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AN ANALYSIS OF CURRENT COMMUNICATIONS INITIATIVES IN THE FCC AND CONGRESS

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I. INTRODUCTION

In the wake of Judge Harold Greene's consideration and ap-

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‡ The views expressed herein are those of the authors and do not necessarily represent the views of the American Telephone and Telegraph Company.

proval of the AT&T divestiture agreement with the Department of Justice,¹ a single concern—that of preserving universal telephone service²—has occupied center stage in this year's telecommunications policy drama. A Federal Communications Commission (FCC) Access Charge Order,³ which would have instituted a new method of recovering local exchange costs allocated to interstate long-distance services, has been the principal focus of the debate. The Access Charge Order, designed to move the telephone industry from the monopoly era into the new era of competition, would have reallocated certain fixed, non-traffic sensitive (NTS) costs⁴ from long-distance users to the local end-user. According to its advocates, the FCC plan was well considered. It is supported by an extensive record, based on 5 1/2 years of experience, and deserved a chance to work.⁵

The Access Charge Order contained five key elements designed to preserve universal service in the post-divestiture environment:

1. A gradual six year transition to the new system of access charges would give consumers time to adjust.
2. Certain of the local exchange NTS costs would remain with the long-distance user.

1. *United States v. American Tel. & Tel. Co.*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 103 S. Ct. 1240 (1983).

2. "Universal service" refers to the goal of providing access to a telephone to nearly all those individuals who want one. According to the 1980 Census, 92.9% of the households in the United States have telephone service. *In re* Petition of the State of Mich. Concerning the Effects of Certain Fed. Decisions on Local Tel. Serv., CC Docket No. 83-788, FCC 83-567, slip op. at attachment 2 (released Dec. 21, 1983) [hereinafter cited as *Report After Inquiry*].

Universal service has existed throughout the United States for several years. *In re* MTS & WATS Market Structure, 93 F.C.C.2d 241, 266 (1983) [hereinafter cited as *Access Charge Order*], *recon. granted*, CC Docket No. 78-72, FCC 83-356 (released Aug. 22, 1983) [hereinafter cited as *Reconsideration Order*], *further recon.*, CC Docket No. 78-72, FCC 84-36 (released Feb. 15, 1984) [hereinafter cited as *Further Reconsideration Order*]. This docket was commenced in 1978.

3. *Access Charge Order*, *supra* note 2.

4. *Reconsideration Order*, *supra* note 2, paras. 5-7. Certain costs are incurred irrespective of the amount of use by the telephone subscriber. These are the costs of installing and maintaining the line from the subscriber's premises to the local telephone company's switching office. *Id.* para. 5. These costs must be incurred to give the subscriber access to the telephone network; they do not vary with the number or duration of the subscriber's calls. Hence, these costs are referred to as non-traffic sensitive costs. *Id.*

5. *See Universal Telephone Service Preservation Act of 1983: Joint Hearings before the Committee on Commerce, Science, and Transportation United States Senate and the Committee on Energy and Commerce House of Representatives*, 98th Cong., 1st Sess. 62-65, 106-16 (1983) (testimony of Mark Fowler, Chairman, FCC) [hereinafter cited as *Joint Hearings*]; *id.* at 277-82 (testimony of Charles L. Brown, Chairman of the Board, AT&T).

3. A Universal Service Fund would be created, funded by long-distance carriers and designed to preserve telephone service in high-cost areas.
4. The transition would be carefully monitored by the FCC so that adjustments could be made if necessary.
5. A waiver process would be provided to protect low-income telephone subscribers from the new access charges.⁶

Congressional critics disagreed with the FCC access plan. At a joint press conference held July 20, 1983, the chairmen of the House Energy and Commerce Committee and the Senate Commerce, Science and Transportation Committee announced the introduction of bills, H.R. 3621 and S. 1660 respectively, to reverse the Commission's action. Representative John Dingell (D. Mich.) called the FCC's action "shameful" and vowed to push his legislation which would "overturn the FCC access charge decision."⁷ Senator Robert Packwood (R. Ore.) said, "Unless Congress acts swiftly, reasonably priced phone service for all Americans could be destroyed."⁸

A spate of legislative proposals to either reverse or modify the FCC's Access Charge decision followed. Fourteen bills and several resolutions were introduced in Congress before the August recess.⁹ On November 10, 1983, H.R. 4102, entitled the "Universal Telephone Preservation Act of 1983," was passed by the House.¹⁰ Consideration of the Senate bill, S. 1660—reported favorably out of the Senate Commerce Committee on September 30, 1983—was tabled on January 26, 1984 by the full Senate following four days

6. *Id.* at 62-65, 106-16 (testimony of Mark Fowler).

7. *Wash. Post*, July 22, 1983, at D-8, col. 3.

8. *Id.*

9. The bills with the most support were S. 1660, 98th Cong., 1st Sess. (1983) (Sen. Packwood), S. 1677, 98th Cong., 1st Sess. (1983) (Sen. Lautenberg), H.R. 3621, 98th Cong., 1st Sess. (1983) (Reps. Dingell and Wirth), H.R. 3647, 98th Cong., 1st Sess. (1983) (Reps. Markey and Luken), and H.R. 3671, 98th Cong., 1st Sess. (1983) (Rep. Whittaker). The other legislation introduced consisted of S. 1382, 98th Cong., 1st Sess. (1983) (Sen. Stevens), S. 1626, 98th Cong., 1st Sess. (1983) (Sen. Sasser), S.J. Res. 151, 98th Cong., 1st Sess. (1983) (Sen. Specter), H.R. 3364-66, 98th Cong., 1st Sess. (1983) (Rep. Bates), H.R. 3440, 98th Cong., 1st Sess. (1983) (Reps. Swift and Wyden), H.R. 3522, 98th Cong., 1st Sess. (1983) (Rep. Boner), H.R. 3569, 98th Cong., 1st Sess. (1983) (Rep. Gore), and H.R. Con. Res. 150, 98th Cong., 1st Sess. (1983) (Rep. Smith).

10. *See* 129 CONG. REC. H9701 (daily ed. Jan. 26, 1983). Due to the large number of amendments to H.R. 3621 during the markup sessions in subcommittee, the bill was re-numbered H.R. 4102, 98th Cong., 1st Sess. (1983), before being submitted to the Energy and Commerce Committee and subsequently considered by the full House.

of debate.¹¹ As part of the political considerations that led to the defeat of S. 1660, the FCC issued a new order which, inter alia, delayed implementation of its access charges for residential and single-line business customers pending further study.¹²

In all likelihood, there will be no telephone legislation this year. Nonetheless, these bills and the FCC Access Charge Order and Reconsideration Order¹³ are a useful framework in which to discuss the best way to preserve universal service. They represent the two poles of thought on the issue. Moreover, they may well preview the legislative battle ground for the 99th Congress.

Both sides of the debate profess to act in the public interest to preserve universal telephone service. The sharp disagreement surrounds not the policy but the means to achieve the result. Section II of this Article reviews the new competitive environment in telecommunications. A review of the industry's move from regulated monopoly to competition in long-distance markets and the key FCC decisions of the 1960's and 1970's precedes an analysis of how these changes are affecting pricing considerations in the industry. Section III analyzes in detail the principal elements of the FCC access charge plan. Section IV presents the key provisions of the House and Senate bills. Section V analyzes these bills and concludes that no legislation is necessary to preserve universal service and legislation could, in fact, be detrimental and counterproductive.

II. THE COMPETITIVE ERA

A. FCC Decisions

The earliest FCC decision that arguably began the competitive tide in long-distance telecommunications was the *Above 890*¹⁴ decision, which permitted the establishment of private microwave networks.¹⁵ In this decision, the FCC did not envision the possibility that private microwave networks would be competing with

11. See 130 CONG. REC. S211 (daily ed. Jan. 26, 1984).

12. A tentative decision to delay access charges was made by the FCC on January 19, 1984, affirmed on January 25, 1984, and issued February 15, 1984. See *Further Reconsideration Order*, *supra* note 2, para. 4; FEDERAL COMMUNICATIONS COMMISSION, NEWS REPORT NO. 17839, COMMISSION AFFIRMS DECISION TO DELAY TWO DOLLAR END USER CHARGES (Jan. 25, 1984).

13. *Reconsideration Order*, *supra* note 2.

14. *In re* Allocation of Frequencies in the Bands Above 890 Mc., 27 F.C.C. 359 (1959), *recon. granted*, 29 F.C.C. 825 (1960).

15. *Id.*

AT&T's long-distance services. In fact, the Commission dealt only in terms of private beneficial use.¹⁶

The first major commercial inroad on AT&T's interstate long-distance services was the grant in 1969 to Microwave Communications, Inc.¹⁷ (MCI), authorizing construction of microwave facilities between St. Louis and Chicago.¹⁸ MCI was authorized to provide a limited point-to-point system "designed to meet the interoffice and interplant communications needs of small business."¹⁹ The initial MCI proposals provided only for transmission between MCI microwave towers; customers were responsible for supplying the link between their place of business and the MCI tower location. MCI had not proposed a public switched message service like long-distance, but a point-to-point private line service.²⁰

After the MCI authorization, the FCC was swamped with applications from MCI and others for approval of similar facilities to compete with Bell. The FCC response was a general rulemaking to formulate a policy on permitting entry of new carriers into the field of "specialized" communications.²¹ Following a long series of proceedings, the FCC concluded that a general policy permitting new entrants and competition in the "specialized" communications market would serve the public interest.²² The Commission did not reach the question of competition with traditional long-distance services since that had not been proposed.²³

During this time, the Commission was concluding a broad inquiry into the legal, technical, and policy implications of authoriz-

16. *Id.*

17. Microwave Communications, Inc. later changed its official name to MCI.

18. *See In re Applications of Microwave Communications, Inc. For Construction Permits to Establish New Facilities in the Domestic Pub. Point-to-Point Microwave Radio Serv. at Chicago, Ill., St. Louis, Mo., and Intermediate Points*, 18 F.C.C.2d 953 (1969), *recon. denied*, 21 F.C.C.2d 190 (1970), *modification granted*, 27 F.C.C.2d 380 (1971).

19. 18 F.C.C.2d at 953.

20. *Id.* at 953-54.

21. *See In re Establishment of Policies & Procedures for Consideration of Applications To Provide Specialized Common Carrier Services in the Domestic Pub. Point-to-Point Microwave Radio Serv. & Proposed Amendments to Parts 21, 43 and 61 of the Comm'n Rules*, 24 F.C.C.2d 318 (1970).

22. *See In re Establishment of Policies and Procedures for Consideration of Application To Provide Specialized Common Carrier Serv. in the Domestic Pub. Point-to-Point Microwave Radio Serv. and Proposed Amendments to Parts 21, 43 and 61 of the Comm'n Rules*, 29 F.C.C.2d 870, 917-20, *recon. denied*, 31 F.C.C.2d 1106, 1108 (1971), *aff'd sub nom. Washington Util. & Transp. Comm'n v. FCC*, 513 F.2d 1142 (9th Cir.), *cert. denied*, 423 U.S. 836 (1975).

23. *See* 29 F.C.C.2d at 904.

ing the use of communications satellites by non-government common carriers.²⁴ On the basis of an extensive record, the FCC in 1972²⁵ determined that there was considerable uncertainty about the viability and effectiveness of satellites for voice communications, that operational experience was needed to resolve the uncertainty, and that multiple entry by competing carriers was probably the best way to demonstrate fully this new transmission technology.²⁶ Again, there was no consideration of the possibility of long-distance competition because it was not an issue.²⁷

The policy debate on competition in telecommunications continued in FCC Docket Number 20003,²⁸ which examined the economic consequences of the FCC's newly mandated policies on existing carriers and found the impact to be insubstantial.²⁹ The FCC's general analysis was that long-distance revenues of existing carriers, including funds used by local operating telephone companies to help support local rates, would not be greatly affected because private line and specialized services constituted only a small portion of interstate revenues.³⁰ Once again, the implicit assumption was that there would be no competition in long-distance services.

An important decision in this process of policy development arose during an interconnection dispute between MCI and AT&T. After negotiation, AT&T refused an MCI interconnection request for foreign exchange (FX) and common control switching arrangement (CCSA) services,³¹ claiming these services were switched services, not point-to-point services, and, therefore, were not within the authorizations granted in the MCI³² or Specialized

24. *In re* Establishment of Domestic Communication- Satellite Facilities by Nongovernmental Entities, 22 F.C.C.2d 86 (1970).

25. *In re* Establishment of Domestic Communications- Satellite Facilities by Non-governmental Entities, 35 F.C.C.2d 844, *recon. granted*, 37 F.C.C.2d 184, *further recon.*, 38 F.C.C.2d 665 (1972).

26. 35 F.C.C.2d at 847.

27. *Id.* at 854.

28. *In re* Economic Implications & Interrelationships Arising from Policies & Practices Relating to Customer Interconnection, Jurisdictional Separations & Rate Structures, 61 F.C.C.2d 766 (1976).

29. *Id.* at 774.

30. *Id.*

31. "FX" is a service by which the customer is directly connected to a switching office in a distant city and operates, in effect, as if the phone were located in the distant city. CCSA permits the user to link offices in various cities switching the calls through local telephone company central offices.

32. 18 F.C.C.2d 953; *see supra* notes 17-20 and accompanying text.

Carrier³³ decisions. The FCC disagreed, finding that FX and CCSA, although switched services, were in AT&T's private line tariff.³⁴ Thus, the Commission held that AT&T had unlawfully refused to provide the connections.³⁵ The Third Circuit Court of Appeals upheld the ruling and ordered AT&T to provide the connections.³⁶ This ruling later became the central focus of an anti-trust suit brought by MCI against AT&T.³⁷

Another competitive storm arose in 1977 when MCI began offering a new service called "Execunet." Customers shared transmission facilities and were charged on a per call basis, according to time and distance of the call. The "Execunet" system was very similar but less expensive than AT&T's basic long-distance service. Following a complaint from AT&T, the FCC ruled that the new service was a long-distance or message telephone service (MTS), not a private line service, and, therefore, beyond any of MCI's authorizations.³⁸ MCI was ordered to cease providing the service.³⁹ This was a clear expression of the Commission's view that long-distance competition had not been considered or authorized. The District of Columbia Circuit Court reversed, holding that the FCC, in its early grants of operating authority to MCI, had not specifically limited the construction authorizations by making an affirmative finding that the new facilities would be restricted to private line services.⁴⁰ Thus, although the FCC believed it had never authorized competition in areas other than private line services, it was left powerless to order MCI to cease providing a long-distance service. The court held that a new proceeding examining the question of monopoly versus competition in long-distance services be completed before MCI could be restricted in using its facilities.

33. 29 F.C.C.2d 870; *see supra* notes 21-23 and accompanying text.

34. *In re Bell Sys. Tariff Offerings of Local Distrib. Facilities for Use by Other Common Carriers*, 46 F.C.C.2d 413, 428, *enforced* 48 F.C.C.2d 676, *aff'd sub nom.* *Bell Tel. Co. v. FCC*, 503 F.2d 1250 (3d Cir. 1974), *cert. denied*, 422 U.S. 1026, *recon. granted*, 56 F.C.C.2d 14 (1975).

35. 46 F.C.C.2d at 435-36.

36. *Bell Tel. Co. v. FCC*, 503 F.2d 1250 (3d Cir. 1974), *cert. denied*, 422 U.S. 1026 (1975).

37. *MCI Communications Corp. v. American Tel. & Tel. Co.*, 462 F. Supp. 1072 (N.D. Ill.), *aff'd*, 594 F.2d 594 (7th Cir. 1978), *cert. denied*, 440 U.S. 971 (1979).

38. *In re MCI Telecommunications Corp.*, 60 F.C.C.2d 25 (1976), *rev'd*, 561 F.2d 365 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978).

39. 60 F.C.C.2d at 58.

40. *MCI Telecommunications Corp. v. FCC*, 561 F.2d 365 (D.C. Cir. 1977) (Wright, J.), *cert. denied*, 434 U.S. 1040 (1978).

ties.⁴¹ Thus, long-distance competition was born.

This series of events was followed by the FCC's initiation of a major rulemaking proceeding, Docket Number 78-72.⁴² The Commission examined the issue of whether the public interest was, in fact, served by competition in the provision of long-distance (MTS and WATS) services.⁴³ In 1980, the FCC concluded that a competitive structure in long-distance services and the imposition of greater marketplace forces was in the public interest.⁴⁴ This conclusion was based, in part, on the rationale that competition in these areas had been a *fait accompli* following the court's *Execunet*⁴⁵ decision in 1977.⁴⁶ Consequently, the FCC's next step was to establish policies for interconnection of long-distance carriers to their customers using local telephone carriers and local telephone company exchange facilities; in other words, a plan for exchange access and charges for such access.

B. Competitive Versus Monopoly Pricing

The cost of operating the local telephone exchange plant is significantly greater than the cost of operating long-distance facilities.⁴⁷ During the monopoly era, AT&T, with regulatory approval, priced long-distance rates significantly higher than cost in order to subsidize the cost of the "local loop," the line and equipment connecting the local customer to the local telephone company office.⁴⁸ Forty percent of AT&T's long-distance charges had been devoted to subsidizing local rates.⁴⁹ This kept local rates low and affordable for almost all Americans.⁵⁰ Today, an estimated 93-95% of all American families have telephones.⁵¹

As we have seen, in recent years the FCC has sanctioned competition in long-distance services. There has also been an explosion

41. 561 F.2d at 379-80.

42. *In re MTS & WATS Mkt. Structure*, 67 F.C.C.2d 757 (1978), *recon. granted*, 73 F.C.C.2d 222 (1979).

43. *Id.*

44. *In re MTS & WATS Mkt. Structure*, 81 F.C.C.2d 177 (1980).

45. 561 F.2d 365.

46. *See* 81 F.C.C.2d at 180-81.

47. *Access Charge Order*, *supra* note 2, at 246; *Reconsideration Order*, *supra* note 2, paras. 5-7.

48. *Access Charge Order*, *supra* note 2, at 250-51.

49. *See Joint Hearings*, *supra* note 5, at 279 (testimony of Charles L. Brown); *Click! Ma Bell is Ringing Off*, TIME, Nov. 21, 1983, at 66.

50. Discounting for inflation, the cost of telephone service has actually declined by 30% over the last decade. *Joint Hearings*, *supra* note 5, at 111 (testimony of Mark Fowler).

51. *Id.* at 110; *id.* at 280 (testimony of Charles L. Brown); *see also supra* note 2.

of technology, such as new microwave and satellite communications,⁵² making it practical for certain companies to build their own telecommunications systems. Large companies now have the ability to avoid paying the large local loop subsidy that is built into AT&T's long-distance rates by bypassing the national and local telephone systems.⁵³ Similarly, providers of discount long-distance service, such as MCI and GTE (Sprint), are also able to undercut AT&T's rates and thereby siphon revenues which would otherwise be used to subsidize local rates.⁵⁴

This proliferation of bypassers and discounters could result in a reduction of revenue available to subsidize local rates and poses a substantial threat to affordable telephone rates for the average residential customer.⁵⁵ If divested local operating companies are to be financially viable, a post-divestiture plan must guarantee that these companies are able to cover the expenses associated with their local loop, currently subsidized by AT&T's long-distance service.⁵⁶ The problem faced by the FCC was how to recover local costs while removing the incentive to bypass the local telephone systems.

III. THE FCC ACCESS CHARGE ORDER

On February 28, 1983, the FCC released its Access Charge Order.⁵⁷ The Order was designed to move the telephone industry from the monopoly era, which was dominated by AT&T and its local operating companies, into the new era of competition.⁵⁸ The FCC reached a well-balanced, reasonable accommodation be-

52. See generally Hamilton, *Implications for Economic Regulation of Cable Television*, 10 WM. MITCHELL L. REV. 433 (1984).

53. See *Access Charge Order*, *supra* note 2, at 342 app. F (on file at William Mitchell Law Review office); *Teleports May Be the Newest Threat to Bell Companies' Local Dominance*, Nat'l J., Nov. 21, 1983, at 2348-52 [hereinafter cited as *Teleports*]; *Phone Service Heading for a Crisis*, USA Today, Nov. 25, 1983, at 3-B, col. 6; *Pacific Telesis Starts Strong Under Guinn*, Wall St. J., Nov. 25, 1983, at 15, col. 3.

54. Competitors can offer significant discounts because they pay only about one-fourth of what AT&T pays for use of local facilities. See *infra* Section V. C.

55. See *Access Charge Order*, *supra* note 2, at 251-53.

56. After divestiture, the local companies will no longer be affiliated with the traditional source of their subsidy, AT&T's long-distance network, now known as AT&T Communications. The FCC estimated these costs to be approximately \$11.5 billion for 1984. *Access Charge Order*, *supra* note 2, at 250.

57. See *supra* note 2.

58. In arriving at its decision, the Commission was limited by the divestiture agreement between AT&T and the government. Divestiture severs the corporate ties between AT&T and the local operating companies, thereby limiting the manner in which the heretofore jointly owned assets could be used to accomplish the FCC's goals. Severe time

tween the multiplicity of conflicting interests. The Commission took into account the subsidy flowing from long-distance to local service, the incentive to bypass the network and avoid paying the subsidy, the technology that now makes the threat of bypass a reality, and the overriding need to maintain universal service.⁵⁹

The FCC's solution was to shift a greater portion of the local loop costs directly to the users of the services over a transitional period of six years.⁶⁰ Under the plan, flat monthly charges were to be assessed on residential and business end-users for their access to the network. These charges were designed to cover part of the fixed costs of the local plant.⁶¹ The monthly residential access charge was to start at \$2.00 in 1984 and rise to \$3.00 in 1985 and \$4.00 in 1986.⁶² The monthly business access charge was to be \$6.00 throughout this period.⁶³ The imposition of the access charge on the end-user would result in a reduction of long-distance rates reflecting the removal of the subsidy.⁶⁴ Before the end of this three-year period, the FCC would conduct another proceeding to "evaluate nationwide and local effects of the transition before proceeding with the final steps in the transition plan."⁶⁵

One major linchpin of the FCC's decision was its belief that the transition to a fully competitive telecommunications industry can be accomplished only if artificial subsidies and pricing policies are replaced by cost-based pricing mechanisms.⁶⁶ According to the

constraints also existed since divestiture became effective on January 1, 1984 and the FCC plan had to be in place early enough for the industry to appropriately prepare.

59. *Joint Hearings*, *supra* note 5, at 111 (testimony of Mark Fowler).

60. *Reconsideration Order*, *supra* note 2, paras. 33-34.

61. A substantial part of this fixed local cost would still be paid by long-distance users through usage charges. *Reconsideration Order*, *supra* note 2, paras. 92-128.

62. *Reconsideration Order*, *supra* note 2, para. 33; *id.* app. A § 69.203.

63. *See supra* note 62.

64. The FCC expected long-distance rates to fall 35-40% by 1989 as a result of the access charge plan. *Joint Hearings*, *supra* note 5, at 70 (testimony of Mark Fowler). On October 3, 1983, AT&T filed a long-distance rate reduction request of about \$2 billion, or about 10.5%. Its request was made conditional, however, on the implementation of the FCC's access charge plan.

65. *Reconsideration Order*, *supra* note 2, para. 36. The FCC provides a formula for calculating the access charges for transition years 1987-89. *Id.* at app. A § 69.204. The FCC, however, is likely to establish charges for this period based on the record developed in the proceeding discussed in paragraph 367 of the Access Charge Order. *See id.* para. 36; *see also Access Charge Order*, *supra* note 2, at 340.

66. *See Reconsideration Order*, *supra* note 2, para. 7. The FCC stated:

The driving force behind our decision to move toward flat changes[sic] is our commitment to promoting efficient use of the nationwide telecommunications network and our recognition that pricing reform is necessary to enable our society to maximize its efficient use of the telecommunications network and realize

FCC, when prices are set in a competitive environment, the marketplace will replace the regulators. To remain competitive, carriers will set charges toward actual cost. Thus, cost-based pricing should become a self-perpetuating pricing mechanism.

Another major linchpin behind the Access Charge Order was the FCC's determination that the incentive to bypass local exchanges can be removed only by eliminating the artificial subsidy for local service. The FCC stated:

One major concern has been that continued inefficient pricing of the subscriber loop could lead to a high level of uneconomic bypass. . . . [H]igh volume users may have the greatest incentive, under the present rate structure, to engage in bypass of the local exchange. If such users were to abandon the local exchange in this manner, the cost of in-place local exchange plant might have to be recovered from the remaining users, causing their rates to rise to levels which many low-volume users might not be able to absorb. The rate structure we have developed in the access charge plan is designed to avoid that calamity and preserve the universal telephone service which we now enjoy.⁶⁷

By charging residential and business users directly for their use of the local exchange, the FCC would take a significant step toward preventing bypass for purposes of avoiding the local loop subsidy.⁶⁸

Contrary to the contention of FCC critics,⁶⁹ all fixed local loop costs would not be transferred to end-users. Only a portion of the cost of the local exchange plant would be paid by users during the transition period. Of the approximately \$10.7 billion cost of the local loop in 1984,⁷⁰ the access charges for residential and business

the benefits possible from increasing competition in the interexchange marketplace. Artificial pricing structures, while perhaps appropriate for use in achieving social objectives under the right conditions, cannot withstand the pressures of a competitive marketplace. We see the imposition of moderate flat charges on telephone subscribers as an effective, orderly and fair means of guiding telecommunications pricing in the direction which it inevitably must take, toward efficient, cost-based rates. The concept that users of the local telephone network should be responsible for the costs they actually cause is sound from a public policy perspective and rings of fundamental fairness. It assures that ratepayers will be able to make rational choices in their use of telephone service, and it allows the burgeoning telecommunications industry to develop in a way that best serves the needs of the country.

Id.

67. *Id.* para. 8.

68. *Id.*

69. See *Joint Hearings*, *supra* note 5, at 330-32 (comments of Rep. Albert Gore, Jr.).

70. *Reconsideration Order*, *supra* note 2, para. 127.

users would produce only \$3.5 billion.⁷¹ The bulk of the remaining \$6.2 billion would continue to be paid by long-distance carriers through carrier charges. Of this amount, AT&T would pay a *minimum* of \$2.17 billion as a premium access charge surcharge.⁷² Approximately \$1.2 billion would be raised through surcharges on special access facilities.⁷³ At the end of the transition in 1989, long-distance carriers would still pay about \$2 billion annually for NTS costs and \$1 billion annually for the Universal Service Fund.⁷⁴

The Commission was sensitive to concerns expressed by many parties to the rulemaking proceeding that the transition to a cost-based pricing system might result in low-income subscribers being unable to afford telephone services. Consequently, the FCC ruled that state regulators could request waivers of residential access charges for classes of low-income individuals who qualified for regulator-approved "lifeline" services.⁷⁵ The Commission also suggested that states consider a limited class of service which would be available to any subscriber, but would include the access charge. This form of "lifeline" service would not require a waiver request.⁷⁶

In a further effort to ameliorate the effects of the transition, the Commission created a Universal Service Fund⁷⁷ (Fund). The costs of local telephone exchange plants vary widely throughout the country due to differences in terrain, population density, and age of the existing plant. The Fund, which would be maintained through access charges assessed upon long-distance carriers, was designed to ensure that local companies in areas of high costs establish local rates that would not substantially exceed rates charged by other companies. These high cost companies would be partially reimbursed for their local costs in excess of national aver-

71. *Id.*

72. *Id.* paras. 92-128.

73. *Id.* para. 89. To avoid discriminatory pricing of facilities used to provide services similar to ordinary long-distance service, special access users, such as private line subscribers, resellers (such as hotels), sharers, and enhanced service providers will pay a monthly surcharge of \$25 per line. *Id.* paras. 50-54.

74. S. REP. NO. 270, 98th Cong., 1st Sess. 46 (1983) (minority views of Sen. Goldwater). There is an additional cost of approximately \$10 billion of traffic sensitive costs, costs directly related to long-distance use of facilities, that the long-distance carriers will continue to pay in full. *Id.*

75. See *Access Charge Order*, *supra* note 2, at 282; *Reconsideration Order*, *supra* note 2, para. 12.

76. *Reconsideration Order*, *supra* note 2, para. 14.

77. *Access Charge Order*, *supra* note 2, at 281-82.

age costs.⁷⁸ By reimbursing substantially all costs over average, the Fund would protect high cost areas without creating uneconomic incentives to bypass the local exchange.

The FCC plan contains provisions to move the industry toward cost-based pricing and discourage bypass while protecting universal service. Criticisms of the FCC access charge plan are both misplaced and exaggerated.

Some critics have sought to link the FCC Access Charge Order and Reconsideration Order with a doubling or tripling of local rates.⁷⁹ Such a conclusion is illogical and without foundation. The FCC plan would limit monthly residential access charges to \$2 in 1984, \$3 in 1985, and \$4 in 1986.⁸⁰ In order to assess the effect of the access charge, it must be compared to the total customer bill and not a portion thereof.⁸¹ The average total telephone bill for a Bell System residential customer nationwide is about \$37—of that amount about half, or \$18.50, is long-distance, both interstate and intrastate, and the rest is represented by the local rate, equipment, installation, and other services.⁸² Moreover, long-distance rates would decrease as a result of the imposition of the access charge. The FCC estimated that this decrease will be approximately 35-40% by the end of the transition.⁸³ The decrease is ignored in calculations by opponents of the access plan. The access charge, in combination with the long-distance decrease, represents a small portion of the average customer's bill. Although the net effect of the FCC Access Charge Order on the average residential customer would depend upon the customer's usage, the average would have been about \$1.00 per month in 1984. For example, the total impact of federal and state access charges on Michigan residents in 1984 would have been slightly less than one dollar on an average residential bill of \$35.15.⁸⁴

Furthermore, the truly needy are targeted under the FCC plan. Low-income citizens in need of special assistance are protected under the FCC plan by a waiver of the entire residential access

78. *See id.*

79. 129 CONG. REC. H9649 (daily ed. Nov. 10, 1983) (remarks of Rep. Leland).

80. *See Reconsideration Order, supra* note 2, para. 33; *id.* app. A § 69.203.

81. The access charge is often compared to the local basic rate, which excludes long-distance, vertical services such as touch-tone and extension phones, local charges, and taxes. *See* 129 CONG. REC. H9656 (daily ed. Nov. 10, 1983) (remarks of Rep. Walgren).

82. S. REP. NO. 270, 98th Cong., 1st Sess. 41 (1983).

83. *See supra* note 64.

84. Detroit News, Sept. 25, 1983, at 16A, col. 2.

charge for those who qualify for lifeline services.⁸⁵ Residents in rural and other high-cost areas would have their rates subsidized through the FCC's Universal Service Fund.⁸⁶

In light of the limited effect on local rates that the FCC's carefully considered plan would have had, it is surprising that the plan became such a hotly debated issue. Apparently, the reason is the rate requests that were filed by local telephone companies in 1983.⁸⁷ Although there is no relationship between the FCC Order and these rate requests, the myth persists and is fueled by the politics of the situation. Local telephone companies request rate increases every year based on a number of factors related to expenses, inflation, depreciation, and rate of return. State public service commissions have the power, and use that power, to deny any portions of the rate request that they deem unjustified.⁸⁸ In fact, the supporters of H.R. 4102 and S. 1660, legislation which would have substantially modified the Access Charge Order, admitted that their bills would not have affected local rate requests.⁸⁹

Recent studies of the FCC access plan support the approach taken by the FCC. In December, the Wharton Econometric Forecasting Associates of Philadelphia released the results of a study analyzing the economic effects of the FCC's Access Charge decision on the United States economy.⁹⁰ According to the study, the Access Charge Order would benefit residential and business telephone users.⁹¹ The study stated that fears of the FCC plan's effect

85. See *supra* notes 75-76 and accompanying text.

86. See *Access Charge Order*, *supra* note 2, at 281-82.

87. See, e.g., *Joint Hearings*, *supra* note 5, at 36 (remarks of Rep. Leland); *id.* at 48 (remarks of Sen. Danforth).

88. Despite the inflationary pressures and changes in depreciation schedules which make local rate increases inevitable, state commissions are becoming more and more protective of consumers. Since 1981, there has been a steady decrease in both the gross amount awarded and the percentage of the original request ultimately granted. In 1981, the Bell Operating Companies (BOCs) were granted \$3.1 billion, 61% of the total amount requested. The total amount awarded in 1982 fell to \$2.3 billion, 56% of the amount requested. As of September 15, 1983, state commissions had granted only 37% of the amounts requested for a total of \$1.3 billion in rate increases. The percentage of revenue increases derived from these rate increases has declined over the same period. In 1981, the \$3.1 billion rate increase produced an 8.5% increase in revenues. That percentage fell to 7.1% in 1982 and stood at 5.2% in September 1983. S. REP. NO. 270, 98th Cong., 1st Sess. 46 (1983) (minority views of Sen. Goldwater); see also *Report After Inquiry*, *supra* note 2, attachment 3 (summary of revenue requests and awards for major BOC's).

89. *Joint Hearings*, *supra* note 5, at 91 (remarks of Rep. Wirth).

90. WHARTON ECONOMETRIC FORECASTING ASSOCIATES, *IMPACT OF THE FCC ACCESS CHARGE PLAN ON THE U.S. ECONOMY* (Nov. 1983) [hereinafter cited as WHARTON].

91. *Id.* at 15.

on universal service were “unsubstantiated”⁹² and that the present approach of direct subsidies to all telephone users regardless of need will “increase cost[s] and promote inefficiency.”⁹³

The Wharton study found that a major effect of the Access Charge Order would be to reduce the average price for all telephone customers. Substantially lower prices for long-distance service would “more than offset” local rate increases.⁹⁴ Furthermore, the study found that “universal service will be maintained through lifeline and Universal Service Fund initiatives.”⁹⁵

The Wharton Long-Term Model of the U.S. Economy was applied to reach four main conclusions with respect to the broad economic implications of the FCC plan: (1) the real Gross National Product would increase by \$46.2 billion over the next four years; (2) 400,000 new jobs would be created in 1987; (3) overall consumer price levels would decrease by almost one percent by the end of 1988; and (4) the federal debt would be reduced by \$21.5 billion by 1988.⁹⁶

On December 9, 1983, the FCC issued a report in response to a petition from the Michigan Public Service Commission.⁹⁷ The Michigan PSC had asked the FCC to review the cumulative effects of certain FCC decisions, including the Access Charge decision and the AT&T divestiture, on the price and availability of local telephone service.⁹⁸ After inquiry and analyzing responses from twenty-seven states and twenty-one other parties, the FCC concluded there was no evidence that federal decisions, including the Access Charge decision, would cause residential subscribers to discontinue service and thereby threaten universal telephone service.⁹⁹ The FCC found that in almost all cases revenue requests by exchange telephone companies *vastly* exceeded actual revenue authorizations by state commissions¹⁰⁰ and that the majority of these current rate requests were linked to factors other than federal decisions such as the Access Charge Order.¹⁰¹ The FCC also found that users would benefit from the significant long-distance rate re-

92. *Id.* at 1.

93. *Id.* at 6.

94. *Id.* at 1-3, 6-10.

95. *Id.* at 1; *see id.* at 5.

96. *Id.* at 1, 3, 12, 17.

97. *Report After Inquiry*, *supra* note 2.

98. *Id.*

99. *Id.* at 24-31.

100. *Id.* at 7-8.

101. *Id.* at 9-11.

ductions resulting from the FCC's access policies.¹⁰²

Economist Lewis J. Perl of the National Economic Research Associates, Inc.¹⁰³ studied the universal service issue and concluded there would not be a significant drop-off by residential subscribers as a result of expected increases in the price of local service.¹⁰⁴ Since any price increases have their greatest effect on low-income subscribers, Perl concluded the provisions of lifeline rates to low-income consumers can mitigate the effects of cost-based pricing while assuring that most consumers pay the full cost of telephone service.¹⁰⁵

The evidence and studies to date demonstrate that there are no serious grounds for belief that the FCC access charge plan would disrupt universal service.

IV. THE LEGISLATION

A. H.R. 4102

The legislation, passed by the House on November 10, 1983, effectively reverses the FCC Order. Its key provisions are summarized as follows:

1. End-user charges on residential customers or single-line businesses are prohibited.¹⁰⁶
2. Special access charges are imposed on lines that indirectly interconnect with exchange carrier facilities, including private lines, whether or not provided by the exchange carrier. Several exemptions are provided for:
 - a. lines that totally bypass exchange facilities;
 - b. lines that technologically could not rely on exchange facilities for back-up;
 - c. customers' internal communications systems;
 - d. lines located on a simple unit or contiguous units of real property; and
 - e. mobile radio companies not providing interexchange communications.¹⁰⁷
3. Interexchange carriers or other persons (including govern-

102. *Id.* at 3.

103. L. PERL, RESIDENTIAL DEMAND FOR TELEPHONE SERVICE: PRELIMINARY RESULTS OF A NEW MODEL (Dec. 13, 1983).

104. *Id.* at 8.

105. *Id.*

106. H.R. 4102, 98th Cong., 1st Sess. § 4(b); H.R. REP. NO. 479. 98th Cong., 1st Sess. 1-13 (1983) (proposed amendment to Communications Act of 1934).

107. H.R. 4102, *supra* note 106, § 4(b).

- ment), who do not directly or indirectly interconnect with the network but who may rely on it for backup, must pay an additional charge not to exceed 10% of the special access charge to compensate for the availability of exchange facilities. Those who certify that they will not use the network as a backup need not pay the charge.¹⁰⁸
4. The discounted rates that other common carriers (OCC's) pay for the use of local exchange facilities¹⁰⁹ are frozen at the July 1983 level until at least July 1985, with discounts continued beyond that point until equal interconnection is available and received by the OCC. If an OCC does not choose to take equal interconnection when available, it must pay the cost of services received. The shortfalls which result from continued discounts are to be borne by telephone customers.¹¹⁰
 5. A Universal Service Fund (USF) is established, to be funded by charges set annually by a Universal Service Board (USB) and levied on interexchange carriers and those who directly or indirectly connect with an exchange carrier. Exchange common carriers are entitled to payments from the USF based on their size and the amount that their average fixed costs per subscriber line exceeds the national average:
 - a. Carriers with 100,000 or fewer subscriber lines are reimbursed on a sliding scale starting at 85% of costs above 110% and up to 100% for all costs over 250%.
 - b. Larger carriers are reimbursed on a two-step scale, starting at 80% of costs between 150% and 250% of national average costs, with 100% reimbursed above 250%.
 - c. Additional amounts are to be made available to larger carriers under USB rules to further decrease rate differences between their customers in rural or remote areas and the customers of other carriers.¹¹¹
 6. The Universal Service Board is to be composed of five FCC commissioners and four state commissioners to ensure equitable, efficient treatment and an orderly transition to the new access charges. The USB has authority to review pending decisions of the present Joint Board, to make changes in separations during the transition period, and to give final authority,

108. *Id.*

109. *See infra* section V. B.

110. H.R. 4102, *supra* note 106, § 4(b).

111. *Id.* § 5.

- subject only to judicial review.¹¹²
7. State Commissions are required to establish rules for the provision of lifeline telephone service offering a limited number of exchange calls for a discounted charge, which cannot be less than 33% nor more than 50% of the average residential rate. Eligibility for such service may be determined by state commissions but must include persons already obtaining benefits under Aid to Families with Dependent Children, Social Security, or the Food Stamp Act.¹¹³
 8. The creation of a non-profit Citizens' Utility Board is authorized in each state. These organizations would be funded through voluntary contributions by residential telephone subscribers. Procedures for state and national mechanisms to manage, administer, and carry out the charge of representing the public interest are provided.¹¹⁴
 9. Non-supervisory employees or individuals making \$50,000 or less who were employed by AT&T or one of its subsidiaries as of December 31, 1983 are given full portability of pensions and benefits in the future when transferring to or from AT&T and the Bell Operating Companies.¹¹⁵

B. S. 1660

A motion to consider the telephone legislation S. 1660 was tabled by the Senate on January 26, 1984.¹¹⁶ The bill differs in several respects from its House counterpart and is considerably less extensive. S. 1660 postpones rather than prohibits residential and single-line business access charges and does not contain an Exchange Network Facilities for Interstate Access (ENFIA)¹¹⁷ provi-

112. *Id.* § 6.

113. *Id.* §§ 5, 9.

114. *Id.* § 12.

115. *Id.* § 13. H.R. 4102 deals with a variety of other issues, including (1) state authority over depreciation rates, (2) shared use of telephone facilities, (3) public participation, (4) prohibition of cross-subsidies between regulated and non-regulated services, (5) state authority to require exchange common carriers to lease and maintain on request a simple basic one-line telephone instrument and associated inside wiring, (6) notification requirements, (7) penalties for non-compliance and fraud, (8) procedures for petitioning the FCC for a review of exchange access charges, (9) limits on charges for long-distance directory assistance, and (10) transitional procedures. *See id.* §§ 1-13.

116. S. 1660, 98th Cong., 1st Sess., *Joint Hearings, supra* note 5, at 5-13 (1983). Had the motion to consider not been tabled, S. 1660 would have been subject to amendment on the Senate floor. An ENFIA provision, *see infra* Section V. C., would surely have been the center of debate.

117. *See infra* Section V. C.

sion. The principal elements of the Senate bill are summarized as follows:

1. Access charges on residential customers and single-line business customers are deferred until January 1, 1986.¹¹⁸
2. A Universal Telephone Service Joint Board is established consisting of five FCC commissioners and four state commissioners. If a vacancy occurs, the membership is to be reduced so that there is always one less state than federal commissioner. Joint Board decisions are final.¹¹⁹
3. The FCC is directed, after consulting the Joint Board, to report to Congress by March 1, 1985 on how the FCC had administered the act, to submit any proposed action regarding access charges and universal service, and to make recommendations for legislation. The report is to include recommendations as to whether the act should continue or be terminated.¹²⁰
4. The Joint Board is directed to establish and schedule collection of surcharges on interexchange carriers, those connecting either directly or indirectly with the local exchange, and bypassers. Providers of traditional telegraph services are not subject to the surcharge. The surcharges are to help maintain universal service fairness to interexchange carriers and others, at the same time promoting competition and the development of new technologies.¹²¹
5. A High-Cost Fund is established to reimburse rural carriers (those eligible for REA loans) and carriers serving 50,000 or fewer lines or having revenues of not more than \$100,000,000, if their costs exceed 110% of the national average. The fund reimburses 90% of the costs between 110% and 250% of the national average, and 100% of costs exceeding 250% of the national average. Costs eligible for reimbursement are non-traffic sensitive (local) costs reasonably incurred in the provision of basic exchange service, without regard to intrastate or interstate allocations. Reimbursements are to be used by carriers to reduce rates for basic exchange service on a non-discriminatory basis.¹²²
6. A Universal Telephone Service Lifeline Fund is to be set up by

118. S. 1660, *supra* note 116, § 4.

119. *Id.* § 5.

120. *Id.* § 8.

121. *Id.* § 4.

122. *Id.*

the Joint Board to help defray "lifeline" costs. Lifeline service is to be established for the needy in accord with the orders of the respective state commissions. The percentage of lifeline costs defrayed by the Fund must be the same for all carriers and may not be more than 50% of lifeline costs.¹²³

7. Interstate long-distance rates for Alaska and Hawaii are adjusted by the FCC in accord with similar rates for the other states.¹²⁴

V. ANALYSIS OF THE LEGISLATION—PROBLEMS WITH THE BILLS

Both H.R. 4102 and S. 1660 are misdirected and counterproductive. Some of the major infirmities with the bills are discussed below.

A. Prohibition of End-User Access Charges

H.R. 4102 prohibits the imposition of the flat rate end-user access charges on residential and single-line business users.¹²⁵ S. 1660 delays for two years the imposition of access charges on residential and single-line business lines.¹²⁶ These provisions defeat the central purpose of the FCC Access Order, which was to eliminate monopoly era pricing policies by removing, gradually, much of the subsidies which were built into long-distance rates.¹²⁷ These bills retain monopoly era subsidies in the telephone industry, despite other legislative, judicial, and regulatory mandates to move to a cost-based competitive pricing system. In addition, the legislation compels AT&T to withdraw its request for a \$1.75 billion long-distance rate reduction.

Section 8 of S. 1660 compels the FCC to review the Joint Board's administration of the Act and report its findings to Congress by March 1, 1985.¹²⁸ By eliminating residential access charges during the period of agency review, the study would be rendered meaningless. Congress would know no more in 1985 about the most controversial aspect of the bill than it knows now.

123. *Id.*

124. *See id.* § 7. S. 1660 also address penalties for non-compliance and transitional provisions. *Id.* §§ 5-6.

125. H.R. 4102, *supra* note 106, § 4(b). H.R. 4102 also exempts qualified orphanages. *Id.*

126. S. 1660, *supra* note 116, § 4.

127. *See supra* note 66.

128. S. 1660, *supra* note 116, § 8.

Furthermore, 1986, like 1984, is an election year, and the political motivation at that time will be equally strong to avoid the imposition of access charges.

B. Bypass Provisions

The most efficient way to avoid the disastrous effects on local rates resulting from large users bypassing the local exchange carrier is to remove the incentives to bypass by moving toward a subsidy-free system of cost-based pricing for long-distance services.¹²⁹ H.R. 4102 and S. 1660 eschew this solution. Instead, they retain a pricing system that affirmatively encourages bypass, and then attempt to "fix" it. The result is that the Senate and House bills not only fail to discourage bypass, they encourage it. The bills permit the business access charge to be imposed, but only on larger or multi-line business users.¹³⁰ By postponing the residential and single-line business access charges, the largest users' share of the distorted subsidy will increase through artificially high long-distance charges. The result will be an added incentive for large users to bypass the network.

The bypass issue is the most troublesome problem facing local telephone companies today. Five percent of the local telephone companies' customers generate 50% of the total annual revenue, and 1% generate 30%.¹³¹ If a local company loses a substantial number of these largest users to bypass systems, the viability of that company will be endangered.

There can be no dispute that bypass is a major problem requiring attention. Bypass is a growing phenomenon among major corporations, hotels, office buildings, government agencies, and other large organizations.¹³² Should the large users leave the network,

129. See *Access Charge Order*, *supra* note 2, at 342 app. F (on file at William Mitchell Law Review office); *Teleports*, *supra* note 53, at 2348-52; *Phone Service Heading for a Crisis*, USA Today, Nov. 25, 1983, at 3-B, col. 5; *Pacific Telesis Starts Strong Under Guinn*, Wall St. J., Nov. 25, 1983, at 15, col. 3.

130. See *supra* note 62.

131. S. REP. NO. 270, 98th Cong., 1st Sess. 43 (1983).

132. Current or imminent bypassers include Atlantic Richfield Company, Brown University, Chase Manhattan, Citicorp, Aetna, Westinghouse, Indianapolis public schools, Harris Corporation, the cities of New York, Boston, Philadelphia, San Francisco, Dallas, Houston, Atlanta, Baltimore and Phoenix, San Diego County, the Boeing Corporation, the General Services Administration, the Defense Communication Agency, and the Federal Telephone System (FTS). The list grows daily. Touche Ross & Co. surveyed Bell operating companies in seven states and found of the 758 largest customers, 25% are already bypassing and another 25% said they plan to bypass by 1986. TOUCHE ROSS & CO.,

those left on the system—residential and small business users without resources or economic incentive to bypass the network—will be subject to the significantly higher local rates needed to recover the difference between local costs and local charges for those costs. Therefore, these bills would hurt the very people they purport to help.¹³³

After encouraging bypass, the bills seek to avoid its effects by imposing a charge on bypassers.¹³⁴ The bypass provisions are deceptive and their approaches are seriously flawed in several ways. The basic problem is the retention of the massive subsidy mechanism which is anticompetitive and uneconomic in today's competitive long-distance communications marketplace.

The implementation of the bypass charge under both bills is inadequate and ineffective.¹³⁵ First, those who completely bypass the network—who do not connect at all with local facilities—make

REVIEW OF THE NATURE, IMPLICATIONS, AND RISK TO LOCAL TELEPHONE COMPANIES OF BYPASS (n.d.); see also *Teleports*, *supra* note 53, at 2352.

The Senate Committee on Commerce, Science and Transportation clearly recognized the importance of the bypass issue and viewed the bypass provisions of their bills to be critical. It stated:

Despite the uncertainties, the Committee remains concerned about the potential impact of bypass on universal telephone service. The Committee, like the FCC, has not been able to compile complete information on when and why users bypass. Therefore, although the Committee believes it should address the problem of the cost differential between traditional telephone providers and bypassers, the Committee appreciates that any response must reflect this uncertainty.

S. REP. NO. 270, 98th Cong., 1st Sess. 14 (1983). The House Energy and Commerce Committee recognized the "potential bypass problem" but believed opponents of the legislation have overstated its scope and effect. See H.R. REP. NO. 479, 98th Cong., 1st Sess. 19-21 (1983).

133. The minority on the Committee stated:

[T]he bill would produce a perverse economic incentive for heavy interstate callers to build their own private interstate communications networks. To the extent that heavy rates would increase substantially because local customers would be forced to make up for the revenue lost as a result of not receiving compensation for use of local facilities Moreover, interstate telephone rates would rise dramatically because the 7¢ per minute contribution to local service that would have been paid by the bypasser would be paid instead by those interstate callers who continue to use the regular long-distance network. Local and interstate telephone rate hikes that would result from the loss of just one major interstate telephone user to a bypass system would spur additional interstate users to bypass, which would lead to even higher local and interstate telephone rates. Spiraling increases in local and interstate telephone rates would eventually be devastating to residential customers who cannot afford to construct private interstate communications systems. The result would be a threat to universal telephone service in the United States.

H.R. REP. NO. 479, 98th Cong., 1st Sess. 109 (1983).

134. H.R. 4102, *supra* note 106, § 4(b); S. 1660, *supra* note 116, § 4.

135. H.R. 4102 contains more detailed procedures for charging bypassers.

no contribution whatever to local service costs.¹³⁶ Second, the bill is replete with specific exemptions for certain kinds of companies and technologies.¹³⁷ This legislation would encourage requests for further exemptions from a plethora of special interest groups. Third, and fundamentally, companies should not be penalized for taking steps to reduce costs and become more efficient. National policy should encourage the development and use of more efficient and less costly technologies. H.R. 4102 and S. 1660 would stifle innovation by taxing companies' attempts to reduce expenses. The overall result would be detrimental to the nation's technological development and ability to compete in world markets. What is needed is a policy that discourages *uneconomic* bypass, bypass prompted solely by a desire to avoid paying a subsidy totally unrelated to the cost of the service. Simultaneously, this policy should not discourage economic bypass resulting from an ability to do things better and cheaper. The way to fashion such a policy is to do what the FCC Order did and the bills undo—remove the incentives for *uneconomic* bypass.¹³⁸

C. *Exchange Network Facilities for Interstate Access (ENFIA)*

The Exchange Network Facilities for Interstate Access (ENFIA) agreements,¹³⁹ which are supervised by the FCC, take into account that the local telephone network is not presently engineered to

136. H.R. 4102, *supra* note 106, § 4(b).

137. *Id.*

138. There was also serious concern whether the bypass charge imposed by H.R. 4102, as reported out of the Energy and Commerce Committee, constituted an unconstitutional tax. According to the only evidence on the record dealing with the issue, memoranda by GTE and the City of New York, the bypass charge was to be determined without regard to the cost or value of the services provided to those persons assessed, would be a tax. The power to tax is purely legislative and cannot be delegated by Congress. *See* National Cable Telev. Ass'n v. United States, 415 U.S. 336, 340 (1974). Since H.R. 4102 delegated the power to determine the bypass charge to federal and state agencies, the "tax" was illegal. *See* H.R. REP. NO. 479, 98th Cong., 1st Sess. 111 (1983). After the bill was reported out of committee, its bypass provisions (H.R. 4102 § 4(b)) were modified in an attempt to circumvent the tax problem and avoid referral to the House Committee on Ways and Means. *See id.* at 93-94 (letter from Chairman Rostenkowski to Chairman Dingell). While the modification may have avoided the tax problem, it creates an exemption from the bypass charge which would exacerbate the bypass problem.

139. ENFIA is an agreement between the Bell System and competitive long-distance companies, the OCC's (Other Common Carriers such as MCI and SPRINT). The agreement sets the charges that OCC's pay for interconnection to Bell telephone companies. It has been in operation since 1979, will end by its own terms in April 1984. *See In re Exchange Network Facilities for Interstate Access (ENFIA)*, 71 F.C.C.2d 440 (1979), *recon. granted*, 90 F.C.C.2d 202 (1982).

provide OCC's precisely equal interconnection to that received by AT&T.¹⁴⁰ ENFIA provides for discounts to the OCC's and the amount of the discount is based on the OCC's reported minutes of use. Assuming actual OCC minutes of use are properly reflected in reported minutes of use, OCC's are obligated under ENFIA to pay the equivalent of 55% of the amounts paid by AT&T. The line usage, which forms the base for charging the OCC's, however, is vastly understated, and the current discount is not 45% but about 75%.¹⁴¹ The ENFIA discount gives the OCC's a prime advantage when competing with AT&T's long-distance service.

As part of the settlement in *United States v. AT&T*,¹⁴² AT&T agreed to undertake engineering and programming changes in the local network to make interconnection absolutely equal.¹⁴³ These changes are to be accomplished in three phases beginning in 1984 and completed by September 1, 1986.¹⁴⁴ ENFIA, and the present process for AT&T, are to be replaced by cost-based access charges.¹⁴⁵

Following a detailed analysis of the rationale behind the ENFIA rates and consistent with the Modified Final Judgment,¹⁴⁶ the FCC Access Charge Order would have replaced ENFIA with access charges that continued to provide discounted rates over the three-year transition to equal interconnection. The Access Charge Order also required OCC's to pay for traffic sensitive facilities according to actual minutes of use.¹⁴⁷ Even with the 1984 increase called for by the FCC plan, the OCC's would still have paid 26%

140. AT&T's superior interconnection is said to include less noise in the line and the customer's ability to make long-distance calls by dialing 10 numbers, rather than over 20 as on other carrier's systems. AT&T customers can also access the long-distance network with rotary phones, while the discount services require those of the more expensive touch-tone models. See *Access Charge Order*, *supra* note 2, at 286; *Reconsideration Order*, *supra* note 2, paras. 97-98. Recent evidence suggests that many customers, in fact, perceive little difference in quality between OCC and AT&T services. *Update: Cut-Rate Phone Services*, 48 CONSUMER REP. 618 (1983). Customers are not concerned with technical configurations; customers desire effective communication at the lowest possible price.

141. This is according to the OCC's own admissions. See Brief for Interviews GTE Separation & GTE Sprint Communications, *NARUC v. FCC*, No. 83-1225 (D.C. Cir. filed Oct. 12, 1983).

142. 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom.* *Maryland v. United States*, 103 S. Ct. 1240 (1983).

143. 552 F. Supp. at 227; *see id.* at 195-200.

144. *Id.* at 232-33.

145. *Id.* at 233.

146. *Id.* at 226-34.

147. *Access Charge Order*, *supra* note 2, at 285-86; *Reconsideration Order*, *supra* note 2, para. 75.

less than AT&T. The FCC plan would be fair and equitable basing access charges on actual use and the availability of equal quality access.

H.R. 4102 imposes a freeze on ENFIA rates at the current level until July 1985, namely the 45% discount and the understated minutes of use.¹⁴⁸ Thereafter, the OCC's would continue to pay the local company on a basis that does not reflect actual use of the facilities. Furthermore, the OCC's would not be required to pay the costs of providing equal interconnection. Instead, OCC's would be required to pay only for access they actually elect to receive. Local companies would be obligated to construct equal access facilities and incur the full costs of building that capability, but the OCC's could reject the offer preferring a substantial discount to equal access. This would surely be an anomalous result, but would be consistent with current OCC practice. AT&T presently offers interconnections with significant technical improvements over those used by the OCC's. Nevertheless, the OCC's continue to use about 135,000 of the lowest grade ENFIA connections and only about 6000 of the improved connections. GTE is using only three of the superior connections nationwide, and MCI is using only one. Despite AT&T's offer to fill any order for the superior connections, none have been requested.

The effect of the ENFIA provisions is to discriminate against the average telephone ratepayer. Since the OCC's choose to serve only the densely populated areas of a state and direct their marketing efforts to those who make \$25 or more per month in long-distance calls, low-volume long-distance users and those in areas not served by OCC's would be penalized. These telephone users

148. H.R. 4102, *supra* note 106, § 4(b). The ENFIA freeze section was added to the bill during subcommittee markup and further amended during full committee markup. Prior to the incorporation of the ENFIA provision, the OCC's were strongly opposed to the legislation. The OCC's had supported the position taken by FCC Chairman Mark Fowler and AT&T Chief Executive Officer Charles Brown with respect to Access Charges—the need for cost based pricing and the inadvisability of any federal legislation. Theodore Brophy, Chairman and Chief Executive Officer of GTE Corporation, which owns SPRINT, stated that “[i]n our opinion the FCC's balanced solutions do not necessitate legislative action at this time.” *Joint Hearings, supra* note 5, at 282, 290 (testimony of Theodore Brophy). MCI's Chairman William McGowan urged Congress to carefully consider the necessity of immediate action and the adverse impact that legislative proposals would have on competition and innovation in the industry. He asked Congress to wait until the AT&T divestiture was accomplished and the FCC system of access charges implemented to determine what, if any, support for local rates was necessary. *Id.* at 290, 292 (testimony of William McGowan).

S. 1660 is silent on ENFIA. It would therefore leave the FCC plan intact.

would subsidize OCC customers and bear the burden of H.R. 4102's indefinite perpetuation of the inequitable subsidy of the OCC's, amounting to about \$1 billion per year.¹⁴⁹

D. Universal Service Fund

The cost of providing local service is uneven throughout the nation. Generally, providing service to rural and high-growth areas is more expensive. The FCC recognized that subscribers in high-cost areas could experience significantly greater increases in local rates than users in other areas when local loop costs shift to the end-user.¹⁵⁰ To ameliorate this effect, the FCC would have created a Universal Service Fund, funded by access charges on long-distance carriers, to subsidize local companies in high-cost areas.¹⁵¹ The FCC plan would strike a balance between compensating local companies for costs beyond their managerial control and encouraging efficiency of local company operations. Under the FCC Access Charge Order, high-cost companies would be reimbursed to the extent that their local loop costs exceeded the national average according to a sliding scale: fifty percent of costs between 115% and 160% of the national average, 60% of costs between 160% and 200%, 95% of costs between 200% and 250%, and 100% of the costs above 250% of the national average.¹⁵²

H.R. 4102 establishes its own Universal Service Fund (USF) funded by charges levied on interexchange carriers and other connections with an exchange carrier. Under the bill, each exchange common carrier is entitled to payments from the USF based on its size and the amount by which its average cost for non-traffic sensitive facilities per customer line exceeds the national average. Carriers with 100,000 or fewer subscriber lines are reimbursed on a

149. As the recent study of the impact of the FCC access charge plan on the United States economy states:

The subsidy of local service benefits AT&T's competitors in the long-distance market, because they are not required to pay a comparable subsidy. As a result, these competitors are growing rapidly and enjoying healthy profits. . . .

Any 'tax' on long-distance revenues for the benefit of local service operations must be applied equally, in a percentage sense, to all participants in the long-distance market. If the 'new' AT&T alone is taxed (i.e., forced to continue subsidizing local service and thereby its competitors in the long-distance market) and not allowed to compete, then the consumer probably will not benefit from the breakup of the 'old' AT&T.

WHARTON, *supra* note 90, at 4.

150. *Access Charge Order*, *supra* note 2, at 281-82; *Reconsideration Order*, *supra* note 2, para. 11.

151. *See supra* note 150.

152. *Joint Board Order*, Docket 80-286, 47 Fed. Reg. at 54485.

sliding scale starting at 85% of costs above 110% and up to 100% for all costs over 250%.¹⁵³ Larger carriers are reimbursed on a two-step scale, starting at 80% of costs above 150% and up to 250% of cost, with 100% reimbursed above 250%.¹⁵⁴

The Fund established under S. 1660 limits eligibility to companies that: (1) have loans pursuant to the Rural Electrification Act, (2) are subject to certain limited FCC jurisdiction, or (3) serve 50,000 or fewer lines, or have revenues of not more than \$100,000,000. Ninety percent of the costs above 110% of the national average are reimbursed; 100% of all costs in excess of 250% of the national average are reimbursed.¹⁵⁵

The legislative provisions are both unnecessary and counter-productive. The FCC plan addressed the issue more successfully than either bill. The FCC fund would be larger than either bills' funds and its disbursement policy would be more equitable, efficient, and focused. The bills significantly skew the high cost funds in favor of small carriers who would receive more money from the fund than larger companies with equally high costs. High-cost telephone companies in several states would receive substantially less assistance under the bills than under the FCC proposal. The bills ignore that local Bell companies and large independent companies serve about one-half of the rural population of the United States and, in effect, require these rural customers to subsidize the high cost of smaller companies.¹⁵⁶

Another substantial problem with the bills' funds is the large proportion of local service costs which are above national average and compensated. When 85% or 90% of all non-traffic-sensitive costs above 110% are reimbursed, incentives for cost control are effectively eliminated. Hence, ratepayers in states with efficient, low-cost companies will subsidize inefficient, wasteful companies in areas that may not warrant high-cost subsidies. Rather than providing partial compensation to all high-cost companies for costs beyond their control, the bills extend nearly complete reimbursement to a minority of small companies.

153. H.R. 4102, *supra* note 106, § 5.

154. *Id.*

155. S. 1660, *supra* note 116, § 4.

156. Reminiscent of the way H.R. 4102, section 5 handled the bypass issue, the bill first creates a problem and then ineffectually attempts to solve it. For example, section 5 requires the Universal Service Board, without guidance, to establish procedures minimizing these legislatively imposed disparities. *See* H.R. 4102, *supra* note 106, § 5.

E. Citizens' Utility Boards

H.R. 4102 proposes the establishment of a nonprofit association to represent residential telephone consumers in each state. The bill provides detailed procedures for state and national mechanisms to manage, administer, and carry out the charge of representing the public interest.¹⁵⁷

Public input into the ratemaking process is a legitimate concern. The provisions of H.R. 4102, however, are ill-advised, redundant, and wasteful.¹⁵⁸ H.R. 4102 sets forth extremely detailed requirements for the organization and operation of state associations and requires telephone companies to include material furnished by state associations in their periodic customer billings.¹⁵⁹ This provision is out of place in a federal statute. It preempts each state's right to decide whether to provide a consumer association and, if so, how such a group should be organized and operated.

The utility board provision also provides for intervention by state associations as a matter of right in state civil and administrative proceedings.¹⁶⁰ Fundamental concepts of federalism are violated when Congress dictates that parties may intervene as of right in a state court or before a state administrative agency. A state association should be required to make the same showing of interest as any other intervenor.

There is little need for a federally mandated consumer group to represent residential telephone users' interests. Several states have public advocates or consumer counsels representing consumers in proceedings before a variety of state regulatory agencies. State public utility commissions with telephone expertise are charged with protecting consumers' interests.¹⁶¹ Public interests are already better represented by a diversity of consumer organizations and interests.

VI. CONCLUSION

The telecommunications issues facing the nation in the wake of the AT&T divestiture are very complex. The effects of new tele-

157. *Id.* § 12.

158. An amendment to strike this section of the bill was narrowly defeated in Committee by a vote of 22-19. *See* H. REP. NO. 479, 98th Cong., 1st Sess. 97 (1983) (additional views of Thomas J. Bliley, Jr. and Richard Shelby on H.R. 4102).

159. H.R. 4102, *supra* note 106, § 12.

160. *Id.*

161. *See supra* note 88.

communications policies will be far reaching. Consequently, the ramifications of the chosen plan must be carefully considered.

S. 1660 and H.R. 4102 were conceived in haste in an illogical, political response to local telephone company rate filings. The records established during the hearings in the House and Senate were woefully inadequate.¹⁶² Legislation in the face of such an inadequate record would have been irresponsible, particularly when one considers the extensive record made before the FCC.¹⁶³

Although H.R. 4102 and S. 1660 were each entitled the "Universal Telephone Preservation Act," they did not guarantee universal service; instead they represented a threat to universal service. These bills would not have lowered local rates. Instead, they would have maintained an unworkable subsidy system encouraging large users to bypass and reduce the rate base, instituted a skewed, economically inefficient and costly fund for subsidizing small telephone companies, and perpetuated an inequitable system of OCC discounts.

Although the legislation was not enacted, it had a pronounced effect. The FCC delayed major elements of its access charge plan. The residential and single-line business end-user charges were postponed. Moreover, the FCC reduced the OCC's share of access costs by enlarging their access discount from 35 to 55%.¹⁶⁴ The Access Charge Order and the Reconsideration Order should have been allowed to begin the necessary and beneficial transition to a cost-based pricing system for telephone services.

162. There were only two days of Joint Senate-House Hearings at the full Committee level. These took place on July 28-29, 1983. No economic evidence relative to cost-based pricing versus monopoly pricing in a competitive marketplace was presented. Large users did not testify on the issue of bypass, and no evidence was heard on enforcement of the bypass provisions. Furthermore, there was absolutely no investigation of the substantial antitrust or tax implications of the bill. See *Joint Hearings*, *supra* note 5.

163. In its more than five years of analysis, the FCC considered the comments of scores of interested parties including exchange and interexchange carriers, broadcasters, states, consumer advocacy groups, major corporate users, and state regulatory commissions.

164. See *Further Reconsideration Order*, *supra* note 2, paras. 59-92. AT&T has filed an emergency petition asking the FCC to reconsider its new position on the OCC discount. Emergency Petition for Reconsideration, *In re* MTS & WATS Mkt. Structure, CC Docket Nos. 78-72, 83-1145 (filed Feb. 27, 1984).

