

**UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON THE JUDICIARY
SUBCOMMITTEE ON ECONOMIC AND COMMERCIAL LAW**

TESTIMONY OF

**THE HONORABLE PATRICIA M. WORTHY, CHAIRMAN
PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA**

ON BEHALF OF THE

**NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS
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ON THE

OVERSIGHT HEARINGS ON THE AT&T CONSENT DECREE

AUGUST 1, 1989

SUMMARY

THE UNITED STATES CONGRESS IS FACING A CHALLENGE OF IMMEASURABLE IMPORTANCE IN DETERMINING THE FUTURE PROVISION OF TELECOMMUNICATIONS SERVICES AND EQUIPMENT OFFERED BY THE BELL OPERATING COMPANIES (BOCS). IN LIGHT OF THIS CHALLENGE, THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS (NARUC) URGES THAT IF CONGRESS CONSIDERS LEGISLATION WHICH WOULD MODIFY OR REMOVE THE MODIFIED FINAL JUDGMENT (MFJ) RESTRICTIONS ON THE BOCS, THAT SUCH LEGISLATION INCLUDE LANGUAGE TO LEAVE TO THE STATES THE JURISDICTION TO FASHION SAFEGUARDS TO AVOID PRICE DISCRIMINATION AND CROSS-SUBSIDIES. STATE REGULATORS' PRIMARY CONCERN IS THE EFFECT DIVERSIFICATION INTO HIGH-RISK LINES OF BUSINESS WILL HAVE UPON TELEPHONE RATES. MANY STATES HAVE SEEN REGIONAL HOLDING COMPANIES AND THEIR AFFILIATES AGGRESSIVELY SEEKING TO AVOID APPROPRIATE STATE REGULATION OF THEIR VENTURES INTO MORE COMPETITIVE MARKETS, THROUGH LEGISLATION, LITIGATION, TRANSFER OF ASSETS AND CORPORATE REORGANIZATION.

WHILE THE D.C. COMMISSION SUPPORTS THIS NARUC POSITION, IN MY VIEW AS CHAIRMAN OF THE D.C. COMMISSION, RELIANCE ON CURRENT FEDERAL REGULATORY SAFEGUARDS TO GUARD AGAINST THE POSSIBILITY OF ANTI-COMPETITIVE CONDUCT, SUCH AS PRICE DISCRIMINATION AND CROSS-SUBSIDIES, MAY NOT PROTECT THE PUBLIC INTEREST. IT IS MY OPINION THAT IN THE EVENT OF ANY ATTEMPT AT LEGISLATIVE MODIFICATION OF THE MFJ, THE REGULATORY FRAMEWORK USED TO REPLACE THE CURRENT MFJ RESTRICTIONS SHOULD BE SUBJECTED TO CLOSE SCRUTINY TO ASSURE THAT IT IS IN THE PUBLIC INTEREST.

MR. CHAIRMAN AND MEMBERS OF THIS SUBCOMMITTEE:

MY NAME IS PATRICIA M. WORTHY AND I AM CHAIRMAN OF THE PUBLIC SERVICE COMMISSION OF THE DISTRICT OF COLUMBIA (D.C. COMMISSION). I AM TESTIFYING HERE TODAY AS REPRESENTATIVE OF THE NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS (NARUC), AND, AS THE CHAIRMAN OF THE D.C. COMMISSION, A MEMBER OF NARUC. BECAUSE OF THE DUAL NATURE OF MY REMARKS, I WOULD LIKE TO MAKE CLEAR THAT THE FIRST PART OF MY TESTIMONY CONCERNS THE POSITION OF NARUC, AND THE SECOND PART OF MY TESTIMONY CONCERNS MY POSITION AS CHAIRMAN OF THE D.C. COMMISSION.

NARUC IS A QUASI-GOVERNMENTAL, NONPROFIT ORGANIZATION FOUNDED IN 1889. WITHIN OUR MEMBERSHIP ARE THE GOVERNMENTAL AGENCIES OF THE FIFTY STATES, THE DISTRICT OF COLUMBIA, PUERTO RICO, AND THE VIRGIN ISLANDS WHICH ARE ENGAGED IN THE REGULATION OF TELEPHONE UTILITIES. OUR CHIEF OBJECTIVE IS TO SERVE THE CONSUMER INTEREST BY SEEKING TO IMPROVE THE QUALITY AND EFFECTIVENESS OF GOVERNMENT REGULATION IN AMERICA. THE D.C. COMMISSION, ORGANIZED IN 1913, OVERSEES AND REGULATES THE PUBLIC UTILITIES OPERATING WITHIN THE DISTRICT OF COLUMBIA AND PROVIDING SERVICES WHOLLY WITHIN THE DISTRICT OF COLUMBIA.

NARUC APPRECIATES THIS OPPORTUNITY TO PRESENT ITS VIEWS ON THE CURRENT STATUS OF THE MFJ AND WHAT, IF ANY, LEGISLATIVE OR OTHER CHANGES ARE NEEDED IN THIS AREA. AS THIS SUBCOMMITTEE IS AWARE, YOUR COLLEAGUES IN THE HOUSE SUBCOMMITTEE ON TELECOMMUNICATIONS AND

FINANCE HAVE PENDING H.R. 2140, THE "CONSUMER TELECOMMUNICATIONS SERVICES ACT OF 1989," WHICH WOULD LIFT THE RESTRICTIONS PLACED UPON THE BELL OPERATING COMPANIES (BOCS) IN THE AREAS OF MANUFACTURING AND THE PROVISION OF INFORMATION SERVICES. BOTH NARUC AND THE D.C. COMMISSION APPLAUD THIS SUBCOMMITTEE'S EFFORTS TO GATHER INFORMATION CONCERNING THIS SUBJECT.

THE UNITED STATES CONGRESS IS FACING A CHALLENGE OF IMMEASURABLE IMPORTANCE. IT IS NOW IN THE EARLY STAGES OF DETERMINING THE FUTURE PROVISION OF TELECOMMUNICATIONS SERVICES AND EQUIPMENT OFFERED BY THE BOCS. I AM BEFORE YOU TODAY NOT AS AN ADVOCATE OF THE PROS AND CONS ASSOCIATED WITH WHETHER, OR HOW, THE MFJ SHOULD BE MODIFIED. THE PURPOSE OF TODAY'S TESTIMONY IS TO INFORM YOU OF THE STATES' CONTINUED INTEREST IN THE MFJ AND TO DEMONSTRATE WHY ANY CHANGE TO THE MFJ SHOULD TAKE INTO ACCOUNT THE INTERESTS OF STATE REGULATORS IN PROTECTING BOTH THE LOCAL RATEPAYERS AND THE CONCEPT OF UNIVERSAL SERVICE.

SINCE DIVESTITURE AND IN THE NAME OF "COMPETITION," STATE REGULATORS HAVE BEEN FACED WITH INCREASED REGULATORY COMPLEXITIES AND A CONSTANT PRESSURE TO INCREASE LOCAL TELEPHONE RATES. THE ACTIONS OF THE MFJ COURT HAVE RESULTED IN UNCERTAINTY, COSTLY LITIGATION, AND THE EXPENDITURE OF LIMITED STAFF RESOURCES AT THE STATE LEVEL. I HAVE SEEN ESTIMATES FOR THE ONE-TIME COST OF PROVIDING EQUAL ACCESS (PURSUANT TO THE MANDATE OF THE CONSENT

DECREE) RANGING FROM \$4 TO \$11 BILLION.^{1/} THE AVERAGE RESIDENTIAL TELEPHONE BILL HAS INCREASED SINCE DIVESTITURE APPROXIMATELY 50% FROM \$180 TO \$270 ANNUALLY. IN ADDITION, AND AS A RESULT OF ANTICIPATED FEDERAL COMMUNICATIONS COMMISSION ACTIONS WITH REGARD TO THE REVISIONS OF THE COST ALLOCATIONS BETWEEN THE FEDERAL AND STATE JURISDICTIONS, HUNDREDS OF MILLIONS OF DOLLARS OF REVENUE REQUIREMENTS WILL BE BORNE BY LOCAL RATEPAYERS IN THE NOT TO DISTANT FUTURE.

ALL OF THESE DECISIONS HAVE LED TO THE POSSIBILITY OF ADDITIONAL COSTS BEING SHOULDERED BY THE LOCAL RATEPAYER. IN THE FACE OF THIS TURMOIL, THE STATES HAVE BEEN VIGILANT IN THEIR EFFORTS TO PROTECT UNIVERSAL SERVICE. IN ORDER TO PERMIT THE STATES TO CONTINUE TO KEEP PACE WITH THE RAPID INTRODUCTION OF THE INFORMATION AGE ON THE STATE LEVEL, STATES MUST RETAIN THE AUTHORITY AND THE FLEXIBILITY TO ASSURE AFFORDABLE LOCAL TELEPHONE RATES FOR ALL RATEPAYERS.

AS YOU ARE AWARE, THE MFJ PLACES RESTRICTIONS ON CERTAIN OF THE ACTIVITIES IN WHICH THE BOCS CAN ENGAGE. AT THE END OF THE FIRST TRIENNIAL REVIEW, THE DISTRICT COURT ISSUED TWO RULINGS WHICH MODIFIED CERTAIN OF THOSE RESTRICTIONS. ALTHOUGH CURRENTLY SUBJECT TO FURTHER LITIGATION, THE DISTRICT COURT'S DECISION PERMITTED BOC PARTICIPATION IN THE INFORMATION SERVICES ARENA AND LIFTED THE

^{1/} See Kraus, Duerig, "The Rape of Ma Bell, The Criminal Wrecking of the Best Telephone System in the World" (Lyle Stuart, Inc.).

RESTRICTION ON NON-TELECOMMUNICATIONS LINES OF BUSINESS. WHILE THE BOCS ARE NOT PERMITTED TO GENERATE CONTENT IN THEIR INFORMATION SERVICES, UNDER THE DISTRICT COURT'S RULING, THEY ARE PERMITTED TO OFFER THE "CONDUIT" OR GATEWAY FUNCTIONS FOR OTHER INFORMATION SERVICE PROVIDERS. THE DISTRICT COURT'S DECISION RETAINED THE PROHIBITION ON BOC MANUFACTURING AND INTEREXCHANGE SERVICE.

NARUC POSITION

NARUC HAS BEEN ACTIVELY INVOLVED IN THE EVOLUTION OF THE MFJ AND THE REQUESTS OF THE BOCS TO SEEK RELIEF FROM THE MFJ RESTRICTIONS. AS HAS BEEN TESTIFIED PREVIOUSLY BEFORE CONGRESS BY NARUC,

STATE REGULATORS' PRIMARY CONCERN IS THE EFFECT DIVERSIFICATION INTO HIGH-RISK LINES OF BUSINESS WILL HAVE UPON TELEPHONE RATES. MANY STATES HAVE SEEN REGIONAL HOLDING COMPANIES AND THEIR AFFILIATES AGGRESSIVELY SEEKING THROUGH LEGISLATION, LITIGATION, TRANSFER OF ASSETS AND CORPORATE REORGANIZATION TO AVOID APPROPRIATE STATE REGULATION OF THEIR VENTURES INTO MORE COMPETITIVE MARKETS.^{2/}

THE STATE COMMISSIONS ARE CONCERNED THAT THE BOCS WILL HAVE THE INCENTIVE TO USE THEIR MONOPOLY SERVICES TO SUBSIDIZE THEIR COMPETITIVE OFFERINGS. AVOIDING THESE TYPES OF INCENTIVES IS THE RESPONSIBILITY OF ALL REGULATORS, AND THE STATE COMMISSIONS, IN PARTICULAR.

^{2/} Testimony of Sharon L. Nelson, Chairman, Washington Utilities and Transportation Commission, on Behalf of [NARUC], before the United States Senate Committee on the Judiciary, Subcommittee on Antitrust, Monopolies and Business Rights at 7 (April 30, 1987).

THE STATE COMMISSIONS' CONCERNS ARE GROUNDED IN THEIR RESPECTIVE EXPERIENCES, EXEMPLIFIED BY A NARUC STAFF SUBCOMMITTEE REPORT ON AUDITS CONDUCTED ON FIVE REGIONAL HOLDING COMPANIES.^{3/} I THINK IT IMPORTANT TO NOTE THE FOUR GENERAL PROBLEM AREAS THAT THESE AUDITS CONCENTRATED ON.

FIRST, THE COMPANIES CONSISTENTLY ATTEMPTED TO BLOCK ACCESS OR DELAY ACCESS TO ACCOUNTING AND COST ALLOCATION RECORDS DURING THE AUDIT PROCESS. SECOND, THE COMPANIES WERE FOUND TO HAVE EMBARKED ON AMBITIOUS AND UNPROFITABLE INVESTMENT PROGRAMS IN HIGHLY COMPETITIVE, UNREGULATED MARKETS. THIRD, THE COMPANIES TRANSFERRED VALUABLE REVENUE-PRODUCING SERVICES FROM THE TELEPHONE COMPANIES TO NEW, UNREGULATED SUBSIDIARIES, REDUCING THE "CONTRIBUTION" OF THESE NEW SERVICES TO THE BOCS' GENERAL REVENUES. AND, FOURTH, THE NARUC STAFF EXPRESSED CONCERN OVER THE GRADUAL SHIFT TO A CAPITAL STRUCTURE CHARACTERIZED BY LARGE DEBT ISSUES AND THE TRANSFER OF NET INCOME TO THE PARENT CORPORATION.

IN ORDER TO ADDRESS THESE CONCERNS WHICH MAY RESULT IN CROSS-SUBSIDIES AND PRICE DISCRIMINATION, NARUC SET OUT ITS POSITION, IN THE CONTEXT OF THE MFJ, AS TO HOW TO PROTECT THE PUBLIC INTEREST. A BRIEF DISCUSSION OF CERTAIN ACTIONS BY NARUC'S COMMITTEE ON COMMUNICATIONS MAY BE INFORMATIVE.

^{3/} Summary Report on the Regional Holding Company Investigations, NARUC, Washington, D.C., September 18, 1986.

IN 1987, THE COMMITTEE ON COMMUNICATIONS SPONSORED A RESOLUTION WHICH WAS ADOPTED BY NARUC AND WHICH RATIFIED EARLIER STATED CONDITIONS WHICH, IF EACH WERE MET, WOULD BE A PRECONDITION FOR NARUC'S SUPPORT OF THE REMOVAL OF THE MFJ RESTRICTIONS. THE CONDITIONS WERE INTENDED TO PROTECT BOTH THE PUBLIC INTEREST AND THE JURISDICTION OF THE STATES. FOR YOUR CONVENIENCE, I HAVE ATTACHED TO MY TESTIMONY TODAY A COPY OF THAT RESOLUTION. SEE ATTACHMENT A. IN THE 1987 RESOLUTION, IT WAS INDICATED THAT NARUC WOULD SUPPORT THE REMOVAL OF MFJ-RELATED RESTRICTIONS, IF THE FOLLOWING CONDITIONS WERE MET:

- (A) EACH SERVICE OR FUNCTION SHOULD BE VIEWED AND EVALUATED IN TERMS OF HOW IT CONTRIBUTES TO THE ENHANCEMENT OF A "FULL SERVICE" NETWORK FOR THE PURPOSE OF DETERMINING HOW THE FUNCTION OF SERVICE SHOULD BE INTEGRATED IN, OR STRUCTURED TO, RELATE TO THE NETWORK;
- (B) THE ACCOUNTING OR CORPORATE FORM FOR THE OFFERING OF ANY NEW SERVICE [WOULD BE] A STATE REGULATORY DECISION AND MAY INCLUDE TREATMENT "ABOVE THE LINE," OR "BELOW THE LINE" THROUGH ACCOUNTING SEPARATION OR SEPARATE SUBSIDIARIES OF THE REGULATED COMPANY OR REGIONAL HOLDING COMPANY;
- (C) 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; AND
- (D) THE STATE REGULATORY COMMISSIONS SHALL HAVE FULL ACCESS TO ALL BOOKS, RECORDS, FACILITIES AND PREMISES OF THE BOCS AND ALL AFFILIATED COMPANIES....

IN ITS WINTER MEETING OF THIS YEAR, NARUC PASSED A SIMILAR RESOLUTION REGARDING THE MFJ WHICH, LIKEWISE, I HAVE ATTACHED TO THIS TESTIMONY. SEE ATTACHMENT B. THE RESOLUTION REINFORCES THE

INTEREST OF NARUC THAT THE AUTHORITY OF ITS MEMBERS, THE STATES, "TO ENGAGE IN REGULATORY ACTION THAT ANY STATE DEEMS ESSENTIAL TO PROTECT MONOPOLY SERVICE CUSTOMERS," NOT BE PREEMPTED BY THE CONGRESS OR THE FEDERAL COMMUNICATIONS COMMISSION. THE RESOLUTION, THEREAFTER, PROVIDES A "MENU" OF REGULATORY OPTIONS WHICH COULD BE UTILIZED AT THE DISCRETION OF A STATE TO EFFECTUATE ITS OWN STATUTORY MANDATE. INCLUDED IN THIS MENU WERE: (1) THE USE OF SEPARATE SUBSIDIARIES; (2) ACCESS TO ACCOUNTING RECORDS OF BOC AFFILIATES; (3) STATE-DETERMINATION OF APPROPRIATE ALLOCATIONS OF COSTS BETWEEN REGULATED AND UNREGULATED BOC OPERATIONS; (4) AN ANNUAL AUDIT REQUIREMENT; (5) THE ALLOCATION TO THE NEW SERVICES OF NEW COSTS TO THE TELEPHONE NETWORK AND THE REQUIREMENT OF CONTRIBUTION TO THE UNDERLYING NETWORK COSTS; (6) STATE APPROVAL OF BOC/AFFILIATE PURCHASE AGREEMENTS, "INCLUDING THE AUTHORITY TO REQUIRE AND ESTABLISH THE TERMS OF COMPETITIVE BIDDING FOR BOC CONTRACTS"; (7) STATE APPROVAL OF THE SALE BY A BOC OF ITS CUSTOMER PROPRIETARY NETWORK INFORMATION; (8) OVERSIGHT AUTHORITY CONCERNING AFFILIATE RECOURSE CREDIT ARRANGEMENTS AGAINST BOC ASSETS; AND (9) AUTHORITY TO DISALLOW, IN RATEMAKING PROCEEDINGS, INCREASED COSTS ASSOCIATED WITH "COST OF CAPITAL DUE TO A FAILED COMPETITIVE VENTURE" IN WHICH THE BOC AFFILIATE MAY HAVE ENGAGED. AS THE RESOLUTION INDICATES, THE MENU ONLY "ILLUSTRATES THE KINDS OF ACTIONS STATES MAY CONSIDER TAKING...." IN SHORT, THE RESOLUTION'S MENU INDICATES THE DEGREE OF FLEXIBILITY THAT THE STATES SEEK IN FASHIONING REGULATORY RESPONSES TO BOC-PARTICIPATION IN THE

TELECOMMUNICATIONS MARKETS CURRENTLY FENCED-OFF TO THE BOCS BY THE MFJ.

WITH THIS INFORMATION AS BACKGROUND, NARUC URGES THAT IF CONGRESS TAKES ANY LEGISLATIVE ACTION TO MODIFY THE MFJ SO AS TO REMOVE THE RESTRICTIONS IMPOSED ON THE BOCS, THAT SUCH LEGISLATION SHOULD INCLUDE LANGUAGE TO LEAVE TO THE STATES THE JURISDICTION TO FASHION SAFEGUARDS TO AVOID PRICE DISCRIMINATION AND CROSS-SUBSIDIES.

RECOGNIZING THE IMPORTANCE OF THIS SUBCOMMITTEE'S FACT-FINDING EFFORTS, NARUC TRUSTS THAT THE POSITION IT HAS TAKEN CONCERNING THIS MATTER WILL BE REFLECTED IN ANY ACTION THAT THIS SUBCOMMITTEE, IN PARTICULAR, OR CONGRESS, IN GENERAL, MAY TAKE WITH REGARD TO THE MFJ. AGAIN, NARUC URGES THAT ANY MFJ-RELATED ACTION PROTECT THE JURISDICTION OF THE STATES TO FASHION SAFEGUARDS TO AVOID PRICE DISCRIMINATION AND CROSS-SUBSIDIES.

D.C. COMMISSION VIEW

WHILE THE D.C. COMMISSION SUPPORTS NARUC'S POSITION, IT IS MY VIEW THAT, IN ADDITION, CONGRESS SHOULD BE WARY IN PLACING TOO MUCH RELIANCE ON THE CURRENT FORM OF FEDERAL REGULATORY SAFEGUARDS TO GUARD AGAINST THE POSSIBILITY OF ANTI-COMPETITIVE CONDUCT, SUCH AS PRICE DISCRIMINATION AND CROSS-SUBSIDIES. SUCH SAFEGUARDS, CALLED "NON-STRUCTURAL SAFEGUARDS," RELY ON COST-ACCOUNTING PRINCIPLES TO DETECT ANTI-COMPETITIVE ACTIVITY. THESE SAFEGUARDS MAY NOT BE

SUFFICIENT TO PROTECT THE LOCAL CAPTIVE RATEPAYER IF THERE ARE CHANGES TO THE MFJ.

I NOTE THAT YOUR COLLEAGUES IN THE HOUSE SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE HAVE BEFORE THEM H.R. 2140. IN ORDER TO AVOID CROSS-SUBSIDIES, H.R. 2140 RELIES ON EXISTING FEDERAL COMMUNICATION COMMISSION (FCC) INITIATIVES IN THE AREA OF COST ACCOUNTING KNOWN AS "NON-STRUCTURAL SAFEGUARDS" AND ANNUAL AUDITING TO OVERSEE BOC INVOLVEMENT IN THE AREA OF MANUFACTURING AND INFORMATION SERVICES. FURTHER, WITH REGARD TO INFORMATION SERVICES, THE BILL RELIES UPON: (1) AN AS YET UNCOMPLETED FCC PROCEEDING REGARDING "OPEN NETWORK ARCHITECTURE"; AND (2) ANY FUTURE FCC REGULATION ENACTED IN, OR RELATED TO, THIS AREA. I QUESTION WHETHER THESE EFFORTS ARE SUFFICIENT TO ASSURE THAT THE NEGATIVE EFFECTS THAT COULD RESULT FROM PASSAGE OF THE BILL ARE CURTAILED.

FOR EXAMPLE, THE ABILITY OF THE FCC TO EFFECTIVELY OVERSEE SUCH COST-ACCOUNTING, NON-STRUCTURAL SAFEGUARDS HAS BEEN THE SUBJECT OF CONSIDERABLE DEBATE. THE GENERAL ACCOUNTING OFFICE (GAO) PREVIOUSLY HAS RAISED QUESTIONS CONCERNING THE ABILITY OF THE FCC TO CONTROL CROSS-SUBSIDY BETWEEN REGULATED AND COMPETITIVE SERVICES THROUGH ITS JOINT COST ACCOUNTING MEASURES. SEE TELEPHONE COMMUNICATIONS CONTROLLING CROSS-SUBSIDY BETWEEN REGULATED AND COMPETITIVE SERVICES, GAO/RCED-88-34 (OCTOBER 1987) (GAO REPORT) AT 54-55.

IN LIGHT OF THESE VIEWS, THIS SUBCOMMITTEE SHOULD RAISE A CRITICAL EYE TO THE ABILITY OF SUCH NON-STRUCTURAL SAFEGUARDS TO ASSURE THAT THE INTERESTS OF RATEPAYERS TO ENJOY LOCAL RATES, WHICH ARE NOT INFLATED BY THE POTENTIAL FOR A BOC TO CROSS-SUBSIDIZE ITS COMPETITIVE VENTURES WITH ITS REGULATED OPERATIONS, ARE PROTECTED. IN ADDITION, I NOTE, WITH REFERENCE TO H.R. 2140'S "AUDIT" REQUIREMENT, THAT THE GAO REPORT REFERENCED EARLIER HAS ALSO QUESTIONED THE FCC'S ABILITY TO ASSURE COMPREHENSIVE REVIEWS EVEN WITH THE USE OF INDEPENDENT AUDITORS, ESPECIALLY IN VIEW OF ITS LIMITED STAFF. SEE GAO REPORT AT 50-51.

APPARENTLY, STAFFING LEVELS AT THE FCC ARE STILL A CONCERN, AS EXPRESSED RECENTLY BY THE FCC'S CHAIRMAN TO CONGRESS. SEE STATEMENT OF DENNIS R. PATRICK, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION BEFORE THE SUBCOMMITTEE ON THE DEPARTMENTS OF COMMERCE, JUSTICE AND STATE, THE JUDICIARY, AND RELATED AGENCIES OF THE HOUSE APPROPRIATIONS COMMITTEE (MARCH 7, 1989). FURTHER, THE D.C. COMMISSION'S EFFORTS TO GATHER INFORMATION CONCERNING THE AFFILIATE TRANSACTIONS BETWEEN BELL ATLANTIC, THE PARENT CORPORATION, AND ITS SUBSIDIARIES, INCLUDING THE CHESAPEAKE AND POTOMAC TELEPHONE COMPANY IN WASHINGTON D.C. (C&P), HAVE BEEN FRUSTRATED. ONLY C&P IS SUBJECT TO THE D.C. COMMISSION'S JURISDICTION, NOT BELL ATLANTIC. THEREFORE, THERE REMAINS THE QUESTION AS TO A STATE COMMISSION'S ABILITY TO REQUIRE SUCH INFORMATION FROM THE PARENT

CORPORATION IN THOSE STATES WHICH DO NOT HAVE AFFILIATE INTEREST LEGISLATION.

THIS SUBCOMMITTEE, LIKEWISE, SHOULD NOTE THAT JUDGE GREENE HAS QUESTIONED THE ABILITY OF THE FCC TO EFFECTUATE THESE ACCOUNTING SAFEGUARDS. IN HIS SEPTEMBER 10, 1987 DECISION, HE QUESTIONED THE ABILITY OF THE FCC TO OVERSEE SUCH SAFEGUARDS BASED ON THE FCC'S REDUCED STAFF AND THE FCC'S LACK OF A "COMMON DENOMINATOR" WITH REGARD TO THE JOINT COST ORDER'S APPROACH TO THE ISSUE. UNITED STATES V. WESTERN ELECTRIC CO., 673 F. SUPP. 525, 570-71, 573 (D.D.C. 1987).

THE POINTS MADE ABOVE REGARDING THE INABILITY OF COST ACCOUNTING SAFEGUARDS ARE EQUALLY TRUE IN THE CONTEXT OF THE OTHER MFJ RESTRICTIONS. IN ADDITION, ANY LEGISLATIVE EFFORTS TO MODIFY THE MFJ SHOULD CONSIDER THAT IF THE BOCS BECOME VERTICALLY INTEGRATED, THEY COULD ENGAGE IN PREFERENTIAL POLICIES FAVORING THEIR OWN AFFILIATES. FOR EXAMPLE, IN THE CONTEXT OF MANUFACTURING, WHILE THE BOC MAY HAVE A CHOICE AMONG COMPETING SWITCH MANUFACTURERS, THE BOCS COULD PURCHASE ALL EQUIPMENT FROM THEIR AFFILIATE MANUFACTURING COMPANY REGARDLESS OF PRICE OR QUALITY. FOR A DECISION SUBJECT TO THE BUSINESS JUDGMENT OF THE INDIVIDUAL COMPANY, THE BOC COULD CITE SOME QUALITY OR DESIGN CHARACTERISTIC TO JUSTIFY THE PURCHASE OF ITS OWN MANUFACTURED SWITCH, RATHER THAN A PURCHASE OF AN ALMOST IDENTICAL, BUT LESS EXPENSIVE, SWITCH FROM ANOTHER VENDOR. THE BURDEN OF POLICING SUCH

A TRANSACTION, AND DECIDING WHETHER THE BUSINESS JUDGMENT WAS CORRECT, FALLS UPON THE REGULATORS. POLICING SUCH TRANSACTIONS MAY BE HAMPERED BY THE LACK OF INFORMATION CONCERNING THE TRANSACTION FLOWING TO THE APPROPRIATE REGULATORY AUTHORITY.

IN CONCLUSION, IN THE EVENT OF ANY ATTEMPT AT LEGISLATIVE MODIFICATION OF THE MFJ THE REGULATORY FRAMEWORK USED TO REPLACE THE CURRENT MFJ RESTRICTIONS SHOULD BE SUBJECTED TO CLOSE SCRUTINY TO ASSURE THAT IT IS IN THE PUBLIC INTEREST. IN MY VIEW, THE FEDERAL REGULATORY ENVIRONMENT, WHICH PLACES ITS RELIANCE ON THE CURRENT ACCOUNTING SAFEGUARDS AND MONITORING EFFORTS, SUCH AS THROUGH AUDITS, IS INSUFFICIENT TO PROTECT THE PUBLIC INTEREST SHOULD THE MFJ RESTRICTIONS BE MODIFIED. IN ANY EVENT, THE STATES SHOULD RETAIN THE JURISDICTION TO USE WHATEVER REGULATORY TOOLS THEY DEEM NECESSARY TO OVERSEE THE OPERATIONS OF THE BOCS AND THEIR AFFILIATES SHOULD THERE BE LEGISLATIVE MODIFICATION OF THE MFJ RESTRICTIONS.

Resolution Supporting Conditions for
Removal of Competitive Restrictions
on Bell Operating Companies

WHEREAS, The United States Department of Justice (DOJ) has recommended to United States District Court Judge Harold Greene that the Modified Final Judgment (MFJ) in the AT&T Divestiture Case be further modified to permit the seven Regional Holding Companies (RHCs) to manufacture telephone equipment, to provide electronic information services, to offer long distance service in areas where the offering Bell Operating Company (BOC) does not have a State-protected monopoly local franchise, and to enter any other non-telecommunications business without the need to obtain special permission from the Court; and

WHEREAS, While the great uncertainty caused by the AT&T divestiture may have made it necessary for restrictions to be placed upon the competitive activities of the BOCs at the time the MFJ was approved, conditions in the industry have stabilized, making it appropriate to reconsider the MFJ; and

WHEREAS, Many regulated telephone companies have actively attempted by legislation, litigation, transfer of assets, corporate manipulation and other means to avoid regulatory accountability; and

WHEREAS, The authority of State regulatory agencies varies, which affects the ability of each State to monitor regulated activities; and

WHEREAS, The National Association of Regulatory Utility Commissioners (NARUC) is currently completing an audit of the relationship between the RHCs and the BOCs; and

WHEREAS, In the "Dartmouth Resolution" ratified by the NARUC Executive Committee in July, 1986, which resolution set forth conditions for removal of limitations on the BOCs, NARUC resolved as follows:

RESOLVED, By the Committee on Communications of the National Association of Regulatory Utility Commissioners that growing and maintaining a "feature rich" switched network that (a) spreads its richness to the broadest possible body of ratepayers through the application of low-cost (micro-electronic) technologies, and (b) seeks to expand the revenue base for maintaining the ubiquitous character of the switched network is fundamentally a function of State regulation; and be it further

RESOLVED, That the Committee on Communications of the National Association of Regulatory Utility Commissioners,

subject to the conditions listed below, support the removal of constraints on information, enhanced and electronic publishing services, interLATA intrastate services, and manufacturing that is functionally related to the switched network, such as software; and be it further

RESOLVED, That activities which are not functionally related to responsibilities for maintaining a "features richness" and ubiquitous, switched network are not the primary concern of State commissions, except to the extent that the spawning of affiliates in non-essential or non-regulated areas may adversely affect the cost of capital to the regulated utility or divert its resources; and be it further

RESOLVED, That it should be recognized that the regional holding company probably provides the best insulation of the regulated utility subsidiary against ventures of other affiliates in high risk, non-essential or non-related activities; and be it further

RESOLVED, That any function or service to be authorized that is now proscribed by the MFJ should be integrated into the switched network of the BOC or otherwise structured to relate to the regulated operations in accordance with the following concepts:

- (a) Each service or function should be viewed and evaluated in terms of how it contributes to the enhancement of a "full service" network for the purpose of determining how the function of service should be integrated in, or structured to, relate to the network;
- (b) The accounting or corporate form for the offering of any new service is a State regulatory decision and may include treatment "above the line," or "below the line" through accounting separation or separate subsidiaries of the regulated company or regional holding company;
- (c) 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; and
- (d) The State regulatory commissions shall have full access to all books, records, facilities and premises of the BOCs and all affiliated companies; now, therefore be it

RESOLVED, That the Executive Committee of the National Association of Regulatory Utility Commissioners (NARUC),

assembled in its Winter Committee Meeting in Washington, D.C., strongly reaffirms the conditions of the Dartmouth Resolution, notes that the DOJ report does not address these conditions, and urges Judge Greene to give these conditions primary consideration in his response to the DOJ report; and be it further

RESOLVED, That the DOJ proposal be reviewed not only on antitrust grounds, but also on broader public interest grounds, as the Tunney Act directs; and be it further

RESOLVED, That the NARUC General Counsel be directed to file this resolution, the results of the NARUC audit of the RHCs, and other material deemed appropriate, with the MFJ Court of jurisdiction.

Sponsored by the Committee on Communications
Adopted February 26, 1987

Resolution on MFJ Relief

WHEREAS, The Modified Final Judgment (MFJ) administered by United States District Court Judge Harold Greene prohibits the Bell regional holding companies (RHCs) from manufacturing telecommunications equipment and providing information services content; and

WHEREAS, Judge Greene has determined that the RHCs should be prohibited from entering these markets as long as they have bottleneck control of the local telephone network; and

WHEREAS, The RHCs are seeking relief from the information services and manufacturing restrictions from the United States Congress; and

WHEREAS, There is contradictory information regarding the effect the RHCs being restricted from offering the services has on the demand for services; and

WHEREAS, The RHCs may have incentives to subsidize their unregulated competitive businesses with revenues from their regulated monopoly business; and

WHEREAS, A 1987 study by the United States General Accounting Office of the Federal Communications Commission's cost allocations rules concluded: "The level of oversight the FCC is prepared to provide will not, in GAO's opinion, provide telephone ratepayers or competitors positive assurance that FCC cost allocation rules and procedures are properly controlling cross-subsidy;" and

WHEREAS, The FCC's Computer III decision preempts State regulatory authority over Bell operating company (BOC) provision of enhanced services and prevents State regulators from requiring that BOCs provide enhanced services through a separate subsidiary; and

WHEREAS, The corporate policy of some RHCs is to pursue on the State and Federal levels deregulatory approaches which may significantly reduce regulatory oversight of BOCs' regulated and unregulated costs; and

WHEREAS, The RHCs routinely guarantee the debt of their unregulated subsidiaries, which could increase the cost of capital for their regulated businesses; and

WHEREAS, Some RHCs have defied the intent of the AT&T Consent Decree by transferring to unregulated affiliates enterprises which could contribute to revenues available to support basic telephone service--for example, yellow pages--and might therefore attempt to do so again with respect to other services; now, therefore, be it

RESOLVED, That the Executive Committee of the National Association of Regulatory Utility Commissioners (NARUC), assembled at its 1989 Winter Meeting in Washington, D.C., urges the Congress to include in any statute lifting the MFJ restrictions on RHC provision of information services content and manufacturing of telecommunications equipment the explicit requirement that neither Congress nor any Federal agency should preempt the States' authority to engage in regulatory action that any State deems essential to protect monopoly service customers. The following list illustrates the kinds of actions States may consider taking:

1. States may require that BOCs use subsidiaries separate from their basic telephone service operations to provide enhanced or information services or to manufacture equipment; and
2. States may require access to the accounting records of all affiliates of the BOC providing basic exchange service in their State; and
3. States may determine the appropriate allocation of costs between BOCs' regulated and unregulated intrastate services; and
4. States may require the RHC serving a given State's region to submit the results of annual audits conducted pursuant to standards established by that State's regulatory agency; and
5. States may require that new RHC services must bear all new costs to the telephone network which are not necessary to the provision of basic exchange service and that BOC affiliates must contribute to underlying network costs by sharing any cost savings resulting from economies of scope and scale with basic service ratepayers; and
6. States may require that all purchase agreements between a BOC and an unregulated affiliate must have State agency approval, including authority to require and establish the terms of competitive bidding for BOC contracts; and
7. States may require State agency approval for BOCs to sell telephone customer proprietary network information and to set the terms of the sale so that the regulated telephone business receives appropriate compensation; and
8. States may prohibit BOC affiliates from obtaining credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the telephone service affiliate; and

9. States may disallow, in the course of setting rates for BOCs' regulated services, the costs associated with increases in a BOC's cost of capital due to a failed competitive venture of a BOC affiliate; and be it further

RESOLVED, That network information, services, and telecommunications equipment sold by one RHC subsidiary to another of that RHC's subsidiaries must be made available to any other company on the same basis; and be it further

RESOLVED, That reporting requirements for the FCC's Automated Report Management Information System (ARMIS) must be expanded as necessary in order for the States and the FCC to adequately reconcile cost data and to effectively monitor jurisdictional revenue shifts.

Sponsored by the Committee on Communications
Adopted March 1, 1989