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# FEDERAL-STATE COMMUNICATIONS JOINT BOARD

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HEARING  
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BEFORE THE  
COMMUNICATIONS SUBCOMMITTEE

OF THE

COMMITTEE ON COMMERCE

UNITED STATES SENATE

NINETY-FIRST CONGRESS

FIRST SESSION

ON

S. 1917

A BILL TO AMEND THE COMMUNICATIONS ACT OF 1934, AS AMENDED, TO ESTABLISH A FEDERAL-STATE COMMUNICATIONS JOINT BOARD TO PRESCRIBE UNIFORM PROCEDURES FOR DETERMINING WHAT PART OF THE PROPERTY AND EXPENSES OF COMMUNICATION COMMON CARRIERS SHALL BE CONSIDERED AS USED IN INTER-STATE OR FOREIGN COMMUNICATION TOLL SERVICE, AND WHAT PART OF SUCH PROPERTY AND EXPENSES SHALL BE CONSIDERED AS USED IN INTRASTATE AND EXCHANGE SERVICE, AND FOR OTHER PURPOSES

DECEMBER 9, 1969

Serial No. 91-42

Printed for the use of the Committee on Commerce



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HEARING

BEFORE THE

COMMUNICATIONS SUBCOMMITTEE

OF THE

COMMITTEE ON COMMERCE

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JOHN O. PASTORE, Rhode Island  
VANCE HARTKE, Indiana  
PHILIP A. HART, Michigan  
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CHARLES E. GOODELL, New York

(II)

Serial No. 91-42



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## FEDERAL-STATE COMMUNICATIONS JOINT BOARD

MONDAY, DECEMBER 9, 1969

U.S. SENATE,  
COMMITTEE ON COMMERCE,  
Washington, D.C.

The committee met at 10 a.m. in room 5110, New Senate Office Building, Hon. Warren G. Magnuson (chairman of the committee) presiding.

Present: Senators Magnuson, Pastore, and Cotton.

The CHAIRMAN. The committee will come to order.

### OPENING STATEMENT BY THE CHAIRMAN

The Chair has a very short opening statement. The committee begins consideration today of S. 1917, a bill which would amend the Communications Act to establish a Federal-State joint board to prescribe uniform procedures in determining what part of the property and expenses of the communication common carriers shall be considered as used in interstate or foreign communications toll service, and what part of such property and expenses shall be considered as used in intrastate and exchange service, and for other purposes.

During this phase of the hearing the committee expects to hear testimony from the FCC and representatives of the National Association of Regulatory Commissioners. Many of the commissioners are here today.

Recently the FCC determined that the Bell System has \$237 million of excess earnings on its interstate operations. As a consequence, there would be an interstate toll rate reduction for that amount with the Bell System telephone companies. On the other hand, the Commerce Committee has been informed by the National Association of Regulatory Utility Commissioners that rate proceedings have been instituted in 16 States seeking rate increases totaling in excess of \$500 million. The committee expects to review the testimony as to whether the creation of a Federal-State joint board to prescribe uniform separation procedures as provided in S. 1917 would lessen the disparity that now exists between costs for local and intrastate service and the rates for interstate toll service.

Now, in effect, that states the problem, or at least the matter that is before the Commerce Committee, as we understand it. Of course, we will hear from the witnesses in detail as to this matter.

(A copy of S. 1917 and an agency comment follows:)

Staff members assigned to this hearing: Nicholas Zapple and John D. Hardy.

(1)

[S. 1917, 91st Cong., 1st Sess.]

A BILL To amend the Communications Act of 1934, as amended, to establish a Federal-State Joint Board to prescribe uniform procedures for determining what part of the property and expenses of communication common carriers shall be considered as used in interstate or foreign communication toll service, and what part of such property and expenses shall be considered as used in intrastate and exchange service, and for other purposes

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Federal-State Communications Joint Board Act of 1969."*

SEC. 2. The Communications Act of 1934, as amended, is further amended by striking subsections (c) and (d) of section 221 and inserting in lieu thereof the following:

"(c) There is hereby established a Federal-State Joint Board (hereinafter defined) vested with sole administrative authority under this Act to adopt and amend from time to time by order uniform procedures for determining what part of the property and expenses of common carriers engaged in wire or radio communication shall be considered as used in interstate or foreign communication toll service subject to the jurisdiction of the Commission, and what part of such property and expenses shall be considered as used in intrastate, exchange or other communication service not subject to the jurisdiction of the Commission. Such uniform procedures shall be determined after opportunity for hearing, upon notice to each affected carrier, the State commission (or the Governor, if the State has no State commission) of any State in which the property of such carrier is located, and such other persons as the Federal-State Joint Board may prescribe. The establishment of the Federal-State Joint Board shall not impair in any way the right of any State commission, the national organization of the State commissions, hereinafter referred to, or any other interested party to advocate its position on issues before such Board, to submit evidence and oral argument concerning same, and to seek reconsideration and judicial review of the Board's decisions.

"(d) The Federal-State Joint Board shall be composed of four Commissioners of the Commission designated by the Commission, and three commissioners of State commissions, nominated by the national organization of the State commissions, as referred to in sections 202(b) and 205(f) of the Interstate Commerce Act, as amended, and appointed by the Commission. The Commission shall designate one of the members of the Board as Chairman.

"(e) Each State commissioner member of the Federal-State Joint Board shall be selected in the following manner. The national organization of the State commissions or a committee designated by it shall nominate one, two, or three State commissioners, as requested by the Commission, and certify the name, title, and address of each nominee to the Commission within ninety days after the date this Act becomes law, or at least ninety days prior to the expiration of the term of an incumbent State commissioner, or within thirty days after a vacancy occurs in the office, as the case may be. Within thirty days after receipt of such certification, the Commission shall appoint the nominee or one of the nominees as a member of the Federal-State Joint Board. In any case where the national organization of the State commissions fails to so nominate and certify State commissioners within the prescribed time, the Commission shall appoint a State commissioner as a member of the Board to serve in lieu of the nominee it would have otherwise appointed.

"(f) Each State commissioner member of the Federal-State Joint Board shall hold office for a term of three years, except that (1) any member appointed to fill a vacancy occurring prior to the expiration of the term for which his predecessor was appointed shall be appointed for the remainder of such term, and (2) the terms of office of members first taking office after the date this Act becomes law shall expire as follows: one at the end of one year after such date, one at the end of two years after such date, and one at the end of three years after such date, as designated by the Commission at the time of appointment, and (3) the term of any member shall be extended until the date on which the successor's appointment is effective. The office of a State commissioner member of the Board shall become vacant upon the incumbent ceasing to be a State commissioner.

"(g) A State commissioner member of the Federal-State Joint Board shall, while attending meetings or hearings of such Board or otherwise engaged in the business of such Board, be entitled to receive compensation at a rate fixed by the Commission, but not exceeding \$100 per diem, including traveltime, and

while away from his home or regular place of business he may be allowed travel expenses, including per diem in lieu of subsistence, as authorized in section 5 of the Administrative Expenses Act of 1946 (5 U.S.C. 73b-2) for persons in the Government service employed intermittently. Payments under this section shall not render a State commissioner member of the Board an employee or official of the United States for any purpose.

"(h) The Federal-State Joint Board shall meet from time to time upon the call of the Chairman of the Board or of three members of the Board. A majority of the members of the Board shall constitute a quorum. Each member of the Board shall have one vote. All decisions of the Board shall be by majority vote. The Commission shall designate an examiner to advise with and assist the Board in the handling of any proceedings before it. The Commission shall provide the Board from among the personnel and facilities of the Commission such staff and facilities as are necessary to carry out the functions of the Board. In conducting hearings, the Board, within the scope of its authority, shall be vested with the same rights, duties, and powers as are vested in the Commission in holding a hearing. An order of the Board shall be deemed an order of the Commission for purposes of judicial review.

"(i) In making a valuation of the property of any telephone carrier, the Commission, after the adoption of the uniform procedures authorized in subsection (c) of this section, may in its discretion value only that part of the property of such carrier determined to be used in interstate or foreign communication toll service."

OFFICE OF THE DEPUTY ATTORNEY GENERAL,  
Washington, D.C., December 11, 1969.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR: This is in response to your request for the views of the Department of Justice on S. 1917, a bill referred to as the proposed Federal-State Communications Joint Board Act of 1969.

S. 1917 would amend the Communications Act of 1934 to establish a Federal-State Joint Board, composed of four Commissioners of the Federal Communications Commission and three commissioners of state regulatory commissions. The bill would vest in that Board the sole administrative authority to prescribe uniform procedures for determining what part of the property and expenses of common carriers engaged in wire or radio communication shall be considered as used in interstate or foreign communication toll service subject to the jurisdiction of the Commission, and what part of such property and expenses shall be considered as used in intrastate, exchange or other communications service not subject to the jurisdiction of the Commission. An order of the Board would be deemed an order of the Commission for purposes of judicial review. The bill further provides that upon the adoption by the Board of these uniform procedures the Commission, in making a valuation of the property of any telephone carrier, may in its discretion value only that part of the property of such carrier determined to be used in interstate or foreign communications toll service.

Whether this legislation should be enacted involves policy considerations as to which the Department of Justice makes no recommendation.

The Bureau of the Budget has advised that there is no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

RICHARD G. KLEINDIENST,  
Deputy Attorney General.

The CHAIRMAN. We have a statement from Senator Tydings which will be made a part of the record at this point.

(Statement of Senator Tydings follows:)

STATEMENT OF HON. JOSEPH D. TYDINGS, U.S. SENATOR FROM MARYLAND

Mr. Chairman, I have come to testify before the Commerce Committee today as an expression of concern over rising telephone rates. In Maryland last month, the Maryland Public Service Commission granted a 7.7 percent increase in telephone rates; the Chesapeake and Potomac Telephone Co. termed this steep in-

crease as inadequate. At the same time the Federal Communications Commission has negotiated an interstate rate reduction of \$237 million with the Bell System.

As monthly telephone rates for local users are rising, interstate rates continue to decline. However, there are few long-distance users and calls when compared with the number of families which pay monthly telephone charges. Are the overwhelming majority of telephone users paying too much and subsidizing interstate callers? Is the proportion of plant and expenses allocated to interstate as opposed to intrastate calls too low? I think these questions must be answered after a new, searching inquiry.

Unfortunately, the body that strives to keep long-distance rates low, the FCC, is the very same body that decides how much of the plant and expenses of the telephone companies will be paid for by these rate. This is obviously a situation which is not conducive to search inquiry or totally disinterested judgement.

For this reason I believe we must look for a new institutional approach to the telephone rate-setting question. S. 1917 presents one method that has great merit. I am certain the Committee will give this and other proposals careful scrutiny and evolve a solution to this problem.

I believe we must ensure that the local telephone user bear an equitable share of the costs—and no more.

The CHAIRMAN. The Honorable Dean Burch is here, Chairman of the FCC, accompanied by Commissioners Cox and Bartley.

We will be glad to hear from you at this point.

Now there is before the committee S. 1917, which was introduced and the committee expected to take that up even prior to the decision of the FCC; in other words, hearings were intended prior to that decision. But this decision has made the importance of our consideration of S. 1917 even more pertinent.

**STATEMENT OF HON. DEAN BURCH, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION; ACCOMPANIED BY COMMISSIONER ROBERT T. BARTLEY, COMMISSIONER KENNETH A. COX, BERNARD STRASSBURG, CHIEF, COMMON CARRIER BUREAU, AND H. LEROY BAKER, CHIEF, FIELD OPERATIONS DIVISION, FEDERAL COMMUNICATIONS COMMISSION**

Mr. BURCH. Yes, sir; I understand.

Mr. Chairman, we have with us today also Mr. Bernard Strassburg, the Chief of the Common Carrier Bureau, and Roy Baker, the Chief of the Field Operations Division, Common Carrier Bureau, both of whom are very reliable in this particular field.

Mr. Chairman, the Federal Communications Commission welcomes this opportunity to give you our views on S. 1917, a bill which would establish a joint Federal-State board to administer the separation of telephone company costs for jurisdictional purposes.

In this connection we will also discuss our recent actions concerning interstate rate reductions which, we believe, provide relevant background for a consideration of S. 1917. Thus, we will include treatment of the suggestion that, as an alternative to such reductions, we should have required the interstate jurisdiction to absorb a greater share of telephone company costs as a device for reducing the costs now being assigned to intrastate operations.

At the outset it is important to understand the purpose and significance of separation or cost allocations in telephone rate regulation by the Federal and State authorities. As you well know, a major objective of all utility rate regulation is to determine the costs of

rendering service that the utility must recover from the public in the form of revenues which are produced by the rates charged for the various services provided by the utility.

This problem is especially complex where the same companies are subject to regulation by more than one jurisdiction. In exercising this dual jurisdiction there are certain legal and practical constraints that must be respected by regulatory authority—State and Federal.

Because most telephone plant is used in common to render both intrastate and interstate services which are subject, respectively, to State and Federal regulatory jurisdiction, the costs of such plant, as well as associated expenses, must be equitably apportioned between the two jurisdictions. Without such equitable apportionment the rates for services under one jurisdiction may well result in a burden to the ratepayers of other jurisdictions.

Thus, effective exercise by each jurisdiction of its ratemaking authority is dependent upon the use of separation or allocation procedures which properly reflect the costs related to the service subject to that jurisdiction.

As early as 1930 the U.S. Supreme Court, in the landmark decision of *Smith v. Illinois Bell Telephone Co.*, 232 U.S. 133, had occasion to rule on the necessity for an appropriate separation of commonly used telephone plant and associated expenses.

The Court made it clear that a proper allocation of costs is the keystone to the sovereign exercise by the Federal Government and the States of their respective regulatory jurisdictions over intrastate and interstate rates. In this regard the Court said:

The separation of the intrastate and interstate property, revenues and expenses of the Company is important not simply as a theoretical allocation to two branches of the business. It is essential to the appropriate recognition of the competent governmental authority in each field of regulation.

While acknowledging that extreme nicety is not required, the Court stressed that a separation of costs is essential to regulation of telephone companies by the several jurisdictions and that such separations must give appropriate recognition to the different uses to which the commonly used plant is put.

Senator PASTORE. Is this a precise science?

Mr. BURCH. No, sir; it is not.

Senator PASTORE. That is just the point, isn't it?

Mr. BURCH. That is correct.

Senator PASTORE. All right.

Mr. BURCH. In light of the *Smith* decision and other relevant court precedents, it is clear and generally undisputed that neither the Commission nor the State regulatory authorities are free agents in fixing the method of allocating joint plant between intrastate and interstate services.

It is equally clear and undisputed by all regulatory authorities that the Federal Communications Commission is by no means free to arbitrarily allocate sums of money between jurisdictions solely to achieve a given purpose such as alleviating or minimizing intrastate rate increases.

Since the *Smith* decision the history of telephone separations has been characterized by an almost continuous Federal-State cooperative effort to devise, refine, and improve separations procedures with the

overall objective of producing an equitable allocation of costs among services subject to different jurisdictions.

This cooperation has been carried on within the organizational machinery of the NARUC with which the Commission and its staff has had the closest of working relationships.

In our judgment, and notwithstanding the current disagreement that recently emerged, our joint and cooperative efforts have been effective and productive. It may also be stated that the results of those efforts have consistently worked to benefit the users of local services.

In sum, therefore, separations of plant and expenses have provided the fundamental cost bases for the actions taken by the State commissions with respect to the rates charged by the telephone companies.

Senator PASTORE. May I ask another question? This last action by the FCC, was that predicated upon a cooperative effort?

Mr. BURCH. Well, Senator Pastore, the members of NARUC attended as observers at the hearings that preceded our November 5 statement. They did not participate.

Senator PASTORE. What do you mean by "observers"? Just sit there and listen to what was going on or play a part in the proceedings?

Mr. BURCH. They listened to what was going on.

Senator PASTORE. You would say, then, it wasn't a cooperative effort?

Mr. BURCH. Well, continuing surveillance, Senator Pastore, as I understand it, has been the function of the Federal Communications Commission.

Senator PASTORE. I realize that. That is just the point. I am wondering if we are trying to put a "feather in our cap" on the national level, bragging about reducing rates, and at the same time we are up against this incongruity, at the same time the same companies were asking for a tremendous amount of money on the State level. That has been the complaint.

Mr. BURCH. I understand that.

Senator PASTORE. I mean, when you find Bell has earned more than \$200 million in interstate operations, and you are forced to give a rate reduction because of that, while at the local level Bell companies are asking for a rate increase. The ordinary consumer or the ordinary person, whether he is a member of this committee or even a Commissioner, would say "something is wrong in Denmark." That is the point here. After all, all telephone service begins at the local level.

Now, you see I am not against the reduction of Federal rates, but I would like to see reductions—Federal and State. But when it only happens on one side and you increase it on the other side, I wonder if we are not, in this procedure, really hurting the housewife who likes to call her sister down the street.

Mr. BURCH. Senator, if I could respond just briefly outside of my statement, I think the problem we have here is twofold. First of all, as is pointed out later in the statement, the technological advances in the interstate service are far greater than have been achieved as yet in intrastate.

Senator PASTORE. But it takes two to tango. You can't have one without the other. We get that even in the mail rates. Fundamentally unless you have the local service, the very base, where the call originates, you couldn't have interstate. That is where the cooperative effort ought to come in. I think they should have been a little more

than just being observers. I think they should have been a party to these proceedings. Some equity has to be worked out in view of the fact you admit this is not a precise science.

Mr. BURCH. Senator, we have had a continuing discussion with NARUC at all times concerning separation procedures. We have established in the last year a means whereby they can ask for a change in separation procedures as rulemaking at the Commission.

I would like to make a further point, Senator. Senator Magnuson made the observation that we are talking about a \$237 million interstate reduction, whereas the States are faced with a \$500 million rate increase. Senator, if we had passed all of this over to the States it would not have solved the problem we are here talking about today.

Senator PASTORE. Not necessarily, but you would have come closer to equity. That is the point I am making. I am not saying that would be the result. But you maybe could have achieved a more equitable situation on the local level.

Now, I am familiar with my own State. I am familiar with my own State. A rate increase has been asked for in my State and the proceedings are going on now. And here is a housewife that realizes she is getting the cut, somebody is getting the cut, on an interstate call, because that is being reduced, but at the same time she is being asked to pay more for a local call. I am not saying who is right and who is wrong. I think the only way you can do it is through cooperative participation in view of the fact this is not a precise science. If it were a precise science, then you would have the precise answer. But you can't have a precise answer. So it has to be negotiated, worked out. And this idea that you pin a medal on yourself down here in Washington because you are reducing interstate rates and at the same time the commissioner in Rhode Island is taking it on the chin because he has to grant an increase in the rates on the local level, that doesn't fit too well.

The CHAIRMAN. All right, Mr. Chairman, you may proceed.

Mr. BURCH. With this regulatory framework in mind I would like to briefly describe the background of our longstanding policy of "continuing surveillance" as it has been applied to our regulation of the Bell System's interstate operations. It was the current application of this policy which led to our November 5 announcement of the pending interstate rate reductions.

In dealing with the propriety of rate levels and structures for individual classifications of service such as private line or TWX, we have found that evidentiary formal hearings are generally necessary in the interest of resolving the types of issues involved in such class ratemaking. However, with respect to the regulation of the overall level of interstate rates and earnings of the Bell System the Commission has found over the years that there is much merit to approaching the problem in an informal framework—namely, "continuing surveillance."

This process involves continuous study and review of the carrier's overall interstate earnings. It facilitates timely relief to subscribers in the form of rate reductions when warranted by the company's overall level of earnings. In other words, the so-called regulatory lag can be reduced to a matter of months, rather than years, which is generally the case where formal proceedings are involved. This process also makes possible material conservation of and saving in public and private resources.

In accordance with these procedures the Commission's staff reports to the Commission at frequent intervals on the level of earnings, earnings trends, conditions of the capital market, and other factors relevant to an appraisal of the Bell System's interstate revenue requirements.

The Commission is kept informed of the company's plans for new construction and financing, as well as the company's views concerning the level of earnings it requires.

Periodically these matters are discussed with representatives of the Bell System in informal conferences. There is no fixed time schedule for such conferences. Rather, they have been held whenever the Commission has concluded that circumstances warrant such discussions to be held.

The procedures embraced by the "continuing surveillance" policy have been examined and affirmed by the courts (*The Public Utilities Commission of the State of California v. United States*, 356 F. 2d 236 [9th Cir. 1966]; certiorari was denied by the Supreme Court).

In the fall of 1965, in connection with the Commission's telegraph inquiry, docket 14650, Bell submitted a cost study of seven different classes of its interstate services. The study indicated a wide disparity in the level of earnings among these different classes of services.

In addition there were problems which had been raised before the Commission by members of the industry concerning a recent revision in separation procedures which was hastily designed to help State revenue requirements but which, nevertheless, soon revealed a number of basic infirmities. There were also a number of other fundamental issues which had never been formally treated in a comprehensive rate investigation of the Bell System.

Consequently an investigation was instituted by our order of October 27, 1965, into the lawfulness of the charges of the American Telephone & Telegraph Co. and the associated Bell System companies for interstate and foreign communications services and other related matters:

These matters were designated for formal public hearing as FCC docket No. 16258. This was the first general rate investigation of this scope and type in the history of the Commission.

We believe it is relevant to take note of the Commission's views on the relationship of the formal proceedings in docket No. 16258 to its policy of "continuing surveillance" as stated in our memorandum opinion and order of December 23, 1965, denying petitions for reconsideration filed by Bell. We said:

We have not repudiated continuing surveillance. We agree with Bell that it is often an effective and highly efficient method of regulation and we appreciate the cooperation which has contributed to its past success. Under appropriate circumstances, we intend to use the method again. Indeed, we believe that the standards and criteria developed on the record here will enable us to employ continuing surveillance even more effective in the future.

The critical aspect of docket No. 16258 as it pertains to the present situation involved a determination of the appropriate revenue requirements of the Bell System companies applicable to their interstate and foreign communications services and the basis upon which such revenue requirements are to be ascertained. This necessarily included a determination of the allowable rate base and rate of return for the Bell System's interstate operations.

With respect to the specific matter of separations, the proceeding also required a determination of the appropriateness of the procedures used to allocate costs to Bell's interstate operations and the changes, if any, which should be made in such procedures.

On July 25, 1967, based on all the pertinent facts before it, the Commission adopted an interim decision and order. In connection with a rate of return the Commission found that a range of 7 to 7.5 percent was appropriate in the light of conditions existing in the test year 1966. The Commission further stated:

As, and when, the going level of Respondents interstate earnings approaches either the upper or lower limits of this range, we will promptly consider what further action may be required in light of the then current conditions. This is not to be construed to mean that any future level of earnings which exceeds 7.5 percent or falls below 7.0 percent will warrant immediate action looking toward rate adjustments. Whether or not remedial action will be required will depend upon all relevant circumstances obtaining at the time.

In addition, the Commission also addressed itself to the question of jurisdictional separations as part of this phase of the proceeding and received detailed recommendations for changes in preexisting separation procedures.

As a result of our decision in 1967 there was a \$120 million annual reduction in interstate long-distance rates. There was also a shift of revenue requirements from intrastate to interstate of approximately \$85 million, as the result of the separations procedures determined therein to be appropriate.

It should be noted that absent the shift in revenue requirements to the interstate operations as the result of separation changes, which we found to be justified on the facts in the record of that proceeding, the reductions in interstate rates would have been nearly twice what they actually were, or some \$205 million.

Because of various petitions for reconsideration of the separations procedures adopted in our 1967 decision, further changes in the procedures were adopted this year through rulemaking proceedings which increased the net benefit to the States to about \$135 million. This rule-making adopted for the first time the FCC-NARUC Separations Manual as a part of the Commission's rules.

Despite the rate reductions and the separations changes resulting from our decision, Bell's rate of return, which was 8.25 percent for 1967, declined only to 7.6 percent in 1968, the first full year of the reductions and separations changes; and by the first 6 months of 1969, the return had again climbed to 8.25 percent. Accordingly, the Commission wrote to the American Telephone & Telegraph Co. on June 5, 1969, and stated in part:

In keeping with its policy of continuing surveillance, the Commission has been reviewing the continuing growth in the level of your interstate revenues and earnings, changes in the nation's economy during recent years, and the need, if any, for rate adjustments that may be required in the public interest.

Between September 8 and September 19, 1969, the Commission held a series of meetings with Bell System representatives involving about 6 full days. Bell's presentation was offered by a number of its key officers plus outside experts in various economic fields. In addition the Commission's staff submitted a number of exhibits.

The complete Bell presentation was subjected to lengthy questioning by the Commission and by its staff. A complete transcript was

made and is a matter of public record, open to inspection and review by any interested party.

Representatives of the National Association of Regulatory Utility Commissioners—NARUC—and the independent telephone companies attended the meetings as observers.

Upon consideration of the facts adduced at the meetings it was apparent to the Commission that changes in the Nation's economy indicated a somewhat higher cost of capital for the Bell System than in 1966 and 1967. This development had a bearing on whether our 1967 finding that a rate of return in the range of 7 to 7.5 percent is, under current conditions, still appropriate.

Nevertheless, Bell's volume of interstate business had grown, and was growing, at a rate such as to place it in an excess earnings position. This meant that the using public was paying rates at an unreasonably high level and, absent remedial action, would continue to do so.

This left the Commission with two alternatives: One, it could have instituted a formal investigation similar to that which it conducted in docket No. 16258 and, after having amassed a similar record, ordered such rate reductions as appeared justified. This, however, would have meant that the public would continue to pay rates at the present level for approximately another 2 years while the proceedings were being conducted.

The other alternative was to enter into discussions with the Bell System and arrive at a mutually acceptable reduction in rates, thereby affording telephone users prompt benefits in the form of lower rates.

For what I think are sound and readily understandable reasons the Commission chose this latter alternative.

With this background for the announcement by the Commission of reductions in interstate rates in the amount of \$150 million, I would like to revert to the principal problem which has occasioned our appearance this morning; namely, the subject of jurisdictional separations of investment and expenses incurred in the rendition of telephone service.

For it has been urged that the Commission had a third alternative at the time of the consideration of the Bell System's earnings; namely, to reallocate, by a revision in separations procedures, the Bell System's investment and expenses so as to transfer portions of such investment and expenses from its intrastate services to its interstate services. This would have resulted in an increase in interstate revenue requirements and a lower rate of return on Bell's interstate operations. Correspondingly, it would have relieved intrastate operations on a nationwide basis of an equivalent amount of revenue requirements.

Just prior to the conclusion of our discussions with A.T. & T., the Commission was requested by the president of the NARUC to agree to an increase in the allocation to interstate operations of the investment and expenses applicable to local dial switching equipment. However, the suggested revision was without any apparent justification and, in fact, was subsequently dropped from consideration by the technical staff experts of the NARUC and the FCC. Accordingly, there was before us at that time no logical sound and legally supportable basis for a revision in separations, and as I have already developed, the Commission cannot under the law arbitrarily reallocate costs.

In this connection I would like to review briefly the record and results of Federal-State cooperation that have actually been achieved over the years in this complex area. At the same time I shall explain why reductions in interstate rates at a time when requests for rate increases are pending in various States are not necessarily, as some of the States contend, the result of deficiencies in the separations procedures.

Our cooperative activities with the State Commissions have, in fact, resulted in major reassignments of costs from the intrastate to the interstate jurisdiction which have relieved the States of very substantial amounts of costs and revenue requirements applicable to local exchange service. This statement is borne out by the actual results which have been achieved by Federal-State cooperation in this area over the years for the benefit of the intrastate services.

Since 1952, five major revisions have been adopted in the separations procedures. Each of them has resulted in net overall transfers of revenue requirements from the intrastate to the interstate operations.

It is estimated that, on the basis of current operations, these revisions have relieved the intrastate operations of the Bell System, and therefore the local subscriber, of an estimated \$800 million of revenue requirements annually.

This sum, in turn, has been absorbed by the users of interstate services who are now paying some 20 percent more for interstate services than they would have been required to pay if pre-1952 separation procedures were still in effect. It also means that, on a nationwide basis, local rates are lower by the same amount.

In order that you may appreciate the magnitude of the individual revisions we call your attention to the cumulative, direct effects of these revisions upon local exchange users.

As an example, let us look at the allocation of subscriber plant which currently represents more than 40 percent of the Bell System's total investment. As of 1952, when separations were based on measurements of actual use, less than 3 percent of subscriber plant was assigned to interstate operations. This assignment was made by measuring the proportion of interstate use of this plant to its total use for all services.

Today, through the development of new concepts of separations, more than 16 percent of these costs are assigned to interstate operations, even though such operations account for only about 5 percent of the actual use of the subscriber plant.

Furthermore, certain built-in features of the most recent revision will result in a steady increase in the proportion of subscriber line plant costs assigned to interstate.

It should also be noted that the interstate operations and particularly the local exchange operations tend to benefit from interstate message toll rate reductions. This is because of the way in which the separations procedures operate. Interstate rate reductions in the past have resulted in substantial stimulation of interstate toll calls. The increased interstate usage thus generated has increased the proportion of total usage accounted for by interstate calls. This in turn has increased the assignment of costs to interstate operations.

In the case of subscriber plant particularly, where increased interstate usage does not necessitate an increase in plant investment, the formula operates to assign a larger proportion of the costs of such

plant to interstate and thus relieves intrastate operations of a corresponding amount of such costs.

As recently as October of this year we agreed with the NARUC to certain modifications in the details of implementing the separations procedures which have resulted in an additional assignment of some \$35 million of annual revenue requirements from the intrastate to the interstate services. In addition, a new series of separations studies is now being undertaken by the staff experts of our Commission and the State commissions with respect to possible further revisions in the procedures.

We cannot now predict the outcome of these studies, but we will certainly take the status or results of those studies into account when we will again be reviewing the level of interstate earnings within our program of continuing surveillance.

Senator PASTORE. When did these studies start?

Mr. BURCH. In October of this year.

Mr. STRASSBURG. Actually studies have been going on—

Senator PASTORE. I mean in cooperation with the States.

Mr. STRASSBURG. In cooperation with the States, there have been almost continuous meetings throughout 1969. There were in fact, six meetings of the technical staff experts, which are made up of representatives of the FCC and the State commission. This went on right through to the end of the year, sir.

Senator PASTORE. Where do these studies stand now?

Mr. STRASSBURG. Sir, what we have been doing in all of these meetings is searching for a responsible acceptable separations formula that would improve upon what we have now.

Senator PASTORE. Have you reached an impasse?

Mr. STRASSBURG. As of now, we have not agreed or have not evolved a plan which is generally acceptable. I might say the States commissioners committee, which group is responsible, are submitting a petition to the Commission today, I understand—making a proposal. We know generally what the proposal involves. But we have no idea so far as to its justification or logic. We have to examine it. But this has been a continuous effort, Senator Pastore.

Senator PASTORE. You say here we cannot now predict the outcome of these studies. I was curious to know when we can hope for some understanding from these studies.

Mr. STRASSBURG. This remains to be seen as to what is involved. As I say, sir, we have an idea of what concept is involved. But exactly what the factual basis for it is, what exactly the operational basis for it is, what the views and reactions and responses of the industry are to it remain to be determined and evaluated.

The CHAIRMAN. How do the States participate as a practical matter? You say you conduct these studies with the States. Do they send down here a group of experts? There are 50 State commissions. Are there 50 of them or do they have a committee. How do they participate?

Mr. STRASSBURG. Mr. Chairman, the matter of separations is a matter of continuing study on a joint basis by the FCC and the States. The NARUC has a committee of which we are a part.

The CHAIRMAN. I am not asking that, I am asking how they participate.

Mr. STRASSBURG. It is through the National Association of Railroad and Utilities Commissions.

The CHAIRMAN. That is what I wanted to find out. Do they have a committee in this field? Obviously you could not have all of the State commissions gather. But you could get a rough idea of what the commissions think. How many have sat around with you people since October, bodywise?

Mr. BAKER. About 15 State staff members, Mr. Chairman, have been attending these meetings.

The CHAIRMAN. They have been here and meeting with you every day, or do they come in and out or do you do it through communication or how?

Mr. STRASSBURG. We are at their beck and call, sir.

The CHAIRMAN. I am not asking whether you are at their beck and call. I am asking you how you do this. You say, you make the flat statement that they participated, they are participating in this study. I want to know how they do it.

Mr. STRASSBURG. Well—

The CHAIRMAN. I am not talking about the study or the problems you have.

Mr. STRASSBURG. The committee, the technical staff experts, which is made up of representatives of the FCC and the State commissions, meet periodically to program various studies, to explore various alternatives. We meet periodically at the call of the chairman of that committee, sir. That is a representative committee made up of the people selected from various State commissions who are knowledgeable in the field of separations. They also meet and report regularly to their superior committees, to Chairman Wiggins' committee, the committee on communications problem of the NARUC. Our commissioners, like Chairman Hyde, had I would say fairly continuous communication with the members of the communications committee of the NARUC on the programs and objectives of that committee in the area of separations. We would meet in Denver, we would meet in places like New York City, we would meet here in Washington, when there was something to be done, something to be analyzed, when new information had been developed for us to focus on.

So as I say, it is a continuous program. Does that answer your question, sir?

The CHAIRMAN. Yes. I wanted to know how you got together and how many times and whether or not there is actually a joint participation physically and every other way.

Mr. STRASSBURG. There definitely is, sir.

The CHAIRMAN. How many joint participations were there prior to the issuing of this interstate order?

Mr. STRASSBURG. There were approximately I think six meetings, again at the staff level over the period of 1969, prior to this order. There were discussions going on, you might say, in parallel with our continuing surveillance.

The CHAIRMAN. Did the commissions or their representatives, the group that represent them, were they apprised ahead of time of the order?

Mr. STRASSBURG. Were they apprised of the order?

The CHAIRMAN. Yes, what the Commission was going to do?

Mr. STRASSBURG. They were advised by Commissioner Bartley before the Commission made its announcement, but after the Commission had come to some conclusions.

The CHAIRMAN. When were they advised? Do you know; can you tell me?

Mr. BARTLEY. Yes.

The CHAIRMAN. I mean timewise.

Mr. BARTLEY. The same day.

The CHAIRMAN. The same day you issued the order?

Mr. BARTLEY. That is correct. But it is not an order, Mr. Chairman.

Mr. COX. It is not an order.

The CHAIRMAN. Well, you made a decision. You agreed on the decision.

Mr. STRASSBURG. We reached, we concluded our discussions in effect with the American Telephone & Telegraph Co.

The CHAIRMAN. I want to get this clear. As I understand it, is not there an order or rulemaking that this takes effect January 1?

Mr. STRASSBURG. No, sir.

The CHAIRMAN. But the Commission has made up its mind on this. Is that correct?

Mr. BURCH. The Commission accepted the proposal of A.T. & T.; yes, sir.

Senator PASTORE. As a matter of fact, it was done through negotiation; was it not?

Mr. BURCH. Yes, sir.

Senator PASTORE. Negotiations between the Federal authorities and the telephone company to the exclusion of the local commissioners. Am I correct in that statement?

Mr. BURCH. On November 5 you issued this public notice.

Mr. BURCH. Yes, sir.

The CHAIRMAN. They were notified the same day you were going to issue it?

Mr. BURCH. Correct.

The CHAIRMAN. I think that clears up the record about their participation.

Mr. BURCH. Senator Magnuson, if I could respond briefly to that point, we have not suggested that the State regulatory commissioners participated in the continuing surveillance and negotiations. Neither does S. 1917 have anything to do with that. All that the bill proposes is that they sit in on separations procedures, and we have said we do consult with them on that particular matter.

Senator PASTORE. But look at this: In 1967, if I remember what you read correctly, you decreed their rate of return on interstate should be between 7 to 7½ percent.

Mr. BURCH. Yes, sir.

Senator PASTORE. As a result of the rate reduction in the allocations that you made in 1967, nevertheless, even with that decree of 7 to 7½ percent, it zoomed up to 8.25 percent, correct?

Mr. BURCH. It was 7.6 the first year.

Senator PASTORE. Before it went down to 7.6 percent, after you decreed in 1967—

Mr. BURCH. That is correct.

Senator PASTORE. The earnings of 8.25 percent went down to 7.6 percent, right?

Mr. BURCH. Correct.

Senator PASTORE. Then you find out in 1969, without a new separation, it zoomed up again to over 8 percent.

Mr. BURCH. Yes, sir.

Senator PASTORE. Was not that because of this new reduced rate after 7 o'clock at night?

Mr. BURCH. Senator, I will have to ask for help in answering that.

Mr. STRASSBURG. I would say, Senator, it is due to a combination of things.

Senator PASTORE. All right, but did not—

Mr. STRASSBURG. There is no question about it; there is a more sufficient use of the plant stimulated by reduced rates.

Senator PASTORE. But the point is this, how in the world can you increase the use of interstate unless you at the same time increase the use of intrastate, for the simple reason that you have to have a point of beginning of the call.

Mr. STRASSBURG. Right, sir.

Senator PASTORE. Why are you giving all of the benefits on the long line and no benefits at all on the short line?

Mr. STRASSBURG. I think you misunderstand the situation, sir, with all due respect.

Senator PASTORE. Maybe I do. Now you explain it.

Mr. STRASSBURG. You are absolutely right, it takes the exchange plant, the same plant that is made use of for exchange service, that plant is also used for originating and terminating interstate long-distance calls.

Senator PASTORE. That is right.

Mr. STRASSBURG. To that extent a share of the cost of that plant is allocated to the interstate jurisdiction. That share was determined originally on the basis of relative use, which today would be 5 percent. Today actually 16 percent of that plant, as a result of the revisions and improvements we have made in separations, is now being assigned to the interstate jurisdiction. And as the use is stimulated of that plant by interstate rate reductions it promotes and stimulates a greater allocation of those joint costs to the interstate jurisdiction. And relieves intrastate to that extent.

Do you want to add something?

Mr. BAKER. Without creating a need for new plant.

Mr. STRASSBURG. Subscriber plant, OK.

Senator PASTORE. I realize what you are saying. But the point I am making is this: In 1967 you decreed it should be 7 to 7½ percent. It zoomed up to 8.25 percent. Then you made an allocation and it dropped down to 7.6 percent. But then the next year, 1969, because of this new idea, which I applaud, you see, it shot up again to over 8 percent. Now the point I am making here is do you not think at that point there should have been a restudy of allocation, so that this could be put in proper context? Let me say this to you, as far as the telephone company is concerned, this makes very little difference to them. They have to make a fair rate of return on their investment, whether it is interstate or intrastate, and the Court has decreed that. The question here is where are you going to place the burden? How

are you going to do this equitably? You reach a point that no matter what you do here you always find out interstate zooms up to a rate of return that has to be brought back into a saving, and at the same time the rate of return remains static on the local basis, whereby the telephone company has to come in and ask for an increase in rate. That is why I say it appears to me, without being an expert in the field, that it requires a little cooperative thought. That is all I am saying. I am not saying you are right or wrong. But these people have complained to me, they have complained to you, I have seen this thing develop and it looks a little funny to me, rather incongruous. As I said before, that in the interstate they are making so much money you have to reduce the rates, yet at the same time you are increasing the rate on the local level, you see.

Mr. BURCH. Senator, I—

Senator PASTORE. Go ahead. I understand Commissioner Bartley wants to say something at this point. Go ahead.

Mr. BURCH. Would you like me to proceed with the statement or would you prefer I try to respond to that question?

Senator PASTORE. Can you respond to it?

Mr. BURCH. I think the only response that can be made is there are certain technological advances which have not been paralleled. The cost per circuit mile has been reduced substantially, whereas the cost of installing a telephone and the subscriber plant has not been reduced accordingly. There have been those who suggested that this is because the Bell System spends all of its research funds trying to lower the cost of its interstate operations where it has competition. But there does not seem to be any well-founded basis for that charge. Those who have knowledge of the plant seem to find that the Bell system has made a good faith effort to reduce these charges. But in the local service, you are dealing with basically the more expensive aspect of the operation, such as in your own State, Senator, where you have relatively short hauls, but which do require a great deal of machinery and manpower to produce.

Senator PASTORE. But do you not think the local users should get advantage of these technological developments that have been made? Or do you give them to the fellow only who uses the long line? Why do you not have a sharing of this advantage of technological advantage? I know it is cheaper per unit mile to run a call from New York out to California. I know that. The same way it is cheaper to run a plane from Providence to Miami, Fla., and it may be more expensive to run that plane, per mile, between Providence and New York. I realize that. But if it were not for that guy in Providence, who takes the plane to New York, that fellow could never go to Miami. That is the point I am making here.

If it was not for the local user, who is basically the user of the telephone, that is what I am trying to bring out here, there should be an equity here. I know you cannot measure this precisely. We all agree with that. But as this interstate develops because of the technological developments, especially when the satellite begins to go up, that sort of thing, why should not the fellow at home, the housewife, get a little benefit, too?

Mr. BURCH. That housewife is probably making some long-distance calls, too, Senator.

Senator PASTORE. But probably, that is the point. Probably. But she is making a lot more calls calling up Aunt Mamie.

Mr. BURCH. I do not believe you will find anybody on the Commission or anywhere else that seriously disputes what you are saying. But we do feel that we are bound by our rule of law and logic and until such time as somebody can come up with a procedure whereby we can arbitrarily say 50 percent of this plant is in interstate—

The CHAIRMAN. What if you just reversed the procedure, and when you found the Bell Telephone System, which is almost as much intrastate operations, calls, as is interstate—

Mr. BURCH. Senator.

The CHAIRMAN. I don't know where you divide it any more in the whole system, but say to the local utility districts, let's give the rate reduction to the intrastate part of the bill, and that in turn would cut down the 8½ percent.

What if you just reversed it and kept the long distance tolls as they were?

Mr. BURCH. The reason for that, I think, is the Supreme Court and all of the courts in the United States have ruled that a utility must receive a fair rate of return on its investment in the area being regulated.

The CHAIRMAN. But the investment is a pretty loose formula. Where is the investment, on the long line? The investment is in the plants right in the local communities that handle all of the calls.

Here is another thing, I don't know if my figures are correct or not, but I understand that the rate base on intrastate is about \$8½ billion.

Mr. BURCH. What was that, sir?

The CHAIRMAN. Interstate.

Whereas, to support the rate base for the State commissions, they have a \$22½ billion investment.

Is that a correct figure?

Mr. BURCH. I think that is correct.

The CHAIRMAN. So there is almost three times as much involved as far as when you look at this separation, using the rate base and all this, I don't know, I am not expert on it. But the biggest investment is right in the States.

Mr. BURCH. About 70-80, Senator.

The CHAIRMAN. Over 90 percent of the calls are intrastate calls. So it seems to me when a telephone company, be it Bell or anybody else, starts to get above this figure that you have, 7½, whatever it is, the first place you ought to say is, reduce your intrastate rates.

Mr. BURCH. Senator, I don't want to be argumentative—

The CHAIRMAN. Or at least let the commissioners know, so they can beat you to it and reduce the intrastate rates, so the companies will say, look, we have reduced revenues over here, so maybe you better not reduce the interstate rates.

Wouldn't that be a better way to do it?

Mr. BURCH. Senator, I don't think it is a legal way to do it.

The CHAIRMAN. Would your lawyers tell you that?

Mr. Cox. Yes.

The CHAIRMAN. Who is going to sue you if you do that? They wouldn't have a leg to stand on, because the investment is hard to divide.

Mr. BURCH. That does not stop the courts from taking a whirl at it if somebody asks them to.

The CHAIRMAN. Maybe we ought to test that 1930 decision again, anyway. This is 39 years ago. Times have changed.

Mr. BURCH. Yes, sir; but I don't believe the principle has changed, Senator.

Senator PASTORE. When you say the Supreme Court has done this, isn't the difficulty here that no matter what you do, your problem, of course, insofar as the telephone company would be, and I suppose as far as the Federal agency is concerned, that if you did make an allocation, it would have to be national in scope?

I mean, every State would have to subscribe to it, because if you did not subscribe to it in every State, of course, you would have a hodge-podge. That is how the case gets to the Supreme Court. Because then the telephone company is compelled to come in and say in Rhode Island, this is our investment, and based upon our investment in Rhode Island on the intrastate level, we are entitled to a 7½-percent investment return. And they would be right.

I have gone through this before when I was Governor. There is no question about it. The trouble here is that each State has its own rule of how these costs are going to be allocated. That is how you get up to the Supreme Court.

What we ought to do is work out here an agreement whereby when you institute an allocation that applies to Rhode Island and also applies to the 49 other States. If you don't get that, I am afraid you will always have confusion.

Mr. STRASSBURG. As of now, we have such uniformity, sir.

Senator PASTORE. You do?

Mr. STRASSBURG. Yes, we have.

Senator PASTORE. In other words, the allocation procedure now applies to all States?

Mr. STRASSBURG. Correct, they use the allocation procedures uniformly in every State.

Senator PASTORE. When you say they, you mean the telephone company or the commissioners?

Mr. STRASSBURG. The commissioners use it for purposes of making their rate adjustments and regulating their rates, just as we use that same procedure on the interstate side.

The thing to keep in mind is what we are trying to do in cooperation with the States is relate their rates to the cost of the services subject to the jurisdiction. That is the name of the game so far as separation is concerned.

What are the legitimate relevant costs in each jurisdiction? That is the purpose of the procedures. We are constantly searching for improvements in the procedures. We have had five major improvements since 1952, sir.

Senator PASTORE. I know that, but the point I am making is—

Mr. STRASSBURG. If I may continue for a moment, sir—once you abandon costs as a measure of your jurisdiction, you have lost all anchor, you are at sea.

Costs, the relevant costs, do give meaning and viability in my opinion to separate jurisdictions. If you abandon that, you have lost everything.

Senator PASTORE. You make a good point.

But the point I am making is this, you see, when you saw that you made an adjustment in 1967, which intended to bring it down to 7.6 and then it zoomed up to 8.25, the decrease you made in your reductions of rates in 1969 were predicated upon that former adjustment, and was not restudied.

Am I right or wrong on that?

Mr. STRASSBURG. You are right, but—

Senator PASTORE. That is the point I am making.

When it zoomed up, you changed it because you were above 8 percent.

Mr. STRASSBURG. Well, we didn't change it because of that. It is true we did change the separation procedures—

Senator PASTORE. In 1967.

Mr. STRASSBURG. In 1967, which did relieve the States of revenue requirements, which shifted over to the interstate.

At the same time we were able to reduce interstate rates, and since that time, we have had discussions with the States, looking for additional changes which could be defended logically. And we are in the process of doing that now.

Senator PASTORE. But the point I am making, the rate reduction that was given, the new schedule of rates that is being filed to take effect January 1, 1970, is predicated upon the old separation decision?

Mr. STRASSBURG. All right; yes, sir.

Senator PASTORE. That is the point. Why wasn't that restudied in the meantime, before you made the reduction?

Mr. Cox. Senator Pastore, there is a procedure clearly open to any individual State commission or to NARUC, collectively. We have incorporated these procedures into our rules for the first time. They can request a rulemaking any time they believe they can suggest to us a logical, rational, legal basis for adjusting separations. They have not done so. When they do so, we will consider it. And if they have come up with a better basis for adjusting the distribution, the allocation of plant and cost, we will accept it. Until they do so, in my judgment it would be illegal and unfair to the users of the interstate service to make an arbitrary adjustment simply because of an argument of equity.

Senator PASTORE. I am not talking about that at all, Ken. I am say to you, this: What procedures did the commissioners follow when you did it in 1967? You did it on your initiative, didn't you?

Mr. Cox. We went through a formal, on-the-record proceeding, in which NARUC and individual State commissions participated fully. They had an opportunity to offer any evidence they wished.

Senator PASTORE. Did you do that for the 1967 reduction?

Mr. Cox. No.

Senator PASTORE. Of course. That is the point I am making.

Mr. Cox. That is not the point, Senator.

In 1969 we did not make an ordered reduction as we did in 1967, based on a formal proceeding. In 1969 we reverted to informal procedures under continuing surveillance.

Senator PASTORE. To the exclusion of the commissioners.

Mr. Cox. We have never, in continuing surveillance, included the commissioners from the States. This is a matter involving whether an adjustment is required in the level of interstate earnings.

The only question that relates to them is whether, if there are funds, if there are excess earnings which permit reductions, whether concurrently it can be shown that there is a legal and logical method for changing separations. In this instance, we found that there were excess earnings, but as the chairman has testified, there was before us no proper plan for adjusting separations.

If we had decided that we would consider further whether this \$150 million could be made available to the States, we would have simply delayed the benefit of these rate reductions to the public.

Senator PASTORE. And nobody wants that. Don't let's begin to wave the flag.

The CHAIRMAN. Why would it be delayed? I don't understand.

Mr. COX. Because we would have had before us no basis on which we could logically make a shift in separations. There was no basis on which we could agree to new separations procedures which would permit the shift to the interstate jurisdictions of additional revenue requirements, relieving the States of those charges.

As the chairman testified, if we could have done that, this would have resulted, without any changes in rates anywhere, in a calculated lower rate of return for interstate, and a calculated higher rate of return for intrastate.

The CHAIRMAN. This may be a very naive question, but does the telephone company, like the Bell System, have a separate set of books for interstate operations?

Mr. COX. Yes. In other words, they maintain records as to their overall investment. Then, through these procedures, a calculation is made to distribute their plant costs—some of these plant costs are only related to interstate. The investments in the long-lines department of the Bell System are almost exclusively used for interstate purposes.

The CHAIRMAN. Who finds this out?

Mr. COX. That is shown on the plant records. They invested  $x$  millions of dollars to build a new facility between New York and Chicago.

The CHAIRMAN. I don't see how that can be just related to interstate.

The telephone company has so much gross revenue, it has so much expenses, if you want to simplify it. I guess no accountant can simplify it for you; they are like the railroads, they have different methods. But they make so much, have so much gross earnings, and they have so much expenses in interstate and intrastate. All of the plants are interconnected.

Mr. COX. But some of the plant is used only for interstate calls—the microwave facilities between New York and Chicago.

The CHAIRMAN. Wait a minute. I am trying to get this straight. How can you sit down and say this is the plant investment on interstate alone?

Mr. COX. We start with that plant—

Mr. CHAIRMAN. Unless they come up and tell you.

Mr. COX. We start with that plant which their records show was built and used for interstate alone. We then add to that a percentage of plant which is jointly used.

Most of the argument currently is about that part of the plant which is called subscriber lines and equipment, which involves the

lines to the individual residences, the telephone instrument in the home or office, which, as the chairman said, represents about 40 percent of their total investment.

Mr. STRASSBURG. I think another way of answering the question is the Bell System companies keep one set of books, or at least I hope they do—I am sure they do—

The CHAIRMAN. You are not sure, are you?

Mr. STRASSBURG. They keep that set of books, sir, in accordance with a system of accounts which the Commission has prescribed. That is not expressed, those accounts are not expressed in terms of whether it is interstate or intrastate. It is classes of plants, classes of expenses.

Then what happens, is for purposes of jurisdictional ratemaking, those—the total costs have to be equitably apportioned between the two jurisdictions, to give you the interstate rate base, the intrastate rate base. This is done in accordance with the separation principle prescribed by the Commission, and in accordance with the division of revenue procedures, which the company has devised to implement it.

The CHAIRMAN. I understand that, but you are getting so complicated that nobody can understand it up here.

What I am trying to say is, do the telephone companies decide they make 8, 7, or 8½ percent on purely interstate business?

Mr. STRASSBURG. That is decided by the application of the separation principles to the books of the company. That is done—

The CHAIRMAN. Do they do it?

Mr. STRASSBURG. Yes, they do it under the procedures and principles we prescribe. We cannot do it—

The CHAIRMAN. They tell you how much they earn—

Mr. STRASSBURG. They report monthly to us, the results of these separations of their books.

The CHAIRMAN. How do you determine what is interstate and what is intrastate in the investment?

Mr. STRASSBURG. This is determined by the separations principles and separation procedures.

The CHAIRMAN. That you folks laid down?

Mr. STRASSBURG. That we laid down.

But we say we have laid down with due regard to the concerns and interests of the State and in cooperation with the States.

The CHAIRMAN. There are some differences of opinion about that.

I am trying to get this clear in my mind how this operates. It seems to me, if the telephone company is making more than 7½, whatever the amount is, that the rate decrease ought to be across the board.

Mr. BURCH. Senator Magnuson—

The CHAIRMAN. Why can't it be across the board?

Mr. BURCH. Because we don't have an authority that has that right. We can't do it. The States can't do it.

The CHAIRMAN. But if you get together with the State commissioners, you will both say "Amen," wouldn't you?

Mr. STRASSBURG. They are making 7½ percent—

Senator PASTORE. Mr. Chairman, the thing that disturbs me is this: They are right, you start out with the installation on the ground, in the State. Then you have this new mechanism come in of the interstate. It has expanded, and developed, and it improved the progress of America.

We are not confined alone to an area now. We are nationwide, even on telephone calls. But the point I am making, you are talking about jurisdiction.

Now, the States have a vital interest; they are an interested party. Yet, as I get it, the FCC alone has the authority to decree the allocation. And you call these people in as observers and you think that saves them just because they can come there and see and hear. But they have no power to decide.

Now, that is the reason for this bill. The reason for this bill is to give the jurisdiction on a multiple basis, because you have the interests of the State.

Now, you have got to admit that if you had a capricious commission, and I am not saying you are capricious, but if you had a capricious commission that wanted to brag about what they were doing about reducing rates, they could actually work this thing around to the prejudice of the local commissioners.

Mr. BURCH. Certainly they could.

Senator PASTORE. And the only way the local commissioners could fight it would be when the telephone company comes to them for a rate increase. They could say, "No; this isn't the basis; our basis is this." But there again you get to the Supreme Court, where the Court is going to hold, well, how can you decide this? That is the reason why we have led up to these cases.

The thing that is bothering me is this: You did not follow the same procedures in 1969 as you did in 1967. You did not.

Mr. Cox. It would have required a formal case, Senator—2 years.

Senator PASTORE. Why should not this have been a formal case?

Mr. BURCH. Because it would have cost the taxpayers \$300 million while we were doing it.

Senator PASTORE. What taxpayers?

Mr. BURCH. The people who use the telephone lines.

Senator PASTORE. What about the people being asked to pay more money back in Rhode Island now. So you save \$150 million and you allow the telephone company to ask for \$500 million. That is what you are doing.

Mr. BURCH. If we had given it all to them, they would have asked for \$350 million.

Senator PASTORE. Maybe that would have been better; maybe the housewife would have gotten a break, not a guy running an insurance agency in New York calling up his agency in Florida.

Mr. BURCH. And the telephone company would have made excess revenues, which we could have prevented.

Senator PASTORE. Not when you act fast.

Mr. Cox. You cannot act fast in a formal proceeding. We acted with unprecedented speed in docket 16258, and it took 18 months.

Senator PASTORE. I am saying you should have brought the commissioners in to be a party.

Mr. Cox. The commissioners would have been, in January, February or March of 1969, if they had a sound proposal for changing separations. Are you saying just because there are excess earnings we should say, be our guests—take \$150 million?

Senator PASTORE. Of course, they have an interest. Who are they? These are the commissioners who have to defend the people in their State. They are just as superior as you are.

Mr. Cox. They are there to regulate the business of the utility within their jurisdiction.

Senator PASTORE. They are there to protect the consumer of Rhode Island.

Mr. Cox. We are here to protect the interstate users of telephone service.

Senator PASTORE. That is right. I am here to protect that little woman in Rhode Island who wants to use the telephone.

Mr. Cox. All right. We have procedures whereby she is fully protected. She is getting the benefit already of some \$800 million shift in investment on an annual basis.

Senator PASTORE. Well, it looks like you are going to stick to it and that is it. But it is obvious to me now that you are the protectors of the interstate and you are forgetting intrastate, and you are putting on them a burden, if they want to come in. Let them come in with a proposal. After all, you are here to protect all of the consumers of America whether they use long-distance or short-distance calls.

Mr. BARTLEY. Senator, we have no jurisdiction over intrastate calls.

Senator PASTORE. But they do. You should have called them in to let them exercise their jurisdiction.

Mr. BARTLEY. Some States do not have them.

Senator PASTORE. I never heard anything like this in my life. This proves the point. I was here when Rosel Hyde came in and bragged about he was going to reduce these rates, and he had done this by negotiation. He put a badge on himself.

In a few weeks they file a big tariff in the individual States. You have 16 States now where they have filed for an increase. So, you have taken it out of the left pocket and put it in the right pocket.

Mr. BURCH. Senator, I would like to offer this analogy: I do not believe the Senate of the United States is going to confer with the Legislature of Arizona when it deals on a Federal topic.

Senator PASTORE. You would be surprised how often we do it; that is all we do; we confer with every citizen. Every man that comes in this room belongs in a State. So do you.

Mr. BURCH. I understand that. But when you make a decision, you are acting as a U.S. Senator.

Senator PASTORE. For all of the people.

Mr. BURCH. That is correct.

Senator PASTORE. For all of the people; that is what I am asking you fellows to do, to act for all of the people. If that man and woman does not pick up that telephone, you cannot put a long-distance call through to California, unless somebody in some home in that State uses that telephone. Why does he have to be the forgotten man?

Here we are falling all over the people who use a long-distance call and forgetting the people who are using the local calls. That is why all of these people are here today. What do you think they are here for? They are all appointed officials. There is no profit to them to come here today any more than there is profit for you. But they are on the other side of this coin. All they want is a day in court. All they want is to be consulted before you wham these increases on them. That is all it amounts to.

And you sit there and say this is impossible. We did it by negotiations. If you are going to do it by negotiations, not through a formal

hearing, why did you not call in the commissioners and say, let's sit down together and resolve this?

Mr. BURCH. We are talking about two different things, Senator, I believe.

The CHAIRMAN. Could not the negotiations involved with the telephone company say, look, you are making too much here: \$350 million, whatever the amount was. Why don't you reduce the intrastate rates and the interstate rates together? They have the authority to do it. You do not have to order it. They could do it by negotiation. Why could not that have been in negotiation with the commissioners?

Senator PASTORE. And they brag about the reduction: that is the point.

Mr. BURCH. Senator, I do not think anybody here is bragging about the reduction. The answer is, Senator, yes, we could do anything like that, if we wanted to completely abandon what we are supposed to be doing.

The CHAIRMAN. This is the point I make, because I cannot in my mind quite know where you separate interstate from intrastate.

Mr. BURCH. Granted this is somewhat of an occult science, but nevertheless you do have to make a reasonable approach to how you are going to divide a piece of equipment, whether it is all intrastate, whether it is partially intrastate. One proposal, which you more or less alluded to, if you had one supreme authority that set the rates for everybody in the United States, possibly you could work that way. You would only have one base and one rate to worry about.

The CHAIRMAN. You negotiated this with the Bell System. They do not care where they reduce the rates, whether it is intrastate or interstate, as long as the reductions are going to be the total amount. Is not that correct?

Mr. BURCH. That is basically correct.

Senator PASTORE. We do not want to take anything away from the telephone company. It is a question of where you put the load.

Mr. BURCH. If I could just respond one more time, Senator. When we were talking about the telephone company in 1969, we were talking about rate of return on their interstate investment. We were not talking about separations procedures. The only person, to my knowledge, who is obliged to sit in on a meeting of that sort, those authorized to, is the FCC, because that is our bailiwick. When we are talking about separations procedures, that is when we talk with the States, and we have done so.

Senator PASTORE. When you say the separation procedures, it is the crux for what the rate of return is.

Mr. BURCH. Granted.

Senator PASTORE. Therefore, when you talk of one, you talk of the other. I do not see how you can separate these considerations. The way you allocate the costs makes a big difference as to where the rate of return falls; is that true?

Mr. BURCH. Certainly.

Senator PASTORE. So one is tied with the other.

Mr. BURCH. We were attempting to do both.

Senator PASTORE. I know you were attempting, but the question is it did not happen.

Mr. BURCH. That is correct.

The CHAIRMAN. Please continue. I know you want to finish your statement.

Senator PASTORE. Yes. All we are getting is Supreme Court decisions.

The CHAIRMAN. You may proceed.

Mr. BURCH. In view of the growth that is anticipated in interstate revenues and earnings, it is expected that such a review will take place sometimes in the first half of 1970, after, among other things, the effects on earnings of any revision in the Federal income tax surcharge are known.

I turn now to the argument of some States that the mere fact that the FCC is in a position to effectuate substantial interstate reductions at a time when even greater intrastate rate increases are sought by the same company demonstrates *ipso facto* that there must be fundamental deficiencies in the separations procedures. We cannot agree with this view. The critical fact is that there are inherent differences in the cost characteristics associated with the provision of the two types of service. These differences in cost characteristics are not created by the separation procedures but simply reflect differences in technological and economic factors.

In general, there have been increased economies of scale associated with circuit costs for long distance interstate toll calls. Technological breakthroughs have dramatically reduced the necessary investment from about \$200 per circuit mile some 30 years ago to about \$10 per circuit mile in the most modern facilities now being installed. There have not been comparable breakthroughs in the case of local or exchange services.

Thus, a major element of toll costs has been drastically decreased while no similar reductions have been realized in the cost of exchange plant. Of course, exchange plant is used to originate and terminate long distance calls. However, the decreases in the circuit costs have more than offset the increases in costs of the local exchange plant used for the origination and termination of long distance calls.

The commission is, of course, fully cognizant of the disparities which exist between interstate and intrastate toll rates in some States. Here again some urge that these disparities are caused by inequities in separation procedures. The fact is that these disparities result mainly from the economies of scale which occur for the most part in longer hauls. Moreover, the cost of exchange facilities used to originate and terminate these calls, which costs are relatively fixed, therefore represent a higher proportion of the total cost of shorter haul toll calls than that involved in longer hauls.

Thus, the cost per mile for handling a call decreases as the distance increases. Since the average distance of calls in most States is much shorter than the average distance of interstate calls, the cost factors related to distance are much more favorable for interstate calls. To state it another way, the higher cost factors of the terminal facilities are more readily absorbed and offset by the economies resulting from lower unit costs at the longer distances.

The CHAIRMAN. There again, why should not all of the people benefit by this, not just the person that makes the long-distance call? Every customer should benefit by these efficiencies.

Senator PASTORE. That is the point exactly.

Mr. BURCH. Senator, the only way I know you could do that is take the telephone company as a whole, treat it as a total investment and say you will get a certain return on your investment.

The CHAIRMAN. You could have negotiated that with them.

Mr. BURCH. Oh, sure.

Senator PASTORE. You could have negotiated and worked that out. By all logic we are going to work it out. It is going to be cheaper to make a call in the long-run from New York to San Francisco than from New York to Albany. That could happen.

Mr. BURCH. That is probably true today, Senator. It costs less to do that.

Senator PASTORE. Isn't that a swell situation? Isn't that marvelous? It is going to cost you more money to make a call from New York to Albany than from New York to San Francisco. That is just swell.

Mr. BURCH. Senator, what I said was it probably costs more to place that call per mile, certainly.

Senator PASTORE. I realize that. You can justify almost anything you want. But isn't this an impractical, incongruous situation if that should come to pass? As Senator Magnuson brought out, this whole thing is one complex. Unless you had these high unit costs on the local level, you could never have this technological development on the long-haul level. The two should be wedded together in some way. The only way I see you can do it is by some understanding. I think maybe the bill is the answer to it. Call it an impartial jury that takes into account all of it, and do it that way.

You people come in here and say even though we recognize this may be unfair, the fact still remains we do not have the jurisdiction to do it. Well, that does not satisfy me. Anything that is unfair ought to be corrected.

Mr. BURCH. Senator, I have to respond to this point, that if we give all of this money to the States, it is not really going to solve the problem you are talking about.

Senator PASTORE. It would solve the problem of equity. You still need \$350 million. I grant you that, but just the same, you are sharing the saving with the entire network of telephone users.

Mr. BURCH. Senator, would you seriously suggest we arrive at a figure with the telephone company of \$150 million and then say, now we are just going to say, you take half and we will take half? Is that it?

Senator PASTORE. I do not want that at all. But what you do is call in the telephone company, and sit down and say, look, how is it on the long lines you make so much money, on the short lines you are losing money. Why don't we get a base that is equitable, so we will both be on an even keel. And let us separate these costs in such a way that it will not reflect this disparity in the rate of income. I mean, the best proof of the pudding is in the eating.

The mere fact that your allocation has worked out in this lopsided situation means it is off balance.

Mr. BURCH. Senator, for one thing, we can never make Rhode Island as big as California, regardless of how much we negotiate; there is no way we can do that. Rhode Island has problems which do not occur in California.

Senator PASTORE. Do you think that is a very smart analogy? Do you mean I am trying to tell you Rhode Island is as big as California? How ridiculous can we get.

Mr. BURCH. I am telling you the State of Rhode Island has problems the State of California does not have.

Senator PASTORE. But a consumer in little Rhode Island is just as good as a consumer in big Colorado, Arizona, or any place else.

Mr. BURCH. Nobody denies that, Senator.

The CHAIRMAN. Well, we are running a little late here.

Mr. Chairman, would you put the rest of your statement in the record up to page 14. That is two pages, and then get down to where you discuss the bill.

Mr. BURCH. Yes, sir.

It should, therefore, be clear that unit costs for furnishing interstate toll telephone service can decrease at the same time that the costs of furnishing local or intrastate services are increasing. In any system where plant is subject to different jurisdictions, separations procedures must reflect these differences. In concluding this point, it is relevant to note that even in those services which are subject to the same jurisdiction, for example, the FCC, rates must be, and are, related to costs. Thus, in the rate adjustments now under consideration there are both increases and decreases. Cost studies prepared by the telephone company indicated to it that upward rate adjustments were required for broadcast transmission services and in the Telpak tariffs. They, therefore, filed tariffs calling for annual increases of \$87 million, which are to be offset by decreasing charges for message toll telephone services. This was done to prevent one class of users subject to the Federal jurisdiction from bearing costs of services furnished to another class of users subject to the same jurisdiction. Obviously the same principle must apply as between the users of interstate toll telephone service and the users of higher cost exchange and intrastate toll services.

To sum up, therefore, the purpose of separations is to ascertain as objectively and fairly as possible, by the use of sound and rational allocation procedures, the legitimate costs applicable to services subject to separate jurisdictions. It is not the purpose of cost separations to artificially or arbitrarily equalize costs of services which are inherently disparate and unequal. It is only by adhering to sound and rational cost allocation procedures that our system of regulation, which is predicated upon appropriate recognition of Federal and State authority, will have meaning.

With this background, I should like to address myself to the provisions of S. 1917 which would amend the Communications Act with respect to the determination of methods of jurisdictional separations. In brief, the Commission is opposed to the bill because it would divest us of jurisdiction to determine what investment and expenses are properly attributable to the public services which we are charged with the responsibility of regulating.

S. 1917, which is designated the "Federal State Joint Board of 1969" would establish a joint board composed of four FCC commissioners and three State commissioners designated by the NARUC. This joint board would have sole administrative authority to adopt, and to amend, from time to time, procedures for determining what part of the property and expenses of communications common carriers shall be considered as used in interstate or foreign communications service subject to the jurisdiction of the FCC.

The CHAIRMAN. Right there, percentage-wise that is not as important as the other, is it? It is a small amount?

Mr. STRASSBURG. The foreign part is minimal, yes.

Mr. BURCH. As we understand the bill, the actions of the joint board would be final so far as the FCC's regulatory authority is concerned. The full Commission would have no authority to review or modify the action of the board. It would not even be allowed to seek judicial review of the board's actions, even though the bill provides for such review at the behest of the States.

Fundamental to the regulation of public utilities by any regulatory authority is determination of the investment, or rate base, upon which the utility shall be allowed to earn its fair rate of return. Equally fundamental is a determination of the operating expenses the utility may recover from the ratepayer. These determinations, in turn, are responsible for the level of the rates paid by the public. Yet under the provisions of S. 1917, action by three State commissioners in conjunction with one FCC commissioner would preempt six FCC commissioners from any voice in the determination of questions so fundamental in carrying out the responsibilities imposed on them by Congress.

A major point advanced by NARUC, which supports this legislation, is that it is inequitable for the FCC, whose regulatory authority extends to only 25 percent of the telephone plant, to unilaterally prescribe how the total plant shall be allocated for jurisdictional purposes. Actually, current separations procedures allocate about 30 percent of the total plant to interstate. It should be noted, of course, that no other single jurisdiction is responsible for so much as 30 percent of the plant investment. More important, however, is the fact that almost every part of the total plant is used in some degree in furnishing interstate service.

NARUC seems to base its support for this legislation in part on the claim that the FCC, in adopting its order prescribing separations methods, has abandoned the long-established Federal-State cooperative approach to jurisdictional separations. We do not agree.

The CHAIRMAN. We have a vote on the floor, so we will have to recess. We will recess at this time until 1 o'clock, and then we will go from 1 to 2, or if some others are here, I can leave and we will see how far we can get at that time.

(Whereupon, at 11:25 a.m., the committee was recessed, to reconvene at 1 p.m., this same day.)

AFTERNOON SESSION (1 P.M.)

Senator PASTORE (presiding). I am going to ask the indulgence of Commissioner Burch for just a few moments. Mr. Francis Pearson, president of the National Association of Regulatory Utility Commissioners has asked that we interrupt the proceedings so that he might introduce to the committee the various commissioners who have come here and some of them who have to leave immediately, who are not going to testify. And if they have any statements, they can put them in the record.

All right, Mr. Pearson you may begin.

Mr. PEARSON. Thank you very much, Senator Pastore. I am going to introduce our second vice president, Mr. Francis Riordan, the

chairman of the New Hampshire commission, who has the list and will read the names off.

I am sorry to say that I think some of them have already gone. But there were some 32 or 33 State members of Bell Systems here this morning.

Senator PASTORE. All right.

Mr. RIORDAN. I would like to call for Commissioner Jack Owen and Engineer James B. Williams of the Alabama Public Service Commission.

Mr. OWENS. I have a statement for the record and will leave it.

Senator PASTORE. Do you want that in the record, sir?

Mr. OWENS. Yes, sir, a part of these proceedings.

Senator PASTORE. Yes, of course.

Mr. RIORDAN. From Arizona, Commissioner Dick Herbert, who apparently is not back yet.

From the California Public Utility Commission, we have the president, Bill Symons, and the communications engineer, James McCraney.

Mr. Symons has a statement he wishes to make a part of the record.

Senator PASTORE. Without objection, it is so ordered.

Mr. RIORDAN. From Colorado, Commissioners Edwin R. Lundborg and Howard S. Bjelland. They apparently are not back from lunch.

From Delaware, Commissioners Robert L. Hagenbach and John F. Abbott, Jr. Do you have a statement you wish to place in the record, a prepared statement?

Mr. HAGENBACH. No.

Mr. RIORDAN. From the District of Columbia Public Service Commission, Commissioners George A. Avery and William L. Porter.

Mr. AVERY. I do have a statement for the record, Senator.

Senator PASTORE. Without objection, it will be a part of the record.

Mr. RIORDAN. From the Georgia Public Service Commission, Commissioners Walter R. McDonald and Ben. T. Wiggins.

Mr. WIGGINS. We will have a statement.

Senator PASTORE. And it will be entered into the record.

Mr. RIORDAN. From Idaho Public Utilities Commission, president Ralph H. Wickberg.

Mr. WICKBERG. I have a statement which I have already left with the clerk.

Mr. RIORDAN. From Kansas we have Commissioner Jules Doty.

Mr. DOTY. I have a statement for the record.

Senator PASTORE. Without objection, it will be made a part of the record.

Mr. RIORDAN. From Illinois, John W. Kissel, Jr.

Mr. KISSEL. I have a statement here that I would like to have accompany the record.

Mr. RIORDAN. From Kentucky, the executive director, R. L. Hutchinson, and Commissioner W. Howard Clay.

Mr. HUTCHINSON. Kentucky has a statement which it would like to submit.

Senator PASTORE. It will be inserted in the record.

Mr. RIORDAN. From Louisiana Public Service Commission, Chairman Nat B. Knight, Jr.

Mr. KNIGHT. I have a statement also.

Mr. RIORDAN. From Michigan, the chairman, Willis F. Ward.

Mr. WARD. I am present, but we have no prepared statement at this time.

Mr. RIORDAN. From Mississippi, Chairman Norman A. Johnson, Jr., who apparently has not returned yet. He has a statement, I am sure. From Maine, Commissioner John G. Feehan.

From Maryland, Chairman William O. Doub, and Chief Auditor E. E. McLean.

Mr. DOUB. The Maryland Commission has a statement they would like to offer for the record.

Senator PASTORE. Without objection.

Mr. RIORDAN. From the Missouri Public Service Commission, Chairman William Robinson Clark. He is not here at the present time, but he also has a statement to place in the record.

Myself as chairman of the New Hampshire Commission have already provided the clerk with a statement which we would like to have incorporated into the record.

Senator PASTORE. Without objection, it is so ordered.

Mr. RIORDAN. From Nebraska, Commissioner Eric Rasmussen and Chairman John W. Swanson.

Mr. SWANSON. We also have a statement for the record.

Mr. RIORDAN. From Nevada, Commissioner Noel Clark.

Mr. CLARK. Mr. Chairman, I have a statement I would like to place in the record.

Senator PASTORE. Without objection, it is so ordered.

Mr. RIORDAN. From North Carolina, the director of Public Utilities, Robert Koger, and Commissioner John McDevitt, and Attorney Edward B. Hipp.

Mr. KOGER. North Carolina has a statement, Senator.

Senator PASTORE. Without objection.

Mr. RIORDAN. From New York, Norman Abell, assistant director, utility division, and T. J. Brady, chief of the Telecommunications Bureau.

Mr. ABELL. I have a statement, Senator.

Senator PASTORE. Without objection.

Mr. RIORDAN. From Ohio, Professional Engineer Loren J. Fritz.

Mr. FRITZ. I would like this statement to be placed in the record.

Senator PASTORE. Without objection.

Mr. RIORDAN. From Pennsylvania, Engineer P. M. Schuchart and Chairman George Bloom, who has not returned from lunch yet.

Mr. BLOOM. Yes, I am here. I have with me Mr. Schuchart, our communications specialist. I expect to make an oral statement as part of the presentation.

Senator PASTORE. All right, sir.

Mr. RIORDAN. Did I skip anybody?

Senator PASTORE. Let me ask you a question. The commissioners who submitted their statements and those who arose and were introduced and haven't yet prepared a statement or do not choose to submit one, are you in favor of S. 1917?

(Several affirmative responses.)

Senator PASTORE. That is the tenor and purpose of your statements, is that correct?

Mr. WARD. Michigan is in favor of S. 1917.

Senator PASTORE. All these statements are in favor of this bill?  
(Several affirmative responses.)

Senator PASTORE. All right. The record wouldn't show a nod of your head, it has to be a viva voice.

Mr. RIORDAN. From Rhode Island, Archie Smith, chairman. He will be making a statement here later as a witness.

From South Carolina, we have Clyde F. Boland, commissioner.  
South Dakota, Commissioner Harvey Schard.

Mr. SCHARD. Mr. Chairman, we also have a statement for the record.  
Senator PASTORE. All right.

Mr. RIORDAN. From Tennessee, the General Counsel, Eugene W. Ward.

Mr. WARD. We also have a prepared statement in support of the bill, Mr. Chairman.

Senator PASTORE. Fine.

Mr. RIORDAN. From Vermont, Chairman Ernest W. Gibson and Engineer Rexford Roberts.

Mr. GIBSON. We have no statement for the record. We do support the bill and the NARUC position on separations.

Senator PASTORE. All right, sir.

Mr. RIORDAN. Of course we have from Washington Commissioner Francis Pearson who will be testifying.

Mr. PEARSON. A statement from Washington has already been presented for the record.

Senator PASTORE. But you are going to testify, is that correct?

Mr. PEARSON. Yes, sir.

Mr. RIORDAN. From Wisconsin, Chairman Arthur L. Padrutt, and Staff Accountant Norman Young.

Mr. PADRUTT. Mr. Chairman, we have a statement for the record in support of the bill.

Mr. RIORDAN. From West Virginia, Commissioner Robert L. Stewart, Commissioners Griffith and Callahan.

Mrs. CALLAHAN. I am Commissioner Callahan from West Virginia and we have a statement in behalf of the bill we would like to make a part of the record also.

Senator PASTORE. Thank you.

Mr. RIORDAN. Commissioner Dick Herbert from Arizona has come in since I first called on him.

Mr. HERBERT. Mr. Chairman, I would like to place a statement in the record and would like to make a brief comment.

Though Dean Burch, Chairman of the FCC, is a proud Arizonian and we take some pride in whatever good he does as a representative of our State, the utility commission, which we call the Arizona Corporation Commission, unanimously adopts and supports and urges you to adopt and we support S. 1917.

Senator PASTORE. Thank you.

Mr. RIORDAN. From Arkansas—

VOICE. Mr. Chairman, the State of Arkansas has a statement to offer for the record.

Senator PASTORE. Without objection.

Mr. RIORDAN. Commissioner Peterson, would you identify yourself for the record, please?

Mr. PETERSON. Fred Peterson, Nebraska. We have already entered our statement.

Mr. RIORDAN. I have two other statements I would like to offer. One is from the Public Service Commission of Montana and one from the State of Wyoming, Public Service Commission.

Senator PASTORE. Is that it?

Mr. RIORDAN. The Georgia Commission, Commissioner Ben Wiggins just came in and he would like to make a statement.

Mr. WIGGINS. Mr. Chairman, we do have a statement in support of the legislation.

Senator PASTORE. I have a list of four witnesses, Mr. Pearson, Mr. Smith, Mr. Wiggins, and Mr. Bloom. Is that it? Those are the ones that will testify?

Mr. RIORDAN. Yes sir.

Senator PASTORE. Anyone else who desires to file a statement?

Commissioner Norman Johnson from Mississippi is here now.

Senator PASTORE. The record will be open for any further statements you may have.

All right, Dean Burch, you may proceed.

**STATEMENT OF HON. DEAN BURCH, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION; ACCOMPANIED BY COMMISSIONER ROBERT T. BARTLEY, COMMISSIONER KENNETH A. COX, BERNARD STRASSBURG, CHIEF, COMMON CARRIER BUREAU, AND H. LEROY BAKER, CHIEF, FIELD OPERATIONS DIVISION, FEDERAL COMMUNICATIONS COMMISSION—Resumed**

Mr. BURCH. Mr. Chairman, NARUC seems to base its support for this legislation in part on the claim that the FCC, in adopting its order prescribing separations methods, has abandoned the long-established Federal-State cooperative approach to jurisdictional separations. We do not agree.

The Commission stated in its rulemaking order of January 30, 1969, prescribing separation methods, that:

In this connection we intend to continue our cooperation with the NARUC, as in the past, in the conduct of joint studies and reviews of jurisdictional separations matters. In fact the Commission will look to these joint studies as the prime forum for continued analysis of separation procedures and the source of proposals for their refinement, improvement or modification in light of actual experience and technological changes.

As I have already noted, since that date the Commission has approved a further transfer to interstate of \$35 million in revenue requirements as a result of cooperative efforts between the States and itself.

Moreover, at this time, cooperative studies are in progress involving representatives of the States and the FCC to explore the possibility of further refinements and improvements in separations methods.

We believe the record clearly shows that we have not abandoned the cooperative approach. On the contrary, the purpose of our formal prescription of uniform separations methods was to provide for an orderly and legally recognized procedure for considering proposed changes in such methods.

Our codification of these methods as part of our rules provides an established procedure by which amendments can be proposed and a forum in which all interested parties can be heard. It provides a means

by which the justification for changes can be examined in the light of a public record. It also affords an opportunity for judicial review of Commission action.

On the other hand, S. 1917 appears to call for hearings—a lengthier, more cumbersome process than the more flexible and speedier rule-making procedures under section 4 of the Administrative Procedure Act.

An analysis of the provisions of S. 1917, in contrast with the provisions of present statutes relating to joint boards, serves to emphasize the problems we have with the proposal. The presently existing joint board procedures have long been utilized by the Interstate Commerce Commission and are also provided for in the Communications Act.

Under the latter provisions the joint board has the jurisdiction and powers conferred by law upon an examiner provided for in section 11 of the Administrative Procedure Act. Its decision is an intermediate one fully reviewable by the FCC. Thus, the FCC retains full jurisdiction and authority to determine matters fundamental to the discharge of its regulatory responsibilities. This would not be so under S. 1917.

Another difference between the proposed legislation and the present provisions for joint boards is that relating to the appointment of the participating State Commissioners.

Under the presently effective statutes, the FCC has veto power over the State Commissioners designated. Moreover, the designation is by State governmental authority, either by a State Commission or the Governor of the State. Under S. 1917, the FCC has no authority to reject any nominee of the NARUC. Moreover, the latter organization has, at most, only quasi-official status.

Although we at the FCC have great respect for NARUC and its members, delegation to it of authority to appoint officials to whom the bill would grant so much power over the regulation of interstate commerce would appear to be inappropriate and is certainly without precedent.

It should be noted that the presently effective joint board provisions are designed to give certain States directly interested in a question peculiarly affecting them a voice in the determination of that question as it affects their individual States.

However, because of the interstate nature of such questions, the ultimate responsibility for their determination is left to the Federal agency.

On the other hand, the matters with which S. 1917 is concerned affect not just a few States, but all of the States. Further, the States are affected by separations changes in different ways and their interests are often disparate.

It would be difficult for the three State Commissioners envisioned by S. 1917, with their own local concerns, to represent the divergent interests of some 50 jurisdictions.

It is for these reasons that we believe that the informal but effective cooperation which we have maintained with the States, with the full opportunity for all interested parties to participate in our rulemaking proceedings, is a far more appropriate and effective procedure for handling this complex subject of jurisdictional separations.

Accordingly, it is our opinion that we were fully justified in bringing about the \$150 million reduction in interstate rates. It is also our opinion that S. 1917 should not be enacted.

Thank you very much, Mr. Chairman.

Senator PASTORE. Thank you, Mr. Burch.

I don't know if the other Commissioners would like to make a statement at this time or whether you would prefer to hear from these other witnesses and then make a rebuttal type statement. How would you like to do it?

Mr. BURCH. That might be very appropriate, sir.

Senator PASTORE. All right. Then we will hear from Mr. Pearson.

**STATEMENT OF FRANCIS PEARSON, PRESIDENT, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS, AND COMMISSIONER, WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

Mr. PEARSON. Senator Pastore, I am Francis Pearson, president of the National Association of Regulatory Utility Commissioners and a member of the Washington State commission. I have been a member of that commission since I resigned from the State senate in April 1957. I have also been an active member of the communications committee most of the years since that time.

I am accompanied at the witness table this morning by: George I. Bloom, first vice president of the NARUC and chairman of the Pennsylvania Public Utility Commission; Francis J. Riordan, second vice president of the NARUC and chairman of the New Hampshire Public Utilities Commission; Ben T. Wiggins, chairman of the NARUC Committee on Communications and vice chairman of the Georgia Public Service Commission; Archie Smith, chairman of the Rhode Island Public Utilities Commission; A. L. Hutchinson, chairman of the NARUC Subcommittee of Staff Experts and executive director of the Kentucky Public Service Commission; P. M. Schuchart, chairman of the NARUC Staff Subcommittee on Separations and Toll Rate Disparity and an engineer for the Pennsylvania Public Utility Commission; and Paul Rodgers, general counsel of the NARUC.

I am also accompanied in the hearing room this morning by representatives of the majority of the State commissions and of the District of Columbia Public Service Commission engaged in the regulation of communications. At this time, I will ask Vice President Riordan to briefly introduce the representatives from each of these commissions and I respectfully request that the representatives stand at the time of introduction.

The NARUC is a quasi-governmental nonprofit organization founded in 1889. Within its membership are the governmental bodies of the 50 States and of the District of Columbia, Puerto Rico, and the Virgin Islands engaged in the regulation of carriers and utilities. Our chief objective is to serve the public interest by seeking to improve the quality of government regulation.

The members of the NARUC appreciate the opportunity you have given us as their spokesmen to make their views known on S. 1917, a bill proposing the Federal-State Communications Joint Board Act of 1969 which was introduced by Senator Magnuson on April 23, at the request of the NARUC. We also appreciate the opportunity to make our views

known on the FCC proposal to reduce Bell System interstate toll rates in the amount of \$237 million at a time when the same Bell System is now seeking from State commissions rate increases totaling in excess of \$500 million for State and local telephone service.

Our testimony this morning will be divided into four parts.

First, Chairman Smith of Rhode Island will describe in general terms the longstanding and steadily worsening problem we have with the FCC regarding the separation of costs between the interstate and intrastate operations of the Bell System and the serious adverse effect which this problem exerts upon the broad consumer interest in this Nation.

Second, Vice Chairman Wiggins of Georgia, in order to place this problem in clearer perspective, will briefly relate the significant historical aspects of Federal-State relations in telephone separations.

Third, Chairman Bloom of Pennsylvania will describe S. 1917 and what we perceive to be the justification for its prompt enactment.

And, fourth, I will conclude our testimony with a recommendation to the committee for taking prompt action in asking the FCC to reconsider and to seek to utilize the \$237 million of interstate earnings for the benefit of the basic users of telephone service in this Nation, instead of, as now intended, for the benefit of the far fewer and generally more affluent users of interstate long-distance service.

Chairman Smith, please proceed.

Mr. SMITH. Mr. Chairman and members of the committee, in the United States today there are over 110 million telephones which average out to about 52 telephones per 100 people. Of these, 72 percent are classified as residential and the remaining 28 percent are classified as business.

These telephones comprise a nationally interconnected system which transmits approximately 150 billion calls a year.

Dominant in this national communications network is the American Telephone & Telegraph Co. and its 24 associated companies which comprise the Bell System. This system is concentrated primarily in the metropolitan areas and has over 91 million telephones, a gross plant investment of over \$46 billion, and annual revenues of approximately \$14.5 billion.

The remainder of the telephone service in the Nation is provided by 1,850 independent, or non-Bell, companies who have 19½ million telephones, a gross plant investment of almost \$12 billion and annual revenues of \$2.5 billion.

Regulatory jurisdiction over the telephone industry is divided between the FCC and the State commissions. The FCC regulates interstate message toll calls, commonly referred to as long-distance calls. The State commissions regulate intrastate message toll calls and local exchange calls even in instances where the boundaries of the exchange area overlap State lines.

Under this division of regulatory responsibility, the FCC regulates approximately 2½ billion interstate long-distance toll calls a year and the State commissions regulate approximately 147 billion intrastate toll and local exchange calls a year. In terms of plant investment, the FCC exercises jurisdiction over approximately 25 percent of Bell System plant while the State commissions exercise jurisdiction over the **remaining 75 percent and over virtually all of the plant of the independent telephone companies.**

Under the rate base concept of ratemaking, practiced by the FCC and the State commissions, the Bell System, through its rates, is entitled to earn a reasonable return on its plant invested in common carrier service and to recoup its expenses reasonably incurred in furnishing such service. Since the vast bulk of Bell System plant and expenses are used in furnishing both interstate and intrastate communication service, such plant and expenses must be allocated or separated between the interstate and intrastate uses for purposes of ratemaking by the respective Federal and State jurisdictions.

The procedures employed in the division of these joint telephone costs are commonly referred to as "separations procedures." Inherently, they involve judgment factors in which there is no absolute correctness or incorrectness. We do not expect the committee to focus on the very technical details of separations procedures. However, there is involved, as hereinafter explained, a basic policy question of tremendous effect upon the American consumer which we hope the committee will consider and act upon.

It is essential to the public interest that procedures for separating such plant and expenses be fair and equitable so that no unreasonable burden will be placed on either the interstate or intrastate users of the telephone service.

Although the FCC has controlled the prescription of separations procedures since the beginning, it has never prescribed equitable ones because it has consistently refused to allocate a fair amount of the cost of providing local telephone service to the users of the interstate service. Local telephone service is an integral part of the national and international toll network. It is the gateway to the toll network and without it the toll network would be worthless.

The FCC's proclivity for inequitable separations procedures which favor its narrow regulatory interests is magnified by a strong technological trend in the telephone industry which results in reduced costs for long distance service and increased costs for local service. The extensive use of microwave facilities and of coaxial cable, with its high volume circuit capacity, has dramatically reduced the cost of long-distance circuits. Ten years ago coaxial cable could carry only about 500 telephone calls at a time. The newest ones can handle about 32,000 calls at a time, and it is anticipated that in the near future this capacity can be increased to 100,000 calls. During the same period, the cost of installing such cable has decreased from about \$100 a mile for each channel to less than \$5.

In contrast, there is no such technological breakthrough in the furnishing of local exchange service and hence the cost of providing this service steadily rises due to inflation. Although exchange plant is employed in both interstate and intrastate service, the investment in such plant is determined by the number of exchange subscribers served and not by the volume of local traffic generated. In other words, the investment in the local distribution plant connecting the subscriber to his central exchange office, as well as a significant portion of the investment in the central office, have a one-to-one correspondence with the number of subscribers. Accordingly, exchange plant costs vary directly with the number of subscribers while the magnitude of the long-distance toll lines plant investment is largely determined by actual usage and hence this high use factor permits long-distance calling to achieve a high degree of economic efficiency.

The very low use of exchange plant was described by the FCC in July 1967 in the following terms:

As a consequence of this characteristic of subscriber plant, although such plant is available for use of the subscriber twenty-four hours a day, it is in actual use, on a nationwide average basis, only twenty-nine minutes out of the twenty-four hours. For the remainder of the time, the plant stands idle but available for the subscriber's use. In other words, actual use for all services, intrastate and interstate, accounts for only 2 percent of total time such plant is available for use. Of this 2 percent, interstate toll service makes actual use of the plant for an average of 4 percent, intrastate toll for an average of also 4 percent, and exchange service for an average of 92 percent. Re American Telephone and Telegraph Company et al., 70 PUR 3d 129, at p. 212, par. 286.

Presently, it is estimated that the average telephone is used 1½ minutes a day for interstate toll service, 1½ minutes a day for intrastate toll service, and 27 minutes a day for local exchange service; and remains idle 23½ hours a day. The FCC stated on page 3 of its letter to Chairman Magnuson on November 17 that in 1952 less than 3 percent of subscriber line plant was assigned to interstate operations whereas today "16 percent of these costs are assigned to interstate operations even though such operations account for only about 5 percent of the actual use of their subscriber plant." By completely ignoring the 23½ hours of idle time, the FCC seeks to cast itself in a magnanimous role. In reality, the more affluent interstate callers are paying the cost of maintaining subscriber plant, which is absolutely indispensable to long-distance service, for only about 3 hours and 50 minutes a day whereas the local and intrastate callers are paying for the remaining 20 hours and 10 minutes.

Furthermore, the FCC failed to mention that subscriber line plant only includes the telephone plant on the subscriber's premises and lines connecting the premises with the local central office. The local central office equipment, which is an integral part of both exchange and toll service, has only a 6-percent assignment to interstate operations.

Obviously, the paramount criterion employed in the separation of all telephone plant has been far too heavily based on actual time in use with far too little consideration being given to idle time which someone must pay for. Accordingly, the primary criterion for the separation of telephone plant is consistent with the character of the toll business but inconsistent with the character of exchange business.

Senator PASTORE. May I interrupt for a question? Has this formula that you are speaking of, which you are criticizing at the moment, ever been presented let's say to the Supreme Court in a controversial case and the Court either sustained or rejected it, or is this a question that still is in limbo? Do I make myself clear?

Mr. SMITH. Yes, sir.

Senator PASTORE. If your attorney is prepared to answer that question, I would appreciate it.

In other words, what Mr. Smith has brought out about this 23.5 hours and so on, has this argument ever been the premise in any dispute that reached the courts?

Mr. RODGERS. The main case on this is the *Smith* case, which was decided in 1930; and that laid down the guidelines that there must be some relation to use, but it did not tie the Commissions to an absolute adherence to the use factor. In fact, even the FCC in its separation proposals has afforded some weighting for the local service, for the benefit of the local service, but it has always been insufficient.

As was pointed out this morning, the art of separation is not an exact science, and judgment comes into maximum play in the formulation of the procedures.

Senator PASTORE. The point I am making, it is not to argue the merits of it, but rather I want to know if this has ever been determined by the courts so that we are cut off from it.

Mr. RODGERS. No, sir.

Senator PASTORE. In other words, there is still flexibility, regardless of anything that has gone to court, there is still flexibility here, it is negotiable?

Mr. RODGERS. Yes, sir.

Senator PASTORE. That is the point I wanted to make. All right, you may continue.

Mr. SMITH. The basic vice in FCC policy in telephone separations is to take an overly simplistic view of our nationally integrated communications system as being divided into two parts—interstate and intrastate—and to shower the economics of long-distance calling upon the interstate callers instead of flowing the benefits through to the far more numerous and less affluent local callers.

Largely as a result of the FCC's long-standing unreasonable separations procedures, the consumers of America are now confronted with a ridiculous situation which would be laughable if the financial stakes were not so high.

On the one hand, the FCC on November 5 determined that the Bell System has \$237 million of excess earnings on its interstate operations. On the other hand, the same Bell System has instituted proceedings now pending before State commissions to seek rate increases totaling in excess of \$500 million. This figure, of course, does not include the rate increases now being sought by the non-Bell telephone companies who are also adversely affected by unfair separations procedures.

All non-Bell companies will lose revenue if the proposed reduction is effectuated since they will receive less interstate toll revenue through their settlements with the Bell System and, therefore, this loss of revenue will have to be recovered from intrastate and local users of service.

Furthermore this growing tide of rate applications during this accelerated inflationary period clearly indicates that virtually all of the Commissions of the 50 States will be pressed in the near future to increase rates for local telephone service.

The FCC, in its letter to Chairman Magnuson on November 17, page 3, has sought, we believe, to exaggerate the benefit to the average telephone user of "low rates for long-distance calls made during evening and nighttime hours and throughout the weekend."

The FCC says that this "has made the service economically attractive and available to the householder and members of the family who, in the age of travel and family dispersion, have become dependent upon the telephone as a principal means of communications with each other."

The FCC chooses to ignore the fact that in the vast majority of cases the person who makes an interstate toll call for a few cents less is the same person who must pay unduly high charges for exchange service and for interstate toll calls. The result is a net loss to the average consumer.

The \$150 million interstate rate reduction which the FCC has negotiated with A.T. & T. to take effect January 1 will accomplish the following significant changes in long-distance rate structure:

Reduction to 90 cents for three-minute customer-dialed coast-to-coast calls, and advancement of the time these "night rates" apply to 5:00 p.m. from the present 7:00 p.m.

Introduction of a 35 cent coast-to-coast rate (less for intervening points) for a one-minute customer-dialed call between midnight and 8:00 p.m.)

Lengthening of the reduced rate period by an additional hour from 7:00 a.m. to 8:00 a.m. of particular advantage to callers in western time zones.

Inauguration of a separate, discounted rate schedule for customers who dial their own calls covering distances more than 200 miles.

The Wall Street Journal, in reporting on this proposed reduction on December 3, stated that "Business customers would be among the chief beneficiaries, particularly those transmitting short bursts of data late at night."

In contrast, the Maryland Public Service Commission has been forced to grant a rate increase to the Chesapeake & Potomac Telephone Co. of Maryland, an A.T. & T. subsidiary, which will increase its annual revenues by \$22.7 million.

The Maryland commission has approved a rate of return of 7.65 percent for intrastate operations whereas the FCC has indicated that a rate of return of 8.5 percent for interstate operations would not be unacceptable.

It is expected that the rate schedules which will have to be approved to implement the Maryland increase will range from 80 cents to \$1.25 for residential customers in the Maryland suburban portion of the Washington metropolitan area.

The Chesapeake & Potomac Telephone Co. of Virginia, another A.T. & T. subsidiary, has filed a request with the Virginia State Corporation Commission to increase service charges. This proposal includes provision for raising the charge for connecting new telephones from \$12 to \$15 for business and from \$8 to \$11 for residential subscribers, and for raising from \$6 to \$8 the charge for changing business and residential telephone service from one location to another.

The Chesapeake & Potomac Telephone Co. for the District of Columbia, another A.T. & T. subsidiary, is now seeking rate increases from the District of Columbia Public Service Commission.

These kinds of cases, which involves the Washington metropolitan area, epitomize the kind of rate increases which are being sought across the Nation. Many of these increases are described in the statements of individual State commissions which are being offered by their representatives for insertion in the record at the conclusion of our testimony.

These kinds of increases hurt the little consumer the hardest and the injurious effects are by no means offset by the kind of interstate reductions negotiated by the FCC.

This kind of rate discrimination is particularly severe on the economically underprivileged. The U.S. Department of Commerce reports that the median family income in 1964 of households with telephone is \$7,281, compared with a median family income of \$3,386 for families without telephones.

These statistics of the Department of Commerce further reveal that there are over 7.25 million families without telephone service and that

44 percent of these families have less than \$3,000 annual income, that 7.3 percent have less than \$5,000 annual income, and that 82.3 percent have less than \$6,000 annual income. This is particularly unfortunate since the American people have become dependent upon telephone service for police, fire, and medical protection.

Also hard hit are retired people living on fixed incomes. Their numbers are reflected by Department of Commerce figures showing that there are 9.3 million households with a median income of \$2,715 and a head of household, 65 years of age or older, who is not in the labor force.

The effect of inequitable separations procedures is also depicted by the following indexes which reflect that charges for local exchange service is significantly increasing while charges for long-distance calling is going in the opposite direction.

These index figures are derived from a presentation by Dr. Harry M. Trebing, director, Institute of Public Utilities, Michigan State University, to the annual convention of the Midwest Association of Railroad & Utilities Commissioners on June 9, 1969, in Hot Springs, Ark.

	1945	1967-59	1966
Local service revenue per telephone.....	64	100	111
Intrastate telephone rates.....	68	100	99
Interstate telephone rates.....	96	100	94
Consumer price index.....	62	100	116
Wholesale price index.....	58	100	106

Clearly the average user of telephone service is benefited more by fixing his flat monthly charge for service at the lowest practicable level rather than by reductions in interstate toll rates—rates which are generally paid by a more affluent class of users.

The lower the flat monthly charge, the more accessible telephone service is to the economically depressed and to others who are severely disadvantaged by inflation.

Furthermore, the value of telephone service increases proportionately with the number of telephone users, and the more users the lower the cost of service for each user.

These basic economic tenets are reflected in an observation made by Senator Pastore on March 5 of this year during a hearing of the Subcommittee on Communications on FCC policy matters. He stated, in reference to separations procedures, that:

If the advantage is weighted in favor of the local caller who is least able to pay it, I think there is a definite advantage to the average American citizen and the telephone subscriber. Certainly I find no fault in that. . . . I think only too long the heavy arm of the Federal Government has striven to reduce the long distance call rate which only results in an increase in the local call rate. After all, you are going to make a certain return on the capital investment, and it all depends on how you separate that capital investment and where you put your weight.

Personally, I would rather see Momma call up her son or daughter more cheaply than some business executive in New York calling Washington.

That is from the hearings on "Federal Communications Commission Policy Matters and Television Programing," part 1, March 4-5, 1969, serial 91-6, page 102, last paragraph.

The separations procedures and principles prescribed by the FCC, being uniformly applied to all the States, are particularly unfair,

inequitable, and discriminatory toward the ratepayers of Rhode Island. This results largely from the small size of the State.

Whereas generally in the country approximately two-thirds of the revenues received from toll calls result from intrastate calls and only one-third of the revenues come from interstate calls, in Rhode Island less than 10 percent of the toll revenues result from intrastate calls while over 90 percent of the revenues from toll calls are from interstate calls.

The allocation of costs of subscriber plants, that is, telephone instruments and the lines which connect them to their local central office, on the basis of relative intrastate and interstate minutes of use in part on a national average is therefore not a fair and equitable apportionment of such costs to Rhode Island ratepayers.

The heavy allocation of costs to the intrastate rate base appears particularly burdensome to Rhode Island ratepayers when they consider that before any interstate call can be made there must be a telephone instrument and a line from that instrument to the central office.

Further, because of its small size and low proportion of intrastate toll, Rhode Island is burdened by a relatively large investment in local dial central office equipment. The allocation of this dial equipment to interstate should be carefully reviewed.

In conclusion, I wish to point out that a \$237 million interstate rate reduction at this time would aggravate the telephone service problem we now have because it would stimulate interstate calling and thereby place another burden on telephone plant which is now overburdened in various parts of the Nation.

I now defer to Chairman Wiggins of the committee on communications to relate the significant historical aspects of Federal-State relations in telephone separations.

Senator PASTORE. All right, Mr. Wiggins.

**STATEMENT OF BEN T. WIGGINS, CHAIRMAN, NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSION, COMMITTEE ON COMMUNICATIONS, AND VICE CHAIRMAN, GEORGIA PUBLIC SERVICE COMMISSION**

Mr. WIGGINS. Thank you.

Mr. CHAIRMAN. Senator Pastore, I am Ben T. Wiggins, vice chairman of the Georgia Public Service Commission and chairman of the NARUC Committee on Communications since 1962.

As a country lawyer, I would like to adopt the testimony and the questions this morning that you have presented to this group—

Senator PASTORE. How come you southerners always call yourselves country lawyers, but you win every case?

Mr. WIGGINS. We don't win them in the Supreme Court, sir; nor before the Federal Communications Commission.

Senator PASTORE. I am sorry, that is a vote.

We will be right back.

(Recess.)

Senator PASTORE. The committee will come to order.

Mr. SMITH. Mr. Bjelland from the State of Colorado also has a report to present for the record.

Senator PASTORE. All right. All right, you may proceed, Mr. Wiggins. Mr. WIGGINS. Mr. Chairman and members of the committee, the earliest efforts at effective State regulation of telephone services came with the enactment in 1907 in Wisconsin, New York, and Georgia of enabling legislation creating commissions with jurisdiction over telephone service. While the Interstate Commerce Commission obtained nominal authority over interstate telephone service with passage of the Mann-Elkins Act of 1910, this area of the business remained unregulated as a practical matter until the creation of the FCC in 1934.

The history of the problem of separating plant and expenses between States and interstate services for the purposes of establishing rates is generally regarded as beginning with the *Minnesota Rate Cases*, decided by the U.S. Supreme Court in 1913 (230 U.S. 352, 435 (1913)).

In these cases the Court criticized the use of revenues as an inappropriate basis for separation of property, but accepted without criticism the employment of weighted usage as an allocation method.

The paramount issue which arose about the time of the *Minnesota Rate Cases* and continued until about 1930 was the controversy over the board-to-board versus station-to-station method of telephone separations. Under the board-to-board principle, toll service costs included only those facilities which extended from toll switchboard to toll switchboard, excluding any consideration of exchange facilities.

The station-to-station principle included the costs of all facilities from the originating telephone station to the terminating telephone station. The term "station" means the telephone instrument itself.

This controversy was decided by the Supreme Court in 1930 in *Smith v. Illinois Bell Telephone Company*, 282 U.S. 133, in which it adopted the station-to-station basis of telephone separations. The Court emphasized the absence of the need for "extreme nicety" in separating telephone costs with "only reasonable measures being essential."

The Court further emphasized that the separation of telephone costs between the intrastate and interstate operations of the company involved "is essential to the appropriate recognition of the competent governmental authority in each field of regulation."

Following the creation of the FCC in 1934, the FCC initiated a number of interstate message toll rate reductions. As a result, intrastate toll message rates for calls of the same distance and duration as interstate calls were provided at higher charges than required by the interstate rate schedules. This problem is known as the "toll rate disparity." Accordingly, the nature of separations procedures became of major importance.

A shift of telephone plant and expenses from intrastate to interstate services derived from modification of separations procedures is a means of increasing the interstate revenue requirements to alleviate the disparity in jurisdictional toll rate schedules.

The toll rate disparity problem exists in every State except Delaware and Pennsylvania which have adopted the policy of maintaining the charge for intrastate toll calls on a parity with charges for interstate toll calls. The toll rate disparity problem could be eliminated in the remaining 48 States, but this would create an even larger consumer problem because the burden removed from intrastate toll would then have to be absorbed by the users of local telephone service.

Following the 1941 interstate toll rate reduction, the NARUC

urged the FCC to conduct hearings on separations procedures. Also, in 1941, a committee composed of staff members of the FCC and State commissions was assigned the task of formulating equitable and simplified separations procedures. The report of this committee was presented to a joint FCC-NARUC committee of commissioners in the early part of 1942.

The State commissioners approved the report and recommended its adoption by the FCC as a procedure to be followed in the separation of telephone costs. The FCC, on June 9, 1942, instituted a formal investigation—docket No. 6328—to determine whether such procedures—incorporated in the proceeding as exhibit 2 with certain amendments—or other procedures should be adopted.

Although hearings were held in the docket no decision was ever reached therein and the docket was closed in January 1966 during consideration of the separations issues in the A.T. & T. rate proceeding—docket No. 16258.

Great pressure was exerted on State commissions for increases in telephone rates after World War II. An anomalous situation existed then, as it does today, where exchange and intrastate toll charges were being increased in the States and interstate toll rates were being reduced by the FCC.

In an effort to correct this irrational situation, a subcommittee appointed by the NARUC-FCC Staff Committee on Telephone Regulatory Problems in 1947 reviewed the procedures contained in exhibit No. 2, as amended, and recommended a number of changes in the procedures. This report was later approved by the NARUC without the FCC taking any formal action with respect thereto.

The subcommittee was then instructed to rewrite the procedures on a direct station-to-station basis, eliminating the necessity of first making a board-to-board separation. The procedures, so rewritten, were incorporated into the original separations manual which was reviewed and approved on October 22, 1947, by the NARUC Special Telephone Committee, the predecessor to the committee I now chair. The FCC approved the manual on an interim basis.

The transfers of annual revenue requirements from State to interstate operations which were approved by the FCC at that time, and subsequently, are reflected in the following table:

SEPARATIONS CHANGES TRANSFERRING REVENUE REQUIREMENTS FROM STATE TO INTERSTATE OPERATIONS  
[Dollars in millions]

Year	Change	Revenue requirement (time of change)	Revenue requirement (current value)
1947	Simplification in methods	\$13	\$80
1952	Charleston plan	30	235
1956	Modified Phoenix	40	140
1962	Simplification in methods	46	90
1965	Exchange plant plan	134	177
1969	FCC plan	108	108
1969	Mechanical changes	35	35
Total		406	865

The FCC in its letter to Chairman Magnuson of November 17 seeks to place these figures in their most favorable light by stating that "Since 1952 five major revisions have been adopted in the separations

procedures" and that "It is estimated that, on the basis of current operations, these revisions have relieved the intrastate operations of the Bell System of an estimated \$800 million of revenue requirements annually."

(The FCC's figure of \$800 million is somewhat exaggerated since the six revisions approved from 1952 to 1969, inclusive, only total \$785 million, and the "five" major revisions during this period only total \$750 million.)

As indicated by the above table, the separations transfers at the time of approval totaled \$393 million and their current value is now estimated at about double—\$785 million. In order to place these figures in their proper perspective, it should be remembered that the period from 1952 to 1969 has produced the greatest growth in the history of the Bell System and the worst inflation in the Nation's history. During this period, the annual revenues of the Bell System have increased from a little over \$4 billion to \$14.1 billion.

Furthermore, the FCC in selecting the year 1952 apparently seeks to give the impression that the first major separations change in history was voluntarily arrived at by it. The background behind this change is of particular relevance of this hearing.

In 1950, the NARUC began a reexamination of separations procedures because of a rapidly growing disparity between intrastate and interstate toll rates. The NARUC proposed a change in separations procedures to alleviate the burden on the local users which was rejected by the FCC on October 18, 1950.

The FCC on January 19, 1951, directed the Bell System to show cause why its interstate rates should not be reduced and to submit a response by March 23, 1951.

Rebuffed in its efforts to obtain relief for the local users of telephone service, the NARUC brought the matter to the attention of Chairman McFarland of the Subcommittee on Communications of this committee then known as the Senate Committee on Interstate Commerce. Chairman McFarland on January 31, 1951, sent a letter to the FCC which, after citing the toll rate disparity problem and the pending interstate toll rate proceedings, stated that:

The trouble is the general public does not realize that every move that is made to reduce long distance toll rates results directly or indirectly in an eventual increase in local telephone rates and in intrastate toll rates. Put very simply and plainly, this merely shifts the cost from the big user to the little user . . .

I had hoped that the proposal of NARUC for a tryout of its new separation formula would get a green light from the Commission (FCC). Now, I understand the Commission is going ahead with a heavy schedule to begin in April for a further reduction in long distance toll rates . . . and that the state utility commission's proposed separation formula should be formally presented at the hearing. Frankly, I do not think that is going to the State commission . . .

I am not in a position to pass upon the question as to whether the remedy suggested by NARUC is the proper one, but I am certain that something should be done—and at once.

And we are in the same situation today.

On February 14, 1951, the FCC decided to do "something at once" and postponed the response date in its interstate rate investigation in order to reexamine the NARUC separations proposals. As a result, FCC Chairman Walker at the 1951 NARUC Annual Convention in

Charleston, S.C., proposed a plan for use on an interim basis which later became known as the Charleston plan as indicated in the above table. Unfortunately, congressional intervention was required to bring about the first major revision of separations procedures in history.

The FCC further states in its letter of November 17 (p. 1) that the NARUC has failed to specify inequities in separations procedures. This is untrue. The NARUC in a letter to the FCC on September 18, 1969, urged the FCC to use the interstate excess earnings of the Bell System for the benefit of local subscribers by significantly increasing the 6-percent assignment of local central office equipment to interstate operations.

Moreover, the NARUC was working cooperatively with the FCC on proposed improvements in separations procedures which would have accomplished this objective at the very time the FCC announced that Bell's excess earnings would not be available to serve the larger consumer interest.

When the FCC does not like the separations modifications proposed by the NARUC, we believe it has an affirmative duty to propose modifications which it deems appropriate instead of, as it has done so many times in the past, acting in a negative, critical and obstructive manner.

Time does not permit me to describe all of the difficulties which the State commissions have experienced in their almost continuous battle with the FCC to achieve fair separations procedures for the average consumer. However, in order to complete the account of this tortured history of separations, I respectfully request that there be inserted in the record a "History of Telephone Separations" which appeared in the appendix to an address delivered by President Pearson on June 20, 1968, to the 1968 Western Conference of Independent Telephone Associations.

Senator PASTORE. How long is this History of Telephone Separations?

Mr. WIGGINS. Quite long, sir. About 15 pages. I am not going to—that is a part of the record, sir. I am not going to take up your time with that.

Senator PASTORE. I was just wondering whether or not we should insert it into the record. I mean we don't want to increase the congressional expense of the record here unnecessarily. Let's incorporate it by reference.

Mr. WIGGINS. All right, sir.

Senator PASTORE. All right.

Mr. WIGGINS. I respectfully urge the members of this committee, as Senator McFarland did in 1951, to promptly exercise their influence to see that the \$237 million of excess earnings will be employed by the FCC to ease the burden on the backs of the local users of service who make approximately 147 billion calls a year, instead of for the benefit of the favored few who make approximately 2½ billion interstate long-distance calls a year.

I now defer to Chairman Bloom of Pennsylvania who will describe S. 1917 and what we perceive to be the justification for its prompt enactment.

Senator PASTORE. Mr. Bloom.

STATEMENT OF GEORGE I. BLOOM, FIRST VICE PRESIDENT,  
NARUC, AND CHAIRMAN, PENNSYLVANIA PUBLIC UTILITIES  
COMMISSION

Mr. BLOOM. Mr. Chairman, members of the committee: Before I address myself to S. 1917, may I call your attention to a letter that I wrote to the Chairman of the FCC on November 13, 1969.<sup>1</sup> I have provided the Commission with 75 copies that I submitted today. I think the letter is a very temperate letter, a very logical letter, explaining Pennsylvania's situation in connection with the separations and rate reduction.

Because we in Pennsylvania and the State of Delaware have a rule of parity which the United States do not have, and this results in the fact that we accept as intrastate rates the rates that are fixed by the Federal Communications Commission so that there will not be any difference between the State rates per mile and the intrastate rates. So that, as a result, it is set forth here in the letter, the separations really required approximately \$8 million of additional revenue at the State level. And that was before the tariffs were filed with reference to the \$150 million rate reduction or the \$237 million. It is not in the letter, but this adds to our troubles, because intrastate we lose another \$900,000 to a million dollars. And I wanted to make that statement before I proceed with my statement in connection with the bill. And that is only with reference to Bell. Now we have 77 independent telephone companies in our State and they are affected as well as the Bell System of Pennsylvania.

Now on S. 1917, it proposes the Federal-State communications joint board act of 1969 which was introduced by Senator Magnuson at the request of NARUC on April 23. Adoption of the act would create a seven-member board composed of four FCC Commissioners designated by the FCC and three State commissioners nominated by the NARUC and appointed by the FCC. The board would have sole administrative authority under the Communications Act of 1934 to prescribe uniform procedures for determining what part of the property and expenses of communication common carriers shall be considered as used in interstate or foreign communication toll service, and what part of such property and expenses shall be considered as used in intrastate and exchange service.

Such uniform procedures would only be determined after opportunity for hearing and upon notice to the affected carrier and State commissions and other interested parties. The establishment of the board will not impair in any way the right of any State commission, or any other interested party, to advocate its position on issues before the board, to submit evidence and oral argument on them, and to seek reconsideration and judicial review of its decisions.

The FCC is given latitude in the appointment of the three State commission members in that it may require the NARUC to nominate one, two, or three State commissioners for each State position on the board, and the FCC may choose from among these nominees in making an appointment. Each of the three State commissioner members would hold office for a term of 3 years and the three terms would be staggered.

<sup>1</sup> See letter on p. 147.

The board would meet from time to time upon the call of the chairman of the board or of three members of the board. A majority of the members of the board would constitute a quorum. Each member of the board would have one vote and all decisions of the board would be by majority vote.

Senator PASTORE. What if a Commissioner ceased to be a Commissioner after he had been appointed during his term?

Mr. BLOOM. I would think a vacancy would occur and a substitute would be nominated and appointed by the Commission.

Senator PASTORE. All right.

Mr. BLOOM. The FCC would designate an examiner to advise with and assist the board in the handling of any proceedings before it. The FCC would also provide the board from among the personnel and facilities of the FCC such staff and facilities as are necessary to carry out the functions of the board. Accordingly, the board would not require a separate staff and the FCC would not require any additional staff positions since it presently has a staff familiar with separations procedures.

Section 2(g) of S. 1917 provides that each State commissioner member of the board would receive a per diem not to exceed \$100 for each day engaged in the business of the board and reimbursement for expenses incurred for travel, food, and lodging. However, we would have no objection to the deletion of this provision if the committee desires.

Senator PASTORE. I think you should delete it, because I do not think a State employee should be paid by the Federal Government. It would be in conflict.

Mr. BLOOM. Yes, sir. We have no objection to the deletion, and thereby the expenses of the State commission members would then be borne by their respective State commissions.

While the enactment of S. 1917 as now proposed would require very little expenditure of federal funds, or no expenditure if section 2(g) was deleted, as we have just suggested, it would nevertheless provide important and long overdue protection for the American consumer.

The enactment of S. 1917 would provide a balanced approach in the future development of fair and equitable separations procedures which would result in relatively lower rates for the users of local telephone service.

Aside from the necessity for developing fair separations procedures, it is patently unfair for the FCC, which has jurisdiction over only 25 percent of Bell's property, and represents only 2½ billion calls in interstate and foreign compared with 147 billion calls at the local exchange and intrastate toll, to control this situation. In effect for them to exercise complete authority and to determine the separation is certainly very unfair in our opinion. The State commissions should have at least a minority voice in the making of such a determination and when we are willing to submit or have suggested the submission of nine names and they shall select three and they shall have four or a majority of the Commission, there should not be any objection to an arrangement of that kind.

It has been stated here that there is no authority and it has never been done, the delegate to a body like NARUC the power to nominate

and the Federal Communications Commission have the authority to appoint from the nominations made by a body of this kind. That I do not believe is so. There is a Public Law 89-1701 that gives NARUC—Congress gave NARUC—the right and authority to make appointments to a joint board and to operate for the Federal Government. And that is on the books today. So that there is a precedent for the authority and for the appointing power.

Senator PASTORE. They do not make the appointment, they merely make the recommendation, as you suggest, and the appointment is made by the FCC, and he has to be a qualified commissioner of one of the States.

Mr. BLOOM. Yes. It has been stressed that the Congress vested the Federal Communications Commission with the sole authority to make separations and if the Congress vested them with the sole authority, Congress can divest them of the sole authority and have them share that responsibility with the concept that we have advanced here of a Commission of four Federal Commissioners and three nominated from the nine, from the regulatory bodies or suggested or nominated by NARUC. I think this would be a very equitable and proper way to handle it. We believe the long and difficult history of separations procedures clearly reveals the need for this legislation to benefit consumers.

Moreover, we believe time is of the essence in its enactment. The reason I say time is of the essence is because the FCC in its letter of November 17 stated its intention of reviewing Bell System's interstate earnings in the first half of 1970. Accordingly, we respectfully urge the committee to promptly seek the enactment of S. 1917 so that the board may be in existence prior to the FCC again determining excess interstate earnings for the Bell System, so that this joint board could function and make an effort to get an equitable separation of the plant, both interstate and intrastate.

Thank you very much.

Senator PASTORE. Now the Chair will hear from President Pearson.

Mr. PEARSON. Thank you, Mr. Senator. I think that in the 20 years I have spent in the Washington State Legislature, I know when enough has been said. I believe that we have presented a very strong case for our position. I feel that we must have the Federal regulatory agency as well as the State regulatory agencies. Each one of us has a function to do. Unfortunately, the long lines got a free ride, a totally free ride on the States for the first 50 years of this century. And then it took a letter from this committee, the Senate Commerce Committee, to the Federal Communications Commission, to jog them into some sort of what they call cooperation with the States.

I feel very reluctant to get very harsh with Chairman Burch, who has just come on the Commission. I know very well he knows very little about separations and could know very little about it in the length of time he has been on there. No one could learn that. He has to take advice from his staff. And when his staff stands up today, as Mr. Strassburg does, and says we have continued studies, I mean, yes, they have studies, studies, studies, but no results. Never, and as far as the cooperative endeavor with our staff, with our commissioners committee is concerned, I do not care whether it was the Charles-

ton plan or the modified Phoenix or the Denver plan, whatever plan it was, it was worked out first by A.T. & T. and FCC, and then presented to the States on a take it or leave it basis. This is the way it has continually been. We thought we were having some sort of studies and some sort of cooperation going on before this last miscarriage of justice, this \$237 million, and the worst miscarriage of justice, if you please, in the history of regulatory agencies in the United States. We find ourselves back in the various States trying to answer the public and answer our Governors and answer our legislators, why is it that an interstate call is so much less than an intrastate call? Why is it that those people who are on pensions, the millions who are on pension today, how is it the farmer with a small income, a small farm, how is it that a small businessman with inflation the way it is today, how is it the handicapped have to pay so much per month for their telephone, when the FCC apparently can find ways and means of doing this much cheaper for the long distance caller?

And under the guise of a cut and a reduction of rates for the A. T. & T., what have they done? They have raised the rate of return from  $7\frac{1}{2}$  to some  $8\frac{1}{2}$  percent or a quarter of a billion dollars of net income, to A. T. & T., where we just got through with a rate case in the State of Washington, where after a full rate case, with all of the consultants necessary, and cost of money and all of the various other things, we come up with a  $7\frac{1}{4}$  to a  $7\frac{1}{2}$  percent rate of return.

I think this could be true in most of them. Mr. Senator, we have no other recourse to protect our people back home except to come to you and to have you, the Congress of the United States, and the Senate Commerce Committee in general, write another letter as did Senator McFarland, to the Federal Communications Commission asking them for a stay of the present \$237 million in cutting rates and that they do accept a filing that we made before the FCC today on separations of \$250 million. We have come forward with this again as we have in times gone by.

When they say it is not acceptable, who is it not acceptable to? It is acceptable to people who we have no recourse before nor no word in the arguments. When we had the last case, we had our observers there, no voice, no vote in the decision, no knowledge of the decision until the day it was made. What kind of cooperation is that? It just plain is not cooperation. So we have no other alternative, Mr. Senator, except today we have filed a petition for a stay in these rates.

We have also petitioned for a separation of \$250 million. We can do this promptly and immediately if they want to do it. There is nothing to stop them from doing it. There is nothing illegal, there is nothing improper, there is nothing irregular about it. And it can go back to the States and I want to assure you as President of the NARUC that we will appoint a committee that will work with the States to assure that the customers of the telephone usage will be able to get whatever the results of that separations might be, that it is not going to go to a local telephone company and a higher rate of return for them. And we have no other alternative except to come to you as we have today and with all of the Commissioners that have come in from all over the United States, it shows you the tremendous interest and the tremendous wrath that the Commissioners are showing in trying to get something done.

So in closing I urge you from the bottom of our hearts to again come to the consumers' protection as you have so many times in the past, do write that letter to the FCC, do promptly pass this bill, and with certainly a seven-member Commission, being able to appoint four of their members, the majority if you please, cannot stack that committee, they are not doing a very good job as far as appointing their members on that, and also with their staff. With that in mind, I would like to simply state we would like to have the presentation as we have presented it here in written form made a part of the record inasmuch as we have shortened it somewhat.

And I thank you very much for calling this hearing and for giving us the opportunity and taking the time out of a very busy time and realizing the importance of this matter and giving us voice today.

Thank you very much.

(The balance of Mr. Pearson's statement follows:)

Mr. Chairman and members of the committee, my colleagues have described in as clear and as forceful terms as possible the longstanding refusal of the FCC to allocate a fair amount of the cost of providing local telephone service to the users of the interstate service irrespective of the fact that local facilities are an integral part of the national toll network.

In the area of separations, the FCC has simply failed to discharge its responsibilities to the American people. The FCC has failed to recognize that the legal existence of jurisdictional lines does not alter the fact that the State commissions and the FCC represent the same broad consumer interest, and that their regulatory responsibilities and interests are essentially the same.

Accordingly, we stand today in the midst of another crisis in the field of telephone costing where the FCC is seeking to bestow a \$237 million benefit upon a relatively affluent class of users who make approximately 21½ billion interstate long-distance calls a year and thereby to deny this long overdue economic relief to the millions of users of local telephone service who make approximately 147 billion calls a year—users who are threatened with rate increases totaling in excess of \$500 million a year from the Bell System alone. This is by far the worst disservice that the FCC has ever sought to inflict upon the local consumers in the long Odyssey of Federal-State relations in telephone separations.

If the \$237 million interstate rate reduction is permitted to go into effect early next year, this money will, as a practical matter, never be recaptured for the benefit of the local users.

The American consumer cannot afford this loss especially in this era of intense inflation.

And so the State commissions turn again to this committee, as they did 1951, as the last resort for preserving this economic benefit for the economically underprivileged. We strongly urge this committee to promptly request the FCC to postpone the proposed reduction and to immediately enter into consultation with the State commissions and other interested parties in an effort to fashion a reasonable and equitable modification of separations procedures which will permit this \$237 million benefit to flow through to the local users.

We urge this committee to stand up again, as it has so many times in the past, in defense of the American consumer.

Thank you for your attention.

Senator PASTORE. Thank you. Does the Commission wish to say anything?

Mr. BURCH. Mr. Chairman, I do not feel there could be any further addition to the store of knowledge that has been brought forth today. I do not think a rebuttal would be, much gain, particularly for either side. So I would rest at this time.

Senator PASTORE. Let me say this: All of us are charged with a very, very high level of responsibility. The men who have come here from all over the Nation are responsible to their governments; that is, to their State governments, the Governor, or their legislature; they are public servants, and they are held to high accountability. The men who serve on the Federal Communications Commission have the same sense of responsibility and the same quality of responsibility. And so do we on this particular committee. I would hope that this whole matter would be taken under serious consultation and advisement, and that equity and justice will be done to all. The committee will take this under advisement. I am only one of several members here, but you can rest assured this record will be studied very carefully.

As far as your letter to the Commission is concerned, I am in no position to speak for the committee with regard to that of holding of any reduction. But I would hope in view of what has been said here, the petition that you have filed with the Commission will be given serious immediate consideration.

(Thereupon, at 2:25 p.m., the committee was adjourned.)

We urge this committee to stand up again, as it has so many times in the past, in defense of the American consumer.

Thank you for your attention.  
 Senator Lister: Thank you. Does the Commission wish to say anything?

Mr. Bacon: Mr. Chairman, I do not feel there could be any further addition to the store of knowledge that has been brought forth today. I do not think a rebuttal would be much more particularly profitable on either side, so I would rest at this time.

Senator Lister: Let me say this: All of us are charged with a very, very high level of responsibility. The men who have come here from all over the Nation are responsible to their constituents; that is to their State governments, the Governor or their Legislature; they are public servants, and they are held to high responsibility. The men who serve on the Federal Commissions, Commissions have the same sense of responsibility and the same quality of responsibility. And so I would hope that the whole matter would be taken under serious consideration and that some final fact that equity and justice will be done to all. The committee will take this under advisement. I am only one of several interested parties, but you can rest assured this report will be studied very carefully.

As far as your letter to the Commission is concerned, I am in no position to speak for the committee with regard to that or holding of any reduction. But I would hope in view of what has been said here the petition that you have filed with the Commission will be given serious immediate consideration.

(Thereupon, at 2:25 p.m., the committee was adjourned.)

ADDITIONAL STATEMENTS, LETTERS, AND ARTICLES

FEDERAL COMMUNICATIONS COMMISSION,  
Washington, D.C., December 10, 1969.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: At the hearings of your Committee held on December 9, 1969, with respect to S. 1917, the statement was made by one or more witnesses testifying on behalf of the state commissions that this Commission, by its public notice of November 5, 1969, has indicated that it regards a rate of return of 8.5% for interstate telephone operations of the Bell System as acceptable. It was also suggested that the Bell System companies are using this alleged determination by the FCC to support their requests for higher local and intrastate rates in various states.

We believe, in fairness to all concerned, that the record in this regard should be clarified immediately since our public notice of November 5 did not purport to set forth a specific allowable rate of return. Any such specification was deemed by the Commission to be inappropriate to a negotiated rate adjustment in the context of the informal procedures of continuing surveillance.

Our public notice did, however, express our view that in light of current conditions of the capital market, interstate rates which would produce a rate of return which exceeds 7.5%—the upper limit of the range of return found to be reasonable in 1967 by our decision in Docket No. 16258—are not unreasonable. We also recognized in the public notice that there was reason to expect that, absent any further action by the Commission, the reduced rates announced by the public notice, will not, *in themselves*, prevent the company from achieving earnings in a range of 8.0% to 8.5%.

In making the latter observation, the Commission was not indicating an acceptance or approval of earnings in this range. We were simply expressing our anticipation that the growth patterns inherent in interstate business, combined with the stimulating effects of the contemplated rate reductions on interstate traffic, would continue to increase the going-level of interstate earnings. For these reasons, we stressed our intention to maintain a continuing surveillance of the matter and to take appropriate action in the light of future conditions. In this connection, as the Commission advised you in its letter of November 17, 1969, and as we testified, we will again be reviewing the level of earnings in the first half of 1970 after, among other things, the effects of any revision in the Federal income tax surcharge are known.

Accordingly, any claim that the Commission specified, as acceptable, a level of earnings in the aforementioned range is a misconstruction of our November 5 public notice and misrepresents our current policies.

Because of the obvious concern of this matter to the state commissions, we are taking the liberty of sending them a copy of this letter together with a copy of our statement before the Committee.

This letter was adopted by the Commission on December 10, 1969.

Commissioner Johnson dissented and will issue a separate letter.

By direction of the Commission.

DEAN BURCH, *Chairman.*

FEDERAL COMMUNICATIONS COMMISSION,  
Washington, D.C., December 10, 1969.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: This letter is submitted as a separate statement with the Commission's letter to you of this date regarding the ATF rate of return. As indicated in the Commission letter, I dissented to its adoption.

I simply cannot agree that the Commission's action of November 5, 1969, did not constitute "acceptance or approval" of a rate of return for the Bell System in the range of 8.0 to 8.5%. The majority press release, which was drafted in consultation with Bell, states: "[I]t is anticipated that the rate adjustments announced today will not, in themselves, prevent the Company from achieving earnings in the aforementioned range." That "aforementioned range" was 8.5%. Bell's own press release stated that the rate reduction "will not by itself reduce our interstate rate of return below 8% and we concur in the Commission's view that this reduction should not preclude our achieving interstate earnings next year approaching 8.5%."

Now that the Commission has come down firmly on all sides of this issue, and "approved" virtually all rates of return from 7.0 to 8.5%, the obfuscation is admittedly thick. But I fail to see how any fair reading of these documents can lead to any other conclusion than that the Commission and Bell believe the recent rate reduction will not reduce Bell's interstate rate of return below 8.0 to 8.5%.

That conclusion will, no doubt, be pressed by Bell on state regulatory commissions that will be urged to do no less than the federal regulatory authority. In fact, I expect that other utilities will press the same argument before other regulatory agencies and that the havoc the Commission has wrought will be felt throughout our entire economy.

The Commission accepted a rate of reduction offer from Bell which Bell says will not reduce its rate of return below 8.0%. If the Commission did not "approve or accept" an 8.0 to 8.5% rate of return, it could have moved against Bell rather than accepting its offer. The majority's letter confuses and obfuscates this basic point and that is the reason for my dissent and separate statement to you.

Respectfully,

NICHOLAS JOHNSON,  
Commissioner.

STATEMENT OF COMMISSIONER NICHOLAS JOHNSON, FEDERAL COMMUNICATIONS  
COMMISSION

Chairman Magnuson and members of the Committee, I appreciate the opportunity to share with you this outline summary of my separate views in support of the Commission's testimony on S. 1917.

Few subjects are so draped in irrelevant obfuscation as telephone regulation. The nineteenth century language of public utility regulation—"rate base," "separations," and so forth—is used by few and understood by none. It is time the American people and their representatives got some straight talk from the telephone company and the supposed "experts" as to what is going on here.

The electric utilities average a 6.7% rate of return. Senator Metcalf and Vic Reinemer, in their book, *Overcharge*, suggest this is too high. All agree the telephone company is far less risky as an investment than the electric. This would normally result in a lower rate of return for Bell. And yet the FCC permits it to charge defenseless subscribers rates that may produce rates of return around 8.5%. How can this possibly be justified to telephone subscribers? How, indeed, can the company's management policies even be justified to Bell's shareholders—who are earning only 9.3% on equity compared to the 11.9% earned by shareholders of the electric utilities, even with the electric's much lower overall rate of return?

But the point is that our principal focus ought to be elsewhere—as shocking as these figures may be. We ought to recognize that there are social, political, and economic implications that flow from our regulatory decisions—and then decide the issues before us in the light of those consequences.

You can call a Senator in Washington from London, England cheaper than you can call him from Anchorage, Alaska or Honolulu, Hawaii. What are the implications of that for participatory democracy in the "United" States?

The costs of providing long distance service are now roughly one percent of what they were a few years ago—and yet the costs of providing local service are rising. What does this tell us about the investment of the resources of Bell Labs?

The prices charged for long distance service are grossly inflated. (They have not come down as fast as cost reductions would warrant.) Calls are still priced on a time and distance basis, instead of on a flat-fee basis (like the "local" service that may include a very large area). How do these pricing decisions inhibit the use of the telephone, and relationships, between far-flung family and friends? How do they affect the growth patterns of national retail businesses?

About 10 percent of our population does not have telephone service. Why? To what extent would further subsidization of the costs of local service from the excessive profits from long distance revenues stimulate additional installations? What would be the relative benefits and costs to the country of more (or fewer) installations?

My point is simply that these questions—and a thousand others like them—have not even been asked by the FCC. Needless to say, we do not yet have the data or analysis necessary to address them intelligently.

That is what telephone regulation is about in fact. That is what telephone regulation ought to be about in theory. It is the context in which questions of "separations" and federal-state cooperation ought to be addressed.

Now to the metaphysics of public utility regulation.

As you know, Bell's "rate of return" is applied to a "rate base." The rate base is Bell's investment. The local profit is a rate of return on local rate base. The interstate profit is figured on something called "interstate rate base." Thus, investment is "separated" between intrastate and interstate service.

Geographically, of course, this is utter nonsense. There is no such place as "interstate." There are only states. All the telephone company's equipment is, necessarily, located within some state. So the whole "separations" exercise is a fiction at the outset.

As long as the game is to be played, there must be some rational basis for it—or so one would first assume. A logical point of beginning is that prices ought to reflect costs, and that the costs of using equipment used for multiple purposes (interstate and intrastate telephone calls) can best be ascertained by usage by subscribers. Such an approach would result in allocating about five percent of the total investment to interstate services. Interstate telephone rates would then be less than one-third of what they are now—and local rates would have to be raised substantially.

And so we have chosen to subsidize—that's right, "subsidize"—local service with the profits from long distance service. But we have talked about it, and thought about it, and held hearings about it, as if we were only playing with theories of metaphysics and higher mathematics. That is wrong, in my judgment, from everyone's point of view.

Here are some summary observations which I shall not take your time to develop.

(1) The history of separations has been one of political infighting between the FCC, the state regulatory commissions and the Bell System. Understandably, elected state officials would prefer not to increase local telephone rates as costs increase. Bell has been able to play one regulatory jurisdiction off against another to its own benefit. The Commission's separations decision in 1967 was an attempt to end this chaos.

(2) Despite the FCC's rhetoric, the present separations procedures have never been subjected to the searching economic analysis that a complex and significant matter of this nature warrants.

(3) When the Commission shifts costs from intrastate to interstate, it is unclear how much of the benefit has simply been moved from one Bell pocket to another and how much has been passed on to the consumer.

(4) The essential indivisibility of the telephone system exacerbates the problem. Whatever procedures are adopted are largely arbitrary. While this makes the determination of appropriate procedures more difficult, it also presents an opportunity and obligation to tailor separations procedures to identifiable economic and social goals.

(5) There are at least three arguments that can be made for increased costs to be borne by the interstate system. (a) If the interstate long-distance system bears a higher share of the total system costs, basic exchange telephone service will cost less and more people may have basic service, possibly increasing one of the values of the total system. As a matter of equity, the ratepayers for the interstate long distance system may have a greater "ability to pay" than those

who use intrastate and local exchange service. There is almost no direct representation of the local exchange user when these decisions are made in closed door negotiations. (b) Students of separations strongly suggest that the costs of providing exchange and intrastate service are increased by the fact that these components tie into the interstate long-distance network. Thus, the plant for exchange and intrastate service is more costly in order for it to be used for interstate long distance. These costs have not been systematically identified and allocated to the interstate system. (c) Much of the plant for interstate and intrastate-local exchange is fungible. Bell's decision as to whether low-cost plant will be used interstate are essentially arbitrary. Decisions about which users pay which costs are made by Bell in deciding where plant is built, who builds it, and how the network is designed.

(6) One of the basic problems in the cost disparities between interstate and intrastate service is that the Bell System has concentrated on achieving its most dramatic cost reductions in the interstate service—where it faces actual and potential competition—while neglecting cost problems in intrastate and exchange service. Bell Laboratories, whose \$500 million annual budget is twenty times that of the entire FCC, apparently has been unwilling to attempt cost reductions which would honestly address the rate problems in the states.

The Commission's recent decision on continuous surveillance has compounded the problems of the states. First, a much greater reduction was fully justified. Second, the Commission's acquiescence in a rate of return of 8.0 to 8.5% will heighten the problems state commissions face in trying to resist Bell rate increases. The FCC has done nothing about the service problems which have provided headaches for the state commissions. Now Bell can argue for state rate increases based on the FCC's decision.

As an appendix to this brief statement I will be adding excerpts from opinions and statements dealing with these issues in greater depth.

#### APPENDIX

#### STATEMENT OF FCC COMMISSIONER NICHOLAS JOHNSON BEFORE THE SENATE COMMERCE COMMITTEE ON S. 1917, DECEMBER 9, 1969

The following documents are relevant to an understanding of separations issues:

(1) A. T. & T., — F. C. C. 2d — (1969), FCC 69-1210, November 5, 1969 (separate statement).

(2) NARUC, — F. C. C. 2d — (1969), FCC 69-1077, Oct. 1, 1969 (dissenting opinion).

(3) Jurisdictional Separations, — F. C. C. 2d — (1969), FCC 69-1055, Oct. 1, 1969 (statement of Commissioner Kenneth A. Cox concurring in part and dissenting in part in which Commissioner Nicholas Johnson joins).

(4) Jurisdictional Separations of Telephone Companies, 16 F. C. C. 2d 317, 335, 78 P. U. R. 3d 479, 496 (1969) (dissenting opinion).

(5) A. T. & T., 11 F. C. C. 2d 493, 502 (1968) and A. T. & T., FCC 68-74, 33 F. R. 2452 (1968) (dissenting statement).

(6) A. T. & T., 9 F. C. C. 2d 30, 122, 70 P. U. R. 3d 129, 233, 234 (1967) (concurring opinion).

I will subsequently file with the Committee my separate statements in these cases. For a full appreciation of the issues as seen by the Commission majority the full opinions, as cited above, should be examined.

Attached is a statement about the general performance of the Bell system which appeared in the form of an interview in *Electronics* magazine. [Field, Nicholas Johnson, A Man With a Mission, *Electronics* (Oct. 27, 1969) 139.]

GOVERNMENT: NICHOLAS JOHNSON, A MAN WITH A MISSION—CONTROVERSIAL FCC COMMISSIONER TAKES ON ALL CORNERS, PARTICULARLY MA BELL, IN HIS ZEST TO PUT PUBLIC GOOD AND PUBLIC INTEREST AHEAD OF EVERYTHING ELSE

(By Roger Kenneth Field)

Once a slumbering agency, the Federal Communications Commission has become in recent months the high court for the electronics industry. The agency has handed down several landmark decisions that are having tremendous impact on the way electronic technologies are applied, on the way communications products are sold, and on the way the telephone system is viewed.

Much of the pressure for change at the FCC has come from within the commission itself—from Nicholas Johnson, the controversial commissioner who is often described as a maverick. Johnson thinks in terms of “the public good, the public interest.” Simply put, he places public interest before industry interest. The result is that he has made some powerful enemies of broadcasters and telephone-company executives. And with good reason.

Johnson’s primary thrust is aimed at the broadcasting and telephone industries. Johnson authored the now-famous Carterfone decision opening up the \$55 billion telephone system to “foreign attachments,” although AT&T had fought just such a decision for decades. Johnson was instrumental in the decision allowing Microwave Communications Inc. to set up a microwave link from St. Louis to Chicago and lease channels to all comers—in direct competition with AT&T. And Johnson has been instrumental in effecting price reductions in off-hour long-distance calls—a course of action that could have enormous consequence for executives and designers involved with communications and computers.

How Johnson feels about these and other issues could well give a hint of the future for those industries affected by decisions of the FCC. In the following exclusive interview, the commissioner speaks out and reveals his feelings and opinions.

*Where is the telephone system falling down in its service to society and in its preparation for the future? What would you do to change this situation if you could control the telephone system completely?*

JOHNSON: My principal concern with the telephone company [AT&T] is what I view to be the failure of the company to recognize its social, economic, and political role in our society. I think that it is impossible even to “profit-maximize,” let alone serve the public interest, if one operates the telephone company the way some librarians used to operate their libraries. You may recall the story of two librarians meeting at a convention. One asked the other, “How are things going?” She replied, “Everything is marvelous. All the books are in but two—and they are coming in next Tuesday.”

*In what way is the telephone company like that librarian?*

JOHNSON. Much of what the telephone company does is designed to prevent people from communicating, rather than encourage it.

*Like what?*

JOHNSON. The telephone company has failed to adequately anticipate and prepare for the present and future demand for communications service for computers. The telephone company has failed to anticipate and provide the services now being offered by cable-television companies. It has failed to conceptualize itself as in the “communications” rather than the “telephone” business. Look at all the terminal equipment potentially available that could be used: facsimile transmission computer-access devices, closed-circuit tv, teaching machines, and so forth. The telephone company has failed to anticipate communications demands, generally, in ways that are now coming back to haunt it, such as the recent breakdown in Wall Street and elsewhere.

I would point out that each of these failures has produced a lower rate of return for the company, less profits, less dividends for shareholders, and has had a very retarding impact on the economic growth of our country and upon the ability of this company to serve the public in ways that are demanded of it. I am speaking of failures that have been just as costly for shareholders as subscribers—maybe more so.

But my principal interest is the public interest. The telephone is a device that could help to unite far-flung families and friends, yet our system of billing for long-distance calls tends to impede that. There is a political significance as well. It presently costs more to call Washington from Hawaii or Alaska than it costs to call Washington from London. This has a measurable impact on what we describe politically as the “United” States.

There are numerous other examples I could point to of practices of the telephone company that not only disserve the public interest, but also tend to rob the shareholders. I have twice attempted in two different on-the-record proceedings, to get the company to address the consequences of our providing them a rate of return substantially in excess of what they’re now earning—perhaps no limit on rate of return at all. Would you believe that they [telephone executives] were so enamored of the 19th Century public-utility principles they have grown to love that they were unwilling even to address the question? I was stunned.

The company's debt-equity ratio, which the company itself finally acknowledged had been undesirably weighted on the equity side, has held down shareholders' dividends at the same time it raised subscribers' rates. That's pretty hard to do, but Bell did it.

The company is considering trying to rectify its failure to exercise options under liberalized depreciation provisions. It has delayed introducing the new technology of electronic switching. It failed to provide a national emergency number for the people of this country—long after the “inferior” telephone companies of most of the civilized nations of the world provided the service as a matter of course. It expressed excessive reticence to develop a coin-operated telephone that would enable people to place calls to the operator without first depositing a dime. One could go on endlessly multiplying the examples of ways in which this company has failed to recognize the social, economic, and political role that it plays, to its own detriment and that of the country at large.

*The Carterfone case and the MCI case seem to outline two areas that FCC has specifically opened up for competition with AT&T. One is the question of terminals, the other is the question of transmission of the information itself. Are you planning to open up competition on all fronts for AT&T—telephone communication, Picturephone, video transmission for tv network?*

JOHNSON: The FCC is in the business of deciding cases one at a time as they arise. And I would not want to prejudge any cases that might come along in the future. But as a general proposition, I would prefer to stand with the assumption that a fully functioning free private enterprise competitive system, with informed consumers, will best serve the public interest—and will do so better than Government regulation. It would only be in those instances in which the marketplace, for one reason or another, does not work as effectively or efficiently as it should that I would want to substitute regulation.

But certainly there is no justification in my mind for providing an essential service in our society through a Government-regulated monopoly if that service could be provided with higher quality and lower cost through a competitive system. So I think it is fair to say that—while my principal commitment is, as it must be, to serving the public interest in these matters—I will be continuing, as I have in the past, to look for areas in which the FCC can legitimately work itself out of a job and turn more of these matters over to the marketplace.

*What do you think of AT&T chairman H. I. Romnes' announcement that in the future there will be a one-minute connection with a target-charge of 35 cents coast to coast? This is primarily intended for the computer people, but it is merely a token gesture in answering the data problem?*

JOHNSON: I have often found the public statements of Mr. Romnes and other high officials of AT&T quite imaginative, public spirited and encouraging; it is the actions of the company that distress me. Two years ago when considering AT&T rates, I pointed out to them the gross underutilization of their \$35 billion plant. The company has simply never understood—or, if it has understood, has failed to apply—the most elementary principles of peak-load pricing.

The telephone system is virtually unused from 10 p.m. until 8 a.m. I suggested that the company's shareholders would be richer and the public better served if the company would provide very significant reductions in after-midnight rates. Its response was to cut the rate from \$1 to 75 cents after midnight. This was not quite the order of magnitude that I had in mind. There are very few people who would stay up until midnight in order to save a quarter.

The one-minute rate is another example of Bell's offering too little too late. In most of the civilized nations of the world, it has long been possible to call anywhere in the country on a message-unit basis—as the distance increases the time decreases. But it is possible to call the longest distance possible for some period of time for a message unit charge that may be 5 cents or less! Compare that with our “low, low telephone rates.”

*Has anyone proposed that calls be priced on a continuous curve?*

JOHNSON: Well, even better, some reports I have seen indicate that as much as 50% of the cost to the telephone company of a long-distance call is the cost of billing you for that call, and otherwise running a system which is dependent upon a time-distance formula and individually billed calls.

*Might it be cheaper if the company simply charges you for the connection and forgets about the time? Or distance?*

JOHNSON: As a general proposition, it would seem to me that the telephone company would want to offer as much service as possible on an incremental cost-free basis. That is to say, it seems to me that both the company's profits and the

public interest would be served if people chose whether to use the communication system on the basis of their communications needs versus other demands upon their time, rather than in terms of cost. Note that this is what we do with most of the so-called "local" services.

When you make a local call you do not reflect upon the price that you must pay for this service. It is incremental cost-free; that is, once you pay your monthly telephone bill there is then no additional cost for your use of the telephone. You use the phone; or not, based solely upon to whom you want to talk, when, and for how long. If a system would be devised for a nationwide telephone service of this character—a system that would provide adequate revenue to the telephone company—it might be a clearly more satisfactory way of providing service.

The telephone company's principal objection to this, to the extent that I can fathom it, is that such a plan would produce an increase in the use of the telephone—an argument which the company often raises to oppose proposed improvements in service.

*As you interconnect more and more phones, thoroughly, with more and more long-distance lines and more and more lines between phones, the system approaches what in physics is a real network. If that is the case, would it not be better to have either a blanket charge for any call independent of distance, or no charge at all, simply billing people for the use of the phone?*

JOHNSON: It has often been argued that the so-called long-distance service has been grossly overpriced and used as a subsidy, in effect for local service—a political decision to serve the needs of the state regulatory commissions, which are loathe to raise their local rates. The result may also be salutary in terms of national economic and social goals—or it may not be. Maybe we should want to encourage the installation of home telephones by soaking the rich for "long-distance" calls. Maybe it would be better to encourage greater national use of the system. My point is only that the issue has never been addressed in these terms. Your observation about the relationship between distance and cost of telephone service is interesting.

It seems to me that the irrationality of the present pricing system is best illustrated when one thinks in terms of satellite communications. If a satellite is positioned 22,000 miles from the earth's surface, then by definition all calls travel 44,000 miles—22,000 up and 22,000 back down. It makes no difference to the satellite whether the ground stations on the earth are separated by 1,000 miles or 10,000 miles. With such a system it becomes very difficult to rationalize why distance is a relevant factor in calculating price.

*Is there anything manufacturers of communications equipment—the modems, terminals, receivers and transmitters—can do in the design of new equipment to cooperate with and help the FCC?*

JOHNSON: There are a number of things. The answer depends upon which particular product line you are talking about. We have some difficulty with the tv receivers—X radiation and electronic radiation are now problems. We passed legislation regarding the uhf tuner: the all-channel bill. We need, from time to time, to improve mobile radio receivers and transmitters to permit them to operate on narrower bands.

#### TUNE HIM OUT, SAY THE BROADCASTERS

Commissioner Johnson may be a thorn in the side of telephone executives, but he is even more of a thorn to broadcasters. So much so, in fact, that a group of Southern broadcasting associations has petitioned President Nixon to oust Johnson from office now—four years before his seven-year term expires.

The rancor of broadcasters centers on a statement the commissioner made on a nationally televised panel show. Johnson, who has always favored allocation of free broadcasting time for candidates for public office said, "For the industry to hold up elected officials and make them pay to get time from public property (the airwaves) is kind of like a criminal stealing a woman's wedding ring after he's raped her."

To be sure, criticism of the broadcast industry by FCC commissioners is nothing new. FCC chairman Newton Minow is best remembered for characterizing television programming as "a vast wasteland." His predecessor, James Fly, likened radio to "a dead mackerel in the moonlight—it both shines and stinks." But Johnson goes beyond colorful quotes: he questions the automatic renewal of broadcast licenses, insisting instead on reevaluation each time a license comes up for renewal. And on this point, quite understandably, broadcasters are extremely sensitive.

Does the commissioner's position warrant Presidential removal? Here, in Johnson's own words, he describes what rights he believes broadcasters should and shouldn't have, and precisely why he feels that granting licenses "in perpetuity" would violate the original intention of those congressional acts that defined the purpose of commercial broadcasting:

"I think it's very unlikely that any local broadcaster who has been in the business a long time, doing an outstanding job of public service and of quality programing, is going to be deprived of his public trust—at least not by anyone I know of who has sat upon this commission, does so now, or is likely to in the future. But in this industry, as in any other, there is a small percentage of broadcasters more interested in ever-increasing profits than in their local responsibilities and public trust. Whether that percentage is 1/100 of 1% or 15% is a matter for some debate. But I think the leaders of any industry would recognize that some of their competitors are more responsible—better citizens in the business community—than others. Some of the grossest failings of broadcasters have involved double billing and misrepresentations to advertisers; the FCC has not been much more strict in penalizing those broadcasters than it has been with the broadcasters who are disserving the public.

"But the important point here is that Congress in 1927 and 1934 recognized expressly the threat to democracy of the potential for control of the mass media in America. Congress anticipated stations would be owned locally, operated by people whose only business was the broadcasting business, and who recognized their responsibility to their local community.

"It expressly provided that no one could own a broadcasting license . . . in the very first section of the portion of the Communications Act that deals with commercial broadcasting. It provided that broadcasters are to be public trustees of public property, that they have no rights, save during the term of their three-year license. They have no more right to a renewal of that license than a highway contractor has to a second contract after he is finished building the first stretch of highway. They must, like an elected public official, 'run on their record.' That's a quotation from the U.S. Court of Appeals.

"One of the leading spokesmen for the Communications Act said that if ever broadcasting property should fall into the hands of a few and the mass media should be so dominated, then 'woe be to him who disagrees with them.'

"We have seen this political power come into effect today where the broadcasting industry can obtain virtually any single piece of legislation that it wants from Congress. Any elected official in this country who is running from a district that is preponderantly covered by one or a few vhf television stations simply must look to the owners of those stations as his principal constituents. I think this is dangerous. Increasingly, we are seeing stations owned not by local citizens, but by national industrial conglomerate corporations with no ties to the local community. And some of these conglomerates are running stations on a formal basis, profit-maximizing and putting out the same programing in all the communities that they cover."

APPENDIXES TO STATEMENT OF FCC COMMISSIONER NICHOLAS JOHNSON BEFORE THE SENATE COMMERCE COMMITTEE ON S. 1917, DECEMBER 9, 1969

Attached are my separate statements in the cases listed in my testimony.

SEPARATE STATEMENT OF COMMISSIONER NICHOLAS JOHNSON

I. Introduction

The Commission today offers for public view the results of its recent informal negotiations with the Bell System on the appropriate level of interstate rates. The effectiveness of the Commission in this area and the suitability of continuous surveillance as a regulatory technique can now be evaluated. My analysis indicates that the technique is rather ineffective and the Commission's adherence to announced principles is sharply limited when it comes into conflict with ATT. The Commission here issues a press release designed to show that significant decreases have "voluntarily" been agreed to by Bell. The implication is that some wonderful victory has been achieved for the consumer through the activities of the Commission and the benevolence of ATT. Unanswered is the question of whether *enough* has been achieved or whether the Commission's representation is a true reflection of the facts.

## II. Continuous surveillance as a regulatory technique

"Continuous surveillance" is a regular informal review of particular regulatory issues—in this case ATT's interstate rate of return. Informal closed door negotiations were held with Bell to examine going levels of earnings with a view to possible appropriate action by the Commission or Bell. The theory is that in the context of these negotiations the Commission will be able to make an informed judgment as to what action would serve the interests of the public as consumers *and* that Bell would agree to take that action even though it is harmful to the interests of its stockholders. Initially there seems no reason that a regulated company would agree to actions inimicable to the interests of its stockholders. However, a company may in fact be willing to meet certain levels of public responsibility which are not too harmful in terms of stockholder reaction.

The Commission has certain penalties it can impose if a company is unresponsive. A company does not wish to receive the unfavorable publicity generated by public Commission criticism of a failure to respond to the interests of the consumer. (Thus, not only has the Commission negotiated with Bell on the rate reduction; the content of the FCC majority's *press release* was negotiated with Bell officials who are clearly concerned as much with publicity as with profits.) The Commission could issue a show cause order to require a recalcitrant company to prove why its rates should not be lowered. Finally, there is the threat of a full-scale investigation with its attendant uncertainty and unfavorable publicity. The Commission is not without weapons to compel action by the regulated company—even though the continuous surveillance proceeding is not a formal hearing from which orders may be issued.

There are severe limits to the Commission's ability to function in this type of a proceeding. Virtually all of the information was selected, packaged and presented by Bell—there was no direct case from our staff or outside representatives. There was no leavening from outside consumer representatives—even though the New York City Consumers Affairs Department requested (and was denied) the opportunity to appear. The negotiating process depends on the skill and dedication of the negotiators—and a company with a single position faces a multi-member Commission with a variety of positions. There are no limits on the lobbying efforts by the company—to staff or Commissioners—since *ex parte* rules do not apply. Whatever decisions are made—whether adjustments are needed, how much, what the company agrees to and how much the Commission compromises—are not normally explained publicly in the way formal decisions are. Public statements are made long after the decisions in fact have been made. Appeal from decisions is difficult—there is no opportunity to seek reconsideration of a formal Commission decision or appeal it to the courts. There are no parties to appeal. Apparently all that can be done is to petition for rejection of whatever revised tariffs Bell decides to file as a result of the negotiations.

## III. Consumer advocates

In response to some of the inherent problems with the continuous surveillance proceeding the Commission in this instance decided to denominate two staff members to ask questions of the ATT witnesses from the consumer's point of view. Operating in a capacity separated from that of the Commission's Common Carrier Bureau staff, these staff members conducted their own cross-examination of Bell's witnesses and offered some additional materials relating to their examination. The quality and completeness of the information before the Commission was improved by their performance. Bell's discomfiture was obvious. On balance, the continuous surveillance process was clearly improved by this limited use of denominated consumer representatives.

The innovation did, however, heighten the tension as to the role of the Commission's staff in rate proceedings. The Commission has traditionally viewed its staff in ratemaking proceedings as combined protector-of-the-consumer and neutral adviser-to-the-Commission. I have elsewhere argued that the combined functions necessarily affect the quality of the consumer advocacy and this was confirmed by the experiment in this proceeding. A.T. & T., 9 F.C.C. 2d 30, 122 at 141 (1967). I believe the Commission ought to use staff consumer advocates in all important ratemaking matters. The Commission ought to do all it can to have forceful advocacy for alternatives presented to it—a necessary ingredient for competent choice in any decision-making process.

#### IV. Results reached and achieved

Bell argued it should be allowed to earn 8.5 to 9.0% on its total allowed rate base—and thus that the Commission should modify *de facto* its 1967 decision that the appropriate Bell rate of return was 7.0 to 7.5%. This 2% range from 7.0 to 9.0%, for interstate operations alone, could cost consumers as much as \$500 million more per year depending on the level fixed by the Commission. (A change of 0.1% in Bell's rate of return has a \$24 million effect on the amount of gross revenues the consumer must pay.) The majority concluded that Bell's current going rate of return is 8.25%, that 7.4% was appropriate for purposes of negotiation and a \$200 million rate decrease (after adjusting for stimulation effects) was warranted. (8.25 minus 7.4 equals .85; .85 times \$24 million equals \$204 million.) To this sum was added the \$90 million in MTT rates Bell had agreed to file as a result of price increases made in non-MTT (Telpak, TWX, Program Transmission) services. The majority was seeking \$290 million through negotiations conducted by the staff and the Telephone Committee.

Bell now says they have agreed to reduce rates by \$240 million. The majority's compromise in negotiations will cost the consumer \$50 million per year. The majority first sought \$200 million in reduction plus the \$85-90 million MTT reductions as offsets to the other rate increases Bell has filed. Bell as a counter offered \$120 million plus the offsets. Bell also wanted a statement from the Commission that a return of 8% was justified. The majority commendably refused, although offering to say that a rate above 7.5% is justified, and that earnings "in the range" of 8.0 to 8.5% will result from its decision. It is, in any event, indisputably clear that the Commission today sanctions a rate of return in excess of 7½%—the maximum permitted under its own prior order! Now Bell has offered to reduce MTT rates by \$240 million and the majority has accepted. The majority's compromise appears to cost the consumer \$50 million per year. In fact the majority's additional compromise from what it *should have sought* from Bell may cost the consumer \$250 million per year!

The majority's decision to seek only \$290 million in reductions in the face of Bell's present level of earnings severely harms the consumer and is a strong critique of the continuous surveillance process. Let us assume for the moment that the majority's 7.4% floor for Bell's rate of return is correct. Would \$300 million in reductions have reached this level? We can be almost certain that it would not. One need only examine the history of continuous surveillance as well as the results of the 1967 rate proceeding. Bell's interstate rate of return has never fallen below 7.5% since 1961. (1961—7.72%; 1962—7.55%; 1963—7.51%; 1964—7.99%; 1965—7.95%; 1966—8.29%; 1967—8.25%; 1968—7.60%.) Although rate reductions were occasionally achieved during this period, it is not at all clear that they were enough. Bell appears to have been successful in earning extra profits through the ineffectiveness of the continuous surveillance process. These profits may have led to a significant over-valuation of Bell's stock during this period and the subsequent readjustment.

The rate of return for 1968 is particularly significant. After a formal rate proceeding the Commission ordered Bell to file tariffs to reach an allowed rate of 7.0 to 7.5%. The effect of \$20 million in a \$120 million rate reduction order was deferred for a substantial period in 1968 out of the professed fear that earnings might fall below the 7.0% level. [A.T. & T., 12 F.C.C. 2d 167, 168 (1968).] The Commission's fears for Bell financial health were misplaced. Not only did Bell not go below the lower end of the range, it exceeded the *higher* limit, earning 7.6%. As if this were not enough, only the Vietnam War and its attendant surtax saved the Commission from further embarrassment. Without the surtax Bell would have earned in the range of 8.2%—a full 0.7 to 1.2% above the range supposedly established by the Commission's 1967 decision. The record suggests that Commission decisions systematically err in Bell's favor on rate of return matters.

An examination of today's decision suggests some of the reasons for the FCC's errors. No estimate is made for growth in Bell's 1970 earnings, although Bell has enjoyed steady growth. No estimate is made for possible lower unit costs, although Bell proudly reports its cost-reducing achievements. No account is taken of the effects of relaxation of the income tax surcharge. If the surcharge rate is reduced to 5% on January 1, 1970, then \$70 million less gross revenues will be needed to reach 7.4%. By June 30, 1970, when the remaining 5% is scheduled to be lifted, another \$70 million less in gross revenues will be needed by Bell. Since the surveillance process generally takes at least a year from the time excess earnings occur, to Commission recognition, to Commission action, to tariff filing,

the majority's failure to take account of the probable effects of the surcharge changes may cost the consumer \$100 million in 1970. (The majority could have directed Bell to have tariff reductions in hand ready for filing when the surtax changes come. For this discussion it is recognized that Bell has effectively passed the entire surtax on to its consumers.)

The majority's willingness to settle for \$240 million in reductions can also be attacked for its *de facto* modification without hearing of the Commission's 1967 order. The Commission rejected the participation of outside parties representing consumer interests but did allow attendance by representatives from NARUC (the association of state regulatory commissioners). The majority has made a decision in fact, but there is no announcement of it, no rationale offered for it, and no consideration of the rights of parties who may feel aggrieved. A leading case is often cited for the proposition that no legal redress is available for decisions reached under continuous surveillance. [*The Public Utilities Commission of the State of California v. United States*, 356 F. 2d 236 (9th Cir. 1966)]. However, the fact that the Commission recently made an on-the-record determination, and now changes it without hearing, may present a different legal situation.

Bell argued that circumstances had changed from the 1967 environment, and that these changes warranted a change in their allowed rate of return. Its evidence focused on one basic point—the change in the interest rate for long-term debt capital. The majority agreed with Bell to the tune of \$100 million per year. (The difference between a range of 7.0 to 7.5% and 7.4 to 7.9% is between \$24 million and \$196 million.) In 1967 the Commission reached two basic conclusions—the overall rate of return should be 7.0 to 7.5% and Bell had been severely negligent in not using more debt financing in the past, a policy that has been and continues to be costly to both consumer and shareholder.

The issues concerning proper capital financing of a public utility need not be as confusing as they appear. A company can raise capital by equity or by debt. Equity includes retained earnings and money gained from stock sales. Debt is capital borrowed from money-lenders at a fixed rate of interest. Other things being equal debt financing is generally less costly to the consumer while being beneficial to the stockholder. Debt costs less since the interest rate is normally lower than the required return for equity. Interest costs are a cost of doing business and as such are deducted before the payment of corporate income taxes. And for any given level of overall return the use of debt financing can often increase the pool of earnings available to equity holders.

Since the 1967 decision Bell has gone to all-debt financing and even at the present high interest rates, debt financing continues to exert a favorable leveraging effect on Bell's earnings. In fact as the staff consumer representatives pointed out in a chart submitted during cross-examination, Bell has been able to offset the effects of high interest through increased leverage.

1966 (TEST YEAR) ALLOWED RATE OF RETURN 7 TO 7 ½ PERCENT

	Low	High
31.5 percent debt at 4 percent interest.....	1.26	1.26
68.5 percent equity at 8.4 to 9.1 percent return.....	5.74	6.24
Total allowed rate of return.....	7.00	7.50

1969 calculation incorporating :

1. Higher interest rates being paid;
2. Changed capital structure;
3. The same return on equity range as allowed in the 1967 decision.

	Low	High
40 percent debt at 5 percent interest.....	\$2.00	\$2.00
60 percent equity at 8.4 to 9.1 percent return.....	5.04	5.46
Total allowed rate of return.....	7.04	7.46

Note: The increased interest cost for debt is counteracted by the increase in debt ratio so that if the return on equity remains the same, the allowed rate of return would remain the same.

The majority's calculation is perhaps simpler. In 1967 the Commission said the Bell System could be earning at least 9% on equity if it had achieved a debt ratio of 40% at 4% embedded interest cost, although Bell had debt ratio of about 35% at the time. (A debt ratio is the ratio of the amount of debt to the total capital of a company—a company with \$100,000 total capital of which \$35,000 is debt has a 35% debt ratio. "Embedded interest cost" is the average interest rate being paid on debt capital of the company.)

If Bell had a 40% debt ratio and was paying on the average of 4% in interest, a 7% overall return on capital would result in a 9% return to equity.

	<i>Percent</i>
40 percent debt times 4 percent interest.....	1.6
60 percent equity times 9 percent return.....	5.4
<b>Total return.....</b>	<b>7.0</b>

At 7.5 percent return Bell would be earning 9.83% on equity.

	<i>Percent</i>
40 percent debt times 4 percent interest.....	1.6
60 percent equity times 9.83 percent return.....	5.9
<b>Total return.....</b>	<b>7.5</b>

Today Bell has a 40% debt ratio but borrowing at higher interest rates has made its average interest cost for all debt capital 5%. In order to achieve a 9% return on equity, the overall rate of return must be set at 7.4%, the majority's figure.

	<i>Percent</i>
40 percent debt times 5 percent interest.....	2.0
60 percent equity times 9 percent return.....	5.4
<b>Total return.....</b>	<b>7.4</b>

The crucial question is whether the 1967 decision "guaranteed" Bell a 9% return on equity. There is a strong suggestion it did not. As noted, a 7.0 to 7.5% rate of return suggested a return on equity based on 1966 test year data of 8.4% to 9.1%. The leveraging effect of all-debt financing has retained that range of equity return even if there is no change in the allowed range of 7.0 to 7.5% on total capital. And there was no demonstration by ATT that the fundamental factors affecting the required return on equity have caused the cost of equity capital to ATT to increase.

The majority could easily have taken account both of the surtax and reduced the going rate of return to 7.0%. It could have made some estimate of the impact on rate of return in 1970 from growth and lower cost technology. It did not. Cost to the consumer: at least \$200 million a year.

#### V. Conclusion

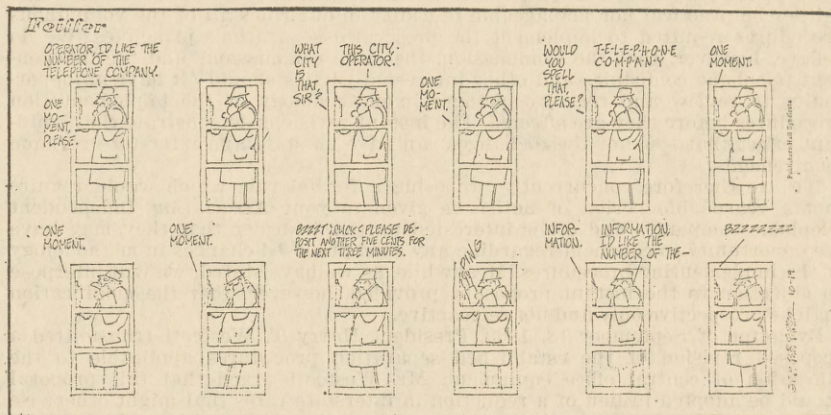
There are a number of concluding comments which seem relevant. Consumers and Bell's shareholders continue to suffer from Bell's past errors in financing. Bell abhorred debt financing in periods of low interest rates and thus finds it necessary (and cheaper) to use debt exclusively at a time of very high interest rates. But it is even more disquieting that Bell now speaks of returning to equity via convertible bonds despite the fact that debt financing continues to be less costly to the consumer and more beneficial to the stockholder than equity financing. Moreover Bell's debt ratio, although increasing, is still not within shouting distance of that employed by most other major telephone, electric and gas utilities. Today consumers still must pay Bell a higher rate of return on total capital than they pay electric utilities while stockholders still get a lower return on equity from Bell than they obtain from the electric. Moreover, these relationships are likely to prevail for some time in the future as Bell attempts to extricate itself from its past inefficient financing policies. It is of some concern that the Commission majority says nothing on this issue—as it remained silent when Bell followed costly equity financing in the past—even after it has concluded that Bell is not more risky than the electric. If Bell elects to improve its capital structure at its leisure, must the consumer pay for today's inefficient financing as well as yesterday's?

— Bell continues to refuse to use liberalized depreciation with either normalization or flow-through. The majority refuses to take action despite the fact that liberalized depreciation could in the past and would now provide substantial

benefits to both consumers and stockholders. [See the discussion in Trebing (ed), *Rate of Return Under Regulation*, pp. 129-175 (1969)]. Bell and FCC errors on the use of liberalized depreciation are very likely of the same order of magnitude as the errors in capital financing—with the attendant adverse impact on the consumer and stockholder. The Commission implicitly allows Bell to pass the full amount of the Vietnam surtax on to consumers for the purpose of rate level calculations. A strong case can be made that Bell should bear at least *some* of the costs of this special war-inflation tax and the Commission said in a letter to the then Consumer Affairs Assistant, Betty Furness in 1968 that it would at least consider that possibility.

Bell and the FCC use electric utilities for comparison purposes. Several comments are relevant. Implicit is the assumption that the regulation of the electric is a proper benchmark. Some might disagree. Senator Lee Metcalf in his book, *Overcharge*, urges that in fact electric utilities—the FCC's comparative standard—are earning too much. [Metcalf and Reimer, *Overcharge* (1967)]. But even so the electric, because of a higher debt ratio, require less in overall rate of return (6.7% in 1968 for the electric to Bell's 7.6%) while returning more to equity holders (11.9% in 1968 for the electric to Bell's 9.3%). The electric also make substantial use of liberalized depreciation.

Bell's contempt for the consumer is clear, not only for refusing to lower exorbitant rates but also for its shocking acquiescence in the decline in the quality of telephone service its slipshod performance has permitted, as Jules Feiffer has so concisely portrayed:



© 1969 Jules Feiffer - 10-19, Courtesy of Publishers-Hall Syndicate

It is difficult to evaluate the process of continuous surveillance as a regulatory tool. It offers some real procedural benefits. But it requires somewhat more than the Commission was able to bring to it this time.

FEDERAL COMMUNICATIONS COMMISSION,  
Washington, D.C., October 1, 1969.

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS,  
Post Office Box 684, Washington, D.C.  
(Attention: Paul Rodgers, Esq., General Counsel).

GENTLEMEN: This refers to your letter of August 18, 1969, proposing certain changes in the implementation of the procedures for separating investment, expenses, taxes and reserves between the interstate and intrastate jurisdictions as contained in Part 67 of the Commission's Rules. Reference is also made herein to the letter, dated September 18, 1969, from Honorable Harry T. Westcott,

President of your Association concerning the allocation of central office equipment as now provided for in Part 67 of our Rules.

The Commission has considered the two revisions in the implementing procedures you propose in your letter of August 18 which would shift approximately \$35 million in revenue requirements from the intrastate to the interstate service based on current operations. The first proposed implementing change would alter the present method for computing the annual average of the second and third factors of the formula for calculating interstate usage of subscriber plant. The results of this change would be to treat the current study month as the midpoint of the annual average compared to the present method which results in a six-month lag in the midpoint used for the current study month. The other change would revise the method of measuring the relative use of interexchange circuit plant and certain toll switching plant. This revision would include in such measurements week-end traffic which is now excluded.

Upon our consideration of these proposed revisions in the implementing procedures, and available data with respect thereto which has also been the subject of analysis by our respective technical staff experts, it is our view that such revisions would constitute improvements in the existing implementing procedures. Accordingly, the Commission has no objection to the two proposed revisions.

We are also advised that the United States Independent Telephone Association would have no objection to the merits of the proposed changes on the condition that they are treated as being the subject of rule making procedures. However, implicit in the latter proposal of USITA is that all procedures used to implement the separations principles prescribed by the Commission should, in effect, be codified in the Commission's Rules, and that all changes in such codified rules be the subject of rule making. The Commission is of the view that it would neither be practical nor manageable to codify in our rules all of the voluminous procedures required to implement the prescribed separations principles. We do believe, however, that the Commission, the state commissions and the independent telephone companies and other interested parties should all have an opportunity to review and react to changes in methodology of the implementation procedures before they are effected. The instant revisions demonstrate the significant effect that some of these changes can have on state and interstate revenue requirements.

We are therefore concurrently proposing a formal rule which would require that a reasonable period of notice be given to your Association, independent telephone companies and other interested parties in order that they may have the opportunity to comment regarding any such proposed changes in methodology of the implementing procedures. Meanwhile, as we have stated, we will interpose no objection to the instant proposals, provided, however, that the modification shall be prospective only and not retroactive.

By letter of September 18, 1969, President Harry T. Westcott transmitted a proposed revision of the established separation procedures applicable to the allocation of central office equipment. Mr. Westcott urged that this proposal should be adopted in lieu of a reduction in interstate rates that might otherwise be warranted by the current level of interstate earnings. In making this proposal, Mr. Westcott noted the number of states in which requests are now pending for increases in rates for local telephone service and the likelihood of similar requests occurring in additional states. Thus, he urges our cooperation with state commissions in seeking to reduce the cost of local service by favorable action on the proposed revision.

The Commission fully shares the concern of Mr. Westcott and believes that all reasonable measures should be taken to avoid increases in the costs of consumer services subject to our respective jurisdictions. At the same time, you will appreciate that constraints of law and sound regulatory policy require that separation procedures should be premised on acceptable and rational principles of cost allocation, and that such procedures cannot be predicated solely upon considerations of shifting revenue requirements from one jurisdiction to another. We are therefore prepared to undertake promptly appropriate consideration of the merits of the suggested revision in the allocation procedures applicable to central office equipment. To this end, we are recommending that the Technical Staff Experts of the NARUC and FCC forthwith commence a study and analysis of the proposed revision and upon consideration of their joint report and recommendation the Commission will determine promptly what further action may be warranted with respect thereto.

The Commission is not satisfied that it should take action at this time with respect to your petition of August 19, 1969, requesting amendment of Part 67 of our Rules governing the timing of elimination of the effects of the Modified Phoenix Plan.

Please be assured of our full cooperation in arriving at an early resolution of these matters.

This letter was adopted by the Commission on October 1, 1969. Commissioner Cox issuing the attached separate statement; Commissioner Johnson dissenting and issuing the attached statement; Commissioner H. Rex Lee absent.

BY DIRECTION OF THE COMMISSION,  
ROSEL H. HYDE, *Chairman*.

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#### SEPARATE STATEMENT OF COMMISSIONER KENNETH A. COX

As indicated in my separate statement in connection with the Notice of Proposed Rule Making in Docket No. 18686, issued concurrently herewith, I believe that changes in methodology of the magnitude here involved should be made only through rule making. On the merits of these particular suggestions, the proposal to shift from a five to a seven day week for the purpose of message-mile-minute studies has merit and should be put out for rule making. However, I think that the proposal to calculate all three subscriber line use factors on an annual period for which the current month is the midpoint is unsound and should be rejected. It involves the use of projections for the future which may not turn out to be true, and seems designed to produce a substantial one-time shift in favor of the states without really enhancing the precision or usefulness of our separations procedures.

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#### SEPARATIONS

##### LETTER TO NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS— DISSENTING OPINION OF COMMISSIONER NICHOLAS JOHNSON

I am still of the view that there ought to be *some* rationale beyond political expediency for our shifting of millions of dollars of revenue requirements between long distance and local telephone service. I do not find such a rationale in the first or second paragraph of this letter which cavalierly disposes of \$35 million.

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#### BEFORE THE FEDERAL COMMUNICATIONS COMMISSION, WASHINGTON, D.C.

In the Matter of Amendment of Part 67, Jurisdictional Separations, to require that a reasonable period of notice be given to interested parties in order that they may have the opportunity to comment regarding any proposed changes in the implementing procedures, Docket No. 18686.

#### NOTICE OF PROPOSED RULE MAKING

Adopted: October 1, 1969. Released: October 3, 1969 by the Commission; Commissioner Cox concurring in part and dissenting in part and issuing a statement in which Commissioner Johnson joins; Commissioner H. Rex Lee absent.

1. Notice is hereby given of proposed rule making in the above captioned proceeding. This rule making would add Section 67.2 to Part 67 of the rules to read as follows:

##### *Section 67.2. Changes in implementing procedures*

No change in the methodology employed in the division of revenues procedures used to implement the principles laid down in the Separations Manual shall be made except after 60 days notice to the Commission and other interested parties together with an explanation of the reasons for the proposed change. If within such 60 day period no adverse comments have been filed with the Commission, and the Commission shall not have stayed such change on its own motion, the change may be placed in effect. Otherwise the proposed change shall become effective only upon further order of the Commission.

2. The detailed methods for implementation of the Separations Manual are too voluminous and technical to be incorporated into our rules *in toto*. However, it is possible through changes therein to effect shifts in revenue requirements between the state and interstate jurisdictions. It is felt that any such changes affecting the respective revenue requirements should be made only after affording interested parties the opportunity for comment.

3. This Notice of Proposed Rule Making is issued under authority of Sections 4(i), 221(c) and 221(d) of the Communications Act of 1934, as amended.

4. Pursuant to applicable procedures set forth in Section 1.415 of the Commission's Rules, interested parties may file comments on or before November 3, 1969, and reply comments on or before November 20, 1969. All relevant and timely comments and reply comments will be considered by the Commission before final action is taken in this proceeding. In reaching its decision in this proceeding, the Commission may also take into account other relevant information before it, in addition to the specific comments invited by this Notice.

5. In accordance with the provisions of Section 1.419 of the Commission's Rules and Regulations, an original and fourteen copies of all statements or briefs shall be furnished to the Commission.

FEDERAL COMMUNICATIONS COMMISSION,<sup>1</sup>  
BEN F. WAPLE, *Secretary*.

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STATEMENT OF COMMISSIONER KENNETH A. COX CONCURRING IN PART AND DISSENTING IN PART IN WHICH COMMISSIONER NICHOLAS JOHNSON JOINS

I agree that the details of separations methodology are too voluminous to be incorporated into our rules. However, I think that any significant changes made hereafter should be put out for conventional rulemaking and, if approved, made a part of our rules.

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SEPARATIONS

DISSENTING OPINION OF COMMISSIONER NICHOLAS JOHNSON

In the Matter of Prescription of Procedures for separating . . . plant . . .  
Dkt. No. 17975.

One of the prime responsibilities of the Federal Communications Commission is to insure that its actions serve to encourage and promote the creation of the telephone system best suited to serve all the needs of the nation. In fulfilling that responsibility the Commission must articulate the goals and purposes it seeks to serve, consider the alternatives for the achievement of those goals, and choose the most feasible alternative. I have previously indicated my concern about the lack of knowledge of the social and economic consequences of the Commission's decisions regarding telephone regulation—and even its disinclination to consider those decisions in the light of these consequences.

With regard to separations I noted in July, 1967: “[T]he social-economic-political implications of charging costs to one telephone user rather than another are questions the Commission has been able to give less consideration than I think desirable in evaluating the alternative separations procedures available to us.” *AT&T*, 9 F.C.C. 2d 30, 127 (1967). And when this rulemaking was opened I urged: “[W]e should direct the FCC staff to come forward with a well-thought out, economically rational separations analysis, not taking into account the political pressures and reactions of those whom changes would affect. Presumably there are several policy alternatives available to us—depending on the assumptions and objectives to be achieved by such a plan. Then, after the Commission had arrived at its best judgment from adequate examination of the policy matters involved, rulemaking could be proposed.” *AT&T*, 11 F.C.C. 2d 493, 503 (1968). Insofar as I can discern, the past year and one-half since the July 1967 decision has brought no progress in the directions I then thought to be necessary.

Jurisdictional separations is an important matter for the Commission, the Bell system, potential competitors to Bell, the states, their regulatory authorities—and the 200 million Americans who must pay the bill, and depend upon the telephone system. Separations procedures have a profound impact on dividing

<sup>1</sup> See attached statement of Commissioner Cox in which Commissioner Johnson joins.

the costs of the Bell system, assignment of costs to users, and, ultimately, the prices users pay for the services they buy. Exchange service and long distance service may be more or less costly as a result of separations decisions—with a profound influence on the functioning of our society.

Jurisdictional separations is an inherently arbitrary undertaking: the dividing among regulatory authorities constituted along state lines of an industry that is designed as a national system, its parts interdependent and constructed to serve a whole nation. One need only look to the history of separations for illustration of the wide variation in procedures that at one time or another have constituted the conventional wisdom on this subject. The point to be drawn from this review is that justification for a particular methodology must be sought elsewhere than the pseudointellectual metaphysics of the "Charleston Plan," "Denver Plan," "Modified Phoenix," and 100% to 200% of "SLU."

Historically, the separations problem has not been addressed within the framework of public policy objectives of communications regulation, nor has it involved a thorough consideration of the consequences of alternative separations methods. Separations procedures involve arbitrary cost allocations which traditionally have been made on the basis of informal negotiations, out of the public eye, in accord with the criteria of political expediency. For Bell, separations procedures merely transfer revenues and costs from one pocket to another. If revenues appear too high in interstate services, and a rate cut seems likely, it can shift some additional costs to the interstate side of the business and make rates of return look lower. The state commissioners (many of whom must stand election) want to avoid having to raise rates to the home owners, and therefore seek to shift as much cost as possible away from their regulatory jurisdiction. The FCC wants to avoid trouble with NARUC, the association of state commissioners) and the Congress. Within this framework the Bell System has been able to exert dominant influence over the resulting separations methods because of its singular dominance in dealing with the diverse and fragmented regulatory authorities of 50 states and one federal commission. The procedures that have been undertaken and the events that have developed since the Commission's July 1967 decision, together with the new separations proposal, demonstrate a continuation of the unhappy tradition of separations "analysis." Just as in the past, the separations proposal is devoid of consideration of any social or public policy objectives, and lacks a thorough analysis of the economic and social consequences of the change.

The Commission's role prior to the formal July 1967 decision and proceeding was to participate in negotiations between the parties involved—Bell, the states, and others—and then to not disapprove the separations procedures worked out by others. The procedures are embodied in a one-volume manual which consists more of exhortation than of detailed procedures. Detailed procedures are embodied in a multi-volume Bell manual prepared for its own use. Whatever one might say of the history of FCC involvement in separations, it can scarcely be accused of regulatory enthusiasm. In one instance Bell made an administrative shift in its own internal procedures which resulted in a change in separations results involving millions of dollars without changing the separations manual.<sup>1</sup>

I have detailed my general objections to the specific separations proposals discussed by the majority—and the concomitant adoption of the entire separations Manual. But there are specific problems with the subscriber and interexchange plant proposals here prescribed. I do not care to elaborate on the subscriber plant formulas except to note the complete lack of rationale for the value of the ratios chosen. A substantial additional amount of cost is shifted from intrastate to interstate jurisdictions, enough to roughly balance what is to be done with interexchange plant, and to cause no embarrassment to Bell in either jurisdiction.

For interexchange plant, the Commission action here appears to provide Bell with substantial flexibility in terms of the assignment of plant among jurisdictions and service categories (Message Toll Telephone versus private line). Further, the adopted separations procedures will be implemented by Bell via its division of revenue methodology over which the FCC cannot exercise effective control. In essence, it is adopting a separations methodology without knowing the extent to which the costs are manipulable by Bell in its implementation, or establishing effective control procedures so that the separations can be done by the Commission and not by Bell. The end result of the adoption of the proposal may be that it has moved to a point where the costs cannot be manipulated among

<sup>1</sup> Gabel, *Development of Separations in the Telephone Industry*, pp. 69-70 (1967).

jurisdictions by political pressures, as has been in the case of the past, but only by Bell within the adopted procedures. In either instance, public interest considerations are ignored.

The proposed change in the interexchange allocation methodology is justified by the necessity to eliminate the erratic or irrational distribution of benefits among states in accordance with an arbitrary methodology dependent upon the age, density and location of plant as well as the particular assignment for usage, it does not change the basic problem of distribution of benefits. It simply distributes them in a different arbitrary manner.

The second principal argument for changing the interexchange allocation procedures is to obtain the costs necessary for an economic comparison among the different technologies. Such an argument must be entirely fallacious. Any comparison of technologies that is undertaken after cost elements are arbitrarily allocated among jurisdictions can certainly not be very useful. And there is no indication that if and when domestic satellites become an operational part of the domestic communications system, that jurisdictional separations problems of severe complexity will not be involved. The Commissions concern for Bell's ability to compete fairly is heartwarming—would that we extended it to Bell's competitors.

Finally, we are dealing with an integrated plant that can be used alternatively for a wide variety of uses. Additions to it are based upon an aggregation of interrelated factors. The particular accounting cost of a particular item of plant in a particular location need not provide any indication of the true cost of providing the service that happens to be provided over that plant at any point in time.

In summary, it is clear that the separations problem is a complex one subject to strong political forces and vested interests. Inasmuch as a state line is an artificial boundary for separating jurisdictions, the cost allocations must remain inherently arbitrary. This leaves open significant discretion in cost allocation that can be used for good or ill—that can be used to pursue the political desires of private parties and particular regulatory agencies, or that can be used to extend and broaden public interest considerations in accord with the social benefits and costs of allocating book cost to particular jurisdictions. Rather than take the broad view and use the discretion to further public interest objectives, the Commission continues to prefer the more familiar, if less intelligible, path. It is content to leave primary control in the hands of the Bell System for implementation in terms of its objectives.

The net result is that the Commission's action ends up granting to Bell in 1969 what it sought unsuccessfully in 1967. Today's grant is made for reasons which clearly do not provide justification to overrule conclusions reached then. Moreover, the Commission opinion ignores the only substantial independent academic works in the field—both of which are strongly critical of the Commission's past failures and the specific proposals adopted here. One critic, a member of the present FCC staff, wrote two articles when he was on the staff of the Federal Power Commission in 1963.<sup>2</sup> The other analyst, long familiar with FCC actions in this area undertook his study as a Brookings Fellow—a study published by the Michigan State University Institute of Public Utilities.<sup>3</sup> He notes:

"Other criteria might involve significant redistribution of telephone costs. The telephone industry is not renowned for its risk taking. Telephone regulators are prone to follow the industry pattern. Both the industry and its regulators have been reluctant to develop comprehensive cost allocation principles and aggressive pricing practices in terms of public policy objectives. Alternative separations treatment could reduce costs of local exchange service and, eventually, exchange rates, making possible a universal development of exchange services. Increased toll revenue requirements should be met not with higher rates, but by reduced unit charges.

\* \* \* \* \*

"We have concluded our chronology of telephone cost allocation methods. It should be clear that separations principles have been influenced strongly by the regulated utility, the American Telephone and Telegraph Company. It should be equally clear that the criticisms expressed herein are not primarily directed

<sup>2</sup> Bushnell, "Regulatory Responsibilities in Telephone Cost Allocation," *Public Utilities Fortnightly*, Nov. 7 and Nov. 21, 1963.

<sup>3</sup> Gabel, *Development of Separations Procedures in the Telephone Industry*, p. 5, 126 (1967).

to the myths that have been generated to rationalize the 'philosophy' of telephone separations. Nor is the primary question one of cost accounting method or of identifying separations principles with appropriate telephone engineering practice. Neither should separations be viewed merely as a subject of academic interest. The matter is one of sound public policy: what objectives are to be achieved and what separations methods are appropriate to achieve these objectives. Our criticism is that our public policy makers, fragmented and competitive, have been unable to arrive at a clear public direction."

It may well be that our critics are wrong—that virtue and wisdom are served by the FCC's action. But does that not impose *some* obligation upon us to explain why we think so? And for the Common Carrier Bureau to fail to even mention these major studies, much less to deal with their arguments, does strike me as unnecessarily arrogant and professionally irresponsible. I dissent.

#### SEPARATIONS DETERMINATION AND RULEMAKING

##### DISSENTING STATEMENT OF COMMISSIONER NICHOLAS JOHNSON

"In the matter of American Telephone and Telegraph—Charges for Interstate and Foreign Communication Service . . ."

The FCC has today made yet another effort to straighten out its position regarding "separations procedures" in setting ATT's telephone rates. I dissent.

Jurisdictional separations procedures are a part of the regulation of the telephone industry. The Bell System provides telephone service within communities ("exchange service"); *intrastate* long-distance calling; and *interstate* long-distance calling. The Federal Communications Commission regulates only *interstate* long-distance calling; state or local agencies regulate exchange and *intrastate* service. However, much of the plant and equipment of the Bell System is used to provide all types of service. Thus, the plant costs (and revenues) of the Bell System must be divided among these jurisdictions in order to compute a "rate of return" on ATT's "investment" in each service. Jurisdictional separations procedures are prescribed as guidelines. The issues involved in separations include which service shall bear what proportion of the cost of commonly-used plant.

I have previously discussed separations problems in my opinion concurring in the Commission's Interim Decision [AT&T, 9 F.C.C. 2d 30, 126 (1967)]. There I discussed what I thought separations was all about and what the Commission should be considering in the process of deciding separations questions—much of which is consistent, with Commissioner Loevinger's separate opinion regarding today's action—and I will not repeat it here. Commissioner Cox and I dissented to the subsequent suspension of the effect of the Interim Order, and the procedures that were being followed after the ratemaking hearing. [AAT Rate Hearing, FCC 67-1310 (1967)].

The Commission even tried an industry-staffed "Technical Experts Group" to tell it what refinements and improvements would best suit the companies involved. That didn't work either. For on November 15, 1967, the Group reported, "no one plan is acceptable to all members."

Today the Commission provides but a limited affirmation of its earlier Interim Decision on separations. And it simultaneously institutes a new written rulemaking proceeding to again deal with separations.

As a result of today's action there is to be a separations plan for the FCC to use in determining what AAT's interstate revenue requirements are; a separations plan for ATT to use in determining how to divide revenues and costs with the states (this plan is itself an interim compromise prepared as a stop gap by ATT); and the states are left to choose whichever of the two plans they want in dealing with ATT. On top of this mess, we are again opening the whole question of separations procedures—but this time in a written rulemaking we hope to conclude quickly. No doubt we secretly hope that the whole thing will suddenly disappear. What we have done is to get ourselves into an administrative morass which, I believe, we are making worse by our action today.

There are better ways to proceed.

We ought to affirm our interim decisions as the best result that could be reached on that record, but with the understanding that we will continue to explore separations problems.

A new rulemaking now will provide little more than a written rehash of the parties' positions as they have evolved in the rate hearing and the Technical Experts Group meeting. We will get more "from-the-hip" comments on all competing proposals.

Instead of a new rulemaking we should direct the FCC staff to come forward with a well-thought-out, economically rational separations analysis, *not* taking into account the political pressures and reactions of those whom changes would affect. Presumably there are several policy alternatives available to us—depending on the assumptions and objectives to be achieved by such a plan. Then, after the Commission had arrived at *its* best judgment from adequate examination of the policy matters involved, rulemaking could be proposed.

The policy questions surrounding jurisdictional separations are far more important than just allocating telephone plant into federal and states' jurisdictions. Jurisdictional separations is most fundamentally cost allocation—precisely one of the matters at issue in Phase I-B of this proceeding. And decisions on cost allocations have a profound affect on what prices are paid by whom for what service. These problems deserve more than the muddled set of proceedings the majority is now proposing.

#### CONCURRING OPINION OF COMMISSIONER NICHOLAS JOHNSON

##### I. SUMMARY AND INTRODUCTION: UNDERSTANDING THE SIGNIFICANCE OF TELEPHONE RATE REGULATION

The uniqueness of the human being stems from his capacity to create, manipulate, store, and respond to symbols—in other words, to communicate. Human society is, above all else, people talking to each other. A free, democratic society is distinguished by its communications policies. These most fundamental aspects of our life are influenced in substantial measure by America's telephone communications system—the world's finest. The telephone communications system contributes to:

- (a) The social cohesion of far-flung family and friends.
- (b) A nationwide market for buyers and sellers.
- (c) The political identity necessary to "the United States."
- (d) A national intellectual community.
- (e) The instantaneous response of our system of national security.

Clearly, regulatory actions affecting our telephone communications system are of basic importance to every citizen.

This telephone rate case now comes before the Federal Communications Commission (FCC) for a first and partial decision in the general rate investigation of the American Telephone & Telegraph Co. (A.T. & T. or Bell) ordered in October of 1965. Without limiting the scope of the investigation in any way, the Commission has divided the hearing into separate phases and is considering in this phase IA issues characterized as the "rate-of-return" for A.T. & T., "jurisdictional separations," certain components of the "rate base," and other related rate of return issues common to conventional public utility theory.

Although steeped in history and a built-in complexity bordering on metaphysics, the necessary public utility concepts can be quickly and simply defined for our purposes. "Rate base" is defined as the investment (less depreciation) employed in providing the service—the plant and equipment. "Net earnings" is the difference between total revenue and total expenses (including taxes). The "rate of return" is net earning expressed as a percentage of the rate base. (For example, if a company's investment ("rate base") were \$10 million, and its profit ("net earnings") was \$900,000, its "rate of return" would be 9 percent.) "Jurisdictional separations" refers to the accounting procedures used to allocate commonly used plant and commonly incurred expenses between Federal and State regulatory jurisdictions. The "capital structure" of a company refers to the relative proportions of long-term debt and equity (or stockholder) capital in the total financing of the company.

Specifically, the FCC has concluded in this phase that:

The rate of return for the Bell System should be between 7 and 7.5 percent. (It was below 7.5 percent prior to 1959 and 7.8 percent in 1966—8.1 percent for the interstate services.)

Most "separations" formulae previously employed are generally acceptable, but adjustments should be made which result in the transfer of \$85 million in revenue requirements to interstate from intrastate.

The capital structure of the Bell System can support debt of more than 40 percent of total capital (it is currently 32 percent), and that substantial benefits to stockholders as well as subscribers would result from such an increase in the proportion of debt. (Bell agreed during the hearing to the wisdom of modifying its policies in this regard.)

No amount should be included in the rate base for telephone plant under construction, nor for working capital (which is supplied by the ratepayers rather than the shareholders).

The Bell System is no riskier as a business enterprise than electric utilities.

I concur in these conclusions.

I was not a member of the Commission when this investigation was begun, nor have I participated up to now in the formulation of issues, procedures, or the order for decision in this complex proceeding. Accordingly, it is with some hesitancy that I express individual views at this time.

I wish to make clear that this opinion is not intended as criticism of what my colleagues and I (or A.T. & T.) have done during this phase of the case. Where we have resolved issues based upon our largely unsupported judgment I believe the result has been more sound than had we adopted the only alternatives available: Accepting the even less supportable, and more self-serving, judgments of company witnesses. Where we have not explored the breadth and depth of issues to the extent I would have wished it is because the necessary evidence and analysis was not introduced into the record by Bell and the other parties—or was simply unavailable. To the extent there has been a conflict between the intellectual restraints of conventional public utility theory and more modern innovations, I believe it is the FCC that has taken the lead. I do not intend to repeat these limitations on my comments in every section that follows, but they are intended to be generally applicable.

Nevertheless, as fine a job as I think the FCC has done with this case, and as formidable as may have been its burdens, my participation has led me to believe that a complete rethinking of our regulation of the telephone system is necessary and desirable.

I believe that:

What we do here should—and can—be understood by the general academic community and general public.

Telephone rate cases have a substantial impact upon our use of communications facilities, and thus the kind of nation we are building.

Public utility telephone regulation should be approached in terms of the social-economic-political consequences of decisions, in addition to (or perhaps rather than) conventional “rate of return” and other seemingly isolated financial issues.

When decisions are premised upon unscientific “expert judgment,” or political considerations, it should be candidly conceded.

We should constantly be searching for understanding and improvement in conventional public utility regulation, and exploring fundamental alternatives to the present relationship between consumers (through government) and private shareholders (in the form of private national monopolies).

I am hopeful that the fuller elaboration of such views at this time will be a constructive influence in the future stages of this and subsequent proceedings.

## II. LIMITATIONS OF THE COMMISSION'S DECISION AND OPINION

I concur in the results reached by the Commission in this phase. In general, my concern is simply that some of the implications and effects of our decision have not been as fully confronted, examined, or justified as would be desirable.

### A. Rate of return

We have determined that the reasonable range for the overall rate of return is 7 to 7.5 percent. Bell asked for 7.5 to 8.5 percent, with permission to continue around 8 percent. (The jurisdiction of the Federal Communications Commission is limited to regulations of interstate and foreign telephone service. The determination of rate of return, while based on an analysis of the total Bell System, is applicable only to the interstate portion. Some question might be raised as to whether the FCC's computations should assume all portions of Bell's operations should earn the same rate of return.) What will be the effect of this determination on communications services over the next 5 to 10 years?

What will be the effect on A.T. & T. management's incentive to cut costs and otherwise manage effectively for greater earnings?

What will be the effect on A.T. & T.'s schedule of introduction of new equipment and other innovations?

What will be the effect on A.T. & T.'s incentive to undertake projects whose returns are relatively risky?

Will lowering the rate of return have an effect on quality of service and the range of prices and output—which may well change dramatically over the next period of years?

The Commission opinion does not treat these matters explicitly, and no wonder—even the company gives them only the most general mention in the record. By implication the Commission has necessarily made the judgment that the public interest will be better served, not impeded, by the 7 to 7.5 percent rate of return—in these as in other ways. Based upon intuition and the limited record before me, I concur in that judgment. Yet these considerations are important, perhaps even more important than the consequence that interstate phone bills should be cut 3 percent. And I would have preferred to have seen them considered more explicitly. For it is the real cost over time to the consumer that ought to be our principal concern.

Will this lowering of earnings result in lower quality of service, higher prices, and a less satisfactory communications system in the long run? Or will our decision only minimally affect these variables, or even encourage expansion and innovation in the telephone system by the increase in use lower rates may bring? (Bell has been virtually forced by this Commission into every recent interstate rate reduction it has made, and each of these reductions has resulted in increased usage and better telephone service—as well as, it should be noted, higher revenues and profits.) Perhaps reductions in excess of 3 percent would have better served shareholders and subscribers alike.

We have established a fair, perhaps even generous, rate of return, and range of earnings. For the one-half percent spread (7 to 7.5 percent) provides \$80 million of flexibility in interstate earnings and \$300 million for the total system. Both the rate of return and the concept of a range of earnings substantially exceed the rates of return allowed by State commissions. The States have rarely permitted a range of earnings, have often gone to one-hundredth of a percent in precision (for example, 6.38 percent in Nevada in 1966), and have ranged during the past 15 years from a high of 6.89 percent in Wyoming (1953) to a low of 4.53 percent in Indiana (1956). And yet, I do not cast aside the possibility that perhaps a rate of return in excess of the 7.5 to 8.5 percent asked by the company would better serve the public interest in the long run. It should be noted, however, that even A.T. & T. counsel was unwilling to address the implications of such an alternative when the question was put to him explicitly (Tr., 10,311).

The interrelationship between rate of returns, stock prices, and availability of capital is an issue I wish only to identify. To what extent does a “fair rate of return” mean that telephone subscribers should be required to pay enough for telephone service to provide the constantly increasing earnings that will make A.T. & T. a “growth stock”? Should a stable, or decreasing, stock price be taken as evidence of unduly restrictive limitations on profits imposed by the FCC? Or ought the mere guarantee of a range of rate of return to be adequate for an investor in A.T. & T.? A.T. & T. is one of the few American corporations that has never missed a dividend from its inception in 1900. Its stock is rated as a “blue chip” and its bond “AAA” by the investment services. Is it a part of the FCC’s responsibility by Bell’s shareholders to help the company continue this record? To what extent does the price of the stock reflect expectations about FCC regulation? Should such expectations be relevant to the Commission in fixing a rate of return? I believe such questions warrant far more open evaluation than they have received.

It is clear that the public interest, which this Commission must protect, is best served by as low a rate of return as is consistent with a fair return to stockholders and the optimum service to the public over time. The Commission has implicitly concluded that quality of service will not be harmed by a rate of return lower than that desired by Bell. It was incumbent on Bell to demonstrate specifically (not just through the expression of generalized concern and the unscientific “expert judgment” of its own witnesses) how a higher rate of return would benefit the public interest. This Bell has not done, and thus we have no responsible option but to reject any higher rate.

Surely a somewhat scientific measure of the sensitivity and correlation between rates of return and quality of service could be devised. As I noted earlier, there is a wide range of rates of return allowed and earned in the 50 States. The California Public Utilities Commission has taken what Bell views as a harsh attitude toward rate of return—now set at 6.3 percent. Of course, “quality of service” is a matter largely within the control of Bell in ways unaffected by cost. Even so, an examination of the quality of service in California and other jurisdictions might serve to provide some insight into how rate of return can affect

what consumers can buy, what they must pay, what choices are available, and the speed of service (installation or repair; availability of circuits).

I do not mean to suggest answers to the questions listed in this subsection. Quite the contrary. My point is simply that neither we nor the company really knows the answers, and that we have not indicated any awareness or concern about our lack of knowledge. To the extent there is a direct relationship between a given rate of return and social consequences of substantial national impact, I believe those consequences should be addressed directly, rather than left to chance.

The Bell System provides telephone service within communities ("local exchange" service), for long-distance toll calls within a State, and for interstate and foreign toll calls. The FCC regulates the interstate and foreign service furnished by Bell, and State or local agencies regulate the intrastate and local services. Each regulatory agency must determine the rate base subject to its jurisdiction. The telephone company, being a single entity larger than governments, does not suffer this inconvenience. And, as might be anticipated, much of the equipment of the Bell System is used to provide interstate and intrastate service jointly.

The Bell System is essentially a holding company in structure with associated companies (such as Washington, D.C.'s Chesapeake & Potomac Telephone Co.) providing service to States or regions. These associated companies are physically tied together for purposes of interstate long-distance calls by the Long Lines Department of A.T. & T. Bell Laboratories and Western Electric (the telephone equipment manufacturer) are separate companies in the Bell System. The General Department of A.T. & T. provides business services to the other company components.

Because each jurisdiction (Federal and States) must figure the allowable rate of return on the rate base subject to its jurisdiction, "separation procedures" are required to allocate the property costs, revenues, expenses, taxes, and reserves among the separate jurisdictions. (Bear in mind that there is no geographical area known as "interstate," and that all telephone equipment used for interstate calls must, therefore, be located within some State.) There are two main types of telephone plant to be divided by these procedures. One is the "exchange plant" associated with provision of local service. Included are individuals' telephone receivers and the lines to a local switching office. The other category is the "interexchange plant" which is used to provide long-distance toll connections between exchanges. It is because much of the "exchange" and "interexchange" equipment is used for both interstate and intrastate service that it must be "separated" (for ratemaking accounting purposes) by jurisdiction. For example, a telephone instrument can be used for both interstate and intrastate calling; intrastate toll lines also connect and provide service to the interstate network.

Of course, separating plant also involves the allocation of cost. In computing telephone rates and determining rate of return, the cost of providing telephone service (related to "revenue requirements") must be borne by charges for local service, intrastate long-distance tolls, and interstate long-distance tolls. How are costs allocated for ratemaking purposes between State and Federal jurisdictions? In this case the Commission has made judgments as to the most appropriate formulae and procedures. I concur in these judgments under the circumstances of this case. But the social-economic-political implications of charging costs to one telephone user rather than another are questions the Commission has been able to give less consideration than I think desirable in evaluating the alternative separations procedures available to us.

Of course, individual parties and interests view the results of separations from different perspectives. Those who are predominantly the users of local exchange and intrastate toll would rather have more costs borne by the interstate system. To the extent that is done local costs and rates are lower than they otherwise would be. States' Governors and public utility commission members, who must either stand election or be appointed by those who do, want to avoid raising local rates, and, therefore, tend to support formulae for shifting "revenue requirements" from the States to the interstate system. The independent (non-Bell) companies agree. To the extent a larger share of the independents' costs can be assigned to the interstate network they can contend for a greater share of interstate revenues under their agreements with Bell. Theoretically, Bell should be concerned only that all its costs be covered. In practice, of course, it does not want costs shifted arbitrarily to services where such higher costs may impede sale of the service. On the other hand, cost reductions from recent technological innovation have

affected almost exclusively (and dramatically) long-distance calling rather than local service. (A long-distance microwave relay tower circuit costs roughly 1 percent of the cost of the old-fashioned long-distance open wire circuit.) The reductions in cost make it possible to (1) reduce long-distance rates substantially, (2) absorb millions of dollars of local service costs into the interstate system, and (3) still make substantial interstate profits. For these reasons, Bell is able to accept the politically expedient course of holding local charges to levels below those dictated by cost—by increasing long-distance rates to levels higher than the dramatically reduced costs would make possible.

The standard most generally accepted by economists and accountants for allocating joint costs within a complex network like the Bell System is actual use. That is, whoever uses the joint plant pays for it—in proportion to his use. (For example, if a State's telephone plant cost \$10 million and, when in use, is used for interstate calls 10 percent of the time, allocation according to use would "separate" \$1 million of this value into the interstate rate base, and \$9 million into the intrastate rate base.) A.T. & T. maintains the statistics necessary to administer such a system. And allocation of costs by use is the standard I would adopt—absent compelling reasons to deviate from it. It is rational, it is fair, it is widely used elsewhere, and it avoids unarticulated subsidies. It is not, however, a separations formula available for Commission adoption here.

I accept the Commission's formula for two reasons which I view as adequately compelling to justify deviating from actual use under the circumstances of this case: The nature of the toll network, and practical political considerations.

In allocating interexchange plant the Commission has chosen to average the lower costs of circuits used for interstate use with the higher cost of intrastate circuits. I believe this deviation from allocation by actual usage to be reasonable. Averaging reflects the integrated aspects of the nationwide toll network. Each part of the toll network depends on every other part. The division of toll circuits into intrastate and interstate is essentially arbitrary anyway. It also affects Bell's capacity to utilize lower-cost circuits in competitive interstate services while using the higher-cost circuits intrastate markets with less competition.

All exchange plant, with one exception, is to be allocated on the basis of actual function—which is identifiable. "Subscriber plant" (telephone instruments and lines to the local office) is the exception. It is to be allocated on the basis of use ("subscriber lines usage," abbreviated SLU)—plus a factor. As a national average, during the time a telephone is actually in use, it is used about 4 percent of the time for interstate long-distance calls. Thus, actual usage would dictate that 4 percent of the value attributed to subscriber plant in the rate base should be allocated to the interstate rate base, and 96 percent to the intrastate rate base. Under the Commission's formula, however, on the average not 4, but 12 percent, is allocated to the interstate rate base. Why? Because the Commission adds to the 4 percent a factor of two times the national average SLU, or 8 percent, making a total of 12 percent. But why does it add such a factor? This factor is chosen, the Commission opinion says, to reflect the value of the "availability of access" to the long-distance toll system (that is, when you pick up the phone you can just as easily call long distance as local—even though you choose not to), and the inhibition on long-distance calling caused by the system of per-call pricing for toll calls and flat rates for exchange. Thus, even though, during the time of actual use, subscriber plant is used only 4 percent of the time for interstate calls, roughly 12 percent of the cost is to be borne by the interstate system. The effect of this decision is to relieve the States of an additional \$85 million in revenue requirements beyond the relief already provided—for a total of \$510 million more than actual use would dictate.

There are several reasons why this manner of providing a \$510 million subsidy to intrastate services is questionable—even if warranted in this case. Our opinion does not make explicit what, or why, we are subsidizing and with what effect on our national communications behavior—whether beneficial or undesirable. Will more homes have local telephone service as a result? If so, is it worth the cost (in possible decrease in long-distance calling)? What would be the consequences of taxpayers providing such a subsidy directly out of the Treasury's general fund, rather than as an assessment against long-distance calls? How and to what extent are the number of long-distance calls impeded by these pricing policies? Why 12 percent? Why not 6, 8, 14 percent? We offer little or no factual rationale for our "expert judgment" in this regard—even though it be more rational and expert than Bell's even less supportable suggestion of 15.6 percent. Little can be (or has been) said for the choice of the 12-percent factor for subscriber plant except that it reaches a politically desirable result: \$85

million more in local costs will be paid by those who make long-distance calls. But there is little or no exploration by the Commission of the consequences of forcing interstate ratepayers to subsidize intrastate services—or of their desire to do so.

My concurrence in the Commission's judgment on this issue is pragmatic.

It may be that no viable rationale can be constructed for our 12 percent allocation. On the other hand, it does not deviate from use as much as the 15.6-percent formula urged by A.T. & T.—which is even less supportable. (Indeed, I find almost humorously irrelevant the rationale that the allocation percentage should be an average of the "availability" of the telephone for long-distance usage (50 percent; that is, it can be used either for local or long distance) and actual usage for interstate long distance (4 percent).)

The parties have given us little option. Having argued the issue as a matter for expert judgment, we have resolved it, to my satisfaction, on that basis. I indicated my preference for allocation of cost according to use—"absent compelling reasons to deviate from it." There well may be such compelling reasons in this case—all I am contending is that we haven't inquired and, therefore, don't now know.

Furthermore, even if adequate analysis were to demonstrate that we ought to adopt a formula for allocation strictly according to use, that is not the kind of transition one makes instantaneously. If the effect of making local subscribers pay the full cost of local service would produce substantial increases in local rates this would be a decision with nationwide political and economic impact that would probably require phasing over a significant transition period. Today's decision at least slows the trend that has seen the allocation percentage go from 3.95 percent in 1947, to 7.5 percent in 1952, 10.27 percent in 1965—and the urging of 15.6 percent today. I believe it to be the wisest compromise under the circumstances of this case.

Actually the whole process of overlapping jurisdiction could stand reexamination. Why should different principles and results occur because one agency regulates rates between New York City and Albany and another regulates those between New York City and Philadelphia? Perhaps the FCC should regulate all toll rates. In any case the regulatory scheme ought to reflect the unified nature of the company and the service it provides our Nation. Perhaps no phenomenon illustrates the inherent absurdities and complexities of dual regulation as dramatically as the convolutions produced by the economic and accounting mythology we call "separations."

### *C. Capital structure and risk*

Bell's present debt ratio is about 32 percent—contrasted with the 50-percent level characteristic of electric utilities. (Debt ratio is that percentage of a company's total capital (shareholders' equity and bonded indebtedness) represented by debt.)

Let us evaluate the adverse consequence of Bell's debt ratio for its shareholders for a moment—without regard to the debt ratio's impact on the public interest. Bell's shareholders have provided a higher percentage of the capital used by the Bell System than have the shareholders of electric utilities. As a result, any given level of earnings must be used to reward more equity capital than would be the case if Bell had employed a capital structure which relied more heavily on debt financing:

For example, assume a company can borrow at 4 percent and is permitted a 7-percent rate of return. For every \$100 it borrows and puts in its rate base it earns \$7, pays \$4 interest, and has \$3 profit. If its rate base is \$10 million, all represented by equity, the shareholders divide \$700,000, for a 7-percent return. If \$9 million of the rate base is represented by debt, however, it only takes \$300,000 to pay the interest on that debt at 4 percent. The remainder of the \$700,000 profit, or \$340,000, is paid out in dividends—for a 34-percent rate of return to the holders of the \$1 million in equity! Yet the company is still earning an "overall 7 percent rate of return." This example (\$9 million of debt in \$10 million of capital) would be a 90-percent debt ratio. Lower ratios produce less startling, but comparable results. (For simplicity I am assuming the company's risk is not adversely affected by the higher debt ratio and that capital costs do not increase with a higher debt ratio.)

If Bell were to move to a 50-percent debt ratio, or even to 40 percent, it would be better able to reward its shareholders for any given level of overall return authorized by this Commission. Electric utilities have earned about 12 percent

on common equity at overall rates of return which are very similar to what we authorize here for Bell (7 to 7.5 percent). Because of Bell's lower debt ratio, however, Bell stockholders have been penalized into accepting only about 9.5 percent at the same time Bell is earning higher overall rates of return than electric utilities now generally earn.

The impact of this debt ratio upon telephone subscribers is even more startling. Interest paid by the company on capital represented by debt is tax deductible. Dividends paid by the company on capital represented by stockholders' investment not only fails to qualify as a deduction, it is taxed as income. Here's an overly simplified example:

*Case A.*—The company raises \$100 in capital by sale of stock. The ratepayer must contribute \$20 a year to fund that capital: \$10 of his \$20 will be paid to the Federal Government by the telephone company as income tax, and \$10 will remain as a 10-percent rate of return on equity after taxes—to be retained by the company or paid to the stockholder.

*Case B.*—The company raises \$100 in capital by borrowing. The ratepayer must contribute \$4 a year to fund that capital: The \$4 the company must pay to the lender at 4 percent interest (and then claim as a tax deduction).

Note that the difference to the telephone subscriber between a 4-percent rate of return on debt and a 10-percent rate of return on equity is not \$6 a year for each \$100, but \$16—five times the cost of debt to the ratepayer. In short, equity financing is extraordinarily costly to the ratepayer, and Bell is as heavily financed by equity as any major public utility. Given the fact that the shareholders are also substantially penalized under this system there is real hope, as well as reason, for change.

It is natural for Bell's management to be cautious about evaluating the business risks it faces. Yet the evidence suggests that Bell is considerably less risky than electric utilities. The Bell System is not only a nationally based and dominant component of our present system (unlike municipal or regional electric utilities), but controls a resource for innovation (Bell Laboratories) as well as the dominant telephone equipment manufacturer (Western Electric). It can sell to the full range of communications users and utilize all competing technologies: Open wire, coaxial cables, microwave, and (through its partial ownership of Comsat) satellites. (Electric utilities confront meaningful competition from, among other energy sources, natural gas.) These resources give Bell substantial capability to profit from the course of future changes in the communications industry. Individual electric utilities simply do not possess this security and insulation or command these resources.

Most of the issues just discussed have already been resolved. In the parts of this opinion which follow I want to suggest areas, issues, and questions that I am hopeful will be considered in our further proceedings in this case.

### III. IMPROVING CONVENTIONAL TELEPHONE RATE REGULATION

There are many areas of concern to which a thoroughgoing effort to improve telephone regulation should lead us. I mean only to provide brief discussion of a few.

#### *A. Result-Oriented Regulation*

Our decisions in this case will surely help to shape the design and development of our national communications system. The FCC and Bell have no alternative. The consequences of our decisions will not go away just because we close our eyes to them. The results of our regulation are just as fully our responsibility whether or not they ultimately come to us as a surprise. Our only choice is whether those results will contribute to constructive national design or chaotic national disaster.

What national communications policy goals should we strive for? What types of communication behavior do we want to encourage? What groups in society will (or should) benefit most from our decisions? What are the most important communications needs of this country presently susceptible to our influence?

Experience with some of the lesser developed countries indicates a correlation between communications capacity and economic growth. What relationships are these in the United States? Unpredicted and unaccountable increases in transportation and communications often follow increases in capacity. Suppose broadband (closed circuit television, facsimile transmission) services were widely

available, what and where would the increased usage likely be in this country? Of course, if our country is to be rewired (as the "cable television" industry is now doing), there are also questions of who should install the new systems, at what rate, and with what systems of safeguards for consumer interest.

We should recognize, in this connection, that demand is not alone a function of price. It is also the product of desire—an emotion that can be stimulated by advertising. To what extent should the telephone subscriber be asked to pay rates that include the cost of restructuring the telephone system by manipulation of his desire through company advertising? There is relatively little such restraint on the advertising expenditures and practices of American business generally. Should a public utility be treated any differently? What of its public relations expenditures and activities, lobbying, or political and charitable contributions? Some of these issues have already been addressed and resolved in public utility law. Others remain open.

We need wholly new ways of observing, analyzing, and talking about communications behavior. Here are a couple examples:

The intimacy of personal communications can be viewed along a continuum. At one extreme is personal, face-to-face, two-way communication. At the other is a mechanically written telegram or letter. In between is the telephone—for two individuals or "conference calls." There is in this choice what might be described as a "dollar-intimacy trade-off." Face-to-face communication for individuals across the country (that is, airline travel) involves considerable time and expense. A letter (even counting executive and secretarial time) is much cheaper—and also less intimate. Given present options, there is a substantial jump—in cost and intimacy—from face-to-face confrontation to a phone call: ("dollar-intimacy") gap. Improvements in closed circuit television (such as Bell's "picturephone") and facsimile transmission (such as Xerox's "long-distance xerography") will tend to close this gap. As they do, the impact upon national information transfer (and airline travel), human relations, and the gross national product is bound to be as substantial as it will be unpredictable. To deal with such issues this Commission (and Bell) need counsel from the broadest range of the social and physical sciences.

What are the political consequences of long-distance toll differentials for citizens calling Washington? Our Nation's Capital was centrally located for all Americans in the late 18th century. It is no more. It can still be reached, by mail, for a flat rate from every State in the country. But not by phone. You can even call Washington from London (3 minutes, day rate, person-to-person, for \$9) cheaper than from Honolulu (\$9.50). With what consequences?

These seem to me important issues—issues that will be affected by our telephone rate decisions, as interpreted and carried out by A.T. & T., whether or not the FCC and Bell specifically address the social consequences of our activity.

The present case should demonstrate the great discretion available to the Commission in these matters. On the basis of this hearing we could have reached substantially different results—and might have, had we and Bell more clearly in mind what we are trying to accomplish and what alternative paths could get us there.

### *B. New technology and service improvement*

Those who regulate communications systems will have an impact upon, and, therefore, ought to concern themselves with, the rate at which new technology is introduced, and its impact upon improvements in quality of service and decreases in cost. I noted earlier that the cost of moving a telephone message by high-capacity microwave relay towers today is about 1 percent of the cost of moving it by conventional telephone line 30 years ago. Satellites, waveguides, and laser beams now seem to promise still greater capacities and economies.

How should basic research be translated into service to the customer? Where are the cost-reduction innovations for the local subscriber comparable to those for the user of interstate communications services? What are the economic forces impeding technological change? What incentives to innovation do the managers of Bell face? What is the impact of our regulatory policy on those incentives? How should we use depreciation rates to effect equipment replacement? Who stands to gain (or lose) from innovation? How much, and in what ways? What levels of quality and character of service would consumers like (or be willing to pay for)? Who should bear the costs of introducing cost-saving or capacity-expanding equipment and techniques, and in what proportions? What accounts

for the quality of the Bell Laboratories? Is this facility being used to its best advantage?

The analysis of such issues is, in my judgment, fully as relevant to serving the public interest in telephone regulation as our examination of Bell's rate of return.

### *C. Competition*

One ingredient in the regulation of any industry is the relative level of competition. Indeed, the current investigation was begun, in part, because of FCC concern over the competitive effects of Bell's pricing structure. We have deep American traditions regarding the relationship between economic regulation and the degree of competition. We believe the public interest must be served in the marketplace. We believe it can be best served by free and open competition. If the protections of full competition are not present a measure of governmental regulation is necessary. We believe that those who are blessed with the profits and security of monopoly in providing basic services are subject to the highest standards of public responsibility—and have the greatest need for regulation. Bell is such a company. And it cannot have it both ways: It cannot accept the security of stifled competition and pocket the protected profits and then complain about Government regulation. The two go hand-in-hand—in America. If more competition would equally or better serve the public interest, and A.T. & T. doesn't like regulation, perhaps the regulators should join with Bell in the search for competitors.

How do the rates we approve for Bell affect Bell's competitors, either actual or potential? How much competition is possible or desirable in various services within the telephone communications industry? What present policies of Bell and this Commission affect the growth of competition? Should this Commission consciously encourage competition, as was apparently its motivation in the "above 890 megacycles" decision regarding private microwave communications systems? Competition has often been viewed as a positive alternative or supplement to utility regulation. Its use should be fully explored.

### *D. Management techniques*

Bell's service to the telephone subscriber is substantially affected by the effectiveness of the company's management techniques. To what extent is this a proper area for regulatory inquiry? For example, we have already explored the impact of Bell's debt ratio upon subscribers and shareholders alike. Even before the Commission's opinion was issued, simply on the basis of the evidence during the hearing, Bell reevaluated its long-time assumptions about debt ratio and agreed to the wisdom of their revision. This is a prime example in which "bureaucratic second-guessing" of company policy normally thought best left to management's prerogative has paid dividends (literally and figuratively) for everyone. Is it an isolated instance, or are there areas worth inquiry (personnel practices, purchasing, distribution systems, management information systems, systems design, and economic planning)? Should the public be represented in the form of a "management consultant" serving its interests—either within the FCC, or reporting publicly from within the company?

Nor are modern management techniques limited to company operation. They are equally relevant to the FCC in its relation to Bell. At the present time the FCC has little in the way of management information system regarding any of its responsibilities—the way information about Bell reaches the individual Commissioners (or staff) is only symptomatic. Does the kind of hearing we have just conducted provide us the information we most need to know in the most usable form at the most appropriate time? I don't think so.

There have been significant advances in econometric, simulation, and other economic modeling techniques in the past few years. One staff witness, Professor Gordon, offered into the record a progressive and stimulating effort at a model for rate regulation of A.T. & T. The model, and the responses of other witnesses to it, is sympathetically discussed in the Commission's opinion and I will not go into it in detail. The FCC staff, and Professor Gordon, are to be commended for this innovative effort that may have far-ranging effect on future rate regulation. But surely they would be the first to acknowledge that such effort has only begun and ought to be intensified. It may, or may not, be useful to utilize the capabilities of computers more than we have in this case. There is no magic in computers, and no reason why they must be used simply because they exist. But to the extent past efforts at regulatory technique have been rejected because of the masses of data involved, they may now be possible.

In short, the operation of the telephone system by Bell, and its regulation by the FCC, are principally management tasks, and we ought to assure that both are utilizing fully such applicable modern techniques as are available.

#### *E. Rate structure, costs, and telephone use*

The design of Bell's rate structure results from prices set for the individual communications services Bell offers. Of greatest significance to me in this regard is the extent to which use patterns for these services are affected by the price charged. For it is in our effect upon national use patterns, or communications behavior, that our design of a rate structure becomes our design of a nation. The price of a New York to San Francisco 3-minute nighttime station-to-station call has fallen from \$18.50 50 years ago to \$1 today. Similar adjustments have been made throughout the rate structure—and we can see and feel the consequences across a continent. And for those concerned about the effect of rate cuts on shareholders' profits, it perhaps is relevant to note that during this time of declining prices Bell's earnings have increased 40 times over: From about \$50 million to about \$2 billion today.

Bell is fortunate to be in an industry so bountifully blessed by the cost savings of technological improvement. So are its customers. The telephone business is, in this respect, similar to the airline business. Jet planes, and the substantial technological obsolescence in their wake, have made possible simultaneous fare decreases and profit increases. Today's rates of technological innovation do on occasion produce a bonanza for everyone—shareholder and customer alike. Modern-day public utility theory must not only recognize and accommodate, but fully harness, the thinking and forces of our topsy-turvy new economics.

What will be the demand for individual telephone services at different prices? What are the social consequences of greater or lesser use? How much revenue will different rate structures produce?

What is the optimum quantity of standby capacity (the unused circuits available for peak periods like Christmas and Mother's Day)? What is the cost to consumers of that capacity (for they continue to pay a "rate of return" to Bell on its "rate base" whether or not they use it)? How can consumer choice among various qualities of service be maximized? Is choice desirable?

What reasonable alternatives exist for assigning cost? What are the effects of using one or another of these alternatives? What experimental or promotional rates would be useful? Under what circumstances (if any) are subsidies of services warranted? The long-distance rates from Washington to Los Angeles are higher than from Washington to New York. How relevant is distance as a measure of cost to the system? Should pricing take even greater account of peak telephoning periods, to encourage more constant demand and usage of facilities (as airline rates tend to do)? How does the rate structure influence the amount and quality of service supplied and pace of technological innovation—and vice versa?

What is the cost of administering the long-distance toll, individual-call-billing system? (Operators; recording, computing, and billing; the proportionate cost of incompleting calls or person-to-person frauds; the subscriber-protected unpaid-for calls.) What would be the cost of individual billing for local calls? How much more would local service cost under such a system? The answers to such questions are relevant to analyzing and making judgments about alternative pricing systems for telephone service.

A technological innovation with implications for pricing theory is pulse code modulation. Without going into detail, all information (voice, still pictures, telegraph, television) can be translated into "information bits" which exist as electronic pulses. Individual bits, or pulses, are indistinguishable. Only in substantial number and pattern do they take on meaning as sound or picture. As bits, passing through a circuit, they are a commodity, like natural gas, electricity, or water. This being the case, time loses its relevance as a measure of use of a telephone circuit. Many users can use a single circuit simultaneously. Each user's "bits" are simply sorted out and reassembled at one end so as to reconstruct their relationship as they were inserted at the other. Thus, information can now be "metered" like other comparable commodities. Should the use of facilities for its transportation be sold on that basis?

The construction of Bell's rate structure is the task next before this Commission. Many of the questions posed in this section are wholly consistent with the Commission's general statement of issues for the hearing to come, and with the more progressive thinking in public utilities opinions and literature today. I am hopeful these issues will prove to be illustrative of the depth, breadth, and

creativity of our inquiry to come. Indeed, throughout this section of the opinion I have relied upon questions primarily, simply as an illustrative means of urging a general approach: A thorough examination of all the factors that influence the prices consumers pay, the range of services available, the quality of those services, the ways they are used, and the national social-economic-political consequences of the resulting communications behavior. There is more to the public responsibility and consequences of monopoly utilities than can be served by governmental review of rate of return, the value of the rate base, and prohibitions against unreasonable price discrimination. I have suggested possible improvements and a reorientation of the process of conventional public utility regulation. But I believe at least passing consideration should also be given to more fundamental changes. That is the subject of the next section.

#### IV. ALTERNATIVES TO CONVENTIONAL PUBLIC UTILITY RATE REGULATION

##### A. "Regulating" Bell

Most of the FCC's regulation of the communications carrier system is regulation of Bell. A brief review of the company and its regulators offers a valuable perspective on the magnitude of the regulatory task.

A.T. & T. is the world's largest company in assets—\$35 billion. It grosses over \$12 billion a year, employs about 800,000 men and women, is owned by more than 3 million shareholders of 539 million shares worth about \$21 billion, and purchases every year some \$1.6 billion in goods and services from more than 45,000 suppliers. This makes it a larger operation than all but very few national governments. A.T. & T.'s gross revenue is several times larger than the budgets of all the Federal regulatory commissions, the Federal court system, and the U.S. Congress combined; larger than the budgets of each of the 50 States; 6,000 times larger than the total budget of the FCC's Common Carrier Bureau. A.T. & T. owns 82 million telephones and handles 97.5 billion calls a year. Bell Laboratories alone employs 14,000 people and spends some \$300 million annually.

The FCC's Common Carrier Bureau (which carries prime responsibility for the Commission's telephone regulation) is staffed with able and dedicated men. But there are only 100 professionals in the Bureau and they must also bear the burden of overseeing Western Union, numerous other communications common carriers, all American-based international communications companies, and administration of the Communications Satellite Act. The contrast between the Bureau's task and its resources speaks for itself.

Indeed, lack of resources is an even more serious problem for State and municipal regulatory bodies. And the splintering of jurisdiction between the Federal Government and the States undoubtedly contributes further to the deterioration of effective, coordinated regulation. A.T. & T. is so much bigger, and better financed, than any government agency it confronts that even the process of selecting which information it will offer the regulator gives the whole operation a substantial aura of self-evaluation.

To what extent, and in what respects, does the public interest require a check upon, or regulation, of A.T. & T.? Whatever the answer to that question may be, the sheer magnitude of Bell is such that very little governmental regulation is (or can be) provided by the FCC and the States. To believe otherwise is to encourage the rankest of self-delusion. What can we do? Are there any alternatives?

##### B. Costs and results

The thesis has been advanced from time to time in economic literature that utility regulation does little to improve the welfare of the consumer, and in fact distorts the natural tendencies of a firm in ways that are positively harmful to the public interest. It is difficult to evaluate such assertions. Nevertheless, it is useful to at least consider some of the implications of such a view. There are substantial costs associated with detailed utility regulation. Large parts of the FCC and State commission budgets are allocated to the regulation of telephone companies. The companies, in turn, must counter with numerous personnel, often highly paid officers, concerned with regulatory matters. More substantial costs may accrue to society because of ill-informed regulatory decisions.

What have we accomplished so far by the formal investigation technique? If formal proceedings for utility regulation have no meaningful (or even a detrimental) impact, the Nation might be better off without them. At the present time I do not have enough information to make such judgments, one way or the other. But I believe the question ought to be posed and addressed. Nevertheless,

one cannot vest a national monopoly with all the security of protection against competition, and profits without check or limit, and then remove such modest regulation as does exist without substituting an alternative system to control potential abuse. What alternatives might there be?

### *C. Competition and regulation*

The designation of communications common carriers as public utilities occurred many years ago. Our conventional wisdom describes the chaos of competing telephone systems in the 1920's—"Why, you had to have two telephones and two telephone books just to call everyone in town." But the early telephone systems were based on a particular state of technology, limited varieties of competitive alternatives, and a particular set of economic and legal judgments.

The very least one can say is that the total environment of our communications systems has changed radically, and that change is continuing. In addition to advance in the production of services Bell offers, other elements, such as computer-switched communications systems, broad-band cable techniques, satellites, lasers, and other types of information transmission devices, suggest that the fundamental nature of the industry has changed.

What's thought of by the antitrust lawyer or economist as competition is seen by the scientist or engineer as a problem of "interface." An interface is the point of interconnection between two components: The base of a light bulb and a lamp socket, an electric appliance plug and the wall outlet, a container for cargo that can fit on truck, train, ship, or plane. In each of these examples the interface is "sharp"—most of the components nationally available from various suppliers interconnect with precision and ease. Whenever "adapters" are necessary the interface is less sharp. If adapters are not available and reconstruction is required the interface is very fuzzy. And, of course, components may be simply wholly incompatible. To what extent do we wish to encourage competition in the telephone business by providing for (or insisting upon) sharp interfaces (for example, plug-in telephone equipment)? To the extent Bell constructs a system which limits the utility of alternative suppliers' components competition may be difficult, unnecessarily costly, and occasionally impossible.

How could more competition be encouraged? Where a single physical plant is dictated (such as wires into the home, or computer switching) should competitors be required to meet specifications for interconnection between systems (as the independent telephone companies do now), make access available to all at non-discriminatory rates, and establish formulae for sharing costs and revenues (as the railroads and airlines do now with equipment and ticket sales)? Are there some areas of telephone operation where duplicate plant is permissible, or even desirable?

Must the industries providing communications service be public utilities? Should we give consideration to a thoroughgoing attempt at establishing a competitive communications system—beginning in the home and extending to the satellite? Are potential competitors available? Would the gains from competitive performance offset the possible diseconomies of multiple competitors? What are the political and social implications of such an effort? Or is there a better competitive "mix" available to us—either more or less competition? For perhaps the most fundamental alternative to regulation is competition—the absence of which dictated the need for governmental protection of the consumer in the first place. Bell might, or might not, welcome trading competition for regulation—but that should not be our principal concern. The question is simply whether it would better serve the public interest. Given the present effectiveness and scope of regulation, such alternatives might well be worth exploration.

### *D. The performance of the communication industry*

The major concern of regulatory policy ought to be the performance of the industry regulated. The telephone subscriber wants to be sure that his interests in lower prices, better and more abundant service, and increased choice are protected. Telephone company shareholders, on the other hand, are entitled to a fair return. Thus, regulation of the rate of return, size of the rate base, and reasonableness of expenses are merely means to an end. Could this end be accomplished more effectively directly than by beating around the bush of conventional public utility financial issues?

We have developed a good deal of experience in improving the performance of defense contractors in recent years. Two firms independently and competitively designing novel weapons systems to accomplish a specified purpose, with the incentive of a large order to the firm with the most effective, lowest-cost system,

can often build two, more satisfactory, systems for less than a single contractor, without such incentives, can build one. Other "incentive contract" devices (such as estimating costs and permitting the contractor to share in ultimate savings) have produced results at less cost than cost-plus contracts. (And, since it is costs that are being controlled rather than profits, it is quite often the case that profits are much higher for a low-cost contractor than for a high-cost contractor.) "Result-oriented" contracts ("build us a device that will do  $x$ ") often produce more innovation, higher quality, and lower cost than "specification-bound" contracts ("build us a device made of  $y$  parts").

The people's contract with the telephone company is currently a cost-plus contract—almost literally. The company's costs will be paid, however low or high (unless clearly unreasonable). Rates cover costs—plus a percentage on rate base. The higher the rate base, the higher the rates and the profits. There is little incentive in such a system (especially in those portions totally free of competition) to cut costs, improve efficiency, and reduce unnecessary capital investments.

The only qualification is the product of something in which we can take little pride: Regulatory lag. If the Commission's rate of return regulation were current and constant the company would be held to the stated rate of return. Because it is not, however, there is an incentive to cut costs, and thereby increase the rate of return beyond the allowable maximum, knowing the excess profits will not have to be refunded. (For example, Bell's overall rate of return in 1966 was 7.9 percent, its interstate rate of return 8.1 percent.) But such incentives as exist are merely a fortunate byproduct of the malfunctioning of the present system, not an intended virtue.

Perhaps it would be useful to explore the possibility of having the Commission simply establish performance standards for the telephone industry—and ignore rate of return. As with increased competition, Bell might, or might not, welcome trading performance standards for unrestrained profits. Again, the company's desire is, if not irrelevant, at least not controlling in our quest for the highest public service.

What might such performance standards be? As simple examples, prices per unit service might be reduced a given percentage annually over a given period of time (such as long-distance rates); service capacity might be increased in certain respects (such as cable capacity for picture telephones); or the subscriber's choice of alternative monthly rates and services might be increased by a set amount. Financial penalties might be imposed for a failure to meet such standards.

Would the Commission be justified in directing its attention solely to such performance standards and then allowing Bell to operate as efficiently as possible—"pocketing" the rewards of that efficiency so long as the performance of the industry was constantly improving? Could we develop sufficient information to set reasonable and practical standards? Would the results of such a policy produce more efficient and satisfactory service than our present "cost-plus" regulation? Even if performance standards were not substituted for rate of return regulations, the mere consideration of such alternatives would force us to a salutary focus upon the real objectives of regulation: The maximization over time of the welfare of consumers.

#### *E. Disclosure*

A dominant feature of the regulation of another industry—securities—is simply full disclosure. One of the objectives of public hearings—including ours in this case—is to bring information to public attention. What information or reporting techniques might be useful in accomplishing the regulatory purposes of this Commission regarding Bell? (On the other hand, what information do we now require of Bell that is unused, irrelevant to present purposes, or unnecessarily burdensome in terms of the use made of it, and thus could be dispensed with at a saving both to Bell and to the Commission?) What would be the effect on the company of more complete disclosure of information concerning its operations? How could telephone subscribers, once well-informed, be mobilized to express their grievances and desires? Disclosure is another alternative, or supplement, to regulation that might well be worth further exploration.

These issues and alternatives, and those others have or might suggest, seem to me important ones. They necessarily involve some matters more directly relevant to future parts of this proceeding, and others requiring even longer-range evaluation—and legislative changes. I express no view or conclusion with regard to any, except to urge the wisdom and value of continual consideration of fundamental alternatives to our present scheme of representing consumer interest in matters involving telephone communication.

## V. CONSEQUENCES OF THE COMMISSION'S RATEMAKING PROCEDURES

A. *The general nature of the procedural issues*

There are four aspects of our procedures central to my various concerns. The Commission issued no initial decision prior to this final decision. Neither the Common Carrier Bureau, nor any other party brought in by the Commission, was charged with responsibility to advocate the interests of small, unorganized telephone users. There was a combination of functions (participant and adviser) in the Bureau. We have separated into separate phases issues I believe interrelated.

(1) *Absence of initial decision.*—It is common administrative practice for an agency to issue a preliminary, tentative, or initial decision before its final decision in a case such as this. We have occasionally had the Chief of the Common Carrier Bureau perform this role for the FCC. That procedure was not followed in this case in order to expedite its disposition, as A.T. & T. desired. I do not believe this to be illegal.

The arguments and factual assertions on which the decision was based were fully discussed in the record and briefs, and the expedition has served Bell's interests. Ratemaking is regulation, not adjudication. This proceeding is simply one instance of an on-going process of surveillance and supervision of an enormous economic institution to see that it adequately serves the public. No individual has been found guilty of violating a legal or moral norm of proper social conduct; the Commission's action threatens no one's life, liberty, or reputation. Thus, it seems to me specious to invoke against the Commission's manner of handling the case the authority of Kafka, the Administrative Procedure Act, or the Constitution. In any event, I certainly do not believe A.T. & T. can now legitimately complain of what it has requested. See, for example, Bell exhibit 31 and Tr. 109, 130. However, I do believe our procedures to have been unfortunate, especially when coupled with the role of the Common Carrier Bureau.

(2) *Role of Common Carrier Bureau.*—As the Commission's repository of expertise concerning the Bell System, the Bureau was given two important tasks in the present proceeding.

At the hearing, the Bureau was made a "nonadversary participant." It was equipped with the conventional tools of a lawyer—the power to exchange written data with other parties, to present witnesses, and to cross-examine those presented by others—but it was not to use these tools to advocate a preconceived or adversary position opposed to that of the company or any other participant. It was simply to provide an impartial role, assuring the Commissioners a full and complete record by testing the claims of all parties and introducing independent evidence.

The Common Carrier Bureau was also instructed to provide personal staff assistance to the Commissioners, informally and off the record, after the hearings were completed.

Bell cannot successfully urge the theory that a failure to separate the staff's functions of advocate and judge during a rate regulation case denies the company the fair hearing commanded by the Administrative Procedure Act and the Constitution. (Indeed, my objections to the role of the Common Carrier Bureau are not just the combining of functions as such. It is not that the judge's staff was also vigorous advocate. In part, quite the contrary. It is also that no one took a vigorous position of advocacy for the consumer interest, a position challenging Bell—a defect of which Bell can scarcely complain.) Some measure of fusion of the roles of advocate and decisionmaker is often necessary in administrative proceedings, especially with matters as complex and time-consuming and involving the large staffs required by public utility ratemaking. Strict separation would deprive the Commissioners of invaluable assistance and very probably reduce even more substantially its ability to reach fair and wise decisions. It is for these very reasons that the Administrative Procedure Act and the Communications Act exempt ratemaking from the separation-of-functions requirement of section 5 of the Administrative Procedure Act. *Wilson & Co. v. United States*, 335 F. 2d 788 (7th Cir. 1964); *Willapoint Oysters v. Ewing*, 174 F. 2d 676 (9th Cir. 1949). See also the discussions of the role of the Common Carrier Bureau in rate cases by Professors Auerbach and Davis in the annual report of the American Bar Association's section of "Public Utility Law—1966" at pages 6 and 25.

But even if the Commission's procedure did not deny the company the fundamental fairness required by the Constitution and the Administrative Procedure Act, the legitimacy of the Commission's determination necessarily must be somewhat reduced in the eyes of a contestant which lacked formal opportunity to

see and challenge its opponents' argument. This is a cost the Commission need not have incurred. There is no reason some provision could not have been made for A.T. & T.'s counsel to confront in an open hearing all the contentions offered to the Commissioners by the Common Carrier Bureau. Little was gained by our receiving those views privately.

The trouble, therefore, is not simply the legalistic observation that the Common Carrier Bureau was both participant and judge's staff. Rather, the problem is the consequence: In neither role was the Bureau contributing its full potential value. The system deprived the decisionmakers and the affected parties both of vigorous advocacy and of sound and impartial advice. For the Common Carrier Bureau has never operated under a clear-cut directive to play either role, either in its ambiguous status of "nonadversary" participant at the formal stage, or in its amorphous role of adviser to the Commission at the decision and drafting stages. During the hearing, to the extent the Bureau was conscious of the dictates of propriety and appearance for an "impartial advsier," it was to that extent less forceful as a participant or adversary. After the hearing, to the extent the Bureau had earlier been an effective participant, it was to that extent less impartial as adviser.

#### *B. Significance of procedural absence of consumer representation*

(1) *Impact on consumer interest.*—The public—especially the homeowner and small business consumer of the services offered by A.T. & T.—suffers from this method of fixing the telephone company's rates, for the Commission's procedures insure that there is at no stage of the proceeding a forthright advocate for the consumer interest. Members of the Bureau who appear in the hearings are under an obligation not to contest Bell's contentions with all the vigor mustered by the company's talented legal representatives. To be sure, the staff did oppose many of the arguments pressed by A.T. & T.'s counsel. The staff's performance reflected unquestioned devotion to its task of giving the Commission a nonpartisan view of the issues raised by Bell. But one cannot help but feel that the public would have been better served if, at some stage of the proceeding, someone had been directed by the Commission to analyze the issues from the quite adversary standpoint of the consumer interest, in addition to the judicial balancing, public-interest perspective of the Commission.

The comments of Martin S. Fox, counsel for the New Jersey Board of Public Utility Commissioners, at the oral argument, though slightly different in emphasis, are worth setting forth at length:

The adversary system which is generally employed to aid fact-determining bodies in this body has not functioned as well as might be desired in this case.

The respondent is a vast enterprise, having almost unlimited technical and legal resources available to him.

The staff of the Commission might very well be the equal of the respondent in these areas. However, due to its position in relation to the Commission, the staff must take the attitude that it is an opinionless factfinder rather than an adverse party.

Although the cross-examination conducted and affirmative witnesses presented by the staff were of very high caliber there was a sense of letdown in the absence of staff participation in oral argument, briefing, and preparations of proposed findings and conclusions.

Except for the States, the remaining parties represent special interests, generally not concerned with all the issues in the case.

Unfortunately, the States did not satisfactorily arrange themselves in groups as originally suggested by the Commission. It would have been hoped that all of the States which intervened might have jointly presented evidence.

This problem is mentioned not for the purpose of criticizing the manner in which this case has been conducted but rather to stimulate some thinking as to how the problem might be obviated in the future. (Tr. 10419-10420.)

As Fox points out, the conduct of the staff during the hearings in assuring a complete record was commendable. And Fox acknowledges that the role of the States before the Commission could have been more effective. But I believe his expression of concern even more strongly highlights the need for our staff to have been free to function as advocate throughout the entire proceeding. We can be appreciative and thankful for the contribution to this hearing of States' counsel such as Fox, but their fortuitous presence scarcely relieves us of our responsibility to assure full advocacy of all points of view.

(2) *Impact on the Commission's decisional process.*—The Commission itself suffers from this procedure. It does not have the benefit of hearing all views tested in an adversary setting. Without such testing the possibility that we will make mistakes—major or trivial—is heightened. When a judge hears one side of an argument presented, he profits from the opportunity to hear the other side's immediate response—and then the first party's counter-response. He needs to question both sides in tandem so he can probe beneath partisan rhetoric and the advocate's inevitable tendency to ignore or downplay unfavorable facts or arguments. Only in this manner can a decision-maker define and relate for himself the basic issues involved. Only by witnessing a true adversary proceeding can he perceive the real areas of accord and discord between the interests affected by a case. In any event, I believe that I would be better informed now, if, at the hearing stage, we had received the benefit of uninhibited controversy. Such an experience would have honed more sharply my appreciation of the issues. It would have enabled me to take better advantage of the expertise of the staff when I came to the stage of reaching a final decision.

(3) *Impact on A.T. & T.'s interests.*—As I have said, A.T. & T. is, in my judgment, in no position to complain about the Commission's procedures. But A.T. & T., like any other organization, benefits from the new perspective of informed and candid critics. It has not received the full measure of that benefit from this proceeding—criticism presented in a setting where its import and accuracy can be known and fleshed out by company response.

### *C. Alternative procedures*

For anyone to comment regarding the procedure fashioned by the Commission for ratemaking implies an obligation to suggest alternatives. This is not an easy task, any more than commenting upon the substantive issues under the present system has been an easy task. Determining the appropriate rates to be charged by Bell is one of the most complicated matters which any Federal agency is called upon to decide. By blithely adding a step, arena, or participant to the process one may easily expand the already-great amount of money, time, and personnel devoted to this task with little or no, or even a negative, impact upon the rationality and fairness of the whole decisional process. But alternatives were, and are, available to us and ought to be considered.

We could, for example, have brought in lawyers—from the FCC General Counsel's office, or perhaps from private law firms—to represent consumer interest as advocates in these proceedings before the Commission. We could have designated part of the Common Carrier Bureau as advocates, and left to a distinct part of the Bureau staff the role of counseling the Commission after the hearings were finished.

Professor Davis, in the article cited earlier, suggested a plan whereby the Bureau would participate in the hearings as a frank and forthright advocate for the public interest, as well as participate in the decisional process as expert counselor to the Commission, but only before the filing of a recommended decision. After the recommended decision was filed, and the parties had a chance to respond to it, the staff would be barred from off-the-record consultation with the Commissioners as they reached their final determination.

It is by no means clear which, if any, of these alternatives would be the optimum way for the Commission to meet an admittedly difficult problem. But it is clear that any of them would be more satisfactory than the confusing procedural framework the Commission has used to administer this most important confrontation between the Federal Government and the country's largest and most important national monopoly.

### *D. Separate phases and the interrelation of issues*

In its original orders the Commission indicated an intention to consider both the questions of rate of return and relevant ratemaking principles in the first phase. (FCC 65-1143, 2 F.C.C. 2d 142.) Questions of appropriate rate base, allowable expenses (including those charged by Western Electric), and jurisdictional separations were to be considered in phase II. The Commission subsequently modified its plan for consideration of these matters.

What we decide in this decision is inextricably linked with our consideration of issues and decisions in the latter phases of this case. I do not criticize the order in which issues have been considered. Rate cases necessarily involve determinations as to rate base, rate of return, the cost of supplying capital, and rate structure, and the Commission must begin somewhere. Rate of return is of crucial importance to the managers of A.T. & T.—which no doubt accounts for

their desire for its expeditious resolution. But we must take care not to act as though what is decided today bears no relation to information and decisions yet to come. We have only begun this investigation, and while the results reached today are important, it is future proceedings which will decide the issues of perhaps greatest national significance: The prices paid by consumers, the costs to be allocated to individual services, and the design of the communications system this Nation will enjoy in the years to come. In short, the issues in this telephone rate case are interrelated, and we pay a price for treating them in separate phases.

#### VI. CONCLUSION

The opinion of the Commission in this phase I disposition of the telephone rate case before us represents, in my judgment, a reasonable resolution of the issues in terms of conventional public utility theory. It represents a tremendous amount of skilled effort on the part of the many participants in this case including, especially, the Chief and staff of the FCC's Common Carrier Bureau. I concur in that opinion.

And yet all who have participated in or studied this case will agree, I am sure, that improvements are possible in our approach to telephone rate regulation.

Earlier in this opinion I suggested that there were, perhaps, additional (or alternative) issues to our emphasis on profits and rate of return that should be considered in the context of a public utility hearing dealing with the telephone company. I suggested that we should consider questions regarding development and rate of introduction of new technology, and that more important than holding down profits may be emphasis upon reducing the costs of providing service.

I suggested that we should frankly face the fact that telephone rate-making (pricing theories and subsidization of services) has a direct and substantial impact upon human communications behavior, with vast social, economic, and political consequences for our Nation. The question is not whether we are going to make decisions with such consequences, but how, and with which effects. In my judgment, to close one's eyes to these consequences, as if ratemaking theory were an end in itself, is to sit in the ball park eating peanuts while ignoring the game. As America's late Robert Frost has written,

"\* \* \* We're plainly made to go. We're going anyway and may as well have some say as to where we're headed for: just as we will be talking anyway and may as well throw in a little sense. Let's do so now. \* \* \*"

Having discussed means of improving present conventional regulation, I examined fundamental alternatives: Standards of performance (instead of standards for profits) and increased competition, to name two examples.

Finally, I have expressed some concern about the wisdom of the Commission's procedures in this case—instructing its Common Carrier Bureau to play a neither fish-nor-fowl role of nonadversary adviser—in terms of the impact upon the public, the Commission, and the company.

In short, I think significant improvements could be made in the way in which we now go about the task of public utility ratemaking. Such improvements could benefit, in my judgment, shareholders, consumers, and regulators alike. Their consideration will require the full and creative attention of interested and affected parties in and out of Government, the industry, the academic and research community, and interested citizens generally. With such attention there is hope we can begin to match our law, economics, and social sciences to the wonders of modern communications technology Bell brings us in that common, everyday object we call the telephone.

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STATE OF ALABAMA,  
ALABAMA PUBLIC SERVICE COMMISSION,  
*Montgomery, Ala., November 20, 1969.*

HON. DEAN BURCH,  
*Chairman, Federal Communication Commission,  
Washington, D.C.*

DEAR MR. BURCH: The Alabama Public Service Commission very vigorously protests the unreasonable and discriminatory action of the FCC in requiring the AT&T to reduce interstate telephone rates by \$150 million per year effective January 1, 1970, while at the same time Bell operating companies have pending in numerous states petitions for rate increases aggregating at least \$500 million per year.

This action will have a very damaging effect on the Bell operating companies as well as on the more than forty (40) small independent telephone companies under the jurisdiction of this Commission by causing an overall earnings reduction without a hearing. This will further delay the time when they can extend telephone service to remote rural areas and will transfer the burden from the relatively fewer and usually more affluent interstate users to the many more intrastate users, who will find it increasingly difficult to bear the extra burden.

It is our opinion that this reduction should be made by changes in separations of expenses and capital expenditures so that a more equitable percentage of the expenses would be borne by interstate rather intrastate operation, which is already bearing a disproportioned amount of these costs.

Yours very truly,

EUGENE "BULL" CONNOR,  
President.  
C. C. (JACK) OWEN,  
Associate Commissioner.

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STATE OF ALABAMA

ALABAMA PUBLIC SERVICE COMMISSION

P. O. Box 991

Montgomery, Ala., December 4, 1969.

Senator WARREN G. MAGNUSON,  
Chairman, Senate Commerce Committee,  
Senate Office Building,  
Washington, D.C.

DEAR SENATOR MAGNUSON: The Alabama Public Service Commission very vigorously protests the recent action of the Federal Communications Commission when it ordered a reduction in interstate toll rates without giving proper consideration to the effect it will have upon companies regulated by various state commissions and upon the average telephone users.

We have not yet been furnished copies of the new rate schedules, therefore, we cannot fully determine the effect they will have; however, we are certain that it will adversely effect the earnings positions of all operating companies by reducing the average revenue per message on interstate calls.

During the past three years this Commission has had twenty-two (22) formal rate proceedings and numerous informal proceedings where telephone companies were given rate relief by adjustment in miscellaneous charges. Still other companies have seen their earnings positions deteriorated by inflationary trends. This action by the Federal Communications Commission will have the affect of further deteriorating their earnings and hasten the time when still other companies must seek relief through their state commission.

This Commission fully endorses and supports Senate Bill S-1917 which would establish a joint Federal-State Communications Board, however, we suggest that the proposed legislation should be broadened to bring all joint intrastate-interstate communications matters involving national policies under the Board's authority.

Yours very truly,

C. C. (JACK) OWEN,  
Associate Commissioner.

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ARIZONA CORPORATION COMMISSION

Phoenix, November 25, 1969.

Hon. DEAN BURCH,  
Chairman, Federal Communications Commission,  
Washington, D.C.

DEAR CHAIRMAN BURCH: First, I wish to take this opportunity to extend to you my congratulations on your appointment as Chairman of the F.C.C.

Secondly, I would like to bring to your attention a fact which is of great concern to this Commission.

The F.C.C. has recently announced a reduction in interstate long distance toll charges in the amount of \$237 million. The income of the Bell Operating Companies will be greatly affected by any reduction in the interstate rates of A.T. & T.,

the mother company. In these times of increasing costs of labor, materials and taxes, the Bell Systems, as well as all public utilities, are finding it very hard to maintain rate levels consistent to the best interests of the public. The reduction in interstate toll rates will be a windfall to a very small percentage of the telephone subscribers in the nation. The result of lowered income to the Bell Operating Companies will pose a threat to the majority of the Operating Companies' subscribers in the way of higher rates.

This Commission is striving to maintain telephone rates at their current level and ask that you intercede in this matter, and rather than grant this rate decrease explore the possibilities of revising the "Separation Procedures" used by A.T. & T.

The proper division of revenues derived from interstate toll calls would reduce the A.T. & T. income and increase the income and profits of the Bell Operating Companies, and could possibly result in reduced rates or maintaining the present rates for the vast majority of the telephone subscribers.

With kindest personal regards and best wishes, I am

Sincerely yours,

MILTON J. HUSKY,  
*Chairman, Arizona State Corporation Commission.*

ARIZONA CORPORATION COMMISSION,  
*Phoenix, Ariz., December 9, 1969.*

Mr. Chairman and members of the committee: My name is Dick Herbert and I am a member of the Corporation Commission of the State of Arizona. This Commission is the public utility commission of our state. The members of the Corporation Commission are elected.

During the course of the campaign for this office I traveled throughout the State of Arizona soliciting votes. I was being constantly exposed to serious concern of the public over high utility rates in our state. I was in a nearly impossible situation. I ran in a primary against the incumbent, a former commissioner, and one other candidate. In spite of being underfinanced and understaffed, I was successful in my election endeavors, and the reason, I believe, was that I promised the people that if I were elected I would do everything humanly possible to effect lower utility rates.

Arizona is a large state. It contains more than 110,000 square miles. Of this approximately 70% is owned by the Federal Government as National Parks, National Forests, military reservations, Indian reservations, and for myriad other uses. This means that our utilities must travel substantial distances to serve spread-out customers. The cost naturally is higher than in densely populated urban centers.

Arizona's population, in the last few years, has grown rapidly. Many of Arizona's new residents have immigrated from Eastern population centers.

Our new residents are appalled when they see their new utility bills.

As an utility commissioner, I welcome any opportunity to work for lower utility rates for my constituents and for these residents. I fully understand that the adoption of S. 1917 will not, in and of itself, guarantee any lower rates for the phone users in my state. However, it is clear to me that the creation of a board composed of both F. C. C. Commissioners and state utility commissioners, with the authority to adopt and amend separations procedures will help. If this legislation is passed, each of the states would have a voice in apportioning the revenues of large companies to their interstate and intrastate operations.

I have taken the liberty of attaching to my prepared statement a copy of a resolution passed by the Arizona Corporation Commission. You will see that it was an unanimous decision.

Thank you very much for allowing me this opportunity of testifying. I would be most pleased to answer any questions.

DICK HERBERT.

## RESOLUTION OF THE ARIZONA CORPORATION COMMISSION

Know all men by these presents that it has been resolved by the Arizona Corporation Commission at its office at the State Capitol at Phoenix, Arizona on this 8th day of December, 1969, that this Commission unanimously endorses, supports, and urges the adoption of S. 1917.

MILTON J. HUSKY,  
*Chairman.*

DICK HERBERT,  
*Commissioner.*

CHARLES H. GARLAND,  
*Commissioner.*

STATEMENT OF THE ARKANSAS PUBLIC SERVICE COMMISSION TO THE U.S. SENATE  
COMMITTEE ON COMMERCE

Charged with the knowledge of pending applications for rate increases of the Bell System Operating Companies of more than 5 hundred million dollars to be paid by local exchange customers, it ill behooves the Federal Communications Commission to initiate a reduction in interstate toll rates which inevitably must spawn further such applications for rate increases, the burden of which falls on those who are least able to pay any increase, while benefiting those of comparative affluence.

We are all aware of the huge sums being spent by the Bell System in the news media urging you or your son, daughter, grandson, or granddaughter to call by long distance to talk to one or more of his ancestors. While this is appealing, we who live in the state of Arkansas think a penciled note sent at a cost of 6¢ would be as welcome and as highly desirable, if our monthly bill for local exchange service could either be maintained at its present level or reduced by any amount.

In the past year, several operating companies of the continental telephone system have filed for and have been granted rate increases for local exchange service in Arkansas. We are on notice that the General Telephone Company of the Southwest will petition for a substantial increase no later than February, 1970. These are two of our largest independent companies. We have had no expression from the subsidiary of AT&T operating in Arkansas, but we have no assurance that it will not move in that same direction. It has done so in our neighboring states and there is reason to believe that it will do so in Arkansas. There are approximately forty-five other independent telephone companies in Arkansas who could ask for what they term "rate adjustments" which in common parlance means rate increases.

We have made a concerted effort over the past two years to bring about the upgrading of telephone service in Arkansas. We have made progress and, in our judgment, have made more progress than many of our surrounding states. In November of 1969, the last manual telephone exchange in Arkansas was converted to dial. This was achieved through the efforts of the Arkansas Public Service Commission with the cooperation of most of the companies regulated by the commission. The upgrading of these services has been resisted by some companies who insist that the cost would necessitate substantial increases in local exchange rates, which increase would put an undue burden on their subscribers. One of our goals is to achieve service with no more than four subscribers per line and, while we are far short of achieving that goal, including many circuits of the Bell System company substantial progress has been made.

One answer to more rapid improvement of local service is certainly a modification of the allocation of costs between interstate and intrastate service. This, of course, is inextricably a part of the proposed order of the Federal Communications Commission.

While we would not charge or imply that the Federal Communications Commission proposes to act with indifference to the welfare of the average consumer, we, at the same time, would be in no position to defend it against such a charge.

STATEMENT BY WILLIAM SYMONS, JR., PRESIDENT OF THE CALIFORNIA PUBLIC  
UTILITIES COMMISSION

As the representative of the California Public Utilities Commission, the opportunity to present this statement to this Committee is greatly appreciated. The California Public Utilities Commission, in protecting the interests of the more than 20,000,000 residents of our State, is greatly concerned with the recent action

of the Federal Communications Commission in requiring the American Telephone and Telegraph Company to reduce interstate message toll rates in the amount of \$150 million annually. Viewing the nation as a whole, it is inequitable for the FCC to reduce interstate rates \$150 million at the same time that \$500 million of rate increase requests are pending in states on the same integrated network during this highly inflationary period. In the balance of this statement, the specific effects on California will be detailed.

California has the largest population in the Nation and is experiencing the largest annual population growth, thereby requiring very substantial additions to communications facilities. Our State now has the largest Bell System company and the largest General Telephone System company, with a state total of over 12 million telephones.

There are present service deficiencies in California that require augmentation of the existing plant, particularly local central office equipment. The stimulated business created by the proposed lower interstate rates can only aggravate this situation. To attempt to meet these service problems and to care for California's rapid growth, our Bell System company, which constitutes about 10% of the entire Bell System, has a construction program of \$561 million in 1969, \$665 million in 1970 and \$710 million in 1971. These construction programs are for both interstate and intrastate operations (interstate 20% and intrastate 80%), and will require the financing of vast amounts of very expensive capital in the next few years. For example, a debenture issue of \$150 million on last Tuesday, (December 2, 1969) resulted in a cost of 9.21% to the company. In 1970, it is expected that \$300 million in additional issues will be required by the Bell System operating company in California.

With a need for all this costly capital to finance expanding construction programs in order to meet the service requirements of our rapidly growing population, this is not the time to have an interstate rate cut, because such rate cuts can only ultimately result in further increases for intrastate ratepayers. The interstate rate reduction therefore has the ultimate effect of transferring the burden for meeting increased service demands from the relatively few interstate toll users to the millions of subscribers to local telephone service. It is our view that an appropriate means for adjusting the interstate earnings to a reasonable level is through making changes in separation procedures that will result in a more balanced load being carried by intrastate and interstate telephone users. California heartily supports the NARUC petition for separations rule-making that was filed with the FCC. This petition contains a wholly workable plan for properly reflecting the use of local central office equipment by interstate toll callers. As it would be inappropriate to have the interstate rate changes effective prior to consideration of these separation changes, a complaint will be filed to suspend the tariffs pending public hearing on their reasonableness. When the California Commission appealed the \$100 million decrease in 1965 the FCC successfully urged that our remedy was to file a complaint challenging the reasonableness of the rates. At that time, we argued that this was no remedy. Depending on whether FCC stays the effectiveness of the new rates and accords a public hearing thereon, we shall see how much of a remedy the filing of such a complaint will afford when FCC reduces interstate toll rates outside of the procedural vehicle it has opened.

#### QUESTION OF DUE PROCESS

When I say "FCC reduces interstate toll rates" I use the phrase advisedly. No one is fooled by double-talk about a "voluntary reduction" by AT&T. No company will *voluntarily* throw \$150 million out the window. This FCC reduction was accomplished after a series of backroom hearings in which no one but AT&T and the FCC staff was permitted to participate. A few observers from the number of those directly affected were reluctantly suffered to attend, but the "invisible shield", to use the phrase from the deodorant ad, was lowered between them and the Commission and the parties to the proceeding, and they were not permitted to speak, file statements, or in any manner record their opposition to a decrease. Even the independents, whose revenues are directly and adversely affected by the action of the FCC, were not permitted to be heard. This type of action cannot be construed as due process.

The FCC has Docket 16258 open and pending, its first full investigation of AT&T in 32 years. In 1967 the FCC found in that proceeding, which is still open, that a 7 to 7.5% range in rate of return on interstate toll was reasonable. FCC had underestimated the rise in net revenues resulting from increasing use of interstate toll service because of reductions in rates. When AT&T's rate of return

exceeded the upper limit of the range, FCC had the procedural vehicle ready in its hand in which to determine, in a manner prescribed by the Federal Administrative Procedural Act, whether AT&T's rate of return was excessive and whether a rate decrease was in order, and if so, how much. But FCC ignores the laws which Congress has enacted for rate regulation. After its private hearings with AT&T it issued—not a decision or order—but a press release entitled "Public Notice," which, of course, is not appealable. The FCC Commissioners went through the sorry spectacle of voting on a press release, as they would on an order arrived at after due process, and there is even a dissenting opinion to the press release!

#### TOLL RATE DISPARITY

One of the big problems facing state regulatory agencies has been the disparity between state and interstate message toll telephone rates.

While today there are a few states which have message toll telephone rates for certain classifications lower than interstate and a few states have rates equal to interstate, the vast majority of states have rates which exceed interstate for comparable distances. Rate disparities are not just an academic matter; they are a matter of dollars and cents to the telephone customer. Customers cannot understand why there is a higher rate applicable to a shorter distance on an intrastate route as compared with an interstate route.

I have had three charts prepared which illustrate the almost ridiculous rate disparity that will result from the proposed interstate message toll rates filed to become effective January 1, 1970. These charts compare the distance applicable to customer dialed station-to-station calls originating in San Diego, California for a comparable state and interstate charge. Chart 1 shows that for the maximum proposed interstate day rate of \$1.40 a call may be made to anywhere in the United States, a possible maximum distance of 3,000 miles. For the same \$1.40 a California intrastate call can reach up to a maximum 685 miles. Chart 2 shows that for only 90 cents an interstate night call may be made to the most distant point in the United States. The longest distance in California, less than 900 miles, is 85 cents. At a comparable charge of 80 cents a San Diego caller can call 510 miles to San Francisco or a little beyond, intrastate, but out to 1,910 miles, somewhere beyond Chicago, on the interstate schedule. The after midnight rate shown on Chart 3 introduces a new element of disparity—the one minute toll call. As shown, for 35 cents an interstate call can be made to anywhere in the nation. For the same minimum charge an intrastate call of 30 miles may be made. Comparing like times of 3 minutes, for 75 cents an interstate call can be made to anywhere in the nation; an intrastate call out to 360 miles.

The problem of a rate disparity has been with us for a long time. Throughout the period of the early 1920's, state and interstate toll rates were generally at the same level of rates per mile being based upon the World War I Postmaster General schedule of rates. From about 1926 to World War II various reductions took place in the state and interstate toll rates. During post World War II years, interstate rates continued to be reduced, with two notable exceptions, whereas intrastate rates, both message toll and exchange, in these years were generally increased. Illustrative of the effects of these rate changes throughout the years is the tabulation set forth on Table 1 which shows the revisions authorized by the Federal Communications Commission since its establishment to date. Based upon straight additions of the savings to customers at the time of the rate change, the reductions for the FCC throughout these years total \$359 million. Obviously, if the reductions were priced out at today's level of business, the total savings would be many times as great. The reductions in California intrastate toll rates during the same period have totaled only \$2 million. This, of course, does not tell the full story as the rate increases are weighed heavily in the earlier years. If all the increases and decreases were priced out at today's level of business, the California intrastate toll would show a net increase.

In addition, exchange rates have been increased substantially for intrastate users. Just in the last year Bell rates in California have been increased by \$50 million and General Telephone by \$12 million. Thus it may be seen that any attempt to correct the toll rate disparity must come at the expense of increased rates for exchange users unless a more fair and equitable allocation of toll costs between state and interstate operations can be developed.

## INTERSTATE CREAM SKIMMING

I'm sure that many of you wonder why anyone should object to a rate reduction. I was formerly in the cattle business, so I'll use an analogy which is familiar to me. Please envision the joint ownership of a cow—the Bell System—with the states owning 70% (intrastate) and FCC owning 30% (interstate). The only trouble is that the states have responsibility for feeding the cow, caring for the cow, and cleaning up after the cow. All the FCC does is to extract the milk and skim the cream from the 30% that it owns. In this case, the FCC milked Bell for \$150,000,000 and gave it to the rich.

In spite of my analogy, there is nothing facetious about the concern of the California Commission. The separations methods advocated by the NARUC in Docket 16258 were sound. FCC considered them and adopted a plan of its own, which benefited states by about only one-third of the NARUC proposal. The FCC then reversed itself and came out with a new plan, which, it assured NARUC, would in a year's time work out just about the same as its original plan. FCC was wrong. It has not worked out that way—on the contrary, for 1970 the states are almost \$70 million worse off.

## SEPARATIONS METHODS

The allocation of telephone costs between jurisdictional operations is referred to as separations. In California, we have set toll rates on an earnings basis. California intrastate toll earnings have generally been on a close parity with interstate toll earnings. Thus, the separations methods used in determining state and interstate toll earnings are of prime importance to California.

The results of the last FCC order on telephone separations were particularly disturbing to us. While there was a transfer of costs from exchange operations to interstate toll, there was a reverse transfer from interstate toll to intrastate toll.

We agree with Chairman Burch that separations procedures are not an exact science; that arbitrary transfers of costs from intrastate to interstate jurisdictions should not be used as a device to alleviate the need for rate adjustments, and that there must be a substantial and rational basis for the proposed transfer. The changes in separations plans which have been made over the years have been the result of the most agonizing efforts of the states to get AT&T and the FCC to recognize the fact that without the local exchange facilities which stand by in readiness to serve all telephone customers 24 hours a day, every day in the year, there would be no access to the interstate toll lines. It should not be a matter of self-congratulation for FCC to claim that from time to time it has assumed a little of the burden. Neither should the statement made by Chairman Burch in his letter of November 17, 1969 to the Chairman of this Committee go unchallenged. He said, "It has been the Commission's policy objective over the years to channel the benefits of technological cost savings to the less affluent and the residential subscribers."

The "less affluent and residential subscriber" uses prepaid, unmeasured exchange service; that is, he pays in advance for the service whether he uses it or not. This is the bread and butter service of the American people, the less affluent residential customers, most of whom seldom or never make an interstate telephone call. If FCC's reductions are permitted to go into effect, the total system will need more dollars to finance growing service requirements. They can be supplied, according to FCC, by the intrastate exchange and intrastate toll user, while the interstate toll user gets a rate reduction. It is easy to understand the Bell System's desire to maintain its prepaid monthly rates as high as possible. It is easy to see why FCC wants to be able to show Congress large interstate toll rate reductions, since it is dependent on it for its budget requirements and has had difficulty in getting appropriations adequate to enable it to truly regulate the telephone industry. It is difficult to understand—indeed, incomprehensible—why FCC would reduce interstate toll rates further at a time when they are already so low that the Bell System in many parts of the country is overloaded. Inadequate consideration of stimulation in traffic and revenues at the time of the preceding "voluntary reduction" of \$100 million (in 1965) was one of the factors which gave rise to the upsurge in earnings which caused the FCC to reduce the rates again, and again without adequate consideration of the effects of increased use.

On the same day that the latest interstate rate cuts were filed, Mr. Ben S. Gilmer, president of AT&T is reported in the Wall Street Journal as saying, "It is a fact of life that the economies we have been able to achieve in long-

haul communications don't apply to local service". We agree that there have been economies in the long-haul service. The fact not mentioned by Mr. Gilmer is that those economies are only possible as a result of the integrated nature of the whole toll network and the fact that millions of dollars have been spent on augmenting the local exchange and toll feeder networks to make the long-haul savings possible. To arbitrarily retain the long-haul economies in the interstate operation is wholly inequitable.

#### PROPOSED LEGISLATION

The California Public Utilities Commission believes that S-1917 in its present form would not ameliorate problems of the States with the FCC, since it provides for four FCC members on a joint board to consider separations and only three State Commissioners.

The membership on such a joint board should reflect the relative size of state (70%) and interstate jurisdictions (30%) of plant and revenues. An equitable balance would be five State Commissioners and two FCC Commissioners. The California Commission would look more favorably toward the bill if amended in this manner.

I would be more inclined to urge that Congress amend Section 211(c) of the Communications Act. It presently reads:

"(c) For the purpose of administering this Act as to carriers engaged in wire telephone communication, the Commission may classify the property of any such carrier used for wire telephone communication, and determine what property of said carrier shall be considered as used in interstate or foreign telephone toll service. Such classification shall be made after hearing, upon notice to the carrier, the State commission (or the Governor, if the State has no State commission) of any State in which the property of said carrier is located, and such other persons as the Commission may prescribe."

It would be desirable to add a policy directive along the following lines:

"It is the policy of Congress that rates for basic exchange service shall be fixed at the lowest reasonable level, and to this end the Commission is directed in determining what property of said carrier shall be considered as used in interstate or foreign telephone service, to give effect to this policy, and to give weight to the fact that exchange plant provides the continuous access vital to the functioning of the interstate toll network."

#### SUMMARY

The California Public Utilities Commission opposes the FCC action to require the Bell System to reduce interstate rates \$150 million for the following reasons:

1. Appropriate separation changes should be made because of the unequal burden on interstate and intrastate telephone subscribers.

2. The interstate rate cut at this time results in transferring the costs for growing communication needs from the relatively few interstate users to the millions of local telephone subscribers, a great number of whom are economically depressed.

3. The huge financing requirements of the California unit of the Bell System make an interstate rate reduction at this time unwise in view of the present all-time high cost of capital.

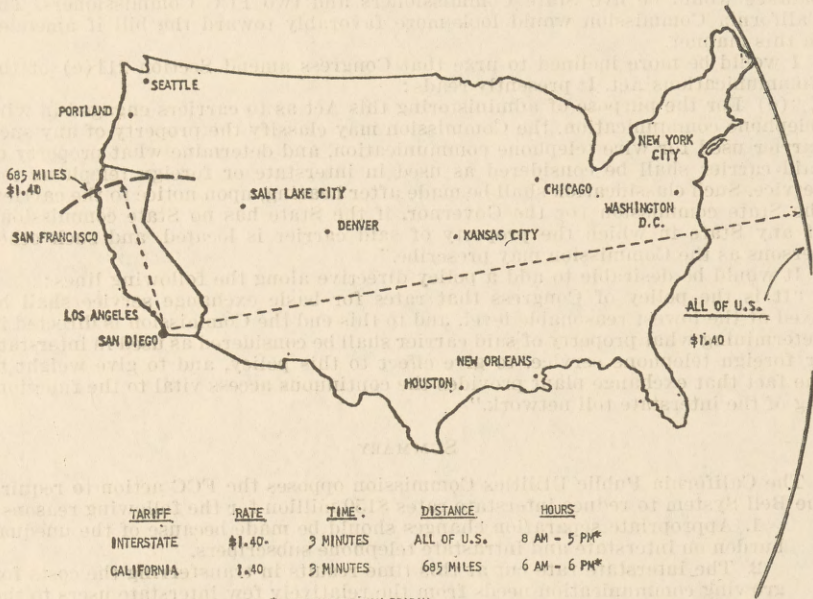
4. The proposed rates filed with the FCC on December 2, 1969 create intolerable disparities between California intrastate and interstate toll rates that unreasonably discriminate against the intrastate toll users and unreasonably benefit the interstate toll users. Relief from this condition can be had through withdrawal or suspension of the proposed interstate rates and implementation of appropriate separation changes as already proposed to the FCC by the NARUC.

CHART 1

STATE VS INTERSTATE CALLING DISTANCES  
FOR COMPARABLE CHARGE  
FROM SAN DIEGO, CALIFORNIA

PROPOSED INTERSTATE RATES EFFECTIVE JANUARY 1, 1970  
CALIFORNIA INTRASTATE RATES EFFECTIVE DECEMBER 2, 1968.

CUSTOMER DIALED STATION-TO-STATION  
DAY RATE



TARIFF	RATE	TIME	DISTANCE	HOURS
INTERSTATE	\$1.40	3 MINUTES	ALL OF U.S.	8 AM - 5 PM*
CALIFORNIA	1.40	3 MINUTES	695 MILES	6 AM - 6 PM*

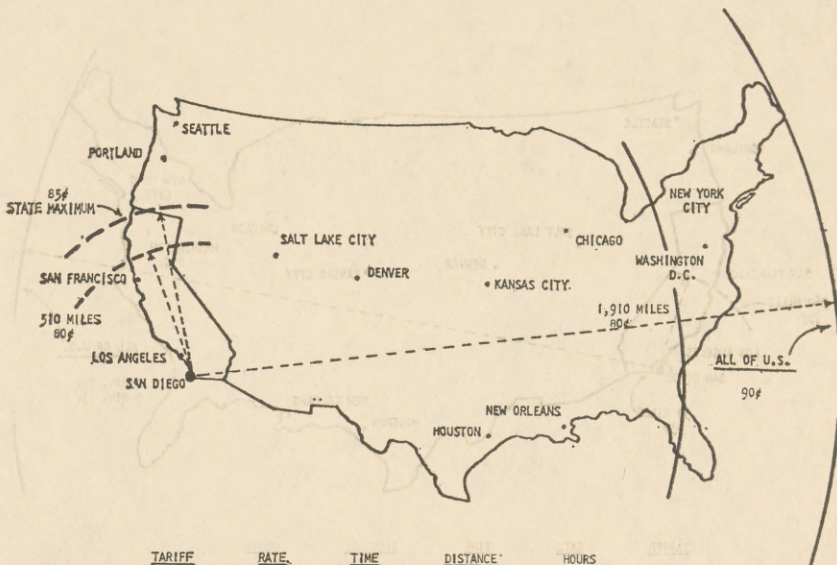
\* MONDAY THROUGH FRIDAY

## CHART 2

STATE VS INTERSTATE CALLING DISTANCES  
FOR COMPARABLE CHARGE  
FROM SAN DIEGO, CALIFORNIA

PROPOSED INTERSTATE RATES EFFECTIVE JANUARY 1, 1970  
CALIFORNIA INTRASTATE RATES EFFECTIVE DECEMBER 2, 1968

CUSTOMER DIALED STATION-TO-STATION  
NIGHT, SATURDAY AND SUNDAY RATE



TARIFF	RATE	TIME	DISTANCE	HOURS
INTERSTATE	\$0.90	3 MINUTES	ALL OF U.S.	5 PM - 12 PM*
	.80	3 MINUTES	1,910 MILES	5 PM - 12 PM*
CALIFORNIA	.85	3 MINUTES	STATE MAXIMUM	6 PM - 6 AM*
	.80	3 MINUTES	510 MILES	6 PM - 6 AM*

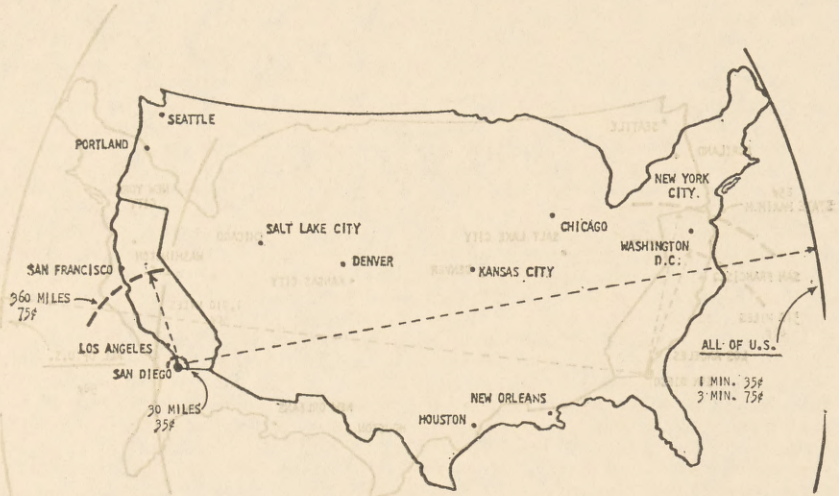
\* PLUS ALL DAY SATURDAY AND SUNDAY

CHART 3

STATE VS INTERSTATE CALLING DISTANCES  
FOR COMPARABLE CHARGE  
FROM SAN DIEGO, CALIFORNIA

PROPOSED INTERSTATE RATES EFFECTIVE JANUARY 1, 1970  
CALIFORNIA INTRASTATE RATES EFFECTIVE DECEMBER 2, 1968

CUSTOMER DIALED STATION-TO-STATION  
"AFTER MIDNIGHT" RATE



TARIFF	RATE	TIME	DISTANCE	HOURS
INTERSTATE	\$0.35 .75	1 MINUTE 3 MINUTES	ALL OF U.S. ALL OF U.S.	12 PM - 8 AM 12 PM - 8 AM
CALIFORNIA	.35 .75	1 TO 3 MINUTES 1 TO 3 MINUTES	30 MILES 360 MILES	6 PM - 6 AM 6 PM - 6 AM

TABLE 1.—SUMMARY OF MESSAGE TOLL RATE REDUCTIONS SINCE 1935, ESTIMATED SAVINGS TO CUSTOMERS AT TIME OF CHANGE

Year	Federal Communications Commission	California Public Utilities Commission	Year	Federal Communications Commission	California Public Utilities Commission
1935	\$581,000		1953	161,940,000	
1936	8,440,000		1954	157,000	4,916,000
1937	12,180,000		1955	102,000	
1938		\$516,000	1956	477,000	
1939	1,320,000		1957	42,000	
1940	5,404,000	1,918,000	1958	12,900,000	18,766,000
1941	13,005,000		1959	45,324,000	
1942			1960	2,740,000	
1943	31,842,000	375,000	1961	82,000	
1944	7,710,000	3,803,000	1962		
1945	22,220,000		1963	30,000,000	3,200,000
1946	19,742,000		1964		10,500,000
1947	835,000	11,250,000	1965	100,000,000	
1948		1,865,000	1966		60,000
1949		19,368,000	1967	100,000,000	2,100,000
1950	229,000		1968	20,000,000	11,900,000
1951			Total	358,671,000	1,937,000
1952	1,025,000				

<sup>1</sup> Rate increase to customers.

## STATEMENT OF COMMISSIONER HOWARD S. BJELLAND FOR THE COLORADO PUBLIC UTILITIES COMMISSION

My name is Howard S. Bjelland. I come from the State of Colorado and am a Commissioner of the Public Utilities Commission of the State of Colorado. The Public Utilities Commission of the State of Colorado desires to be of record that it favors the adoption of Senate Bill 1917, which would create a seven-member board composed of four Federal Communications Commission (FCC) Commissioners designated by the FCC and three state commissioners nominated by the National Association of Regulatory Utility Commissioners and appointed by the FCC. This board would have the sole administrative authority under the Communications Act of 1934 to adopt and amend separations procedures.

We believe there is a definite need for the creation of such a board, and we would like to take this opportunity to illustrate some of the present problems that the State of Colorado faces in regard to the disparity between interstate telephone rates and intrastate telephone rates, and of equal importance the financial burdens placed on local exchange service, brought about by the present administration of the separations manual as applied to the division of Property Costs, Revenues, Expenses, etc. Let us assume that there is a telephone system rendering interstate telephone service as a separate entity under the control of the FCC. This system would have its own facilities including poles, wire, cable, central offices, telephones, etc., and the rates would be set by the FCC. Now also assume that we have a separate intrastate telephone system in Colorado under the jurisdiction of the Colorado Public Utilities Commission (Colorado PUC). This system would also have its own facilities including poles, wire, cable, central offices, telephones, etc. Its rates for telephone service would be set by the Colorado PUC. If two such separate systems in fact were to exist, it is easy to see that there would be a great duplication of facilities. Each customer would be required to have two telephones if he wanted interstate service with all its attendant duplicate charges.

In the interest of good economical telephone service to the public it is evident that these two types of telephone systems should be combined with the attendant elimination of duplicate facilities. Appropriate jurisdiction is retained to each commission to set rates. It would seem that under such an arrangement the customer would benefit and both inter- and intra-state rates would be held to the level commensurate with regulatory principles. In fact, as we know, a single system does exist, but we have grave doubts as to the fairness of present separations procedures applicable to such consolidation. In order to regulate such a combined telephone system a separations procedure has been devised which separates the plant costs, revenues and expenses for the joint operation between Federal and State jurisdictions. Regardless of the problems inherent in the mechanics of a separations procedure, we are gravely concerned with the results being obtained by this dual regulation.

Historically the FCC has prescribed rate decreases, while in Colorado we have been faced with two problems:

1. As the interstate rates have been decreased, Colorado has not found it economically feasible to apply the same toll rates for all classes of intrastate as is applied to interstate service for comparable distances and periods of time. This has resulted in a disparity between the rates prescribed by the FCC and the Colorado PUC and results in a lower rate for interstate service than for intrastate service for comparable distances and periods of time.

2. The Colorado Commission has been compelled to allow an increase in the local exchange rates of Mountain States Telephone and Telegraph Company (the Bell System affiliate in Colorado) in order to give the Company the fair rate of return to which it is entitled and thereby we believe is subsidizing the interstate toll rates. We subscribe to the policy as set forth in the *F.P.C. vs. Hope Natural Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, wherein the court in effect has said it is not the method used that is determinative but the results obtained. We maintain that the present procedure prescribed by the separations manual produces results that are not fair and equitable to the intrastate ratepayer. We believe there is discrimination because of toll rate disparity between inter- and intra-state tolls which is being subsidized in Colorado by the local exchange telephone subscriber. Continued rate reductions by the FCC of the interstate toll rates increases the disparity between inter versus intra state toll rates imposing a further burden on the local exchange telephone subscriber to subsidize the interstate toll service.

We would like to cite for the Committee's attention two items which we have found very helpful in setting forth the problem and which we believe clearly states the conditions as they exist:

1. A book: "Development of Separations Principles in the Telephone Industry" by Richard Gable, published by Michigan State University in 1967.

2. An article: "Regulatory Responsibilities in Telephone Cost Allocations" by Curtis M. Bushnell, published in *The Public Utilities Fortnightly* in November of 1963.

We are attaching for your information a copy of the article referred to above by Mr. Curtis M. Bushnell as an appendix to this statement.

The present regulatory aims of many states are creating an even greater conflict between the FCC and the state regulatory commissions. Basically Colorado, and we think many of the other states, desire to develop additional extended area service calling, that is toll free calling between adjacent local exchanges. We are also in favor, generally speaking of a flat rate as opposed to measured service. These two factors taken together tend, in the present separations formula, to place a greater burden on intrastate rates. The more we encourage increased volume and longer holding time of local calls the less benefit we obtain from application of the existing separations formula. It is therefore a safe statement that unless something is done the problem is going to become more and more acute and the states eventually will be forced to take action on their own.

Two avenues of approach are open to the state regulatory commissions. The first avenue would be to disregard the separations manual and develop our own set of separations. If this is done, it is quite possible that we might have a very interesting situation where the Bell System might have a \$1,000 investment, \$250 of which would be allocated to interstate, \$250 of which would be allocated to intrastate, and \$500 of which would be allocated to no service at all. The second alternative is to accept the rulings of the FCC as to separations as a bible for intra state, as well as inter state telephone separations and then try to work within this framework to get the best possible allocation to the states out of such separations. Neither of these alternatives appears to be acceptable. We have always felt that if we know the rules of the game and the rules are applicable to all players that we will take our chances in getting our fair share of the proceeds. In other words, we would take the separations formula and attempt to set up an intrastate operation which would give us the greatest break on separations. This can be done very simply and the answer comes out as follows: We could eliminate extended area service; we could eliminate flat rate local calling and return to measured rates; we could give generally bad local service which would cut down on the minutes of usage in intrastate commerce. It is our opinion that, generally speaking, if we reduce the quality of intrastate service we would increase the amount of money available to us under the separations formula. Very simply, the lower the quality of intrastate service the greater return from existing separations formula.

On January 7, 1969, Colorado PUC authorized Mountain States Telephone and Telegraph Company, which Company supplies over 90% of telephone subscribers in Colorado, to increase its intra state revenues in the amount of \$5,878,961 to provide a rate of return on an original cost rate base of 7½%. This increase was distributed across local exchange services as well as intrastate toll service. If the present policy continues and the separations manual implements this policy with further decreases in inter state rates, the result undoubtedly will be additional increases in intra state toll and exchange rates. This points up the need for a point board to eliminate unilateral prescription of separations.

To summarize: Colorado wishes to support Senate Bill 1917. We also wish to cooperate in every way with the FCC because we feel a grave question of national communication is involved.

Thank you for the opportunity of expressing herein the position of the Colorado Public Utilities Commission in these matters.

#### PART I.—REGULATORY RESPONSIBILITIES IN TELEPHONE COST ALLOCATIONS

(By Curtis M. Bushnell)<sup>1</sup>

For years, disparities between intrastate and interstate long-distance telephone rates have created regulatory difficulties for the federal and state commissions, as well as the Bell and independent telephone companies involved. The first part of this article deals with the background of allocation procedures which have resulted in inequities which, this author feels, unduly favor the interstate seg-

<sup>1</sup> A certified public accountant, presently employed on the staff of the Federal Power Commission.

ment of the toll business. It is not however, a criticism of overall revenue levels, but a commentary on the allocation of such revenue requirements between the different classes of business.

State and local regulatory commissions have granted increases of \$1 billion a year in telephone rates to Bell system companies since 1946. At the current level of business these increases now amount to at least \$2 billion a year in charges to telephone users. During this same period increases and decreases in interstate telephone rates have nearly equalized and some interstate rates have been reduced substantially. In fact, the Federal Communications Commission has stated recently that decreases in interstate toll rates since the commission's inception in 1934 would amount to \$1 billion a year at the current volume of business.<sup>2</sup>

What has caused this divergence in rates? Why have state regulatory commissions been required to grant repeated rounds of increases that frequently have amounted to as much as 200 to 300 percent in some intrastate rates while interstate rates have been reduced? Why is the rate usually higher for a toll call within a state than it is for a call across the state line to a more distant point? Looking to the future, an even more searching question is the matter of what should be done to establish telephone rates at levels that are adequate and at the same time will stimulate the maximum development of communication services to the public.

These are the problems with which this article is primarily concerned. There are a number of related problems in this same area of regulatory responsibility which, although not in the main stream of this article, are no less important. Why are independent telephone companies being forced to request increases in intrastate rates while at the same time their revenues from interstate business are being cut? Within a state, why is it necessary to grant higher telephone rates to an independent telephone company than to a Bell company? At the federal level the question is now paramount as to where regulation is headed in its responsibilities with respect to competition between telephone and other communication media.

The one factor that has a major impact on all of these problems is telephone cost allocations. It is not feasible for telephone companies to keep their accounts in sufficient detail to show the costs separately for each class of telephone service they provide. Most telephone facilities are used for all classes of message telephone service; therefore, the investment recorded in a company's accounts represents joint costs of providing all services. The same is true of operating expenses. For these reasons cost allocation procedures must be resorted to any time it is necessary to obtain the portions of the investment and expenses that are assignable to a segment of a company's operations.

In regulating telephone rates the matter of whether increases or decreases in the total required revenues of a company will fall in its intrastate or its interstate operations is almost entirely dependent upon the way its investment and operating expenses are allocated to these operations. Over the past twenty years if telephone costs, particularly those costs that have no relationship to use, had been allocated in a more equitable manner the necessary increases in telephone rates would have fallen somewhat proportionately on both intrastate and interstate services instead of wholly on intrastate services. This would have meant that approximately \$400 to \$500 million in the current annual volume of increased charges now included in the intrastate rate schedules would have fallen into the interstate rate schedule instead.

Independent telephone companies enter into this picture because they generally receive their required revenues from two sources. An independent company receives revenues in the form of toll settlements for the toll business which it handles jointly with other telephone companies, usually the Bell companies. The remainder of its required revenues must come from local telephone services and the relatively small amount of toll business which it handles entirely by itself. The matter of what portion of required revenues it derives from toll settlements and what portion it must obtain mainly from local service depends upon the manner in which its investment and operating expenses are allocated

<sup>2</sup> *Author's note:* This article is not concerned with any overall "overcharge" or commentary on the general revenue requirements of the telephone industry or the Bell system or other telephone companies. On the contrary, it deals solely with methods used to allocate, or divide, costs of a telephone company among the various classes of services that make up its total operations.

between these two segments of its operations. Because independent companies have been unable to negotiate settlements based upon an adequate allocation of their costs to interchanged toll business, they have been forced to obtain a larger share of their required revenues from local telephone service.

This is one of the principal reasons, if not the chief reason, why independent companies have found it necessary to request local telephone rates that frequently are higher than Bell rates for comparable services.

The Federal Communications Commission has been able to present a favorable picture of interstate message toll rates as compared with intrastate rates because of the methods that have been followed in allocating telephone costs. Clouds are arising in this picture, however, because the FCC is faced with growing problems from other sources. Practically all of the interstate telephone services which it regulates are in competition either with services provided by other communications companies or with private communications systems. If these competing communications media are to be able to develop, as the FCC seems to have indicated is desirable, the commission must consider equitable allocations of telephone company costs to the telephone company services that are in these competitive areas. Otherwise, these interstate telephone services by being subsidized from intrastate telephone services, for example, will continue to receive unfair competitive advantages that will hinder the development of competing communications services.

In summary, most of today's problems in the regulation of telephone rates and in the divisions of revenues spring from this one source of telephone cost allocations. Likewise, the development of the entire communications industry and the financial health of this industry are dependent largely upon the acceptance of improvements in telephone cost allocations. This is a serious problem and one that is increasing in severity with growth in automation and the changing requirements for telephone services.

Although regulatory commissions frequently make extensive and thorough investigations into cost allocations in other areas of regulation, the majority of commissions have not examined telephone cost allocations with this same degree of responsibility. While they regularly render informed and expert judgment on such rate-making elements as value of property, allowable expenses, and rate of return, they usually have not turned their expert judgment to the equally important element of telephone cost allocations. Regulatory commissions, particularly state, regulatory commissions, probably have been lulled by the presence of the Separations Manual into the practice of accepting telephone cost allocations without the usual inquiry and analysis. To understand the reason for this practice, it is desirable to review briefly the circumstances surrounding the Separations Manual before proceeding to the analysis of the detailed cost allocation procedures.

#### HISTORICAL BACKGROUND

The Federal Communications Commission was created in 1934 and given the responsibility for regulating interstate communication services. Shortly after the commission was formed it commenced an extensive investigation of the telephone industry which produced a series of negotiated reductions in interstate telephone rates, beginning about 1935 and continuing into the 1940's. At that time interstate rates were based on the costs of the Long Lines Department of the American Telephone and Telegraph Company. These were wholly interstate costs so that allocations of the costs of other Bell companies that participated in the interstate services were not considered.

State regulatory commissions became increasingly concerned about the series of interstate rate reductions without corresponding reductions in intrastate telephone rates. This concern was aired in actions and reports of committees as published in the reports of annual proceedings of the National Association of Railroad and Utilities Commissioners (NARUC), beginning in the late 1930's. The reports show that the state commission representatives blamed this rate situation on the improper consideration of costs; consequently, extensive pressure was generated to do something about the allocation of costs in the regulation of telephone rates.

In 1941 the FCC began a formal investigation, Docket 6053, to determine if interstate rates should be further reduced. Shortly thereafter the Bell companies petitioned the FCC to determine just and reasonable procedures for allocating telephone costs. The rate investigation was terminated by a negotiated reduction in interstate rates, and the FCC and NARUC turned to a co-operative informal study of cost allocation procedures. The NARUC created a committee

of five state commissioners and a committee of staff experts to work with representatives of the FCC on this matter, with the co-operation of Bell and independent telephone companies. As part of this activity the FCC in 1942 also commenced a formal investigation of telephone cost allocation procedures, Docket 6328.

Meanwhile, the NARUC staff committee completed a report on allocation procedures. These were essentially the same procedures that had been developed by the Bell companies except that they provided for the allocation of certain costs on either the station-to-station or the board-to-board basis. This report was introduced in the FCC proceedings as Exhibit No. 2. After a series of hearings the FCC suspended the investigation and has since kept this docket open on its records without ever rendering a decision thereon. The committee of five state commissioners approved the report of allocation procedures, Exhibit No. 2, prepared by the staff committee and this report with minor modifications became the first allocation procedures issued by the NARUC.

From the beginning the cost allocation procedures have penalized the intrastate telephone services regulated by state commissions, including the services provided by independent telephone companies. The ultimate effect, of course, has been against the users of these services.

At the time the procedures were issued there was no way of knowing the results they would produce. This could only be learned by experience. The effect of these procedures first became evident to most state commissioners about 1946. At that time the telephone companies experienced the beginning of the long upward spiral in costs which required them to apply for the first of a series of substantial increases in rates.

The allocation procedures assigned practically all of the increases in costs to intrastate operations rather than distribute these cost increases between intrastate and interstate operations. As a consequence, by following these cost indications, the telephone companies requested all of the necessary increases in rates in their intrastate services. As cost continued to climb in ensuing years, the methods of allocation continued to assign practically all of these increases in costs to intrastate operations. The result of these allocations was that telephone companies continued to request repeated rounds of increases in intrastate rates while their interstate services continued to show adequate earnings.

A considerable number of state commissions registered opposition to the original issuance of the NARUC allocations procedure during the FCC's formal proceedings on this subject in 1942. As the effects of the procedures became evident about 1946 the state commissions generally stepped up their criticism. The annual reports of NARUC proceedings, continuing on to the most recent reports, repeatedly voice the persisting dissatisfaction with these allocation procedures on the part of state commissions.

Furthermore, in numerous formal decisions on telephone rates, state commissions have expressed dissatisfaction with the allocations of telephone costs and stressed the need for improvements in these procedures. The NARUC committees that were formed in 1941 to study the matter have been continued since that date. These committees have operated under frequently repeated instructions as to the need for improvements in the allocation procedures. Largely as a result of the efforts of state commissions the procedures have been changed three times. On a system-wide basis each of these changes has resulted in transferring investment and expenses from intrastate to interstate operations. For the most part these changes have been merely compromises, not based on sound principles of cost allocation.

The estimated effect at the time the changes were considered indicates that they would increase the interstate revenue requirements by about \$125 million a year, which, at the current volume of business, would amount to about \$150 million a year. It is doubtful that some of these estimates were realized, however, because of the manner in which the changes in cost allocations actually were applied. Even if these estimates are correct they still represent only a small share of the total required increases in telephone rates since 1946 that should be borne by interstate service under any reasonable method of allocating costs. Nevertheless, despite their dissatisfaction with these procedures nearly all of the state commissions have accepted these allocations in their rate decisions without the searching analysis that they regularly apply to other elements making up the rate-making process.

## DIVERGENCE OF VIEWS

In the face of this long history of the inequitable results produced by the telephone cost allocation procedures, it becomes obvious to inquire why these inequities have not been corrected. This history leads inevitably to the conclusion that the answer lies in the manner in which the NARUC committees are expected to operate. These committees have regularly elicited the co-operation, advice, and assistance of the telephone industry, particularly the Bell companies. The independent telephone companies have only in recent years taken a more active role in these matters and, while they have been heard, the significance of these procedures to the independent companies and their customers has not been fully recognized by the NARUC committees. The NARUC committees operate without any regulatory authority.

The crux of the problem, however, is that the committees normally take no actions and make no recommendations without the unanimous approval of all three interested groups, the state members, the FCC, and the Bell companies. Lack of approval by any one of these three groups normally has been effective in blocking any proposals for improvements that have been considered. Since each of these three groups has its own particular interests in the matter of cost allocations, this method of operation has not accomplished its objective of promoting effective regulation.

The FCC occupies the favored regulatory seat in this matter. The allocation procedures have enabled this commission to avoid increases and even to obtain reductions in interstate rates during the long period of rising telephone costs that has been experienced. Allocation procedures which would have distributed the increases in costs somewhat proportionately between intrastate and interstate operations would have required that roughly one-fourth of the \$2 billion of increases in charges for telephone service that have been found necessary would have been required in interstate rates rather than in intrastate rates. This would have been in addition to the increases of about \$150 million a year which the FCC did accept through three relatively minor changes in allocation procedures.

The advantages to the FCC of just sitting tight on these allocation procedures is most obvious. Under these circumstances it is easy to maintain a friendly co-operative attitude but simply not agree to suggested improvements in allocations. In defense of the attitude of the FCC, it should be pointed out that from the position of that commission it would be most difficult to support, as being in the public interest, any voluntary action that might possibly result in a significant increase in interstate rates. Even if the FCC could voluntarily agree to equitable allocations which would shift a fair share of costs from intrastate to interstate operations there is no assurance that corresponding benefits would be realized in the form of reductions in intrastate rates. The FCC simply is not in a position to participate in the remedying of inequities in cost allocation procedures through voluntary negotiations of committees. Such relatively minor adjustments as the FCC has agreed to, have been compromises for relatively minor increases in allocations of costs to interstate operations largely in lieu of further reductions in interstate rates.

The proper procedure would be for improvements in cost allocations to come before the FCC in formal proceedings on interstate rates after a sufficient number of states had formally taken action in this matter to assure that the public would receive the benefits through reductions in intrastate rates.

The Bell companies, through their co-operative participation with the NARUC committees, have been in a position to protect particular interests or positions that may be considered advantageous to these companies. The reasons why they have resisted improvements in telephone cost allocation procedures usually are not set out in reports of the NARUC committees, but several reasons stand out as to why resistance to changes might be considered to be of advantage to them.

In the first place, local telephone service has long been claimed to be the more stable portion of the telephone business. Resistance to changes keeps a greater share of costs in intrastate operations where they must be recovered largely in revenues for local telephone service. By this process a greater share of the total required revenues can be obtained from the more stable local business. Second, virtually the only direct competition received by the telephone companies is in the area of their toll business, especially the longer-haul interstate toll business. The telephone companies obtain decided competitive advantages from allocation procedures which keep the assignment of costs lower in this competitive area. Third, the Bell companies also compete in an indirect way with independent telephone companies in the form of comparative rates and quality of service.

Cost allocation methods which keep down the share of revenues which the independent companies receive as settlements from interchanged toll business require them to have higher local telephone rates. The financial drain which this practice imposes also keeps the independent companies at a competitive disadvantage in other respects, such as meeting demands for more service and modernizing their facilities. Altogether, benefits from the standpoint of management may make it advantageous to resist improvements in telephone cost allocations and the present co-operative committee arrangement seems to provide a convenient means to attain such objectives.

State regulatory commissions and independent telephone companies together with the users they represent, have suffered from the inequities of the cost allocation procedures. A number of state commissions opposed the issuance of the cost allocation procedures in the first place.

State commission representatives have tried almost continuously to obtain worthwhile improvements in these procedures through the NARUC committee operating arrangements. But they have been rebuffed repeatedly by the friendly and co-operative but sit-tight position of the FCC or the Bell companies. The relatively minor improvements that they have attained on three occasions do not begin to reflect the efforts of many of the most capable state regulatory authorities that have labored in these endeavors. This experience of the past twenty years should convince the state commissions that the present committee arrangement does not serve to promote effective intrastate regulation.

This experience also points up the fact that state commissions should exercise their independent responsibilities for cost allocations in the field of telephone regulation just as they do, for example, in the fields of gas and electric regulation. The logical place for improvements to originate is with state regulatory commissions since more than three-fourths of the telephone business is intrastate. Also, the orderly and equitable process for improvements to be introduced is through the investigations that are involved in formal rate proceedings.

Independent telephone companies have participated in the NARUC committee activities to a greater extent in recent years. The first allocations procedures as well as subsequent issues have been recognized as being applicable to operations of independent as well as Bell companies. In the past few years the independents have made greater efforts to illuminate the inequities of the present allocation procedures, and perhaps their growing problems in this respect will be given more consideration in the future. Their principal concern is to obtain sufficient revenues through toll settlements to cover their costs that are assignable to interchanged toll business.

Before leaving this résumé as to the effects of the telephone cost allocation procedures, it is desirable to consider the Separations Manual itself. The manual is simply an advisory publication which has no official standing from a regulatory standpoint before either the FCC or the state regulatory commissions. It contains an outline of procedures for allocating costs to segments of a company's operations. For the most part it is couched in general terms and contains enough escape clauses that widely varying procedures and results can be said to conform with the general instructions in the manual. It should be noted that the manual does not represent the views of the state commission members of the NARUC committees as to proper methods of allocating telephone company costs since they are repeatedly instructed to continue their studies to try to obtain improvements in the procedures. Nor does the manual represent the views on this subject that are expressed by the FCC.

Presumably the FCC in its informal negotiations on interstate message toll rates does accept costs arrived at by the following manual, although this is not shown in any FCC actions. On the other hand, the FCC has formally advised the NARUC committee that by participating in the work of the committee the commission has expressed no opinion as to the treatment that would be accorded cost allocations in formal rate proceedings. In fact, in the formal rate decisions which the FCC has issued, the commission has accepted cost allocations presented by telephone companies which are at variance with the methods outlined in the manual.

One of the principal purposes for issuing the Separations Manual has been to assure as much uniformity as possible in the allocation of costs by state and federal jurisdictions. By achieving uniformity telephone companies would be assured that costs which are not accepted by the federal jurisdiction would be accepted by the state jurisdiction and vice versa.

But, as indicated above, this purpose of uniformity is not being achieved before the FCC. Nor does the record indicate that this lack of uniform methods is causing any concern to the telephone companies since they have advocated allocations that are not in conformity with the manual in formal rate proceedings before the FCC.

#### MAZE OF DETAILS

Having discussed in some detail the inequitable effects that are produced by the telephone cost allocation procedures, we turn now to an examination of the procedures themselves to see where the inequities actually lie. The purpose of cost allocations is to obtain a reasonable assignment of joint costs among the various services or to a particular service, such as intrastate telephone service. This purpose is no different from that of the usual cost accounting process or from allocations that are made frequently in the regulation of other industries, such as the gas and electric industries. Although the complete process of allocating telephone costs between intrastate and interstate operations has developed into an unnecessarily complex maze of details, the broad picture that is necessary for an evaluation of these procedures is relatively simple.

The process of allocating costs is divided into a few broad steps. The first step usually is to identify the various units or classes of plant that are employed in providing the service under consideration. These ordinarily are expressed in terms of miles of interexchange channels, various units of central office equipment, numbers of local channels, and units of station equipment such as telephones. Next, the investment is assigned to these units and classes of plant, usually by pricing them at costs derived from the associated investment recorded in the company's accounts. The investment assigned to classes of plant is allocated among the various services, generally in accordance with use that is made of that plant in providing service. This use is measured in such terms as minutes and message minutes miles.

The next principal allocation steps relate to expenses. Most of the expenses are allocated on the basis of their relationships to plant investment; i.e., they "follow" the plant investment. If maintenance expenses are running 5 per cent of plant investment then maintenance expenses assignable to a particular service are computed at 5 per cent of the plant investment assigned to that service. Some classes of expenses are allocated according to the work which they represent. Generally speaking, the allocation of the plant investment also controls the allocation of expenses. Therefore, any inequities in allocations of plant investment are carried through the allocations of expenses as well.

For purposes of allocating costs the facilities of a telephone system are divided into three principal classes: (1) exchange circuit plant, (2) local dial central office equipment, and (3) interexchange circuit plant. The proportion of the total plant investment of a company that falls into each of these classes varies somewhat, but in a typical company the total investment will be divided about 50 per cent to exchange circuit plant, 25 per cent to local dial central office equipment, and 15 per cent to interexchange circuit plant. This leaves about 10 per cent that is divided into other smaller classes, such as toll switching equipment, general offices, garages, warehouse, furniture, motor vehicles, and work equipment. For the most part these latter classes of plant are distributed over all services. The chart on page 62 depicts the typical classification of the total plant investment.

Exchange circuit plant represents the local distribution facilities in the telephone system. It consists of the telephones and other equipment on subscribers' premises together with the lines of wires, cables, poles, conduit, etc., between the subscribers' premises and the telephone company's central offices. These facilities are used in providing three classes of message telephone service: (1) local service, (2) intrastate toll service, and (3) interstate toll service.

The investment in exchange circuit plant is allocated among these services on the basis of the aggregate number of minutes it is used in each. This process allocates about 95 per cent of the exchange circuit plant investment and associated operating expenses to intrastate operations, and assigns only 5 per cent to interstate operations. This process seriously overloads these costs onto intrastate operations in two respects. First, it assigns 95 per cent of the stand-by time costs to intrastate operations. Second, it gives no consideration to the difference in nature of the intrastate minutes of use as compared with the interstate minutes of use upon which the allocation is based.

The telephone system is kept in continuous operation twenty-four hours a day, ready for instantaneous use any time the subscriber lifts the hand piece on his telephone. The costs of operating exchange circuit plant are incurred in keeping it on this stand-by basis ready for use. These costs are not related in any way to the minutes that the exchange circuit plant actually is used. The total use of a telephone, on which the allocation of costs is based, averages only about thirty minutes per day. This consists of about twenty-eight minutes for local service, one minute for intrastate toll service, and one minute for interstate toll service. Since a telephone is used only thirty minutes per day, it is operating on a stand-by basis twenty-three and one-half hours per day.

It is obvious, therefore, that practically all of the costs of operating exchange circuit plant relate to this stand-by time. During stand-by operations the exchange circuit plant is being operated *equally* for the benefit of each of the three classes of telephone service. The inequity of the present method of allocation is evident from the fact that although the exchange circuit plant is operating on a stand-by basis equally for all telephone services, only 5 per cent of these stand-by costs are allocated to interstate operations. The chart on page 64 illustrates the allocations of costs that are associated with exchange circuit plant.

This inequitable allocation of stand-by costs incurred in the operation of exchange circuit plant is the principal factor that has caused the divergence in trends of intrastate and interstate rates since 1946. Most of the increases in costs of telephone service during these years have been in these exchange circuit plant costs, nearly all of which are stand-by costs. As these costs have increased, 95 per cent or more have been assigned to intrastate and only 5 per cent to interstate.

The tremendous effect of this allocation upon telephone rates is evident from the fact that exchange circuit plant now represents an investment of about \$12 billion and the associated operating costs amount to around \$4 billion a year. A method of allocation which would have assigned a reasonable proportion of these stand-by operating costs to interstate operations automatically would have resulted in a large share of the increases that have been granted in intrastate rates falling in the interstate rate schedule instead.

#### CHARGING FOR TOLL CALLS

Aside from stand-by costs, the costs of exchange circuit plant during the thirty minutes per day a telephone is used also are overloaded on intrastate operations because no consideration is given to the difference in the nature of interstate minutes of use as compared with intrastate minutes of use. Practically all of the intrastate minutes of use are made up of local telephone calls. Rates for local telephone service usually are a flat monthly rate to the subscriber. This method of charging for local telephone service encourages the subscriber to use his telephone on an unrestricted basis for local calls since he incurs no additional charge for such usage. This naturally encourages much usage of the telephone for local calls that are of lesser value or utility to the subscriber.

The method of charging for toll calls is just the opposite. The subscriber is charged for each call at an increasing rate as the distance increases over which the call travels. The subscriber also is charged additionally for each minute beyond the initial period which, except for the shortest distances, is limited to three minutes' duration. This method of charging naturally restricts toll calls to those having greater value or utility to the user. Furthermore, this restriction applies progressively as the distance increases on toll call. Thus, this restriction is greater on interstate toll calls than it is on intrastate toll calls. In the allocation of exchange circuit plant costs, each unrestricted minute of local service is assigned the same cost as a restricted minute of more valuable toll use. This is contrary to sound principles of allocation that have been accepted in other fields of cost allocation as discussed later.

The increased mechanization of long-distance toll service also has thrown added costs on local telephone service because of these inequitable methods of allocating exchange circuit plant costs. Formerly, when toll service was handled by toll operators, the investment in toll switching equipment, together with the costs of operators and other associated expenses, was assigned to toll service. Roughly one-half of these costs was assigned to interstate toll operations. With the advent of customer dialing of toll calls, the toll operators are eliminated and the toll switching equipment is replaced by lower-cost automatic toll equipment. This reduces the toll costs assigned to interstate toll service.

At the same time, however, improvements are required in exchange circuit plant to make the most efficient use of the automatic toll service. But only 5 per cent of the increased costs of exchange circuit plant are allocated to interstate toll service. Thus, 95 per cent of these added costs of improving long-distance interstate toll service actually is thrown on intrastate operations, and principally on local telephone service. Not only this, but the mechanization results in speeding up the handling of long-distance toll calls. This faster handling cuts down the number of minutes the exchange circuit plant is used for interstate toll service and correspondingly increases the stand-by time, 95 per cent of which is allocated to intrastate service. Therefore, so far as exchange circuit plant costs are concerned, the savings in time obtained through mechanization of long-distance toll service simply mean added stand-by costs which are allocated to intrastate operations.

So here we have a picture of the cost trap that intrastate operations are caught in by the present procedures of allocating exchange circuit plant costs. Stand-by operating costs, although incurred equally for the benefit of all services, are allocated 95 per cent to intrastate operations. With respect to costs during the time in use, a minute of unrestricted local service is assigned the same cost as a minute of more valuable restricted toll use.

Finally, the increased mechanization which improves the operation of the long-distance interstate toll network throws added costs on intrastate operations. These are among the main reasons why virtually all of the necessary increases in telephone rates during the past twenty years occurred only in intrastate rates.

#### PART II.—REGULATORY RESPONSIBILITIES IN TELEPHONE COST ALLOCATIONS

This is the concluding part of a discussion of the belief that the allocation of telephone costs is one of the most notable factors affecting not only the rates which consumers pay but also the overall growth of the entire communications industry.

(By Curtis M. Bushnell<sup>1</sup>)

Independent telephone companies and their subscribers are caught in the same trap by the inequitable allocations of exchange circuit plant costs. The amount of revenues they derive from interchange toll business is dependent upon the amount of their costs which are allocated to these toll services. They have been able to negotiate settlement agreements for jointly handled interstate toll service which allocate exchange circuit plant costs on the basis described above. That is, about 5 per cent of their exchange circuit plant costs are allocated to interstate toll operations in computing interstate toll settlements. Inadequate as this allocation is, they have been unable to do even this well in negotiating compensation for interchanged intrastate toll business. In the latest settlement schedules they have been able to secure agreement for allocating only three-fourths as much exchange circuit plant costs to intrastate toll settlements as the method described herein would so allocate. This means that around 90 per cent of their exchange circuit plant costs, both for stand-by operations and time in use, must be recovered through local telephone rates. The independents, too, are participating in the mechanization that improves the operations of long-distance interstate toll service. But, under present allocations, the more they participate in these improvements the more they increase their costs that are allocated to local service where they must be recovered in local telephone rates.

#### PROPORTIONATE ALLOCATION

As stated previously, the costs of operating exchange circuit plant are incurred in keeping the facilities in full operation at all times in a state of readiness to serve. These facilities are being operated on a stand-by status equally for the benefit of all services. The objective should be to allocate stand-by costs somewhat proportionately among the telephone services which derive the benefits therefrom. In fact, if consideration were given to the desirability of having local telephone rates that permit as many users as possible to have telephone service and that long-distance interstate service is largely business calls, there would be justification for allocating even more than a proportionate share of these operating stand-by costs to interstate toll service.

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The simplest approach to this problem and the one that has much support in logic, or just plain common sense, is that the exchange circuit plant serves two purposes. It is used to make local calls and it is used to provide access to the toll network. On this basis the exchange circuit plant costs would be divided equally between local service and toll service, with the portion assigned to toll to be further subdivided between intrastate toll and interstate toll. This method would allocate stand-by operating costs proportionately to the services for which these stand-by operations are provided. This would be very similar to methods that are used by the Federal Power Commission and the Tennessee Valley Authority, and that have been used by water companies.

The Federal Power Commission in its regulation of natural gas producers has resolved somewhat the same type of allocation problem for costs of wells which jointly produce gas and oil. The costs of these wells are allocated between gas and oil operations on the basis of the cost of wells that would be required to produce each product separately.<sup>1</sup> Very much the same procedure is used by the Tennessee Valley Authority for allocating the costs of multipurpose dams that are used jointly for electric power production, navigation, and conservation. These joint costs are allocated on the basis of the cost of separate facilities that would be required to produce each service separately.<sup>2</sup> This allocation method was developed for the TVA as a result of months of study by a committee of leading public utility authorities. The same method was used in the regulation of water companies some years ago to allocate the costs of local water distribution systems between commercial service and fire protection. A characteristic that has been recognized as the basis for applying this method both to the multipurpose dams and to water distribution systems is that they operate on a stand-by basis most of the time so that the operating costs are incurred in keeping the facilities in a state of readiness to serve rather than in the use that is made of them, just as costs are incurred in stand-by operations of exchange circuit plant.

Also, one of the principal justifications given for this method of allocation is that there are definite savings realized by providing two or more services jointly over the same facilities as compared with the costs of providing each service over a separate system of facilities. The allocation of joint costs on the basis of the estimated cost of separate facilities spreads to each of the services a fair share of the savings that are realized from the joint operation. This is in contrast to the present method of allocating exchange circuit plant costs where practically all of the savings from the joint operation go to reduce costs assigned to toll service since 95 percent of the costs are allocated to intrastate operations and only 15 percent are allocated to interstate toll service.

Another equitable method of allocating costs of exchange circuit plant would be to retain the present minutes of use as the basis but apply weighting factors to place them on a comparable basis for purposes of allocating costs. This method would conform to accepted practices in cost accounting and would be similar to practices followed by regulatory agencies such as the Interstate Commerce Commission and the Federal Power Commission under similar circumstances.

<sup>1</sup> Federal Power Commission, Re Phillips Petroleum Co. (FPC 1960) 35 PUR3d 199, 221 :

"Phillips produces gas alone on certain leases, oil alone on other leases, and both together on still other leases. The purely gas leases are operated by its natural gas department; the oil only and joint products leases are operated by its oil and gas production department. The determination of the production costs, other than exploration costs, of the dry gas in the natural gas department is, in the case of Phillips, relatively simple; the determination of production costs of gas produced with oil and condensate in the production department involves a number of most perplexing problems. For the purpose of allocating joint production costs (exclusive of exploration costs), amounting in all to \$65,252,443 including return and tax incentives as set forth in Appendix 5 [omitted herein], between oil and gas produced from the same wells, a method known as the relative cost method was employed by witnesses for Phillips, the Eastern Companies, and by Wisconsin and was adopted by the examiner. This method allocates the actual costs of joint oil and gas production in proportion to the known costs of producing each product separately. . . ." (Emphasis added.)

<sup>2</sup> House of Representatives, 75th Congress, 3d Session, Document No. 709, June 14, 1938, p. 19 :

"By constructing projects which serve multiple uses, savings may be achieved in expenditures over those necessary for single-use projects. The savings so determined may be divided among the purposes in proportion to the costs of obtaining equivalent results in single-use projects. The alternative cost of any purpose, less its allotted portion of the savings, determines the allocation of the multiple-use investment to that purpose. The same allocation can be obtained more directly by dividing the multiple-use investment among purposes in proportion to the alternative investment for the respective purposes in single-use projects."

It has been pointed out above that the present method is inequitable because it allocates the same cost to a minute of unrestricted toll use. The difference in the nature of these minutes, from the standpoint of users, is substantial. This is demonstrated by the telephone companies' experience as a result of introducing extended area local service and thereby providing unrestricted local calling between areas which prior thereto had been on a toll basis. This elimination of toll charges at the very shortest distances results in subscribers making about three times as many calls between the formerly separate exchanges as they made when the calls were charged for as toll calls. The rate of unrestricted calling increases to five or six times the number of former toll calls as the distance between the combined exchanges increases. Thus, the toll rate schedules clearly result in subscribers restricting toll calls to those having greater value.

The restriction on toll usage is indicated also by the charges the customer pays for a minute of use. For local telephone service the flat monthly charge usually amounts to about one cent per minute for the local calls the customer makes. For toll calls, however, the charge to the customer begins at about five cents per minute and runs up to as high as about one dollar per minute.

#### "ECONOMIC RELATIONSHIP"

Cost accounting authorities are in agreement that, where two or more products or services having different values are produced, differences in values should be recognized in the cost allocation process in order to obtain a reasonable allocation of joint costs. It follows, therefore, that in order to obtain reasonable allocations of costs of exchange circuit plant, the same factors of relative value that are recognized in designing local and toll telephone rate schedules should be recognized in cost allocations.

The recognition of relative values in the allocation of joint costs in rate making for the various railroad services has long been a practice of the Interstate Commerce Commission. The ICC has rejected allocations of joint costs which did not take into consideration the relative value of service.<sup>1</sup> The Federal Power Commission also has followed this same approach in allocating exploration costs between oil and natural gas production. The FPC includes a weighting factor in these allocations to place oil and gas on a comparable basis, which it refers to as the "economic relationship" of gas and oil. This weighting factor is derived by the exercise of administrative judgment, the objective being to assure that oil and gas customers each bear their fair share of joint costs.<sup>2</sup>

This method has been criticized for application to the allocation of telephone exchange circuit costs because it involves the selection of weighting factors to place the toll minutes of use on a comparable basis with local minutes. It

<sup>1</sup> Interstate Commerce Commission, Export and Import Rates, 169 ICC 13, 56:

"Costs which represent nothing more than the estimated average cost of handling all additional traffic, including the lowest as well as the highest grade, and which give no consideration to the value of the commodity or value of the service rendered, are not satisfactory evidence in determining whether rates are reasonably compensatory."

See also, Increased Express Rates and Charges, 273 ICC 231, 242, and Explanation of Rail Cost Finding Procedures and Principles Relating to the Use of Costs, prepared by the Cost Finding Section, Interstate Commerce Commission, November, 1954, pp. 8-14.

<sup>2</sup> Re Phillips Petroleum Co. (FPC 1960), 35 PUR3d 199, 224, 230:

"Total exploration and development expenses before return amount to \$47,474,039, and return and taxes on exploration investment as computed herein amount to \$10,839,194, making total exploration costs of \$58,313,233 as discussed above and as set forth in Appendices 1 and 7 [omitted herein]. The problem before us is how to divide these exploration costs between the production of gas on the one hand and oil on the other. While a portion of the exploration costs can be attributed directly to Phillips' natural gas department, and were so recorded, the greater part are joint costs for which some technique of allocation is necessary. We feel, as explained below, that it is appropriate and in the public interest that we deal with the allocation of Phillips' test-year exploration costs as an allocation of joint costs between coproducts with each required to bear its proper share of the joint costs in the light of all the circumstances that affect the incurrence of the joint costs."

\* \* \* \* \*

"... Upon the basis of the consideration expressed above, and the record in this proceeding, we are of the opinion that the proper economic factor to be applied to the straight Btu content of oil to allocate Phillips' test-year exploration costs is 4, so that the cost relationship of finding one Mcf of gas to one barrel of oil will be about one to 24.

"Our result is reached by an exercise of administrative judgment applied to the record as discussed above..." (Emphasis added.)

makes no difference whether such a weighting factor is called the economic factor, the difference in relative value, or an adjustment to eliminate the restrictive nature of toll use as compared with unrestricted local use. Admittedly, the selection of weighting factors requires administrative judgment just as the Federal Power Commission has selected the weighting factor of four which it employs in its allocation of exploration costs.

Probably there are more guidelines for the selection of weighing factors in the allocation of telephone exchange costs than there usually are in other fields. Experience has shown that when toll rates are removed at the shortest distances subscribers increase their calling rate by about three times. This restriction applies progressively with increases in distance because when the toll rates are removed at slightly longer distances the calling rate increases by five or six times. This would indicate that the weighing factor of three would be the most conservative that could be applied to restricted toll minutes to place them on a comparable basis with unrestricted local minutes. This experience indicates also that the weighing factor probably should be considerably higher for the interstate toll service which is the longer-haul portion of toll service.

In evaluating this method it should be remembered that what is being allocated is almost entirely stand-by costs which are not related to use and that any weighting factor which would bring the allocation of these stand-up costs to interstate operations up to a more realistic level would be an improvement in the allocation process.

Local dial central office equipment is the second largest classification into which the plant investment of a telephone company is divided for purposes of allocating costs. About one-fourth of the total plant investment of a company usually falls in this classification, but this ratio runs higher in many companies. These facilities consist of the local automatic central office equipment, together with associated land and buildings. These facilities, in conjunction with the exchange circuit plant, make up the local telephone system in each telephone exchange. They are used in providing all three types of telephone message service, local calls, intrastate toll calls, and interstate toll calls. This investment and the associated expenses are allocated on the basis of the aggregate number of minutes the facilities are used for each service. By this process, only 2 to 3 per cent of these costs are allocated to interstate operations and 97 to 98 per cent are allocated to intrastate.

Much the same inequitable results are produced in the allocation of costs of local central office equipment that have been discussed with respect to exchange circuit plant. Local dial central office equipment is constructed with sufficient capacity to take care of peak loads of calls during the busy hours. This equipment is in operation continuously twenty-four hours per day and the costs do not vary to any great extent whether the facilities are handling calls or are operating on a stand-by basis ready for instant use. Since the peak loads occur only for short periods, the facilities are operating on a stand-by basis most of the time. Although they are operating on a stand-by basis *equally* for the benefit of all services, only 2 to 3 per cent of the stand-by operating costs are allocated to interstate operations. The allocation of costs associated with local dial equipment during the time in use also reflects the same inequities that have been discussed previously with respect to exchange circuit plant. The same amount of cost is allocated to an unrestricted minute of local use as is allocated to a restricted minute of long-distance interstate toll use.

Because the telephone industry has been in the process of converting from manual central offices to the more costly mechanized dial central office equipment, costs have been increasing in this area even faster than they have for telephone operations as a whole. As these costs have increased, the method of allocation consistently has assigned 97 to 98 per cent of the increases to intrastate operations. This also is one of the significant reasons why the necessary increases in telephone rates over the years have fallen wholly in intrastate rates.

#### EFFECT ON INDEPENDENTS

The inequities in the allocations of costs of local dial central office equipment are accentuated by the improvements that are being added to this equipment primarily for the benefit of long-distance toll service. The nation-wide plan of dialing toll calls is designed to improve the service and to make more efficient use of the long-distance portion of the toll network. In order for customers in all but the largest exchanges to participate in nation-wide toll dialing, additional components must be added to the local dial central office equipment. In addition, it has been found desirable to add still more components to this equipment

in order to permit more efficient use of the long-distance network. These added costs are primarily for the benefit of interstate toll service yet under the method of allocation 97 to 98 per cent of the costs are allocated to intrastate operations.

Furthermore, the speedier handling of toll calls, by cutting down on the amount of time in use, correspondingly increases the stand-by time costs, practically all of which are assigned to local service. Thus, although substantial costs are incurred in connection with local dial central office equipment to improve long-distance interstate service, under the present method of allocation practically all of these costs are assigned to intrastate local service.

The inequities of these allocations are even more pronounced in the case of independent telephone companies and their subscribers. Independent companies must make these same improvements in their local dial central office equipment, at added costs, to permit more efficient use of the toll network that is mostly owned by the Bell companies. But, because of the method of allocation, practically all of the costs of these improvements are allocated to local telephone service of the independent companies and must be recovered in the local rates charged to their subscribers.

The equitable solution to the allocation of costs of local dial central office equipment is the same as that which has been discussed previously with respect to exchange circuit plant. No sound basis has been shown as to why local dial equipment should be allocated on a different basis than exchange circuit plant. These two classifications make up the local telephone system that functions as an integrated unit in each telephone exchange. Both classes are used in making all telephone calls. They are used the same amount of time. The same minutes of use are measured for the allocations of both classes. In fact, prior to 1952 the same allocation factor was employed for the allocations of both exchange circuit plant and local dial equipment. Since that date the same minutes of use have been employed for both allocations except that the minutes of local use have been divided by two in deriving the allocation factor for exchange circuit plant.

Interexchange circuit plant consists of the lines of wires, cables, poles, radio systems, etc., that provide interexchange channels between telephone exchanges. It also includes the associated toll central office equipment installed at the ends of the channels, which is primarily carrier equipment, to divide the broad band channels into individual telephone channels (toll circuits). The share of the total plant investment of a company that is represented by interexchange circuit plant normally ranges as high as 15 per cent for the larger telephone companies that have their own toll lines.

In order to evaluate the process of allocating toll circuit costs, it first is desirable to draw a broad picture of the nation-wide toll network and its operations. The framework consists of main line toll routes that run between all of the larger cities much like the main lines of railroads. They carry heavy concentrations of toll calls and frequently are constructed of coaxial cables or radio systems that have thousands of telephone toll circuits.

The telephone circuits in the main line routes carry the long-haul interstate toll calls and they usually contain other circuits that drop off along the way that carry shorter-haul interstate and intrastate toll calls. These mainline toll routes frequently are owned jointly, with the Long Lines Department of the American Telephone and Telegraph Company owning the long-distance telephone circuits that carry only interstate toll calls and the associated Bell companies owning the circuits in these main routes that carry both intrastate and interstate toll calls. A small part of the main-line toll routes is owned and operated by independent telephone companies. Branching out from these main routes is a tremendous network of feeder line toll circuits. These feeder lines reach into every single telephone exchange in the country to interconnect it with the nation-wide toll network. The smallest exchanges frequently are reached by only one or two toll circuits. These feeder lines serve a dual purpose. They serve to provide toll service among the telephone exchanges in an area such as part of a state. They also serve as the feeder lines to feed toll calls into and receive toll calls from the main-line routes. Most of these feeder lines are owned and operated by the associated Bell companies but a large number are owned and operated by independent telephone companies.

The entire nation-wide toll network of Bell and independent companies operates as a single integrated unit. Every part is mutually dependent upon every other part. Each part must work simultaneously with any other part in providing the continuous electrical circuits that are necessary in toll service. Toll circuits in any one state or in any one company have a direct effect upon the operations of the other parts of the nation-wide network.

For purposes of allocating costs, the usage of toll circuits is expressed in terms of message minute miles (MMM), sometimes referred to as conversation minute miles (CMM). For example, a three-minute toll call that travels 100 miles represents 300 message minute miles of usage. If considered separately, as they are in the present allocation process, costs per unit of use vary widely between the main lines and the feeder lines. The main lines have large capacities of telephone circuits so that the investment and operating costs per circuit are low. In addition the main lines can be designed with proportionately fewer spare channels and they are in use a large part of the day. This lower cost, coupled with more efficient use, produces a low cost per unit of use, per message minute mile. It is most significant from the rate-making standpoint that these efficient operations on the main lines are possible because of the feeder lines that feed calls to the main lines and provide the large concentrations of calls which they handle. The reverse is true of the feeder line portion of the nationwide toll network. Feeder lines are required to reach every telephone exchange even though in many instances they carry only a few calls per day. Because they consist of smaller numbers of circuits, the cost per telephone circuit is much higher. This less efficient use, coupled with the higher cost, produces a high cost per unit of use, per message minute mile.

#### DEFECT OF AUTOMATION

The introduction of operator and customer toll dialing of toll calls has accentuated the disparity in cost per unit of use between the main lines and the feeder lines. Dialing of toll calls, together with the automatic routing of these calls, is designed to make more efficient use of the main lines by automatically selecting alternate main-line routes. This reduces the amount of spare capacity that must be built into main lines to take care of peak capacities and provides a greater amount of use per day for these circuits. All of this greater efficiency produced by automation brings the cost per unit of use still lower on the main lines. This automation has the opposite effect on the operations and the costs of feeder lines. When toll operators were handling calls they were able to make more efficient use of feeder lines by watching the toll circuits and putting through calls when circuits became available. With automatic handling of toll calls this is not possible. In order to attain the more efficient use of the main-line routes, it frequently is desirable to add circuits on the feeder routes to provide more available facilities. Thus, automation is still further reducing the efficiency of operations of the feeder lines and is running up the cost per message mile minute for the toll calls they handle.

The present method of allocating interexchange circuit costs appears to run counter to all of the standards of reasonableness, as indicated by the following greatly simplified description of the process. For purposes of cost allocation the integrated toll network is fragmented into several different classes of toll circuits: (1) transiting Bell interstate circuits which cross a state; (2) terminating Bell circuits with one or both ends in a state; and (3) circuits furnished by independent telephone companies. Prior to 1956 the costs of both Bell and independent companies were allocated by the same method. Costs allocated to circuits handling only interstate calls were assigned direct to interstate operations. Costs allocated to circuits handling both intrastate and interstate calls were divided between these operations on the basis of the message minute miles the circuits were used in intrastate and interstate operations.

The transiting and terminating classifications for Bell circuits were created by the revision of the Separations Manual in 1956. The transiting class of Bell circuits consists of the middle sections of interstate circuits that are mostly in the main-line routes. These middle sections of the main-line routes, as thus isolated, have by far the lowest costs per unit of use, per message minute mile. These costs are assigned direct to interstate service.

The terminating class of Bell circuits in reality consists of several classes. It includes the terminating ends of the main-line interstate circuits operated by the Long Lines Department of AT&T; the terminating ends of circuits used for interstate calls by the associated Bell companies; and the circuits of the associated Bell companies that are used jointly for intrastate and interstate calls. The Long Lines terminating circuits are used twice in the allocation process. The investment and operating costs allocated to these circuits are assigned direct to interstate service. Then, the investment and message minute miles of usage of these circuits are combined with the investment and usage of the terminating interstate circuits and the terminating jointly used circuits

of the associated Bell companies for the purpose of allocating the costs of these associated company circuits between intrastate and interstate operations.

Because the terminating portions of interstate circuits are stated to have lower costs per message minute mile than jointly used circuits in most states, this revision in 1956 was asserted to have attained an objective of transferring some costs from intrastate to interstate operations in those states. In other states the 1956 revision produced the reverse effect by increasing the share of these costs assigned to intrastate operations.

The process of allocating toll circuit costs under the present method is extremely complex and arbitrary. The toll circuits in a single toll route frequently fall into more than one of these classes of circuits. Moreover, a continuous circuit that is set up to handle a single long-distance call is fragmented into a number of these classes of circuits. For example, a continuous circuit to handle a long-distance call between a city in California and a city in Wisconsin would be divided into transiting circuits in about five intervening states, and into jointly used terminating circuits of Bell or circuits of independent companies in these two states. This fragmentation then requires that the message minute miles for this single call be counted as many as four different times in the different segments of the continuous circuit to obtain the usage data that are utilized in allocating the costs. In addition, the method of allocating costs for each of these classes of circuits is different so that the toll circuit costs of handling this single long-distance call would be allocated in as many as four different ways.

If accuracy is the objective of this confused method of allocating costs, it does not accomplish this purpose. The more significant factors that lead to inaccuracies should be mentioned. The accounts of telephone companies are not maintained in a manner that provides for division of the investment in toll circuits between transiting and terminating circuits. This division is performed in various arbitrary ways that vary materially among the companies. Although the terminal equipment at the ends of long-distance circuits operates to divide the broad band channels into telephone circuits throughout their entire length—including the transiting portions—the costs of such equipment are all included in the terminating class of circuits. Message minute miles of usage for all calls are measured over the toll routes that are the first choice in the routing of calls. However, many of the long-distance calls are routed over alternate routes which would produce materially different measurements of message minute miles of usage. The routing of calls over alternate routes is increasing along with the growth of dialing of toll calls. Costs associated with terminating circuits used only for interstate calls are allocated two different ways. Those of the Long Lines Department of AT&T are assigned direct to interstate service. Those of the associated Bell companies are combined with and allocated as a part of the circuits that are used jointly for intrastate and interstate services. This either departs from the use principle in the allocation of costs or constitutes a very broad-minded interpretation of that principle.

These inaccuracies are not the principal criticism that has been leveled at the allocation of costs of toll circuits. The principal inequity arises from the fact that the costs of the various fragments of the network are each allocated as if they were separate systems that operated entirely independent of the other portions of the integrated network. This fragmentation does not take into consideration the integrated nature of the network, the mutual dependence of every part upon each other part, and the direct effect that operations in one part have upon costs in other parts. Specifically, no consideration is given to the extent that the volume of business and the low costs which are achieved on the main lines are the result of contributions by the feeder lines. Likewise, no consideration is given to the fact that the increasing automation, which further reduces costs on main lines, actually requires changes which cause inefficiency and increase costs on the feeder lines.

In short, this method of allocating toll circuit costs is unreasonably complex, extremely arbitrary, and not based either on facts or on sound principles of cost allocation. This method assigns low costs to interstate toll services and high costs to intrastate toll services. The result is that intrastate toll services and toll services of independent telephone companies are penalized and serious discriminations are created.

Independent telephone companies and their subscribers are particularly discriminated against by the present methods of allocating costs for the portions of the toll network which they operate. These companies provide both intrastate and interstate toll services jointly with Bell companies. In addition, they usually provide toll service over these same toll circuits between telephone exchanges entirely within their own territory. It is this latter class of toll service which suffers from the inequities of the present method of allocating toll circuit costs. A similar problem exists with respect to the toll service that in some cases is handled entirely by interconnecting independent companies. The present procedure applied to the cost of all toll circuits of an independent company is to allocate the costs of toll circuits on the basis of the message minute miles that these circuits are used for all of the toll calls which they handle. Since the portions of the toll network that are operated by an independent company are mostly the feeder line portions of the toll network, they have higher costs per unit of use than the network as a whole. This creates a serious rate problem because these higher unit costs are applied to all of its toll calls, including those which the independent handles entirely by itself and jointly with other independent companies. Under present procedures the independent is faced with two alternatives in setting rates for these calls, either of which is inequitable. Rates for this independent company toll business if set high enough to cover the costs that are allocated to these toll calls will be considerably above the prevailing toll rate schedules. If the costs allocated to this independent company toll business are not recovered in toll rates, the remaining choice is that they must be recovered in rates for local telephone service from the subscribers of the independent company.

Again we come back to the fact that the portions of the nation-wide toll network that are operated by independent companies are the feeder lines for the main-line portions of the network. The present practice of treating these portions of the network independently for cost allocation purposes gives no consideration to the extent to which these feeder lines contribute to the revenues earned on the main lines and to the greater efficiency and resulting lower unit costs which are achieved on the main-line portions of the network. This problem is becoming even more serious to independent companies with the growth of automation of the nation-wide toll network through the dialing of toll calls.

In order to achieve the added benefits which automation produces on the main lines, independent companies frequently are called upon to add to the number of their toll circuits on the feeder lines which they operate. The addition of more circuits to the feeder lines cuts down the frequency with which long-distance calls over the main lines are delayed because all feeder circuits happen to be busy. This is of greater importance in the case of toll calls coming into the area of the independent company than it is for toll calls going out of the area. These circuits added by independent companies run up the cost per message minute mile of usage on their own portions of the toll network for the purpose of improving the operations on the main-line portions of the network that are owned and operated by the Bell companies. But under the present basis of allocating costs these higher costs per message minute mile are allocated as well to the toll calls which the independent handles entirely by itself.

A solution to the allocation of toll circuit costs that has been advanced by many state commission representatives is that they should be allocated in a way that produces a uniform unit cost per message minute mile for all toll service, both intrastate and interstate throughout the entire toll network. This method adequately reflects the nature of the operations of the integrated network; hence, it provides for the reasonable allocation of the costs associated therewith.

In fact, taking into consideration the nature of the operations of the nation-wide integrated toll network of feeder lines and main lines, it is difficult to see how any method of cost allocation other than one based on a uniform cost per unit of use could have any validity. This method would also have decided advantages of simplicity and savings in cost of administration.

Under this method a system-wide cost per message minute mile of usage would be determined periodically. This cost would be applied to all of the calls handled on the feeder lines. That is, it would be applied to message minute miles of usage for intrastate calls to obtain the portion of the interchange circuit investment assignable to intrastate operations. The balance of this investment, assigned to interstate, would produce the same unit cost per message minute mile for all interstate service. For an independent company this unit cost would be applied to the messages which it handles entirely by itself and jointly with other independent companies. The balance of the toll circuit costs of the independent would

be assigned to toll business interchanged with the Bell companies. This method, by recognizing the extent to which the feeder lines contribute to the revenues, greater efficiency, and lower unit costs on the main lines, would promote uniformity in toll rates throughout the toll network.

As further support for this method we again turn to the experience of other regulatory agencies. A similar method employed by the Federal Power Commission for the allocation of costs of long-distance gas pipeline systems has been approved by the U.S. Supreme Court.<sup>1</sup> These pipeline systems carry gas both in intrastate and interstate services and only part of the interstate service is under the rate-making jurisdiction of the FPC. In rate proceedings the FPC has found it desirable to allocate costs in a way that produces a uniform cost per unit for all gas transported through the entire pipeline system, including that gas which does not come under its jurisdiction. This approach would appear to be even more justified for the toll telephone network than it is for a gas pipeline system because all parts of the toll network are even more closely integrated and mutually dependent than are the operations of a pipeline system. This method also conforms to the pattern adopted by the Interstate Commerce Commission in regulating both rates and divisions of revenues for railroads.

The ICC has held that rates should not be established on the basis of costs on feeder lines by themselves, where the feeder lines are operated as a part of a large railroad system.<sup>2</sup> Moreover, the ICC has held in establishing rates and divisions of revenues among railroads that consideration should be given to the extent to which the feeder lines help to swell the business and revenues of the main lines. In this connection, the ICC has even gone so far as to hold that it would be proper to raise rates on main lines and pay the whole of the increase in revenues to operators of feeder lines where these feeder lines were a necessary part of an integrated system.<sup>3</sup> The practices accepted by the FPC and ICC appear

<sup>1</sup> U.S. Supreme Court, *Colorado Interstate Gas Co. v Federal Power Commission et al. No. 379*; *Canadian River Gas Co. v Federal Power Commission et al. No. 380* (1945) 324 US 581, 89 L ed 1206, 65 S Ct 829, 58 PUR NS 65, 72.

<sup>2</sup> Colorado Interstate objects because the commission treated the transmission line as a unit. It points out that some laterals and equipment (such as metering stations) are used exclusively for making wholesale sales, some are used exclusively for making intrastate sales for direct industrial sales, and some are used in common in varying degrees by the several classes of business. It is pointed out, for example, that the line north of Pueblo is used almost exclusively by the regulated business but that under the commission's formula the pipeline was treated as if all the gas went into the pipe in Texas and came out at the Denver city gate. These objections are partially met by the manner in which distribution costs, to which we have referred, were allocated. But that is no more than a partial answer since they pertained only to metering and regulating equipment. The laterals were not segregated. They, however, appear to be used more commonly for direct industrial rather than for wholesale sales; and we are not convinced that the direct industrial sales were saddled with greater costs than they would have been had the laterals been segregated. The gravamen of this complaint is that the industrial sales are being burdened with costs of a part of the system which the direct industrial gas never uses. That contention points up our earlier observation that judgment and discretion control both the separation of property and the allocation of costs when it is sought to reduce to its component parts a business which functions as an integrated whole. The commission found that but for the direct industrial market at Pueblo, Colorado, and the wholesale market at Denver, the pipeline would not have been constructed. 43 PUR NS at p. 210. It is therefore obviously fair to determine transmission costs for the pipeline as a whole and not to compute them on a mileage demand basis. In that way the beneficiaries of the entire project share equitably in the cost. To allow the costs to accumulate the closer the gas gets to Denver would be to assume that the extension to Denver was a separate project on which the earlier customers were in no way dependent. These circumstances illustrate that considerations of fairness, not mere mathematics, govern the allocation of costs. Cf. *Wabash Valley Electric Co. v Young*, 287 US 488, 499, 77 L ed 447, 455, PUR1933A 433, 53 S Ct 234. What we have said also answers Canadian's complaint that the wholesale sales in Texas for consumption in the towns of Dalhart, Hartley, and Texline, Texas, are burdened with too large a share of transmission costs. We can see in this situation no difference between those customers and the ones located at more distant point on the pipeline."

<sup>3</sup> Interstate Commerce Commission, *Billings Chamber of Commerce v Chicago, B & Q. R. Co.*, 19 ICC 71, 75.

"The fact that branch lines considered by themselves fail to show large earnings does not justify the charging of unreasonable rates, where the branch lines are operated as part of a great and prosperous system and are feeders to the main line and help to swell the revenue of that line. A part of any great railroad system might be selected and, counting cost of operation and fixed charges, such part be shown to be unprofitable. This, however, would not truly indicate its value and profitability as an integral part of the whole property."

<sup>4</sup> U.S. Supreme Court, *The New England Divisions Case*, 261 US 184, 191:

"Raising joint rates for the benefit of the weak carriers might be the only feasible method of obtaining currently the needed revenues. Local rates might already be so high that a further increase would kill the local traffic. The through joint rates might be so low that they could be raised without proving burdensome. On the other hand the revenues of connecting carriers might be ample; so that any increase of their earnings from joint rates would be unjustifiable. Where the through traffic would, under these circumstances, bear an increase of the joint rates it might be proper to raise them, and give the weak line the whole of the resulting increase in revenue."

to point the way toward the equitable allocation of toll circuit costs in the regulation of rates and the division of revenues.

#### DISPARITIES OF TRENDS

The obvious conclusion is that the allocation of telephone costs is one of the most significant factors affecting not only the rates the public pays for communication services but also the development of the entire communications industry that is required to serve the rapidly growing communication needs in this country.

Experience of the past two decades has proven that the NARUC committee operating arrangements, whereby improvements in cost allocations are recommended only after unanimous acceptance by several groups having widely divergent interests, have not served to promote the effective regulation of telephone rates and divisions of revenues that fall within the responsibility of state and local regulatory authorities. Inasmuch as more than three-fourths of the telephone business is intrastate and these are the services that primarily are being discriminated against by the present allocation procedures, the development of improvements in these procedures should be mainly the concern of state and local regulatory authorities.

The existing wide disparities as well as the divergences in trends between intrastate and interstate telephone rates that have developed over the past two decades are almost entirely the results of the cost allocation procedures that have been followed.

These disparities and divergent trends in rates are unreasonably discriminatory against the public and they are unnecessary. As pointed out in this article, by any reasonable standards of cost allocation about \$400 to \$500 million a year that the public is now paying in intrastate telephone rates as a result of the increases that have been granted since 1946 would have been shown to be necessary in interstate rates instead. Improvements in the allocation procedures are necessary to permit the elimination of these discriminations in rates as well as to correct the related inequities that exist in divisions of revenues.

Equally, if not more, important is the need for improving the cost allocation procedures to permit the orderly development of all communication services. State and local regulatory authorities, by assuring that intrastate telephone operations were carrying no more than their fair share of telephone costs, would encourage the development of the telephone systems within each state. Areas served by independent telephone companies in particular are emerging as potentially the fastest-growing segment of the nationwide telephone system. Equitable cost allocations that would assure independent telephone companies fair divisions of revenues for their participation in the operations of the nation-wide telephone system would automatically stimulate the development of telephone services to the public in these areas.

STATE OF CONNECTICUT,  
PUBLIC UTILITIES COMMISSION,  
*Hartford, Conn., December 4, 1969.*

HON. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce, U.S. Senate,  
Washington, D.C.*

DEAR CHAIRMAN MAGNUSON: This letter is submitted pursuant to the notice of hearing to be held by your Committee at 10:00 A.M. Tuesday, December 9, 1969, to consider (i) the Federal Communications Commission proposed \$237,000,000 negotiated interstate toll rate reduction, and (ii) S. 1917, a bill proposing the Federal-State Communications Joint Board Act of 1969.

Our position with respect to the action of the Federal Communications Commission in approving the \$237,000,000 reduction in interstate toll rates is that such action is detrimental to the interests of the vast majority of "local service" telephone subscribers in that it transfers to them a burden that equity demands should be borne by the relatively small number of patrons who utilize interstate long distance facilities.

To demonstrate the impact of the Federal Communications Commission action on Connecticut ratepayers, we offer the following. This Commission has recently authorized an increase of \$13,157,000 in the rates of the Southern New England Telephone Company. The subsequent action of the Federal Communications Commission transfers to this company an additional revenue requirement of

approximately \$2,000,000 per annum, which will have to be made up by the "local service" ratepayers.

This Commission is of the opinion that this arbitrary reduction of interstate tolls by the Federal Communications Commission, if not modified, will have the effect of reversing in part the results of many years of effort to establish fair and equitable separations precedures and eliminate the existing burdensome disparity between interstate and intrastate toll rates. In order to safeguard the interests of the "local service" customers in the future, we believe it is imperative that the State Commissions be adequately represented in the 7-member regulatory board proposed by S. 1917, which will make the determinations as to adoption of or amendment to new or existing separations precedures.

The Connecticut Commission urges your Committee to accept and adopt the course of action presented by Francis Pearson, President of the National Association of Regulatory Utility Commissioners, in his letter of November 8, 1969.

Sincerely,

EUGENE S. LOUGHLIN, *Chairman.*

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STATEMENT OF GEORGE A. AVERY, CHAIRMAN, D.C. PUBLIC SERVICE COMMISSION ON S. 1917

The Public Service Commission of the District of Columbia joins with the other state commissions in protesting the action of the Federal Communications Commission in reducing interstate rates of the American Telephone and Telegraph Company at a time when subsidiaries of that same company are seeking increases in local rates. As an alternative to rate reductions, the FCC should have considered changes in separations procedures which would have shifted additional plant and expenses to the interstate category, thus relieving at least a portion of the pressure on the states for increases in local rates.

At the request of the Honorable Francis Pearson of the Washington Utilities and Transportation Commission, president of the National Association of Regulatory Utility Commissioners, we have prepared information concerning our most recent telephone rate order, the current status of telephone rate proceedings, and the estimated effect upon current separations procedures of the FCC's reduction in interstate toll rates. That information is as follows:

1. *The most recent telephone rate order of the District of Columbia Public Service Commission.*—By Order No. 4887 dated December 22, 1964, as amended by Order No. 4899 dated February 18, 1965, The Chesapeake and Potomac Telephone Company was allowed a rate of return of 6.25% and an increase in gross operating revenues of \$2,346,900.

2. *The current telephone rate proceeding.*—On November 8, 1968, The Chesapeake and Potomac Telephone Company filed an application seeking a further increase in rates. The Company is contending that it requires an 8½% rate of return. Based upon its test year figures, such a return would require an increase in gross operating revenues of \$13,282,000. The case has progressed through the presentation of direct testimony of the Company witnesses and we are nearing the end of the cross-examination of those witnesses. There still remains the direct and cross-examination of staff and intervenor witnesses, company rebuttal, and post-hearing briefs.

3. *Estimated effect of the reduction in interstate toll rates on current separations precedures.*—If the reduction in interstate rates becomes effective, past experience indicates that it will increase toll usage in relation to the local usage. At some future time, as such a pattern became apparent, a greater portion of the plant and expenses would be allocated to the interstate category. The timing and the amount of this shift in the rate base and expenses would depend upon the stimulation effect of the new toll rates. There would likely be no effect upon the issues in the rate case presently before this Commission. If, in lieu of the decrease in interstate rates, separations procedures were changed now so that a greater portion of plant and expenses fell in the interstate category, immediate effect could be given in our current proceeding to such changes.

For instance, the NARUC Communications Subcommittee is currently reviewing separations procedures applicable to local dial switching equipment. The investment in such equipment is currently separated on a dial equipment "minutes of use" theory. The most recent changes in separations, those involving subscriber station plant, changed the separation of subscriber station plant from minutes of use by adding value factors which gave greater weight to the minutes of use for interstate calling.

It is estimated that the change in the allocation of local dial switching equipment costs proposed by the NARUC Subcommittee would, on an overall basis, transfer \$100,000,000 in annual revenue requirements from the states to the interstate jurisdiction.

If the separation of local dial switching equipment could be handled on a basis similar to that which is used for local subscriber station plant, it is our estimate that approximately 15% of C&P's approximately \$70,000,000 investment in local dial switching equipment would be changed from the intrastate to the interstate category. Thus, about \$10,000,000 of plant would be shifted. This alone would eliminate the need for intrastate revenues of between approximately \$1,250,000, at the currently authorized rates, and \$1,700,000, at the new rates sought by C&P.

#### CONCLUSION

It is clear, therefore, that we in the District of Columbia are considering whether local rates should be raised. A change in the separations procedures, such as that currently being considered by the NARUC Staff Subcommittee on Communications, would enable us to reduce by a significant amount, the amount of local revenue which The Chesapeake and Potomac Telephone Company would require. The recent reduction in interstate toll rates, while it would benefit some District customers, would not have the same benefit for all customers as would the opportunity to avoid or reduce an increase in local rates.

FLORIDA PUBLIC SERVICE COMMISSION,  
Tallahassee, December 2, 1969.

Hon. DON FUQUA,  
Congressman, Second District,  
Cannon House Building,  
Washington, D.C.

SIR: The Committee on Commerce of the United States Senate has scheduled a hearing at 10 A.M. on Tuesday, December 9, in Room 5110, New Senate Office Building, Washington, to consider the proposed \$237 million negotiated interstate toll rate reduction of American Telephone and Telegraph Company and S. 1917, a bill proposing the Federal-State Communications Joint Board Act of 1969.

It will be impossible for me or any member of this Commission to attend the hearing because of a heavy schedule of hearings and conferences. Because of this, I have been asked by them to advise you of the Commission's position in regard to both bills.

The enclosed letter sets forth our stand in regard to the proposed interstate toll rate reduction. A copy of the letter, included in a news release, has been mailed to every member of the Florida Legislature. A copy of the letter has been mailed to members of the National Association of Regulatory Commissioners, FCC Commissioners, State Commissions, American Telephone & Telegraph Company and United States Independent Telephone Association.

In regard to S. 1917, the Federal Communications Commission has had a long history in telephone separations of grossly discriminating against the users of local and intrastate service so as to unjustly favor the users of interstate calls. Since the overwhelming majority of calls are of a local or intrastate nature, the FCC's long-standing separations policy does not, in my opinion, benefit the interest of the general public at state level.

We believe that the Joint-Board would give the State Commissions a stronger position protecting the interest of the public at State level and are therefore in full support of the passage of S. 1917.

Your support will be greatly appreciated.

With kind regards, I am

Sincerely,

WILLIAM T. MAYO, *Chairman.*

DECEMBER 1, 1969.

HON. DEAN BURCH,  
*Chairman, Federal Communications Commission,*  
*Washington, D.C.*

DEAR CHAIRMAN BURCH. The Florida Public Service Commission is gravely concerned over the recent action of the Federal Communications Commission with respect to the reduction of interstate toll rates by the Bell System Companies. It seems extremely incongruous to have a *reduction* of a quarter of a billion dollars in interstate toll rates while these very companies have pending before state regulatory agencies applications for *increases* in local exchange rates and intrastate toll rates in excess of a half billion dollars. If present interstate toll rates are producing such excessive earnings it is not difficult to conclude that something is wrong with present separation procedures.

We are not saying that the public is not entitled to the benefit of a reduction in earnings, as contemplated by your recent action. However, we do find it extremely difficult to accept the method employed in passing this benefit on to the public. Such a reduction in revenues would benefit a much larger segment of the telephone using public were it used to reduce the revenue requirements of Bell System Companies with respect to local exchange service. After all, basic exchange service is the backbone of the telephone communications business and without it interstate toll service would be seriously handicapped if not eliminated.

In all sincerity this recent action by the Federal Communications Commission in this matter emphasizes the necessity for a complete reevaluation of separation procedures. This, of course, takes time and the public should not have to await the long drawnout proceedings necessary to come up with a more equitable separation formula. The Federal Communications Commission could, and in our opinion should, rectify this inequitable situation by appropriate allocations of revenues, expenses, and investments, so as to make required reductions in interstate toll revenues available for use by state commissions in adjusting local exchange and intrastate toll rates. This would be consistent with past practices and would give practical recognition to the continuing efforts of your agency and state agencies to hold telephone rates to a reasonable level.

The present situation could well lead to an abandonment of uniform separation procedures which obviously favor interstate operations at the expense of intrastate business.

We respectfully urge your Commission to take appropriate action to rectify the inequities of your recent action in this matter.

Sincerely,

WILLIAM T. MAYO, *Chairman.*

STATEMENT BY BEN T. WIGGINS, VICE CHAIRMAN GEORGIA PUBLIC SERVICE  
 COMMISSION

Mr. Chairman, members of the committee: Your courtesy in permitting this appearance before your committee is sincerely appreciated by members of the Georgia Public Service Commission. We thank you for the opportunity to place into the record of your proceedings this prepared statement. In substance, the statement is intended to reflect the views that we have formed by experience on the urgent need for passage of S-1917, a bill proposing the Federal-State Communications Joint Board Act of 1969. We are hopeful that, as a result of this committee's hearing, that the Federal Communications Commission will reconsider its recent action in the reduction of interstate toll rates which are scheduled to become effective on January 1, 1970.

We are also hopeful that the information that we have endeavored to furnish will be helpful to this committee in its deliberations.

My name is Ben T. Wiggins and I reside in Atlanta, Georgia and have been a member of the Georgia Public Service Commission since 1957. Appearing with me today is my distinguished colleague and the former Chairman of our Commission, Mr. Walter R. McDonald, who has served as a member of the Commission since 1923.

The Commerce Clause of our Constitution is a common bond which has welded the United States into a great nation. At the same time, it has probably provoked as many differences of opinion between the states and the federal government as any other provision of that great document. The tremendous expansion in the activities of federal government agencies during the past decade has increased the frequency of these controversies and the magnitude of their impact on state regulation. In the area of telecommunications, the most important area of discussion between the state and federal regulatory agencies has been the separation of telephone property and expenses between state and federal jurisdictions. Telephone companies' operations (exchange and state toll services) are regulated by the State Public Service Commissions while their interstate toll services are regulated by the Federal Communications Commission. Since every telephone, every line to your telephone central office, much of the central office switching equipment and even some of the long distance toll lines can be used in common for both state and interstate services, an allocation of their costs "is essential to the appropriate recognition of the competent governmental authority in each field of regulation." (US Supreme Court (282 US 133) (1930).)

The Georgia Public Service Commission recognizes and respects the jurisdictional authority of the Federal Communications Commission over interstate long distance telephone rates, and we further feel that fair and effective regulation of telephone services can be accomplished only in an atmosphere of cooperation and trust among the various jurisdictions. The legal evidence of jurisdictional lines does not alter the fact that the state and federal commissions represent the same people. The person who makes the local exchange call or intrastate toll call is the same person placing the interstate toll call. Most of the plant and facilities involved in all three calls are one and the same, and are physically inseparable, and therefore are also our interest and responsibilities.

Regulations of the telecommunications industry is a complex matter involving the balancing of many factors. Most of these involve matters which are poorly located or are statewide in nature and they continue to be handled with fairness and dispatch by the state commissions. Our principal concern is service to the customer as desired and the rates which are fair to all classes of telecommunication users. The Georgia Public Service Commission believes that telecommunication regulatory problems that are of mutual concern to the respective state and federal regulatory commissions can and should be resolved by thorough joint cooperative state and federal action. It does not appear that such cooperation is being sincerely extended to the states at present.

Over the last 20 years, many constructive changes have been made in separations procedures but these revisions have historically been the result of the cooperative efforts involving the Federal Communications Commission, the state commissions through the NARUC and its committees, and the telecommunications industry. However, in its July 5, 1967 order in Phase 1A of Docket 16258, the Federal Communications Commission appeared to do a complete about face and assumed the role of final, if not sole arbitrator, on separation methods.

The Georgia Public Service Commission has not concluded any major Bell or Independent Telephone rate proceedings since 1962 because none was filed until the first quarter of 1969. The Commission now has pending a General Telephone Company rate increase application which totaled some \$4,500,000 and a Bell rate increase application of some \$29,750,000.

This Commission has representation on the important NARUC Committee on Communications, which Committee has worked untiringly for many years in the interest of all the states for the purpose of obtaining more realistic and equitable separations procedures that would result in more revenue requirements being placed on interstate facilities, thus eliminating the necessity for such large rate increases now being requested on local exchange and interstate toll service. Further, this Commission on November 26, 1969, wrote the Chairman of the Federal Communications Commission expressing our disapproval of the interstate toll rate reduction that is scheduled for January 1, 1970 and calling attention to the adverse effect this will have on intrastate telephone service in Georgia, not only on the some million Bell subscribers, but the quarter million subscribers served by the Independent Telephone Companies in Georgia. This letter also requested reconsideration of this reduction of interstate toll rates by the Federal Communications Commission.

Attached hereto as Appendix I is a schedule showing the effect of separations changes from 1962 to the present time that have benefitted the State of Georgia. It is noted that since 1962, \$5,810,760 in revenue requirements have been transferred to interstate and Georgia has passed these benefits on to its subscribers in the amount of \$3,474,000. The difference is now pending in rate proceedings currently being considered by the Commission. Had the revenue requirements been larger on the interstate portion, the impact of increases on intrastate service of course would have been much less on the Georgia ratepayers.

The Georgia Public Service Commission believes that there is a real need for continued Federal Communications Commission-NARUC cooperation in separations. However, the Federal Communications Commission with regulatory jurisdiction over only 25% of telephone service cannot be permitted to make decisions for the other 75% of telephone service under state regulatory jurisdictions. Therefore, separations procedures should be defined by statute and we respectfully urge your favorable consideration of S-1917.

Respectfully submitted,

BEN T. WIGGINS, *Vice Chairman.*

APPENDIX I

EFFECT OF SEPARATIONS CHANGES FROM 1962 TO PRESENT—GEORGIA

Nature of change	Month plan made effective	Estimated increase in interstate revenue requirements	Rate decreases (intrastate toll)
Simplification of procedures.....	January 1962.....	\$940,760	<sup>1</sup> \$973,000
Denver plan.....	November 1965.....	<sup>2</sup> 1,310,000	<sup>3</sup> 1,323,000
Interim plan (FCC, July 5th).....	December 1967.....	610,000	<sup>4</sup> 1,178,000
		490,000	
FCC, January 29th.....	January 1969.....	1,100,000	( <sup>5</sup> )
NARUC suggested changes.....	January 1970.....	1,670,000	( <sup>5</sup> )
		790,000	
Total.....		5,810,760	3,474,000

<sup>1</sup> May 14, 1962.

<sup>2</sup> April 1966 review increased this amount by \$610,000 additional.

<sup>3</sup> Apr. 1, 1966.

<sup>4</sup> Feb. 1, 1968.

<sup>5</sup> Pending.

IDAHO PUBLIC UTILITIES COMMISSION,  
*Boise, Idaho, December 9, 1969.*

Re Congressional hearing involving telephone separations.

HON. WARREN G. MAGNUSON,

*Chairman, Committee on Commerce, U.S. Senate, Senate Office Building, Washington, D.C.*

DEAR MR. CHAIRMAN: These statements will be offered for insertion in the record.

The recent action of the Federal Communications Commission in negotiating interstate toll reductions with the American Telephone & Telegraph Company has fanned a smoldering controversy into a raging conflagration.

The FCC and the state regulatory commissions have been using the tactics of gentlemen in arriving at the disposition of excess earnings from the interstate operations. Some of the benefits of past negotiations have accrued to the states and the FCC in analyzing the disposition of these funds by the states have concentrated on whether these funds were used for rate reductions or have eliminated the disparity between interstate toll calls and intrastate toll calls. This present controversy should bring into focus the entire needs of the telephone users in the United States. The quality of the service is now at issue just as the total quality of environment is now at issue.

The FCC and the AT&T are performing a ritualistic economic dance while the state commissions deal with the actual American consumer. This is the consumer who is on an 8 or 10-party line and who is demanding better service. This is also the individual who receives no service and wonders why. He can also be described

as the individual who would like to call his doctor, his school, or his local government officials without a toll charge. Succinctly he would like to share in the communications revolution. He could care less about the data processing transmission, 10¢ toll calls after midnight or any other exotic offer.

This can be illustrated by an actual dialogue communicated at an Idaho Commission hearing where extended area service was being offered between adjacent communities. This lady was on a 10-party line and stated that she was not interested in extended area service, she wanted service period. Her best friend's home was visible from her kitchen window and they enjoyed communicating with each other on mutual problems. She told the Commission that she was unable to use the phone but she had a "Tom Cat" upon which she could tie a note to his collar and this "Tom Cat" would carry the note to her neighbor. The "Tom Cat" had now died and she wished telephone service.

We in Idaho have used the financial benefits from former AT&T-FCC negotiations for service improvements. The local AT&T subsidiary, Mountain Bell, is just completing a rural improvement program that has made possible 4-party service to all of its rural customers. This has been accomplished without increasing rates to these individuals.

I might illustrate some of the actual problems that occur within the State of Idaho. On a very recent survey there are still 8,691 telephone users on more than 4-party lines. This number only represents the regulated telephone companies within the state and does not include the rural cooperatives. There are undetermined but significant numbers of people who live in isolated areas that do not have service of any kind.

We respectfully call to your attention the communication requirements of the rural population. The farmer is a businessman who in many instances requires better telephone service since the very success of his operation is his ability to communicate to his market.

The last point I would like to make is that many of the independent companies have not been able to improve service as the costs are so large that the monthly station charges cannot support the required investment.

We urgently request that some forum be established to evaluate the total service requirements of all telephone users.

Sincerely,

RALPH H. WICKBERG, *President.*

STATE OF ILLINOIS, HOUSE OF REPRESENTATIVES,  
RURAL TELEPHONE STUDY COMMITTEE,  
December 4, 1969.

HON. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,*  
*U.S. Senate,*  
*Washington, D.C.*

DEAR SENATOR: We, as members of the House Rural Telephone Service Committee of the State of Illinois, are writing to recommend to you a course of action in regard to the proposed F.C.C. increase in intra-State telephone rates.

The residents of Illinois have a deep concern over the quality and cost of intra-State Telephone Service and feel strongly about any possible rate increase.

The action taken in the F.C.C. order of January 29, 1969 in regard to the separation and allocation of costs is against the best interest of the citizens of the State of Illinois. In short, Illinois citizens don't want the costs of inter-State telephone service to be borne by intra-State telephone use.

We urge you to adopt the provisions of Senate Bill 1917 proposing the Federal-State Communication Joint Board Act of 1969. This Act would permit both State and Federal regulations to work together in allocating costs between State and local service. We also wish you to know that we emphatically support Mr. David H. Armstrong, Chairman of the Illinois Commerce Commission in his testimony before your Committee.

This trend of intra-State users supporting intra-State service must be halted.

Sincerely,

BEN C. HARPSTRITE,  
*Chairman, House Rural Telephone Committee.*

## STATEMENT OF CHAIRMAN DAVID H. ARMSTRONG, ILLINOIS COMMERCE COMMISSION

Chairman Magnuson, Members of the Senate Commerce Committee: I wish to acknowledge my deep appreciation to you gentlemen in allowing me to make this presentation to your committee.

We, the Illinois Commerce Commission, are vitally concerned with the ever increasing problem of Federal and State jurisdiction. Regulation by the Federal Communications Commission does have a most serious effect on the regulation on a state level. The residents in the State of Illinois have a deep concern over the reduction of interstate message toll service on a federal level, while the companies within our state are seeking substantial local rate increases. Thus the F.C.C.'s action against A.T.&T. requiring a reduction of interstate telephone rates by \$150 million is most serious to the telephone users in our state. The further reduction in interstate message toll rates in the amount of \$87 million being contemplated by the F.C.C., if permitted to go in effect, will bring further problems to our Commission.

The January 29, 1969 order of the F.C.C. in Docket Case 17975 concerning procedures of separating and allocating plant investment, etc. between intrastate and interstate operation of telephone companies, had a very negative result in relation to the State of Illinois. While many states gained substantially from that new separation procedure, Illinois' allocation was greatest in a negative direction. Thus I feel that it is most imperative that the separation procedures prescribed in the F.C.C. order of January 29, 1969, must be modified by changes in methodology of computing certain factors therein, so as to give greater weighting of plant cost and expenses to the interstate operations.

The present separations procedures are now fixed by the F.C.C. order of January 29, 1969, while the majority of the plant and expenses are subject to intrastate jurisdiction. I urge your prompt adoption of Senate Bill 1917 proposing the Federal-State Communication Joint Board Act of 1969. This Act would permit state and federal regulators to cooperate more closely with the matter of separations between federal and state jurisdiction. We, the state regulators, would learn the problems of the federal regulators while the federal regulators could be given firsthand information concerning our problems on the state level. Thus, I again urge support of Senate Bill 1917, which I believe would prove a fair and equitable approval to the problem of great magnitude.

DAVID H. ARMSTRONG,  
*Chairman, Illinois Commerce Commission.*

IOWA COMMERCE COMMISSION,  
*Des Moines, Iowa, November 19, 1969.*

HON. DEAN BURCH,  
*Chairman, Federal Communications Commission,*  
*Washington, D.C.*

DEAR CHAIRMAN BURCH: The Iowa State Commerce Commission respectfully protests the action of your Commission in the proposed \$150 million reduction in interstate revenues of American Telephone and Telegraph Company. We must adopt the statements previously made by Ben T. Wiggins of the Georgia Public Service Commission. The state of Iowa presently is faced with general rate increases by three independent telephone companies totalling proposed increased revenues in excess of \$900,000. To allow this proposed reduction is to further increase the disparity existing between the cost of interstate and intrastate telephone service. We urge the Federal Communications Commission to reconsider its action and to amend its order so that the states may obtain rate relief where it is most urgently needed.

We would also at this time urge the Federal Communications Commission to support Senate Bill S-1917 which would create a federal-state joint board to deal with separations procedures. The creation of such a board would allow the several states to have an effective voice in prescribing the separation procedures which have such a great impact upon intrastate revenues.

Yours truly,

FRANK B. MEANS, *Chairman.*

## STATEMENT BY THE STATE CORPORATION COMMISSION OF KANSAS

Honorable Chairman and Distinguished Members of the Committee: The State Corporation Commission of the State of Kansas respectfully thanks this the Committee on Commerce of the United States Senate for these timely hearings on this most vital matter regarding Senate Bill 1917 and on the effects of telephone separations as prescribed by the Federal Communications Commission.

Time does not permit a full discussion of what we believe to be arbitrary and irresponsible decisions rendered by the Federal Communications Commission with little or no regard for the effects on each individual state. The Kansas effect, as a result of F.C.C.'s separations decision, would be to create an additional revenue requirement for Southwestern Bell Telephone Company in the amount of \$190,680 which would have to be transferred to the local ratepayer of Kansas.

Southwestern Bell Telephone Company, on its Kansas jurisdictional operations for the calendar year 1968 on a net original cost rate base of \$327,890,020, prior to any adjustments, earned a rate of return of 7.40%. When these earnings were adjusted for known changes, such as wage increases, ad valorem taxes, results of F.C.C.'s separations formula, Southwestern Bell Telephone Company's projected rate of return for 1969 was determined to be 6.18% rate of return. This necessitated the Commission's permitting Southwestern Bell Telephone Company to put into effect increased charges for non-recurring services which were estimated to increase revenue by \$900,000 and the rate of return was estimated to be less than 7%.

The most recent decision of the Federal Communications Commission to reduce interstate telephone rates creates a disastrous shift in revenue requirements in the amount of \$2,638,000, with which again the local ratepayer of necessity must be burdened.

The effects of these most unfortunate decisions by the Federal Communications Commission shift from interstate revenue requirements to the local ratepayer \$2,828,680 in Southwestern Bell Telephone Company alone. Our 64 independent telephone companies, as a result of the decrease in interstate toll rates, will be affected by approximately \$1,200,000, making a total of approximately \$4,028,680 that must be supplied by additional local rates. This would require a very substantial rate increase on monthly rates of local telephone users by the State of Kansas to pick up the loss of funds brought about by the F.C.C. alleged rate decrease.

We urge this Committee to suggest to the Federal Communications Commission that it is believed to be to the public interest to reconsider the reduction in interstate toll rates and urgently recommend to this Committee the passage of Senate Bill 1917 establishing a Federal-State Communications Joint Board.

I wish to again thank the Committee for taking time out of their extremely busy important schedule to listen to the presentations of this very grave matter.

DALE E. SAFFELS,

*Chairman.*

JULES V. DOTY,

*Commissioner.*

JOHN W. CUNNINGHAM,

*Commissioner.*

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COMMONWEALTH OF KENTUCKY,  
PUBLIC SERVICE COMMISSION,  
Frankfort, Ky., December 5, 1969.

To: HON. WARREN G. MAGNUSON, *Chairman, Committee on Commerce.*

From: The Kentucky Public Service Commission.

Subject: Congressional hearings—telephone separations.

The operation of the total telephone industry within the United States or for that matter the entire world is unique in that all telephones are connected through a switch network irrespective of company ownership or regulatory commissions. This being true the regulation of this total telephone industry ought to be and must be through necessity a cooperative effort between the several jurisdictions involved, more particularly with respect to the State and Federal relationship.

On November 5, 1969 the Federal Communications Commission (FCC) released a public notice stating that the American Telephone and Telegraph Company

was submitting to the FCC proposed rate reductions for interstate message toll telephone service totaling approximately \$237,000,000. These reductions to become effective January 1, 1970. Concurrent with this interstate reduction there are rate increase requests before some fifteen or sixteen states in which the Bell system operates. These increases total some \$500,000,000 and as all of us well know is just the start of a round of rate increases which will effect all states.

The fact that the interstate rates are being reduced and the intrastate rates facing possible increases of untold millions points up the fact that something is patently wrong. This Commission believes it to be the inequitable allocation of costs between state and interstate operations brought about by the unfair separation procedures in effect at the present time.

This Commission is a member of the National Association of Regulatory Commissions (NARUC), an organization of state and federal agencies engaged in the regulations of public utilities. Appropriate committees of this body have worked jointly with the FCC and the telephone industry in an effort to formulate fair and equitable separation procedures. In fact these committees were so engaged at the very time the FCC announcement was made. NARUC through the years has urged the FCC by modification procedures to increase revenue requirements applicable to interstate operations thereby reducing that necessary to sustain intrastate telephone service. Under these circumstances we believe that the FCC acted prematurely and unreasonably in requiring interstate rates to be reduced at a time when many state regulatory commissions are confronted with telephone rate increases. Modified allocation procedures urged by the NARUC and wholeheartedly supported by the Public Service Commission of Kentucky would have an affirmative impact on the rate structures of the several state jurisdictions who regulate the major portion of the industry.

Accordingly we urge the Committee on Commerce (Interstate and Foreign Commerce) to thoroughly investigate this action of the Federal Communications Commission.

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STATE OF LOUISIANA,  
LOUISIANA PUBLIC SERVICE COMMISSION,  
*Baton Rouge, December 8, 1969.*

HON. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,  
U.S. Senate,  
Washington, D.C.*

DEAR CHAIRMAN MAGNUSON: The State of Louisiana and the Louisiana Public Service Commission are deeply concerned over the continuing inequities in separations procedures applied to telephone utilities throughout the United States, whose preservation and worsening effect are the result of domination of decision-making in this field by the Federal Communications Commission.

In this period of rising costs and other factors which inevitably force upward the cost of local telephone service, the crushing burden on the local consuming public represented by arbitrary and unfair weighting of costs against local services, represents a serious threat to grass roots economy, while further favoring the already advantaged and more prospering interstate business. We in Louisiana have no confidence in the attainment of equity in this area of sad experience through the Federal Power Commission.

With further telephone rate increases about to be sought, Louisiana consumers are feeling the urgent demands of telephone utilities, from the smaller, such as Central Louisiana Telephone Company, Inc., which on June 24, 1969, secured increased gross revenues of \$91,000.00 annually in Louisiana Public Service Commission Docket No. 10315, to the Louisiana Bell Company, South Central Bell Telephone Company, which in Docket No. 10382 is pressing for revenue increases exceeding \$24,000,000.00 annually, and urging \$17,000,000.00 annual increase at once on an interim basis, in default of which the telephone construction program in Louisiana will be severely curtailed.

Equitable treatment of the local telephone consumers was never more needed, nor more endangered by the Federal Power Commission proposal to reduce interstate tolls rates by \$237,000,000.00 annually in January.

We respectfully urge your distinguished Committee on Commerce of the United States Senate to intercede in the interests of justice, and accord to the local service operation recognition of the clearly vital part it plays in the generation and conduct of interstate telephone business, and the need for its economic preservation by according no more and no less than fair play in the public interest.

With best wishes, we are

NAT B. KNIGHT, Jr., *Chairman.*

STATEMENT OF JOHN G. FEEHAN, CHAIRMAN, MAINE PUBLIC UTILITIES  
COMMISSION

Mr. Chairman and Members of the Committee: I am grateful for the opportunity to express my views on the matters in hearing this morning.

I fully concur with the position taken by the National Association of Regulatory Utility Commissioners through its President and its Communications Committee, and I would like to briefly indicate a few reasons in support of this position.

Separations, like any other allocation procedure, is not an exact science and the validity of any such procedure can be measured only by the reasonableness of the end result that it produces. Let us look at these results in the State of Maine.

Maine is a State having an area of 32,000 square miles with a population of less than a million people. These people receive service from twenty-six telephone companies having some 420 thousand telephones. From these stations this year more than 35 million toll messages will be originated—with about 72% of them being of an intrastate nature and terminating within the State over routes of 389 miles or less.

Because Maine lies at one end point of our National telephone system, calls originating near our northernmost boundary, that are directed toward the south, must traverse essentially the same cable or microwave routes regardless of their ultimate destination. This fact prompts subscribers to inquire, "Why does it cost forty-five cents to call Kittery, Maine at night when I can call California for fifty-five cents more?" Our answer, of course, must be that this comes about through separations with rates being set on the basis of cost and volumes of traffic. The subscriber's reply is, "But both calls use the same route as far as Kittery, and are you telling me that fifty-five cents covers the cost of providing the remaining 3000 mile route from Maine to California?" Again, I must explain that through separations procedures, these costs are based on fair and objective allocations. The subscriber's final parting remark is, "Separations or not, this just isn't reasonable." To this answer I can find no meaningful reply.

The fact of the matter is that the situation is becoming progressively worse. For example, to have eliminated all disparity between intra and interstate toll schedules in Maine in 1967 would have cost \$1.8 million in revenues and today the figure is in excess of \$2.1 million, and I might add that during this same period, substantially all of the dollars gained through separation changes were used in reducing this disparity.

In the November 5th F.C.C. Public Notices, it is stated that growth in interstate traffic is continuing unabated and earnings of the A.T. & T. Company have consistently grown despite the increase in costs due to the inflationary spiral. The facts set forth in that release trouble me to the point of asking why, with the same phenomenal growth on the intrastate side and with the same inflationary effect, why it was necessary for the New England Telephone Company, a Bell system subsidiary, to seek rate relief before the Maine Commission last week? A prime answer lies with our present separations procedures and under such procedures with further interstate rate reductions, the present trend will continue.

The large number of local exchange subscribers who are essentially non-interstate toll users must have relief, and I submit that enactment of S. 1917 holds great promise toward that end.

## STATEMENT OF THE MARYLAND PUBLIC SERVICE COMMISSION, BALTIMORE, MD.

My name is William O. Doub and I am Chairman of the Maryland Public Service Commission. I speak for myself and Commissioner Edmondson and Commissioner Shoemaker and in the interest of all telephone users in the State of Maryland.

Maryland is one of the many states that was adversely affected by the separation procedures promulgated by the Federal Communications Commission on January 29, 1969, by order in Docket No. 17975. While the order of FCC did effect a shift of revenue requirements from state to interstate on a national basis in the approximate amount of 107 million dollars, many states, and Maryland was one, suffered a reversal. Of the 107 million shift to interstate 3 states received 55 million, or 51% of the benefits; 62% of the benefits was appropriated to 5 states; and over 84 million, or 78%, was appropriated to 10 states. Of the re-

maining 39 states, including the District of Columbia, 29 received minor amounts of benefits, while 10 states, and Maryland was one, received negative amounts. It should be apparent that an order which allots 78% of the benefits to 10 states, and penalizes 10 other states at the opposite end of the spectrum, can not be equitable. The FCC considered the national effect without proper consideration of the fact that the many states differ widely in many ways, because of relative size, location, population, degree of industrialization, and geographical peculiarities.

Since 1947, when the Separation Manual was formulated, there have been several modifications which effected relatively minor shifts of revenue requirements from state to interstate. Each came about after compelling action by the NARUC.

Over this same period there was one increase by FCC of interstate rates in 1953, followed by four successive reductions. While this spiral of increasing profits from interstate operations has continued, the states have been faced with a succession of rate cases for increases in local, or intrastate rates. In Maryland during this same period we have had 10 major rate cases resulting in revenue increase of more than \$46,400,000, priced at date of inception. In 1965 we reduced rates by \$2,800,000, as the result of the last modification of the manual, the Denver Plan. Those benefits were wiped out by the January 29 order.

On September 18, 1969, the president of the NARUC wrote to the FCC calling attention to the pending state rate cases and soliciting the cooperation of the FCC. On November 5, 1969, the FCC announced that it was reducing interstate rates in the amount of \$237,000,000, despite the sixteen pending state rate cases aggregating more than \$600,000,000 in intrastate rate increases. This is the largest interstate rate reduction in the history of the Bell System. Maryland was one of the states in which applications for rate increases had been filed and we had completed extensive hearings involving revenue increases in the magnitude of \$33,000,000.

In conclusion we would like to say that the order of the FCC can not but have the effect of causing further pressures upon the regulatory bodies of the several states for rate increases for intrastate service. It should be obvious to everyone that subscribers to local service are generally less able to pay for such service than are those using interstate, or long-distance service.

Thank you for your consideration.

STATE OF MICHIGAN,  
DEPARTMENT OF COMMERCE,  
*Lansing, Michigan, November 17, 1969.*

HON. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,  
U.S. Senate,  
Washington, D.C.*

DEAR CHAIRMAN MAGNUSON: A serious problem for telephone users and for state public utility regulatory agencies has arisen because of the recent action of the Federal Communications Commission announcing a reduction in interstate telephone toll rates of more than \$237 million annually which is scheduled to become effective January 1, 1970.

The result of the action of FCC is to reduce charges for interstate toll calls, which are to some degree discretionary to the typical telephone user and are frequently of a business-oriented nature, and to increase charges for the more basic and more essential local exchange telephone service. Such action by FCC will result in increasing the already significant disparity between interstate and intrastate toll rates. This has been a major source of misunderstanding and dissatisfaction for telephone users for many years.

The key to the problem is the separation or allocation of operating expenses and plant investment between interstate and intrastate service. It is difficult to understand how FCC concluded that interstate earnings are excessive by more than \$237 per year at the same time Bell System operating companies are requesting from state regulatory commissions rate increases on intrastate service aggregating several hundred million dollars. This is a significant problem in Michigan because Michigan Bell Telephone Company has applied for an intrastate rate increase of about \$60,000,000 annually, and hearings on the application are currently in progress.

Because of the importance of this situation, we urge you to consider promptly S. 1917 which was introduced recently at the suggestion of the National Association of Regulatory Utility Commissioners. This bill is generally known as the Federal-State Communications Joint Board Act. The purpose of the bill is to attempt to avoid difficulties of the kind outlined above by having a board, composed both of members of the FCC and state regulatory agencies, consider and adopt jointly standard separation procedures. This procedure would assure that the telephone companies and both interstate and intrastate telephone users would receive consistent and equitable treatment.

In addition, it seems to us appropriate to ask that your committee undertake an investigation of the recent FCC action to determine whether or not it is reasonable in view of the present conflicting rate trends in the industry. Such action by your committee appears essential since the background upon which the FCC reached its decision is not a matter of public record but was developed in ex parte discussions between the FCC and the Bell System.

Sincerely,

WILLIS F. WARD, *Chairman.*

ST. PAUL., MINN., December 8, 1969.

PAUL RODGERS,  
*General Counsel, NARUC,  
Interstate Commerce Commission,  
Washington, D.C.:*

Minnesota Public Service Commission requests that your committee urge Federal Communications Commission reconsideration of proposed \$237 million interstate toll rate reduction and its effect on local telephone rates which will be increased in Minnesota and other States contrary to the public interest if such reduction is sustained. Our Commission also strongly supports passage of S. 1917 and respectfully requests that this telegram be made part of the record in the hearing of December 9, 1969.

LEO J. AMBROSE, *Secretary.*

MISSISSIPPI PUBLIC SERVICE COMMISSION,  
STATE OFFICE BUILDING,  
*Jackson, Miss., November 13, 1969.*

HON. JAMES O. EASTLAND,  
*U.S. Senator,  
Senate Office Building,  
Washington, D.C.*

DEAR SENATOR: The Mississippi Public Service Commission along with every other state regulatory commission in these United States, to the best of my knowledge, is very upset concerning the recent proposed 150 million dollar interstate telephone rate reduction announced by the Federal Communications Commission.

For your information, I am enclosing a short news release that I think very well describes our reason for objecting.

My purpose in writing you is to call your attention to two bills that have been introduced—HR 12150 and S 1917—concerning this matter. It is my belief that these companion bills will help to alleviate our intrastate telephone rate problem. I am not necessarily glued to the proposition set out in these bills and if you have a better idea in mind, I certainly would go along with it. There is going to have to be some national legislation along the lines set out in these bills for us to ever have any intrastate telephone rate relief.

I would appreciate very much your reviewing this problem or having someone on your staff to do so in hopes that you can be of assistance to us.

This is a matter that I am very familiar with since I have for several years served as a member of the National Association Communications Committee. I earnestly solicit your assistance and if I can furnish you with additional information, I certainly would be pleased to do so.

Thanking you for your advice and counsel, I am

Respectfully yours,

NORMAN A. JOHNSON, JR.,  
*Chairman, Mississippi Public Service Commission, First District.*

Enclosure.

TESTIMONY OF NORMAN A. JOHNSON, JR., CHAIRMAN, MISSISSIPPI PUBLIC SERVICE COMMISSION

RESOLUTION

At a regular meeting duly called and attended by all members of the Mississippi Public Service Commission, on the 12th day of November, 1969, at Jackson, Mississippi, the following Resolution was unanimously adopted:

Whereas the Federal Communications Commission exercises general regulatory jurisdiction over the rates and services of interstate telephone companies; and

Whereas the regulatory authorities of the several states exercise general regulatory jurisdiction over the rates and services of intrastate telephone companies; and

Whereas the Mississippi Public Service Commission exists under and by virtue of the Laws of the State of Mississippi and is the state regulatory agency having jurisdiction over intrastate rates and services of telephone companies; and

Whereas the Mississippi Public Service Commission represents the people of Mississippi who are adversely affected by disparity between interstate and intrastate rates and charges; and

Whereas there does exist an unjust disparity between interstate toll rates and intrastate toll rates charged by the companies which in many instances cause the intrastate toll rates to be substantially higher than the interstate toll rates over the same lines, although for a longer distance; and

Whereas such an unjust disparity in toll rates has caused confusion and misunderstanding in the minds of the customers of such companies and has created a difficult situation for the regulatory authorities of the several states; and

Whereas the Federal Communications Commission on November 5, 1969, announced that rates for interstate long distance calls would be reduced about \$150,000,000 per year; and

Whereas there are intrastate rate cases pending in at least sixteen states amounting to an increase of one-half billion dollars; and

Whereas if this rate reduction by the Federal Communications Commission is allowed that it would be a serious detriment to the state and local commissions and the users of local telephone service: Now, therefore, be it

*Resolved by the Mississippi Public Service Commission*, That it urgently requests the Federal Communications Commission to reconsider its decision to reduce interstate toll rates of the telephone company \$150,000,000 and to work with the State Commissions in adopting realistic separation procedures and be it further

*Resolved*, That Congress pass immediately the bill proposing the Federal-State Communication Joint Board Act of 1969, which has been introduced in the House as *H.R. 12150*, and in the Senate as *S. 1917*; and be it further

*Resolved*, That a copy of this Resolution be sent to Senator James O. Eastland, Senator John Stennis, Representative Thomas G. Abernathy, Representative Jamie L. Whitten, Representative William M. Colmer, Representative G. V. Montgomery, Representative Charles Griffin, Mr. Peter Flanigan, Assistant to the President of the United States, Mr. Francis Pearson, President, National Association of Regulatory Utility Commissioners, and National Association of Regulatory Utility Commissioners.

Made and entered at Jackson, Mississippi, this 12th day of November, 1969.

NORMAN A. JOHNSON, JR.,

*Chairman.*

D. W. SNYDER,

*Commissioner.*

W. E. "BUCKY" MOORE,

*Commissioner.*

Attest:

E. W. ROBINSON,  
*Executive Secretary.*

MISSOURI PUBLIC SERVICE COMMISSION,  
Jefferson City, November 28, 1969.

HON. WARREN G. MAGNUSON,  
Committee on Commerce, U.S. Senate,  
Washington, D.C.

DEAR MR. MAGNUSON: Attached please find letter dated November 28, 1969 addressed to Chairman Dean Burch of the Federal Communications Commission, which is self-explanatory.

The Missouri Public Service Commission strongly endorses and supports the position and suggestions presented to you by the Honorable Francis Pearson, President of the NARUC, in his letter of November 8, 1969.

Further, the Missouri Public Service Commission, has urged the Missouri delegation to support this position and has written each congressman and senator concerning the seriousness of the matter.

Sincerely,

WILLIAM R. CLARK, *Chairman.*

MISSOURI PUBLIC SERVICE COMMISSION,  
Jefferson City, November 28, 1969.

HON. DEAN BURCH,  
Chairman, Federal Communications Commission,  
Washington, D.C.

DEAR CHAIRMAN BURCH: The Missouri Public Service Commission urges that the Federal Communications Commission's reduction of the American Telephone and Telegraph Company rates, pursuant to your public notice of November 5, 1969, hold public hearings so as to afford all interested parties an opportunity to make a formal record in this matter.

The Missouri Public Service Commission has been, and will be faced with the problem of revenue requirements of not only the Bell System operating companies, but of the 67 independent operating companies local exchange service rates. It is imperative that the average subscriber to local exchange service be afforded that service at the lowest possible rate, and this Commission is of the opinion that these rates may be held to a minimum through improved or different separations procedures, as has been urged by the National Association of Regulatory Utility Commissioners as late as this fall in Denver, Colorado.

Sincerely,

WILLIAM R. CLARK, *Chairman.*

STATEMENT OF WILLIAM R. CLARK, CHAIRMAN, MISSOURI PUBLIC SERVICE  
COMMISSION

Mr. Chairman, Members of the Commerce Committee: I appreciate the Chairman's invitation to make a statement before this Committee in my capacity as Chairman of the Missouri Public Service Commission, and to concur in the position as stated by the Honorable Francis Pearson, President of the National Association of Regulatory Utility Commissioners. It is indeed gratifying to learn that the Honorable Dean Burch, Chairman of the Federal Communications Commission, has fully concurred in Mr. Pearson's stated objectives. It is my opinion that the law allows a most flexible position in the allocation of costs and that the reasons of reasonable men must be governed by the formulation of judicial separations within the terms of existing economical factors at the time of consideration. It is my opinion that the economical climate of this Country requires a redefining of costs and allocation of property before any further consideration is given to a reduction in interstate toll rates.

The Missouri Public Service Commission has disposed, within the last three years, of telephone rate cases in the aggregate amount of \$31,271,713, and has pending before it for consideration telephone rate cases in the aggregate amount of \$2,124,000. Attached at the conclusion of this statement is Appendix A detailing these cases.

It would appear that policies dictate that interstate toll rates are lower than intrastate toll rates for comparable distances, partly due to differences in costs and partly due to policy of keeping exchange rates as low as possible.

Southwestern Bell Telephone Company in Missouri proved a need for a rate increase which was granted on October 14, 1969, in the amount of \$30,689,409 per year. On November 5, 1969, the American Telephone and Telegraph Company and the Federal Communications Commission announced a rate decrease of about 5 times this amount, which reduction under present economic condi-

tions cannot stand with reason. The Bell system has applications in many other states for increased intrastate rates.

Rates are based upon cost of rendering service plus fair rate of return on investment. Expenses and investment are separated between interstate and intrastate on the basis of separations manuals.

The only conclusion I can draw is that the many reductions over the years in interstate rates while increases have been needed in intrastate rates prove the separation procedures are biased toward the interstate jurisdiction. Over the years there has been at least 5 changes in separation procedures. See Appendix B for the various effects with regard to Missouri. The effect on the different states has varied but nationally the changes have overall transferred property and expenses from intrastate to interstate, except in 1969 with respect to the re-apportionment of the toll line plant. Had the procedures of allocation used in the Modified Phoenix Plan been retained, then the 1969 exception brought about by the Federal Communications Commission Interim Order would not have resulted in a transfer of Missouri revenue requirements to the State rate-payer of over \$6 million. This certainly indicates that the allocation procedures are not satisfactory. Present conditions loudly declare that they are still unsatisfactory because they do not produce reasonable results. Separation procedures are based upon various definitions of use.

Present procedures are based upon use and use studies, however, these results can and have been changed from time to time by changing the period studied of the grouping of items studied, e.g., Charleston Plan lumped several categories of plant into one. Studying the usage of the total gave a different result than studying the individual parts.

Since present separation procedures charge too much cost to intrastate operations and too little cost to interstate operations, the local user pays a higher rate for the benefit of the interstate user. As a large percentage of interstate calls are made by business which gets an income tax deduction for this expense, this situation works to the disadvantage of the residence user.

In the past when the Federal Communications Commission has decided to cut interstate toll rates rather than change separations procedures and benefit intrastate users as well as interstate users, the state commissions have had no voice in the decision. As separation procedures affect both state and federal jurisdictions the state commissions should be given a voice in such decisions.

Note also the complete disregard of "the majority rule"; that the man regulating 25% of the business should have the right to tell the man who regulates 75% of the business how he must determine the cost, revenues, and expenses applicable to his jurisdiction.

If the National Association of Regulatory Utility Commissioner's proposed legislation setting up a joint NARUC-FCC Separations Board had been in effect, the precipitous action taken by the FCC would have not occurred.

I urge the passage of Senate Bill 1917 and a stay of the toll reduction until its passage.

Thank you.

#### APPENDIX A

#### TELEPHONE RATE CASES BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION, DECEMBER 1966 TO DECEMBER 1969 CASES RESOLVED AND INCREASES APPROVED

Case No.	Date approved	Increase	Company
16,184	Dec. 29, 1967	\$43,076	Modern Telephone Co.
16,567	Feb. 14, 1969	1,520	Nodaway Valley Telephone Co.
16,522	Mar. 29, 1969	16,208	Southern Telephone Co.
16,662	Sept. 18, 1969	521,500	Missouri Telephone Co.
16,642	Oct. 14, 1969	30,689,409	Southwestern Bell.
Total		31,271,713	

## CASES PENDING AND INCREASES REQUESTED

Case No.	Date submitted and pending	Request	Company
16,826	Sept. 5, 1969	\$150,000	Missouri Central Telephone Co.
16,827	do	900,000	Missouri State Telephone Co.
Unassigned	Nov. 18, 1969	1,074,000	General Telephone Co.
Total		2,124,000	

Note.—Total, increases approved and requested, \$33,395,713.

## APPENDIX B

## EFFECT ON INTERSTATE REVENUE REQUIREMENT OF CHANGES IN SEPARATIONS SINCE 1947

[In thousands]

Label	Year	Effect at time of change		Current effect, Missouri
		Bell System	Missouri	
Charleston plan	1952	\$30,000	\$644	\$5,050
Modified Phoenix	1956	40,000	1,980	6,930
"Simplifications"	1962	46,000	1,960	3,830
Denver plan	1965	134,000	4,380	5,780
Jan. 29, 1969 order <sup>1</sup>	1969	110,000	250	250
"NARUC proposed"	1970	35,000	1,900	1,900
Total		395,000	10,304	22,930

<sup>1</sup> Interim procedures were introduced in November 1967 which resulted in a transfer of Missouri revenue requirements to interstate of \$940,000. The Jan. 29, 1969 FCC order revised these interim procedures. As a result, the transfer to interstate was reduced to \$250,000 at the end of 1969 when modified Phoenix is completely eliminated. The separation procedures used by SWB for the rate case "test period" understated its intrastate revenue requirements by \$690,000.

## MISSOURI

Net book cost	1952	1969
Assigned interstate	\$28,500,000	\$223,800,000
Total <sup>1</sup>	\$210,600,000	\$883,000,000
Percent assigned interstate	13.5	25.3

<sup>1</sup> Includes all of SWB investment in Missouri (intrastate plus interstate).

BOARD OF RAILROAD COMMISSIONERS,  
OF THE STATE OF MONTANA,  
Helena, November 14, 1969.

Senator MIKE MANSFIELD,  
Senate Office Building,  
Washington, D.C.

DEAR SENATOR MANSFIELD: The Montana Public Service Commission urgently requests your unqualified support for S. 1917 and H.R. 12150.

We are enclosing a copy of a letter recently sent to the Chairman of the FCC, which explains the urgency of obtaining passage of S. 1917 and H.R. 12150.

The passage of S. 1917 and H.R. 12150 could mean a considerable savings in telephone rates to the citizens of Montana.

This latest action of the FCC in reducing interstate long distance rates by \$150,000,000, instead of passing it on to the States, is completely unwarranted and shows no regard for the citizen rate payers of Montana.

We again urge your wholehearted support in obtaining passage of S. 1917 and H.R. 12150.

Sincerely yours,

PAUL T. SMITH,  
Chairman.  
LOUIS G. BOEDECKER,  
Commissioner.  
ERNEST C. STEEL,  
Commissioner.

BOARD OF RAILROAD COMMISSIONERS,  
OF THE STATE OF MONTANA,  
Helena, Mont., December 4, 1969.

Re S. 1917, a bill proposing the Federal State Communications Joint Board Act of 1969.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR MAGNUSON: The Montana Public Service Commission wishes to express its profound and sincere desire to see the passage of S. 1917. This will be the culmination of long and hard fight for equal representation for the States in the determination of the separation factors to be used in determining earnings for the AT&T Company, regulated by the FCC, and in determining the earnings of the subsidiary companies, regulated by the State Commissions.

Theoretically there now exists a cooperative effort to do just this between the States and the FCC. However, without the required representation of the States as provided for in S. 1917, it just does not turn out to be much of a cooperative venture.

The most recent glaring example of that lack of cooperation by the FCC is the unilateral action taken by the FCC in ordering a reduction of \$150,000,000 in interstate rates of the AT&T Company.

This on the face of it appears to be a great saving for all of the telephone rate payers. But is it? The answer is a definite and resounding *No*. How many people in Montana of the lower and middle income groups make calls to New York, Rhode Island, or Florida? Very, very few indeed, and yet this is what they would have to do, if they are to take advantage of this magnimous gesture by the FCC to provide lower interstate rates for him.

The State Representatives on the Joint Board, as provided for by S. 1917, would have advocated an adjustment in the separations procedures so as to allocate a greater portion of the plant and related expenses to interstate operations. This would have the effect of increasing the amount of revenues needed for interstate operations and reducing the amount of revenues needed for intrastate operations. The interstate revenues could remain the same as at present, and the ever increasing demands for intrastate rate increases, by the AT&T subsidiaries, would be slowed by \$150,000,000. The advocating of this procedure is not without its logic. If the revenues of AT&T increase, without any increase in rates, to such an extent that the FCC determines a rate reduction is necessary, it logically follows that there must be a much greater use of the plant by the interstate callers. This is what separations is all about and why the change in allocations of plant between interstate and intrastate operations is the only sensible approach to the disposition of the surplus of revenues accrued by AT&T under FCC jurisdiction.

The rate reduction ordered by the FCC would also reduce the revenues of the independent telephone companies operating in Montana. The Montana Commission is presently faced with rate increase applications from four independent companies and the action of the FCC, if allowed to go through, would compound the problem. We have recently held an increase in rates hearing for the local AT&T subsidiary. Without S. 1917 and a reconsideration of the interstate rate reduction, another will soon be forthcoming.

At the present time you can call, more cheaply, a given number of miles interstate than you can intrastate. The action of the FCC would further increase this disparity.

The reduction of interstate rates ordered by the FCC would be of great benefit to the affluent and corporate telephone users. The only glimmer of hope on the horizon for the lower and middle income class of telephone users, to lower or even keep at the existing level, their contributions to AT&T is S. 1917 and a reconsideration of the recently ordered interstate rate reduction.

We, therefore, respectfully urge you and your committee to recommend passage of S. 1917 and to urge the FCC to reconsider its action in reducing interstate rates by the \$150,000,000, so urgently needed by intrastate ratepayers to just maintain the status quo.

Sincerely yours,

PAUL T. SMITH,  
Chairman.  
LOUIS G. BOEDECKER,  
Commissioner.  
ERNEST C. STEEL,  
Commissioner.

## STATEMENT OF NEBRASKA STATE RAILWAY COMMISSION, LINCOLN, NEBB.

The Nebraska State Railway Commission is a constitutional agency of state government, having jurisdiction, among other things, over regulation of rates, service and exercise of general control over the communications industry rendering intrastate service in the state.

The official records of the Nebraska State Railway Commission reveal that Northwestern Bell Telephone Company is the name under which the American Telephone & Telegraph Company furnishes telephone service in the State of Nebraska. This company is required by law and regulation of the State Railway Commission to file annual reports. In the year 1967 its annual report revealed that the total telephone calls in this state were 687,381,544 and of this total number 13,555,482 or 2% were interstate calls. In the year 1967 Northwestern Bell Telephone Company served approximately 58% of the 767,938 telephones in the state and accounted for 65% of the \$98,454,554 in revenue. In addition to the Northwestern Bell Telephone Company there are 52 independent telephone companies operating under the jurisdiction of the state commission. Based upon the foregoing figure of the Northwestern Bell Telephone Company then it is logical to assume that a considerable number of telephone subscribers make few, if any, interstate toll calls. The separators procedures used, therefore, place an unfair financial burden upon the users of intrastate service and the customer who makes no interstate toll calls is required to pay a portion of the costs of those few customers who make the greatest use of interstate service.

When one federal agency has the sole power to determine the division of the revenues of a telephone company's plant and expenses between interstate and intrastate, then Nebraska, along with other states, has lost effective intrastate jurisdiction, since by merely shifting a greater portion of the revenue requirement to the intrastate side, interstate rates could be reduced and the states would be forced to raise local rates to provide a fair rate of return on the intrastate investment.

In our opinion it appears that it is absolutely necessary to consider the overall system, including the intrastate system, as a factor in determining the rates for interstate calls. For, it is necessary that we no longer consider the volume in dollars and cents as the main factor in determining the rates for interstate because this alone does not show the full picture.

Instead of reducing interstate rates, the same customers who make interstate calls could be benefited by transferring a portion of the revenue requirement to the interstate jurisdiction and thereby permitting a reduction in rates for local exchange service since customers making interstate calls also use local service.

In the last three years Nebraska has approved general rate increases amounting to \$23,697 for four independent telephone companies serving a total of 2,819 telephones. There are no general rate increase cases pending at this time in Nebraska.

The Nebraska State Railway Commission is of the official opinion that the Congress should establish a Joint Board as provided in S. 1917 to deal with separations procedures. This Commission is of the further opinion that the interstate toll reductions in the sum of 237 million dollars authorized by the Federal Communications Commission should be reconsidered in order to avoid inequities.

In witness whereof the undersigned has subscribed his official signature and caused the official seal of the Commission to be affixed hereon.

JOHN W. SWANSON, *Chairman.*

[From the Lincoln Evening Journal and Nebraska State Journal, Thursday, Nov. 20, 1969]

## A LOOK AT A GIFT HORSE

It might seem like looking a gift horse in the mouth, but the protests of the Nebraska State Railway Commission over lower interstate telephone rates are well grounded.

\* \* \*

The Commission is objecting to the recent order of the Federal Communications Commission (FCC) directing the American Telephone & Telegraph Co. to reduce interstate rates by \$150 million effective at the first of the year.

\* \* \*

So why should anyone object to lower long distance phone rates? Because the lower rates for calls out of the state actually will have to be made up by higher charges on calls made within the state, says the Nebraska Commission.

Understanding that, the Commission's protests begin to make sense—and dollars, for that matter. As Chairman John W. Swanson put's it in his letter to the FCC:

"It passes all understanding that your commission could logically reduce interstate rates by \$150 million while requests are pending for approximately \$500 million in intrastate rate increases on the same integrated telephone system."

Swanson made it clear that he was talking about the charges of Northwestern Bell, a part of the AT&T system, within Nebraska.

The proposed reduction really is a "direct transfer of burden from the relatively fewer interstate users to the many millions of subscribers to local telephone service," the letter declared.

\* \* \*

"It could be said that the proposal also is a penalty on the many small businesses in Nebraska, and a deterrent to the economic development of the state, in order to benefit the large national firms which are the chief patrons of interstate telephoning."

STATEMENT OF POSITION OF PUBLIC SERVICE COMMISSION OF NEVADA ON  
RECENTLY ANNOUNCED FCC INTERSTATE TELEPHONE TOLL REDUCTIONS

The State of Nevada finds itself emphatically opposed to further *interstate* rate reductions prior to a thorough evaluation of the effect of additional reductions upon *intrastate* rate structures. In Nevada, our present economic growth and development has largely been confined to two urban areas—Reno and Las Vegas. These two centers have nearly 84% of Nevada's population and they are approximately 350 airline miles apart. The impact of an *interstate* rate structure that is out of balance with *intrastate* rates should be readily apparent.

Although there are no telephone rate cases currently pending before the Nevada Public Service Commission, the last rate case involving Bell of Nevada, which was heard and decided in 1968, offers a dramatic example of the wide disparity between *interstate* and *intrastate* rates which the Nevada Commission had to authorize in view of the wholly inappropriate and FCC-dominated separations procedures then in effect. The Nevada Commission issued its opinion and order in that matter on August 30, 1968, allowing a 6.84% rate of return. At that time, well in advance of the present effort to reduce *interstate* rates by some \$150,000,000 the imbalance between *interstate* and *intrastate* revenues—made mandatory by existing settlement procedures—had already taken effect in Nevada.

Some of the matters that were of concern in the Nevada Commission's consideration of Bell of Nevada's 1968 rate case are as follows:

1. Despite continuing *interstate* toll reductions, the Applicant alleged that its rate of return had fallen to an unprecedented low of 3.44% on *intrastate* operations.

2. The Applicant was faced with a continuing obligation to satisfy the demand for telephone service required by Nevada's phenomenal growth rate.

3. The Applicant presented testimony that the use of telephone facilities had greatly expanded, but the additional usage had *not* generated additional revenue.

In arriving at its decision, the Nevada Public Service Commission made the following observations in the opinion rendered:

"... there is also room for disagreement with respect to the division between intrastate and interstate plant, such division having been predicated by Applicant on the so-called 'separations manual' which deals with telephone plant separations on a national basis. A detailed analysis of the separations procedure applicable to Nevada might very well reflect a disproportionate share of interstate plant and expense charged against Nevada intrastate operations."

"... we will have to rely upon existing procedures contained in the separations manual submitted by Applicant for the purpose of arriving at our ultimate decision herein."

As a result of the 1968 decision, a paradoxical situation has arisen whereby a telephone subscriber can call long distance, station-to-station for 3 minutes, from Reno to Tucson, Arizona, Denver, Colorado, Great Falls, Montana, Albuquerque, New Mexico, Portland, Oregon, Seattle or Spokane, Washington or Wyoming for approximately the same rate to talk to Chicago, Illinois, New Cheyenne, Wyoming for approximately the same amount that it costs to call station-to-station for 3 minutes from Reno to Las Vegas. A Reno subscriber placing a 3-minute person-to-person call pays approximately the same rate to talk to

Chicago, Illinois, New Orleans, Louisiana, Dallas or Houston, Texas or Minneapolis, Minnesota as the rate chargeable for a 3-minute person-to-person call from Reno to Las Vegas. Even more ridiculous is the fact that within a few minutes drive of Nevada's capital city, a 3-minute person-to-person call can be placed *interstate* from a California point to Las Vegas for \$1.25, whereas the same call, made *intrastate* from Carson City to Las Vegas, costs \$2.75.

All of the foregoing long distance toll disparities must already be contended with by Nevada's telephone subscribers. Now comes the FCC's announcement of a \$150,000,000 reduction in interstate tolls as of January 1, 1970, and as a result, such disparities will only be magnified to an intolerable extent. Accordingly, we view the FCC's recent action as completely inexcusable in light of the fact appropriate separations allowing for further transfers of *intrastate* rate base and expense to *interstate* operations would narrow the already existing disparities and give Nevada's *intrastate* telephone users a measure of relief to which they are clearly entitled. The Nevada Public Service Commission has therefore urged the FCC to reconsider the recently announced *interstate* telephone toll reduction, and we earnestly hope more equitable separations procedures will be worked out with the states in the immediate future pursuant to the legislative proposals now under consideration.

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STATE OF NEW HAMPSHIRE,  
PUBLIC UTILITIES COMMISSION,  
Concord, November 13, 1969.

HON. NORRIS COTTON,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR COTTON: The Federal Communications Commission (FCC), on November 5, 1969, released a public notice stating that it had negotiated with the Bell System telephone companies an interstate toll rate reduction totalling \$237 million which we understand will be effective on or after January 1, 1970.

Under the rate base concept of rate making, practiced by the FCC and the State Commissions, the Bell System, through its rates, is entitled to earn a reasonable return on its plant invested in common carrier service and to recoup its expenses reasonably incurred in furnishing such service. Since the vast bulk of Bell System plant and expenses are used in furnishing both interstate and intrastate communication service, such plant and expenses must be allocated or separated between the interstate and intrastate uses for purposes of ratemaking by the respective Federal and State jurisdictions.

The FCC's present method of allocating the cost of sustaining our national telephone system is inequitable and the many states suffer from the imbalance.

It is an anomaly that the FCC should decree an interstate reduction when at the same time the affected companies (including New England Telephone in New Hampshire) have filed tariffs for greater intrastate revenue. Some of these requests are pending and some have already been granted.

The action of the FCC in this instance of not consulting with the states or with the NARUC appears to be at odds with the concept of the new federalism attempted to be put into effect by the present administration.

We respectfully urge you and your colleagues on the Commerce Committee to take two steps to effect prompt protection to the rate payers interests placed in jeopardy by the FCC's proposed action.

*First*, we request that the Committee or the Subcommittee on Communications promptly schedule hearings on S. 1917, a bill proposing the Federal-State Communications Joint Board Act of 1969, which you introduced at our request. The enactment of S. 1917 would create a seven member Board composed of four FCC commissioners designated by the FCC and three State Commissioners nominated by the NARUC and appointed by the FCC. The Board would have sole administrative authority under the Communications Act to adopt and amend separations procedures. The enactment of this proposal would provide a balanced approach in the future development of fair and equitable separations procedures.

*Second*, and as a matter of even greater urgency, we request you to *immediately* schedule oversight hearings regarding the proposed negotiated interstate rate reduction of \$237 million, and require the members of the FCC, who voted in the majority, to seek to explain on a public record why they have chosen to favor the few and not to use the excess earnings to aid the vastly larger number

of users of local telephone service—users who are threatened with the possibility of assuming an additional economic burden in excess of \$500 million.

You will recognize that some of the content of this letter is identical to that contained in the letter from the NARUC, directed to you by its President. I am writing this letter to you as Chairman of the New Hampshire Public Utilities Commission and with the full knowledge of my colleagues who are equally as interested in this matter as I am. I attempted to contact you personally by telephone to discuss this with you but you were in committee hearings and I felt I could not delay sending this letter any longer.

With warm personal regards and best wishes, I am,

Very truly yours,

FRANCIS J. RIORDAN,  
*Chairman.*

STATE OF NEW YORK,  
PUBLIC SERVICE COMMISSION,  
*Albany, November 25, 1969.*

Hon. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,*  
*U.S. Senate,*  
*Washington, D.C.*

DEAR CHAIRMAN MAGNUSON: The New York Public Service Commission has considered at length the recent action of the Federal Communications Commission set forth in that commission's public notice of November 5, 1969 directing a reduction in interstate toll rates of about \$237 million for the Bell System.

By letter dated November 25, 1969 addressed to Chairman Dean Burch of the FCC the New York Commission has requested the FCC to call a hearing immediately for the purpose of affording all interested parties an opportunity to present alternative methods of accomplishing the desired reduction in Bell System interstate earnings without the obvious, adverse effects which will accrue to the users of basic exchange telephone service if the excess revenues found under present separations procedures are used for the purpose of interstate toll rate reductions. A copy of that letter is attached for your information.

The New York Commission strongly endorses and supports the position and suggestions presented to you by Francis Pearson, President of the National Association of Regulatory Utility Commissioners in his letter of November 8, 1969 and respectfully urges your committee to take action along the lines recommended therein.

We would appreciate an opportunity to present our views before you and the members of your committee.

Sincerely,

JAMES A. LUNDY, *Chairman.*

STATE OF NEW YORK,  
PUBLIC SERVICE COMMISSION,  
*Albany, November 25, 1969.*

Hon. DEAN BURCH,  
*Chairman, Federal Communications Commission,*  
*Washington, D.C.*

DEAR CHAIRMAN BURCH: The New York State Public Service Commission has utilized the time since it received your Commission's Public Notice of November 5, 1969 relating to the proposed reduction in interstate message toll rates for the Bell System in reviewing that decision and the impact it may have upon local exchange and intrastate toll rates of New York Telephone Company and the 63 independent telephone companies and miscellaneous common carriers serving the public of this State.

Our Commission now has under consideration a rate application by New York Telephone Company to increase local exchange, intrastate toll and other intrastate charges by approximately \$175 million annually which must be finally determined by February 1970. Similar proceedings are pending or in prospect in other state jurisdictions in amounts aggregating in excess of \$500 million. It seems rather anomalous to have a situation exist where repeated rate reductions on the interstate side are being more than offset by continuing rate increases on the intrastate side of the Bell System's operations. The result is a mounting hardship upon the users of basic exchange service out of all proportion to the public benefits obtained from interstate toll rate reductions.

This Commission feels that more appropriate consideration should be given to the impact your decision, (based as it was on currently effective separations procedures), will have upon the ability of the state commissions to resist, at least in part, the enormous intrastate increases presently proposed by the Bell System operating companies, and which will very likely be proposed by the independent companies in the future.

The New York Commission feels strongly that before action on your decision of November 5, 1969 is finalized and made effective the FCC should publicly consider and pass upon the merits of the latest suggestions heretofore made by the National Association of Regulatory Utility Commissioners staff subcommittee on separations under the established cooperative procedures at meetings held during 1969 in Rockland, Maine, Denver, Colorado and New York, New York. This does not appear to have been done in your decision.

The New York Commission believes that the FCC should pursue its "continuing surveillance" of the Bell System's interstate earnings. We do object however, to final important rate action being taken with reference to A.T. & T. proposals or agreements obtained as a result of such "continuous surveillance". A public hearing should be called by your Commission to receive the views or evidence of interested parties, viz. the state commissions, and National Association of Regulatory Utility Commissioners, consumers, and independent companies whose earnings may be adversely affected, as to how any excess Bell System earnings found to exist under present separations procedures should be used; also, more specifically, as to whether the present separations procedures should not be changed to allocate more joint costs to interstate service and less costs to intrastate service.

Accordingly, the New York Commission respectfully requests the FCC to call a public hearing in the immediate future for the purpose of affording all interested parties affected by the Public Notice of November 5, 1969 an opportunity to express on the formal record their views or to present evidence concerning matters referred to in your Public Notice of November 5, 1969.

Sincerely,

JAMES A. LUNDY, *Chairman.*

STATEMENT OF THOMAS J. BRADY, CHIEF OF THE TELEPHONE BUREAU, NEW YORK  
STATE PUBLIC SERVICE COMMISSION

Mr. Chairman and members of the Committee: My name is Thomas J. Brady and I am Chief of the Telephone Bureau of the New York Public Service Commission. In that capacity, I have the responsibility of supervising the Commission staff on all regulatory matters affecting the telephone and telegraph industry in New York State. I am a member of the NARUC's Staff Committee on Communications and I am a member of the Staff Subcommittee on Separations and Toll Rate Disparity.

The New York Commission feels very strongly that the recent action of the Federal Communications Commission in ordering a reduction in interstate toll rates in the amount of \$237 million will have an adverse impact upon the local exchange and intrastate toll rates of New York Telephone Company and the 63 independent telephone companies and miscellaneous common carriers serving the public of the State of New York.

As you gentlemen know, the New York Commission now has under consideration a rate application by New York Telephone Company to increase local exchange, intrastate toll, and other intrastate charges, by approximately \$175 million annually. Similar proceedings are pending or are in prospect in other state jurisdictions in amounts aggregating in excess of \$500 million. The situation has been created whereby repeated rate reductions on the interstate side of the Bell System's operations are being more than offset by continuing rate increases on the intrastate side. The obvious result is a mounting hardship upon the users of basic exchange service which is out of all proportion to any public benefits possibly obtained from interstate toll rate reductions.

The New York Commission believes that the Federal Communications Commission should pursue its continuing surveillance of the Bell System's interstate earnings. However, it believes that before final important rate action is taken with reference to AT&T rates, public hearings should be held so as to permit interested parties, namely, the state commissions, the NARUC, consumers and independent companies, whose earnings may be adversely affected, to present their views or evidence with respect thereto.

This is particularly true with respect to the allocation of investment and expenses between the interstate and intrastate jurisdictions for ratemaking purposes. This is commonly known as the "Separations" procedure and is carried out in accordance with the methods and procedures set forth in the Separations Manual recently adopted by the Federal Communications Commission under a rule-making procedure.

Improvements and modifications have been made from time to time over the years with respect to this separation of costs and expenses and there is currently under consideration by the NARUC Staff Committee on Communications and the NARUC Staff Subcommittee on Separations and Toll Rate Disparity further modifications which it is believed will more equitably allocate costs from intrastate service to interstate service. It has been estimated that the effect of the change under consideration would be a transfer of between \$100 million and \$120 million of revenue requirement from intrastate operations to interstate on a national basis and in the State of New York the effect would be between \$17 and \$20 million. These are substantial sums which could be used by the state commissions to offset, at least in part, the enormous increases being requested by the Bell System's operating companies in local exchange and intrastate toll rates.

The F.C.C. was fully aware of the fact that further changes to the separations procedures were under consideration by the NARUC staff committees and that discussions under the established cooperative procedures have been held on at least three separate occasions during 1969. The action of the F.C.C. in ordering the reduction in interstate rates and permitting a higher level of earnings for AT&T enormously magnifies the difficulty of obtaining these desired changes in separations procedures so desperately needed by the state commissions in their efforts to protect the interests of the local exchange rate payers.

Accordingly, we urge this Committee to exercise its influence in causing the F.C.C. to recall its recent order and reconsider its action in the light of the views here presented.

The New York Commission also wishes to be recorded as endorsing and supporting the opinions and suggestions made today by the NARUC, and it respectfully urges your Committee to take action along the lines recommended by it.

STATE OF NORTH CAROLINA,  
UTILITIES COMMISSION,  
Raleigh, November 25, 1969.

Hon. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.

DEAR MR. MAGNUSON: On November 5, 1969, the Federal Communications Commission (FCC) issued a *Public Notice* in its FCC File 69-1210 stating that the FCC had found that American Telephone & Telegraph Company (AT&T) had \$237,000,000 in excessive earnings in 1969, which by agreement between the FCC and AT&T would be reduced by giving *interstate* toll telephone customers reductions in interstate long distance telephone charges. The notice fails to give any recognition to the needs of customers of *intrastate* telephone service of the Bell System Companies and independent companies in North Carolina and the other 49 states.

The North Carolina Utilities Commission is glad that the increased AT&T earnings will permit new customer benefits, but protests this use of the entire amount for interstate toll, with nothing for intrastate service. We have requested the FCC to reconsider its action and allot a fair portion of the available amount to intrastate benefits. A copy of the request for reconsideration directed to Chairman Dean Burch of the FCC is attached hereto, setting out the basis for the protest and request for reconsideration.

The \$237,000,000 in interstate rate reductions will actually come only partly from AT&T. The balance will come partly from Bell System telephone operating companies which provide intrastate service in North Carolina and partly from the independent telephone companies divisional share of long distance telephone revenues.

It can be observed from the attached protest that the excess profits of AT&T result from combined services of the Long Lines Division of AT&T and the originating and terminating local exchange telephone service facilities of the Bell operating company in North Carolina and the 28 independent telephone

companies operating in North Carolina. (The same situation exists in the other 49 states.)

The FCC action results in discrimination against intrastate telephone service in North Carolina. It arises from an inequitable and outmoded formula used by the FCC in dividing the interstate toll revenues between (1) the Long Lines Division of AT&T and (2) the originating and terminating local telephone companies which provide all of the basic telephone plant and local service connections utilized in interstate long distance calls, and who bill and collect all of the charges for these calls.

This letter is to request your consideration and support for *S. 1917, a Bill proposing a Federal-State Communications Joint Board*, consisting of 4 FCC Commissioners and 3 State Commissioners with administrative authority to adopt and amend the separation procedures and formulas to be applied to the interstate toll revenues, in allocating a fair share of the revenue from each call to the local service telephone companies originating and terminating the calls. The existing formulas fail to recognize a fair share of the local telephone plant and local expenses of toll operator services, billing and collecting procedures, maintenance expenses, and the myriad other expenses of the local companies utilized in an interstate toll call.

We urgently request your consideration for the needs for local service telephone operating conditions, including the needs recited in the attached letter for upgrading of the 55,030 8-party and 10-party lines in North Carolina and the need for reduction of mileage charges for telephones outside the telephone base rate area, and the need for reducing the existing disparity between interstate toll rates and intrastate toll rates in North Carolina.

The FCC has determined in its negotiations with AT&T that AT&T has \$237,000,000 of excess profits for 1969, with the prospect that the excess profits will increase in 1970. These monies are properly being returned to the benefit of telephone consumers, but the strong objection of the North Carolina Commission is that they are utilized entirely for interstate consumers with no regard for the consumer needs of intrastate customers in North Carolina and the other states. S. 1917 will correct this inequity and your early and favorable consideration of S. 1917 will be a great service to all local service telephone customers in the United States.

Thank you for your consideration in this regard.

Very truly yours,

By H. T. WESTCOTT, *Chairman.*

STATE OF NORTH CAROLINA,  
UTILITIES COMMISSION,  
Raleigh, November 25, 1969.

Re Request for reconsideration of FCC action in public notice, November 5, 1969, FCC 69-1210, Bell System Telephone Co.

Hon. DEAN BURCH,  
*Chairman, Federal Communications Commission,*  
*Washington, D.C.*

DEAR MR. BURCH: The North Carolina Utilities Commission has studied with great interest your Public Notice of November 5, 1969, FCC 69-1220, in which the Federal Communications Commission (FCC) indicates that it has found the earnings of the American Telephone & Telegraph Company (AT&T) to be excessive and that a \$237,000,000 interstate toll rate reduction is being proposed as the means to restore these excess profits to telephone customers and to reduce American Telephone & Telegraph Company's rate of return.

The North Carolina Utilities Commission fully agrees with a policy of restoring this money to the telephone customers and reducing an excessive AT&T rate of return. However, the North Carolina Commission objects strenuously to the proposal of using all of the money for interstate customers in the reduction in the AT&T return by a reduction of interstate toll rates, as recited in your Public Notice, to the exclusion of needed reductions in intrastate rates for local and intrastate toll telephone service, and to finance urgently needed improvements in local service.

The North Carolina Utilities Commission respectfully requests that the Federal Communications Commission reconsider the proposed \$237,000,000 interstate toll reduction, and in lieu thereof requests that the FCC assign all or a fair portion of said reduction to the states so that improvement of customer service on the local level, reduction of intrastate toll rates and the provision of better grades of service on a local level, can be accomplished.

Interstate toll rates received a large rate reduction in 1967, and it is respectfully submitted that it is now time to apply some of the excess Bell System earnings to the benefit of customers on a local level before making further reductions in the interstate toll rate.

Your Public Notice of November 5, 1969, refers to the rate reductions in terms of "AT&T" with the details of the rate changes to be "worked out by the company". It is noted in this connection that "AT&T" does not have any customers for interstate toll service in the usual sense of residential customers and does not render any bills to residential customers. It is only the local operating telephone companies in North Carolina that charge interstate toll calls and render bills for such interstate toll calls that originate in North Carolina. These local companies whose interstate toll rates have been so drastically affected by the FCC action were not examined by the FCC in its surveillance proceeding and the needs of their local service customers were not considered by the FCC in its public Notice. The interstate toll rate reduction proposed in your Public Notice will work effects on local telephone companies, including independent companies, and local telephone users in North Carolina which are not considered in your Public Notice. It is the belief of the Utilities Commission that the effect will be adverse to the public interest, and will exhaust the AT&T excess earnings without a proper consideration of the more urgent need for use of such excess earnings on customer benefits in the respective states, including North Carolina.

There are still 55,030 telephone customers in North Carolina receiving 8-party and 10-party service, including customers of the Southern Bell Telephone & Telegraph Company and the 28 independent telephone companies in North Carolina. The North Carolina Utilities Commission is seeking by all possible means to eliminate the outmoded and inadequate grades of service and to raise the overall quality of telephone service. Thus far, we have experienced difficulty in finding an economically feasible means of improving the quality of telephone service for many of these customers.

We believe that local telephone service is the key to good nationwide telephone service and that the AT&T rate of return reduction should be applied so that it will produce the greatest benefit to the local telephone users rather than effecting this rate of return reduction by another round of interstate toll rate decreases.

The problem is solely a matter of accounting for the plant and expenses of the Bell System and the independents devoted to interstate toll service as compared to the plant and expenses of the Bell System and the independents devoted to local service and intrastate toll service. The National Telephone System is in essence one unified system and the interstate toll network is entirely dependent upon local service exchange plant. The adjustment in this separations method referred to on page 3 of your Public Notice by a \$35,000,000 transfer of revenue requirements is totally inadequate to recognize the significant further transfers in expenses and local plant which should be supported by the interstate toll rate structure. The continuous increase in AT&T's rate of return while a gradual decrease is occurring in the return of intrastate operations strongly indicates that the separations and settlement procedures between interstate and intrastate operations need to be changed to reflect a more realistic allocation of plant and expenses to AT&T.

The North Carolina Commission has directed all 29 North Carolina telephone operation companies to eliminate 8 and 10-party service and to provide zone plans in lieu of mileage charges in order to improve local service. Sixteen of these companies plead financial inability to improve the service, and the ten that have initiated the improvements threaten to file rate increases before the improvements are fully implemented.

The interstate toll rate reductions of "AT&T" will not only reduce the AT&T excess earnings but will reduce the revenue of the North Carolina operating companies. The requiring of these 27 independent companies and Southern Bell in North Carolina to give up this portion of the interstate revenue for which they provide North Carolina service at continuing expense could lead to the breakdown of the uniform national interstate toll rates and cause the North Carolina independent companies and Southern Bell in North Carolina to reject the "AT&T" rates and file charges at different rate levels for billing of North Carolina customers on interstate calls.

Your proposed action could also cause a breakdown of state acceptance of the national separations formula. This could compel North Carolina and the other respective states to make their own separations of plant and expenses on interstate calls for use in determining the justness and reasonableness of local service telephone rates in the respective states.

We urge further study of your proposed action for the following purposes :

(1) Neither the North Carolina Commission or the North Carolina operating companies have had an opportunity to be heard on the record on the urgent need for use of the excess earnings of AT&T for local consumer rate relief and service improvement.

(2) We do not yet know the method by which AT&T will reduce its interstate toll rates \$237,000,000.

(3) We do not know if the entire \$237,000,000 interstate toll reduction is to come from the Long Lines Division of the AT&T's share of the interstate toll rates or if it is to come partly from the Long Line Division of AT&T and partly from the independent telephone companies and Bell operating companies that provide local service operations in the respective states, including North Carolina.

(4) The respective State Commissions have not had opportunity to present to the Commission the further needs for revision of the separations method to allocate a fair share of plant expenses and cost of local service to interstate toll service.

(5) The proposed AT&T rate reductions will create greater disparities than already exist between interstate toll rates and intrastate toll rates, without any logical explanation to the customers of long distance toll service except that the separations formula is outmoded and inequitable as it relates to intrastate service.

Based upon the above considerations, it is respectfully requested that the Federal Communications Commission reconsider the use to which the \$237,000,000 excess AT&T earnings are to be devoted, to the end that a fair share of such excess earnings may flow to consumers and enable improvements in local service in North Carolina and the other respective states.

Very truly yours,

H. T. WESTCOTT, *Chairman.*

#### STATEMENT OF THE NORTH CAROLINA UTILITIES COMMISSION

To the Members of the Committee on Commerce of the U.S. Senate: On November 5, 1969, the Federal Communications Commission (FCC) issued a *Public Notice* in its FCC File 69-1210 stating that the FCC had found that American Telephone and Telegraph Company (AT&T) had \$237,000,000 in excessive earnings in 1969 which by agreement between the FCC and AT&T would be reduced by giving *interstate* toll telephone customers reductions in interstate long distance telephone charges in the amount of \$237,000,000.

The North Carolina Utilities Commission supports the use of excessive AT&T earnings for telephone customer benefits, but protests the use of the entire amount in the reduction of interstate toll telephone charges, without any benefits being allotted to urgently needed improvements in local telephone service and local telephone rates. The North Carolina Commission has requested the FCC to reconsider its decision announced in the *Public Notice* of November 5, 1969, and to allocate a fair share of the available \$237,000,000 excessive AT&T earnings to the improvement of local service and local telephone rates.

The decision of the FCC to assign all of the excessive earnings to the reduction of interstate long distance telephone charges arises from inequitable accounting formulas utilized to separate the telephone plant utilized in long distance service from that utilized in local telephone service. The present separations formulas discriminate against local telephone service. This is evidenced by the excessive earnings of AT&T from its pro rata allocation of long distance toll charges, while the local service telephone companies are increasing local monthly telephone charges to support the local telephone plant used in making the toll calls, and local telephone service is deteriorating through lack of adequate toll revenues from the present formula to install and maintain the urgently needed local telephone plant used in the toll calls.

The long range correction of this discrimination in separations formulas can be accomplished through the enactment of S. 1917, a *Bill proposing a Federal-State Communications Joint Board*, establishing four FCC Commissioners and three State Commissioners with administrative authority to adopt and amend the separations procedures and formulas to be applied to interstate toll revenues, in allocating a fair share of the revenues from each call to the local service telephone companies originating and terminating the calls:

The separations formulas which would be corrected by S. 1917 are the formulas used in dividing interstate toll revenues between (1) *the Long Lines Division of AT&T* and (2) *the originating and terminating local telephone companies* which provide all of the basic telephone plant and local service connections

utilized in long distance calls, and who service, bill and collect all of the charges for these calls. The present formulas do not give a fair share of the toll revenue to the local telephone companies providing the local plant and local service rendered on each interstate long distance call.

The present discriminatory formulas result in local telephone service subsidizing the AT&T Long Lines Division, resulting in excessive profits of the AT&T Long Lines Division, at the cost of local telephone service and local telephone rates.

#### LOCAL TELEPHONE SERVICE

Local telephone service is performed in North Carolina by the following local telephone companies:

	Number of telephones	Percent of total
Southern Bell Telephone & Telegraph Co.....	1, 154, 163	53. 85
28 independent telephone companies.....	912, 473	42. 57
Chapel Hill (municipal).....	31, 721	1. 48
Pineville (municipal).....	1, 294	.06
Telephone cooperatives.....	43, 689	2. 04
<b>Total North Carolina telephones.....</b>	<b>2, 143, 340</b>	<b>100</b>

North Carolina has a large rural population. Mileage or zone charges apply outside of base rate areas, and 55,030 telephone customers in North Carolina still receive 8-party and 10-party service. This service is outmoded and inadequate for today's telephone customer requirements. The North Carolina Commission is seeking every possible means to eliminate this outmoded service by upgrading it to 4-party service, 2-party service, or 1-party service. The upgrading program is expensive, and the local telephone companies greatly need a larger share of the toll revenues to complete these service improvements. This is just and reasonable because the toll revenue is derived in part from the use of this more expensive local plant, in making long distance calls.

The North Carolina Commission has under investigation complaints regarding the service of many of the telephone companies under its jurisdiction. They involve primarily lack of maintenance personnel, operating personnel, installers, repairmen and repair equipment to keep the telephone plant in good running order. This service condition stems from rising prices, restricted operating budgets, and lack of sufficient revenues from the pro rata share of interstate toll revenues on toll calls coming through the local telephone plant.

Revisions in the separations formulas for interstate toll revenue will allocate a fair share of the present excessive earnings of AT&T's Long Lines Division to the needed improvements in local telephone plant, including upgrading of outmoded multi-party service and improvement in general standards of performance through adequate maintenance budgets.

#### LOCAL SERVICE RATES

The local service monthly charge paid by all telephone customers establishes and supports the basic telephone plant which is used jointly for local calls and interstate long distance telephone calls. The local service monthly charges in North Carolina are already at a high level and cannot be further increased without hardship to the local service telephone subscribers. Five telephone companies under the jurisdiction of the North Carolina Commission have increased local service telephone charges in the last three years, as follows:

	Date	Applied for	Received
Concord Telephone Co.....	May 19, 1969	\$807, 329	\$671, 505
Lee Telephone Co.....	June 6, 1968	196, 496	132, 294
Lee Telephone Co.....	July 28, 1969	239, 973	142, 437
General Telephone of Southeast.....	Dec. 19, 1968	2, 319, 564	1, 192, 836
Denton Telephone Co.....	July 7, 1969	29, 571	29, 571
E. Rowan Telephone Co.....	do.....	46, 217	46, 217
<b>Total.....</b>		<b>3, 639, 150</b>	<b>2, 214, 860</b>

A general reduction of AT&T long distance telephone tariffs as proposed in the FCC Public Notice of November 5, 1969, would not only reduce the earnings of AT&T's Long Lines Division, but would also reduce the pro rata share of the calling revenue due to the local service telephone companies originating and terminating the long distance telephone calls. Unless the separations formula is changed when the interstate toll reductions become effective, they will result in loss of toll revenue to the local service telephone companies and will produce pressure on local service budgets to cut service and maintenance, or to increase local service monthly telephone charges to offset the loss of long distance telephone revenues. Either of these results, or both of them in conjunction, would be disastrous to local telephone service in North Carolina.

## CONCLUSION

1. The North Carolina Commission supports the return of \$237,000,000 in excess telephone profits to telephone customers, but strongly objects to the method by which it is to be returned to the relatively few interstate long distance telephone users, to the detriment of local service telephone customers.

2. The North Carolina Commission urges the Committee on Commerce of the United States Senate to exercise its oversight procedures with the FCC to revise the separations formulas so that a fair share of the \$237,000,000 will go to local service telephone customers through improvement of the quality of the local service and reductions in local telephone charges.

3. The North Carolina Commission further urges the enactment of S. 1917 to the end that a permanent joint board may be established to insure just and reasonable separations formulas for proper allocation of interstate toll revenues to the local service telephone customers who must support the local service telephone plant utilized in long distance service.

Respectfully submitted, this 9th day of December, 1969.

H. T. WESTCOTT, *Chairman.*

NORTH DAKOTA PUBLIC SERVICE COMMISSION,  
*Bismarck, December 5, 1969.*

Hon. WARREN G. MAGNUSON,  
*U.S. Senator, Old Senate Office Building,  
Washington, D.C.*

DEAR SENATOR MAGNUSON: The North Dakota Public Service Commission is in support of the enactment of S1917.

This Commission is a member of the National Association of Regulatory Commissioners (NARUC). Committees of this body have worked jointly with the FCC and the telephone industry in an effort to formulate fair and equitable property separations procedures. NARUC has urged the FCC, by modification of existing separations procedures, to increase revenue requirements applicable to interstate operations, thereby reducing the requirements necessary to sustain intrastate service. Instead, the FCC has ordered interstate rates to be reduced at a time when many state regulatory commissions are confronted with telephone rate increases. We believe that the FCC acted precipitously and unreasonably.

We feel that this action by the FCC illustrates the need for S1917.

Respectfully yours,

ELMER OLSON, *Secretary.*

PUBLIC UTILITIES COMMISSION OF OHIO,  
*Columbus, Ohio, December 8, 1969.*

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,  
*Senate of the United States,  
Washington, D.C.*

TO THE HONORABLE MEMBERS OF THE COMMITTEE: We wish to protest the proposed reduction in interstate rates as presented by the Federal Communications Commission in agreement with the American Telephone & Telegraph Company.

As you know, a *Public Notice* issued by the FCC on November 5, 1969, stated that AT&T had \$237,000,000 in excessive earnings in 1969, which would be reduced by giving interstate toll telephone customers reductions in interstate long distance telephone charges.

We certainly are in favor of extending benefits to customers, however, we feel we must protest the action of the FCC because the proposed reduction will constitute a considerable loss of revenue to the Bell System Companies and independent companies in Ohio. We have long opposed the separation structure, feeling that more revenue ought to be allocated to Ohio companies, and this proposed reduction will only have an adverse effect on an already trying situation.

Specifically, the reduction would constitute a revenue loss to Ohio companies of approximately \$3,740,000. The economic pinch is dramatically illustrated by the fact that today the Public Utilities Commission of Ohio begins hearings on a request by the Bell System of Ohio for a rate increase. A cut in revenue sources at this time affects the possibility of holding rates at their present level presuming the Bell rate request offers even a minimum of validity.

We would much prefer that the reduction, if there is to be one, be utilized to benefit intrastate customers, rather than only the users of interstate service. Therefore, we ask that the proposed reduction be reconsidered and a more equitable means of revenue distribution between AT&T and local companies be sought.

The attached sheet shows the approximate revenue loss to Ohio companies if the proposed reduction is allowed to stand.

Yours truly,

CARL R. JOHNSON,  
KENNETH B. JOHNSTON,  
ELMER A. KELLER,  
*Commissioners.*

Subject: The FCC's proposal to reduce the interstate long-distance rates by \$150,000,000 effective January 1, 1970.

The Wall Street Journal of December 3, 1969 discussed the probable effects of the \$150,000,000 reduction on various long-distance interstate rates, presumably after some discussion with AT&T officials, in these general areas:

1. The reduced rates will apply to direct distance dialing calls only
2. Rates for operator-handled calls will remain unchanged
3. The evening rates will be for the period from 5 p.m. to 8 a.m. instead of the previous 7 p.m. to 8 a.m.
4. A typical reduction on a 3-minute direct distance dialed long-distance interstate call between 8 a.m. and 5 p.m. would be 30c (down \$1.40 from \$1.70)
5. In the 5 p.m. to 8 a.m. period, a typical reduction for direct distance dialing 3-minute coast-to-coast call would be 10 cents (\$1.00 to 90c)
6. A new rate would be introduced for a 1-minute DDD call for the period between midnight and 8 a.m. The coast-to-coast rate for such a 1-minute call would be 35 cents
7. Reductions will be applicable only to those long-distance interstate calls in excess of 200 miles. The Ohio Bell *estimate* that the effect of these changes will be a reduction of \$3,750,000 in revenue for 1970 for long-distance calls originating or terminating in Ohio Bell territory. Ohio Bell's long-distance interstate revenue would be reduced approximately \$2,000,000. This includes the settlements with the independent telephone companies. These settlements would be reduced in the range of \$200,000 to \$250,000 from the present settlement.

The remaining \$1,750,000 would be Long Line's (AT&T) share of the reduction. Nothing definite is known at this time regarding the nature of the reduction of \$87,000,000 to become effective February 2, 1970.

However, assuming that the \$87,000,000 reduction would be applied along the same lines as the \$150,000,000 reduction, the effect on the LDI revenues in Ohio Bell territory would be a reduction of \$2,135,000.

Ohio Bell's share of the amount would be approximately \$1,140,000 including the settlements with the Independent Telephone Companies. These settlements would be reduced in the range of \$110,000 to \$150,000.

The remaining \$950,000 would be Long Line (AT&T)'s share of the reduction in LDI rates effective 2/1/70.

The Public Utilities Commission of Ohio estimates that the total effect for the Ohio portion of the Cincinnati Bell territory resulting from the reduction in LDI rates effective 1/1/70 will be approximately \$715,000, of which \$380,000 is applicable to Cincinnati Bell and the remainder of Long Lines (AT&T).

Similarly, it is estimated that the total effect for the Ohio portion of the Cincinnati Bell territory resulting from the reduction in LDI rates effective 2/1/70 will be approximately \$415,000 of which \$220,000 is applicable to Cincinnati Bell and the remainder to Long Lines.

## OHIO BELL

	Amount	Long lines (A.T. & T.)	Total
Jan. 1, 1970.....	\$2,000,000	\$1,750,000	\$3,750,000
Feb. 2, 1970.....	1,140,000	995,000	2,135,000
Total.....	3,140,000	2,745,000	5,885,000

## CINCINNATI BELL

	Amount	Long lines (A.T. & T.)	Total
Jan. 1, 1970.....	\$380,000	\$335,000	\$715,000
Feb. 2, 1970.....	220,000	195,000	415,000
Total.....	600,000	530,000	1,130,000

Note: Total revenue loss to Ohio companies equals \$3,740,000.

PUBLIC UTILITY COMMISSIONER,  
Salem, Oreg., December 10, 1969.

HON. WARREN G. MAGNUSON,  
Chairman, Committee on Commerce,  
U.S. Senate,  
Washington, D.C.

DEAR SENATOR MAGNUSON: I wish to indicate the Oregon Public Utility Commissioner's support of S. 1917 providing for more direct representation of state interests in separation matters before the Federal Communications Commission. Further, I respectfully urge the Committee on Commerce to take favorable action on this bill.

As the current controversy so well illustrates, many states do not believe the majority of their citizens receive adequate consideration under present separation procedures. S. 1917 presents a relatively uncomplicated and effective method to allow state participation, on behalf of all telephone subscribers, in this important aspect of the regulation of our nation-wide telephone system.

Sincerely,

SAM R. HALEY, Commissioner.

COMMONWEALTH OF PENNSYLVANIA,  
PENNSYLVANIA PUBLIC UTILITY COMMISSION,  
Harrisburg, November 13, 1969.

HON. DEAN BURCH,  
Chairman, Federal Communications Commission,  
Washington, D.C.

DEAR CHAIRMAN BURCH: The Pennsylvania Commission appreciates the courtesy extended by your associates, both on Commission and Staff level, to Mr. Schuchart, Staff Engineer of this Commission and Technical Assistant to the NARUC Cooperating State Commissioners in various proceedings before your Commission, including the recent "continuing surveillance" meetings between FCC and AT&T. We are especially grateful for the opportunity to explain to various Commissioners and Staff members the peculiar situation of Pennsylvania as regards any reduction in interstate toll rates, different from that of any State, except Delaware.

During the early 1930's, the Pennsylvania Commission, by Order in a proceeding on its own motion, accepted the FCC prescribed interstate toll rate schedule as proper for application to intrastate toll operations. The Order was appealed to and sustained by both the State Superior Court and the State Supreme Court. The Order and the policy it established are still in effect.

The benefits of this policy are two-fold. It eliminated the ever increasing and, up to that time, the ever present criticism of the disparity in the charges between inter and intrastate toll calls of the same distance and for the same length of conversation. The second benefit, relating directly to the millions of State telephone rate payers, is the speed and facility with which a transfer of revenue requirements from intra to interstate, or vice versa, can be translated into a change in basic telephone charges, local exchange rates. For example, the P.U.C. Docket C. 17519, the Order in which was issued April 16, 1962, effective June 1, 1962. The Bell Telephone Company of Pennsylvania was directed to reduce local exchange rates \$1,500,000 per year to reflect the transfer of revenue requirements from intra to interstate operations resulting from changes in "separations" which were effective April 1, 1962. Conversely, any transfer of revenue requirements from inter to intrastate operations, as occurred following the January 29, 1969 FCC Order in Docket No. 17975, can be just as readily translated into increases in the monthly charges for local exchange service. Likewise, any reduction in intrastate toll revenues, resulting from a downward revision of interstate toll rate schedules, such as the \$150 million reduction recently announced by your Commission, can also be just as readily translated into increases in local exchange rates to recoup the reduction in intrastate revenues.

And this brings us right to the point of this letter.

In the event that the "separations" procedures prescribed by your Commission in the January 29, 1969 Order are permitted to stand, even though modified by changes in methodology of computing certain factors recently approved, annual revenue requirements amounting to approximately \$8 million will be transferred from inter to intrastate operations. It is not likely that Pennsylvania Bell will be forced to seek rate relief on this account.

However, if the announced reduction of interstate toll rates effects calls of 250 miles in length, there is a most distinct possibility that 82 to 85 telephone companies under the jurisdiction of this Commission, including Pennsylvania Bell and various Independent companies, will immediately be forced to file applications for increases in local exchange rates. This will affect between  $4\frac{1}{4}$  and  $4\frac{1}{2}$  million Pennsylvania customers, many of whom make few, if any, toll calls, either inter or intrastate. All because the FCC, with possibly less than full and complete knowledge of the attending results, had chosen to reduce AT&T's return on interstate operations by what appears to be an across-the-board reduction in interstate toll rates.

It will be difficult indeed to explain how the best interests of the public are served by reducing toll rates for those, who by their widespread use, indicate that they can well afford current rates, when such a reduction forces an increase in local exchange rates to many, who in this period of inflation, can barely afford what they presently pay. This is especially true since simple changes in "separations" procedures and the resulting transfer of revenue requirements from intra to interstate operations could easily bring AT&T's rate of return on interstate operations within the range of reasonableness deemed proper by your Commission.

The Pennsylvania Commission earnestly and sincerely urges that the Commission, reflecting your wise and understanding guidance, will reconsider the proposed interstate toll reduction, not only in the light of what the effect will be on the millions of Pennsylvania telephone rate payers, but also in the light of the additional burden it will impose on those millions of rate payers in the 16 states in which rate increases, totaling more than \$500 million per year, have already been filed.

Sincerest best wishes for a successful administration as Chairman of the Commission.

Sincerely yours,

GEORGE I. BLOOM, *Chairman.*

STATE OF SOUTH CAROLINA,  
THE PUBLIC SERVICE COMMISSION,  
*Columbia, November 26, 1969.*

HON. DEAN BURCH,  
*Chairman, Federal Communications Commission,  
Washington, D.C.*

DEAR MR. BURCH: The South Carolina Public Service Commission very vigorously protests the unreasonable and discriminatory action of the FCC in requiring the AT&T to reduce interstate telephone rates by \$150 million per year effective January 1, 1970, while at the same time Bell operating companies have pending

in numerous states petitions for rate increases aggregating at least \$500 million per year.

This action will have a very damaging effect on the Bell operating companies as well as on the more than forty (40) small independent telephone companies under the jurisdiction of this Commission by causing an overall earnings reduction without a hearing. This will further delay the time when they can extend telephone service to remote rural areas and will transfer the burden from the relatively fewer and usually more affluent interstate users to the many more intrastate users, who will find it increasingly difficult to bear the extra burden.

It is our opinion that this reduction should be made by changes in separations of expenses and capital expenditures so that a more equitable percentage of the expenses would be borne by interstate rather than intrastate operation which is already bearing a disproportioned amount of these costs.

Yours very truly,

GUY BUTLER, *Chairman.*

#### STATEMENT OF THE POSITION OF THE SOUTH CAROLINA PUBLIC SERVICE COMMISSION

The South Carolina Public Service Commission feels that the Federal Communications Commission reduction of \$237 million in interstate toll rates is very detrimental to the intrastate rate payers of this State as well as other States. It is only reasonable that this reduction should have been passed back to the intrastate operations through better operation procedures. It is essential to the public interest that procedures for separating plant and expenses be fair and equitable so that no unreasonable burden will be placed on either interstate or intrastate users of telephone service.

Due to the FCC's long standing unreasonable separation procedures, the telephone customers are confronted with a ridiculous situation. The FCC has determined to reduce the Bell System's interstate operation by \$237 million while the same Bell System has rate proceedings now pending before State Commissions seeking rate increases totaling in excess of \$500 million. This figure, of course, does not include rate increases now being sought by non-Bell Telephone Companies who are also affected by unfair separation procedures.

In South Carolina rate increases have been granted in the past three years in the amount of approximately \$3.3 million, and the Commission has pending before it rate cases requesting rate increases of \$2.8 million. It should also be pointed out that Southern Bell Telephone and Telegraph in South Carolina is earning 6.1% on its intrastate operation at this time.

This Commission feels very strongly that the FCC should immediately institute a proceeding to revise separation procedures so as to dispose of Bell's excess earnings by increasing the allocation of costs to interstate operation thereby reducing the amount of money needed to sustain interstate local telephone service. We request that this Committee take prompt action on seeing that Senate Bill No. 1917 be enacted immediately.

CLYDE F. BOLAND, *Commissioner.*

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#### STATEMENT BY THE SOUTH DAKOTA PUBLIC UTILITIES COMMISSION

The South Dakota Public Utilities Commission has long recognized the fact that under current separations procedures the FCC continuously finds it necessary to reduce long distance telephone rates while state commissions are continuously forced to increase local service rates. It is obvious that in order to remain in business a telephone company must collect enough revenue to cover its operating expenses. The fixing of telephone rates is not an exact science and whether the revenue comes from one type of customer or another, the telephone companies must still earn sufficient revenues to pay their operating expenses and give a reasonable rate of return to their investors.

There is no doubt that a regulatory agency would find it quite pleasant to reduce the telephone rates under its jurisdiction. However, someone must bear the responsibility of seeing that the telephone companies earn a sufficient return to attract them to continue offering good telephone service to the public.

The revenue needed to support telephone service could be paid entirely by interstate long distance users, or it could be paid entirely through local service charges. However, it seems that the best method of obtaining sufficient revenues would be to set the rates for each type of service at such a level as to make that type of service support its own operating costs. We feel that the rates charged

for interstate long distance service are not adequate to cover the true costs of that service, and that this inadequacy results in the rates being paid by local users having to help support interstate long distance usage.

The average telephone user does not use interstate long distance service heavily. While basic local telephone service has come to be considered a necessity by the average person, long distance service is still a luxury used only on special occasions by the great majority of telephone users. The average consumer can derive more economic benefit from a reduction in local service rates than he can from a reduction in interstate long distance rates.

It has been said that 85% of our long distance usage comes from 15% of our telephone users. If this relationship still holds true, we are practicing discrimination in favor of the 15% of consumers who are heavy long distance users at the expense of the remaining 85% majority of consumers who use long distance service only sparingly. We feel that it is against the public interest to set telephone rates in favor of such a limited number of affluent telephone users.

The fact that interstate long distance telephone rates are decreasing at the same time local service rates are increasing should create questions about the equitableness of the present separations procedures. However, the fact that in certain cases intrastate long distance rates already exceed interstate long distance rates is indeed difficult to explain.

It seems evident that the separations procedures should be revised to reflect a more realistic amount of jointly used plant and jointly incurred expense in the cost of interstate toll service. The present separations procedures give far too much weight to the minutes of actual use. A telephone set is actually in use only a very small fraction of each 24-hour day, however, each type of service is entirely dependent upon a plant which must exist 24 hours every day. Therefore, any separation of the cost of idle time which is based on minutes of actual use is unrealistic.

In separating the cost of stand-by time we recommend a complete departure from the minutes of actual use theory. All facilities used in joint service are equally available for both toll and local use. Local plant must be available for long distance usage just as much as for local usage. If the plant were not available on a stand-by basis for both types of service, each type of service would have to build and maintain a separate telephone system. Therefore, division of the cost of stand-by time on a 50-50 basis is more equitable than is division on a minutes of use basis.

The South Dakota Public Utilities Commission has recently found it necessary to grant intrastate rate increases in order to assure adequate telephone service for the future. Our most recent telephone rate case was Re Northwestern Bell Telephone Company, 77 PUR 3d, 215 in which Northwestern Bell Telephone Company was granted a rate increase to provide approximately \$1,213,987 additional gross revenues.

We are satisfied that if the separations had been made on the availability of service basis rather than the minutes of use basis, we would not have had to increase the rates in that hearing. We are further convinced that the decreases in interstate long distance rates have been a major contributing factor in the need for higher local service rates.

The South Dakota Public Utilities Commission respectfully offers the foregoing statement for insertion in the hearing records of the Committee on Commerce of the United States Senate.

HARVEY SCHARN, *Chairman.*

TENNESSEE PUBLIC SERVICE COMMISSION,  
Nashville, Tenn., December 1, 1969.

HON. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.*

DEAR CHAIRMAN MAGNUSON: The Tennessee Public Service Commission has considered the recent action of the Federal Communications Commission of November 5, 1969 directing a reduction in interstate toll rates of approximately 237 Million Dollars for the Bell System.

This Commission by letter addressed to Chairman Dean Burch of the Federal Communications Commission, has requested the FCC to reconsider this decision because of the adverse effects which will accrue to the users of local telephone service.

This Commission strongly endorses and supports the position and suggestions presented to you by Francis Pearson, President of the National Association of Regulatory Utility Commissioners, in his letter of November 8, 1969 and respectfully urges your Committee to take action along the lines recommended therein.

Very truly yours,

CAYCE L. PENTECOST,  
*Chairman.*  
HAMMOND FOWLER,  
*Commissioner.*  
Z. D. ATKINS,  
*Commissioner.*

STATEMENT OF THE TENNESSEE PUBLIC SERVICE COMMISSION, PRESENTED BY  
EUGENE W. WARD, GENERAL COUNSEL

Gentlemen: I am Eugene W. Ward, General Counsel for the Tennessee Public Service Commission, Cordell Hull Building, Nashville, Tennessee, 37219. I appear on behalf of the Commission and its individual members, Cayce L. Pentecost, Chairman, Hammond Fowler, Commissioner, and Z. D. Atkins, Commissioner. The Commissioners were unable to be present at this hearing because of a previously set petition for a major rate increase of the largest water company under the Commission's jurisdiction.

We appreciate this opportunity to appear before you and show you the detrimental and harmful effects of the inequitable separation procedure adopted by the F.C.C. on November 5, 1969, wherein the F.C.C. negotiated with the Bell System Telephone Company an interstate toll rate reduction totaling \$237,000,000, to become effective on and after January 1, 1970.

We also appear in support of S-1917, a bill proposing the Federal State Communications Joint Board Act of 1969, and urge your adoption of said bill.

The local telephone users of the State of Tennessee have been forgotten and discriminated against by the F.C.C.'s opinion of November 5, 1969. This separation is inequitable because state regulatory agencies like the Tennessee Public Service Commission are responsible for establishing rates for local intrastate calls. The F.C.C. establishes the rates for interstate calls. The F.C.C. determines what portion of the telephone company's revenue should come from long distance interstate calls vs. local calls. This separation order by the F.C.C. is unfair to the average citizens and local subscribers and benefits only big business and other groups that make many long distance calls per year.

The vast bulk of the Bell Telephone System's plant and expenses is used in furnishing joint interstate and intrastate communication service. There must be a separation of plant and expenses between the interstate and intrastate operations for the purpose of rate making by the F.C.C. and the state regulatory bodies. It is essential for the public interest that no unreasonable burden be placed upon either the interstate or the intrastate users of telephone service. The average user of telephone service is benefited more by fixing his flat monthly charges at the lowest practical level rather than by reducing the interstate toll rates, which are generally paid by a more affluent class of users.

It has been shown by a number of other state regulatory bodies and the N.A.R.U.C. that the Bell System now has proceedings pending before 16 state commissions seeking to increase its local rates in excess of \$500,000,000. I do not know whether or not Tennessee is one of these 16 states, but the Tennessee Commission now has under advisement a petition by South Central Bell to increase its Tennessee intrastate rates by \$4,657,800 annually. This year alone in Tennessee, there have been petitions seeking local rate increases in excess of \$7,000,000 filed with this Commission.

It is inequitable for the F.C.C. to issue a separation procedure that places the burden of financing the operations of a major telephone system on the back of the local user. There is no question of the fact that the overwhelming majority of calls are made by the local telephone user as compared to interstate long distance telephone users. Therefore, this reduction of \$237,000,000 is intended to, and does, favor a limited class of telephone users. Now, the F.C.C. alone determines the "separation procedure" and decides what portion of the total plant and expenses of the Bell System will be interstate and what portion will be intrastate. This separation procedure would be crediting the interstate operations with virtually all the benefits of technological improvements.

The interstate operations have seen consistently high revenues. When these revenues are applied alone by the F.C.C. in determining the rate base, they do result in a rate reduction. On the other hand, the Tennessee Commission in its determination of a rate proceeding must consider the plant and expenses allocated to the intrastate operations and must, under the Constitutions of both the United States and the State of Tennessee, grant the Company an adequate rate of return. To do otherwise amounts to confiscation of property, without due process of law.

Proceedings should be begun at once to remedy this separation procedure so as to dispose of the Bell System's excessive earnings by increasing the allocation of costs to interstate operations and, thereby, reducing the amount needed to maintain local telephone service.

This Commission further specifically requests that this Committee promptly recommend for passage S-1917, a bill proposing the Joint Board Act of 1969. This Joint Board would then have the sole administrative authority under the Communications Act of 1934 to adopt and amend and provide for separation procedures. The enactment of this proposal would provide a balance and equitable approach to the separation procedures. This matter of separation procedure is a matter of grave concern to this Commission and we, hereby, urge you to take steps to remedy the inequity placed upon us by the F.C.C.'s action of November 5, 1969 and further request the approval of Bill S-1917.

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STATE OF VERMONT,  
PUBLIC SERVICE BOARD,  
*Montpelier, December 2, 1969.*

Senator WINSTON L. PROUTY,  
*New Senate Office Building,  
Washington, D.C.*

DEAR SENATOR PROUTY: I was very pleased to have the opportunity on Monday, November 24, to visit with you a little about the forthcoming hearing to be held before the Senate Commerce Committee on December 9 relative to the recent action of the Federal Communications Commission in approving interstate toll reductions amounting to \$237,000,000. As you have perhaps gathered, the state regulatory commissions and their national association (NARUC) are very concerned about the method employed by the FCC in implementing its rate reduction. The NARUC position is that the major part, if not all, of the \$237,000,000 interstate rate reduction ought to be incorporated into the basic separations formula, so that the various states and the smaller customers would benefit accordingly.

It is further the position of many State Regulators that the basic separations formula now employed in the allocation of interstate and intrastate toll revenues is highly arbitrary and to a great degree reflects the needs and desires of the FCC and the Bell Telephone System rather than the various state regulatory commissions and the ultimate consumers.

There are presently pending before a number of state commissions rate filings requesting increases amounting to more than \$500,000,000. A reduction in revenues for the interstate traffic without changing the separations formula will not ease the situation for those companies needing rate increases. In Vermont we are in the fortunate position of not presently having before us any filings for rate increases by telephone companies, and I hope that this situation will continue, although it is possible that one or more companies will have to consider rate changes in the coming year.

It has been suggested that a reduction in the interstate rates will primarily benefit the larger users to the detriment of the smaller customers who are less able to afford their telephone service.

In this regard, \$87,000,000 alone is specifically designed to reduce charges for special services employed by large business users, i.e. Telpak, Teletype and program transmission services, etc. It would seem to me that it would be most appropriate for the FCC to sit down with the State Commission representatives to discuss how best this excess revenue situation might be handled. We would hope that the Senate Commerce Committee would make a strong recommendation to the FCC to this effect. It just does not make sense to have one regulatory body granting rate relief amounting to \$237,000,000 while other bodies regulating the same industry are confronted with rate increases totaling more than \$500,000,000.

The State Commissions and NARUC are also very much interested in Senate Bill No. 1917, which would establish a Joint Board to study telephone separations

procedures. A Joint Board would consist of four FCC Commissioners and three State Commission Representatives, and it would be a major step forward in securing for the states an equitable procedure for dealing with the very complicated question of separations. I hope that when this Bill comes before your Committee it will receive favorable consideration. Our Board and the NARUC office in Washington, D.C. will be more than happy to supply you with any information you might desire. I know that Paul Malloy is acquainted with Paul Rodgers, General Counsel for NARUC, and Mr. Rodgers, as well as myself, will be happy to discuss this matter with Paul or with you at any time.

Again, I was very happy to see you last week and to have the opportunity to visit with you.

Sincerely yours,

ERNEST W. GIBSON, III, *Chairman.*

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COMMONWEALTH OF VIRGINIA,  
STATE CORPORATION COMMISSION,  
November 13, 1969.

Senator WILLIAM B. SPONG, Jr.,  
*Senate Office Building,*  
*Washington, D.C.*

DEAR SENATOR SPONG: I am writing you in regard to the above-styled matter. You most likely have noticed from the news media that on November 5, 1969, the FCC released a public notice stating that it had negotiated with the Bell System telephone companies an interstate toll reduction totaling \$237 million, which we understand is to become effective on or after January 1, 1970.

This proposal is against the best interests of the State and is clearly adverse to the users of local telephone service. This proposed reduction will affect a limited class of affluent telephone users who make approximately 2½ billion long distance telephone calls a year, while, at the same time, the execution of this proposed reduction would be adverse to the users of 147 billion telephone calls a year. This is a most outrageous and highhanded attempt by the AT&T to cater to the wishes of the FCC which is detrimental to the users of local telephone exchange service in the various states. While AT&T proposes to reduce long distance calls \$237 million, they have rate cases pending in sixteen states asking for rate increases. Evidently these proposed rate increases are to offset AT&T's reduction in rates of long distance service to satisfy the FCC.

The Virginia Commission urges your active and valuable support in behalf of S.B. 1917, which was introduced by Chairman Warren G. Magnuson of the Senate Committee on Commerce.

With best wishes, I am  
Sincerely yours,

H. LESTER HOOKER, *Commissioner.*

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WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,  
*Olympia, December 1, 1969.*

COMMITTEE ON COMMERCE,  
*Senate Office Building,*  
*Washington, D.C.*

GENTLEMEN: This Commission is deeply disturbed by the action taken by the Federal Communications Commission November 5, 1969, in announcing it had negotiated with the Bell System an interstate toll rate reduction of \$237 million effective to the extent of \$150 million January 1, 1970 and the balance during the year 1970. The FCC completely disregarded the more realistic approach of effecting changes in separations procedures which would have equitably distributed among both interstate and intrastate telephone users the benefits to be derived from a reduction in the revenue requirements of the American Telephone and Telegraph Company.

The following applications for general increases in intrastate telephone rates are recently concluded in this state or are in the process of final determination:

1. Pacific Northwest Bell Telephone Company filed December 4, 1968 for and increase in intrastate toll and exchange rates approximating \$27 million per year. Final order of this Commission entered November 3, 1969, authorized \$14 million increase in exchange rates.

2. United Telephone Company of the Northwest filed September 2, 1969 for an increase of \$115,000 in intrastate exchange rates and was awarded the same amount by order of this Commission dated September 30, 1969.

3. General Telephone Company of the Northwest, Inc. filed on July 3, 1969 for a judgment as to fair level of return which will be followed by application to increase intrastate exchange rates in approximately January, 1970, by an amount now unknown.

A change in separation procedure assigning additional investment and expense to interstate support would immediately be considered in rate proceedings now pending before this Commission to the extent that intrastate revenue requirements would be affected. Such procedural changes effect shifts in revenue requirements to interstate for the independent industry as well as for the Bell System.

To the extent that changes in separations procedure will cause shifts in revenue requirements affecting companies for which rate making has recently concluded, this Commission will take early action in achieving recognition of such shifts in benefiting the exchange rate payer in this state. All such previous shifts have resulted in intrastate toll rate reductions in this state excepting the change surrounding the proceedings in FCC Dockets #16258 and #17975 which were considered in the recently concluded Bell Company rate case in this state.

It would, therefore, appear that the most immediate relief to states could be provided in causing the FCC to set aside the scheduled toll rate reductions and proceed at once to further separation changes which would assume an amount comparable to the scheduled reductions in increased revenue requirements to be absorbed by interstate operations.

Further, to assure long-term cooperate effort between state and federal regulatory interests in the vital area of separations, your favorable consideration of S. 1917 is urgently requested.

The representative designated to represent this Commission before your December 9, 1969, Committee considerations is the Honorable Francis Pearson, President of the National Association of Regulatory Utility Commissioners, and member of the Commission in this state.

Sincerely,

ROBERT D. TIMM, *Chairman.*

STATE OF WEST VIRGINIA,  
PUBLIC SERVICE COMMISSION,  
*Charleston, November 18, 1969.*

HON. JENNINGS RANDOLPH,  
*New Senate Office Building,  
Washington, D.C.*

DEAR SENATOR RANDOLPH: As you no doubt know, the Federal Communications Commission has recently announced an agreement with the American Telephone and Telegraph Company by which the company would reduce its rates for interstate toll service by \$150,000,000 per year, starting January 1, 1970.

At the same time, there are pending before various state commissions rate cases brought by Bell System Companies requesting increases of more than \$500,000,000 per year, including one by The Chesapeake and Potomac Telephone Company of West Virginia for \$11,000,000 in increased rates.

The inter-relationship between these two matters is caused by the fact that much of the telephone plant used for interstate toll calls is also used for intrastate business conducted by the various operating companies. Because of the joint use of such facilities, it is necessary to divide the costs associated with those facilities between interstate service and intrastate business by some method of allocation or apportionment.

For many years such allocation has been accomplished by use of a Separations Manual prepared by a committee representing the National Association of Regulatory Utility Commissioners and the Federal Communications Commission. That manual, with its numerous amendments, has been accepted by the various state commissions and, at least tacitly, by the Federal Communications Commission for many years. Recently, the FCC appears to have arrogated unto itself the power to say what costs shall be charged against the interstate business and what must be borne by the intrastate business.

Not only will this approach, if successful, result in the FCC's affecting drastically the regulation of intrastate commerce, but it also contributes to a situation where the toll rates for intrastate calls are substantially more than those for interstate calls of the same distance, even though the Bell System is

allowed to earn a higher rate of return on interstate service than it is on intrastate service.

Since the costs of either interstate service or intrastate service are drastically affected by the formula by which joint costs are apportioned between the two types of service, it would seem obvious that before one decides that interstate rates are too high while intrastate rates are too low, even though intrastate rates are already higher than interstate rates, a re-examination of the methods of allocating the costs would be appropriate.

In addition to the situation outlined above, which affects all states in substantially the same manner, West Virginia has its own peculiar problem in relation to separations between interstate and intrastate. In its recent AT&T rate case, the FCC approved a separations method which would have reduced the intrastate cost of service of the West Virginia Bell Operating Company by more than \$300,000 per year. However, upon the application of AT&T, that Company was permitted to put into effect a method which would increase the West Virginia cost of service by \$700,000. Although the latter plan apparently has not been finally approved by the FCC, it would increase the West Virginia intrastate cost of service by a million dollars over that which would have resulted from the FCC's order.

If the FCC is to be permitted to dictate to the states what a substantial portion of the cost of service for telephones in their state shall be, then the theory that each state shall be permitted to regulate intrastate commerce within its boundaries will become an illusion. We feel that in matters of joint concern to the states and to the FCC each should have an effective voice in the determination.

For this reason, the West Virginia Commission joins with NARUC and other interested states in urging the Congress to investigate this matter and to hold hearings on the Federal-State Communications Joint Board Act of 1969, introduced in the Senate as S. 1917 and in the House as H.R. 12150.

Although the bill may not represent the only solution to the problem or even the best solution, we believe that it will serve to focus the attention of the Congress upon a matter requiring an answer. In addition, we hope and believe that we can count on West Virginia's representatives in the Senate and the House to help protect West Virginia consumers from the arbitrary imposition of additional costs.

If we can furnish any additional information, please let us know.

Very truly yours,

ELIZABETH V. HALLMAN, *Chairman.*

#### STATEMENT OF PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

The Public Service Commission of West Virginia supports the position of the National Association of Regulatory Utilities Commissioners on the desirability of readjusting costs between interstate and intrastate telephone business rather than reducing interstate toll rates and urges consideration of the proposed Federal-State Communications Joint Board Act of 1969, S. 1917, as a means of solving problems in this area in the future.

Illustrative of the problems created by past and present regulatory practices is the disparity between the charges for toll calls entirely within the State of West Virginia and those partly in and partly outside the State of West Virginia. For example, a person-to-person call from Charleston, West Virginia, to Huntington, West Virginia, costs \$1.20, while a person-to-person call from Charleston, West Virginia, to Chesapeake, Ohio, costs \$0.65. Huntington and Chesapeake are separated only by the Ohio River and persons may call from one to the other toll free. Similarly, a person-to-person call from Charleston, West Virginia, to Bluefield, West Virginia, costs \$1.20, while a person-to-person call from Charleston, to Bluefield, Virginia, costs \$0.80. Bluefield, West Virginia, and Bluefield, Virginia, are separated only by the state line and also have free calling between them.

In each of these instances, the intrastate call and the interstate call are made over exactly the same facilities with minimal additions on the interstate call. The disparity between station-to-station rates between these points is similar but smaller.

Since interstate calls over the same facilities cost substantially less than intrastate calls and since earnings on the interstate business have always been higher than those on the intrastate business, it is apparent that it is the *method* of arriving at the costs of jointly used facilities to be assigned to each class of business which results in the difference. The heart of that method is the assignment of

costs related to jointly used facilities partly to interstate business and partly to intrastate business, a process which has been formalized in the Separation Manual.

Although we have stressed differences in toll rates for illustrative purposes, the effects of the separation process extend also, and perhaps more importantly, to exchange service. All costs not picked up by the interstate or intrastate toll service must be borne by the individual subscriber.

In addition to the question of the over-all assignment of costs between interstate and intrastate service, there is the perplexing question of the effect on individual states of any one method of separations. This matter has been, and continues to be, particularly vexing to this Commission. In 1967, the Federal Communications Commission approved changes in the Separations Manual which would have resulted in savings to West Virginia of \$480,000. This change was never placed in effect. On the contrary, as we understand it, the Bell System companies were permitted to place in effect on an interim basis their proposal which would have added \$700,000 to West Virginia intrastate business. This additional \$700,000 of expense is reflected in the Company's exhibits in the current rate case of The Chesapeake and Potomac Telephone Company in which it seeks a total increase of \$11,000,000. Although we understand that this question has not been finally answered, it is apparent that its effect on West Virginia can vary by over \$1,000,000, and this out of the total reduction to all states of less than \$100,000,000. We certainly could not say with any assurance what a total transfer of \$237,000,000 in revenue requirements from intrastate business to interstate business would mean to West Virginia, but we feel sure that it would represent a substantial portion of the increase now being requested from us.

The interstate telephone business rides piggy-back on the intrastate systems of the separate operating companies. It is extremely doubtful that it could survive in anything like its present form without the intrastate systems. On the other hand, the intrastate systems could survive, although not so well, without the interstate business. Interstate toll business may, for awhile, have been an infant requiring special care and feeding but it has now become a lusty giant which we feel should be required to bear a larger share of total system costs.

The West Virginia Commission urges this Committee and the United States Senate to give careful consideration to means of alleviating what we feel to be inequities in the assignment of costs between different services and, thus, between the ultimate consumers.

Respectfully submitted.

ELIZABETH V. HALLANAN, *Chairman.*

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STATE OF WISCONSIN,  
PUBLIC SERVICE COMMISSION,  
*Madison, Wis., December 9, 1969.*

HON. WARREN G. MAGNUSON,  
*Chairman, Committee on Commerce,  
U.S. Senate, Washington, D.C.*

DEAR CHAIRMAN MAGNUSON: Included in the duties of this Commission with respect to regulation of electric, gas, telephone, water and sewer public utilities operating in Wisconsin is the establishment of just and reasonable rates for telephone local exchange service and intrastate toll rates compatible in so far as possible with interstate long distance rates for similar route distances.

Accordingly, this Commission through its staff has actively participated for more than two decades in the joint Federal-state-industry cooperative efforts in the establishment of reasonable methods of separating telephone plant investment, operating expenses and revenues between jurisdictional operations and Bell and industry segments of the industry. This Commission has consistently used the benefits from improvements in separations procedures in the public interest to eliminate the disparity between intrastate and interstate long distance calling rates in Wisconsin.

During the past three years through activities in Docket 16258, Docket 16795, and the Rulemaking Notice of October 1, 1969, in Docket 18686, much of the prior cooperative work with respect to separations has been replaced with unilateral action by the Federal Communications Commission.

At this time when national efforts are directed to the arresting of current inflationary trends, proceedings are pending or anticipated in various states involving potential intrastate rate increases exceeding \$500,000,000 for Bell System operating companies. The Wisconsin Telephone Company has an application before our Commission for an annual increase of \$21,600,000.

By public notice on November 5, 1969, FCC announced a proposed reduction in interstate message toll rates for the Bell System which with present separations procedures will still result in a level of earnings substantially in excess of that considered reasonable by FCC in its order of July 5, 1967, in Docket 16258. We are deeply concerned as to the impact of such action and the present methods of providing changes in separations procedures upon the local exchange and intrastate toll rates of Wisconsin Telephone Company and the 130 independent telephone companies serving the residents of Wisconsin.

We are grateful for your response to the National Association of Regulatory Utility Commissioners' request for a hearing on this matter and the opportunity for our Commission to express to the Committee the importance of equitable separations procedures and our support of S. 1917, Federal-State Communications Joint Board Act of 1969.

For your information, we are attaching hereto a copy of our letter of December 5, 1969, to the Federal Communications Commission with respect to our concern at this time as to the affect of recent actions on consumers of telephone service in Wisconsin.

Sincerely,

ARTHUR L. PADRUTT, *Chairman.*

STATE OF WISCONSIN,  
PUBLIC SERVICE COMMISSION,  
Madison, Wis., December 5, 1969.

HON. DEAN BURCH,  
*Chairman, Federal Communications Commission,*  
Washington, D.C.

DEAR CHAIRMAN BURCH: Since establishment of the NARUC-FCC Committee on Telephone Regulatory Problems in 1947, this Commission has actively participated at all times in the development of equitable procedures for jurisdictional division of telephone property, revenues and expenses. In the public interest, this Commission has diligently utilized the benefits from improvements in separations procedures to eliminate the disparity between interstate and intrastate toll rates.

The Wisconsin Commission is now in the process of taking testimony on a rate application by Wisconsin Telephone Company to increase local exchange, intrastate toll and other intrastate charges by approximately \$21,600,000 annually. In other states similar proceedings are pending or anticipated, involving potential rate increases exceeding \$500,000,000.

Accordingly, we are gravely concerned with respect to the impact of your Commission's public notice of November 5, 1969, upon the local exchange and intrastate toll rates of Wisconsin Telephone Company and the 130 independent telephone companies serving the residents of Wisconsin. Said notice relates to the proposed \$237,000,000 reduction in interstate message toll rates for the Bell System.

Telephone utilities in Wisconsin are installing large additional amounts of central office equipment and subscriber plant. In many instances they are replacing present installations inadequate under present requirements for expanded service. Such plant additions and replacements have become necessary in part, from increasing interstate toll usage. After completion, the expanded plant will, in turn, also permit increasing and more effective use of the interstate toll network.

We consider that increasing amounts of subscriber plant and exchange central office equipment must be equitably allocated to interstate toll business on a usage or availability basis.

Although retained as a part of separations procedures in your order of July 5, 1967 (Docket 16258), your Commission's order of January 29, 1969 (Docket 17975), eliminated the "Modified Phoenix Plan" adopted in 1954 which was of continuing and increasing benefit to the telephone users of Wisconsin.

In July 1969, NARUC, following meetings of its Executive Committee and Communication Problems Committee, requested appropriate action by your Commission for elimination of the Modified Phoenix Plan over a three year period rather than by two steps in 1969. Such a "stretch-out" period for absorbing the adverse effects of the Phoenix Plan elimination would be of substantial benefit to the people of Wisconsin.

The Wisconsin Commission is of the opinion that before the FCC decision of November 5, 1969, is made effective, the FCC should publicly consider and pass upon the merits of the suggestions advanced by the NARUC Committees on Communications Problems at meetings this year in Maine, Colorado and New York. These included stretch use of the "Modified Phoenix Plan" and changes in procedures with respect to station equipment and local central office equipment. We are of the opinion that your proposed reduction in interstate rates should be accompanied by changes in separations procedures reducing prospective levels of interstate earnings to a point more consistent with the order of July 5, 1967. This would permit the state commissions to offset and resist at least in part the enormous interstate increases presently proposed by Bell System operating companies and likely to be presented by independent companies operating in the various states.

Accordingly, we respectfully request that your Commission give further consideration at this time to matters as expressed above with public hearings called, if necessary, so that evidence and testimony may be presented by interested parties including consumers, independent companies, state regulatory commissions and the NARUC.

Sincerely,

ARTHUR L. PADRUTT, *Chairman.*

#### STATEMENT OF THE WYOMING PUBLIC SERVICE COMMISSION

The best interest of the people of Wyoming were not considered and cannot be served by the recent decision of the FCC to apply \$237 million dollars in excess toll earnings of the Bell Telephone Companies only to the benefit of interstate toll users. This action disregards earlier cooperative action between the FCC and the various states' regulatory commissions which allowed benefits to be passed on to intrastate users.

This application of the excess earnings was a result of negotiations between the Federal Communications Commission and the Bell Companies to the exclusion of state regulatory bodies whose interest is vital and indispensable. This interest is illustrated by the fact that sixteen Bell System Companies have applications before state commissions requesting rate increases which total over *one-half billion* dollars.

The Wyoming Commission (and those of other states) has over the years worked diligently to eliminate a disparity in intrastate and interstate toll rates through the separations allocations and every means possible. In the past the FCC, realizing that without the intrastate systems there would be no interstate toll network, worked in cooperation with the state commissions in allowing a book shift of *intrastate* plant to interstate operations when an interstate toll rate reduction was imminent. Our state has required rate reductions each time such a shift was accomplished, with the rate reductions almost totally being applied to decrease the disparity between interstate and intrastate toll rates for the same distance called. The reductions required by the Wyoming Commission resulting from the cooperative state-FCC procedures were as follows:

May 1962	\$251,000
November 1964	34,000
February 1965	28,500
August 1966	167,700
November 1968	109,000
June 1969	742,200
<b>Total</b>	<b>1,332,400</b>

The substantial progress made by Wyoming and other states toward reducing intrastate toll rates to the level of interstate rates will be all but lost through the agreement by the FCC to allow the Bell System Companies interstate toll reductions without any consideration to the necessary coinciding allocation of property and related expenses of the Bell System Companies to the interstate system.

The inequity arises out of the fact that the FCC determined by its own separations procedures what portion of the total toll plant of the Bell System Companies will be interstate, with the remainder being loaded on *intrastate* operations. By controlling this key aspect and crediting the interstate toll operations with virtually all the benefits of technological improvements, interstate operations have consistently shown high and improving revenues, which when applied to the FCC determined rate base support rate decreases; however, we maintain that these decreases should not be applied to interstate operations solely.

Respectfully,

WALTER W. HUDSON,  
*Chairman.*  
PAUL T. LIAMOS, Jr.,  
*Commissioner.*  
ZAN LEWIS,  
*Commissioner.*

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WAHKIAKUM COUNTY POMONA No. 25

RESOLUTION—COMMUNICATIONS JOINT BOARD ACT

Whereas, telephone service billed to customers consists of long distance charges regulated by the Federal Communications Commission (FCC) and local monthly service plus intra state toll charges regulated by the various State Regulatory agencies; and

Whereas, costs of operation of the telephone companies has increased materially causing the Bell System Association Companies and many of the 1,850 Independent Telephone Companies to seek rate increases exceeding \$500 million before the several State Regulatory Agencies in many of the 50 states and other jurisdictions; and

Whereas, technological improvements in communication equipment and increasing volume of long distance toll calls has reduced the cost of handling such calls to the extent that the FCC has ordered interstate toll rate reduction of \$150 million by Jan. 1, 1970 and an additional \$87 million by Feb. 1, 1970 overlooking the fact that there is a local telephone at each end of the conversation and considerable amount of local equipment and facilities involved; and

Whereas, local exchange service has been experiencing rising costs and increasing rates which adversely affect the ordinary consumer because no single regulatory agency has looked to the broad public interest when considering national rated versus state and local rates; and

Whereas, there is a necessity for better coordination between national utility regulation by the FCC and that of the several states as represented by a quasi-governmental non-profit organization founded in 1889 called the National Association of Regulatory Utility Commissioners (NARUC); and

Whereas, the value of telephone properties of the Bell System used to determine rate making decisions exceeds \$30 billion, with \$22 billion subject to State and local regulation and approximately \$8.5 billion to FCC regulation or a ratio of 3 to 1; and

Whereas, accounting and separations procedures determine those portions of costs allocated to state telephone service and those allocated to interstate service by order of the FCC and similarly ordering revenue allocations on an arbitrary basis; and

Whereas, the NARUC has caused to be introduced in the Congress of the United States Senate 1917 in the Senate, and H.R. 12150 in the House of Representatives, which proposed legislation will create a joint Federal-State Board to review and determine settlements of interstate toll separations and thereby encourage greater coordination between Federal and State regulation of telephone rates; and

Whereas, the proposed legislation increases local voice and influence to help prevent inequities arising when one agency lowers rates and another agency rises rates without due consideration of the interest of the ultimate consumer who ends up paying the dollars in some form or another; therefore be it

Resolved, that Wahkiakum County Pomona Grange requests that the Congress

of the United States immediately enact the proposed legislation known as the Federal-State Communications Joint Board Act (1969), and which is presently pending in Congress as H.R. 12150 and Senate 1917; and

Be it further resolved that a copy of this resolution be sent to the Washington State Grange, to each of the Congressional Delegation from the State of Washington, to the Hon. Dean Burch, Chairman of the Federal Communications Commission, to Hon. Robert D. Timm, Chr. Washington Utilities and Transportation Commission, to Hon. Francis Pearson, President of the National Association of Regulatory Utility Commission, Chr. Senate Commissioners, Chr. U.S. Senate Committee on Commerce, Chr. of the House Committee on Commerce, Chr. of the House Committee on Banking and Commerce and to the U.S. Independent Telephone Association.

Passed in regular session of Wahkiakum Pomono Grange #25 Jan. 8, 1970.  
Fraternally submitted,

ROBERT LARSON, *Master.*  
BETHENIC FOSTER, *Secretary.*

