGHT TO PREEMPT STATES IN MANY AREAS.
THIS DEFIES FUNDAMENTAL TENETS OF FEDERALISM AS WELL AS THE
EXPRESS WORD OF LAW. STATES MUST BE VIGILANT IN PROTECTING THEIR
RIGHTFUL JURISDICTION IN THIS AREA.

INDUSTRY RESTRUCTURING

THE MOST FUNDAMENTAL AND IMMEDIATE THREAT TO UNIVERSAL
SERVICE IS, OF COURSE, UNREASONABLY HIGH COSTS OF PROVIDING
TELEPHONE SERVICE. IF TELEPHONE COMPANIES ARE COMPELLED BY
FEDERAL AUTHORITIES TO INCUR GREAT EXPENSE IN EQUIPMENT
PROCUREMENT AND LABOR COSTS TO PROVIDE REGULATED SERVICES, RATES
MUST BE RAISED TO PREVENT A REVENUE SHORTFALL. ACCORDINGLY, STATE

COMMISSIONS MUST SCRUTINIZE CLOSELY COMPANY EXPENDITURES WHEN SETTING LOCAL RATES.

IT IS IN THIS FRAMEWORK THAT COMMISSIONS HAVE HAD TO COPE WITH THE TREMENDOUS COSTS OF THE RESTRUCTURING OF THE TELEPHONE INDUSTRY BROUGHT ABOUT BY THE DIVESTITURE OF AT&T. THE CHALLENGE HAS BEEN RENDERED ALL THE MORE DIFFICULT BY FCC DECISIONS THAT COMPEL STATES TO PASS A DISPROPORTIONATE SHARE OF THESE EXPENSES ON TO LOCAL RATEPAYERS IN ONE FORM OR ANOTHER.

THE DIVESTITURE OF AT&T REQUIRED RATEPAYERS TO FINANCE THE MONUMENTAL CONVERSION TO EQUAL ACCESS, WHICH ALLOWS ALL INTERSTATE LONG DISTANCE COMPANIES TO SERVE LOCAL TELEPHONE CUSTOMERS IN THE SAME MANNER AS AT&T. TELEPHONE COMPANIES HAVE EXPENDED BILLIONS AND BILLIONS OF DOLLARS IN IMPLEMENTING ACCESS TO THE EQUAL ACCESS REQUIREMENT. THEIR LONG DISTANCE CARRIER TO CHOICE, WHETHER OR NOT THESE CUSTOMERS WERE SATISFIED WITH THE SERVICES OF A SINGLE CARRIER. WHILE COMPETITION AMONG LONG DISTANCE CARRIERS HAS CERTAINLY BENEFITED PERSONS AND COMPANIES THAT MAKE MANY LONG DISTANCE CALLS, THE TREMENDOUS COST OF

CREATING A COMPETITIVE ENVIRONMENT HAS NOT BEEN PROPORTIONATELY SHARED. IN THE FINAL ANALYSIS, IT IS UNCLEAR WHETHER LOCAL RATEPAYERS HAVE COME OUT AHEAD AS A RESULT OF DIVESTITURE IN LIGHT OF THE FCC'S DISTRIBUTION OF COSTS.

WE ARE NOW ON THE EVE OF ANOTHER INDUSTRY RESTRUCTURING, ONE THAT IS NOT YET CLEARLY DEFINED. IN ITS COMPUTER III PROCEEDING, THE FCC RULED THAT IT WOULD ALLOW BOCS TO PROVIDE COMPUTER ENHANCED SERVICES WITHOUT MANY OF THE EXISTING REGULATORY CONSTRAINTS PROVIDED THAT THE COMPANIES IMPLEMENT A MONUMENTAL REBUILDING OF THEIR NETWORKS. THE REBUILDING WOULD RESULT IN A SO-CALLED OPEN NETWORK ARCHITECTURE (ONA) WHICH WOULD ALLOW ENHANCED SERVICE PROVIDERS EQUAL ACCESS TO THE NETWORK IN MUCH THE SAME WAY THAT LONG DISTANCE CARRIERS NOW HAVE EQUAL ACCESS. ONA, AS CONCEIVED BY THE FCC, WILL ENABLE ENHANCED SERVICE PROVIDERS, WHICH ARE DEPENDENT ON LOCAL EXCHANGE CARRIERS FOR GETTING THEIR SERVICES TO THEIR CUSTOMERS, TO PURCHASE FROM THE BOCS THE BASIC SERVICE ELEMENTS NECESSARY TO PROVIDE THEIR SERVICES. THE BOCS WOULD ALSO HAVE TO PURCHASE THESE ELEMENTS

FROM ITSELF FOR ITS OWN ENHANCED SERVICE OFFERINGS. THE IDEA IS TO ENSURE THESE OTHER PROVIDERS NONDISCRIMINATORY ACCESS TO THE LOCAL NETWORK AND A LEVEL PLAYING FIELD IN THE ENHANCED SERVICES MARKET. DESPITE THESE LAUDABLE GOALS, A CRITICAL QUESTION REMAINS: WHO FOOTS THE BILL?

THE COST OF IMPLEMENTING OPEN NETWORK ARCHITECTURE IS UNCLEAR. NEVERTHELESS, IT WILL LIKELY BE HIGH, WHICH CREATES THE VIRTUAL CERTAINTY THAT ONA WILL INCREASE LOCAL RATES IN ONE WAY OR ANOTHER. FOR THE MOST PART, STATE REGULATORS AND INDUSTRY AGREE THAT RATEPAYERS SHOULD NOT HAVE TO BEAR THE COSTS OF ONA. ENHANCED SERVICE PROVIDERS, INCLUDING THE ENHANCED SERVICE OPERATIONS OF LOCAL EXCHANGE CARRIERS, SHOULD BEAR THE COSTS OF RESTRUCTURING. AFTER ALL, THEY WILL BE MAKING THE PROFIT. THE KEY IS TO ENSURE THAT CAPTIVE RATEPAYERS ARE NOT FORCED TO BEAR THE COST OF RECONSTRUCTING THE NATIONAL COMMUNICATIONS NETWORK TO PROVIDE SERVICES WHICH THE VAST MAJORITY OF CONSUMERS MAY NEVER USE.

IT IS ESSENTIAL, THEREFORE, THAT THE STATES PARTICIPATE

FULLY IN THE FCC PROCEEDINGS CONCERNING THE DEVELOPMENT OF ONA. EACH OF THE BOCS HAVE PREPARED AND SUBMITTED PLANS FOR THE DEPLOYMENT OF ONA, AND THE FCC IS CONTINUING TO RECEIVE COMMENT ON THOSE PROPOSALS. I URGE EACH STATE TO EXAMINE CLOSELY THE ONA PLAN OF THEIR BOC, AND TO PROVIDE THE FCC WITH ITS VIEWS. IN ORDER TO FURTHER COOPERATION BETWEEN STATES AND THE FCC, AND TO PURSUE UNIFORMITY AMONG THE PLANS, THE D.C. COMMISSION HAS URGED THE FCC TO CREATE A JOINT BOARD COMPRISED OF MEMBERS OF THE FCC AND OF STATE COMMISSIONS. IT IS THE D.C. COMMISSION'S CONCERN THAT THE FCC ACTING ALONE WILL FAIL TO CONSIDER ADEQUATELY THE NEEDS OF LOCAL RATEPAYERS, FAVORING INSTEAD THE NARROW INTERESTS OF OTHERS. THE FCC'S COMPUTER III DECISIONS HAVE REVEALED THE FCC'S PREDISPOSITION IN THIS RESPECT. MY FEELING, AND THAT OF MANY OTHER STATES, IS THAT UNIVERSAL SERVICE MUST CONTINUE TO BE THE PRIORITY; IT CERTAINLY IS AT THE STATE LEVEL. REGRETTABLY, ON THE STATE LEVEL OUR HANDS CONTINUE TO BE TIED BY FCC PREEMPTION.

JURISDICTIONAL SEPARATIONS

ANOTHER AREA WHICH HAS A GREAT IMPACT ON LOCAL RATES IS THE PROCESS BY WHICH THE COSTS OF PROVIDING INTERSTATE LONG DISTANCE SERVICE ARE SEPARATED FROM THE COSTS OF PROVIDING LOCAL AND OTHER IN-STATE SERVICES. THE RESULT OF THIS SEPARATIONS PROCESS DETERMINES THE PROPORTION OF TELEPHONE COMPANY COSTS RECOVERED THROUGH INTERSTATE LONG DISTANCE RATES AND SUBSCRIBER LINE CHARGES (SLC), AND THE PROPORTION RECOVERED THROUGH RATES FOR BASIC LOCAL SERVICE AND STATE LONG DISTANCE SERVICE. AS YOU WILL RECALL, THE SLC IS THE EXTRA FEE THE FCC REQUIRES LOCAL TELEPHONE CUSTOMERS TO PAY EACH MONTH FOR THE COSTS ASSOCIATED WITH PROVIDING INTERSTATE LONG DISTANCE SERVICE. CONSUMERS MUST PAY THE FULL CHARGE WHETHER OR NOT THEY MAKE ANY LONG DISTANCE CALLS. TODAY, THE SLC FOR RESIDENTIAL CONSUMERS IS \$2.60. ABSENT INTERVENING ACTION BY THE FCC, IT WILL RISE TO \$3.50 BY NEXT APRIL. THE SLC, AND OTHER, LESS PUBLICIZED FCC ACTIONS THAT REDUCE LONG DISTANCE RATES AND INCREASE LOCAL RATES, POSE A REAL AND IMMEDIATE THREAT TO UNIVERSAL SERVICE BY RAISING SIGNIFICANTLY THE COST OF MINIMAL TELEPHONE SERVICE.

SINCE THE SEPARATIONS PROCESS, BY ITS VERY NATURE, AFFECTS BOTH STATE AND FEDERAL JURISDICTION, THE PROCESS IS GOVERNED BY A FEDERAL-STATE JOINT BOARD AT THE FCC. THE JOINT BOARD REALIZED THE THREAT SLC INCREASES POSE, AND, IN 1985, RECOMMENDED THAT THE FCC ESTABLISH A LIFELINE PROGRAM TO HELP PERSONS IN NEED TO STAY ON THE NETWORK. THROUGH LIFELINE, QUALIFYING LOW-INCOME TELEPHONE SUBSCRIBERS CAN NOW HAVE THE SLC WAIVED ON EACH THEIR LOCAL PHONE BILL, AS WELL AS RECEIVE A REDUCTION OF \$2.60 OR MORE OFF THEIR LOCAL TELEPHONE BILLS. ULTIMATELY THE COST OF THE SUBSIDY PROGRAM IS SHARED BY LOCAL, INTRASTATE, AND INTERSTATE LONG DISTANCE CUSTOMERS. IN THE THREE YEARS SINCE THE FCC ADOPTED THE JOINT-BOARD'S PLAN, 22 STATES AND THE DISTRICT OF COLUMBIA HAVE ESTABLISHED CERTIFIED LIFELINE PROGRAMS. WHILE LIFELINE BY NO MEANS RESOLVES ALL OF THE ISSUES AND IMPLICATIONS OF REQUIRING LOCAL RATEPAYERS TO SHOULDER AN INCREASED BURDEN OF TELEPHONE COMPANY EXPENSES, IT NEVERTHELESS HELPS DEFRAY NEGATIVE EFFECTS ON UNIVERSAL SERVICE. I WOULD STRONGLY ENCOURAGE EACH STATE THAT HAS NOT YET DONE SO TO ESTABLISH A LIFELINE PROGRAM.

LAST YEAR, THE JOINT BOARD IDENTIFIED ANOTHER THREAT TO UNIVERSAL SERVICE: THE HIGH INITIAL COST OF HAVING TELEPHONE SERVICE INSTALLED. STUDIES HAVE SHOWN THAT THE HIGH, UP-FRONT COSTS ASSOCIATED WITH SERVICE INITIATION IS ONE OF THE GREATEST BARRIERS LOW INCOME CITIZENS FACE IN OBTAINING TELEPHONE SERVICE. AS A RESULT OF PRESSURES FROM STATE REGULATORS, THE FCC LAST YEAR INTRODUCED ITS LINK-UP AMERICA PROGRAM TO EASE THE COST BURDEN OF THE INITIAL PHONE HOOK-UP. LINK-UP PAYS HALF OF INITIAL INSTALLATION CHARGES UP TO \$35 AND THE INTEREST CHARGES ON DEFERRED PAYMENT PLANS UP TO \$200. LIKE LIFELINE, LINK-UP REQUIRES STATES TO APPLY FOR FCC CERTIFICATION. AGAIN, I WOULD ENCOURAGE THE 20 STATES THAT HAVE NOT DONE SO TO DEVELOP THEIR OWN LINK-UP PLANS. WHILE IT MAY BE ONLY A SMALL STEP, IT IS CERTAINLY ONE OF THE EASIEST AND MOST EFFECTIVE WAYS TO ADDRESS THE THREATS TO UNIVERSAL SERVICE IS TO TAKE ADVANTAGE OF THESE TWO FEDERAL PROGRAMS.

PRICE CAPS

I THINK THESE EXAMPLES SPEAK TO THE IMPORTANCE OF THE JOINT

BOARD PROCESS. NO MATTER WHAT THE POLICY, GETTING THE STATES INVOLVED IN FEDERAL TELECOMMUNICATIONS POLICY MAKING IS ESSENTIAL TO A COORDINATED APPROACH TO THE NEW CHALLENGES WE FACE IN THE INDUSTRY.

IN FACING THESE CHALLENGES, REGULATORS AND INDUSTRY ARE PURSUING A VARIETY OF REGULATORY ALTERNATIVES. THE FCC HAS SUGGESTED THAT TRADITIONAL COST-OF-SERVICE, RATE-OF-RETURN REGULATION MAY NO LONGER BE THE MOST EFFECTIVE METHOD FOR REGULATING AT&T OR THE RATES THE BOCS CHARGE FOR CONNECTING LONG DISTANCE CARRIERS TO LOCAL SUBSCRIBERS. THE ALTERNATIVE OFFERED BY THE FCC WOULD CAP PRICES FOR SERVICES INSTEAD OF CAPPING PROFITS, WHICH IS THE TRADITIONAL REGULATORY METHOD. AGAIN, ONE MIGHT ASK IF THIS IS REALLY IN THE BEST INTEREST OF CUSTOMERS. STATE REGULATORS HAVE THEIR DOUBTS.

FOR INSTANCE, WHAT MECHANISM WILL BE USED TO GUARANTEE THAT COST REDUCTIONS WILL BE PASSED THROUGH TO RATEPAYERS? HOW WOULD THE PLAN PREVENT ANTICOMPETITIVE PRICING? HOW WOULD THE INITIAL PRICE CAP BE SET AND WHAT IS THE MOST FAIR AND EFFECTIVE METHOD

OF ADJUSTING THE CAPS? HOW WILL NEW SERVICES BE TREATED? WHAT WILL BE THE EFFECT ON GEOGRAPHIC RATE AVERAGING? AND HOW WILL SERVICE QUALITY BE MAINTAINED?

ALTHOUGH THESE QUESTIONS CREATE GRAVE DOUBTS IN REGULATORS' MINDS CONCERNING THE EFFICACY OF PRICE CAPS, STATES SHOULD NONETHELESS RESERVE FINAL JUDGMENT ON THE CONCEPT UNTIL THE FCC PUTS A SPECIFIC PLAN ON THE TABLE. ASSUMING IT IS A PROPOSAL WORTHY OF SERIOUS CONSIDERATION AND WHICH RESOLVES CRITICISMS RAISED IN FCC PROCEEDINGS LAST YEAR, STATES MAY WISH TO EXAMINE IT CLOSELY. I ASSURE YOU THAT YOUR STATE WILL BE JOINED BY MANY OTHERS.

IN SUM, STATES HAVE BEEN HINDERED IN THEIR PURSUIT OF UNIVERSAL SERVICE BY FCC ACTIONS AND POLICES THAT RAISE RATES FOR LOCAL SERVICE. RECTIFYING THESE IMPEDIMENTS REQUIRES UNITY AMONG THE STATES, VIGOROUS LITIGATION OF UNLAWFUL FCC ACTIONS, AND LEGISLATIVE PRESSURE FROM CAPITOL HILL. THE BATTLE LINES HAVE BEEN DRAWN.

THANK YOU FOR YOUR ATTENTION.