Comments on

"A STATE REGULATOR'S VIEW OF THE PRESENT SITUATION IN TELECOMMUNICATIONS AND OF THE CHANGES IN THE INDUSTRY"

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I will address separately two aspects of Chairman Gioia's presentation: the projected intrastate impact of recent changes in the telecommunications industry, and suggested revisions in the originally proposed settlement of the Bell System antitrust litigation.

INTRASTATE IMPACT

The intrastate impact of changes in the telecommunications industry may be considered under two headings: those that are the products of more extensive competition in the industry and are largely independent of the settlement of the AT&T antitrust litigation, and those that are the products of the antitrust settlement and that might be approached differently even under a regime of competition.

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The Products of Competition

Under this heading, Chairman Gioia lists the following increments to monthly telephone rates projected for New York State.

Item		Amount
Customer premises equipment (CPE) contribution above embedded cost		$ .24
Separations effect of removal of CPE		1.26
Eliminating subscriber plant from separations formula		5.51
Station connection expensing		1.56
Equal life group (ELG) depreciation		.38
	Total	$8.95

The last two items involve more rapid recovery of capital expenditures. While precipitated to a large extent by competition, they are unrelated to the antitrust settlement. They involve no increase in payments by intrastate ratepayers but affect only the timing of such payments.

The first three items are the products of competition in the provision of subscriber equipment and interexchange services. The Bell System cannot compete with independent suppliers in either market if it is compelled to pay separations charges not paid by others. Whether or not the antitrust settlement becomes a reality, it is clear that separations charges applicable to CPE and subscriber plant (as well as any extra CPE contribution) will have to be replaced by an access charge. The *net* impact on intrastate service will depend on the relation of the access charge to the revenues lost as a result of changes in separations procedures.

The Products of the Antitrust Settlement

Under this heading, Chairman Gioia lists the following increments to monthly telephone rates projected for New York State.

Yellow Pages (originally proposed settlement)	$ .76
Western Electric prices	1.04
Reallocation of overheads to exchange service	1.58
Possible debt refinancing	2.48
Loss of intrastate interexchange	.94
Total	$6.80

The last item is a probable indirect result of the antitrust settlement (and may be made mandatory under proposed federal legislation). But it is no different analytically from the substitution of an access charge for separations revenues and is subject to the considerations discussed above.

The increments for Western Electric prices and for debt refinancing are highly speculative. Western Electric may raise its prices slightly, but competitive constraints are also likely to increase over time. The proposed settlement appears to be alert to problems of debt refinancing. Reallocation of overheads also requires closer examination; overheads do not exist independently of the operations to which they relate. Absent strong economies of scope, they will contract with the range of activities undertaken. The contribution made by Yellow Pages would have been vulnerable to competitive pressure (or to antitrust challenge) even if the antitrust settlement had been rejected. (If my position on the originally proposed antitrust settlement is accepted (see *infra*), problems pertaining to reallocation of overheads and Yellow Pages cease to be related to the decree.)

CHANGES IN THE ORIGINALLY PROPOSED ANTITRUST SETTLEMENT

The single most important change that should have modified the originally proposed antitrust settlement is the removal of the restriction on the new Bell Operating Companies limiting them to local exchange service. Specifically, the operating companies were excluded from publishing classified (Yellow Page) advertising, selling customer premises equipment, manufacturing customer premises (or other) equipment, engaging in interexchange services, or providing enhanced services.

The first two items are the only ones that threaten to increase the cost of intrastate telephone service as a result of the decree. (See the preceding discussion.) They also have nothing to do with the antitrust litigation. Whatever may be the merits of operating company involvement in Yellow Page advertising or equipment merchandising, neither activity is related to any distinctive attribute of the Bell System. Presumably, both activities will remain open to independent telephone companies after the decree. It is anomalous to suggest that such activities will be subsidized by local exchange service when state regulatory officials typically insist that services of this kind either return a surplus to support regulated operations or be rigorously separated from regulated operations.

The three remaining items are significantly related to the antitrust litigation, but in each case the Bell Operating Companies could proceed only in competition with AT&T itself. AT&T has near-monopoly positions in interexchange services and telecommunications equipment manufacture. Can the operating companies produce a less competitive result by eroding these market shares? Enhanced services are more competitive than the other sectors, but the major factors are AT&T, IBM, and other large computer and office equipment firms. Moreover, there exists a recently established FCC program, developed in the *Second Computer Inquiry,* which provides significant protection against anti-competitive behavior in the provision of enhanced services (as well as customer premises equipment).

I believe that Chairman Gioia's position on this issue is sound. In other respects, I disagree with his position, but not necessarily with his underlying reasoning. Clearly, the state regulators should have a voice in the determination of asset distributions and the level of access charges. But in neither case should that voice be definitive. In the former matter, the antitrust court is the final arbiter, establishing a structure appropriate to remedy the antitrust problem; in the second case, the FCC is the final arbiter, establishing one of the important components of interstate communications charges. If any matters of valuation are presented, state regulators can deal with them after divestiture is ordered, with one possible exception. If some of the assets of the new Bell Operating Companies are underdepreciated, and have book values in excess of market values, state regulators should seek to have the financial structures of the new operating companies reflect the realities through a write-down of inflated asset values.

Western Electric's pricing should be subject solely to market competition. This is a major goal of the antitrust litigation. But I have no definite feelings on other matters—the switch boundary, the payment of patent royalties, or other aspects of the federal legislation. These matters require further development.

In achieving the primary objective of the state regulators—universal availability of telephone service at affordable costs—the single most important tool is within the control of the states themselves: the substitution of appropriately metered service for present unrestricted local flat rates. The present system fails to bring home to telephone users the increased costs imposed on telephone companies as a result of escalating use. This impact on costs occurs only during peak periods, and time-of-day metering would be desirable. But the relation of usage to peak requirements is complex, and there are many periods of the business day and early evening when the capacity of some segment of the local exchange network is being strained by additional usage. Subscribers should be required to pay for increases in capacity necessitated by their use of the system.