

12-1-1987

Hearing on Local and Long Distance Telephone 'Flexibility' and 'Social Contract' Rate Regulation

Senate Committee on Energy and Public Utilities

Follow this and additional works at: http://digitalcommons.law.ggu.edu/caldocs_senate



Part of the [Consumer Protection Law Commons](#), and the [Legislation Commons](#)

Recommended Citation

Senate Committee on Energy and Public Utilities, "Hearing on Local and Long Distance Telephone 'Flexibility' and 'Social Contract' Rate Regulation" (1987). *California Senate*. Paper 48.
http://digitalcommons.law.ggu.edu/caldocs_senate/48

This Hearing is brought to you for free and open access by the California Documents at GGU Law Digital Commons. It has been accepted for inclusion in California Senate by an authorized administrator of GGU Law Digital Commons. For more information, please contact jfischer@ggu.edu.

CALIFORNIA LEGISLATURE
SENATE COMMITTEE ON
ENERGY AND PUBLIC UTILITIES
SENATOR, HERSCHEL ROSENTHAL, CHAIRMAN

Hearing on

**LOCAL AND LONG DISTANCE TELEPHONE
'FLEXIBILITY' AND 'SOCIAL CONTRACT'
RATE REGULATION**



Santa Monica City Hall
Santa Monica, California

December 1, 1987

Committee Consultants: Paul Fadelli
Michael Shapiro
Committee Secretary: Patricia Stearns

DEPOSITORY

MAR 08 1988

RECEIVED

KFC
22
L500
E54
1987
no. 2

KFC
22
1506
E54
1987
no. 2

California Legislature

NEWTON R. RUSSELL
VICE CHAIRMAN

ALFRED E. ALQUIST
JOHN GARAMENDI
LEROY GREENE
GARY HART
HENRY MELLO
JOSEPH B. MONTOYA
REBECCA Q. MORGAN

SENATE COMMITTEE ON ENERGY AND PUBLIC UTILITIES

HERSCHEL ROSENTHAL
CHAIRMAN

PAUL L. FADELL
PRINCIPAL CONSULTANT

MICHAEL E. SHAPIRO
SENIOR CONSULTANT

PATRICIA J. STEARNS
COMMITTEE SECRETARY

ROOM 2035, STATE CAPITOL
SACRAMENTO, CA 95814
TELEPHONE 445-9764



INTERIM HEARING AGENDA

Tuesday, December 1, 1987
9:30 am to 5:00 pm, Council Chamber, City Hall
1685 Main Street, Santa Monica, CA 90401

"LOCAL AND LONG DISTANCE TELEPHONE 'FLEXIBILITY' AND
'SOCIAL CONTRACT' RATE REGULATION"

GROUP I: LOCAL TELEPHONE INTERESTS

Panel A

George Schmitt
Vice-President, State Regulatory
External Affairs
Pacific Bell

G. Mitchell Wilk
Commissioner
Public Utilities Commission

Tim McCallion
External Affairs
Director of Revenue Requirements
General Telephone

LAW LIBRARY
GOLDEN GATE UNIVERSITY

Panel B

Michael Morris
Counsel
California Cable Television Assn

Sylvia M. Siegel
Executive Director
Toward Utility Rate
Normalization (TURN)

Marvin R. Weatherly
Vice President
Bay Area Teleport

Jeff Beck
Attorney, representing
Rural Telephone Companies
of California Telephone Assn

Kent Blasiar
Past President
Telephone Answering Services
of California (TASC)

J. A. Moffit
Vice President and Financial
Director, Revenue Requirements
Continental Telephone Company
of California

Alan Pepper
Attorney, representing
Western Burglar & Fire Alarm Assn

GROUP II: LONG DISTANCE INTERESTS**Panel A**

Robert B. Stechert
Vice President, External Affairs
AT&T Communications of CA, Inc

Carl Danner
Assistant to
Commissioner G. Mitchell Wilk
Public Utilities Commission

Panel B

Mary Wand
Manager of Regulatory Affairs
Pacific Division
MCI

Robin Quiroz
Manager, Governmental Affairs
US Sprint

James Fisherkeller
President
California Association of
Long Distance Telephone
Companies (CALTEL)

Ken McEldowney
Director
Consumer Action

James Gordon, Jr.
Governmental Relations Director
Communications Workers
of America, #9.

Ed Pope
General Counsel
International Telecharge, Inc.
Dallas, Texas

CHAIRMAN HERSCHEL ROSENTHAL: Good morning. First of all, I'd like to welcome two members of the committee, Senator Joe Montoya and Senator Newt Russell. Thank you for joining us.

Welcome to the third interim hearing of the Senate Energy and Public Utilities Committee since we adjourned. Today's hearing focuses on the departure of rate of return-style regulation, as we know it, for telephone companies in California.

Almost exactly one year ago, this committee held an interim hearing on the future direction of competition in both the recently divested local and long distance markets. Today we see where one of the major new directions, caused by new competitive pressures, has lead directly to the general rate case itself and what is commonly known as "social contract" or "flexible rate" proposals by the utilities.

Our hearing will be divided in two basic parts: The first half will primarily discuss the move by large local telephone companies in the state to submit price-capped "social contract" style proposals to the Public Utilities Commission whereby certain local rates are secured for a multi-year period in return for freedom to price other services on a competitive basis.

After the lunch break, the second half will deal primarily with AT&T and PUC's move to allow the largest long distance company a greater amount of "regulatory flexibility" to compete more freely in setting rates and offering services in California.

We will begin each section with the major utilities which are making such new rate proposals, and include the PUC which must either support or oppose such requests. The second panel in each section will be made up of interested parties who may be directly or indirectly impacted by the changes in the way local and long distance companies might be able to determine their rates and offer their services.

I am well aware that the complexities of telecommunication technologies and regulation make the division of this hearing somewhat artificial. So while I am looking for concise statements so that we may have an ample question period, I do hope that any impacted party in one section will not feel confined and will also describe possible impacts from the changing rate proposals in the other regulated arena, if it is appropriate.

Members of this and our companion Assembly Committee on Utilities and Commerce visited Europe a couple months ago to investigate specific telephone regulatory systems this last fall. And we saw the positives and negatives to price-cap regulation. We saw specifically different regulatory systems in place and discussed the theories about how telephone regulation should be structured in the future.

I requested that the committee further discuss today's topic, because I see great utility effort being spent promoting a change in our basic way of establishing rates. It's been a system which has historically served ratepayers well by providing quality telephone service at declining prices and has provided stable earnings for investors while stimulating technological innovation. Also, I must raise concern that the Public Utilities Commission is continuing to maybe just be a bit too accommodating to

any such request.

Creative ratemaking should not be stifled, but departing so quickly from rate of return regulation raises questions about protecting fair competition, prohibiting cross-subsidization, determining when competition exists, and deregulating real or de facto monopolies.

I hope we will get comments on some of these questions, and most important, hear how ratepayers, especially residential ratepayers, will benefit from any new regulatory proposals which may depart from what we have grown accustomed.

Our first panel, please. We will begin with statements from George Schmitt, Vice President of the State Regulatory External Affairs of Pacific Bell, and Tim McCallion, External Affairs Director of Revenue Requirements, General Telephone. Then I'd like to ask Commissioner Wilk to give us the Commission's comments on the approaches of these local telephone companies and what the PUC is doing to address such changes. And you may begin.

MR. GEORGE SCHMITT: Thank you, Senator. Good morning. I'm sorry I can't see out of both eyes today; but I had a little bug bite, I guess, or some poison oak closed up one of my eyes last night.

I am not going to read through the statement that we have prepared for this morning. I'll rather give that to you and to other members of the audience that wish it. But I would like to take just a few minutes to hit the high points of where we are.

As you'll recall, it's been now almost two years ago that Pacific Bell first suggested to some of the members of the Legislature and the Utilities Commission that some changes in the regulatory framework that we were operating under needed to happen. And we have spent the last two years continuing to litigate a large and burdensome, at best, rate case here in California that finally looks like it's going to be drawing to a close.

But we believe it is time for us to take some small steps away from the rate of return regulation that has existed almost since the inception of the California Commission some 75-80 years ago until the present time. We do not recommend, nor have we ever, that the telephone company or its services be deregulated. And we continue to hold that we need to take some very cautious and small steps away from the traditional rate base rate of return-type regulation with all the adversarial and difficult proceedings that people must deal with in that process -- take some small steps away from that to begin to see how we evolve into a totally competitive world if that does come some day.

We as a business commend what the Utilities Commission has started with the en banc hearings in September where we began to lay out formally those things that Pacific and the other telephone utilities think are appropriate for us as we go forward today.

A couple of things I'd like to hit on briefly. Many people think that somehow our company is trying to accumulate some windfall profits, primarily as a result of changes that are going on in the federal arena primarily with the tax law. We've made very clear to the Commission, and I'd like to make clear to your committee this morning, that we expect that those benefits that accrue to this company as a result of the tax law changes in the federal arena will flow back to our customers and not to us and not be included in any part of our proposal. And in the processes we're going forward, there are a number of uppers and downers that are going to be coming out during the next year that will increase the amounts of

reductions that our total customer body sees.

And to give you an example of where we are, in the last two years, assuming that something around what the administrative law judge has recommended occurs has now come to this rate case and that should happen in the next six or eight weeks, I believe. We will have reduced rates in California almost \$400 million. And next year, with the impacts of tax reform and attrition filing, a very large number in the neighborhood of \$300 million, maybe \$350 million, in further reductions will occur. So we're not looking to try to deny that there have been some things that have gone the way of our business.

CHAIRMAN ROSENTHAL: Excuse me. Senator Russell.

SENATOR NEWTON RUSSELL: Are those rates for the local consumer or for long distance rates?

MR. SCHMITT: Senator, those would be -- they'd be spread through our rate base, but they would be primarily in the local exchange companies' rates. We have another mechanism that's taking care of reducing the inter-exchange carriers' prices, as we call between the LATAs in the state and the interstate arena. So these would primarily accrue to residents, business, and local toll rates.

SENATOR RUSSELL: More than 50 percent?

MR. SCHMITT: Those rate reductions?

SENATOR RUSSELL: Yes.

MR. SCHMITT: No, they'd be more in the line of -- well, or ...

SENATOR RUSSELL: Of the total rate reduction, you said \$400 million. Of that figure, would there be 50 percent or more, 75 percent go to the local consumer?

MR. SCHMITT: Senator, I can't predict that because the Utilities Commission sets the rates rather than where the rates go. Our view is that the basic residential rate, which is \$8.25 a month, is as low as it ought to be; and that requires massive subsidies already to flow from other services. So it's our view that most of those reductions that occur should be coming in the area of intraLATA toll, the short distance toll calls that are part of Pacific Bell's process and in other services that we have.

SENATOR RUSSELL: Well, the reason I asked that, I think Mrs. Siegel's concern is for the small ratepayer, not the one who makes the long distance calls. And it's fine to say that because of the tax laws there's going to be money flow back to the consumer. That's a positive, and I'm all for that. I'm just trying to determine whether it comes back to the local consumer or whether that's going to go to the users of the long distance, AT&T, and so forth, to reduce their rates.

MR. SCHMITT: It would not go to the long distance carriers, at least that's our view. That process that's reducing the long distance carriers' rates is accomplished through a mechanism called SPF to SLU and that will occur between now and 1992 that will reduce their rates closer to cost. But it will impact all the services that Pacific Bell directly provides to customers, the short distance toll calls within the LATAs, potentially touch-tone, Custom Calling features. I can't speak for ...

SENATOR RUSSELL: So we can say basically, the majority of that money which you described will go to benefit Californians who use the telephone system within the State of California?

MR. SCHMITT: That's right.

SENATOR RUSSELL: Thank you.

MR. SCHMITT: I'm sorry. I could have got to that a little quicker for you, but that's correct,

Senator.

CHAIRMAN ROSENTHAL: Let me follow up on that. That's under the present system of the way you're being regulated. If a change takes place, based upon your suggestions and recommendations, how will that be effected?

MR. SCHMITT: Well, one of the things that we're proposing in the process, Senator, is that in the -- we would establish during these en banc hearings a new benchmark rate of return, other than the one that we have today in all likelihood.

CHAIRMAN ROSENTHAL: That's specifically what I'm getting at.

MR. SCHMITT: Yes, that will ...

CHAIRMAN ROSENTHAL: That money will come back based upon what's existing today.

MR. SCHMITT: Right.

CHAIRMAN ROSENTHAL: That will not change if the PUC makes a change in the way rates are set.

MR. SCHMITT: Will not.

CHAIRMAN ROSENTHAL: Okay.

MR. SCHMITT: In our opinion, it will not.

CHAIRMAN ROSENTHAL: I just want to get that clear.

MR. SCHMITT: Our view is that anything ...

CHAIRMAN ROSENTHAL: We're not going to do retroactively anything that affects that.

MR. SCHMITT: I would hope not.

CHAIRMAN ROSENTHAL: Okay.

MR. SCHMITT: We have been opposed to retroactive ratemaking upward, downward, or sideways; and we will continue to be that way, Senator.

CHAIRMAN ROSENTHAL: Okay, I understand. Yeah, right.

MR. SCHMITT: Although we are clearly not booking as accruing to our business any of the kinds of things that we're talking about right now.

CHAIRMAN ROSENTHAL: Okay.

MR. SCHMITT: I'll just briefly run through the themes that we think ought to come out of this. First of all, we have a rate case now that's over three years old. If it were to go on through Phase 3 with the same kind of litigation efforts that we had in the first two phases, the rate case would be old enough to kindergarten before it was done. And we don't think that's good for the people of California. It's not good for our business. It's not good for those of you that hold public office. And it's not good for the Commission. It just goes on too long and it doesn't get very much accomplished.

SENATOR RUSSELL: What dollar figure do you place on that?

MR. SCHMITT: Senator, we in my organization which deals only with state regulatory and legal people that support us, we will spend in excess of \$20 million a year on a rate case. So this rate case ...

SENATOR RUSSELL: \$60 million?

MR. SCHMITT: About \$60 million.

SENATOR RUSSELL: That's just for Pac Bell.

MR. SCHMITT: For Pacific Bell. And that's only the direct cost. It's not all the indirect costs that come along with people who work on preparing testimony in support of witnesses and ...

SENATOR RUSSELL: Would you say it would be close -- the ratepayers pick that up?

MR. SCHMITT: Yes, they do.

SENATOR RUSSELL: Close to \$100 million for three years?

MR. SCHMITT: I would guess that if you looked at the total cost of the rate case, including everybody else's cost, it probably would be in the range of 100 or more.

SENATOR RUSSELL: And your proposal would drop that to, what, zero or to what?

MR. SCHMITT: Well, we don't think that we would need the kinds of rate cases we'd have now. It would not go to zero, because there would be ongoing surveillance of our business that would have to occur and we'd still have to go through a tariffing process.

SENATOR RUSSELL: Half that?

MR. SCHMITT: For new ...

SENATOR RUSSELL: Or a quarter?

MR. SCHMITT: I would guess that we would see, yeah, maybe a 35 to 50 percent reduction in the direct costs that we have associated with working rate cases, between our legal costs and regulatory costs.

CHAIRMAN ROSENTHAL: Well, except that there would still be a three-year rate case.

MR. SCHMITT: Senator, yeah, we're ...

CHAIRMAN ROSENTHAL: And that might -- you know, sometimes when you try to see what's happened in three years, you may spend more money than if you had looked at it each year.

MR. SCHMITT: I suppose, Senator, that could happen. My view is that if we get away from the contentiousness of the rate of return regulation-type rate cases that we have, that we go through the full details on every line item in a results of operation-type showing, and get more into a macro-regulation where you look at our costs, see whether they're right, whether they appear to be appropriate, do audits where that seems to be necessary, work with our customers and the folks that have interests, many of whom are here today, in what's going on -- that there can be a much less contentious process without this sort of courtroom atmosphere that we now have.

CHAIRMAN ROSENTHAL: Yeah. And I'm not -- I don't want to prejudge whether it will be better or not. Let me tell you my bias.

Pac Bell has been penalized a number of times in the last few years for doing things that the Commission felt was wrong, okay? And my concern is that if we go to a system in which it's more difficult to make those determinations, then how do we correct what's wrong before this three-year period comes up? The audit -- it's not even complete yet, and yet you have -- it's been indicated that there are going to be some large fines for things which you did. And my concern is that whatever takes place, whatever changes the way that things are done, that we are able to track those things that you continue to do which are considered wrong, and penalize you.

MR. SCHMITT: Let me try to respond to that, Senator. A couple of things. There have been recommendations for penalties and there are some penalties contained in the draft ALJ decision, but

none have yet been levied against our business.

CHAIRMAN ROSENTHAL: I understand.

MR. SCHMITT: The expectation is that some will be.

CHAIRMAN ROSENTHAL: And we're watching. And I'm taking a good look at those.

MR. SCHMITT: Now, those -- there are two issues primarily that are sitting there for penalties, and we might as well not kid ourselves about them. One of them has to do with our so-called marketing practices where we bundled up services. We've refunded around \$30 million to our customers as a result of that. The judge has recommended that the Commission order us to set up a ratepayer education fund of \$16.5 million that comes out of shareowners' equity. And so that will go on.

But in the event that something like that were to occur, because that occurred outside the rate case process, the Commission would still have the full oversight ability to come in and audit it and levy the same kinds of penalties that they can today.

Our view is our business has grown up and learned a lot as a result of this and that's not a likely occurrence again.

CHAIRMAN ROSENTHAL: The other thing that I want to make sure, and the PUC can respond to this, one of the things that happened is that they didn't have access to your books under certain circumstances, okay? Now, that bothers me, because if you tell me you're doing right, but I can't look at your books to make sure that you're doing right, and I can't do that for three years, what happens to the rate base?

MR. SCHMITT: The books that the Commission had difficulty getting at for a period of time were those of the other telesis subsidiaries. They were not Pacific Bell's books. We have remedied that situation, and in fact, as a result of the draft order of a couple of weeks ago, now the auditors from the Commission are out looking through correspondence files of the telesis auditors -- they were out last Wednesday and I believe they're out again this week -- we would continue to live up to our commitment, that took us a little time to get established after divestiture, that the Commission has the right of oversight and to look at any of our books or correspondence that goes on anywhere in the business. And we'll continue to do that.

CHAIRMAN ROSENTHAL: And I raise these things so that we don't change too quickly. In other words, I want to make sure that step by step whatever is done avoids the penalties, avoids somebody saying, you know, you're doing something wrong.

MR. SCHMITT: We would agree with that, Senator. And it's okay for us to set up a process, even in the rate -- and to change regulatory environment. We would support a process that says free access that the Commission has to look at things would continue. We don't want to be putting anything under the covers that people can't see. There's just no way we can operate that way and no way you can tolerate that or the Commission can tolerate that. So we would not look to change that part of the process at all.

CHAIRMAN ROSENTHAL: Well, last year you testified before this committee on basically the same proposal that you described today. And I guess my question is: What progress do you think you're making in selling the need for changing the rate system for local telephone companies, and not just to PUC, but to your customers?

MR. SCHMITT: Let me talk about our customers, because I believe, Senator, our customers are the people that are most impacted by this. And it's not just the big ones; it's also the small ones. Our biggest customers provide substantial flows of subsidy to take care of our basic rates, which we intend to keep at the level to come out of this rate case through at least 1991. Potentially beyond that, but we can't predict the future well enough to say that. We have lost in the last couple of years twelve of our top twenty customers. We've lost in excess of \$90 million a year in revenue from those customers. We have about fifty requests for proposal out now, or we're expecting them shortly from other of our largest customers. The impacts of us not being able to deal with those customers the way our competitors are say that some of the sources of the subsidy to take care of basic rates will continue to go away. Most of them occur in the area of Centrex, and there's a big range of difference in the cost of providing Centrex for some customers versus other customers, and we believe we ought to be able to, in that area, price out a contract with a customer who may want to deal with us for five or ten years instead of on a 30-day basis that we have in our current tariffs, differently than somebody who wants 30-day tariff rates or differently from somebody who is five miles from our central office where it costs us \$1,000 to \$1,500 a line more to install a Centrex service. We're not trying to price anything below cost. We believe that in that instance we owe the Commission all the cost details behind any contract that we would file, although we would hope that we don't have to go through a litigious process on each contract as we go forward; and I don't believe that's their intent. But clearly, I think it's come clear to the Commission and their staff in a lot of places that just like the gas and electric utilities the telephone utilities now are having customers make choices other than their local telephone company and we need to be able to respond to that to keep the subsidy flows.

CHAIRMAN ROSENTHAL: Do you consider the small business groups business or residential?

MR. SCHMITT: We consider them business, Senator, and they're a very difficult group to ...

CHAIRMAN ROSENTHAL: So there rates will not be frozen.

MR. SCHMITT: They would not be. They would go up in a very predictable fashion. And I spoke earlier about the SPF -- I'm sorry to use these technical terms -- but the SPF to SLU reduction for the interexchange carriers which basically reduces their rates would be passed over on a revenue neutral basis on to all business customers and business services to bring their prices up closer to cost. They won't bring them quite to cost, I don't believe; but that shift would occur predictably during this time frame. They would know how much it's going to be when we get done with whatever comes out of these en banc hearings, assuming that the Commission approves something out of that, and would know what's going to happen with them. That's better than the current process even for them, even if their prices go up \$1.25 or \$1.50 a month each year, because they know what they're going to be and they can deal with them. And when you look at a measured business line at \$8.25 in our state, one would say that that is an exception of value for a business and certainly some increases there are not the kinds of things that are going to hurt business development in our state.

CHAIRMAN ROSENTHAL: What are your views concerning the timetable that's been set? The reason I ask the question is that whatever changes have been made since deregulation have created shock of one kind or another out in the community, and you really haven't always done a good job PR-wise, so it

seems to me that not only in terms of your customers, but your stockholders, the present system has worked very well. You've made money and the stockholders have been happy. I'm just trying to figure out how fast this should happen and how you will be able to deal with those two groups. And in fact, how are you going to make it look better to the investor in terms of your assets? You know, it appears to me that it ought to be done, if it's going to be done, and I'm not prejudging that at the moment, it ought to be done in some fashion which phases in over a period of time, whatever takes place, so that you can educate everybody who's going to be involved as to what changes are taking place.

MR. SCHMITT: We would agree with that, Senator, and let me talk about the schedule a little bit. The schedule as I understand it will be that early on next year we deal with the issues of pricing flexibility and contracts. Now we think we ought to get something in the interim. We have a petition pending at the Commission to give us the ability to respond on a contractual basis to some of the RFP's that some of our major customers currently have out, that have tremendous value, while those hearings go on.

But we believe that contracting and pricing flexibility on competitive services -- in our view, there only are four or five of those -- can be done relatively quickly and be done without being disingenuous to the rest of our ratepayers or customers because they're not going to have major impacts on the revenue flows of our business in the short term. In my view, it will increase the long-term revenue flows of our business if we can get our largest customers to stay with us for five or ten years.

The second phase is going to be the most difficult phase that's been proposed, because it will deal with everything except intraLATA competition and pricing flexibility. We don't believe that we're going to get into the kind of a relationship in dealing with that that we had with the rate case where it could go on for a couple of years. But we do believe that we can very quickly come to agreements on the major issues that need to be settled: what's the right benchmark rate of return, what's the right mechanism for sharing, how does that flow back to customers, what is the right starting point for the rates, because there are some rate design and rate reductions that will occur by the end of next year.

And then we get to the third phase, which I believe is a longer term issue, but we need to deal with it again because the Commission said they would next year or had said they would by 1989 in 1984; and that's the dealing with competition in the intraLATA toll market. Now our view is that intraLATA toll market provides well over a billion dollars a year to subsidize basic residential rates. Those services are priced well above cost and could very easily be cream-skimmed by allowing competition into the LATA at the present time. However, at the completion of the SPF to SLU transition, with the completion of other kinds of movements to bring our costs down closer to our prices and that bring the toll rates down to the level they ought to be in a competitive market; that if we can get all that accomplished -- and my view is that cannot happen in the near term -- that intraLATA competition would be something that would not cause rate shock to our customers.

Our view today is there's \$2 billion of total billed revenue in the intraLATA toll market -- our view today is if competition came in there, you would have rate shock because we'd get hit for \$400 million or \$500 million, in our view, and those kinds of changes in revenue flow simply cannot be linked together with maintaining an \$8.25 basic rate.

So we're agreeable that we agree with you that we cannot do all this stuff all at once, but we think

taking reasoned steps that just slowly move us into a different environment and allow us to deal with our customers as they wish to be dealt with, not the way we want to deal with them, but the way they are insisting that we deal with them, I believe will enhance the total economy here in California. And we believe that telephone service, basic enhanced information services, any way you want to describe it, is critical to the economy of this state. And we intend to keep our service as good as it is today in the future.

CHAIRMAN ROSENTHAL: Senator Russell? Okay.

MR. SCHMITT: Senator, I don't think that there's any sense in me going through the rest of this prepared statement. You'll probably have that ...

CHAIRMAN ROSENTHAL: No, if you'll give us a copy ...

MR. SCHMITT: ... and I'll give you a copy of it, and I'd be happy to respond to any further questions during ...

SENATOR RUSSELL: ... give us the gist of ...

CHAIRMAN ROSENTHAL: Yeah.

MR. SCHMITT: Would you like me to run through just ...?

CHAIRMAN ROSENTHAL: Why don't you just give us the gist of what ...?

MR. SCHMITT: Fine. Why don't I just do that. It'll just take a minute or two.

There are six basic themes that are in our proposal, and I'll just outline them for you quickly. First and foremost, we believe that we need to hold residence access and residence installation and Lifeline rates at the levels they are today or what comes out of Phase 2 in the rate case through at least 1991. By then we will have a better look at our cost structure and see whether or not further adjustments need to be made in the residential rate structure at that time. Our view is that where we predict our costs will be, if we do want to get into a more competitive environment, that it would probably take a 50¢ a month increases over a period of a few years to allow the equilibrium to occur to allow that to happen.

Secondly, we believe that we need to target the subsidies that currently flow across the board to all residential and business customers on basic service toward those folks who need it over time. Now, right now we're not proposing that anything happen to anybody's basic rate, even yours and mine when we can afford to pay what the costs are. But we believe that by ten years from now that it's likely that the subsidies will have to be directed even more than just at all basic residence services; and clearly, we think the subsidies ought to begin to flow away from business services now.

And that's our third proposal, that below-cost business services be brought to cost, over time, predictably, by increases through the SPF to SLU mechanism; and when that's completed in 1992, we take a look and see how the prices and costs match up, and when that's done, we'll take another look and see whether any further adjustments are needed.

Fourthly, we think that we ought to continue to be incented as we have in the past by regulation here in California. We would propose establishing a benchmark rate of return. A natural expectation would be that that it would be somewhat lower than what we have today under the rate of return regulation. I don't know exactly where it will come out. I'm sure that we'll have some discussions about that. But if we are able to exceed that benchmark rate of return through the increased efficiencies that

we in our business are able to garner while keeping our customer service high, that those be shared equally between our customers and our shareholders.

The fifth one is that we would try to get the contract flexibility and pricing flexibility that we talked about.

And finally, I want to continue to reemphasize we are not talking about deregulation Vermont-style or deregulation Nebraska-style or deregulation New Mexico-style in this kind of a proposal. We're talking about a very measured and moderate step away from the kind of regulation we have here and then check in a few years, see how it's working, see if our customers are happy, see if you're happy, see if the Commission's happy with the way we're running our business, leave them with all the audit and oversight that they have, and then see if we need to take another step.

That's a quick ...

CHAIRMAN ROSENTHAL: Give me -- give the committee, if you can, a couple of samples of the kind of thing that you'd like to be flexible on in terms of those things, in terms of competition. Are you talking about 976? What is it we're talking about?

MR. SCHMITT: Senator, no, not 976. In fact, if -- I'd rather not get into 976 today.

CHAIRMAN ROSENTHAL: Okay.

MR. SCHMITT: But if you want to help me figure out how we can do something to get 976 off the air, I'd be delighted to help you through that. (Laughter.) But no, the kinds of things we're talking about are Centrex -- that's our flagship product to our biggest customers, that is highly competitive with PBXs, private branch exchanges, and other, in some cases, even the central office solutions proposed by our competitors; Custom Calling features, which apply equally to both residence and business customers. We have competition, for example, on Call Waiting and Messaging from answering machines and other devices that are now embedded in the customer premises equipment that people buy. We think Touch Tone service ought to have some pricing flexibility; it's priced above cost and it ought to come down. About 60 percent of our residence customers now have, I think, it's 60, maybe a little higher than that now have Touch Tone service, even though it's only \$1.25 a month, I believe that's the rate and maybe -- in that range.

CHAIRMAN ROSENTHAL: You're talking about reducing that?

MR. SCHMITT: Reducing -- we're talking about reducing in all instances. Not increasing above where we are now, but bringing the prices down only. I thank you for mentioning that, Senator, because we're not talking about being able to raise them. We're talking about lowering them from the rates that are set now.

CHAIRMAN ROSENTHAL: And so ...

MR. SCHMITT: And the final area is toll, intraLATA toll calls. We believe we ought to be able to reduce those prices as we can, to get ready for that inevitable day that maybe is ten years from now when there'll be full intraLATA competition.

CHAIRMAN ROSENTHAL: It sounds good, and it's all being done on the basis of competition. And yet, by being able to reduce those rates, you actually eliminate competition.

MR. SCHMITT: (Sighs.) Well, ...

CHAIRMAN ROSENTHAL: You're big enough to squash the little guy.

MR. SCHMITT: I guess, Senator, if a little guy was going to get into the intraLATA toll business ...

CHAIRMAN ROSENTHAL: I'm not talking about intraLATA toll. I'm talking about the answering service. I'm talking about the alarm companies. I'm talking about those kinds of services that nobody could compete with you if you decided to reduce it.

MR. SCHMITT: We're not intending to get in either the answering service or burglar alarm business, in Pacific Bell and, to the best of my knowledge, Pacific Telesis, anywhere. So it's not those kinds of people that we will compete with.

CHAIRMAN ROSENTHAL: Well, that's what I'm trying to get ...

MR. SCHMITT: But a manufacturer from Korea who puts out an answering phone that has the ability to dial 50 phone calls for you, that costs you maybe \$50 or \$60 or \$70 a month, gets attractive to you if you like that versus the couple of dollars a month that our Custom Calling feature that does the same thing from a central office does. So yeah, we're trying to impact the people that are making the customer premises equipment today, but those aren't little guys. Those are big guys. They're multinational corporations in the main.

CHAIRMAN ROSENTHAL: I'm sure before the day is over we'll hear from those who feel that you'll be putting them out of business with your size.

MR. SCHMITT: You probably will hear some of that, particularly from people who believe they ought to be able to get in the intraLATA toll market and keep our rates where they are. I expect that you will, but we'll see.

And I'll be here later on this afternoon, hopefully with my other eye open if needed.

CHAIRMAN ROSENTHAL: Okay. Any questions from the committee? Thank you very much.

MR. SCHMITT: Okay, thank you, Senator.

SENATOR RUSSELL: I do have one more question.

CHAIRMAN ROSENTHAL: Yes, go ahead.

SENATOR RUSSELL: Can you briefly indicate what the loss of that \$90 million, was that an annual loss or a monthly loss?

MR. SCHMITT: That's an annual loss, Senator.

SENATOR RUSSELL: What that means, not so much in terms of dollars, but what does that mean to everybody else that's still on the system?

MR. SCHMITT: In terms of overall contribution, over cost, it probably means about \$20 million. It does not have the kind of impact -- if that were to continue, it would begin to have an impact on basic rates. And let me just give you a notion of what we're talking about there. We have between 7½ million and 8 million residential customers in the state now in Pacific Telephone. If you were to do a straight swap and say if you lose revenue here it was going to go on to the basic residence customers; and that's not the way it would work exactly. Every hundred million we lose is a dollar a month on basic rates. That's not exactly the way it would work, but that's the way the arithmetic works.

SENATOR RUSSELL: That's the concept?

MR. SCHMITT: Yeah.

SENATOR RUSSELL: So, to the extent that you are for whatever reason unable to keep these people in your system, there is some impact upon everybody else who is left.

MR. SCHMITT: Sure. Because they do flow substantial subsidies to the basic rate, Senator.

SENATOR RUSSELL: Thank you.

CHAIRMAN ROSENTHAL: Okay, thank you. Let me call Commissioner Mitch Wilk. I understand that you have a problem in terms of a plane, and this has gone a little bit longer for this first witness than I anticipated; but maybe we've really attacked all the problems during this one presentation. I've asked lots of questions, and there have been some other questions. And maybe you'd like to, because I understand you have a problem with the plane, so maybe you'd like to respond to some of the things that you've heard.

COMMISSIONER G. MITCHELL WILK: You bet. Mr. Chairman and members, first I want to thank you very much for the opportunity to be here.

I view my participation today as basically to reassure you that the California Public Utilities Commission is not going to do any umbilical cord cutting and walking away with deregulation. The key word here is flexibility, not deregulation. And I guess, I did listen with a great deal of interest. And as you well know, I mean, one of the reasons why we're beginning a process of investigation is in all candor to ask the same questions that your panel is asking and to satisfy ourselves that in fact in this day of technologically driven competition as well as competition being, frankly, imposed upon us from decisions being made in Washington, DC, that we respond effectively to that.

So I guess the first question is why do we want to proceed. And I can assure you, number one, whatever we do, we're not going to do it so quickly as to ignore what I consider to be very sincere concerns as expressed by you and your members and, in candor, I've got, as I say, some of the very same concerns. And so I guess the answer to why is so much because we are dealing with forces outside of our control. And some of those forces are the purest variety; technological developments, frankly, have to be responded to in some fashion. We have to have a fabric of regulation in this state that recognizes, I think, that we really are dealing with the telecommunications infrastructure. And we need to be flexible enough to acknowledge those changes. Because everything we do affects, frankly, everything else we do and it all affects people.

And I guess the first thing I'd like to also suggest to you in this vein is that our regulation, our telecommunications infrastructure, and the way we respond to it, affects not just ratepayers as bill payers, but ratepayers as consumers. It affects employees. It affects employers. It affects just about everything in the state. And California being the sixth largest economic power on earth, I think, deserves a responsive regulatory framework; and that's exactly what we intend to achieve with our OII, basically to examine what it is we do, with the idea of having a very thorough investigation.

We have set up, basically, I think, tentative timetables just to keep people focused. Those timetables -- nothing sacrosanct about that. But we do want to move ahead. We don't want to be timid in that sense, to examine just what it is we can do and just how far we can go. Whether or not we want to do anything at all, frankly, is still an open question.

Now, if you'd like, I could go over our investigation, the three phases, Mr. Chairman, if that's ...

CHAIRMAN ROSENTHAL: Well, let me ask a couple of questions of you. I hear what you're saying in terms of deadlines and I understand that you have to set some deadlines. I'm just wondering whether or not your deadlines may be faster than some of us think they ought to be. For example, at the same time as you set those deadlines, what guarantees do you -- how are you going to make sure that the quality and the cost under the new system is actually going to -- will not erode the service that now exists?

COMMISSIONER WILK: Well, that is the threshold question. We're going to ask the same thing. And it's going to be, frankly, up to the utilities, the telephone companies, to satisfy our concern in the same fashion they're going to need to satisfy your concern -- that service is not going to be jeopardized and that ratepayers that have no choice are not going to be harmed. I mean, basically, regulation begins at its strongest point where the ratepayer options end. And we all know that what we're dealing with, frankly, is a blend between a monopoly and, frankly, a competitive side. We can't deny there is a competitive side. And it's how we treat the competitive side, frankly, that we need to address. Where the consumer choices begin to end is where the regulation and the oversight needs to continue. And again, these are certainly just -- I'm only one of five commissioners -- but I can assure that that's where we're headed.

CHAIRMAN ROSENTHAL: I'd just like to kind of get the idea across that the PUC may be giving up regulating control of the telephone rates in the state and that kind of bothers me, because I don't know that it's going to be a better system. There's a resistance to change, as you're certainly aware of. And if we're going to make changes, it seems to me that those who want to make those changes need to prove their case, not us saying, you know, don't do it or we make the choice. But if the telephone company wants to make those changes, they have to actually prove that those changes are going to be good for everybody and there ought to be some kind of a hook so that in the event we discover shortly down the line that something is wrong, we have some way of pulling them back or pulling them short or doing something which puts them on the right track if they haven't moved on the right track on the basis of what they want to do. And have you given that up when you move in this kind of a system?

COMMISSIONER WILK: Absolutely not. In fact, let me make it perfectly clear that the burden of proof has not and will not change. It remains squarely on the shoulders of those who want a change. We have made that abundantly clear, Mr. Chairman, in every single public pronouncement having to do with the proceedings to date and we'll continue to do so. The burden of proof shall not change, number one.

Number two, we're not abdicating authority here. We're not simply saying we're going to have a whole new fabric of regulation and walk away and just pretend as though that's the end of it. In fact, central, if we want to take a look, for example, at the interexchange issue with AT&T, we've made that very clear where there -- where we may look somewhat more benignly, I think, at this juncture in terms of rate ban flexibility, we intend to have a monitoring system carefully in place. So that we can make sure whether we've created a beauty or a beast. And we will act very swiftly if we feel that we've created a beast.

Now, in all candor, I have a bias too. I think what we're going to do, to the extent we can capture the benefits of the competitive side of the house, I think all ratepayers are going to benefit. And I mean, I've heard a lot of people say, whether the core ratepayer or the residential ratepayer, we've got to

protect them. I frankly think, my intention tells me, that a fairly large percentage of those residential ratepayers would like to have some options that perhaps the new technology may offer them. And I don't want to deny that to them. I mean, this is going to be a carefully woven fabric of regulation and a little bit of freedom. And I guess if I have a message to the utilities as a regulator, the quickest way to lose the freedom is to act irresponsibly.

CHAIRMAN ROSENTHAL: Which they appear to have been doing. Even under the old system. And so, I'm maybe a little too cautious. I've seen what's happened and I've seen what you have done in terms of fines and pulling these people up short in terms of putting them on the right track. But to suggest that everything is going to be good just because we've gone to a new system, I have some problems. (Laughs.)

COMMISSIONER WILK: Well, you know, I mean, the problems could very well occur again. I do think that, you know, with public -- the quickest way to jeopardize freedom is to jeopardize public confidence in the process. And I think that you're right. In the three years since divestiture, there's been a lot of learning -- on the utility side, on the regulator side, and the legislator side. In all candor, mistakes have been made. But as we experience divestiture -- and three years is a very small time, a very short period of time -- as we experience divestiture, I think the utilities are learning. I know, well, I've only been a utility commissioner for a year, but I have learned a tremendous amount just in the year that I've been there. And so there is a learning curve element to this. And to the extent that abuses occur, the PUC is not walking away from those responsibilities. Frankly, you have, the Legislature has given us the resources. Those resources are going to be used and they're going to be used effectively to protect ratepayers, but also to make sure that the regulatory fabric we have in place is responsive.

CHAIRMAN ROSENTHAL: Okay. That's really my concern -- that you have certain controls in place so that you can still correct whatever is deemed to be incorrect. And that's one of my main concerns.

COMMISSIONER WILK: I'm sure that there will be ample enough, especially in the competitive side of the house, in all candor, there'll be ample enough controls out there, ample enough interests that will be doing a lot of monitoring for us. And frankly, that's one of the benefits of competition. I want to capture those benefits. To the extent that you hold people responsible to a competitive marketplace with competitive products, if there's going to be abuse, you're going to hear about it. And so in a way, it'll be, in some senses, Mr. Chairman, almost self-regulating.

CHAIRMAN ROSENTHAL: You know, if there are abuses, we will hear about it; and if we hear about it, you're certainly going to hear about it.

COMMISSIONER WILK: I'm sure we will. (Laughter.)

SENATOR RUSSELL: May I add?

CHAIRMAN ROSENTHAL: Senator Russell.

SENATOR RUSSELL: Do you feel confident that in this new arena of three-year hiatus and so forth, you're confident that you can look over their shoulder so that at any particular time that you see their straying from the straight and narrow, you can jerk the chain?

COMMISSIONER WILK: I am. But Senator, let me just clarify a point. I'm not here to embrace the Pacific Bell proposal. They still have to prove their case to me. In fact, we have yet to receive a formal

application. And so we have a proceeding underway in which -- basically a process proceeds policy.

SENATOR RUSSELL: Okay. I understand what you're saying, Mitch. But given the fact that they want to move in this direction, then -- let me rephrase it. If that seems acceptable to you, will one of your criteria be a means in which you can continually, without getting into all this rate case stuff, but continually be aware, monitor, look over their shoulder to make sure that they're maintaining the true faith and that if at any particular point, they do not, are not, that you can do something about it?

COMMISSIONER WILK: Yes, sir.

SENATOR RUSSELL: That will be a part of the agreement that you'll work out with them.

COMMISSIONER WILK: Senator, I personally want to be -- I don't want to abdicate my constitutional obligation to make sure that what we put in place works, and if it doesn't, to rethink or to revise. And I know that -- I'm fairly confident that whatever regulatory framework we ultimately decide to pursue will have adequate monitoring capabilities attached to those new freedoms.

SENATOR RUSSELL: I think that's what the Chairman is concerned about, that's what I'm concerned about, and I think this committee is concerned about. I personally want to provide as much freedom and competition because I think that's healthy, but I also recognize the direction -- the phone company is not only just to serve, but it's to make a profit; and in so doing, many times in that regard, the welfare of the people may come in second and that's where you come in in terms of a monitor.

COMMISSIONER WILK: That's exactly right. Well, you have my promise that I'm not going to, as I say, ignore or abdicate my constitutional obligation to provide just and reasonable rates and to protect those, frankly, that have no choice. And I think I can speak on behalf of my colleagues on the Commission as well.

CHAIRMAN ROSENTHAL: Just one final question.

COMMISSIONER WILK: I don't have to leave until eleven o'clock, so I mean ...

CHAIRMAN ROSENTHAL: Oh, okay. Fine, fine. What's your personal feeling about the FCC's position in terms of its movement ...

COMMISSIONER WILK: I'm sorry, I didn't hear that.

CHAIRMAN ROSENTHAL: ... in the long distance area? You know, the FCC has made some movement in the long distance area and in the local as well. How do you see that as affecting what you do?

COMMISSIONER WILK: Well, I'm not going to follow on lockstep with the FCC. There are some things I like and some things I don't and, frankly, some things I don't understand.

With respect to, for example, the AT&T proposal, I'm beginning to be enamored of this idea of kind of a weighted average approach rather than rate of return bans around a rate of return, basically giving them the flexibility to go within bans on a weighted average basis. To me, it might provide the same kind or perhaps even a better incentive for productivity and good management decisions. But you know, I want to, obviously, learn a lot more about it.

CHAIRMAN ROSENTHAL: Okay, thank you very much. And as long as you don't have to leave, maybe you'll be around for some other response.

We'll now hear from Mr. McCallion, External Affairs Director of Revenue Requirements of

General Telephone. You've heard what's already proceeded. So maybe if you -- how does your proposal differ, and you've heard the questions that have been raised by the committee, you might want to respond, okay?

MR. TIMOTHY J. McCALLION: Perhaps if I briefly go through what our proposal is, what General's proposal is. It's contained in the statement, but it is relatively short. You can view it from the perspective as to how it agrees or disagrees with Pacific's Bell proposal.

At the Public Utilities Commission's en banc hearings held on September 24 and 25, General offered a plan for a new regulatory agreement for local exchange carriers. The plan proposes a wide departure from the current California regulation situation.

We propose that all network services remain under regulatory oversight. All the capabilities and functionality of the local exchange carrier integrated local network should be offered to all users, under regulation. Any new alternative regulatory approach must recognize the value to our customers and to society of an integrated local exchange network and create conditions that allow for its preservation and its enhancement. Of critical importance in reaping the full benefits of such integration is the avoidance of artificial cost allocations that would disrupt underlying efficiencies.

Next, our plan would divide all network services into two categories. The first category would be protected from substantial increases in aggregate prices, but individual services within the category would be subject to rate rebalancing. The second category of services would be subject to less restrictive price constraints. We propose that the first, more protected category include residents and single line business, local usage, public paystations, intraLATA message telephone -- that is, short haul toll -- and intraLATA switched access. Rates for these services would be rebalanced over time to reflect market requirements and be more appropriately aligned with cost. The pace for the rate rebalancing is contingent upon the expected extent of competition. In total, the revenues from these protected services, adjusted for business growth, would be limited to an aggregate change not to exceed the change in a predetermined index--modifiable to reflect impacts beyond management controls, such as changes in tax rates, changes in accounting rules, and jurisdictional separations changes. We strongly recommend that the current restrictions on intraLATA toll competition be retained during this transitional period, until our prices get realigned.

The second category, consisting of all remaining network services -- and that would include multi-line business customers, Centrex, Custom Calling, and any new services that would come on line after this point -- would enjoy a much larger degree of pricing flexibility under our plan. This flexibility is appropriate, since for these services, more competitive alternatives are available. Pricing flexibility would permit prices to decrease in response to market conditions and would limit price increases to no more than 10 percent per year for each service within this category.

Another very important aspect of our proposal is to have cost of service regulation replaced by the regulation of the company's total intrastate return to its shareholders. Under our plan, rates for services with few competitive alternatives are controlled by price regulation and for those services for which price flexibility has been indicated, we have proposed a maximum annual increase. The availability of competitive alternatives for this second category of services also tempers rate increases.

Moreover, continuing regulatory oversight, based on an aggregate intrastate return on equity for all regulated network services, coupled with price restraints imposed on the more protected services, and the incentive aspects of our plan which I will discuss in a few minutes, eliminates the potential cross-subsidy problems and the need for traditional rate-base or cost-of-service regulation. Because of this, abbreviated cost-of-equity hearings and determinations similar to that employed by the Commission in attrition cases would be the primary regulatory oversight that is required. This streamlined approach would be more timely and far less costly to both the Commission and the company's ratepayers than the traditional scheme presently in use.

I also might want to add that we have nothing in our proposal which would preclude the Commission from continuing their quality of service regulation and continuing to have oversight in the area of Commission complaints and any other problems the customers may want to bring forward to them. We would assume and we would propose that that remain the same as it is today.

We are also suggesting that a mechanism be put into place which would be an incentive to local exchange carriers to plan for and achieve greater operational efficiencies. Our incentive plan establishes an initial "benchmark" return on average common equity. The benchmark would begin at the existing authorized rate of return -- adjusted to reflect the increased risk borne by shareholders under the new regulatory framework. The benchmark return on equity would be established for period not exceeding two years. This time frame would ensure a reasonable return is in place that is equitable to both shareholders and ratepayers. A threshold level would then be indicated, above which earnings would be shared between the customers on a graduated scale. The resulting ratepayer benefit should take the form of efficiency credits applied proportionately between network services that are subject to indexed constraints and those in the price flexibility category. It should also be noted that we are not proposing either an earnings floor or an earnings cap be established. In other words, there will be a risk to our company to the extent that we are not able to live within the threshold we do not get an automatic increase. However, to the extent that the company is able to improve its efficiency, we will be able to continue to receive efficiency gains out of that that benefit the shareholder. But I might want to point out a provision of our plan is for an increasing sharing of the efficiency to the ratepayers; for example, at the initial amount of efficiency savings, we may split that 50-50 between the ratepayers and the shareholders. When we exceed a maximum amount for that particular threshold, the sharing could go up perhaps 75 percent to the ratepayers and 25 percent to the company.

Clearly, the provision of this incentive mechanism should cause greater efficiencies to accrue and ensures that an appropriate proportion of these efficiency gains flow directly to the ratepayer.

Finally, I'd like to point out there's really little reason to believe that all residence network connection prices need to be held at heavily subsidized price levels to sustain universal service. However, for some customers, due to qualifying need, a targeted subsidy -- Lifeline service -- must be retained.

In closing, General will carry its plan forth in the investigation established by the Public Utilities Commission in its open meeting on November 25. I'd like to point out that General has not yet filed any tariffs which incorporate price flexibility; however, there has been some rate rebalancing. Over the

years, General has been moving its rates closer to cost, within current regulatory constraints in response to changes in the competitive market.

I thank you for permitting me this opportunity to outline our plan.

CHAIRMAN ROSENTHAL: Question. What's the basic difference between your proposed idea and the one we've already heard, Pac Bell's?

MR. McCALLION: I think the major difference between our plan and that of Pac Bell's is that Pac Bell is proposing a rate freeze into the 1990 time frame. We do not have a rate freeze for residential rates built into our plan. We feel that there is rate rebalancing that is necessary, although we would anticipate, like Pac Bell does, that there will always be some subsidy flowing to basic residential rates from the other services, from the short-haul toll services, from the large business services. We do not see the level of subsidy being able to be maintained at the levels it is at today due to the increasingly competitive nature of those markets.

Therefore, what we are proposing is a gradual reduction of the subsidies, starting with the implementation of our plan, hopefully in 1989, to gradually eliminate some of those subsidies. At the same time, I might add, we're hoping that the need for some of the increases that would occur to the basic residential rates and to the small business rates to offset that subsidy would be offset by increased incentives on the part of our company.

CHAIRMAN ROSENTHAL: It seems to me that you ought to rethink that last difference, and let me tell you what I see happening. When your customers get an increase, your homeowner gets an increase, under your plan that is not taking place with Pac Bell, you will not hear the end of that outcry. So I think that whatever is done, there ought to be some kind of a consistency, Mr. Commissioner, so that ratepayers in one company don't start screaming at me because I happened to be in General Tel's district, okay?

COMMISSIONER WILK: Could I respond?

CHAIRMAN ROSENTHAL: Yes, sir, yes.

COMMISSIONER WILK: You're absolutely right. The last thing in the world we want to do is to have a lot of different regulatory frameworks out there so that it creates a lot of incentive to move all over the state. We don't want to do that. I mean, we -- and frankly, that's going to be a real challenge, to make sure that we have in place something that, frankly, fits the telecommunications companies but also protects those small companies that, frankly, really are not in a position to compete.

CHAIRMAN ROSENTHAL: Yeah, thank you.

SENATOR RUSSELL: Commissioner Wilk, are you saying basically that you don't think it would be a good idea to have variations on a theme for these two companies, that basically whatever comes down will be applied across the board to the two major companies?

COMMISSIONER WILK: Well, that would be my objective at this point, Senator Russell, because I think, frankly, that level of consistency between the two major telephone companies is desirable, unless someone can prove to me that a lack of consistency isn't. But between now and reaching that conclusion, I think it's very healthy to have different proposals.

SENATOR RUSSELL: Thank you.

CHAIRMAN ROSENTHAL: Do you believe that a fair tradeoff for this new rate of freedoms might be to redefine what local competition or the lack of it means in the context of the PUC investigations? IntraLATA? Redefining what monopoly exists as to some sort of a tradeoff here?

MR. McCALLION: Well, I think the situation that we are in, if I am responding appropriately to your question, Senator, is that my company, General Telephone, is getting a very large subsidy from short-haul toll, intraLATA toll calling. To the extent that competition is allowed in that particular area, competition would, most likely, drive those prices down; in other words, we would have two choices. One would be to lose market share because competition was coming in a particular area, or the other choice that we would have would be to adjust our prices in response to the competitor's prices in that particular area. In either situation we will be losing some of the benefit of the subsidy which is now flowing to keep local rates down.

CHAIRMAN ROSENTHAL: Any further questions? Thank you very much.

MR. McCALLION: Thank you, Senators.

CHAIRMAN ROSENTHAL: Now we will have Panel B come up here. Pardon?

MS. SYLVIA M. SIEGEL: Recess?

SENATOR RUSSELL: No.

CHAIRMAN ROSENTHAL: We're going to move right along. Sylvia, we won't call on you first if you'd like to have a little recess. But let me indicate to the panelists that you each have -- and Sylvia, I want you to hear this too -- you've all been given a time limit to respond. I'm going to hold you to that time limit; and when you get within one minute of that limit, I will ask you to conclude.

SENATOR RUSSELL: May I ask that the gentlemen turn their cards so that we can see them?

CHAIRMAN ROSENTHAL: Yes.

SENATOR RUSSELL: Thank you.

CHAIRMAN ROSENTHAL: And when you are speaking, put the red light on that's alongside of your ..., okay? Do you have a light?

Okay, we'd like for you to describe for the committee what you do and you might want to make any comments that you'd like on what you've already heard. Let me call upon you in the order that you are sitting there. Michael Morris, counsel for the California Cable Television Association.

MR. MICHAEL MORRIS: Thanks, Senator. My name is Michael Morris, and I am vice president of Congressional and Regulatory Affairs for the California Cable Television Association. And as such, I am dealing with issues of competition both in Congress, the FCC, and the California Legislature. I appreciate your invitation to me to speak today as the California Public Utilities Commission and the Legislature consider new ways to regulate the local telephone companies.

We in the cable television business in California see basically two areas of concern. One is with regard to the notion of price flexibility. And basically we're concerned that that translates to a problem that we've talked about many times before, and that's cross-subsidy. And an issue here I think is the pricing of what are supposedly competitive services. But we've seen time and time again, and those who have studied the issue and including Judge Greene's most recent decision on whether to allow the Bell operating companies to expand into other competitive areas, that the local telephone companies have

both the ability and a very strong incentive to cross-subsidize any competitive ventures into which they enter.

Now, we have suggested safeguards in the past and in these hearings. One approach with regard to competitive activities is to have separated subsidiaries, so it's easier for the PUC to do their job of overseeing the allocation of costs and making sure that the telephone ratepayer isn't actually harmed by the rate flexibility and the competitive activities that are being proposed. Now, oftentimes we hear from the phone companies that no, no, no, this isn't possible, it takes away a lot of our ability to act efficiently. But I think that we've seen recently, particularly that that hasn't shown itself to be the case. If you take, for instance, the example of Pac Tel Cellular, which I think is a very fine example, because Pacific Bell or Pacific Telesis with regard to their cellular business is proposing, were it not for the recent stockmarket crash, would have done exactly what we think is appropriate in the case of competitive activities; and that's to have a fully separated subsidiary that actually spins off through the issuance of a separate, an entirely separate class of stock. We think that solves a lot of the problems of this cross-subsidy issue. You have separate auditors coming in. You have that whole SEC procedure that really puts in quite stringent safeguards to make sure that the cross-subsidy won't occur.

We have an example of that in the cable business with the telephone companies. Cen Tel (?), which I believe is one of the largest independent telephone companies and also quite a large operator of cable television systems -- they are in the cable business. They operate their cable division entirely separately from their television division. And they have done exactly what Pacific Telesis is proposing to do with Pac Tel Cellular; and that's spin that company off, have separate shareholders, of whom the telephone company, Cen Tel (?) in that case, or in Pacific's case, Pac Tel, is actually a major shareholder, so that the shareholders get the benefit and take the risks of the venture. So that's one example of a structural way that we think is very helpful.

CHAIRMAN ROSENTHAL: Senator Russell.

SENATOR RUSSELL: Mike, I need you to clarify that for me again. Company A, let's say that Pacific Telesis develops a cellular telephone. And it's done through the holding company and the investment of their stockholders, initially. If that is then spun off and they sell separate stock, how does that -- we're down to the benefit of the initial stockholders who started the thing in the first place. How does that work?

MR. MORRIS: Well, I believe the way that works, Senator, is that the initial stockholders retain a percentage of the stock, perhaps 75 or 80 percent of stock, but as a separate class of stock and sell off the other portion of the company.

SENATOR RUSSELL: In other words, if I had one share of Pac Tel stock, I might get two shares of the other?

MR. MORRIS: That's right, depending on how it's structured. But the shareholders remain shareholders in the separate company, but it is separated and it's by separate stock ownership which brings in a whole plethora of safeguards, in the accounting sense.

SENATOR RUSSELL: Now, is that being resisted, that concept?

MR. MORRIS: Well, it's not being resisted in certain areas and Pacific Telesis is proposing to do

this in the case of Pac Tel Cellular. It's been resisted every time we've raised the issue, and the Legislature has raised this issue over the last couple of years. Senator Rosenthal, you remember when this committee held hearings on diversification of the utilities in the competitive businesses. And there were some bills which had been proposed -- an element of some of the original drafts of those bills involved separation of these competitive activities, and that's always been very strongly opposed.

SENATOR RUSSELL: Thank you.

MR. MORRIS: Secondly, we've talked before about another step which we think would be a useful remedy, and that's that we feel it's absolutely necessary to change the state anti-trust laws which now shield the utilities from liability for their -- whatever predatory pricing practices they may have. And it's certainly understandable with the current regulatory scheme, that the PUC tells a utility or a telephone company that it must price certain services below cost, it certainly wouldn't be fair to have anti-trust liability attach to the utility for pricing that service below cost. But now we're talking about moving into a regime with price flexibility. And although there may be price flexibility, as my understanding that the services would continue to be offered pursuant to tariff, although it would be a flexible tariff, so this shield from predatory pricing practices would remain in place and that shield certainly has to be taken away if pricing flexibility is granted. So that's another useful step that we feel could be taken by the Legislature in tandem with the PUC's activities in this area.

It's also going to be absolutely necessary, and this is another legislative activity, so you can assure that the PUC has adequate resources in its audit staff and other staffs to be able to police the activities that are going on and make sure that the cost allocations and so forth are adequately monitored. And frankly, I haven't seen any study done on that, but that's a cost of the taxpayers of this state that has to be taken into account and weighed against any potential benefits that those same taxpayers as customers might possibly receive. That I think is a legislative activity that needs to be done again in tandem with any consideration that the PUC would have of these steps.

And a second question ...

CHAIRMAN ROSENTHAL: Would you sum up? You have another minute.

MR. MORRIS: Okay. The second question has to do with the existence of effective competition. Commissioner Wilk was talking about the competition question as being really the key to this whole flexibility issue. And certainly we've seen the area of competition that we've been watching in the way the PUC has been handling in the past is the area where cable would very effectively be able to compete with the local telephone companies. And we've seen that that area is certainly not open to competition now, and that's in the private line or point-to-point business. This business is not a natural monopoly.

In 1984, the PUC found that private line competition would not be harmful to the ratepayers. And you know, what's missing here today is my favorite chart that the Pacific Bell people generally bring along to these things, that quite graphically shows \$300 million a year in losses in the private line business. And yet they oppose the introduction of competition in this private line business and continue to say, "Please don't allow competitors to come in and take away my losses." We see that as a problem that really needs addressing, and we've been encouraged by Commissioner Wilk and some of the questions at the en banc hearing that have gone on in terms of focusing in on that issue. But we think also that

that's any area where the Legislature needs to keep a close eye.

I will be glad to stop there, Senator, and answer any questions that you may have.

CHAIRMAN ROSENTHAL: Senator Russell.

SENATOR RUSSELL: If it's a loss, why would anybody want to compete for losses?

MR. MORRIS: Well, because you have different costs. It may be a loss for Pacific Bell, but because they operate with a system that is based on a narrow band, a very narrow -- they have a 4 kilohertz wire into the home, and there's different economics of that. And for instance, our industry, which instead of having 4 kilohertz might have 550 megahertz. That's 4,000 hertz versus 450 million or 550 million hertz of band width. And there's different economics in terms of costs. So what's a loss to one party may very well not be a loss to someone else.

CHAIRMAN ROSENTHAL: Senator Montoya.

SENATOR JOSEPH B. MONTOYA: Mr. Morris, I would just ask a kind of a rhetorical question since we've always discussed this business of cable versus telephone companies. Would you be, would the cable industry be willing to be regulated for whatever the PUC does under this administration if they get into the phone business; and if they get into the phone business, doesn't that mean that there might be some cross-subsidization going on there by virtue of the other profit-making operations?

You know, you people have argued forever about what a giant the phone company is as compared to the cable industry. I am bothered a little bit about the fact that it seems that cable is becoming a group of conglomerates. All of the pioneers who used to climb the telephone poles themselves are gone. We see the leverage buyouts, of companies getting bigger, more inefficient. Certainly, it hasn't improved services anywhere.

So I think we have to continue to ask you those questions because they tend to put you ill at ease, but they're relevant. (Laughs.)

MR. MORRIS: No, they don't. I appreciate the questions. And those entrepreneurs, the pioneers in the business, they're not gone. The Bill Daniels and the Glen Jones and so forth -- they tend to be flying around in their corporate jets, vacationing more these days; but they're still out there.

SENATOR MONTOYA: Putting blind pools of international investors together. (Laughter.)

MR. MORRIS: To answer your question quite seriously, we don't have the capability in the telephone industry with the architecture of our systems to be in the phone business. We can provide data transmission services. I don't believe that's the phone business. And frankly, that's a question, an ambiguity that's part of the problem in terms of developing competition. Because the State Constitution and the statutes in California give the PUC jurisdiction to regulate telephone corporations, and telephone corporations are those who provide facilities that help with communications by telephone. We don't think that having one computer talk to another computer is communications by telephone and it doesn't have the same public interest, really rationale, to have public utility-type regulation. You're not talking about necessities. You're not talking about Lifeline-type services. You're not talking about services where there's such a great difference in bargaining power between the customers and the provider of the service that there isn't a negotiation. And you're not talking about natural monopoly services.

So, no, Senator, as far as the services we can provide over our cables, I don't think public utility regulation is appropriate. If we were to be in a switched basic telephone business, I think absolutely, we ought to do it under the same rules as the telephone companies. But we really aren't set up to be in that business. I mean, we could, technically, theoretically, you could provide telephone service over cable television wires; but you have to have a \$5,000 telephone in every home, and I don't think that's a solution we'll ever see.

CHAIRMAN ROSENTHAL: Okay. Mr. Weatherly, Vice President of the Bay Area Teleport.

MR. MARVIN R. WEATHERLY: Thank you, Senator. As you've indicated, my name is Marv Weatherly. I am Vice President of Planning and External Affairs for Bay Area Teleport.

I have submitted written comments to the committee, and we welcome the opportunity at Bay Area to give comment.

CHAIRMAN ROSENTHAL: Would you describe what you do and who you are -- Teleport?

MR. WEATHERLY: Well, Bay Area Teleport is really the provider of interLATA and intraLATA high speed private line transmission services. Bay Area Teleport, or "BAT", as we refer to it, does not provide either "dial tone" or "dial up" service. It does not provide any switched service. Its customers are entirely composed of other common carriers and sophisticated corporate customers who have the need for very large, "bulk" transmission capacity.

And we provide high capacity T-1 digital transmission services between LATAs 1 (San Francisco) and 5 (Sacramento).

SENATOR RUSSELL: If you did not exist, who would provide that service? The telephone company?

MR. WEATHERLY: If we did not exist, we have our competitors. There are other people that provide the same service. So if we did not exist, someone else would.

CHAIRMAN ROSENTHAL: The telephone company?

MR. WEATHERLY: And the telephone company would also be providing and do provide that service with the exception of interLATA communications.

SENATOR RUSSELL: Do you come under the PUC?

MR. WEATHERLY: Yes, we are certificated by the PUC.

SENATOR RUSSELL: Thank you.

MR. WEATHERLY: I might, by way of background which probably gives me a unique opportunity from the outside to look in at the regulated field, I joined BAT as Vice President in August of this year. Prior to that time, I was Chairman of the Alaska Public Utilities Commission where I served for 12 years until my retirement in May. And before joining that Commission, I was the Executive Director of the Governor's Office of Telecommunications for the State of Alaska. I've also served four federal-state joint boards, which have dealt with many of the issues which have been raised here today. In fact, I believe I probably hold the record on the number of federal-state joint boards on which I was a member.

During that time, as a Chairman of the Alaska Commission, a member of NARUC, a senior member of NARUC on the Communications Committee, I've had frequent contact with the members of the California Commission and the staff of the California Commission. Historically, the California

Commission has taken a lead nationwide. Their staff have been professional and very highly respected in the national community.

Also, because of Alaska's unique geography, I've had to deal with the problems of rural telephone companies and the questions of basic service rates to rural America. I was born and raised in Fresno and went to school there, so I'm familiar with the importance of communications from the agribusiness standpoint.

Most of my comments really deal with the question of regulatory flexibility, because it sounds good. It sounds like motherhood and apple pie regulatory flexibility. But what we're really talking about is a freedom from regulation, for what is still beyond any question and it can't be disputed, a very well entrenched billion-dollar monopoly. Precipitous deregulation of such giant enterprises is bound to lead to trouble. Now that doesn't mean that Bay Area Teleport or I personally are against competition or giving Pacific Bell pricing flexibility. But that hazards must be recognized up front. The Commission, in my opinion, in their approach to this really have their priorities backwards. What they're saying, about ten years down the line, we're going to have open competition; but in the meantime, you the monopoly will be entrenched and you can set the prices the way you want; in effect, you will drive out any competition and then we will have flexibility and we will allow intraLATA competition.

A point of comment with regards to Mr. Schmitt's testimony. I was intrigued by his response on the Tax Reform Act and the question from Senator Russell with regards to the amount of money that will go back to the consumer. In fact, the Federal Tax Reform Act has a provision in it that says that such monies, and there's approximately \$7 billion at stake nationwide, cannot be used for ratemaking purposes. Now, it's a magnanimous gesture to say this is going to flow back either part or all to the consumers of Pacific Bell, but there is a bill before Congress right now that would in fact repeal that part of the Tax Reform Act. And to my knowledge, none of the telephone companies have come forward and have endorsed that concept, that state commissions be allowed to consider the windfall profit relative the Tax Reform Act for ratemaking purposes.

SENATOR RUSSELL: Mr. Chairman? I don't understand what you're saying. They, the telephone company, as a result of the Tax Reform law, are going to get a windfall, right?

MR. WEATHERLY: That's correct.

SENATOR RUSSELL: But you're saying that they shouldn't be allowed to give that to the rate ...?

MR. WEATHERLY: No, no, that's not what I'm saying. I'm saying, is that the law itself reads is they have no obligation whatsoever to give that to the ratepayers. In fact, the law would prohibit a state commission from considering that for ratemaking purposes. That's the way the law reads.

SENATOR RUSSELL: Well, suppose they decide, because they're good citizens, that they want to do that?

MR. WEATHERLY: Ah, well, that's a different story.

SENATOR RUSSELL: It doesn't prevent them from doing that, does it?

MR. WEATHERLY: But if, in fact, that is their intent, I would suggest that if they went down there en masse, all of the telephone companies, the BOC's across the nation, and went to Washington, DC --and I believe it's the Dorgan bill or there's a bill in Congress for that -- and would say, "We endorse that; let

our state commissions consider that for ratemaking purposes," it would get back to the consumer. But right now they have no obligation, no matter what the California PUC ...

SENATOR RUSSELL: Your inference is that they will take it and give it to the stockholders?

MR. WEATHERLY: Well, my inference is that they will do whatever they consider in their best interest.

SENATOR RUSSELL: Which is to benefit the stockholders -- that's what you're saying, right?

MR. WEATHERLY: Yes, I think the bottom line could say that. But I would suggest, Senator, that the consumers of the State of California and every other state paid for those taxes. They paid those monies in. Those monies do not belong to the stockholders.

SENATOR RUSSELL: Well, the gentleman from Pac Tel said it was going to go to the ratepayers.

MR. WEATHERLY: And I believe him, if he says that it's going to go to the ratepayers, but I would suggest that as an endorsement of that good intent, that Pac Bell go to Washington and endorse the bill presently before Congress.

CHAIRMAN ROSENTHAL: Let me just break in a little.

MR. WEATHERLY: Sure.

CHAIRMAN ROSENTHAL: Not taking your time. Are you in support of the bill in the Congress?

MR. SCHMITT: Senator, he's talking about something different. (Inaudible.) Ex-Commissioner Weatherly is talking about something very different from the windfalls from the tax law change. The change in our statutory rate down to 34 percent will clearly be flowed back, and the Commission does have the full right to flow back those reductions in our federal taxes, and we do endorse that.

What Mr. Weatherly is talking about are some deferred investment tax credits, and there is a big number of those that are currently in our balance sheets and in our investment base here in the state. There is a point of view that says the Commission ought to take all those investment tax credits/benefits that have been deferred over time and flow them back to the ratepayers today.

Our view is those are now invested in the rate base and they belong there, and over time as the rate base amortizes and the investment tax credits amortize, that will flow back. That's a very different issue than the federal income tax issue.

CHAIRMAN ROSENTHAL: Your talking about a 30-year flow-back?

MR. SCHMITT: I don't know.

CHAIRMAN ROSENTHAL: Or whatever you use as ...?

MR. SCHMITT: Yeah, it's over a period of time, yes. It's not 30; I think it's between 15 and 20, and Mrs. Siegel may know the exact year.

MS. SIEGEL: Senator, can I further confuse the issue? Under the Tax Reform Act of 1986, a special provision, Section 203(a), was included at the last minute which required the regulated utilities to normalize all of the excess collections of income taxes they were accruing because of the change in the tax rate. That excess collection nationally amounts to \$19 billion a year. The utilities cannot give that back under Section 203(a). However, Senator Dorgan has put in Senate Bill 1049 which would eliminate that section and then give states jurisdiction to deal with this \$19 billion in windfall collections, which now the utilities are proposing to trickle back to customers over the life of the plant, which can be as

much as 30 years. So in effect, the present customers will never get back the expenses they paid for that difference.

This is a contentious issue across the country. NARUC has taken a position on it. TURN has taken a position. Congressman Matsui has had a fit. He's the author of Section 203(a). But my understanding is that in California alone, it's something like 7 -- it's \$9 billion. Nationally, it's 19 (?).

CHAIRMAN ROSENTHAL: Okay. Let me just indicate that I have a resolution to try to deal with that particular issue. Let's get back to rate flexibility and the proposals here, and we'll deal with that subject in January.

MR. WEATHERLY: Thank you, Senator. I just wanted to raise it as a point with regards to what the intent was in some of these areas and the effect it has on the consumer.

CHAIRMAN ROSENTHAL: That's a subject for a whole hearing which we may hold.

MR. WEATHERLY: But it's basically my feeling. What I was really trying to indicate there is that it's a matter that should be properly before the California Commission and not something that is hung out and aired to be adjusted according to the whim of the utility.

CHAIRMAN ROSENTHAL: Okay, now on the subject of the hearing, you have a couple more minutes.

MR. WEATHERLY: I'm very supportive of Pac Bell's position and that of General Telephone with regards to rate case delays. Regulatory delay costs the utility and it costs the consumers an extraordinary amount of money. And there are ways that it can be handled. Normally you could track rate case delays due to inadequate staffing and inadequate systems within the Commission to handle the rate cases. That's what it boils down to: the processing time itself.

Now, there's a lot of fingers out there that will be pointing to, and I think it was alluded to, that the process of having a hearing creates a delay. It does, but it's a thing called due process, that everyone should have their opportunity to examine any rate filing before the Commission, and that should not be touched in any way.

I'm somewhat surprised by the ...

SENATOR RUSSELL: Question on that point.

MR. WEATHERLY: Certainly.

SENATOR RUSSELL: Are you suggesting that what is being proposed will modify that? And if so, in what way?

MR. WEATHERLY: In my short experience with the California Commission, in my new role, I've had an extraordinarily difficult time in getting the information I need from the standpoint of assessing a tariff that is being proposed by Pacific Bell. All sorts of proprietary information standards are put up there and all the rest of it. I'm saying that there is a -- the question of due process should be on the front burner so that everyone who has the -- if we go into pricing flexibility, that everyone have the ability to examine what Pacific Bell or General Tel is proposing at every step of the way and that it be -- and comments be accepted.

SENATOR RUSSELL: And is the statement that Mr. Wilk made in response to my questions allay that concern that there will be safeguards and oversight?

MR. WEATHERLY: In due respect to Commissioner Wilk, Commissioner Wilk is one of five commissioners. And if there is a revolving door syndrome in any business, it's being a commissioner. And what Commissioner Wilk says today may be forgotten tomorrow or day after tomorrow with a new commission and a new set of commissioners.

I'm sure right now it's the intent of Commissioner Wilk and all of the commissioners on the California Public Utilities Commission to ensure that due process and full examination takes place. But I suggest over a period of time that may erode and that's why the guidelines, why the regulations have to be very, very

SENATOR RUSSELL: Why would it erode? Because of this new approach that they're proposing? Is that what ...?

MR. WEATHERLY: Yes.

SENATOR RUSSELL: So you are opposed to what they are proposing? You'd like to keep it as it is?

MR. WEATHERLY: No, I'm not. I believe that there is room for deregulation and there is room for pricing flexibility. But I believe that it should be done in a cautioned, well-thought-out manner as opposed to deregulating for the sake of deregulation. When you set a target date of January 1989 for that pricing flexibility. Without having all of the elements in place, I suggest you're rushing to judgment on the question of deregulation without having a full record.

SENATOR RUSSELL: You may be correct, but for my purposes, to try to put everything in proper perspective, I recognize that competitors have different views on things. Let me ask you this question straightforwardly: To the extent that the telephone companies are allowed to have this latitude that we've been talking about, and which I don't really understand much about, to that extent, it impacts you, it may impact your company adversely, is that correct? Is that your concern? As a competitor?

MR. WEATHERLY: As a competitor, if there isn't a commensurate lessening and opening of intraLATA competition, yes. Yes, because it allows predatory pricing, is basically the problem. That theme -- it will come out up and down here from everyone who is not affiliated with a telephone company. The question of predatory pricing, the question of cross-subsidization -- that is a historical concern for every commission and every commissioner.

Now, if you're going to have pricing flexibility, then have a reciprocal lessening of entry restrictions and going into intraLATA.

The point has been made with regards to a \$19 million loss, a \$19 million -- I question that, quite frankly. I probably -- it would be opportunity, marketing opportunity loss as opposed to business loss. I believe if you look Pac Bell today, you'll probably find that their private line services and those other areas that they have competition have grown. They haven't lessened. They're not in the negative column in those areas. But they equate -- because they lose a customer in an open bid with my company, for example, that that is a loss. It just means that they can't compete, that their proposal wasn't good enough. It doesn't mean that they had that business to begin with. That should be examined.

CHAIRMAN ROSENTHAL: Would you finalize, please?

MR. WEATHERLY: Yeah, let me -- if you haven't read Judge Greene's opinion, the Modified Final Judgment, if you haven't read it, if you've only read excerpts from it, then I suggest that you read the

entire opinion, because that opinion sets it out in very clear terms of what the hazards are, what the problems are with regards to the industry.

And I would also say that you read the GAL report with regards to the capabilities of the Federal Communications Commission to adequately regulate and attract the industry. It says they can't do it. And I would suggest with the resources that the California Commission has, staffing and probably systems-wise, that that should be examined from the standpoint of the Legislature in coming up with the necessary mechanism to adequately regulate. If you're going to regulate, regulate effectively. If you're going to deregulate, then make sure that you have the systems to ensure compliance with whatever guidelines that are set forth in that deregulation.

I thank you for the opportunity to come before the committee. And if I can be of future assistance, please call on me.

CHAIRMAN ROSENTHAL: Thank you, Mr. Weatherly.

Our next witness is Kent Blasiar, past president, Telephone Answering Services of California. Yes, sir.

MR. KENT BLASIAR: Thank you, Mr. Chairman and members of the committee. My name is Kent Blasiar and I am the immediate past president of the Telephone Answering Services of California (TASC), which is an association of answering services in California, and also executive vice president of Alert Communications Company in Los Angeles.

We, the TASC represents the interests of approximately 1,000 answering services located throughout the State of California. And while we serve some large businesses, our principal customer base is comprised of small businesses, professional, legal and residential customers, who need constant monitoring of their incoming calls. Any of you who have had to quickly reach a doctor or a plumber know how we operate and how essential we are to individuals whose businesses frequently takes them away from their premises.

Answering services come in all sizes, but can generally be characterized as small businesses. My own company was founded by my parents in 1949 and now employs approximately 325 people providing service to approximately 5,000 accounts over the Southern California area.

I'm not a lawyer and I've never testified before the Legislature or any regulatory body, but I'm here today because of a deep concern that I have that concerns the rate flexibility for Pacific Bell and other exchange companies, that they could dramatically impair our ability to continue to successfully serve Southern California as we have for the last 38 years.

Telephone rates not only affect our cost of providing the service, but also our ability to market our service to new subscribers and keep our existing subscribers. Our members, like the exchange telephone companies, are in the business of call completion. The more calls that are completed, the happier we are, the happier our customers are, and we understand, the happier the exchange companies are. And that's what answering services do, is complete calls. We complete a lot of calls. We estimate that answering services in the state are responsible for completion of a minimum of 20 million calls per month. And our company alone in Southern California completes approximately 750,000 calls per month. Those are calls that would have otherwise gone unanswered. That's why they got an answering services, is to provide

that service to answer the calls when they're not there. And not only going unanswered, but also receiving busies, which ties up the phone company facilities and generates no revenue for the phone companies. In other words, we contribute significantly to the economies of scale that can reduce the cost of telephone service for everyone.

I'm sure the committee has heard a lot about the competitive alternatives available to large users of telecommunications services, and to a large degree, that proposition is advanced as one of the principal reasons for providing rate flexibility to Pacific Bell and other exchange companies. Well, answering services could certainly be classified as large users, at least to the extent that services provided by the telephone company form a significant part of our operating cost. And as I've already stated, our ability to market services is dependent to a very large degree on the prices our customers must pay for the telephone connection between us and our subscribers. Yet we are still monopoly customers, and that is why I'm here today.

To understand the quandary that we're in, you need to know a little bit about how we operate. In general, an answering service services its customers in one of two ways. The customer can request that the telephone company make a connection in the telephone company's central office called a secretarial line, so that when our customer's phone rings, it also rings in our office just like an extension from your kitchen to your living room. We pick it up after a certain number of rings that the customer specifies. And this is the type of service, for example, Senator Russell, that Alert Answering Service provides for you, for your district office in Glendale. And it's a traditional way of serving, that answering services have served our customers historically.

The other alternative is for our customers to order one of the telephone companies' custom calling features or call forwarding. The customer programs the telephone so that an incoming call is routed to our service and answer it.

These two choices present the dilemma that rate flexibility proposals pose to our industry. An example of the predictable increases Pacific refers to is in its last general rate case, they proposed to put, unquote, gradually increase the installation charge for secretarial lines by about 375 percent over a three-year period. How much luck do you think we will have marketing a product that would require our customer to pay a \$440 installation charge? No problem, according to Pacific. The answering services can simply have their customer base go to call forwarding. Well, there is a problem. In fact, several. If you have used call forwarding and you know that you have to program your phone to set it up and again when you want to discontinue it, and how many doctors do you know will want to rely on a system like that? How many times would people forget to call forward their phone before they leave their premises with no way of forwarding short of going back to their premises and initiate call forwarding.

It's true, as Pacific will tell you, that they have an offering called delayed call forwarding which can be preprogrammed through the telephone company business office on a permanent basis. And this forwards calls after two rings, three rings, however many rings you want to set it up for. Unfortunately for anyone using that service, it cannot be adjusted by the time of day. So, if you're in your office during the day and you leave at night, it's still going to be approximately, and they say approximately three rings, it could be up to five rings, before it forwards on. And it can't be adjusted by day of week. So if

you're gone all day Saturday and Sunday, you're still on three rings where you could have had it go immediately.

If you're in your office with this delayed call forwarding, if you're in your office and your phone rings three times and you go to pick it up, it's already forwarded, so you can't pick it up. And the way the secretarial line works is you can pick it up, there can be a three-party call, and the operator can leave the line, and you can take over the call.

If you're answering service is served by another Pacific Bell central office, you can't even get the service. It can only go within the same central office.

The point of all this is not to nitpick these services to death but to draw some conclusions about what life might be like for us in an era of relaxed regulation. The service that Pacific offers that was designed for us, secretarial lines, was targeted by Pacific for sharp increases and a regulated environment. How do you think we'll fare in an unregulated environment?

The custom calling features that Pacific wants us to use were never really designed to function in an answering service environment. Not unexpectedly, they don't work as well as an answering service function and despite repeated attempts by our association, Pacific's product managers won't design a switched service offering that meets our needs. We have no one else we can go to to obtain these services. They are not competitive offerings. That's where we are in a regulated environment.

I'm not enthused by the prospects, particularly in light of the fact that Pacific Bell, the sole company from whom we can purchase these services, wants very much to compete with us through a voice mail offering. If Pacific is permitted to do so, how high a priority will Pacific place on developing services to meet the needs of its competitors.

Before California is sent down what appears to be a very fast track toward rate flexibility, this committee should look hard at the present system and decide whether it has served the ratepayer as poorly as some suggest. Our association just spent a considerable amount of its resources in the pending Pacific Bell rate case, so we're hardly enamored of the time and resources required to effectively participate in a PUC rate proceeding. I know, however, that the committee is aware of the tremendous revenue and thus rate reductions that have resulted from that proceeding. Most of these have been as a result of the fine work of the Commission's Public Staff Division. Because of these hearings, the California citizens who pay Pacific Bell bills will pay one to two billion dollars less per year than might otherwise be the case. When we hear complaints about 175 days of hearing, does it make more sense to complain about regulatory lag? Or does it make more sense to note that the resulting reductions average between five to ten million dollars per day of hearings. The fact that the hearings may have produced a result contrary to the utility's agenda hardly means that the process is flawed.

CHAIRMAN ROSENTHAL: Will you please sum up? I think we have gist of your testimony.

MR. BLASIER: Okay, yes. Basically, what we're saying is that the process is not flawed. You look at the amount of money that will be brought back to the ratepayer and we don't feel that there's a problem there. It's like setting -- the notion that a ratesetting process that took decades to develop has served this state well can be turned over in a single year is like the Legislature putting the state budget on a consent calendar. We feel that it's going too fast.

We would like you to watch over it and we would like participation if you would like us to participate. And we thank you very much for the opportunity to address you.

CHAIRMAN ROSENTHAL: Thank you very much.

MR. BLASAR: Thank you.

SENATOR RUSSELL: One question.

CHAIRMAN ROSENTHAL: Yes.

SENATOR RUSSELL: In today's regulatory situation, does the PUC have the capability of determining the price reasonableness of what they charge you? You said a 400 percent increase or something of that nature. If they were to apply for that, they'd have to verify what it costs to provide that service, would they not?

MR. BLASAR: Yes, Senator. And in this last proceeding, we looked at the secretarial line issue and we found that even with Pacific's numbers, with their cost allocations and so forth, that there was a very -- there was a small percentage of services, secretarial line services, that were priced, or cost at that \$440 level. It wasn't even \$440. They were more priced right around \$50.

SENATOR RUSSELL: Well, then, the PUC's responsibility is not, under that scenario, if all you say is exactly correct, is not to allow that to happen, is that correct?

MR. BLASAR: Right.

SENATOR RUSSELL: And your concern then is that for a longer period of time there'll be no oversight of this nature?

MR. BLASAR: Yes, sir. That's what we're -- where is our form going to be. And because we're in the monopoly area, we don't have anywhere else to go.

SENATOR RUSSELL: They're proposing also though to freeze some rates; that would not apply to you?

MR. BLASAR: No, not considering the 375 percent increase they want to put on us over the next three years.

SENATOR RUSSELL: I wonder, maybe this is all conjecture, but if this new proposal goes forward and you are slapped with a \$400 or \$500 or \$300 increase, it would seem to me that you could still go to the PUC and ask them to look at that, on this ongoing overview that Mr. Wilk seemed to indicate that they would provide. Is that ...?

MR. BLASAR: If that's the case, then that's the possibility, yes.

SENATOR RUSSELL: If that were the case, would that reassure you? If that were the case?

MR. BLASAR: That would reassure me, but what's the difference? In other words, we're going in now and Pacific is actually the one in this last rate case, everybody said, "Okay, we will take a percentage increase in all services across the board." And Pacific is the one who came back and said, "No, we want to go through this lengthy rate case, because we want to section out some services over here and increase them and not over here." So I wonder if we would be able to, under this new flexibility, be able to have as much as input or as much say. We did get involved in this last rate case, and we got very involved, and I wonder if we would be able to have that same capability without

CHAIRMAN ROSENTHAL: See, Senator, it seems to me that there are two kinds of situations. If

the telephone company wants to get into that business, then they have another approach in terms of what they charge them for providing that service which may be higher than their actual costs. On the other hand, if they don't want to get into the cable business, they're not going to be doing anything as far as setting those rates that high because that's not where they want to be. And so that's one of the concerns that I have in terms of this so-called competition where the telephone company wants to compete and set prices in such a way so that there is no competition. That's part of the concern. Okay.

SENATOR RUSSELL: Would it not be the part of PUC where there is this monopoly service in this case, that that would be a focal point of their attention in terms of not allowing that to take place in this three-year ...? I mean, there are certain things that maybe they would allow to go for three years, but there are other things where the only place you can turn to is the telephone company. Maybe that's a lot more than I ...

CHAIRMAN ROSENTHAL: That's one of the concerns I guess of all of these witnesses as well as my own.

Mr. Alan Pepper, the attorney representing the Western Burglar and Fire Alarm Association. Oh, he's not here. I'm sorry, okay.

Sylvia Siegel, Executive Director of TURN (Toward Utility Rate Normalization).

MS. SIEGEL: Thank you, Senator. I'd like to ask for the privilege of either splitting my remarks and covering some this afternoon. I don't think Ken McEldowney is here. I'm here in answer to all of the telco's demands, which I think are patently unreasonable and unjustified. And I would like to address some of the issues that were raised this morning by Pac Bell.

SENATOR RUSSELL: Did you say Telco?

MS. SIEGEL: Telco. That's an abbreviation for telephone companies. Excuse me. I don't want to be talking in buzzwords. I won't do that again.

SENATOR RUSSELL: That's all right.

MS. SIEGEL: It just shortens everything.

SENATOR RUSSELL: I just didn't know the word.

CHAIRMAN ROSENTHAL: You say that Ken will not be here?

MS. SIEGEL: Well, I don't know. I don't see him here. I don't know if he won't be here or not.

CHAIRMAN ROSENTHAL: He is due to come after lunch and you will have an opportunity at the end to make some comments. In the meantime, you now have ten minutes.

MS. SIEGEL: All right, thank you. I appreciate the opportunity to appear here, because what is being proposed is vexatious and causing a great deal of concern across the consumer world. I've just returned from two weeks back East attending meetings of the National Association of State Utility Consumer Advocates and the NARUC and also visiting the Hill in Washington to find out what's going on there. Not much. And everybody seems to be ...

SENATOR MONTOYA: What's new?

MS. SIEGEL: What?

SENATOR MONTOYA: Return to the Congress.

MS. SIEGEL: What did you say? What's new?

SENATOR MONTROYA: Yeah.

MS. SIEGEL: You're right. I hope I poked them a little bit, though. I'm concerned because the price cap edict may be coming down from FCC, but I think FCC is chewing off more than it's bargaining for. And I think there will be a concerted action here and a concerted action in the consumer world, and by that medium, to the Congress to forestall pulling the plug. That's what we're talking about, whether it's flexibility, deregulation, or whatever. We're talking about pulling the plug. And once you pull the plug, you can't put it together again. We rely on the PUC staff to go into the books of Pac Bell and General Telephone and AT&T and get the facts.

The reason these rate cases take three years is not because the PUC staff is not doing its work, not because the interveners, all of us, aren't performing timely and judiciously in terms of the facts of the case but because Pac Bell is delaying the case. Every time a witness challenges Pac Bell's statement, Pac Bell puts on three witnesses in rebuttal. Of course that takes time.

I have to tell you, I've been in this field now since 1969. That's almost 20 years of practice. The dictionary changes every year. When we get an application that thick, and you go through and read it word for word and you cross-examine witnesses based on that application, you'll find (A), that the written word doesn't mean what it really means. So it's really required that you cross-examine these witnesses to find out what the true meaning is of what their proposals are being projected. And (B), once you learn that dictionary, the next rate case is changed. This happens all the time. This company, I can say without any fear of being sued or whatever, even though we are in a privileged forum here -- I'll say it outside, and I have -- they lie, they obfuscate, and they withhold information.

This is why, Senator, you have to have a knowledgeable investigator look into the facts. Without the facts, you can't determine anything, even rate of return. Without the facts, you can't determine anything.

Well, let's look at rate of return regulation. Is it really so awful? For heaven's sakes. Pac Bell's profit rate has increased every quarter since divestiture. For the first time in its history, they earned a profit, a net profit, of \$1 billion in 1986. They're among the stars of the telephone world. They are in an area of assured customer growth.

SENATOR RUSSELL: What percentage profit is that on their investment?

MS. SIEGEL: They're authorized to earn a return on equity of 15 percent, which is the highest in the country. That was frozen for three years.

SENATOR RUSSELL: Does that \$1 billion relate to the 15 percent?

MS. SIEGEL: That's over, that's over 15 ...

SENATOR RUSSELL: \$1 billion means nothing until you relate it to something.

MS. SIEGEL: That's over 15 percent.

SENATOR RUSSELL: What is it ...

MS. SIEGEL: It's over 15 percent. It's over 15 percent. And they can keep that; that's their net profit.

SENATOR RUSSELL: How much over; do you know?

MS. SIEGEL: I don't know. It's a lot over. They are earning at a much higher rate than their

authorized rate of return. So they are doing well, and so is General Telephone and so is AT&T, actually, doing well under regulation. The other companies may have some other problems of subsidiary problems that may affect their bottom line but certainly not the telephone customers.

We have seen ads of national magazines taken out by Pac Bell or Pacific Telesis bragging about the excellent economy in California which assures continued growth, the continued growth of usage, the continued growth of customers, et cetera, that exist here in California. So they are in the best possible situation to improve their performance which has been smashing.

Plus, Senators, I call attention to the fact that ratepayers have invested at the rate of \$2 billion a year to modernize Pac Bell's equipment which gives them unlimited future capability to serve this increased market. We're not talking about optic fiber or fiber optics and digital switches that are required to serve the residential market. You don't need all that fancy stuff. We don't need to invest \$50 million on one switch. We don't need to invest hundreds of millions of dollars on this fiber which is required really to transmit data for large data processors. It is not even required to transmit data for the home user. You can use the existing equipment. So we have installed now huge equipment investments paid for by the ratepayer that really won't reach use until sometime in the future. Those are the uses that they want to be deregulated. Now isn't that nerve? We pay for the installation. They're going to capture all the profits on that equipment and exploit all of the possibilities that that equipment will yield and then sock it to the regulated customer.

Don't just consider the eight and a quarter. That is just part of the cost of local telephone service. The telephone companies and the PUC would have you believe that California enjoys the lowest cost in the world. That simply is not true. Added to the eight and a quarter now ...

SENATOR RUSSELL: Where is the lowest cost?

MS. SIEGEL: Well, it's not here.

SENATOR RUSSELL: Well, where ...

MS. SIEGEL: I don't know, but I'll give you -- I'll give you a survey of what the costs are in every jurisdiction, and you'll see that California does not come at the bottom of the lowest cost of the picture.

SENATOR RUSSELL: How close do they come?

MS. SIEGEL: Not very. I'd say -- I'd say they're about in the middle. Senator, what we have to consider is the total cost of local service. It's not only the eight and a quarter a month; it's the zone usage measurement charges that were instituted by a staff member who is now retired, fortunately. He's also responsible for this dog called SPF to SLU which will transfer more costs from our pockets to the pockets of the company. These are all arbitrary measures; they are arbitrary. There is no rationale for them. I know they were adopted by the Commission but they're phony.

So when you talk about the total cost of local service, it's not only SPF to SLU -- it's not only the eight and a quarter -- it's \$2.60 now for access charges that we never had to pay for before. That will rise to \$3.50 unless it's stopped. It is a surcharge for this, that, and the other thing. And no wonder I get complaints daily with bill enclosures showing 20 different charges on a local telephone bill that adds up to a local bill of over \$20 a month. So don't believe that eight and a quarter

nonsense. It is strictly that. It is nonsense. It's a lot more than that. Local telephone calls in California have gone up markedly since divestiture. Cost to country (?), they've gone up from 25 to 45 percent.

What we have before us now in the context of general case for both Pacific and General Telephone is an opportunity to pass on some of the savings and the efficiencies that really belong to the ratepayer. For example, the tax, the lowered tax rate, from 46 to 34 percent, this is an on-going rate. And that doesn't refer to the deferred, the excess deferred, tax collection under the section 203(a). The interest synchronization savings that should come out of this case, the higher productivity savings that should come out of this case -- in toto, there is a saving of \$700 million possible out of this application on Pac Bell. The same is true on General Telephone. General's case will not be completed until the spring. I'm going down to testify on General Telephone's next week.

And Senator Montoya, I hope you will support your constituents. I want a decrease of that eight and a quarter to \$6 a month. I want all of the zone usage measurement charges eliminated. I want toll calls to go down to 10 cents instead of 20 (cents). The company is making money hand over fist. They can make money but not us, the regulated customers.

CHAIRMAN ROSENTHAL: Let me ...

SENATOR MONTOYA: Mr. Chairman.

CHAIRMAN ROSENTHAL: Yes.

SENATOR MONTOYA: May I ask you why you're directing your comments to ...

MS. SIEGEL: Because they're your constituents.

SENATOR MONTOYA: I have General Telephone and I have Pac Bell Telephone also.

MS. SIEGEL: Okay. No, they're just your constituents.

SENATOR MONTOYA: I happen to have my own preference; neither of them are excellent but ...

MS. SIEGEL: You're right. (Laughter)

SENATOR MONTOYA: I also did want to ask you, you know, it's great to do this Monday morning quarterbacking on what went wrong but it doesn't have the same value being told after as it does before.

Relating to this SPF and this other -- these other acronyms that you just mentioned --

MS. SIEGEL: SLU.

SENATOR MONTOYA: -- were you there telling us before that this was going to be --

MS. SIEGEL: Yes.

SENATOR MONTOYA: -- the disaster that it is?

MS. SIEGEL: Yes.

SENATOR MONTOYA: And haven't you also been critical of rate of return?

MS. SIEGEL: Yes.

SENATOR MONTOYA: So now we're all ...

MS. SIEGEL: Of course. That doesn't mean ...

SENATOR MONTOYA: We're all in this together then, right?

MS. SIEGEL: No. Senator, that doesn't mean ...

SENATOR MONTOYA: No. I mean it's just that I get the feeling that you want to, you want to lynch some people and ...

MS. SIEGEL: I don't want to lynch anyone. I want fair -- I want fair regulation of monopoly services.

SENATOR MONTOYA: And hindsight is excellent but ...

MS. SIEGEL: Senator, I don't engage in hindsight. We're in every major case in this state, and we put into that case and into the record on an affirmative basis.

What I'm saying is that there are -- regulation is not perfect. Rate of regulation is not perfect, but it's better than pulling the screen. And that's about what's going to happen if you engage ...

SENATOR MONTOYA: And yes, I do hope that the prices go down; and more than that, I hope that my telephones work.

MS. SIEGEL: They will.

CHAIRMAN ROSENTHAL: Sylvia, let me ask you a question. Pac Bell and General have said that their new rate proposals would benefit both the shareholders and the ratepayers from the utility incentives that would be created and that money would come back. What's wrong with that?

MS. SIEGEL: Well, in the first place, it won't. In the first place, they're basing that -- their predicate is on their proposed rate structure. We're saying that the \$700 million and reduced revenue requirements has to be applied to the existing case, and any consideration of any change in regulation has to go forward from that as the predicate.

As far as sharing the profits, we will never know. We're in a decreasing cost high-tech industry. There is nothing in their proposal that assures that those costs -- cost savings -- will be passed through to the customer. And there will be continued cost savings. Frankly, I don't take their word for -- based on my extensive experience, I don't take their word without a thorough investigation of what the existing facts are.

CHAIRMAN ROSENTHAL: Well, we're hoping, that if they make these larger profits, that there will be this distribution back to the rate base and we're expecting the PUC to make certain that that takes place.

MS. SIEGEL: But they can't, Senator, because if you're pulling the plug and you're saying go ahead and do this for five years, we will lose the benefit of the PUC staff going in to check their books. I mean even under rate of return regulation, they barely will let them in. And I know that the staff had to fight to get into one of the company's books to check the cost data.

How are you going to get -- how are you going to determine whether it's truly a cost of service if you can't get to the basic facts? And you won't be able to do that.

CHAIRMAN ROSENTHAL: Well, maybe -- and, you know, this just kind of hit me -- maybe if, in fact, we move in this direction piece by piece -- and not January 1st, 1989, as being the final date, maybe the PUC might continue with each phase to continue to look at it for that next year to make certain that what went into effect actually took place so they don't give up the yearly look-at. That might be a suggestion to the PUC that they put something into effect, part of this program, whatever

makes sense at the point, but not the whole program, and then spend the next year making certain that that piece works before you put the next piece into action.

MS. SIEGEL: Well, Senator, you really have -- somewhere along the way, preferably annually, you have to have a total look at the company so that, Number 1, you're sure that the cost allocations are proper; and without going to the books, you can't determine that. Number 2, you have to determine that there's no cost subsidy. And Number 3, you have to determine that you have the facts. And I'm telling you, we have all experienced great difficulty in just getting the facts out, even under rate of return regulation. So if I sound skeptical, I am. And I don't think you do all of this on a piecemeal basis.

If I might suggest, Senator, if you're going to relax regulation at all, I think you have to be darn sure that there, in fact, is competition, verifiable and sustainable competition. Without that kind of finding first, I think you have no right to relax regulation because it will be damaging to the rest of the body of ratepayers.

CHAIRMAN ROSENTHAL: Thank you very much.

Move to our next witness. Mr. Moffit.

MR. PAUL FADELLI: Jeff Beck is first.

CHAIRMAN ROSENTHAL: Oh wait a minute. Jeff Beck. I'm sorry. I think you were out of the order. Jeff Beck, attorney, representing the Rural Telephone companies of California. And let me just ask that you perhaps not repeat. Tell us how it's going to affect your particular company because we now have kind of a picture of what everybody up here is saying in terms of the so-called competition which is going to be created.

MR. JEFF BECK: Chairman Rosenthal, I will endeavor to live up to my well-deserved reputation for brevity in my speech.

CHAIRMAN ROSENTHAL: Thank you. Thank you.

MR. BECK: My name is Jeff Beck and I'm a lawyer in the law firm of Pelavin, Norbert, Harlick & Beck. Our firm represents the 15, plus or minus a couple, Small Independent Telephone Companies in the state. And at your, Chairman Rosenthal's, inquiry to Bob Ringman of the CTA, he suggested that I might speak for that group of the CTA membership.

The companies, commonly grouped, referred to as the Small Independents, are basically family owned companies serving anywhere from a few hundred access lines up to -- the largest ones serve about 12,000. Taken all together, they represent fewer than 1 percent of the state's access lines and serve fewer than 1 percent of the ratepayers. But when you look at a map of exchange areas, you find that they serve a substantial amount of the rural areas of the state. Over recent years -- recent being the last 25 years -- they've expanded into the outlying areas and brought basically large numbers of rural subscribers on to the network with up-to-date, modern telephone service.

As far as where these companies stand in regard to regulatory flexibility, there's a couple of things to cover. One is that the local services provided by these companies, that is, not the toll-type services and the access services that might complete a call from Copperopolis to Los Angeles but rather the local services provided within each exchange are basically fully regulated and in our view

will continue to be regulated monopoly services. We don't see a practical reason to introduce competition and we don't see a long list of people trying to compete in our exchange areas. For that reason, we expect to be regulated. Basically, if you are and remain a monopoly, you're going to be regulated. And the trade-off of that is a social benefit readily embraced by the smaller and larger companies which is the willingness to invest money to serve customers, even if on a single-customer basis. You might say it's not economic to serve that customer. It's a system -- it's a system that requires a phone in Copperopolis, just like one in Los Angeles.

One of my favorite quotes from a few years back from a telephone manager of the Siskiyou Telephone Company in Fort Jones, California, up near Yreka: What good is one tin can and piece of string? The Rural Local Exchange Company is the second tin can that completes that telephone call, no matter where the originating call. It might be in an urban or rural center.

The regulatory structure now that exists for these smaller companies is considerably simpler at the present time than the large company regulatory structure. And for that reason, in the context of the en banc proceedings, we appeared and requested that the Commission not automatically assume to change the relatively less complex, small company regulatory system just because it was going to look at the question of Pac Bell and General. And it's my earnest _____ and hope, somewhat reassured by a quick glance at a draft copy of the Commission's OII decision, that, in fact, this upcoming proceeding of the next year will not directly affect small company local regulation.

That said -- we, as a company, frequently participate as companies, frequently participate in various pieces of larger regulatory proceedings in the telephone area. And it's the company's view -- it's my view as somewhat battle-scarred veteran of few of these proceedings -- that regulatory processes could be improved.

I think I will take Commissioner Wilk and the other commissioners at face value that they intend to take an eyes-open look at this subject. I take the larger exchange carriers at face value that they think there are some real benefits that they can demonstrate. And I think the smaller companies are going to be interested participants. This is an area of great economic interdependency. We provide joint services with Pacific Bell and all the other carriers -- joint access services, joint toll services. It's an economically interdependent industry, which is another way of saying, that when you change their rates, you change our income. So these things are subjects that we'll be looking at closely.

If there's a theme that we would use to sum up the approach -- time and again in regulatory proceedings in the past few years, we've said to the Commission: It doesn't make any sense for the Commission to regulate Pacific Bell to be sure that the result is ideal for a small telephone company serving 5,000 subscribers. What we have asked the Commission time and again is, that in the course of addressing the regulation of Pacific Bell or General or in an industry-wide proceeding, that they give consideration to the needs that may exist because of the unique economic relationships and structures of these smaller companies. And consistently, we've had fair and equitable treatment --

CHAIRMAN ROSENTHAL: Okay.

MR. BECK: -- from the Commission of these companies and we expect to be able to obtain in

the future.

CHAIRMAN ROSENTHAL: So that you don't see whatever takes place in terms of the change affecting your company at all, or your group of companies?

MR. BECK: I think it will affect them dramatically. I think that because basically three-quarters of the activity, and therefore income, of these companies is based on joint toll services or access services that are provided to AT&T for access calls. The point is there's a complex economic structure by which the joint costs are apportioned and paid. And based on a combination of industry relationships and regulatory relationships, that system now works. It's our belief, that no matter which direction the Commission goes, we will be able, working with the Commission and working with the other companies, to make that system continue to work.

CHAIRMAN ROSENTHAL: Okay.

MR. BECK: So it will be dramatic but we think we can deal with it.

CHAIRMAN ROSENTHAL: What are your views of the recent PUC action involving AT&T in its new filing?

MR. BECK: We participated actively in that proceeding. There are a couple of areas of relatively minor concern. We obviously have concern that our ratepayers who make a lot of toll calls -- when you live in a town with 2,000 people, you tend to make a lot more toll calls than if you live ...

CHAIRMAN ROSENTHAL: Okay.

MR. BECK: As a portion of total calling. Basically, it's -- AT&T is in a competitive market. We think that a degree of flexibility is appropriate.

One thing that is worthy of mention that I periodically bring up is that one fallout of all of this, what everyone calls SPF to SLU, basically has been shift from toll to local costs. Our local rates for our customers have gone up. 70 or 80 percent of the people in this state now, as a perceived benefit of that, have the opportunity to be served by multiple exchange carriers, MCI -- or multiple inter-exchange carriers -- AT&T, MCI, Sprint, and the whole raft of others.

AT&T continues to serve our exchanges. None of the others do. And ultimately, a benefit that ought to be realized in the rural areas is the presence of a competitor. And by the way, the answer, oh, that's 'cause their costs are high, it won't wash. The costs of these companies for access charges are identical with Pacific Bell. It is the same tariff. Mile to mile, the mile costs the same; a minute costs the same for any sub-category of service. It's a way of saying: It is, yes, more expensive to complete toll calls in rural areas. But so far, only AT&T is the only company that's willing to accept the obligation along with the benefit.

CHAIRMAN ROSENTHAL: Senator Russell.

SENATOR RUSSELL: To bring it down to where I can understand what you're saying, I think you're saying, that whether they go on as they have been or whether they changed to this more protracted period of time, that you can work with it either way. And so you're not really saying as -- you're not raising the flag of caution to the extent that the others are; is that correct?

MR. BECK: I say we can work with it in this sense: I expect we will have to go in, pound on the

table, raise the voice a few times, kick someone in the knee; and then at the end of it -- and this has been something that goes on over time ...

SENATOR RUSSELL: Do you know where?

MR. BECK: Knee. But at the end of it, because of the fact that all we're doing is setting rates that have statewide implications, and with the support of the Legislature, there have been a couple of bills in the last two years, each of which have been promotive of the policy of a rural/urban degree of averaging in rates. But I think we're going to try to preserve that.

SENATOR RUSSELL: Do you -- are you supportive of the present attempts by the major phone companies to have a longer period and flexibility, or do you prefer to keep it the way it is?

MR. BECK: That's not of direct concern to us except as co-participants in many of the services. Our rates are directly affected by the process. It's really a Pacific Bell-General Telephone-PUC problem again. We don't ask the PUC to regulate Pacific Bell in a way that best suits us. So as a concomitant, we ask that they watch out for us as they do, which they do. And the third leg of the milking stool might be that therefore we try not to tell them how they should regulate Pacific Bell.

CHAIRMAN ROSENTHAL: Thank you very much.

Mr. Moffit, vice-president and financial director to Revenue Requirements, Continental Telephone Company of California.

MR. JIM MILES: Senator, contrary to your introduction, my name is Jim Miles and I'm president of Continental Telephone Company of California.

CHAIRMAN ROSENTHAL: Oh.

MR. MILES: Mr. Moffit was called away and so I came in to substitute for him.

CHAIRMAN ROSENTHAL: Jim Miles. Okay. I'm sorry.

MR. MILES: You and I have had discussions in the past.

CHAIRMAN ROSENTHAL: Right.

MR. MILES: Rather than read into the record our prepared comments, I will leave copies of our comments and they can be introduced that way.

CHAIRMAN ROSENTHAL: Thank you.

MR. MILES: But I would like to just set the record straight on some key issues in my mind and try to differentiate ourselves from Pac Bell and General Telephone to some small degree.

In looking at our plan that we provided during the en blanc hearings, there is a lot of similarity between Pac Bell's and Gen Tel's and Con Tel's plan. There are some minor differences that I can highlight at this time.

I think one thing you have to remember, as far as California and Continental is concerned, we are the third largest independent telephone company in the state. As such, we have approximately 245,000 customers and your fellow constituents in this state. We are actually the largest small telephone company in the state. We serve rural and suburban California. As such, a lot of our customers require and demand some of the same types of services and products that are available in the metropolitan areas. Along those lines, we are striving very diligently to be in a position to

provide those types of products and services.

We implemented modernization programs in the late '70s. Consequently, we are probably ahead of General and Pac Bell as far as digital conversions and the fiber optic deployment that Sylvia so lovely, lovely described it previously. Our cost to provide service is somewhere approximating \$37 a month for each customer. This compares on a nationwide basis to \$19 a month to connect our customer to our central office.

We are able to provide that local residential service to our customers for \$13.50 a month. We are able to do that by the significant revenue flow from the toll revenue side of the house. Approximately 61 percent of our total revenue stream comes from toll revenue services.

As I indicated, there are some agreement between Pac Bell and General and ourselves in our proposal. We definitely agree to a social contract-type of scenario for basic services. We differ from Pac Bell and General Telephone in that we include the small business line rate as part of the core business. I believe General and Pac Bell say that they need to raise those rates and target and eliminate some of that subsidy. We would place the business rate in that core service.

An area that we definitely agree with to larger companies and the Commission is that we are not looking for deregulation. We are looking for pricing flexibility in some areas. We do not believe that deregulation is in the best interests of the company and the consumers of this state.

Contrary to a statement that was made earlier, we do not believe that deregulation in this state is on a fast track. Divestiture happened in 1984 and I have not seen, either through the legislative bodies or through regulatory decisions, a mass fast-track pace of deregulation activities. Nothing is assured, Sylvia. I think the utilities in this state have an opportunity to earn a fair rate of return. That is not assured by growth. We have to continually modernize our network and our investments and economize where possible to make sure that we are providing the best possible service at the lowest possible cost.

With that, I would like to make sure that you're aware that the assets, the resources that Continental has will be utilized in the best possible way during the upcoming en banc or OII as well as participating with you and any Assembly activities in the regulatory framework reform that we're addressing. Thank you very much.

CHAIRMAN ROSENTHAL: Thank you.

Did Mr. Pepper come in? Okay. That concludes the panel for this morning. We will break now for lunch and we will be back here at 2 o'clock.

-- LUNCH BREAK --

CHAIRMAN ROSENTHAL: We'll begin this afternoon's session with Panel A, Robert B. Stechert, Vice-President, External Affairs, AT&T Communications; and Carl Danner, Assistant to Commissioner Mitchell Wilk, Public Utilities Commission. So Stechert can start first.

MR. ROBERT B. STECHERT: All right. Senator, I'd be happy to go first but I had thought it might be more convenient for the Committee to hear from the Commission first, but I'd be happy to address you first.

I too had a prepared statement which we've made available to the Committee. I will not read that statement to you. Rather, I would prefer to describe to you briefly an overview -- what AT&T has actually applied for in terms of limited regulatory flexibility before the Public Utilities Commission. I'm sure that Dr. Danner will, in a few minutes, explain to you the proceeding that the Commission has initiated concerning regulatory flexibility in the interLATA communications market and how the Commission intends to go about addressing that matter. AT&T filed recently an application for limited regulatory flexibility. In that proceeding, the Commission originally initiated back in 1985.

I would point out to you at the outset that an integral component of the regulatory flexibility application that we filed is a comprehensive monitoring program which will review and monitor on an ongoing basis any regulatory flexibility the Commission may grant AT&T. That monitoring program was developed by AT&T and interested parties to the proceeding, including representatives from other interexchange carriers, our competitors, representatives of local exchange carriers, including General Telephone Company and Pacific Bell, and consumers and consumer-interest groups. Any party who wished to participate in that, in the development of that monitoring program was free to do so. It was publicized by the Commission; and indeed, a number of parties did participate.

We put together a detailed monitoring program under the aegis of the California Commission's Evaluation and Compliance Bureau's staff in a series of workshops that were held in August and October of this year. That monitoring plan is designed to measure the impact of any flexibility that AT&T has granted, both in terms of its impact on our customers and as far as the impact on our competitors is concerned. There are a series of measurements and data that the Commission will gather to determine on an ongoing basis whether or not that quality of service that AT&T provides continues to be at the same high level it has been in the past under any regulatory flexibility that we've been granted.

In addition, the Commission will monitor what's happening in the marketplace as far as competitors are concerned to ensure that competition remains viable in the interexchange marketplace.

As far as AT&T's regulatory flexibility plan is concerned, as I said, it envisions limited regulatory flexibility for AT&T. The plan would permit AT&T to change its rates in modest ways around existing rate levels. Indeed, what we would do would be to establish rate bands in which AT&T could change its rates without prior Commission approval in a very modest way -- for our long-distance services, for calls that are from 1 to 70 miles in length -- AT&T would be entitled to change its rate upward or downward by 1 cent. For calls of between 71 and 100 miles in length, we would be entitled to change our rates upwards or downwards by 2 cents. And for calls of distances greater than 101 miles, we'd be entitled to change our rates upwards or downwards by 3 cents.

Similar pricing bands would be established and would apply for other AT&T services including our WATS service, our 800 service, and our private line services that we offer principally to our business customers.

Under the rate flexibility plan that AT&T has proposed, we also make a number of

commitments that are designed to protect the interest of California ratepayers on an ongoing basis. We've committed to not geographically de-average our rates throughout the state. In other words, we'll maintain statewide average rates so that the interests of rural customers will be protected.

In addition, we commit to not abandoning service to any community where we currently provide it. We will introduce new services on a statewide basis and not in selected market areas. And we will place no restrictions on the resale or sharing of our services.

Now we've notified our customers concerning this regulatory flexibility proposal through billing inserts that have been sent out with the bills. Indeed, they went out this month through our customers and through detailed newspaper advertisements.

The plan, the application for the plan, is before the Commission. And we trust the Commission will take timely and appropriate action on it and we look forward -- we look forward to being granted a degree of regulatory flexibility that will begin to put us on a par with the competitors we have in the interexchange marketplace today. Thank you very much.

CHAIRMAN ROSENTHAL: You know, in Washington, Congress held some hearings concerning the FCC's move to allow AT&T rate flexibility. And my understanding is that the consumer groups, as we've heard here also, have defended the rate of return regulation as having been good for telephone users and the industry. How do you respond to that?

MR. STECHERT: Well, Senator, we believe that it's not been rate of return regulation that's been good for telephone customers in this country; rather, it's been the technological advancements and the management that we've brought to the fore in the telecommunications business in the past number of years that have brought the rates for services down. In fact, I believe that's been reflected in the states where we've been granted regulatory flexibility. Indeed, in those states, rates have continued to decline where we've been granted substantial regulatory flexibility, indeed much greater regulatory flexibility, than we've asked for here in California.

CHAIRMAN ROSENTHAL: But hasn't the rate of return enhanced that flexibility?

MR. STECHERT: I'm sorry, Senator. I don't understand the question.

CHAIRMAN ROSENTHAL: The technology?

MR. STECHERT: Well, certainly, the technology has brought our rates down; and that has enabled us to continue to, to pass on savings to our customers, even in states where we've been granted regulatory flexibility.

CHAIRMAN ROSENTHAL: The competition has indicated that rate flexibility would be permissible if the band established was narrow enough so as not to impede competition. You think that your proposal does that?

MR. STECHERT: Yes, I believe it does, Senator. The bands that we have called for are very narrow. And in addition, as I pointed out, the Commission would adopt a comprehensive monitoring program to determine whether or not any flexibility we exercise may be having an adverse effect on our competitors. We don't believe it will. But if any adverse consequences should arise, the Commission would be in a position to step back in and take any appropriate regulatory measures. We, we don't ask to be deregulated. Indeed, we believe the Commission will continue to exercise

significant regulatory control over us under the plan that we've put forth.

CHAIRMAN ROSENTHAL: Why was the monitoring board established before you even made an approach to the PUC?

MR. STECHERT: Well, the Commission in its order indicated that it felt that it would be appropriate, if it was going to consider regulatory flexibility for AT&T, to monitor what happened if we were given some regulatory flexibility. So it set in motion a process to begin to develop a monitoring program and parallel with any application that we might file. So it was simply a procedural way that the Commission had of trying to address how we might be given regulatory flexibility and getting at the question of monitoring the Commission's concerned with.

CHAIRMAN ROSENTHAL: Senator Russell, do you have a question?

SENATOR RUSSELL: We heard from an earlier witness on the panel, on one of the panels, a concern about the technological advances and the expense and so forth. And there was -- the impression I got was that a lot of these technological advances don't go to the benefit of the rate, basic ratepayers. Do you -- would you care to -- were you here this morning?

MR. STECHERT: Yes, I was, Senator.

SENATOR RUSSELL: Would you care to comment on that?

MR. STECHERT: Well, I think some of the comments this morning were directed to the question of the fiber optic networks and some of these things that were being introduced. But ...

SENATOR RUSSELL: Well, that was just one that was mentioned. But the impression I got was the modernization, the technological improvements that were being inculcated into the system.

MR. STECHERT: Yes. I think, as far as AT&T is concerned, I would say that technological advancements have benefited our ratepayers as a whole. Our rates have come down markedly since divestiture. Indeed, here in California, they've dropped some 24 percent from the levels that they were at, at the first of 1984. And that's true for all our customers, our long-distance customers as well as our business customers. We we would intent to continue to flow through benefits to our complete body of ratepayers.

SENATOR RUSSELL: Do you think that's a different scenario for the local telephone companies?

MR. STECHERT: I can't really address what the local companies may or may not do. I believe, that as far as I'm concerned, as far as AT&T is concerned, we've seen the benefits of advances that the local companies have made and the rates that they charge us for the access services that we purchase in order to provide long-distance services to our customers. And indeed under the Commission's plan, those access charges should continue to decline over the next number of years and we would expect to see those decreases and access charges reflected in the rates that we charge our customers.

SENATOR RUSSELL: Well, I always have felt that technological advances, since the beginning of the industrial revolution, has resulted in lower prices to more people. And so I was a little surprised to hear that presentation made. Although perhaps, maybe some sophisticated equipment that's primarily used for the larger companies was what was being referred to rather than a benefit

that the regular ratepayers would use. But I just -- I felt that technological advances does improve, does lower the costs. And that's basically your experience in your company?

MR. STECHERT: It has been, yes.

SENATOR RUSSELL: Thank you.

CHAIRMAN ROSENTHAL: One final question. What do you determine to be the greatest indicator of competition existing in the telecommunications environment?

MR. STECHERT: I think there's several measures, Senator. First of all, there are major facilities-based carriers providing service now nationwide.

CHAIRMAN ROSENTHAL: Well, let's talk about percentages. What becomes competition?

MR. STECHERT: Well, I think that one can't simply measure the amount of competition based on market share and market share alone. And indeed, that's what other states have found; that if granted, AT&T regulatory flexibility. The real measure of competition is whether or not there are viable competitors; they're in the marketplace providing services; and whether or not there is sufficient capacity available in those other carrier systems to meet the needs of customers. And both of those -- both of those matters obtained today in the marketplace in California, both U.S. Sprint and MCI, have significant facility capacities in California to meet the needs of customers. And Californians have a wide choice of carriers other than AT&T for services. Indeed, there are over 100 competing carriers currently certificated in California today. That, I believe, forms the basis for significant and sufficient competition. And the Commission's plan and the plan that we filed with the Commission for regulatory flexibility would provide us with a limited amount of flexibility to begin with; and the extent and the viability of that competition can be measured on an ongoing basis on a monitoring plan. So I believe that the amount of competition that's there today is sufficient and that our plan and the Commission's monitoring plan together will ensure that ratepayers will be protected.

CHAIRMAN ROSENTHAL: Okay. Thank you.

MR. STECHERT: Thank you.

CHAIRMAN ROSENTHAL: Carl Danner, Assistant to the Commissioner Mitch Wilk of the PUC.

DR. CARL DANNER: Good afternoon, Mr. Chairman, Senator Russell. Thank you for the opportunity to be here and represent Commissioner Wilk and the Commission.

What I'd like to do as an opening statement and answer your questions is just to go into a little bit of the background that led the Commission through its investigation into AT&T and has led to the situation where we're now considering the application that AT&T has made for some price flexibility. In contrast to the local exchange side, as was discussed this morning, the Commission has gone a significant distance in its investigation into the long-distance market; whereas in the local exchange side, they're just starting.

The long-distance market became competitive through two major changes that were not of our making. Really, that came out of the federal level. I'm sure you're familiar with the FCC's policies of encouraging competition through entry and which led the justice department to file the antitrust suit and we led into divestiture. The Commission has been trying to cope with the consequences of

that ever since.

Basically, it seems that at the federal level there's been a social choice made that we're going to try to have a competitive market in long distance. The Commission's problem at divestiture is what to do about that. The solution the Commission came up with, I think, made a great deal of sense at the time and it was to set up the dominant and non-dominant framework which indeed continues to this day where AT&T was regulated as if it were a full monopoly with full cost-of-service rate cases. And the other smaller long-distance companies had a great deal more flexibility to set prices as they wished, offered service where they wanted to, and so on. A number of factors, especially pointed towards that, looking at equal access problem, it took some years to move along towards equal access. We're getting fairly close to that goal today. But in anticipation of requests by AT&T for deregulation and in recognition of this overall social choice of a competitive market, the Commission did start its investigation in late 1985 to consider how, whether, or when it would undertake some regulatory flexibility or deregulation for AT&T.

The OII focused on something we -- well, economists -- tend to call "market power," which is basically the ability to set prices significantly above cost and keep them there, despite what your competitors may do. And, of course, there are a couple of bad things that can occur through the unbridled exercise of market power and that's reason why the Commission is here. You can charge captive customers too much for service. That's certainly unfair. You can also take those proceeds and cross-subsidize predatory pricing and put your competitors out of business. That's also bad public policy to permit that to happen.

The Commission took a wide range of written and oral comments in the OII and then decided to conduct a benchmark rate case for AT&T. The idea was to figure out what the costs were and then come back to possibly considering flexibility, once having those costs established as a basis. The Commission went through that rate case. It proved to be a very difficult undertaking. Parts of it, small parts of it, are still continuing. It should be wrapped up soon. And then we came back to the OII and the thinking that led into the decision under which AT&T has now filed its application. And if I might, I'd like to share a little bit of the reasoning that the Commission used in coming to its decision and describe exactly they have done.

The problem is that you -- if you know that the market would be competitive, absent regulation, that AT&T would not have significant market power, that it's competitors could keep the prices down and offer a lot of range of options, then you wouldn't want to regulate it. You would like to have flexibility, or perhaps complete deregulation if the market were working quite well. On the other hand, if you thought that AT&T would continue to exercise significant market power without regulation as a protection, then you wouldn't want to deregulate and you wouldn't want to offer flexibility. The difficulty was in trying to predict that. The way we had initially set up the OII, we basically placed the burden on AT&T and said: Come in and justify to the Commission, that you no longer have this market power. If you can do so, then the Commission may consider some flexibility for you.

We got a large quantity, enormous volumes of learned testimony, exhibits, and evidence, and

determined that it was very difficult to determine in advance what would happen, were one to relax or remove regulation from this market. At the same time, the Commission was concerned, that if competition were viable or workable, that they didn't want to deny the benefits of it to California consumers due to this kind of evidence or prediction problem. So the Commission developed two alternatives in its decision last July -- one called the "prediction approach," where, if AT&T desired a great deal of flexibility or deregulation, they would have to make a very substantial showing to convince the Commission that there was no market power. Alternatively, an observation approach, where the Commission might grant to AT&T a very limited amount of pricing flexibility, carefully monitor the results. And if the results were good, then permit the flexibility to continue or perhaps to be expanded. On the other hand, if the results were bad, pull back on the flexibility. So the Commission has laid out these two options for AT&T, the application that Mr. Stechert described to you that's now at the Commission; and in the early process of being considered, uses the observation approach.

And in response to the earlier question that was asked, the Commission placed so much emphasis on the monitoring of the outcomes in the market for customers and ratepayers of all sorts that it ordered workshops to begin on the monitoring program immediately after the decision so that we could get a better handle on market developments, regardless of whether AT&T submitted an application, whether the Commission granted some flexibility, or the timing of all that.

So where we stand today is that AT&T has made its application before the Commission; we're in the process of receiving some replies and responses from other parties; and the Commission will begin active consideration of the application shortly.

CHAIRMAN ROSENTHAL: What is your view of the present competition environment in California for long distance? You really believe that there's a competitive market?

DR. DANNER: Well, Senator, that's a very difficult thing to determine. One can look at a wide range of markets in the American economy that have sort of a similar structure, a dominant firm in a -- what's sometimes called a "competitive fringe." Some of them seem to work reasonably well. One might look at the computer market, you know, high-tech industry. Others don't seem to work so well. It was the difficulty of precisely determining the degree of competitiveness in advance that led the Commission to develop these two approaches. So the Commission hasn't made a formal finding as to how competitive the market is. I think one can argue, and indeed a number of people did argue before the Commission, that it is very competitive or not very competitive at all. And they all used the same facts to justify their point of view. A great deal depends on what behavior you think would occur in the market absent regulation.

CHAIRMAN ROSENTHAL: Well, I guess basically the question is: What should the PUC's position be toward those long-distance companies and resellers smaller than the Big Three? And there's some suggestion that there may not be a Big Three anymore, on the way to maybe two. Do you have a responsibility to encourage as many choices as possible; and how do you do that?

DR. DANNER: That's a very good question, Senator. The Commission has not formally adopted the protection of particular competitors as a goal in itself. But obviously competitors are the

essence of competition. Without viable competitors, you don't have choices; you don't have competition. Indeed, if the result of flexibility of the Commission may offer here -- or that may be offered by the FCC or in other states -- were that we were converging rapidly on a monopoly market again, my feeling is that the Commission would not hesitate to reimpose full regulation.

CHAIRMAN ROSENTHAL: Do you have any -- when I think of competition -- and this may be my own personal biases -- I look to see what percentage of the market one has. And it's not the same in the computer area, for example. Everybody knows about IBM. There are several companies that are competing with IBM and have large portions of the market. When I look at AT&T, as compared -- you know, if they have 80 or 85 percent of the market, or whatever that figure happens to be, and all of the others combined have 15 percent, I just begin to wonder whether that really is competition or not.

You see, my problem -- I guess I'd like to know whether you're giving up jurisdiction of long-distance oversight in terms of percentage of the market.

DR. DANNER: Well, Senator, market share is one important measure of how competitive the market is, particularly as it changes over time. If you find that competitors, despite their best efforts, can't increase their market share, then you may have one indication that the market is not very competitive. The Commission has not, and I do not believe intends to, cede any of its jurisdiction over long-distance companies. Indeed, the monitoring program, I think, may represent a more viable and active form of oversight than is exercised over a number of other regulated markets. But I agree, it is a vexing situation. And people -- very intelligent, eminent people -- argue persuasively on both sides of that issue.

CHAIRMAN ROSENTHAL: Okay. Thank you very much. May call upon you for responses later.

Panel B, if you will join us here at the front. Sit behind your name. And if your name is not right, please let us know. I'm sorry about the mistake I made this morning.

MS. SIEGEL: Do I get to make my original statement at this time?

CHAIRMAN ROSENTHAL: Looks like Ken is here.

MS. SIEGEL: That's all right. I'm not going to ...

CHAIRMAN ROSENTHAL: When the panel is finished, we'll have an open mike for a few minutes for those who would like to add something that has not already been said. Right, Sylvia?

MS. SIEGEL: Fine. Thank you.

CHAIRMAN ROSENTHAL: Okay. Mary Wand, Manager of Regulatory Affairs, Pacific Division of MCI. There's a button alongside of you to push.

MS. MARY WAND: Got it.

CHAIRMAN ROSENTHAL: To speak or to be heard.

MS. WAND: Good afternoon, Senator. My name is Mary Wand. As you noted, I'm Manager of Regulatory Affairs for MCI's Pacific Division. This involves -- basically, I handle all of the division's appearances and activities in front of the CPUC and at the FCC also and where there's overlap such as today. I also handle a lot of legislative matters. I feel like this is in my ...

CHAIRMAN ROSENTHAL: It picks it up pretty well. You don't have to ...

MS. WAND: Okay. I feel like it's right in my face.

CHAIRMAN ROSENTHAL: Put it down.

MS. WAND: (Chuckle) Okay. I have prepared a statement for you, which I believe has been handed out. And I won't go into the details. I'll let you review that. What I'd like to do is point out a couple of the major points I make in there. And you'll note, as you have an opportunity to review that, that I make a very strong distinction between the regulatory treatment that is appropriate for a local exchange company, as we discussed this morning, and what is appropriate for a carrier such as AT&T, a competitive long-distance carrier. And I'll also touch on a subject I know that there's a significant interest in which is why some folks believed, at least, that MCI suddenly switched course and began advocating regulatory flexibility for AT&T after taking quite a distinctly different position for many years. And I hope I can answer some of the questions you may have in that area and leave you with an understanding of what went into our decision to do that.

First, let me hit, however, on why we take the position that it's appropriate to maintain strict regulatory guidelines for the local exchange companies; but at the same time, it is reasonable to subject AT&T to less regulation. The distinction lies solely in the existence of competition. Regulatory regulation exists as a surrogate of competition where a carrier does not have the threat of the marketplace to constrain its behavior. Then we need a regulatory body to ensure that.

However, I think it's important to recognize, that just because competition exists in a legal sense, in that a regulatory or a legislative body has taken away the legal barriers to entry, that open entry itself does not constitute competition. And I think one of the best examples we have of this right now is in the access market, the exchange access market in California. There is not a ban on what has become known as "bypass" in California. If an interexchange carrier or a customer wishes to bypass the local exchange company and directly connect to the interexchange carrier, they're allowed to do that; it's not illegal. However, I notice in Judge Greene's recent Triennial Decision, he found that only 24 cases of true bypass existed in the United States. Now if there's no legal prohibition against it, why are there so few cases?

Well, there are so few cases because, while there may be open entry, there's still a technological limitation against it. The primary services of the local exchange companies, which are exchange access and the exchange services, the basic exchange rate elements, still are natural monopolies. We're just not going to see carriers going out that are duplicating the copper payer in the ground.

The interexchange industry, however, this is not the case. And is that fuzzing coming from my mike?

CHAIRMAN ROSENTHAL: It seems to be okay.

MS. WAND: I can -- I don't know if it's bothering you.

Several years ago, the courts recognized this when they ordered AT&T to divest itself from the basic exchange services that it also provided. The courts recognized that there was a potential for competition in the long-distance industry, that it was evolving into something that could be a

competitive marketplace separate and distinct from what the local exchange carriers were doing. At that time, in the beginning of 1984, merely spinning off the local exchange companies did not suddenly create competition; though it did open the potential for it to develop.

CHAIRMAN ROSENTHAL: So you're more concerned about Pac Bell's rate proposal than AT&T's?

MS. WAND: Frankly, we're concerned about both of them. But I want to make it clear that we're equally concerned about both of them, that deregulating exchange and basic exchange service -- access services -- is as important to MCI as the regulatory flexibility proposals for AT&T. We depend upon Pacific Bell and General Telephone and the other local exchange carriers for access to our customers, and any proposal for flexibility of what is a monopoly service concerns us.

CHAIRMAN ROSENTHAL: But the local service and the access charges are noncompetitive.

MS. WAND: That's correct.

CHAIRMAN ROSENTHAL: And that's part of your problem.

MS. WAND: That's part of our concern that they are natural monopoly services which we must obtain in order to do business.

CHAIRMAN ROSENTHAL: So you don't think that they should be flexible then?

MS. WAND: That's correct. They have a very strict regulation. There is no competition there; and where there is no competition, regulation should remain. It is a fundamental principle.

CHAIRMAN ROSENTHAL: Okay.

MS. WAND: Getting back and leading into why does MCI now state that it's reasonable for AT&T to be looking at regulatory flexibility, I think it's fair to say that ever since divestiture we have always taken the position that the day would come when a competitive market had developed to the point where strict regulatory oversight of AT&T was no longer necessary. And as our very outspoken chairman, Mr. McGowan (?), has always said, when the time come, we would let you know. Well, earlier this spring, we decided the time has come and we let everybody know. We've quite allowed press release in quite the big bang (?).

Several things led us to this conclusion. Essentially, we believed that competition had come about or AT&T was no longer requiring strict oversight. They still are a dominant carrier. We don't propose to say that all regulatory oversight should be eliminated, and clearly market rules are still necessary as they are the dominant carrier. However, several things did happen.

Primarily, early this year, we essentially had three major nationwide facility-based carriers. The bottleneck which AT&T once had -- and they did at the beginning of divestiture have bottleneck over certain facilities. There were were no alternatives in certain areas. The marketplace has developed and there are now at least three nationwide carriers and then many smaller carriers which are reseller/facility-based carriers, which also have developed significant networks of their own. There's probably not a spot in the country where you don't have the choice of at least two long-distance networks.

CHAIRMAN ROSENTHAL: How about rural areas?

MS. WAND: Even in rural areas. We now, MCI now, serves over 95 percent of the converted-

end offices in California. So we're getting there. And Sprint, if we're not there, Sprint usually is with their fiber network. So the country is pretty well covered in terms of alternate network choices.

Also this spring essentially AT&T's last, what you might call, monopoly service, was eliminated. And I'm referring here to 800 service. MCI and Sprint both wrote out their own 800 services earlier this year. That and the introduction of switch WATS services earlier this year essentially gave every possible customer a choice of services.

In addition, in the next few weeks, MCI will also be introducing operator services which will eliminate yet another last fashion (?) of AT&T. And we will have international dialing capability anywhere that AT&T goes. So there's no longer a single choice for any one customer.

And also importantly is the continued progress towards equal access that has taken place. In California, we have over 80 percent of the lines converted to equal access. It's not all. The process will have to continue, but that's a significant progress over the last few years and I think that those -- all of those factors working together led us to believe that AT&T really cannot dominate any one marketplace and that customers do have a choice.

CHAIRMAN ROSENTHAL: Okay. Thank you very much.

MS. WAND: Thank you.

CHAIRMAN ROSENTHAL: James Fisherkeller, President of California Association of Long Distance Telephone Companies.

MR. JAMES FISHERKELLER: Yes. Good afternoon, Senator. I guess the rest of the Committee isn't here at the moment. My name is Jim Fisherkeller and I am the President of AMERTEL, but I'm not here as AMERTEL today. I am here as the president of CALTEL. CALTEL is an association of about 30 resellers ranging in size from U.S. Sprint to small single switch companies like my own, serving a very small subscriber base. CALTEL was formed in 1984 and has participated in a number of your legislative hearings. I believe we were here about two years ago today.

I'd like to talk a little bit about who we are, what we are in California, and what we can continue to contribute in this state to California telephone users. As I noted earlier, we represent businesses of widely varying sizes and operating characteristics. U.S. Sprint is our largest member and provides long-distance service across the country, largely through its own facilities, very much like MCI. Our small members provide service to single communities and have historically done so by reselling the services of other carriers.

Despite the disparity in our sizes, we have much in common. We all think we have something attractive to offer to long-distance users. We all view AT&T as our principal competitor; however, we also compete quite vigorously with each other.

Having borne certain burdens created by divestiture, it would be a shame if the public didn't receive the promised benefits of divestiture. The public would be ill served indeed if the monopoly in long-distance service formerly enjoyed by the Bell system was ultimately replaced by an oligopoly consisting of a few carriers. Should that occur, one would expect that a relationship between these carriers' rates would develop, such that the rates of all would rise or fall with those of the dominant

carrier -- a truly distressing thought if that dominant carrier is freed from traditional rate base, rate of return regulation.

If the consumer is to truly benefit from competition on the provision of long-distance services, it is essential to maintain the competition that has developed between non-dominant carriers, not just between those carriers and AT&T. Small- and medium-size IECs can, you know, nip at the heels, so to speak, of the larger carriers to ensure that they do not grow complacent with the stable market share.

Moreover, in many small communities, our smaller members -- now frequently referred to as resellers -- provide the only alternative to AT&TC. In some communities, access to the networks of the larger OCCs is technically available but those carriers do not actively market their services or maintain offices.

Our members who provide this competition have done so despite some difficult operating constraints. I am not here today to second-guess these regulatory decisions, although I disagree with some of them.

Is the all-important question of -- well, first problem that we've had is the all-important question of access charges. California's intrastate access charges were far less favorable for the new competitors of AT&T than those adopted by the FCC for interstate service or by other states, notably New York, for interstate service. Our counterparts in other states fared considerably better than the California companies in the early days of long-distance competition.

Second, we in California simply got a later start than our counterparts across the country. The competitive long-distance business is far more a mature industry in other parts of the country than it is in this state. Interstate competition was not even authorized in this state until January 5th, 1984, four years ago, less than four. A company that could offer interstate services only really couldn't offer much. Given the large size of the state, the demand for long-distance services with interstate as well as interstate capability was bound to be more acute than in other small states. Yet, no one could, except the then existing Bell system could, offer a combined product until 1984.

Third, and of great relevance to today's hearing, is the fact that when interstate competition was finally authorized, two of the states' most important interstate markets -- San Francisco/San Jose and Los Angeles/Orange County -- were excluded from the markets available to the long-distance companies. This committee has heard the arguments for and against permitting intraLATA competition many times and I won't dwell on those points now. You should be aware, however, that it is tough to compete when one cannot include major traffic corridors such as these in marketing materials.

The net effect of all the factors that I have mentioned has been a very slow development of competition in this state, a result somewhat at odds with California's image as a national leader in the provision of technologically oriented services. While there were many long-distance companies only two years ago, few attracted the financial resources necessary to make the essential transition from reselling the services of others to installing their own facilities or at least leasing flat-rated transmission services. Most of the companies that started out in 1984 are gone.

And just to diverge from my comments, I believe there were over 200 companies certified in this state at one time. Although I don't know the precise number, there are certainly less than 50 that still exist today. Some were just poorly run; others found too late that the regulatory environment here in California was simply not like that in other states or at the federal level.

Over the last two years, our industry has been marked by a significant level of consolidation. Companies have merged or developed ways to share transmission capacity in an endeavor to remain price competitive by maintaining economies of scale in their operations. As these economies are achieved, the resulting entity becomes a far more attractive candidate for capital placement, the capital necessary to construct facilities and to hire qualified personnel to operate those facilities. Today, while many of our members still resell the services of other companies, very few rely on the sale of AT&T WATS. There is a growing carriers' carrier market which is developed, products designed as wholesale products.

Finally, there is a much greater emphasis today on service competition. Given the present structure of access charges and the gradual fall on AT&T rates, many of our members are finding that it is important to commit significant resources to keeping customers they acquired through price competition by emphasizing service. Some customers want certain types of billing formats or cycles. Some want advice on phone systems, et cetera, et cetera. Some just want a regular phone call. Many of our members find that they can provide the greatest service to the customers by simply being a single source of information and assistance on telephone matters, a source that is frequently located just down the street or as personally known to the customer through other settings and the source that generally wants the customer's business.

We need a regulatory environment that recognizes the importance of competitive long-distance industry in this state. The California Public Utilities Commission took a very positive step in that direction last June when it adopted an access charge transition plan, jointly proposed by our association and Pacific Bell, in order to permit our members a reasonable amount of time to make the transition to their own facilities or to flat-rated transmission mediums before very dramatically increased access charges.

CHAIRMAN ROSENTHAL: Would you sum up, please?

MR. FISHERKELLER: Yes, sir. The point I just made, I'd like to reemphasize that that's probably the only example I can give you that the Commission has directly supported that I feel the Commission has directly supported the competitive industry -- let me skip back to my summary comments.

Our concern is how quickly the Commission has moved towards actively considering the deregulation of AT&T called "rate flexibility" at the moment. Our perception of rate flexibility is that it's just inconceivable to us as to who's to benefit from rate flexibility other than AT&T. And we invite and encourage this committee to step in and actively oppose this proposal which threatens our ability to exist, in our opinion, and does nothing for the California consumer, in our opinion.

Specifically, the Committee, we're encouraging to sponsor legislation which would impose a three-year moratorium on AT&T rate flexibility by requiring the dominant long-distance carrier to be

regulated on a rate base rate of return through at least 1990. During that period, the Legislature can study the issue itself to determine whether there is any public interest that would be served by relaxed regulation of that company. If the Legislature believes that an early termination of the moratorium is warranted, it could enact subsequent legislation so providing.

Secondly, before even considering relaxed regulation of AT&T, the Legislature should act aggressively to promote the health of the long-distance industry in California; and we would be happy to work with your staff to identify specific areas where legislation would eliminate unnecessary constraints on our ability to grow and attract capital to this state. Certainly one area which requires immediate attention is the archaic requirement of requiring commissioner approval on mergers and acquisitions of non-dominant long-distance companies, a law that was originally written in 1915 to ensure that monopoly providers of utility services did not dispose of assets, essential to a continuation of service.

Before closing, I want to touch on one other crucial issue before the Commission in 1988. The investigation into the requisition -- investigation into the creation (?) of local exchange carrier members of the intraLATA panel -- have or will address some of the issues in that proceeding. The one of greatest interest to our members is the question of intraLATA competition. California has some LATAs that are bigger than some states. We would hope that the Commission would finally see fit to open up those markets to competition. Of course, in an environment of intraLATA competition, the local exchange carrier becomes the dominant intraLATA carrier and should be regulated accordingly.

I want to thank the Committee for the opportunity to participate today and for having the foresight to conduct this hearing. As we enter a year of important policy decisions affecting long-distance competition, a year from now, I hope we can look back and say that 1988 was the year in which the common interest of the long-distance users and providers were well served by those who have such a tremendous impact on them. Thank you, gentlemen.

CHAIRMAN ROSENTHAL: We appear to be getting mixed signals here. The first witness indicated the approval of the idea of flexibility. And I take it that Sprint is also of that opinion.

MS. ROBIN QUIROZ: I'm going to talk to you about that in a couple of minutes.

CHAIRMAN ROSENTHAL: Okay. Other -- the other long-distance carriers, smaller than both MCI and Sprint, feel that it would not be a good idea for this competitive market. I'll make a comment after I hear further about what some of the others feel about this particular aspect.

James Gordon, Governmental Relations Director of Communications Workers of America, #9.

MR. JAMES GORDON, JR.: Mr. Chairman, Senator Russell, thank you for the opportunity to appear before your committee this afternoon. Even though this is the long-distance portion of the hearing, our comments will try to also address the local telephone company provider issues as well.

The Communications Workers of America represent about 72,000 workers in California -- employees of Pacific Bell, General Telephone, Continental Telephone, AT&T. And as we see it, there are a couple of problems which exist under, and perhaps, or as a result of, current regulatory practices of the California Public Utilities Commission. They are, one, extremely long and

protracted proceedings or procedures used to handle rate cases. The process of handling rate cases, in our opinion, needs to be accelerated or streamlined so that a rate case filed in 1983 is not still pending in 1987 or 1988. This is not good for the companies; it's not good for consumers or ratepayers.

The practice -- another issue is the practice of regulating some companies but not others, all of who are engaged in the same service provisioning. This does not foster lower competitive-driven pricing for the consumer and ratepayer. This holds -- this issue holds both for the local companies as well as the long-distance companies.

CWA supports flexibility of rates where there is a competitive market and regulated tariff companies are not sole providers but are competing or trying to compete with nonregulated providers. Introduction of new services by regulated companies should not be unduly delayed by regulators while their competitors' products are allowed to immediate entry.

CWA also supports the belief that the California Public Utilities Commission, particularly the Public Staff Division, is not and should not be a party at interest in the collective bargaining process between regulated utilities, telephone or otherwise, and the labor unions which represent their workers. We feel very strongly about that. We feel that if the PUC cannot voluntarily avoid the temptation to interfere in collective bargaining that perhaps a legislative solution should be considered.

Changes in the telecommunications industry since divestiture and through divestiture have caused many to seek new approaches outside the realm of the regulators -- some good and some bad. For instance, the State of California's Division of Telecommunications and the Department of General Services have recently issued a Request for Proposal for a network called CALNET. You may recall several years ago a derailed legislative proposal called CALCO. CALNET, as proposed, will ultimately result in a state owned and operated telecommunications network spanning the length and breadth of California on which practically every level of state, county, city, school, and other government, level of government, will operate instead of the public network. Notwithstanding the issue of whether this will be good or bad for the public, or the public network, certainly our concern is the jobs of existing union workers now performing this work through unionized vendors such as Pacific Bell, General Telephone, Continental, AT&T, and others, and those jobs may be at risk.

Another area needing more scrutiny is the private ownership of public coin telephones. Something that has been missing, and has so far mostly been neglected, by regulators and legislators and corporations during the past changes in the telecommunications industry, is the recognition that employees of the telephone companies -- those that help built this telephone system that used to be a pretty good one -- are a resource, just as valuable as a public network, the value of a piece of stock, or a new piece of technology. This is particularly so if you are one of the more than a hundred thousand telephone workers whose job has disappeared in the past three years since divestiture. Any further changes in the structure of the industry should include protections for employees; new policies should be fair and compassionate; longstanding, experienced, and skilled workers should not be sacrificed as we enter this new era; new jobs created by changed industry rules should be first

filled by qualified existing employees, particularly those facing layoff, and second, by previously laid off skilled workers. Only after utilizing these processes should local telephone companies and others be allowed to hire new, inexperienced employees. Consumers, telephone companies, and workers alike would benefit from such an approach. And we thank you for the opportunity to appear.

CHAIRMAN ROSENTHAL: Well, are you saying that these rate proposals will affect the employees?

MR. GORDON: Not only are we saying they can affect the employees, many of the rate proposals have -- or actions of the Commission have affected employees.

CHAIRMAN ROSENTHAL: Okay. Thank you.

Robin Quiroz, Manager, Governmental Affairs, U.S. Sprint.

MS. ROBIN QUIROZ: Thank you, Mr. Chairman, Senator Russell. First of all, I guess I can sympathize with the perceived confusion about a lot of different thoughts and ideas about the approach to rate flexibility.

CHAIRMAN ROSENTHAL: Yeah. What has changed in one year's time?

MS. QUIROZ: What the issues were last year are the same issues this year but the approaches are different. And it's because this is a very fast-pace, dynamic industry that's moving quite rapidly. And a lot has changed in the past year -- you just asked the question -- equal access. We've continued -- we had a 30 percent increase over the last time I testified at this hearing -- what, November of '86 to now -- 30 percent increase in equal access conversions. We're about 94½ percent complete in California. We have a reduced reliance on AT&T's facilities for purposes of leasing because we are near completion of our nationwide fiber optic network. That will be complete sometime around mid-1988.

Mary Wand mentioned the introduction of 800 services. We've had that. We have more international services. We cover about 95 percent of the world traffic now. We had nowhere near that last year at this time. I believe we had service in about 35 countries last year at this time. We're now in over 80. We've introduced operator services, and you're all too well aware of what's been going on with the FCC. And a variety of other states have already introduced some form of rate flexibility or deregulation.

CHAIRMAN ROSENTHAL: Just one question. Would you be just as happy if the rates were coming down instead of going up?

MS. QUIROZ: Depends on what services we're talking about.

CHAIRMAN ROSENTHAL: You know, supposing the major operator decided to reduce the figures because they're asking for plus or minus, and supposing they thought that by asking for a reduction they might eliminate one of you.

MS. QUIROZ: Let me say -- you're asking an individual who represents the company that lost \$463 million last year. We are certainly not making a profit. And you're talking about rates going down further? I'm going to kind of lead into another subject then with that question and that has to do with access charges. Mary already alluded to it. And any consideration of regulatory rate relief or carving out a new approach to the regulatory framework for Pacific Telesis has, at the heart of it,

is the access charges. We pay over 50 percent of our total operating cost for access charges.

You're asking me if our company would be happy if the rates go up or down. Our rates are really determined by the market. It's not a matter of what we're going to be happy with. It's a determination by the market.

CHAIRMAN ROSENTHAL: I understand that the market should set the rates. But what if the large one decided to eliminate you or to create another loss this year or next year and the year following? I'm trying to get you to ...

MS. QUIROZ: Okay. Well, let me tell you that I'm not here to advocate --

CHAIRMAN ROSENTHAL: No, I understand.

MS. QUIROZ: -- rate flexibility for AT&T.

CHAIRMAN ROSENTHAL: Okay.

MS. QUIROZ: I want to ...

CHAIRMAN ROSENTHAL: Okay.

MS. QUIROZ: I want to clarify that.

CHAIRMAN ROSENTHAL: All right.

MS. QUIROZ: I think you may have a perception that I'm here to do that.

CHAIRMAN ROSENTHAL: All right.

SENATOR RUSSELL: Are you opposing?

MS. QUIROZ: No. We're not opposing it. We're saying it's -- we support the reexamination of the whole regulatory framework by the PUC's efforts, their recent decision. And furthermore, we do not believe that rate bands are synonymous with deregulation. In one form of regulation, a rate banding looks at the price as an indicator of the regulation; whereas rate of return really looks at the company's overall earnings. So it's just a different style and manner of regulation.

CHAIRMAN ROSENTHAL: Okay.

MS. QUIROZ: And we believe, and I've argued this before this committee before and to you individually as well, that any kind of an analysis of competition has to take place and has to be a part of any legitimate decision to move into alternative regulatory frameworks such as rate banding as a replacement to cost of service regulation. We presented this argument before the PUC with the rate flexibility case on AT&T and we lost that argument. As you know, the Commission's more inclined toward, what they call, an observation approach whereby they're going to go ahead and implement the regulatory flexibility in form of a rate band proposal perhaps. And then later, they're going to analyze and review the effects in the marketplace of those bands. We did not ask for that. We're just -- that's what the PUC is moving towards. And one of the reasons, as you know, the PUC is looking at that is because there are so many difficulties in determining to what extent there is really competition in the marketplace. They don't know; they don't know how to measure it. So they said let's go ahead and try the observation approach.

There are several keys, we believe, in any kind of success if you're looking at a rate banding proposal. And we believe that one of the keys is measuring the width of the bands. If the bands are too wide, then you're going to have the opportunity for AT&T to go below the floor and basically

price under cost. And if they're too high, then you're going to present the opportunity to cross-subsidize with another service. So we believe that the bands have to be set at just and reasonable rates. And they have to be at the just and reasonable rates in order to allow competition to continue to flourish and also to provide protections to the consumers.

Also, any kind of rate banding should be accompanied by a rigorous enforcement by the PUC. Without any kind of monitoring, then the bands are really not effective at all. AT&T could go above or below the bands at any time and thereby you have effective deregulation, something that this committee and the CPUC has not wanted in the past.

We're not talking about a potential of rate banding as a permanent replacement to rate of return regulation. The problem is that you -- rate of return is not an all-or-nothing proposition. You can't just move from an environment where you have strict rate of return to suddenly deregulation, right? Where you have rate of return with a monopoly, deregulation, with full competition in the marketplace. So you have a large, grey area. What are you going to do? All we're saying is that we support an examination by the PUC to provide something to help us through the transition so we can get to full and fair competition without any of the regulation and the environment. So what is it? You know, rate bands may be one of those methods.

CHAIRMAN ROSENTHAL: You're on the monitoring committee?

MS. QUIROZ: Sprint is, yes.

CHAIRMAN ROSENTHAL: Sprint is? What is your role then?

MS. QUIROZ: We have some concerns. We believe that there should be effective monitoring by the CPUC. We have some concerns that the staff of the Commission would prefer to use the monitoring concept as an opportunity to have Sprint and MCI to provide very detailed data regarding customer satisfaction for our companies as opposed to merely monitoring AT&T; the point being is, that if you're going to provide any rate flexibility for AT&T, the group that should be monitored are AT&T's customers and AT&T, not to provide additional burdens on our companies.

CHAIRMAN ROSENTHAL: Okay. You want to wind up?

MS. QUIROZ: Sure. I'd like to just briefly -- a couple of other points. We do have two concerns with AT&T's proposal, and, that is, allowing complete rate flexibility for new services, the introduction of new services, and also their proposal to allow the banding for contract services.

I would like to mention that with the new services -- you remember last year, the CPUC threw out Reach Out California? I guess it was in the California business plan because those services were priced below cost. AT&T's proposal would allow them to reintroduce that in California.

CHAIRMAN ROSENTHAL: I guess I need to ask PUC -- in the providing of new services, or old services which are no longer in existence but which may come back as new services, in which there is no band as such, how will the PUC determine competition?

DR. DANNER: Well, Senator, I expect that to be one of the more difficult aspects of the application to look at. On the one hand, one would suspect that a genuinely new service might be a reasonable candidate for pricing flexibility, particularly in the sense that you don't have existing monopoly customers who are relying on it. On the other hand, it can be difficult in

telecommunications to decide exactly what is new and what is simply repackaged or revived. So I expect that to be one of the areas the Commission will focus a great deal of attention on in reviewing this application.

CHAIRMAN ROSENTHAL: Because AT&T, I think, has been accused of repackaging, quote, whatever that means.

DR. DANNER: We've heard such things, yes.

CHAIRMAN ROSENTHAL: Thank you.

MS. QUIROZ: Would you mind if I wound down just a bit and talked about the en banc hearing and access charges, maybe five, three minutes, two minutes?

CHAIRMAN ROSENTHAL: Two minutes.

MS. QUIROZ: (Chuckle) Okay. The most important concern for Sprint, as Mary already indicated for MCI, and any kind of regulatory relief for Pacific Telesis and General Telephone, would be access charges. We need specifically to have a guarantee of just and reasonable rates, terms and conditions. As I mentioned earlier, access charges comprise over 50 percent of our total operating costs. And the access to local exchanges is the only means by which we have for origination and termination of our traffic. It's absolutely vital, essential to our conducting business. It's the only way that we can reach our customers. And the only alternative would be facilities bypass, something that you're quite opposed to and we don't want to do. Judge Greene stated that only one in one million telephone users is able to bypass the local exchange network on its own. And we are asking for fundamental safeguards and any kind of consideration of a regulatory relief for Pacific Telesis, and, that is, just and reasonable rates for all local exchange services that are not subject to competition, particularly access charges and guarantees against discrimination and the provision of access and protection against cross-subsidizing monopoly services.

CHAIRMAN ROSENTHAL: Thank you very much.

Ken McElDowney, Director of Consumer Action.

MR. KEN MC ELDOWNEY: Thank you very much, Mr. Chairman. On the surface, AT&T's proposal for rate bands appears quite innocent. For example, the example that they always use of calls of under 71 miles, the company only seeks permission to raise or lower rates by a penny from the current ones. However, if the whole package is approved, AT&T will have the power to distort the current relationship between day, evening, and night/weekend rates, which presently tend to benefit residential customers. For example, on calls from your homes of more than 100 miles, the charge for the first minute and for each additional minute could be increased or decreased by as much as three cents under the proposal. The discount for evening calls, which are now 20 percent below day rates, could be as low as 15 percent or as high as 25 percent. The night/weekend discount could be set as low as 35 percent or as high as 45 percent. Operator-assisted calls could also be affected. The rate band for calling card calls would be 40 to 60 cents per station-to-station, 75 cents to \$1.25; and for person-to-person calls, \$2.50 to \$3.50. The charge for a three-minute pay phone call paid in coins could vary by as much as 10 cents from the current rate. And finally, the long-distance directory assistance calls, which are now priced at 35 cents, could be as cheap as 15 cents or as

expensive as 55 cents.

AT&T claims that marketplace forces would keep those prices in line. But the company controls 75 to 80 percent of the California market. That fact, combined with a weak financial condition as major competitors, creates a situation in which AT&T will continue to effectively set prices for the entire industry. We believe that MCI and Sprint will welcome the opportunity to follow AT&T in raising rates paid by residential customers.

It's important to remember for the last several years that AT&T has been consistently pestering the PUC for permission to raise rates in California. We believe that the rate band proposal is basically an attempt upon -- on the part of AT&T to get that permission to raise rates through rate bands when they could not get it otherwise from the PUC.

A couple more thoughts, I think, in terms of the market power which I think is a very serious concern, both of the consumers and also for this Committee. We believe that the present percent of the market that AT&T has in California and nationally probably understates their potential market power. Consumers, for the most part, at the present time in survey after survey indicate that they believe that AT&T is like 18 to 20 percent more expensive than MCI and Sprint as major competitors. Yet our most recent survey, which we conducted this summer, based on the most current rates, show that the differences between the carriers are only at most 1 to 3 percent. Yet AT&T, at least up until now, has been refusing to do any sort of advertising or direct mail pieces that focus in on price really to counter that misconception that consumers have of the 18 to 20 percent price differential.

We believe that one of the reasons why AT&T does that basically is to keep MCI and Sprint as quote/unquote viable competitors in order to get regulatory relief both at the state level and also at the national level. But we think that there's really two separate markets: One is the market for the residential customers, and there's a separate market really for their corporate customers. And we think it's important to remember the major competition in the industry is for the large corporate customer. The rate bands would permit AT&T to lower rates during the daytime when most business calls are made while leaving evening and night/weekend rates virtually the same, or in some cases, actually increasing. In essence, the rate band proposal would create a situation in which residential customers would help to fund AT&T's competition for the large corporate customer.

One of the things that both the PUC and AT&T have talked about is that basically what they're talking about is a very limited flexibility. Yet the changes in the discount periods for evening, night, and weekend are almost twice as great as the differences that AT&T is proposing now before the FCC in terms of inter -- in terms of interstate calls. We do not believe that this is limited flexibility that is basically giving AT&T great latitude.

California consumers can get a glimpse of the possible future in California by looking at what has happened in states where AT&T has already received regulatory flexibility. According to the Wall Street Journal, in at least three states that no longer regulate AT&T profits, AT&T earnings have soared while long-distance rates have declined slightly. In other states where earnings have increased, prices have increased also.

Consumer Action believes that the record in other states is far from one that would give

confidence to California consumers, that they will not be hurt by granting AT&T the price flexibility it seeks. Our telephone ratepayers should not be guinea pigs for deregulation lab experiment. AT&T's proposal should be defeated unless the company can clearly demonstrate that market forces will protect California consumers. Thank you.

CHAIRMAN ROSENTHAL: Thank you very much. The PUC -- in the last statement about other states and what's happened in other states where AT&T has received this flexibility, have you looked at any of those other situations?

DR. DANNER: We haven't looked in great detail. We do review the publications of organizations such as Mr. McEldowney's organization; we have seen some articles in the Wall Street Journal as well. And we expect to be reviewing those results more closely as we consider AT&T's application.

CHAIRMAN ROSENTHAL: Are you familiar with SB 1433, Rosenthal, Chapter 1079 of 1985?

DR. DANNER: Perhaps you could refresh my memory.

CHAIRMAN ROSENTHAL: Required the PUC to evaluate the deregulatory efforts of other states and study the feasibility of establishing an open competition pilot project in one of the state's LATAs to allow the PUC to monitor changes.

DR. DANNER: My understanding, Senator, was that was related to intraLATA competition.

CHAIRMAN ROSENTHAL: Yeah, but that was part of it. But we did ask to take a look at what other states were doing --

DR. DANNER: Yeah.

CHAIRMAN ROSENTHAL: -- competitively.

DR. DANNER: Yes, Senator. There is a detailed section in the intraLATA competition report related to those experiences in other states. I'm sorry; I didn't focus on it thinking intraLATA here in California.

CHAIRMAN ROSENTHAL: So that when AT&T stands up here and says, "Look, we don't want very much -- we just want to raise it 1 cent for 70 miles," I thought that was kind of reasonable, 1 cent, okay? But what I hear what that relates to, it becomes very significant. Does that bother you?

DR. DANNER: Well, Senator, the Commission has only started to look at the proposed law.

CHAIRMAN ROSENTHAL: I understand. I mean just on the face of it. I'm not -- maybe it's okay. I don't know. But I must tell you, that when they were first talking about, you know, 1 cent, up or down, what the hell we talking about, you know?

DR. DANNER: Um-hmm.

CHAIRMAN ROSENTHAL: But when I hear hear how that is translated -- by time of day, who's using the phone, when, and we're now talking about significant amounts of increase or decrease -- and I would venture to say the only time they would decrease would be to create some more problems for the competition, otherwise nobody cuts the price -- it appears that there may be very significant amounts of money which are raised by this process.

Maybe, you know, as you look at this, instead of the 50/50 split that they were talking about, maybe there's got to be a different kind of a -- but maybe the ratepayers ought to benefit more

percentage-wise, you know. Instead of a sliding scale going up, one that comes down. I'm just throwing it out for ...

Yeah, well, I think that if, in fact, the increases begin to take place, as they might very well, you're going to have another upheaval in the communities out there. You're going to have people absolutely knocking on my door to do something about it. I don't want to have to do something about it, you know.

DR. DANNER: If I might, Senator, you've raised a couple of very important concerns. One is the complexities of the rate structure. If you're talking about flexibility in several aspects of the rate structure, such as the basic rate, perhaps the degree of averaging -- although that's apparently not at stake here -- the discounts on time of day, add in the amount for an operator service and so on, some of those are multiplicative; some of those can add up into quite wide ranges of flexibility indeed, and that's a very important point I'm sure the Commissioner will be observing closely.

And your other point is that maybe this won't work. And I assure you that if it doesn't, the Commission will step right back in and take the flexibility away. They've committed to that.

CHAIRMAN ROSENTHAL: Yeah. Okay. Thank you.

MR. STECHERT: Senator Rosenthal, if I might, I'd just like to clarify --

CHAIRMAN ROSENTHAL: Sure.

MR. STECHERT: -- a couple of points. Senator, we recognize as well that the proposal that we put before the Commission, if exercised in certain ways, could provide AT&T with significant flexibility in various periods. However, we don't intend to exercise that flexibility and all the aspects that it might provide. Indeed, I think as Dr. Danner just pointed out, the Commission will continue to monitor what happens with AT&T's flexibility and be in a position to step back in and take control if _____ results obtain.

Furthermore, I'd like to address Mr. McEldowney's comments about the experience in other states. Indeed, the experience that we've had in other states where we've been granted regulatory flexibility has been that our rates have continued to fall. We've not seen significant increases and complaints from our customers. Customers seem to be satisfied and happy with the way they're being provided with long-distance services in those states. And we think that California can benefit from that same, from that same situation. And we think the limited proposal that we've put forth, and as you pointed out, we're asking only for a modest flexibility to change our rates upwards or downwards. And without that modest flexibility, we would really have no flexibility at all. Thank you very much.

CHAIRMAN ROSENTHAL: Yeah. Perhaps in those states where you have reduced, you may have created the financial loss we've just heard earlier which eliminates competition and doesn't create it.

MR. STECHERT: Well, indeed, I think if you look at those other states, there have not been adverse effects on competitors either. We've not seen competitors in those states going out of business. We haven't seen competitors going to the Commissions ...

CHAIRMAN ROSENTHAL: Well, they didn't go out of business. We just heard about how much money they lost. It'd be interesting to find out if they lost a larger proportion in those states where

you cut the price. That would be an interesting analysis. And I don't know that that's so. I'm just --

MR. STECHERT: Right.

CHAIRMAN ROSENTHAL: -- talking it out.

MR. STECHERT: Right.

CHAIRMAN ROSENTHAL: Okay. Thank you.

MR. STECHERT: Thank you.

CHAIRMAN ROSENTHAL: Okay. Ed Pope, General Counsel for International Telecharge, Incorporated; Dallas, Texas.

First of all, tell us what is International Telecharge.

MR. EDDIE M. POPE: Yes, sir, Senator. I do have some prepared remarks and I'll submit them for you. I'll introduce those into the record. If they are in front of you, there is a summary sheet --

CHAIRMAN ROSENTHAL: Thank you.

MR. POPE: -- on the front of the ...

CHAIRMAN ROSENTHAL: Yeah. Okay.

MR. POPE: You need to follow along.

CHAIRMAN ROSENTHAL: Right.

MR. POPE: Let me tell you what International Telecharge ...

CHAIRMAN ROSENTHAL: You're not going to read this?

MR. POPE: No, sir.

CHAIRMAN ROSENTHAL: Thank you.

MR. POPE: Just look at the summary sheet.

CHAIRMAN ROSENTHAL: Right.

MR. POPE: And that gives -- the second sheet first.

CHAIRMAN ROSENTHAL: Okay. Yeah.

MR. POPE: And that basically tells you everything that I'll tell you in the next five minutes, I hope.

CHAIRMAN ROSENTHAL: Take ten.

MR. POPE: What?

CHAIRMAN ROSENTHAL: Take ten.

MR. POPE: Well ...

CHAIRMAN ROSENTHAL: Okay. Take five. (Chuckle)

MR. POPE: _____. International Telecharge is an operator services provider. We're the newest kid on the new block in that we provide operator services for hotels, hospitals, private pay phones. And we're looking at offering some interexchange carriers like MCI and Sprint. Basically what that means, we compete against AT&T. We go out to, say, a private pay telephone and switch jobs (?), punch that zero; instead of getting an AT&T or Pacific Bell operator, you get us.

Let me tell you a little bit about me. I'm a former chief telecommunications lawyer from the Texas Public Utility Commission. So I've gone through many of the -- Texas just went through what it appears California is getting ready to go through, looking at -- determining, you know, saying that

the AT&T plan here is similar to the plan in Texas. Before that, I worked with the Oklahoma Legislature and the Oklahoma Corporation Commission so I'm familiar with the kinds of things the legislators are concerned about.

And basically, in my prepared remarks, I point out that the old system of regulation has changed. I think your staff's already told you that. We've got new challenges; we've got to figure out what to do.

The first point I want to make is the dominant carriers -- AT&T, Pacific Bell -- got to be that way for years because deregulation made them big. And you can't ignore the fact that for years they had that protective legislation and that particular regulation. And to say that after three years we're just going to go switch and change that and now start letting them loose, it gives me some concern because they've been billed for all those many years. It's going to take awhile, in my opinion and ITI's opinion, to start taking that apart. They've grown to that size because of regulation. Regulation has to stay there as that size is changed dramatically (?).

The second point I want to make is that regulation and competition are basically two sides of the same coin. Competition that you see up here, competition that you saw this morning, is a creation of regulatory decisions, decisions made by the FCC, decisions made by Judge Greene, decisions made by the California Commission. But those are regulatory decisions; and if you change the regulation, you're going to change the competitors; you're going to change the competition. You cannot change that regulation without also changing who's out in the marketplace. And so as you regulate AT&T, as you regulate Pacific Bell, you're also indirectly regulating the small companies like mine. And incidentally, we are a small company. AT&T spends more in one quarter on advertising than our entire gross revenue for a year. So we're not talking about even an even playing field here.

The analogy that I used in my prepared remarks is this bill is like having Lancaster Junior High School football team going up against the Chicago Bears. And if you want to have that kind of a game, you've got to put some restrictions on the Chicago Bears. Otherwise, they're going to fall all over Lancaster High. Now as they get big -- as Lancaster Junior High gets bigger and bigger and better and better, then you might let some of those regulations go. But you can't do it all _____. So that's where we get the kinds of step-by-step plan that I think you've been talking about already, Senator. And that's why I pointed it out again in my -- in that summary.

I think we can agree on the objectives. I don't think there's any serious disagreement on that one. We've got have people; you've got to protect universal service. I've been preaching at that church for so long, there's no way I can change just because I've switched towns. But you can protect universal service by encouraging competition into the marketplace.

Let me tell you how, Senator. You get the competitors out there. We're paying those access charges that Sprint and MCI have been talking about. Those access charges don't hold down that locally, help hold down both the rates. And even if, say, Pacific Bell is losing at a toll, there is money but they're still -- they still may be getting an access so that it's not all of a sudden, a total loss when a competitor comes along or take a cut. And that's where you have to concentrate. And I

think we have to focus on universal service to make sure that the steps we take and the Commission takes does not (inaudible).

In that regard, Senator, let me say that I don't think Pacific Bell's plan offers you a great deal. They talked about rate increases for residential services for the next -- until 1990. Quite frankly, Senator, I don't think that you can see real major increases in those, clearly not Pacific Bell's plan, if it's adopted. Pacific Bell recognizes, information (?) recognizes, as you recognize, the difficult political decisions that go on in raising those. So those aren't going to be raised regardless of whether or not you've got a social contact theory. So Pac Bell isn't giving up anything. What they're trying to get is regulatory flexibility so that they can start rolling over some of those people who are out in the field such as us.

The plan that I've indicated, the steps that I've indicated, a couple of them are basically just sort of principal and revenue, big steps.

The first step I indicated is that the PUC ought to follow what you said. I understand that you've passed some statutes. Quite frankly, coming from Dallas, Texas, I can't tell you whether or not the PUC is following each and every one of them. But I know that in Texas we had a little problem with that. I think you ought to make sure that the PUC does what you tell them to do.

The same thing, the other side of that coin, Senator, is that you need to be saying what makes sense. For example, you can't say regulate everybody the same way because we're not all the same. You can't say to regulate us like AT&T because we're nowhere near the size of AT&T. We don't have the power of authority AT&T has.

The third step, which is where I think California _____, is that competition should be affirmatively encouraged. That's where this Legislature, and where I think the Commission ought to be right now, is letting competitors into the marketplace and encouraging them to get in, getting rid of barriers to entry, getting rid of the intraLATA prohibition. I'm telling you that in Texas there is no such prohibition. All of a sudden, Southwestern Bell hasn't gone out of business. In fact, they're getting as much or more intraLATA traffic than they used to. What's happening also is that there's lots of other people out there tearing up that business and making money for Southwestern Bell on intraLATA access charges. In lowering the barriers of entry in Texas -- I'm not going to say Texas is not perfect, Senator, because I'll tell you they have -- but at least in Texas, in order to get involved in the marketplace, all I have to do is write them a letter and say here I am; here's what I'm going to be offering; here's where I want to be if you need to talk to me. So that's where I think -- you have to get out there; you have to affirmatively encourage competition to get out into that marketplace. That's how your constituents, Senator, get the benefits of competition, is by getting the competitors out there. We don't get the benefits of competition from the big boys; you get it from the competitor. We get out there; we hustle; we market; we come up with products that people really like; we have the flexibility to design a product. It's just a little bit different for folks; whereas you go to your Pacific Bell, your AT&T's, you're doing good. You know, we don't have enough; we can't make it; it will cost us too much. And if you really want it, we'll charge you for it.

And I think that attitude at least, as both a consumer and a competitor of Pacific Bell and

AT&T, we _____. For example, we service a lot of the private pay phones here in California. You probably know that private pay phones have gone to Pac Bell and said, okay, why don't you pay us a little bit of the commission that you pay your public pay phones? And Pac Bell at least, so far, has elected to do that; while meanwhile, Pac Bell, because there is competition, there's increase in the amount of compensation, commissions that they're paying to their own telephone users, to their own public telephone users.

They are an _____ what I consider to be -- they're acting like a monopoly, Senator. They're business people; they know what they've got; they'll slow roll their competitors while they're moving into the marketplace. And there's -- you can't blame 'em for it. That's what a businessman ought to do. But at the same time, you can't let them loose from the Commission and the Legislature's oversight.

After we get -- and I'll say you can probably do this about the same time -- as you get competition established, as you lower all the barriers to the competitors, you can start working on getting prices at cost so there's universal service. Universal service, we're going to have, you know, we're going to have to have specific target subsidies for it and I don't think anybody's going to argue with that. But you've to get the rest of the prices at cost; you've got to figure out a cost system, stick to it, and use it. What that's going to mean is that some people get increases. I know that that's not profitable. But if they're being offered the price of things below cost, Senator, that's an anti-competitive action that is being sanctioned by this state. It seems strange to me to have one statute that says somebody selling tomatoes can't sell them below cost if they have another statute that says the telephone company has to sell below cost.

It makes more sense to start getting these services up to cost so that everybody -- competitors, consumers -- know what they're talking about, know what they're getting involved in. After you get the costs set, after you get rates set at cost, and then that will wipe out some competitors, I'll tell you right now, because if you get some who, say, lost services up close to cost, that's going to hurt someone. But I think that gives you a logical marketplace to then start saying, okay, now we can start having some rate flexibility. And then the third point, as I say, is more of principal than a position, ought to be done on a step-by-step basis. We start dashing through it. That benefits the baby (?). They've got the capacity; they've got the monies in saying that they can handle it. If you change regulations quickly or very swiftly, what that does is those of us who've made investments in the marketplace that have just changed can't make those adjustments nearly as quickly because we don't have the money so that you have to introduce it on a step-by-step basis. And steps -- excuse me -- I've now gone below. After you get to the point where you've got _____, you start getting some _____.

The first thing you do is let them -- let Pac Bell and let AT&T do rate reductions. If they say that's what they want, well, let's give them that flexibility. I tell you what, Senator, you're not going to see a whole lot of them except in real competitive areas. That's the experience that we've already got.

New -- I think you have to let -- after you've done that, start letting them introduce new

technology, that's really a new technology, slowly and carefully, but more particularly, than having them go through full rate (?). Then, you know, once you've got some real competition is when the time you start getting them flexibility and raising the rates.

And finally, I think for AT&T, and I don't think you'll ever really get to this point, the local exchange company. I think there will come a time when you can deregulate AT&T, but it's not announced, all the time. My 10th point is you've got to monitor, you've got to watch, each step of the way to make sure that you're not _____. You're in a _____ as much as the ratepayers in the State of California. Thank you.

CHAIRMAN ROSENTHAL: Thank you very much. Sylvia ...

MS. SIEGEL: Three minutes.

CHAIRMAN ROSENTHAL: Three minutes.

MS. SIEGEL: Talking fast. Thank you, Senator. I appreciate your indulgence. I want to call your attention to the fact that this rate banding is illegal. We have in this state a Public Utilities Code. Section 454 of the PU Code states that no public utility shall raise any rate or so alter any classification, contract, practice, or rule as to result in any increase in any rate except upon a showing before the Commission and a finding by the Commission that the increase is justified.

I interpret that to mean that the Commission has to find -- make a finding of just and reasonableness of a rate, not a rate band. A rate band has altogether different implications. So I don't see how rate bands come into this business of prices whatsoever.

Secondly, I want to call attention to the fact that you heard Commissioner Wilk -- you know I'm very delicate and I never say what I mean.

CHAIRMAN ROSENTHAL: You're delicate?

MS. SIEGEL: Delicate. But I want to -- I want to call your attention to the fact that both Commissioner Wilk and Carl Danner, who are free marketers, have been pushing free markets, particularly in connection with the AT&T rate case. That case was fully litigated after six months of daily hearings. The decision was written. After Wilk came in on petition by AT&T -- now I don't know that they had any conversation with Commissioner Wilk or there was any prompting or whatever -- however, the fact remains that they were granted a rehearing for one day to put into the record some additional data that was completely irrelevant and upon which now a new decision will be based.

I just don't think that's fair. I don't think that's fair regulation to come in and reopen a case because you're not to give some kind of advantage to AT&T or any other company. I might call attention to the fact that AT&T's commercial and marketing expenses of \$200 million a year is more than the combined national budgets of Sprint, MCI, and all the other competitors combined. I think it's absolutely shocking that even the generous recommendation of the PUC staff to only allow \$95 million, was later raised to a much higher figure. I think it was \$125 million. Now, of course, they're back. So I don't have any confidence that Mitch or Danner -- Danner doesn't have a vote, fortunately -- but that Mitch or Danner are going to be in there looking out for our interests.

As a matter of fact, I think you'll recall that Mr. Wilk said that he likes weighted average basis

rather than rate of return. That hasn't even been considered in a hearing yet. What kind of predetermination is this? If we're going to have a hearing, then let's have a fair hearing on a leveled playing field. And I think if you review all of the records and the communiques that have gone out, you'll see that it's a very prejudice kind of consideration that we're going to get.

Let me tell you that raising rates by just one penny, at least on Pac Bell's system, brings in \$100 million of revenue a year. Now one penny, as you said, Senator, doesn't sound like very much. And the ordinary consumer will think, "Well, that's reasonable; that's not so bad." But wait till they get the full effect of that. You're going to hear wailing from here to San Francisco and the northern border, and I'm not going to be there to protect you, buddy.

We have to talk about social contracts. The social contract we respectfully submit is between the Public Utilities Commission, the Constitutional Agency, given additional statutory authority, and the public. It is not between the PUC and the Utilities to allow the Utilities to do whatever they want. This is not a contract in which the consumers are agreeing as one party. So I think you can abandon all of that nonsense. This is good language that benefits the companies. And I know at the NARUC meeting, they were up and down the halls lobbying like crazy.

And Senator, I'll be happy to submit to you a list of what's going on around the states, both with respect to local prices, flexibility, social contract, and so on. Just because several states are considering regulation changes doesn't mean that they're going as far as AT&T or Pac Bell or any of the other companies want.

Monitoring, we submit, doesn't mean very much without knowing the basic underpinning. And you'll never know the underpinning until you bring the companies in, until you allow the staff to go in there and look at the books and figure out what's happening. Monitoring is just looking. I've talked to people on the witness stand and I said, "Well, how did you investigate that?" "I looked at the numbers." I said, "What do you mean? You just took the sheet of paper and looked at the numbers?" And they said, "Yes." Now is that what you mean by monitoring? That's not what I mean by monitoring, particularly with companies who are slick and sly as these huge monopolies are.

CHAIRMAN ROSENTHAL: Finally ...

MS. SIEGEL: Senator, I'm winding up. I just want to call your attention to the fact that in the airline industry, at first, deregulation did nurture the consumer with fair bargains. But the healthy competition that was supposed to foster, sickened. And without competition, you will never have low fares; and there is no competition. Now all the fares are the same.

Secondly, I brought back with me a copy of the Washington Post business page for November the 24th in which it is asserted by the National Cable Television Association, is recited here, showing that Cable Television subscribers around the country paid bills 7 percent higher in the six months after pricing was deregulated last December under a federal law. This is according to a survey made by the National Cable Television Association.

There are two great examples of what deregulation can provide. I don't care whether you call it social contract, pricing flexibility, or whatever. It's all -- I can't say it here. (Laughter)

CHAIRMAN ROSENTHAL: Thank you very much.

MS. SIEGEL: Thank you.

CHAIRMAN ROSENTHAL: Does anybody in the audience feel compelled to make a statement? Yes, please come up. You have a couple of minutes. On this subject, right?

MS. JOY PALMER: Joy Palmer. I live here in Santa Monica, member of the public. I'm extremely upset. My phone bill -- first of all, there was poor service back in 1982. It was so poor. And when I complained, it got poorer -- it seems like deliberately. And I got rid of the phone and I used the pay phones. Well, suddenly, the pay phones -- I used to make Christmas long-distance calls every year. Suddenly they shot up from \$6 for 20 minutes to \$40 for 20 minutes. And this is in quarters and coins I have to provide. Then the pay phone itself suddenly is no longer a nice, comfortable booth that protects from the cold and the wet and the wind. I can't even hear; the traffic's going by so bad.

Also, even just to call 30 miles away another relative, it's 70 cents per minute, night rate. This is all in the night rate I'm quoting too. I don't feel that the poorer people are the fall guys. I don't believe in having fall guys. And if vandals are causing excess costs, you know, do something about the vandals; don't punish everybody.

I also would be very afraid to have another home phone because, first of all, it cost me like \$40 just to hook up. And the last time I got rid of the phone -- I had just hooked up a couple months before -- we were constantly being threatened with extra costs that they're going to charge us for every minute, even on a home phone too.

I miss the Christmas calls. But if my relatives don't understand, that's too bad. That's their problem. I found it's not really so necessary. I found substitutes. And, you know, once people find substitutes, they may never go back to your business at all.

Also, I don't understand why I can call north to area code 818, a different area code, and it's a local call. But if I want to go a few miles south of here, I have to pay extra. And it doesn't make any sense. Now any business is based on trust, which is totally destroyed now. I'd want a guarantee that you're going to keep the rates the same for five years before I'd ever hook up anymore. And reason. I can't believe that you people -- that what I have seen going on is totally against all reason. In fact, I believe it's crookedness.

I wish I had a phone bill. I once had an intruder break in and I didn't have a phone to call the police. However, I handled it; I think I handled it well. But next time, the person might have a gun. And I really would like to have it. But I am not -- it may never happen, you know. So I am not sure that I want to put up with all I have put up with in the past and always go around angry. It's not only the phone. I find the electric went up five times as much for the little consumer, not for the big one, mind you, for the little one. And also heat; I do not have heat. Also there are taxes on these calls. Every single little county and city is adding extra taxes so it's considerably higher than what you're actually charging. And I'll tell you what my feeling about that is. Look at L.A. County. They have used taxes on everything and they're forever screaming poverty and I'm fed up with them.

Also, I feel, as far as competition goes, that it is natural enough. You don't need to develop competition. The human race didn't advance because of competition. Competition might add a little

more interest; it's a little more spice; it might make you a little sharper; but you don't need that much.

As far as deregulation goes, the only thing I've seen with the deregulation is the big guys have gotten deregulated and the little guys have gotten much less choice and more regulated. They're regulated by money, you know. If you're poor, you're very regulated if the rates go high. So nobody can say you're deregulated. I've seen absolutely the opposite of what deregulation promised with it. All I've seen is a bunch of crooks come in and take over.

I think we need to approach things from a holistic, balanced point of view in trying to -- and sincerely find things that will work, to help people. And for instance, with the little guy, it shouldn't cost more just because he's little. They could have saved on billing me. They could have billed me like every six months. They didn't have to bill me every single month. It doesn't really cost that much more just because of little. If somebody -- it might be more to package little. You might need more labor; but then as far as stuffing it all into a box, it'll fit better. You can carry more in a truck, you know, save there. I don't honestly believe you're going to save that much just because of bigness at all.

Also, as far as the big ...

CHAIRMAN ROSENTHAL: Would you please wind it up?

MS. PALMER: Yeah. Right. One last point. As far as basics, everybody uses basics so there's more use; so it should be cheaper by all rights. I mean if you're going to use that philosophy, it definitely should be cheaper. Thank you.

CHAIRMAN ROSENTHAL: Thank you.

In closing, from what we've heard today, there's an interesting road ahead at the PUC with both local and long-distance issues. I understand that the PUC is going to be monitoring. Let me indicate that the Senate will also be monitoring. And I appreciate all the input. Thank you very much. And the hearing is concluded.

--oo0oo--