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94-68 COMMON CARRIER PROCEEDINGS

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HEARING

BEFORE THE

COMMITTEE ON COMMERCE

UNITED STATES SENATE

NINETY-FOURTH CONGRESS

FIRST SESSION

ON

S. 2054

TO AMEND SECTIONS 203 AND 204 OF THE
COMMUNICATIONS ACT OF 1934

SEPTEMBER 17, 1975

Serial No. 94-68

Printed for the use of the Committee on Commerce



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COMMON CARRIER PROCEEDINGS

WEDNESDAY, SEPTEMBER 17, 1975

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

The committee met at 10:05 a.m. in room 1318 of the Dirksen Senate Office Building; Hon. John O. Pastore presiding.

Senator PASTORE. The Committee meets today to consider S. 2054, a bill to amend certain provisions of the Communications Act of 1934, with respect to common carrier tariff filings. Specifically, S. 2054 would amend sections 203 and 204 of the act to extend to 90 days the period of notice required before a tariff may be changed; to extend from 3 months to 9 months the period for which the Commission may suspend new or revised tariff schedules; and to authorize the Commission, based upon a preliminary written proceeding, to grant or suspend a tariff in whole or in part, pending a hearing and decision on the lawfulness thereof or to grant temporary authorization of the tariff.

[The bill and agency comments follow:]

[S. 2054, 94th Cong., 1st Sess.]

A BILL To amend section 203 and 204 of the Communications Act of 1934.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. Section 203(b) of the Communications Act of 1934 (47 U.S.C. 203 (b)) is amended by deleting "thirty" and inserting in lieu thereof "ninety".

SEC. 2. Section 204 of the Communications Act of 1934 (47 U.S.C. 204), is amended to read as follows:

"SEC. 204. (a) Whenever there is filed with the Commission any new or revised charge, classification, regulation, or practice, the Commission may either upon complaint or upon its own initiative without complaint, upon reasonable notice, enter upon a hearing concerning the lawfulness thereof; and pending such hearing and the decision thereon the Commission, upon delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such charge, classification, regulation, or practice, in whole or in part but not for a longer period than nine months beyond the time when it would otherwise go into effect; and after full hearing the Commission may make such order with reference thereto as would be proper in a proceeding initiated after such charge, classification, regulation, or practice had become effective. If the proceeding has not been concluded and an order made within the period of the suspension, the proposed new or revised charge, classification, regulation, or practice shall go into effect at the end of such period; but in case of a proposed charge for a new service or an increased charge, the Commission may by order require the interested carrier or carriers to keep accurate account of all amounts received by reason of such charge for a new service or increased charge, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order

Staff members assigned to these hearings: Joseph R. Fogarty, James Graf, and Nicholas Miller.

require the interested carrier or carriers to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such charge for a new service or increased charges as by its decision shall be found not justified. The Commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible.

"(b) Notwithstanding the provisions of subsection (a) of this section, the Commission may allow part of a charge, classification, regulation, or practice, to go into effect, based upon a written showing by the carrier or carriers affected, and an opportunity for written comment thereon by affected persons, that such partial authorization is just, fair, and reasonable. Additionally, or in combination with a partial authorization, the Commission, upon a similar showing, may allow all or part of a charge, classification, regulation, or practice to go into effect on a temporary basis pending further order of the Commission. Authorizations of temporary new or increased charges may include an accounting order of the type provided for in subsection (a)."

OFFICE OF TELECOMMUNICATIONS POLICY,
EXECUTIVE OFFICE OF THE PRESIDENT,
Washington, D.C., September 17, 1975.

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

DEAR MR. CHAIRMAN: This is in response to your request for the views of the Office of Telecommunications Policy on S. 2054, proposed legislation to amend Sections 203 and 204 of the Communications Act of 1934. This bill would:

(1) extend from thirty days to ninety days the period of notice required before a tariff may be changed;

(2) extend from three months to nine months the period during which the Federal Communications Commission may suspend new or revised tariff schedules;

(3) authorize the Commission to conduct preliminary written proceedings to determine whether a tariff filing should become effective in whole or in part pending a hearing and decision on the lawfulness thereof, or whether temporary authorization of a tariff filing should be permitted.

To summarize our position, we believe that statutory amendments to extend the notice period to ninety days and to enable the Commission to grant partial or temporary authorization of tariff changes are appropriate and desirable. However, we are skeptical, for the reasons discussed herein, about extending the statutory tariff suspension period from three months to nine months.

Extension of Notice Period.—Sections 203(b) of the Communications Act presently prohibits carriers from making tariff changes except after thirty days notice to the Commission and the public. The same section provides that the Commission "may, in its discretion and for good cause shown, modify [the notice requirement] in particular instances or by a general order applicable to special circumstances or conditions."

In the past, the Commission has found that the thirty day notice period was insufficient in cases involving tariff increases. Such filings generally draw considerable opposition, and the Commission was unable within the thirty day period to review the tariff filing, together with the contentions of parties opposing it, and to reach a decision on whether or not to suspend it and order a hearing. The Commission therefore has modified its rules to require that all tariffs involving increased rates be filed on sixty days notice. 47 C.F.R. § 61.58 (1973). This modification was challenged shortly after its adoption on the sole ground that it was beyond the Commission's statutory authority as set forth in the above-quoted language. The court disagreed, however, noting that the authority to "modify" included the power to lengthen as well as shorten the notice period. *AT&T v. FCC*, 503 F.2d 612 (2d Cir. 1974).

The proposed legislation would extend the notice period to ninety days for all tariff changes. The Commission notes in its Explanation of Proposed Amendments introduced with the bill (121 Cong. Rec. 11965, daily ed. July 8, 1975) that such an extension is "particularly necessary to facilitate effective utilization of the Commission's power to authorize temporary or partial tariff changes," proposed in Section 2(b) of the bill. We agree. As we discuss later, we believe that the proposed authority to grant partial or temporary rate changes pending a full inquiry by the Commission is a necessary and appropriate measure, and

that the Commission will need additional time to make the requisite determinations prior to authorizing a temporary or partial change.

We do note that there may be a question concerning the necessity of a statutory amendment to achieve this objective. In view of the judicial construction of the Commission's existing power to modify the notice period, it would appear that the Commission could extend the period to ninety days without new statutory authority, and that it could do so for all tariff changes, decreases as well as increases, assuming it could show "good cause" for lengthening the period. Nevertheless, given the previous challenge to the Commission's prior exercise of its authority to modify the notice period, it is advisable, on balance, to seek an explicit statutory change and thereby avoid protracted litigation.

Suspension Period.—The Communications Act provides generally that tariff changes go into effect automatically at the end of the requisite notice period unless the Commission takes affirmative action to the contrary. Section 204 of the Act authorizes the Commission to designate a tariff filing for hearing and, pending completion of such hearing, to suspend the operation of the tariff for a period not longer than three months beyond the time when it would otherwise take effect. If the hearing process is not completed by the expiration of the suspension period, the tariff automatically takes effect, and, in the case of an increase in rates, the Commission may require a carrier to account for all funds received pursuant to the new tariff. Upon completion of the hearing, the Commission may order refunds with interest if the tariff, or a portion thereof, is found to be unlawful.

The Commission states in its "Explanation," *supra*, that it has been unable to conclude tariff hearings prior to the expiration of the present three month suspension period, and that a longer suspension time is therefore necessary. A longer suspension period, according to the Commission, will reduce the amount of time during which consumers are without the use of their money and simplify the accounting burden borne by the carriers.

In assessing the merits of the proposed legislation, it is appropriate to address the rationale behind the present suspension provisions of the Act. The statutory limit on the duration of a tariff suspension represents a Congressional recognition of the economic harm to carriers resulting from lost revenues during the time it takes a regulatory agency to decide the lawfulness of a tariff change. This has been recognized by the courts on numerous occasions. The Court of Appeals for the Second Circuit, for example, has pointed out that the statutory scheme "reflects the realization of Congress that when a carrier is prevented from placing in effect new rate increases it may suffer irreparable loss which in turn may impede the provision of adequate service during a period of rising costs." *American Telephone and Telegraph Co. v. FCC*, 487 F. 2d 864 (2d Cir. 1973). Similarly, the Supreme Court, in discussing the limited suspension authority granted to the Federal Power Commission, stated:

"Business reality demands that natural gas companies should not be precluded by law from increasing the prices of their product whenever that is the economically necessary means of keeping the intake and outgo of their revenues in proper balance; otherwise procurement of the vast sums necessary for the maintenance and expansion of their systems through equity and debt financing would become most difficult, if not impossible." *United Gas Pipeline Co. v. Memphis Gas Division*, 358 U.S. 103, 113 (1968).

The Congress has also recognized, however, that when a new tariff goes into effect prior to a determination of its lawfulness, rate-payers should be made whole if the tariff is ultimately found unlawful. Thus, in *United States v. S.C.R.A.P.*, 412 U.S. 669 (1973), the Supreme Court noted in connection with the Interstate Commerce Commission's authority to suspend rate increases that: ". . . Congress was aware that if the Commission did not act within the suspension period, then the new rates would automatically go into effect and the shippers would have to pay increased rates that might eventually be found unlawful. To mitigate this loss, Congress authorized the Commission to require the carriers to keep detailed accounts and eventually to repay the increased rates if found unlawful." 412 U.S. at 697.

The Act is thus an attempt to balance the interests between rate-payers and carriers with regard to tariff increases. We are sympathetic with this legislative proposal to lengthen the suspension period to nine months so as to reduce the amount of time during which rate-payers would be deprived of the use of their money. But we are mindful that the proposal would also increase the amount of

time during which carriers would be precluded from receiving increased revenues under new rates. As a matter of equity in this regard, it is significant that even if the new rates were ultimately found lawful after completion of a hearing, the carrier would be unable to recover the revenues which it would have received but for the suspension, whereas customers have the benefits of the refund provisions if the rates are found unlawful.

The adverse effects of "regulatory lag," i.e., the delay between the time when increased costs occur and the time when they can be reflected in higher tariffs, can be significant, particularly in an inflationary period. If a carrier is prohibited for an extended period of time from instituting tariff increases to cover rising costs, its ability to attract capital, whether debt or equity, could be impaired with a consequent and adverse impact on the provision of adequate service to its customers. The adverse effects of regulatory lag on the electric utilities, for example, was the genesis of the Administration's recent proposal to reform state regulatory processes by imposing a maximum limit of five months for rate and service proceedings. See "White House Fact Sheet," p. 39, January 15, 1975.

The Commission has also stated that a longer suspension period is needed for situations involving tariffs for new services or reduced rates, in which case the accounting and refund provisions of § 204 are not applicable. The Commission notes that customers may make major changes in their operations based on the availability of rate schedules ultimately found to be unduly preferential or discriminatory, and that an order directing cancellation of the unlawful rate schedule would cause serious dislocations. The proposed nine month suspension period would, in the Commission's view, minimize this problem.

Tariffs for reduced rates or new services have often been the result of competitive pressures on the established carriers in various communications submarkets. It has been recognized that long delays in the implementation of tariffs for new services and lower rates can also have an adverse impact on carriers. As the Court stated in *AT&T v. FCC, supra*, "the loss sustained when an agency delays a rate reduction can be equally as damaging, for during the delay customers may turn elsewhere and be permanently lost to the carrier." 487 F. 2d, *supra*, at n. 18.

On the other hand, if such a tariff were ultimately found unlawful, customers who might encounter "dislocations" as a result of an order directing cancellation of the rate or service would have no remedy comparable to the refund provisions available in the case of an unlawful increase. Similarly, no remedy would be available to competitors of the carrier who may have suffered a loss of customers who were attracted to the carrier's new services or lower rates. In view of these considerations, lengthening the suspension period for only those tariff changes involving new services or reduced rates may be an acceptable alternative.

In any event, we believe that there should be an increased emphasis on completing tariff proceedings as expeditiously as possible. In this regard, we note that the Commission, in its "Explanation" accompanying the bill, states that "improvements in procedures, together with expanded staff assigned to rate matters should shorten the time between tariff filing and decision in hearing cases." In addition, the Commission refers to discussions it has had with carriers regarding the development of more expeditious methods of obtaining cost information relating to the various services. We applaud these measures and would encourage the Commission to pursue these and similar steps designed to expedite the tariff investigative process.

Partial and Temporary Rate Increases.—The proposed legislation would also amend § 204 to permit the Commission to authorize temporary or partial tariff changes. This change is generally consistent with the 1972 recommendation of the Administrative Conference that regulatory statutes should be amended, to the extent that existing authority is lacking, to authorize temporary and partial rate increases.

We believe that statutory authority to grant partial increases, as an adjunct to authority to suspend a proposed increase in full or allow it to go into effect without suspension, would mitigate somewhat the adverse effects of "regulatory lag" on carriers. Such authority is particularly appropriate given that, in many cases, an ultimate determination of the unlawfulness of a tariff increase goes to only part of the increase, rather than the entire tariff change.

We do note, that the language of the proposed amendment is somewhat unclear. The report of the Administrative Conference states that temporary increases should be authorized "only when the agency makes a preliminary judg-

ment, on the basis of a written showing by the regulated company and an opportunity for comment thereon by affected persons, that a proposed increase is justifiable at least in part." (See "Report of the Administrative Conference of the United States for 1971-1972," at p. 86, emphasis added.) The language of the proposed amendment differs from this recommendation in certain respects.

The amendment, for example, eliminates the "preliminary judgment" aspect of the Administrative Conference recommendation, and the proposed standard of "just, fair, and reasonable" is somewhat ambiguous. We suggest that a more precise standard be developed, lest the deliberations regarding a partial or temporary authorization become as protracted as an overall rate inquiry.

The Office of Management and Budget advises that it has no objection to the submission of this report from the standpoint of the Administration's program.

Sincerely,

JOHN EGER,
Acting Director.

FEDERAL COMMUNICATIONS COMMISSION,
Washington, D.C., January 26, 1976.

HON. JOHN O. PASTORE,
*Chairman, Subcommittee on Communications, Committee on Commerce,
U.S. Senate, Washington, D.C.*

DEAR MR. CHAIRMAN: Thank you for the opportunity to comment upon the letter submitted by the Office of Telecommunications Policy concerning S. 2054, a bill to amend sections 203 and 204 of the Communications Act of 1934.

Essentially, OTP supports as appropriate and desirable the provisions of S. 2054 to extend the notice period to ninety days and to enable the Commission to grant partial or temporary authorizations of tariffs. It expressed concern, however, that the proposed nine-month suspension period is too long and might result in greater regulatory delay than presently exists.

The period of nine months was chosen because it was felt that during such a period the Commission could realistically come to a conclusion on the lawfulness of a tariff. However, as I testified, there is nothing sacred about the period of nine months.

We have discussed this matter with OTP. While the Commission would prefer the nine-month suspension period, we believe an extension of the present three-month period to five months would be helpful and in the public interest. I understand OTP agrees that the five-month period would meet their earlier objections.

I trust that, with such change, you will be in a position to move promptly in enacting S. 2054.

If further information is needed, I would welcome the opportunity to provide it.

Sincerely,

RICHARD E. WILEY,
Chairman.

Senator PASTORE. We have as our first witness today, the Chairman of the Federal Communications Commission, the Honorable Richard E. Wiley, who, I understand, has a statement to make. This is legislation which I understand is being sponsored by the administration; is that correct?

STATEMENT OF HON. RICHARD E. WILEY, CHAIRMAN, FEDERAL COMMUNICATIONS COMMISSION; ACCOMPANIED BY WALTER HINCHMAN, CHIEF, COMMON CARRIER BRANCH

Mr. WILEY. I believe the administration, OMB, has indicated they have no objection to this legislation.

Senator PASTORE. It is being advanced by the executive department; is that correct?

Mr. WILEY. No; it is strictly the FCC bill. OMB, as I understand it, has no objection.

Senator PASTORE. You are a part of the executive department, are you not?

Mr. WILEY. No.

Senator PASTORE. Well, we are the legislative, the courts are the judicial. What are you?

Mr. WILEY. An arm of Congress, an independent regulatory agency.

Senator PASTORE. All right. Now that we have that straightened out, you may proceed.

Mr. WILEY. Mr. Chairman, I very much appreciate this opportunity—

Senator PASTORE. In other words, I am trying to determine here that this is not a bill introduced by a Senator or Congressman.

Mr. WILEY. No.

Senator PASTORE. This is FCC-sponsored legislation; is that correct?

Mr. WILEY. Yes, sir.

Senator PASTORE. All right.

Mr. WILEY. I appreciate this opportunity to appear before the subcommittee to express the views of the FCC with respect to S. 2054, which as you mentioned, is a bill to amend sections 203 and 204 of the Communications Act of 1934, concerning tariffs filed by communications common carriers. As you know, this bill was introduced at the request of the Commission.

In our judgment, the Commission's authority to process tariffs filed by communications common carriers is no longer adequate to the task. The existing law on this subject was drafted in an era when communications media were far less complex and the Commission's hearing docket was considerably lighter.

We believe that the enormity and complexity of current tariff filings warrant amendments to the Communications Act which will confer upon the Commission additional authority to respond effectively to the demands currently placed upon us by the public, and the industries which we regulate.

In seeking this legislation, it is our intent to foster a regulatory framework in which the interests of consumers and carriers may be placed in balance and each afforded equitable treatment.

We believe that this intent can be realized if the Congress will amend the Communications Act in three ways:

(1) Extend from 30 to 90 days the period of notice which a carrier must give before a tariff may be changed; (2) Extend from 3 to 9 months the period for which the Commission may suspend a new or revised tariff schedule; and (3) Authorize the Commission, based upon a preliminary written proceeding, to grant or suspend a tariff in whole or in part pending hearing and decision on its lawfulness, or to grant temporary authorization of a tariff.

PERIOD OF NOTICE

Subsection 203(b) of the Communications Act currently requires a carrier to give the Commission and the public 30 days notice of its intent to alter a tariff. During this period affected consumers must analyze the tariff changes and prepare and file comments with the Commission.

In the same time frame, the Commission must review the proposed changes and determine whether it should implement it in full or designate it for hearing and order that its operation be suspended.

Senator PASTORE. All within 30 days?

Mr. WILEY. Yes, all within 30 days.

When the requirements of due process are factored in, we are sometimes left with as little as a week to examine the comments of the various parties and to make an appropriate public interest finding. Such a short period of time is inadequate, we believe, to conduct an effective review of current tariff filings, some of which may run to 8,000 or more pages. Citizens groups, law firms and even large corporations have complained to us that they have inadequate time to prepare their comments.

Senator PASTORE. Have you any documentation or experience with reference to how long it takes the carrier to put together the rate or tariff change?

Mr. WILEY. I have with me Mr. Hinchman, Chief of the Common Carrier Bureau. Perhaps he has the background on that.

Senator PASTORE. How long does it take the carriers to put this document together, that is, the filing you must analyze and decide upon in 30 days?

Mr. HINCHMAN. Mr. Chairman, I don't know that we have an accurate estimate of that. I did know that, for instance, in the recent \$717 million rate increase A.T. & T. filed last January, I believe they had been working on that for a period of 6 months or more before it was filed.

Senator PASTORE. I would hope that the telephone representatives will give us an idea just how long it takes them to put the tariff together.

Mr. WILEY. Suffice it to say we would all agree, I am sure, that it would be considerably longer than 30 days.

In 1973, the Commission amended its rules to extend the notice period to 60 days when increased charges were sought. This action was sustained by the Second Circuit Court of Appeals which found that our power to "modify" the notice period included the power to extend it (*A.T. & T. v. FCC* (2d Cir.) No. 73-1758, decided Sept. 23, 1974).

However, the court's opinion did not authorize us to further extend this 60-day period nor to increase beyond 30 days the notice period applicable to filings where increases were not at issue.

For these reasons, we believe that our most appropriate recourse is through amendatory legislation. Accordingly, we propose that Congress authorize us to require up to a 90-day notice period. We recognize that the full 90 days will not be necessary in all cases, and we resolve to use this maximum period of time only where circumstances compel us to do so.

There is an important point on the next page. This additional time is particularly necessary to facilitate effective use of the authority we seek elsewhere in this legislation to authorize temporary and/or partial tariff changes. Under this authority, we would utilize the additional time to conduct a preliminary paper proceeding during which we would determine whether a tariff change should be authorized temporarily and/or partially without formal hearing.

I shall discuss the mechanics of this preliminary proceeding later in my statement.

Senator PASTORE. Do I understand that under the present law you have the authority within 30 days to deny the tariff increase?

Mr. WILEY. Yes, we can deny it.

Senator PASTORE. Is that denial subject to judicial review?

Mr. WILEY. Yes, it would be.

Senator PASTORE. And must you give the reasons why you have denied the filing?

Mr. WILEY. Yes, we would do that, and it would be a final order of the Commission.

Senator PASTORE. Are you saying that within the 30 days it is difficult for you to make an analysis that would stand up?

Mr. WILEY. It would be difficult to do that. It would also be particularly difficult to try to utilize any new authority we might be given to grant temporary partial relief. We were able to do so in this most recent grant of \$365 million, out of a request of \$717 million; because there was a prescription of rates. That is, the Commission has previously prescribed the rate of return, and therefore we could effect the partial increase appropriately. But normally speaking, we would not be able to do that.

We think this temporary or partial relief is something which the carriers have not stressed in their testimony to this committee that will follow, and we think it is perhaps the balance wheel to this entire piece of legislation.

And to really do that effectively, you have to have an extension of the notice period.

We think the 90 days, certainly anything more than 30, would be helpful.

Senator PASTORE. Have you any knowledge at all as to what the time limitation may be in the various States?

Mr. WILEY. Yes; in many States—when we get to the suspension part of the testimony—it is considerably longer than the 3 months we are talking about. In some States it runs as high as a year. In your own State, for example, it is 9 months, similar to what we are requesting. I am talking here about the suspension periods, actually.

Senator PASTORE. You didn't pick out the 9 months because that is the Rhode Island law, did you?

Mr. WILEY. No. We picked out the 9 months—let me be very candid here, there is no magic to that figure—we picked the figure we felt was our best estimate of the optimum time using the most effective means to expedite a hearing where we could get the job done in that period.

The Congress may see fit to grant us a shorter period of time. I would hope not. But certainly, 3 months is clearly an insufficient amount of time.

Senator PASTORE. Let me ask you this; has your experience under the 30-day rule been that you have either had to deny out-of-hand or grant out-of-hand? I mean what has been the experience? If this has been cumbersome, what has been the experience?

Mr. WILEY. Usually, what happens is we take the road of suspending the tariff, Mr. Chairman. We suspend the tariff for the 90-day period, within that 30-day period. It is very difficult to make a final decision.

Senator PASTORE. So what have you been doing?

Mr. WILEY. During the 30-day period?

Senator PASTORE. Yes.

Mr. WILEY. We point out in the testimony a number of things have to take place before we are in a position to make a decision. The parties have to have an opportunity to file their comments. Usually, the Commission ends up with about 4 or 6 days to make a rather crucial decision. And ultimately what we do is to suspend the tariff for a 90-day period, and then try to deal with it during that time frame. Either initiate a hearing or work with the carrier to try to develop an agreement, as far as a partial authorization, and put the rest in hearing, or what have you.

Senator PASTORE. If you don't make a decision within that period, does this higher tariff automatically go into effect?

Mr. WILEY. Yes, sir, if we didn't suspend it, it would go into effect. We have the authority under existing law to suspend it up to 90 days.

Senator PASTORE. Are you actually saying that you either suspend without fully realizing the impact, because you haven't had sufficient time to analyze it, or you automatically let it go into effect?

Mr. WILEY. Or find some reason to deny it, yes; that is absolutely correct.

Senator PASTORE. All right. You may proceed.

Senator PEARSON. If it goes into effect and you have an adverse finding, you have a rebate on the end; is that the way it works?

Mr. WILEY. Excuse me?

Senator PEARSON. If you let it go into effect and later you have an adverse finding, you have a rebate on the end?

Mr. WILEY. If we institute an accounting order relative to the rate increase, that would be correct. The only problem with the accounting order is that it is extremely expensive, and that expense is borne ultimately by the rate payer, and it does not reach each and every person who has paid the higher increase.

For example, concerning one of the most recent filings, A.T. & T. told us it is costing them on the order of \$5 million a year to maintain the accounting order. It would take \$3 million to settle it, and they estimate they have lost probably 13 million separate accounts.

After all, the person who puts his money in the pay phone and pays a higher rate, let's say, is never going to see a refund on that. So we think the accounting order is really an imperfect device to protect all of the rate payers against increased charges. And I think you can't simply put it down as a panacea to take care of any overcharges that the Commission ultimately determines must be refunded.

Senator PASTORE. You may proceed.

Mr. WILEY. Let me turn now to the period of suspension, which is the 3-month period.

Section 204 of the Communications Act authorizes the Commission, upon complaint or upon its own initiative, to designate a tariff filing for hearing and suspend its operation for a period of not longer than 3 months beyond the time it would otherwise take effect. The tariff becomes effective at the end of the suspension period, even if the hearing process remains incomplete. When an increased charge is sought, the Commission may also order a carrier to account for all funds received under the increase following the suspension period. Upon com-

pletion of the hearing, refunds with interest may be ordered as appropriate.

Much like the period of notice, the current 3-month period of suspension is clearly inadequate. The Commission simply cannot complete formal hearings on complex tariff filings within this period. To illustrate the time constraints we face, let me trace the steps which we must take during our consideration of tariff matters.

Initially, the Administrative Procedure Act (APA) requires that we give reasonable notice—generally interpreted as 30 days—of the time and place for hearing. We then must schedule a prehearing conference among the parties to establish procedures for the hearing and resolve uncertainties as to its scope or purpose. Then we conduct the hearing, which generally consists of several rounds of written and/or oral testimony and cross-examination.

Following the hearing, we afford the parties 20 days to file proposed findings of fact and conclusions—which is inadequate and usually must be extended.

The APA then requires us to provide 30 days for the filing of exceptions to the initial decision, which is often extended at the request of the parties.

When the amount of time required to hold the hearing itself and to prepare the initial and final decisions are considered, particularly in the kind of complex tariff filing we are talking about, it is apparent that it is impossible to conclude the process within the present 3-month suspension period.

In recent cases, the Commission has taken what actions it can under existing law to expedite the hearing process. For example, in Docket 19919, an investigation into A.T. & T.'s Hi/Lo private line rate structure, and Docket 19989, an investigation into A.T. & T.'s WATS tariff revisions, we substituted paper evidentiary proceedings for the usual time-consuming oral hearings and established separate trial staffs to handle these matters.

Although these recent proceedings have not been completed within the 9-month period which we now propose, we believe that this is a reasonable target for future proceedings. The procedural improvements noted and special trial staffs assigned to rate cases should continue to shorten the time we require to act upon tariff filings.

Since the proposed period more realistically reflects the amount of time required for a tariff proceeding to run its full course, we will be able either to minimize or avoid completely the heavy cost of accounting and refund procedures—costs which are ultimately borne by the consumer—while at the same time protecting the consumer's interest in the interim.

Let me turn to what I consider to be perhaps the most important aspect of this proposed legislation, temporary and/or partial authorization. I would have to say in all fairness that the carriers in their testimony today, at least as I read their written testimony, are minimizing the importance of this segment of the interim package. It is, indeed, the balancing factor which makes the whole package, in my opinion, acceptable.

Current section 204 authorizes the Commission only to suspend a tariff filing in full or to implement it in full. The Commission does not

have general authority, under present law, to separate questionable from clearly justified aspects of a filing, that is, pick out that part of a filing we feel there is no question on and institute that right away, thereby limiting the hearing and going to hearing only on the more complicated and questionable aspects.

Furthermore, the Commission does not now have the authority to implement a tariff change temporarily. Consequently, clearly justified changes often must await completion of a hearing on questionable elements of a tariff and unnecessary regulatory lag may result.

The amendatory language we propose will confer upon us the flexibility necessary to respond to these circumstances equitably, and expeditiously with benefits to both carriers and consumers. It will authorize us to determine whether a tariff filing should become effective or be suspended in whole or in part pending hearing.

It will also enable us to conduct a preliminary paper proceeding during which we can elect to allow partial tariff changes to go into effect finally, or temporary changes to become effective subject to further orders of the Commission.

Partial authorizations could provide carriers with additional revenue, where warranted, without awaiting the outcome of the hearing process. An accounting order could be issued in connection with a temporary tariff change involving a new or increased charge.

We, of course, share the concern of those who express the view that we should take no action—that is, Congress should take no action contributing to the problem of regulatory lag, and thereby lengthen the period of time during which carriers are unable to obtain justifiable rate relief.

We wish to emphasize that it is not our intent to cause unnecessary delays, nor do we believe that S. 2054, if enacted, will have this effect.

To the contrary, we believe that this legislation will result in an overall acceleration of the administrative process. While S. 2054 would extend both the period of notice and suspension, the authority we seek to grant temporary and/or partial rate changes will offset the impact of these extensions.

For these reasons, we believe that this legislation strikes a proper balance between the interests of carriers and consumers and should enable the Commission to administer tariff proceedings more efficiently.

I might say because there has been some question raised on this that we definitely would plan to act on the tariff or partial grants during that extended 90-day notice period.

Senator PASTORE. Now let me ask you this question: In the event you do make a temporary grant, partial grant, and you go to a hearing on the balance of the schedule, and you determine against the Telephone Co. and they take an appeal, what goes up before the appeals court? What you granted, as well as what you denied?

Mr. WILEY. Of course I would assume they would not be appealing the temporary grants, so that would not be a part of that particular appeal. This isn't to say some other party couldn't come in and attempt to also—

Senator PASTORE. But is the temporary grant separable from the matter that goes to the hearing?

Mr. WILEY. To the extent to which you determine its level. I think we have to distinguish between temporary and partial.

Senator PASTORE. All right. You say temporary partial grant.

Mr. WILEY. Temporary or partial. The partial is where we have already said, "Look, this part of it is justified, we will let you put it into effect right away." The other part we are going to question and look at in the hearing and you suggested—

Senator PASTORE. The question I am asking, the part you question, if you make a determination and it is appealed to the court, what happens to the partial grant you made? Does that go before the courts, too?

Mr. WILEY. Well, I would assume the whole thing, would ultimately be part of the appeal.

Senator PASTORE. All right. What if the court determines that even the partial grant that you made was unreasonable? Must there be a rebate?

Mr. WILEY. Well, if we had put in an accounting order—

Senator PASTORE. After all, if you make a partial grant, they can begin to collect on that, can they not?

Mr. WILEY. Let me make this clear—

Senator PASTORE. Now, you say you want to appeal that, too. So if that is appealable, and a determination is made, that whole package is an overcharge, then what happens to the money that was paid under the partial grant?

Mr. WILEY. Let me say, first of all, it would be our intent to grant partial relief where we think it is clear under the facts and is fully justified. In other words, something that is susceptible to mathematical computation, like the change in the cost of debt. Everything is appealed these days, and I wouldn't deny it would be part of an overall court test. I think that problem might not be as important as it would otherwise seem. But of course, if the carrier does collect money, and there is an accounting order, someone ultimately would pay. Our problem is of course—

Senator PASTORE. So that everybody can understand this, today the notice is 30 days, and the suspension period is 3 months.

Mr. WILEY. Right.

Senator PASTORE. You want to take the 30 days and make it 3 months, and you want to take the 3 months and make it 9 months.

Mr. WILEY. That's right.

Senator PASTORE. Is that what this amounts to?

Mr. WILEY. Right.

Senator PASTORE. At the same time you want the authority to make partial grants?

Mr. WILEY. Temporary and/or partial.

Senator PASTORE. Which you do not have the right to do now.

Mr. WILEY. Under general authority we do not. We did grant in the last case a partial grant simply because we had previously prescribed the rate of return, in the Commission's opinion at least, and that gave us a hold on it, shall we say, that under the normal tariff situation we would not have. I think for purposes of our discussion, essentially we do not have the authority today.

Senator PASTORE. Any questions?

Senator STEVENS. I have some questions. Senator Pearson has requested me to ask on his behalf.

Mr. WILEY. I should correct one thing only. We have on our own extended the 30-day period to 60 days and the court did affirm us on that.

Senator PASTORE. But they wouldn't let you go beyond the 60 days.

Mr. WILEY. Yes.

Senator PASTORE. I read about that; yes.

Mr. WILEY. All right.

Senator STEVENS. Is a large part of the reason for the FCC delay in acting on its telephone rate cases due to the additional filing requirements imposed by the Commission in recent years?

Mr. WILEY. I think the primary reasons for delay are the complex issues. I think we all share some fault—if fault is the word to use. The Commission processes are too slow, and we are trying to do all we can about it. But I also have to say that I don't think the carriers have much incentive to move the hearing along either, because, after all, once they get beyond the suspension period, their full rate is in effect, and I think if we had a longer period, perhaps all of us could work together to try to find procedures which would move those hearings along.

I think everybody would agree that is in the public interest.

Also, of course, we are attempting to institute, I think for the first time, some real surveillance procedures, broadening the effort which has been started by the A.T. & T. Task Force. In the so-called phase II hearing, we are trying to develop the economic models and surveillance principles that will allow us to have a true review of the carriers' rates so that we can perhaps eliminate some of the questions that arise in these tariff proceedings. But I think whatever additional requirements the Commission has imposed in recent years have been absolutely justified to protect the American consumer—the ratepayer.

Senator STEVENS. I am informed the major rate cases in the last 5 years have taken up to 2 years to complete.

Mr. WILEY. Yes.

Senator STEVENS. If that's the case, is there any assurance that even 9 months would be adequate?

Mr. WILEY. We don't say 9 months is going to complete every hearing. But we tried to pick a date we felt would be at least a target, which utilizes the new expedited procedures, such as paper proceeding and separate trial staffs, which are now becoming a fact of life in the Commission. We feel that it at least is a target date.

Some of the complex filings, say, A.T. & T. tariff filings, may take longer.

Senator STEVENS. But how about a small telephone company such as exists in my State? I am also told the 3-month period is adequate in the vast majority of the rate cases. It is only when you get to the major rate cases where you have had a problem. Why do you want 9 months for the case where 3 months is already adequate?

Mr. WILEY. I will let Mr. Hinchman respond to that since he deals with the tariffs every day.

Mr. HINCHMAN. Senator Stevens, I think you are correct, many of

the cases can be decided and settled in 3 months. They can be settled in many cases without a hearing or without suspension. So that is the reason we resolved to use the 9 months flexibly. I don't think you can define in advance which cases are going to require the additional time. You can't simply say because it is a small company, an independent company in one case, in all such cases it will only take 3 months.

Senator STEVENS. But couldn't you define a procedure whereby the applicants could have an opportunity to be heard upon that extra 6 months, and the complexity issue, rather than automatically giving 9 months? My experience has been whatever the time limit is, that is the time that will be used in the regulatory process. Why should we, if it is only a small number of cases, in proportion to the total workload that needs any special consideration, why should we automatically extend them all?

Mr. HINCHMAN. We are not proposing to extend them all to 9 months. We would have the authority—

Senator STEVENS. You are proposing to—

Mr. HINCHMAN. We would have the authority to decide whether or not to suspend for 9 months.

Senator STEVENS. What is the role of the applicants in that decision-making process? Is it solely unilateral on the part of the FCC as to whether you will take 9 months?

Mr. WILEY. That is true now in 3 months. In many cases we suspend for only a day, or for less than 3 months. I suppose you have to in any legislation give some credence to the regulatory agency to utilize the procedures Congress gives it in the appropriate way. If we prostitute this period of time and use only the longest period in all cases, I think it would be unfortunate.

Senator PASTORE. Mr. Stevens has a point. You are asking for leverage of the 9 months as against the 3 months, and you are not compelled under the existing law to make a decision even within the period of 3 months. Isn't there some alternative that can be suggested to cure this problem? What you are actually saying is, take us on good faith, if the case is small and can be decided expeditiously we will do it. Well, of course, that is your position.

The telephone company fellows don't feel that way about it. They feel if you get hung up on something else, and you have the 9 months within which to labor, then in all probability you would be justified in taking the 9 months, where ordinarily, if you have the 3 months limit, you would feel compelled to try to make a decision within 3 months.

Mr. Stevens has raised the question here, is there any procedure that can be suggested whereby there would be protection in these small cases? Or doesn't that alternative exist? That is his question. Isn't that it?

Senator STEVENS. That is the direction I am heading, that is, why isn't there some role for the applicant in the decision as to whether or not the longer period should apply to a particular case.

Mr. HINCHMAN. I can't think of a particular procedure, Senator Stevens. I think our record is not one of using the maximum time on all cases. We do only use the time where it is necessary. I am sure that

we would be amenable to a procedure such as a request for reconsideration of the time, or something, and the Commission could act on it. I would think that we would not want to conduct a hearing on this matter, because that would simply add to the complexity of the situation.

Senator STEVENS. I am not suggesting that. I am suggesting there ought to be some further role for the applicant in this question as to whether, if we go this direction, to extend this period, whether or not they should not also have some further role in it.

Let me ask you this: you are asking to increase time for the notice of rate filing from 30 to 60 days. I am told you already have the authority to increase that period, and in 1973 you did impose the 60-day notice requirement for rate increases.

Mr. WILEY. Yes.

Senator STEVENS. If that 60 days is insufficient, why haven't you changed on your own accord and why do you ask us for authority to do what you did in the past?

Mr. WILEY. We did extend it to 60 days. And it was appealed by the carrier, and the court upheld us in having that modifying authority, but the language of the case dealt only with the situation where we had increased charges for existing services and only for the 60-day period.

We are suggesting that we want a 90-day period, and want it for all tariff cases, because we think with the partial and temporary grant authority we will need that period in order to deal with that additional requirement, that additional obligation, to try to determine whether or not there is a portion of the tariff filing that could be instituted immediately.

It seems to me that is a very salutary procedure, very salutary provision for the carriers. And I am frankly surprised that their testimony before this committee that I read, at least, seems to deemphasize that factor so much.

Senator PASTORE. Can an applicant now file a petition before your body, claiming undue delay?

Mr. WILEY. Of course, they can always claim undue delay. But that is the Commission's decision.

Senator PASTORE. I am directing this question to the situation that was raised by Mr. Stevens.

Mr. WILEY. I am not sure they have the authority to file, for example, a petition for reconsideration of this kind of decision. But that could be modified, of course, to give them a voice, to come back to the Commission, at least. I suppose something like that could be developed. But still I would have to say once again the Commission would be the final judge of it, so they might not feel that that really gives them very much voice.

Senator STEVENS. Correct me if I am wrong: as I understand it now, you can go to 90 days on the rate filing notice, and then you want 9 months on the blanket authority to suspend on all rate cases. Admittedly you wouldn't necessarily take that time. But you want that authority. So that is a year.

Mr. WILEY. That is right.

Senator STEVENS. So we are dealing with a minimum in major cases

of a year, right, in terms of this, and a possible maximum in the minor cases, many of which are being dealt with in much less than the existing 3-month period now.

Mr. WILEY. Well, again—

Senator STEVENS. I mean you are moving 5 months to a year for all cases, as I understand this.

Mr. WILEY. Yes, but again, I have to point out that we are suggesting, of course, this new step of temporary and/or partial grants, which I think places a whole new aspect on this, whole new look at this whole situation. Because now the carrier has an opportunity to get a portion of the tariff filings instituted immediately.

Senator STEVENS. I don't want to seem like the devil's advocate, but what is the reason for the front-end time requirement? Why do you need the additional 30 days on the front end? You already have 30 more than you had a year ago.

Mr. WILEY. For tariffs in which there are increased charges involved, we have 60 days. Anything over 30 is going to be a help. I am not saying 90 days and 9 months are magic figures. We think when you add to it the temporary and partial grants, we will need the additional 30 days beyond 60.

But during the notice period, what happens is the parties all have an opportunity to file comments, and the Commission has to make a basic decision whether to grant the tariff or suspend it in part, or to deny it. That is a very important step. As Mr. Hinchman has pointed out before the Commission, time and time again, we only have had less than a week to make this basic decision under the 30-day period. Clearly, that is insufficient. The 60 days would help. But I think the 60 days should be instituted for all kinds of cases.

Senator STEVENS. That is where I am going. Why shouldn't the extension from 3 months to 9 months be determined on the basis of comments that are made in the front-end period?

Mr. WILEY. Well, it does. It clearly is. We don't suspend every tariff now.

Senator STEVENS. The applicants ought to have a role in that also.

Mr. WILEY. He does now. They come in oftentimes and say don't suspend it for the full 3 months, don't suspend it at all, or suspend it for 1 day. They have a voice.

Mr. HINCHMAN. The whole point of the additional time in the notice period is so we can make an evaluation of the carrier comments, of the reply comments, and make a better judgment for the Commission as to whether that should go into effect, for instance, with no suspension. But in 30 days, even in 60 days, it is almost impossible to make that determination on any factual basis, and you end up in a position of proposing suspension simply to get the additional time to evaluate the basic facts. And we believe that if we had 90 days, we could complete action entirely on many of these cases, particularly on the smaller cases, with no suspension at all.

Mr. WILEY. You know I want to say this: I am very reticent about suggesting anything that extends a period of regulation. Regulatory delay is a concern, and I think the carriers rightly address that point. But in our opinion this legislation will help accelerate processing, not delay it. True, if the Commission were to take a year on each tariff

filing—we have by the way over 2,000 tariff filings in the last 2 years alone—if we were to take a year for each one of them, it would be monumental delay. But that is not our intent. I think when you get to the large Bell-type rate increase, you simply can't do it in 90 days.

Senator PASTORE. Are you actually saying that the most difficult cases would be helped by going from 30 to 90 days?

Mr. WILEY. Precisely. I think also even the—

Mr. HINCHMAN. Even aspects of the major cases would be helped.

Senator STEVENS. Mr. Chairman, that is 60 days already. They have already gone to 60.

Senator PASTORE. Where there is an increase in rate.

Senator STEVENS. My worry is that we approach this period, and I think in my own opinion we are coming into an era of a totally new generation of equipment, and it appears to me that we are going to impose upon that new generation of equipment a time factor that has not been involved necessarily in the past. If in fact rate increases are involved, and by definition if we are going to a new generation of equipment, I think in most instances you will have a rate increase.

Senator PASTORE. No, you might have rate decreases. That is a considerable concern to parties who claim that the decrease is anticompetitive. The competitor won't have much opportunity to do anything about it, because he may be out of business by the time the Commission makes a decision. If there is cross-subsidization involved, the other users won't be protected by any accounting order, either, under that circumstance. With new equipment and competition, rate decreases may be wholly justified in certain instances. But, delay, in the final analysis, hurts all concerned.

Senator STEVENS. I am informed that the longest suspension period at ICC is 7 months, yet we now have a proposal that would permit rail rate increases or decreases of 7 percent without review of the ICC. In other words, the feeling about that regulatory agency is we ought to have some safety valve in terms of what is a moderate rate increase or decrease without review. Have you reviewed the similar proposal for the ICC?

Mr. WILEY. Our answer is the temporary or partial grants, where we could take the cost of debt, for example, as in the recent Bell filing, and say clearly the cost of debt has changed, everybody recognizes that, it can be computed mathematically. And we put that into effect. The rate of return has been over 9 percent since that rate increase has gone into effect.

Senator STEVENS. Have you explored any possibility of taking out of rate regulation the de minimis or normal cases of change that currently require filing procedure, review procedure, anything similar to the 7 percent for the ICC?

Mr. HINCHMAN. Senator, I don't think we have considered that, except in terms of this partial or temporary grant because in the communications industry at least, I think that issue as to what constitutes an appropriate base, allocation of rate base, rate of return, are perhaps more complex than in some of the other industries, and we do not see an automatic formula approach as being a practical way to regulate. We do think it requires a minimum showing by the carriers in this period of time that we could then rule on, yes, the cost of debt

has increased, or other costs have increased, and they are known quantities for this particular service for which you are proposing to increase the rates. Because these are industries which operate an integrated complex of services, and rate changes are seldom just a simple rate change, they are usually rate structure changes where one segment is being charged higher rates, another segment is being charged lower rates, and we think a simple formula probably would not work in this industry. We have not developed any methodology.

Mr. WILEY. I might add, the introduction of competition in this area, I think, has served to exacerbate the problems, the complexity, indeed the problems of regulatory delay. But I don't think that is going to change. Now that you have more than one party involved in many of the tariff filings, I think there is going to be more complication in the whole process.

Senator STEVENS. We are also told that in connection with the CAB, that we ought to permit the increased energy prices for the certified carriers to be passed on to the passenger far on a direct pass-through. This obviously is an energy-related industry. Have you explored the concept of any kind of shortened time frame or minimum procedure requirements for energy adjustments in this period?

Mr. HINCHMAN. Senator Stevens, we have had no representations from the carriers, to my knowledge, that this is a significant factor for them. I think that their use of energy, the communications industry use of energy, is far less in terms of overall resources utilized than the transportation industry. So I don't know that this is a major factor with them. They have not raised it with us, so again we have not on our own initiated or developed any procedures for dealing with it.

Senator STEVENS. Well, I think you have got a good case in terms of the competition aspect. It just seems to me if we are asked to increase the procedural delay in the minority cases, we ought to find a way to assure there is not an unreasonable delay for many of the cases.

Mr. WILEY. Out of the 922 tariff filings we have had this year, many fit into the category you speak of, and were dealt with expeditiously by the Commission. I don't see that changing with this legislation.

Senator PASTORE. We have certain questions that have been submitted to us by Senator Cannon, who is chairing another hearing and cannot be here. I will have them brought to your attention and you can submit the answers for the record.

[The following information was subsequently received for the record:]

UNITED STATES SENATE,
Washington, D.C., September 16, 1975.

HON. JOHN O. PASTORE,
*Chairman, Communications Subcommittee, Commerce Committee, U.S. Senate,
Washington, D.C.*

DEAR MR. CHAIRMAN: A number of my constituents have raised questions regarding provisions contained in S. 2054, the bill to amend sections 203 and 204 of the Communications Act of 1934. There is considerable concern that these provisions may result in a sharp rise in rates for rural residential consumers.

Unfortunately, I cannot attend the hearings scheduled for September 17th, on this legislation as I am chairing an Armed Services Subcommittee hearing at the same hour. Because of the conflict, I am requesting that the enclosed questions be directed to Chairman Wiley and Mr. Crosland for the record and I be provided with the responses.

Your cooperation is very much appreciated.

Sincerely,

HOWARD W. CANNON.

Mr. Wiley, we appreciate your raising before this Committee the problems that you see in attempting to resolve the complex common carrier issues of rate regulation and tariff changes. In doing so, you have suggested some changes for the time period for considering tariff changes in the Communications Act. My concern is that the problems involved go far deeper than a minor revision in the Communications Act for the consideration of rate cases. My concern is that, at the root of this consideration, is the additional workload created by the injection of so-called competition into the common carrier areas through customer-owned equipment and private line services. I am concerned about the impact that such changes will bring to the telephone user in Nevada.

Mr. Wiley, will the individual telephone subscriber in Nevada pay a higher individual rate for his services if we continue to pursue this policy?

Nevada has many small isolated communities that have telephone services primarily because of the economic advantages of price averaging and interstate toll contributions.

What will be the impact of this unlimited competition on the small telephone company, such as we have in Nevada, and their subscribers?

What kind of studies are you conducting in attempting to resolve this issue of impact on the individual consumer?

It seems to me, Mr. Chairman, that these are important issues that need to be examined by this Subcommittee. I would suggest that this Subcommittee consider holding extensive hearings on the impact on the individual telephone consumer of the continued policy of the FCC in granting licenses to specialized private line carriers and expanding the provisions for customer terminal equipment. I hope that the telephone consumer is not the forgotten man in this pursuance of a policy of unlimited competition.

Mr. Crosland or Mr. Minow—I have expressed earlier in these hearings the concern that I have for the policies being pursued by the FCC, with regard to increased number of parties, such as specialized common carriers providing private line services and terminal equipment, will have an adverse impact on the telephone user in the State of Nevada. We long ago made the determination in this country that two telephone companies were not in the public interest serving the same customer, as a matter of convenience and economics. I would hope that we are not beginning to return to that two telephone company per person concept, or three telephone companies, or what have you.

What do you see, Mr. Crosland, as the direction which this policy is leading us?

Will there be an adverse impact on the telephone consumer, and more particularly, the individual telephone subscriber in Nevada?

What do you suggest as a course of action that should be pursued by this Subcommittee in solving that?

Do you feel that this Subcommittee should hold further hearings regarding the impact on the telephone consumer?

Would AT&T be prepared to present any sort of studies at such hearings?

Are any such studies available now?

Mr. Crosland, Nevada, as I am sure you are aware, is a sparsely settled State with many small and sometimes remote communities. My grave concern is whether the adequate telephone services will continue to be available to the residents of those communities if the FCC continues to pursue this policy they embarked upon. If this Committee were to hold further hearings regarding this unlimited competition in telecommunications, would AT&T be prepared to present detailed studies as to the impact such competition would have on the type of telephone service that would be provided in these areas?

Could those studies also show what the impact would be on those small telephone companies who today serve some of the sparsely settled areas?

FEDERAL COMMUNICATIONS COMMISSION,
Washington, D.C., November 4, 1975.

Hon. HOWARD W. CANNON,
U.S. Senate,
Washington, D.C. 20510

DEAR SENATOR CANNON: This is in response to the questions you raised at the time of the legislative hearings on S. 2054.

You expressed concern about the general effect of the Commission's policies allowing competition in the provision of private line services and customer-provided terminal equipment. In addition, you asked specific questions concerning the possible economic impact of such policies on the telephone companies

and subscribers in Nevada. Also, you suggest that hearings be held on these matters.

In responding to your concerns, I feel it is first necessary to clarify the extent of the competition which has been authorized and which presently exists.

Under the Commission's 1971 Specialized Carrier decision, these new entities have been limited to the provision of private line services. In 1971, private line services contributed \$1,069,007,031 to Bell's total operating revenues of \$18,947,760,886 or about 5.6%. These private line services were earning a significantly lower rate of return than Bell considers necessary for its overall operations—a situation which, according to conventional accounting principles, can be interpreted as a cross-subsidization of Bell's private line services by its message telephone subscribers. The Commission concluded in its 1971 Specialized Carrier decision that even the loss of this entire market would not have a serious impact on Bell or on its basic message telephone service; that it was unlikely that Bell would lose a significant part of the market in any event; and that the potential public benefits of competition (e.g., service and equipment innovation, price reductions, etc.) outweighed any likely adverse effects on Bell.

For 1974, Bell's private line services contributed \$1,355,776,372 to its total operating revenues of \$26,755,153,264. The total revenues of the independent telephone industry in 1974 were \$1,569,072,155, continuing a trend of significant annual increases. In comparison, the 1974 revenues of specialized carriers were \$6,548,000—still less than 0.5% of Bell's private line revenues, and less than 0.03% of its total revenues. It is thus most difficult to attribute any present or likely future increase in residential rates for basic telephone service to the effect of specialized carriers.

Turning to the question of terminal equipment, I should first note that the Commission's express and continued purpose in ruling that a carrier may not impose a blanket prohibition on the customer's provision of such equipment has been to provide the telephone consumer with a greater choice of terminal equipment at lower costs. To the extent that telephone companies can provide equipment which satisfies the consumers' needs at prices competitive with those of independent manufacturers and suppliers, they are free under our policy to do so. To the extent that artificially inflated prices for such equipment may have been established in the past, in order to charge lower prices for other services, there could indeed be some necessary shift in the allocation of the total revenue requirement in order to respond to this competitive situation. Again, it is necessary to examine some actual revenue figures to assess the likely impact of any such shift.

According to Bell's recent submission in Docket 20003, the Private Branch Exchange-Key Telephone System (PBX-KTS) equipment sold or leased to customers by independent suppliers equates to an equivalent annual revenue of \$96.7 million, or about 3.7% of the total revenues for all terminal equipment if provided entirely by Bell. Bell implies from this analysis that all equivalent revenues represented by the purchase or lease of equipment from independent suppliers constitutes a revenue loss by Bell. It has not yet been determined, however, whether this is the case or whether the total market may simply have been expanded as a result of innovations and price reductions brought about by the competitive thrust of independent suppliers. In any event, the independent supplier's share of PBX-KTS equipment represents a small part of total terminal equipment revenues (\$96.7M vs. \$3.18B, or about (3.7%); and an even smaller part (0.36%) of Bell's total operating revenues. Once again the potential impact on basic residential telephone rates would appear miniscule.

With regard to the smaller independent telephone company, the potential effects of interstate private line competition and the use of customer provided terminal equipment are comparably limited. Generally, since these companies do not themselves offer interstate private line services but only participate in some end-to-end services, competition in this area could only affect their revenues through a reduction in settlements received from Bell as compensation for the independent's costs in providing their portion of the service. Any loss of message toll revenues to private line services would be the same whether provided by Bell or a specialized carrier. Typically, some companies may receive as much as 50% of their total revenues from settlement arrangements with the Bell companies to compensate them for the costs incurred in the joint rendition of private line and message toll services. Of total independent telephone industry operating revenues of 4.7 billion dollars in 1974, 95.3 million dollars were received from their

interexchange private line services, an increase of 40 million dollars since 1970 or more than 5 times as much as the annual revenues of the specialized common carriers.

Based upon our careful examination of the allegations which were made by the carriers at the time our policy decisions on interconnection and competition in the private line area were being made, the Commission concluded that the public benefits of those decisions far outweighed any potential public losses. Based upon continuing analysis of these allegations, and the inability of the carriers thus far to produce convincing evidence to the contrary, the Commission remains convinced that these policies are sound. However, we are continuing to collect and analyze data on these and other economic issues in Docket 20003, and will promptly institute further proceedings on these matters should the evidence so indicate.

I hope this answers your questions as to the Commission's motivation as well as our assessment of the potential impact of these policies on the telephone consumer. I will be pleased to comment further should you desire.

Sincerely,

RICHARD E. WILEY,
Chairman.

Mr. WILEY. Thank you, Mr. Chairman.

Senator PASTORE. Are you going to stay with us?

Mr. WILEY. Mr. Hinchman is going to remain. This is Commission meeting day and I have to return to the Commission. But Mr. Hinchman will be here and report to me.

Senator PASTORE. The next witness is Mr. Laurence Harris, vice president, MCI Telecommunications Corp.

STATEMENT OF LAURENCE HARRIS, VICE PRESIDENT, MCI TELECOMMUNICATIONS CORP.; ACCOMPANIED BY ROBERT D. SWEZEY, JR., ASSISTANT TREASURER; AND WILLIAM BURNS, COUNSEL

Mr. HARRIS. Mr. Chairman, members of the subcommittee.

Good morning. My name is Laurence Harris, vice president of MCI Telecommunications Corp. With me at the table today are Mr. Robert Swezey, Jr., MCI assistant treasurer, and Mr. William Burns, MCI's counsel.

MCI is an intercity long distance communications company offering private line services among 34 major metropolitan areas within the United States which, taken together, represent approximately 50 percent of the U.S. market for business communications. Our 5,000-mile system uses 218 microwave stations to serve MCI's customers coast to coast.

We presently have over 8,000 circuits installed serving well over 800 business users. Our customer base includes many of the largest companies as well as medium and small businesses across the United States.

I am here today to offer testimony on S. 2054—a bill to amend sections 203 and 204 of the Communications Act of 1934.

MCI generally supports the ways in which S. 2054 revises the Communications Act. While we do not believe that these changes will solve all the problems encountered in dealing with tariff matters, they represent a significant step toward affording solutions to the most obvious of them. We believe that the increase of the "notice period" from 30 to 90 days will be of great assistance to the FCC

and to competing common carriers which must evaluate fully the impact of complex tariff filings.

More important is the amendment proposed to section 204(a) of the act which will increase the "suspension period" to 9 months beyond the date on which the tariff filing would otherwise go into effect. Based on MCI's experience, there is no question that the need exists for an extended time period within which the complete hearings on major tariff filings. In this regard, I emphasize the word "major." Obviously, only a small proportion of the numerous tariffs filed with the FCC will require suspension for the full statutory period.

But, due to the complexity and growing volume of both tariff filings and accompanying support data, the Commission has been unable to complete hearings within the time allowed prior to the revisions envisioned by S. 2054. The result is a situation damaging both to carriers and consumers alike.

For example, when a carrier files a tariff which reduces its rates and that reduction goes into effect before the Commission has concluded its hearing process, a subsequent determination of illegality or discrimination does not and cannot reverse the damage which has already been done to competitors and their customers.

Senator PASTORE. That particular paragraph intrigues me, and I think the record ought to be made clear. Why does a reduction in rate damage competition?

Mr. HARRIS. For instance, sir, if one of the established carriers were to file a rate reduction which we will say in this case MCI believes is anticompetitive or discriminatory, and is intended to hurt competition, if that tariff goes into effect at the lower rates, we are either forced to reduce our rates, or lose customers. If the Commission were later, whether it be 3 months later or 2 years later, to determine that tariff to be discriminatory and unlawful and revoke it, the damage would have already been done to us. We would have already had to reduce our prices, thereby reducing our revenues, and in many cases lose customers. So the damage is done, once the tariff goes into effect if it is later determined to be discriminatory.

Senator PASTORE. You may proceed.

Mr. HARRIS. Thank you.

Similarly, when a tariff is filed which increases a carrier's rates and that increase goes into effect before the Commission can clearly determine whether the increase is legal, needed and nondiscriminatory, then the telephone-using public is clearly damaged. Should the FCC later determine that the rate increase was discriminatory or unlawful, it is scant comfort to the ratepayers who had to pay increased rates all during the interval between the tariff's going into effect and the Commission's finding that it was unlawful. Even if the Commission were to impose an accounting order to provide for refunds of these overcharges, the practical effect is more cosmetic than real. For example, if Bell's 1970 to 1973 general interstate rate increases—which are still under consideration—should ultimately be found unlawful, the amount A.T. & T. would presumably be compelled to refund its interstate customers will exceed \$1½ billion.

MCI gives credit to the Commission for its genuine efforts to expedite tariff hearings. The Hi/Lo and WATS proceedings are

examples. In both, the Commission has prescribed what are, for it, radically different expediting procedures based upon an entire written record. Unfortunately, these attempts have, to date, not been successful. The Hi/Lo proceeding, which involved an effort by Bell to restructure its private line rates in a manner which MCI believes to be clearly anticompetitive, was designated for hearing January 9, 1974.

The expedited hearing procedures were substantially completed by August 2, 1974, yet we still await a Commission decision. According to a September 11, 1975 New York Times article, the Commission has decided to defer a decision even further and to reopen the record to give Bell another opportunity to prove its case. The WATS case, which is following a similar procedure was, for all practical purposes, concluded late last winter, but, again, a decision has not been rendered.

Even when the Commission does take action, such as that reported in the newspapers, it is of such an indecisive nature as to perpetuate—not dissipate—the uncertainty enveloping the entire rationale for the Hi/Lo rates and the legality of the structure of which they are presumably expressive.

Mr. Chairman, with the subcommittee's approval, I have attached to this statement a history of the Hi/Lo matter, which will, I hope, be illustrative of the type of problem emerging carriers too often encounter in their attempts effectively to compete with one another. A glance at the chronology will reveal more persuasively than any testimony I could advance the difficulties in coming to grips with rates first proposed by Bell in February 1973, the legality of which, now 2½ years later, remains suspect and unproven. But the rates have been in effect more than a year. No matter how efficient the Commission's procedures become, decisions in these complex areas are difficult and the rate suspension provisions must reflect that fact.

I would like to comment on Chairman Wiley's remarks on the FCC request for the temporary and partial section of the Communications Act modifications. We would certainly support the Commission in its position on that matter. I would like to make one comment, though. The temporary part certainly poses a danger. For example, if a carrier, based on a temporary grant of authority, were to make a substantial investment in hardware and other equipment to supply the service, he would be in the position of not knowing whether that service was going to be withdrawn later and his investment might be useless or worthless to him.

Also there is a danger that the user never knows when and if the service will be withdrawn.

MCI believes that S. 2054, insofar as it goes, is clearly a step in the right direction. We do suggest, however, that these changes be clearly coupled with an understanding that, except in unusual circumstances, the Commission must complete hearings on tariff filings within the statutory 9-month period or, if at all possible, sooner. Without this qualification, it is possible that the same damaging effects as those I have just detailed will continue to be felt by competitors and consumers alike. If this is made clear, however, we believe that enactment of these amendments will help to protect the consumer and assist in preventing the established carriers from using questionable tariffs to

destroy their competitors or discriminate, in their own interest, either for or against certain classes of customers.

MCI appreciates the opportunity to have appeared before the subcommittee and stands ready to supply any further information you, Mr. Chairman, or the subcommittee may desire. Thank you.

[The attachment follows:]

CHRONOLOGY OF HI/LO PROCEEDING

Date	Event
2/26/73	Bell applies for Special Permission (No. 290) to place Hi/Lo rate changes in effect.
3/6/73	FCC Common Carrier Bureau (CCB) requests additional data.
3/16/73	Bell files supplemental data in partial response to CCB.
3/23/73	FCC requests public comment on Hi/Lo by 4/30/73.
3/28/73	CCB asks Bell to file data withheld from 3/16/73 submission.
4/9/73	Bell asks CCB to reconsider request for additional data.
4/20/73	CCB suspends Comment date and defers action on Special Permission pending resolution of dispute with Bell.
5/11/73	Bell Petitions FCC for review of CCB decision to hold action on Bell request for Special Permission in abeyance pending Bell's submission of further data.
11/14/73	FCC dismisses Bell Petition for Review.
11/15/73	Bell formally files Hi/Lo tariff revisions with supporting evidentiary materials.
1/9/74	FCC suspends Hi/Lo tariff revisions until 4/14/74, orders rate investigation.
1/23/74	FCC establishes procedures for expedited rate hearing.
3/1/74	First interrogatories served on Bell by CCB and non-Bell parties.
3/25/74	Bell files Answers to First Interrogatories.
4/1/74	Non-Bell parties serve second interrogatories on Bell. Non-Bell parties' file direct cases.
4/12/74	At FCC request Bell voluntarily suspends effective date of Hi/Lo tariff changes until 6/13/74.
4/15/74	Bell files Answers to Second Interrogatories.
4/18/74	Bell and CCB serve First Interrogatories on Non-Bell parties.
5/9/74	Non-Bell parties file Answers to Bell and CCB First Interrogatories.
5/23/74	Bell files Rebuttal case and Second Interrogatories to Non-Bell parties.
5/31/74	Non-Bell parties Answer Second Interrogatories.
6/7/74	CCB and Non-Bell parties file further interrogatories to Bell relative to Bell Rebuttal exhibits. Bell subsequently refuses to answer. Parties decide not to delay procedure by seeking to compel.
6/13/74	Hi/Lo rates go into effect.
7/18/74	All parties file Proposed Findings of Fact and Conclusions of Law.
8/2/74	All parties file Reply Findings and Conclusions.
11/5/74	FCC holds oral argument.
9/9/75	FCC votes to reopen record for further evidentiary presentations.

Senator PASTORE. Have there been instances where tariffs have been deliberately lowered in order to affect competitors?

Mr. HARRIS. Yes, sir. We believe—

Senator PASTORE. I mean deliberately so.

Mr. HARRIS. We believe the Hi/Lo tariff A.T. & T. filed in February 1973 was a deliberate attempt on their part to impact the competition.

Senator PASTORE. Once you lose your customers, where do they go?

Mr. HARRIS. Of course, if we lose our customers, they could go to A.T. & T., they could go to Western Union or other specialized common carriers.

Senator GRIFFIN. As I understand it, the *Hi/Lo* case has been going on since 1973, is that right?

Mr. HARRIS. Yes, sir; Senator. The initial filing of the tariff was in February of 1973. And in 1974 the Commission, in January 1974 the

Commission set a procedure up for what they call a paper hearing, expedited hearing. And the paper part of the hearing, everything was filed in August of 1974, and there was a, I believe, one day of oral argument in November of 1974. We have been expecting a decision and last week the Commission came out with a decision and basically the decision is to reopen it and take further evidence on the matter.

Senator GRIFFIN. The 9-month period wouldn't have made much difference in that case, would it?

Mr. HARRIS. No, sir, it would have made no difference. That is one of the things Senator Stevens brought up and one thing we mentioned here, that is, we hope the Commission, after they get the 9-month period, if they get it, would use everything in their power to complete all hearings within the 9-month period.

Senator GRIFFIN. Do you feel that the cases where you file for a rate should take up to 9 months for the FCC to decide?

Mr. HARRIS. I would hope in all cases they would be able to complete those hearings sooner. But there may be cases where we file a tariff which is extremely complex and it would require the 9-month period, Senator. We understand that, when we testified here today, supporting this bill, that we are subject to it also.

Senator GRIFFIN. Thank you.

Senator PASTORE. But under the proposal, the FCC, during the 9-month period, would have the authority to make a temporary grant or a partial grant.

Mr. HARRIS. Partial suspension or temporary authority; yes, sir.

Senator PASTORE. If there are no further questions, we thank you.

Mr. HARRIS. Thank you, sir.

Senator PASTORE. I also have a letter here from Senator Hollings with reference to the testimony of Mr. J. P. Maguire, of Continental Telephone Corp. and ask that it be placed in the record as well.

[The letter follows:]

UNITED STATES SENATE,
Washington, D.C., September 12, 1975.

JOHN O. PASTORE,
Chairman, Communications Subcommittee, Senate Commerce Committee.

DEAR MR. CHAIRMAN: I am informed that Mr. J. P. Maguire of Continental Telephone Company is scheduled to testify before our committee on Tuesday, September 16th. Mr. Maguire's testimony is of particular interest to me, but due to prior commitments I will be in Houston, Texas on that day. I know that the committee will give Mr. Maguire's testimony its due consideration, and I will certainly study his remarks from the record upon my return.

Meanwhile, I would appreciate your making my interest a part of the record.
Sincerely,

ERNEST F. HOLLINGS.

Senator PASTORE. Our next witness is Mr. J. P. Maguire, president, Continental Telephone Corp.

STATEMENT OF J. P. MAGUIRE, PRESIDENT, CONTINENTAL TELEPHONE CORP.; ACCOMPANIED BY JAMES NAPIER, EXECUTIVE VICE PRESIDENT

Mr. MAGUIRE. Mr. Chairman and members of the committee.

Thank you for inviting me here today.

My name is Jack Maguire. I am president of Continental Telephone Corp.

With me today is Mr. James Napier, vice president of Continental Telephone Corp.

And of course, please interrupt me at any time you would like to ask any questions.

Though I speak only for myself and my company on the proposed legislation, I hope that my statement will reflect some of the views held by the independent telephone industry.

Today, I would like to talk about three things:

Why Continental Telephone has a vital stake in the legislation being considered;

The ways this legislation would adversely affect the telephone industry and the telephone subscriber;

The reasons why this legislation would add so substantially to the telephone industry's current economic problems.

Continental Telephone Corp. is the third largest independent telephone company in the United States. Its subsidiary telephone operating companies provide service through some 2.1 million telephones in 41 States, plus approximately 300,000 telephones in the Caribbean and Canada.

In the last 2 days we have come to an agreement with Jamaica, which would reduce that by about 100,000.

Continental's exchanges serve approximately 1,800 small towns and their surrounding rural areas in the United States. Our largest exchange—Manassas, Va.—operates about 26,000 telephones, 79 percent of our exchanges serve fewer than 1,000 customers. Continental also has a subsidiary that manufactures products for the telephone industry.

Interstate revenues and A.T. & T.'s interstate rate of return are important to Continental. Local exchange service is telephone service provided within a community and the surrounding area served by that community. No toll is charged for service within an exchange; the charge for local service is usually a flat monthly fee.

Continental owns the equipment required for telephone service within a community. This equipment includes the typical telephone handset, the outside plant—cables, poles, etc.—and the switching equipment used to connect the telephones within a community so that each user has access to all others.

Continental owns and operates virtually none of the additional equipment used for long-distance service—that is, the transmission and switching links between local exchanges needed to provide interstate and intrastate toll service. This equipment includes switching equipment, coaxial cables, microwave units and, now, communications satellites. By and large, this service is provided by the long lines department of the A.T. & T. and, to some extent by newly formed satellite carriers and specialized common carriers.

Since Continental's basic business is the operation of local telephone service in small communities, you may wonder why we have such a substantial interest in legislation that establishes procedures for considering long-distance, interstate tariffs. The reason is that interstate service generates a vital portion of Continental's overall revenues.

Our local equipment is an essential part of the total facilities needed to make an interstate long-distance call. The same local facilities used

to call a neighbor are also used to make such a long-distance call. Because our facilities are involved, we are entitled to our proportionate share of all revenues generated by long-distance calls to or from our subscribers.

Any legislation adversely affecting those revenues—as I think this bill would—is of serious concern to our subscribers and to Continental's management who are responsible for the financial security of our company. I believe that this is true for the most part for all the independent companies.

These facts of telephone life have created a unique relationship between the Bell System and non-Bell, or as we call ourselves, "independent," companies. Though we are separate, independent companies, we are directly dependent on Bell's interstate revenues for a substantial portion of our revenues.

Twenty-one percent of Continental's gross revenues from domestic telephones are derived from our share of the Bell System's interstate revenues. Continental's financial health is, therefore, dependent on the maintenance of adequate interstate revenues through the timely allowance of needed rate increases.

I'd like to turn now to the reasons why the bill before you bears directly on this problem.

THE ADVERSE IMPACT OF THIS LEGISLATION AND THE LACK OF OFFSETTING PUBLIC INTEREST BENEFITS

While I want to concentrate on the bill's adverse impact on the financial health of the telephone industry, an equally important reason for our opposition is that its enactment will have no offsetting public benefits.

In the first place, this legislation goes in the wrong direction. By lessening the incentives on the Commission and the parties to proceed with all due speed, the bill effectively guarantees that tariff suspension hearings will take longer to complete. But the public and the telephone companies need shorter hearings, not longer ones. These hearings are expensive, and the public ultimately pays the bill.

Senator PASTORE. What do you have to say to the argument made by Mr. Wiley that this gives the FCC discretion and authority to make a partial grant where they feel it is not questionable? That would dispose of it immediately, and what is questionable, of course, would go to a hearing?

Mr. MAGUIRE. It is my understanding, Mr. Chairman, that a partial grant as described by Mr. Wiley is one in which he said there is no argument about it, and they grant that amount. I think one thing that it does is that many applications contain tariffs that are increased, as well as tariffs that are decreased.

Theoretically, the FCC could grant the part that is a decrease and force it down the Bell System's throat, so to speak, without them having any say about it at all. That is just one idea that came to me as I heard his statement.

In other words, the FCC can grant any part of the application that Bell might not want, if it didn't get the whole amount.

Senator PASTORE. I would hope the representative of the FCC could answer that question too. What you are saying is this partial grant would only be given in cases where there is a tariff reduction?

Mr. MAGUIRE. I am not saying that. I am saying it possibly could happen. I assume it wouldn't, but when you think about granting a part of an application, as I say, it sometimes contains increases and decreases in the tariff.

Senator PASTORE. Let's assume there is an accounting order, and you have been paid your share, which is 21 percent of your gross revenue. How do they get it back?

Mr. MAGUIRE. If there is an accounting order made, it would then be a part of the division of revenue. You see, our revenues are determined by taking our costs and the Bell people divide it with us.

Senator PASTORE. Did you ever give anything back?

Mr. MAGUIRE. Not on the Federal level. We have on the State level.

Senator PASTORE. Never on the Federal level?

Mr. MAGUIRE. Not to my knowledge.

Senator PASTORE. This is the Federal level we are talking about here.

Mr. MAGUIRE. We had a refund order in the State of California.

Senator PASTORE. All right. You may proceed.

Mr. MAGUIRE. Moreover, increased regulatory lag can only further impair the effectiveness of rate increases found to be justified.

Second, my view is that the public is fully protected by the law as it now stands. The current statute enables the FCC to require telephone companies to account for funds collected under a tariff that becomes effective before a hearing on its legality is completed. If the FCC later determines that overcharges have been made, those overcharges may be ordered fully refunded, with interest.

I might comment on that, Mr. Chairman. The FCC, the way I read the law, has great latitude in applying or making effective an accounting order. It can be a rather simple order or it can be quite complicated. A complicated one of course, costs more than a simple one does. The only argument I have seen in support of this proposition—that the accounting and refund provision of the current law doesn't support the public—is the FCC's statement in support of the legislation.

This statement was published in the "Congressional Record" on July 8, 1975. The Commission there said that if new or reduced rates "are suspended and become effective * * * before any decision regarding their lawfulness, the accounting and refund provisions of section 204, being applicable only in rate increase situations, provide no remedy at all."

The Commission then noted that business customers might order new services subsequently declared illegal, and thus incur "serious dislocations" in their operations.

While not a model of clarity, the FCC statement seems to be saying that if rate reductions become effective under a tariff that is subsequently declared illegal, business users might suffer "dislocations" of service when having to shift back to the old rate structure.

I have two observations on this. First, it's difficult for me to understand why the Commission needs power to further delay the introduction of reduced rates.

Second, the only "dislocations" that I can think of might occur, if customers shifted to specialized common carriers whose services might

be withdrawn when later declared illegal. In contrast, if customers take advantage of new services offered by established carriers, no "dislocation" takes place if those services are invalidated.

Established carriers can maintain continuity of service; the only change for their customers, in the situation referred to by the FCC, would be the return to the previous service. The Commission's concern with "dislocations" thus seems to be based on a desire to protect specialized carriers and not on public need.

The real question is not whether the FCC needs more time to study tariffs that propose new or lower rates. The question, rather, is whether the public is fully protected by the current statute's accounting order provision. If so, enactment of the proposed legislation would only delay, in most instances, much needed rate relief.

This delay would effectively deny to the telephone industry, for excessively long periods, vitally needed revenues to build and service the plant required for adequate telephone service. This delay also has the effect of forcing the carrier to obtain these revenues by seeking increased local rates.

Other witnesses will surely analyze the procedural aspects of tariff hearings to which this legislation is addressed. But, as a businessman responsible for the financial health of my company, I am by nature and experience bottom-line oriented. So I'd like to proceed to what might be called the bottom-line results of this legislation and try to relate those results to the public interest.

Let me begin with a couple of examples of the effect of delay built into the current regulatory scheme. After that, I'd like to consider the problems of additional delay contained in the proposed legislation.

In January of this year the Bell System filed a new tariff with the FCC which, when effective, would have increased the Bell System's interstate revenues on the order of \$717 million annually. At Continental we estimated that the independent telephone industry's share of this annual revenue increase, apportioned through separations procedures, would be about \$101 million annually.

In March of this year, faced with a probable suspension order and hearing on this tariff, Bell, as I understand it, filed a new tariff seeking rate increases that would generate about \$365 million annually. These rate increases—smaller by about 50 percent than originally proposed—were allowed to become effective.

The Commission simultaneously initiated a separate hearing on Bell's interstate rate of return, estimated to be completed sometime toward the end of this year.

The result of that action is to deny, for a minimum of 12 months, annual revenue increases to the telephone industry on the order of \$352 million. The independent segment's share of these lost revenues is \$50 million annually. If, as anticipated, additional rate increases are deferred until at least the end of 1975, Continental will have lost a minimum of \$4.1 million in revenues. It can never recover these losses.

Senator PASTORE. But on the other hand, how about the poor fellow who has to pay the bill? Isn't he entitled to a fair shake?

Mr. MAGUIRE. Yes, sir.

Senator PASTORE. I mean, all we are hearing here is the Bell Telephone Co. is going to lose \$717 million, that your share of that pie is \$101 million. But the big question is, is the rate fair?

Mr. MAGUIRE. Well, yes. If the rate is fair—
 Senator PASTORE. All they are saying is, we would like to have a little more time to make that decision. What is wrong with that?

Mr. MAGUIRE. The thing that is wrong with it, if the rate is fair and declared to be a reasonable and adequate rate, then we have lost the revenue forever during the suspension—

Senator PASTORE. Who is to decide that?

The company shouldn't take the position, that unless you do this for me in 90 days the rate goes into effect. Then the only alternative that the consumer has is to try to collect the money back. If he has made a long distance call at the bus terminal and paid \$1.50 to call California, he can't ever get it back. How about him? Who is thinking about him?

Mr. MAGUIRE. Well, that is a small problem of the accounting refund order. As I said, it generally covers most situations. There is the one you mentioned, which is a minute portion of the amount involved and very difficult to keep track of.

Senator PASTORE. We hear the statement around here, "fly before you buy." Here we are buying before we fly.

Mr. MAGUIRE. Not exactly, because we figure when we file rate increases, and I am sure the Bell people will agree with me on this they are filing for something they think they really deserve.

Senator PASTORE. But isn't it up to the FCC to protect the public interest?

Mr. MAGUIRE. Yes, sir.

Senator PASTORE. This can't be a one-way street. I will admit there shouldn't be any undue burden placed upon the telephone company to justify whatever it thinks it merits. But on the other hand, I think the FCC and all of us here have a responsibility to that consumer. He is paying the bill. If people didn't use the telephone, there would be no A.T. & T. You have to realize that the consumer is part of the structure. What he has to pay is very important, when he pays it is very important. And this says, let's put the rate in, put the money in escrow, and maybe someday we will pay it back.

From your point of view, that is just lovely, but from my point of view, if I have to pay that money, I didn't have to pay in the first place, it is not lovely at all.

I don't want to quarrel with you, but when you say here, almost crying about it, that in January of this year the Bell System filed a new tariff with the FCC which, would have increased the Bell System interstate revenue on the order of \$717 million annually.

Mr. MAGUIRE. That is right. Let me make one point regarding this—

Senator PASTORE. That's it, isn't it.

Mr. MAGUIRE. May I respectfully ask the Senator to recall my previous testimony that when overcharges are made, those overcharges may be ordered fully refunded, with interest. Remember Continental gets 21 percent of its revenues from interstate revenues, that is, 21 percent of its gross revenue. Now, if a rate is delayed for a period of 9 months, and if that rate increase is delayed and subsequently it becomes legal, during that 9-month period, we have got to go to the local subscriber, the local State authority, and ask for relief, because we can't wait 9 months.

Our problem is regulatory lag, and the more you have regulatory delay, the more it compounds the problem, and we have one source to go to then, or really two choices, go to the State people for greater rates, or let the service deteriorate.

Senator PASTORE. Well, all right. But that is why the FCC is asking for the partial grant authority in order to make that determination, where it is not questionable. All right. You may proceed.

Senator GRIFFIN. Mr. Maguire, if I might, I would like to clear up one thing. At the present time there must be a 30-day notice given before the filing; is that correct? And that 30 days is actually extended to 60 days in the case of a rate increase?

Mr. MAGUIRE. I understand the 30 days was extended to 60, yes, sir. On rate increases.

Senator GRIFFIN. So, in the case of a rate increase, which is concerning Senator Pastore, and concerns all of us, you would have a 60-day period before the filing, and then 3 months after the filing. So, therefore, we are really talking now, under the present procedures, about a 5-month period; is that correct?

Mr. MAGUIRE. Yes, sir.

Senator GRIFFIN. From the time there is notice—and presumably the company claims justification for such an increase—a 5-month period elapses, it goes into effect under the present procedure, is that correct?

Mr. MAGUIRE. Assuming they take the maximum time; yes, sir.

Senator GRIFFIN. Assuming they take the maximum time. Thank you.

Mr. MAGUIRE. I would like to say, of course, this would be an application by A.T. & T., of which we would not be a part. But it would be delayed at the present time a maximum of 5 months. What the bill suggests is it could be delayed a maximum of 12 months.

Senator GRIFFIN. Thank you.

Senator PASTORE. You may proceed, sir.

Mr. MAGUIRE. Other figures are available to show the impact on Continental of reductions in A.T. & T.'s interstate revenues. Until the effects of its recent rate increase began to be felt, A.T. & T.'s interstate rate of return diminished steadily for a substantial period. In July 1974 A.T. & T. calculated an 8.8 percent interstate rate of return for the preceding 12 months.

As of May 1975 that figure was 8.4 percent. As of July 1975, the last month for which figures are available, it was only 8.5 percent despite the fact that A.T. & T.'s rate increase had been in effect for 5 months.

Mr. Chairman, I obtained those figures from the Bell System. I believe someone said they were higher than that. But that is where I got the figures and they should be right. This latest figure is still well below the 9 percent interstate rate of return presently allowed by the FCC.

Translating these figures to show their actual dollar impact on Continental, each 0.1 percent rise or fall in A.T. & T.'s interstate rate of return means about \$533,000 annually to Continental. If, for example, Bell's 12 month rate of return in May 1975 had been the allowable 9 percent instead of the actual 8.4 percent, Continental's revenues for that period would have been \$3.2 million higher.

There are only two means available to Continental to offset the loss

of revenues caused by regulatory lag: To increase charges to residential and small business users for basic telephone service, or to reduce that service to inadequate levels. Both, in my opinion, are poor substitutes.

Under the 3-month provision of current sections 203 and 204 of the Communications Act, and under the Commission's rules providing for a 60-day notice period prior to each new tariff's effective date, the introduction of new rates can be effectively delayed for a period of 5 months. The new bill would extend that period from 5 months to 12 months—3 months' notice and 9 months' suspension. This is an increase of 240 percent in the overall period of permissible delay.

To demonstrate the impact of the requested 12-month delay, I have attached to my statement a chart prepared by General Telephone & Electronics Corp., and offered by Mr. Theodore Brophy, GTE's president, as part of the U.S. Independent Telephone Association's presentation to the Joint Economic Committee of Congress in testimony on February 21, 1975.

Besides the problem of regulatory lag, this chart shows the serious effects of attrition due to inflation. It illustrates the effect on each \$1,000 of assets of a 12-month delay in the implementation of a tariff increase. It assumes an 8-percent rate of annual inflation, a 60-40 debt/equity ratio, a 6-percent embedded interest rate, a depreciation rate that is 20 percent of operating costs, and a 50-percent income tax rate, all of which remain constant throughout the period.

This chart shows that, over a 3-year period from the date the tariff is filed, the telephone company's return on equity and post-tax earnings will both have been 25 percent below the levels sought by the telephone company and approved by the Commission, when allowing the tariff to become effective. As shown in the chart, return on equity average 11.23 percent instead of the required 15 percent; actual earnings totaled \$135 per \$1,000 of assets instead of the required \$180.

Since the telephone industry has billions of dollars invested in telephone plant, regulatory lag, and inflationary attrition alone result in revenue losses of hundreds of millions of dollars under these circumstances.

These much needed dollars, whether considered as part of the return on equity or as part of required earnings, are lost forever to the telephone industry. Without those dollars, the telephone industry cannot avoid continuing job losses and continuing service deterioration in the form of installation delays, inadequate maintenance, and reduced new product development. To the extent that tariff increases can be put into effect sooner, the adverse impact of regulatory lag and inflationary attrition can be proportionately diminished.

Reasons why this legislation would add so substantially to the telephone industry's current economic problems: Why are the problems of regulatory lag and inflation-caused attrition so serious? Why does the telephone industry view the proposed legislation with such alarm? From my vantage point, it is because of the precarious financial position of the telephone industry and other utilities in today's economy.

Our industry faces a host of problems, including misdirected reg-

ulatory policy of which this legislation is one example. Our vitality—not to mention our viability—has not been as seriously threatened since the Great Depression.

Let me support that conclusion with just a few facts:

We have recently calculated, with the help of independent financial consultants, that Continental Telephone's current cost of equity capital is 15 to 16 percent, the highest in our history. And yet, over the last 5 years, Continental's telephone operations have generated an average yearly return on common equity of only 11.2 percent. It is apparent that if this short fall in revenues and consequent earnings is not corrected, our company will be in real jeopardy.

Continental's ratio of debt to equity, currently 71.5 to 28.5, is also the highest in our history, and is representative of the independent telephone industry today. Compounding the danger of this condition is the fact that Continental's cost of debt has risen to record heights.

We recently sold telephone company debt securities bearing a 12-percent interest rate, the highest in our history.

The other side of the coin is that the industry's post-tax interest coverage—obtained by dividing net operating income by interest expense—is dangerously low.

Continental's interest coverage is currently 1.87 times. Bond rating agencies stress the desirability of maintaining this figure at three times in order to maintain a high-quality rating.

Obviously, Continental cannot continue to maintain this low ratio without disastrous results. For example, it is a party to outstanding debenture and preferred stock indentures which set limitations on these ratios. We are now dangerously close to these limitations; if they are reached, we may be foreclosed from issuing additional long-term debt. If that happens, Continental will simply be unable to finance the capital additions and replacements necessary to maintain adequate service to the public.

Another indication of the telephone industry's financial woes is the inadequate price at which we are now forced to sell common stock. During 1974 85 percent of the independent telephone companies sold their equity securities on the market at/or below book value. In November 1974, Continental sold 2.5 million shares of its common stock at \$10.25 per share, well below their then book value of approximately \$13.15 per share.

Every sale of stock below book value dilutes the percentage ownership of current shareholders. This decidedly unsound method of capital formation will result, if repeated sufficiently often, in Continental's total inability to sell its common shares at any price.

Since the market for preferred shares is thin or nonexistent, the lack of a market for its common stock would eliminate the markets for all of Continental's equity securities.

In the mid-1960's, when utilities were considered to be growth stocks, about 25 percent of the total market value of securities held by institutions were of utilities' common stocks. Many of these securities sold at twice book value or more. Currently, mutual funds hold less than 5 percent of their market value in utilities, and no single utility have over 5 percent of its common stock held by funds.

It is safe to conclude that two major sources of new money—mutual funds and pension investments—are virtually unavailable to provide for utilities' expansion. What's more, they will not become available until there is a substantial restoration of confidence in the future of the industry. Fear and uncertainty are the natural enemies of orderly investment. When the investor is frightened, he demands a high price for his money; this can only translate into a need for higher rates.

The increase in Continental's cost of capital accompanying the severe strain on its debt capacity is not surprising. Public utilities' cost of capital has historically been lower than that of unregulated industrial companies for one basic reason: the capital markets have always viewed the utility as a financially sounder institution. Now, however, utilities are paying inflated interest rates and the rates of return to their equity investors have hit lows not experienced since the 1930's. As railroads enter bankruptcy, as airlines face unprecedented high debt, and as venerable electric utilities, such as Con Edison cannot pay regular dividends, the capital market's confidence wanes.

Once the market makes an unfavorable assessment of an industry, the attractiveness of further equity investment in that industry lessens. Responding to this development, the industry turns to increased debt financing. This leads to lower ratings of debts issues which, in turn, further increases the cost of capital—all in an endless spiral.

As if this were not enough, the hard-pressed utilities, including the telephone industry, are facing an increasing number of active competitors in the capital market. Thus the law of supply and demand, operating in conjunction with the loss of investor confidence and increasingly oppressive regulation, compounds the problem. In a capital intensive industry already straining to meet its growing capital needs from limited sources of supply, even a slight increase in demand can have a snowball effect in pushing capital prices upward.

In an article in the March 3, 1975 issues of "Telephony," Messrs. Robert LaBlanc and Winston Hinsworth estimate that established carriers will require \$200 billion of new capital in the next decade, one-third of which must come from outside sources. Staggering increases in demand for capital will occur in the near future as a result of the continuing creation of vast additions to the public debt—local, State, and Federal.

These same authors conclude that increased demands in the next decade will strain capital markets almost to the breaking point. In support of their position they quote a study by Dr. William C. Freund of the New York Stock Exchange to the effect that the total demand for capital in the United States by 1985 will exceed the supply by \$53.8 billion. Translating this figure into somewhat more comprehensible terms, a capital shortage is predicted to accumulate in the 1975-85 decade at the rate of approximately \$15 million per day.

In view of these facts, it is shocking to me—and of real concern, I would think, to you—that legislation placing new burdens on our hard-pressed industry would receive serious consideration.

Businessmen, such as myself, who hold this view have received some support from the current administration. Indeed, the thrust of this

legislation runs directly counter to administration proposals, such as the Utilities Act of 1975. The Utilities Act would, among other things selectively reform utility commission practices by setting a maximum limit of 5 months on rate or service proceedings.

Administration spokesmen have also recognized the need for regulatory innovation to remove unduly burdensome regulatory requirements. For example, Secretary Simon has said in a letter of January 14, 1975, to an independent telephone company :

While the problems of the electric utility industry have received the most publicity of late, the administration is fully aware that the gas and telephone utilities are just as capital-intensive and in need of assistance. Any tax or regulatory proposals we make will reflect this broad-based concern.

In my testimony today, I have attempted to point out some of the problems the proposed legislation would create for the independent telephone industry and its users. I've also offered reasons why the bill's adverse consequences would not be diminished by offsetting public benefits.

The worldwide capital market has shrunk to the point where the independent telephone industry's new construction program is more dependent than ever on internal sources of new capital.

Full and fair rates of return, a prime source of new funds, are essential in today's financial environment. Make no mistake about it, adequate revenues and profits provide the energy needed to run the highly capital-intensive telephone industry. Though perhaps not as obvious, our current capital shortage is every bit as intense as the energy shortage, and its causes much less in dispute.

Clearly, if the Commission unduly delays the implementation of full and fair rate increases, the resultant strains on Continental and the independent industry will be severe.

This threat to our financial health can have only one effect; wholesale applications by the independent segment for unprecedented increases in basic local exchange rates charted residential and small business users. This is a good example of how delay can adversely affect the bulk of all telephone users—by increasing the pressure on telephone companies to raise local rates.

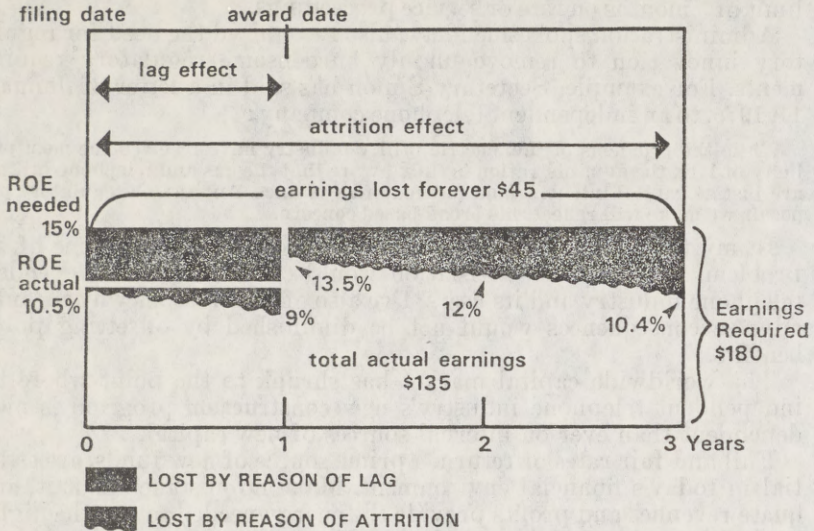
Let me emphasize just one additional point. The U.S. telephone industry provides the world's best, most inexpensive service. Since 1940 the general level of wholesale and consumer prices has increased approximately 200 percent.

In that same period total telephone rates have increased only 35 percent, and interstate message toll rates are, overall, 25 percent less than in 1940. This is the reason why telephone usage by our citizens is almost universal. Though I have emphasized the industry's problems, it is the public who stands to lose the most—through deterioration in service—if we become financially unhealthy.

That is the principal reason why the passage of this legislation would not be in the public interest.

[The attachment follows:]

LAG-ATTRITION EFFECT PER \$1,000 of ASSETS
 (8% Inflation, 12-Month Delay in Award
 — 3 Years Between Rate Filings)



Senator PASTORE. Thank you. Your statement is complete.

Mr. Hinchman, would you please come forward for a moment?

Bell Telephone Co. on April 1 files a rate schedule for an increase in rates, correct?

Mr. HINCHMAN. Yes, sir.

Senator PASTORE. Now, under the suspension rule you now have, let's say this is done on April 1, you have up to June 1 to make a decision?

Mr. HINCHMAN. Yes, sir.

Senator PASTORE. What happens between April 1 and June 1? Intervenor come in.

Mr. HINCHMAN. We receive comments from intervenors and—

Senator PASTORE. How much time do they have to make comments?

Mr. HINCHMAN. I believe they have 25 days to make their comments.

Senator PASTORE. Even with the extended 60 days?

Mr. HINCHMAN. With the 60 days, they get 25 days.

Senator PASTORE. So if it comes in on April 1, by May 1 all of the intervenors have already filed their objections, whatever the case might be?

Mr. HINCHMAN. Yes. Then we have reply comments from the carriers.

Senator PASTORE. You have what?

Mr. HINCHMAN. Reply comments from the carrier, the filing carrier replies.

Senator PASTORE. How much time do you give them?

Mr. HINCHMAN. They have, I believe, 3 days, plus 3 days' mailing time, so they have in effect 7 days.

Senator PASTORE. Seven days. Now what happens after that? After June 1?

Mr. HINCHMAN. After that the Commission staff has to evaluate the reply comments, the filing, prepare a document for the Commission, to decide whether or not to suspend or to allow the tariff to go into effect. And we have to get that to the Commission at least a week in advance of the Commission meeting, which has to be in advance of the effective date, which allows us in the neighborhood of 10 days to 2 weeks for the preparation of the staff recommendation to the Commission.

Senator PASTORE. Do you hold hearing at all?

Mr. HINCHMAN. No, we have no hearings. This is based on the written comments filed by the carriers, and by the opponents.

Senator PASTORE. Now, suppose a question is raised with reference to a carrier's schedule.

Mr. HINCHMAN. Unless we can resolve it on the basis of those filings and comments filed, we have to suspend it and get a decisional 90 days in order to do a further evaluation.

Senator PASTORE. Within that 90-day period, are there any hearings, or is it just merely a study and scrutiny of the presentation that has been made?

Mr. HINCHMAN. There is further scrutiny. Generally, when we suspend we generally designate the issues for hearing. If there are unresolved issues at the end of the 60-day period, we suspend the tariff, set it for hearing, and then the 90 days is just a suspension period, then the tariff goes into effect. During that 90-day period, we already begin the hearing.

Senator PASTORE. The hard thing for me to understand is that the FCC has taken the position that this is helpful to the industry, and yet the industry is objecting to it. And never the twain shall meet. What you are actually saying is under the present procedure, because you don't have enough time, you automatically suspend.

Mr. HINCHMAN. If there is any controversy at all, that cannot be resolved on the basis of the filing, plus the initial comments.

Senator PASTORE. By extending it to 9 months, and giving you the authority to make a partial grant, you say you can be helpful?

Mr. HINCHMAN. We believe in many cases we can resolve the issue, not necessarily suspend it, on routine cases. On major cases, we would hope we could also grant a partial relief, and set the rest for hearing, yes, sir.

Senator PASTORE. And you feel that 9 months is a short enough period?

Mr. HINCHMAN. We feel we can, with the new procedures we are adopting, in most cases reach a decision within 9 months.

Senator PASTORE. Are you actually saying you will have less suspensions?

Mr. HINCHMAN. We would have less suspensions; yes, sir.

Senator PASTORE. With the new procedure.

Mr. HINCHMAN. Some cases we would be able to resolve in the 90-day period, notice period.

Senator PASTORE. Well, if you have nothing further to say, Mr. Maguire, it is 12 o'clock, and I wouldn't want to start these other statements and then interrupt them. I think we have two more wit-

nesses—well, one has quite a group with him. We have Baker and then we have Crosland.

Is there any need to proceed for the next 20 minutes or would either Mr. Baker or Mr. Crosland prefer that we start at 2 o'clock. Are you here?

Mr. CROSLAND. This would be fine with us, Mr. Chairman. It depends on your wishes.

Senator PASTORE. Are you Mr. Baker?

Mr. BAKER. No; I'm Mr. Baker.

Senator PASTORE. How long do each of you expect to be?

Mr. BAKER. I don't think I would take more than 20 minutes, and your convenience is more important to me than starting on my watch. I am going to be here for the entire hearing anyway.

Senator PASTORE. How about you, are you going to be here for the entire hearing?

Mr. CROSLAND. Yes, sir.

Senator PASTORE. We will recess until 2:00 o'clock.

AFTERNOON SESSION

Senator PASTORE. All right, gentlemen, we are ready.

Our first witness is Mr. Warren Baker, executive vice president and general counsel, United Telecommunications, Inc.

STATEMENT OF WARREN E. BAKER, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, UNITED TELECOMMUNICATIONS, INC.; ACCOMPANIED BY JOHN M. LOTHSCHUETZ, COUNSEL

Mr. BAKER. Mr. Chairman, members of the committee:

My name is Warren Baker and I reside in Shawnee Mission, Kans. I am executive vice president and general counsel of United Telecommunications, Inc.—“United”—which is the second largest independent—non-Bell—telephone holding company in the United States. It owns all or substantially all of the common stock of 24 telephone operating subsidiaries which provide telephone service to over 3 million subscribers in 21 States.

During my 35-year legal career, I have been involved for more than 30 years in various areas of common carrier regulation both in government and industry. As a lawyer in government, I spent 2 years with the Maritime Commission, 7 years with the CAB, and 5 years as general counsel of the FCC. I spent the next 10 years in private law practice, during which time I represented various common carriers before various Federal regulatory agencies and in the courts and was general counsel for the U.S. Independent Telephone Association for 6 years of this time. Since 1968 I have served as general counsel of United. In this capacity I have represented United before the FCC and a number of State utility commissions and in the various courts.

I am here today on behalf of United to comment on S. 2054, a bill to amend sections 203 and 204 of the Communications Act of 1934, as amended.

S. 2054 proposes three basic changes to the Communications Act; the most important being the proposed amendment to section 204, to extend from 3 months to 9 months the period of time for which the Commis-

sion may suspend new or revised tariff provisions relating to charges, classifications, regulations, or practices. In addition, the bill proposes to amend section 203 of the act to extend from 30 to 90 days the notice period that a common carrier must give to the public and to the Commission of tariff changes before such changes can become effective.

The cumulative effect of these proposed amendments would be to extend the period from the time a tariff provision is filed with the Commission to the time that a tariff provision can become effective from 5 months to 1 year.

It may sound strange to say 5 months, although technically what I have stated is only 4 months, the Commission by interpretation has modified the 30 days to 60 and has been sustained in court.

ENLARGING THE SUSPENSION PERIOD BEFORE RATES MAY BE INCREASED
WILL SERIOUSLY AFFECT THE FINANCIAL WELL-BEING OF THE TELEPHONE
INDUSTRY

It must be assumed that the FCC would not have proposed this amendment to enlarge the period of suspension of new and increased rates if it did not intend to use the power to delay increases in rates filed by telephone companies. Thus, the inevitable consequence of amending the Communications Act as proposed would be to more than double the length of the delay period in obtaining increases in telephone revenues from telephone tariff filings. This would deprive such companies of funds that are already needed when the proposed changes in tariffs are filed. A tariff filing to increase charges is not and may not be based on a mere belief that revenues obtained will become inadequate at some date 1 or 2 years in the future.

Rather it must be based on a factual showing that the revenues have already, at the time of the filing, become inadequate, based on actual accounting and financial records for a past period, usually called a test year. Thus any delay in putting into effect increased rates results in extending the time during which revenues obtained by the carrier are inadequate.

Obviously, the longer the suspension the larger the amount of revenue deficiency. Now, I do not want to suggest that every penny requested in every rate increase filing is always found by the regulatory agencies to be needed. However, seldom have telephone companies sought increased rates and been found not to require any part of the proposed increase.

To the best of my knowledge it has not been done at the FCC. In a very real sense, then, any delay in putting into effect carrier proposed rate increases imposes a loss of needed revenues on the carrier, at least of that portion of the requested increase in revenues ultimately found to be required.

The longer the delay, the greater the amount of the loss in needed revenues. The grant of the requested authority to the FCC to delay any increased rates for as much as a year, rather than 5 months, will have an adverse financial impact on a carrier.

The result of this proposed amendment, from an actual real-world standpoint, is to insert a 1-year delay in a carrier's ability to recover through increased rates its reasonable and just revenue requirements

for rendering its services regardless of whether all or only some of the increased charges are found to be lawful and reasonable.

Moreover, this delay in receiving a carrier's reasonable and just revenue requirement is a permanent financial loss affecting a carrier's financial well-being. Not \$1 of a carrier's reasonable and just increased charges for services during this proposed extended period of suspension can ever be recovered by the carrier. There can be no retroactive increase in charges for a carrier's services.

It is argued that a telephone company should not be allowed to charge rates one bit higher than determined by the Commission to be reasonably required or justified and therefore should not collect any increased charges until so determined by the Commission. Since it is possible, at least whenever the Commission sets proposed rate increases for investigation and hearing, that something less than 100 percent of the proposed increases will be ultimately determined to be just and reasonable, it is allegedly to protect the public from payment of any excess that suspension is authorized and utilized.

However, such suspension is not, in fact, necessary to protect the ratepayers. Unlike the carriers, who are unable to collect from telephone subscribers the increased rates ultimately found required, ratepayers can recover any and all of the charges which have been collected by a carrier that might be found unjust and unreasonable even though the increased charges have gone into effect.

The existing provision of section 204 of the Communications Act already provides authority for the Commission to enter an "accounting order" with respect to any increased charges which go into effect after even only a 1-day suspension and, thus, a refund with interest by the carrier of any collected charges later found unlawful by the Commission can be entered to make the ratepayers whole.

While theoretically both the existing suspension authority in the Communications Act and the proposed enlarged suspension authority in the amendment apply to reductions in rates as well as increases, neither has, in reality, applicability to reductions. No Commission action has ever suspended a general rate reduction filed by a carrier. As to selective or limited rate reductions, however, no authority ought to be available to suspend reductions filed to meet competitive rates, and certainly the period of suspension now available should not be increased in this area. In those rare instances of alleged unlawful discrimination or undue preferences arising from rate reductions, it can hardly be argued that any additional 7-month suspension period would materially effect an equitable decision.

When Congress originally passed the Communications Act, it made a conscious determination to attempt to balance the equitable interests of the ratepayers and the carriers when it instituted authority to provide the suspension of rates for a relatively short period of time, which was shorter than that which had hitherto been in effect in the ICC, a reduction from 4 months to 3 months. What this actually did was to say that, recognizing that it may be possible that an increase is filed which is more than justified, and it may take some time to determine what is actually correct, a short suspension period which would give some benefit to the ratepayer, and some penalty to the carrier, with the rates then to go into effect under bond, so that any further increases, which might be collected would be paid back to the ratepayers with interest, is an equitable balancing of this.

What we are here about today is that the FCC is just saying, tilt the scales more against the carrier on getting revenues which it needs.

Senator PASTORE. You can't mean that seriously. The fact still remains that you are taking the money of the ratepayer and you are keeping it and if that fraction is unreasonable, you have got his money and he has to wait to collect it back. Now where is the equity in that?

Mr. BAKER. First of all, if I am correct that we ultimately establish we needed increased charges from the day we filed our rate case, we have been deprived of any of the increase for at least 5 months.

Senator PASTORE. That may be so, that is provided they are entitled to it. And the question is, who carries the burden of proof. Here it almost looks like the FCC is going to carry the burden of proof.

Now, I am not quarreling too much with the idea that there may be an inconvenience here and there. But you talk about a fraction being justified, and that is exactly why they want the authority to make a partial grant. And they could do that. They could do that under this legislation.

When a part is very questionable, it would go to suspension and then a hearing.

Now, I am not saying it should be 9 months. As a matter of fact, Wiley admitted it was picked out arbitrarily, it could be 6, a year, 9 months. And I suppose it is anybody's guess as to what would be right.

In my own State it is 9 months. But as it was explained today, and you were counsel for the FCC, you file and it takes 25 days and then there has to be answers within the 25 days, and then there is 7 days to rebut the comments that have been made. There goes your month. Your month is all shot.

Now their argument is if they had the right to grant part, and suspend the balance, that they could do more equity and expedite many of these hearings. I realize there is a certain amount of inconvenience to the telephone company, but on the other hand, after all, how about the consumer?

Mr. BAKER. Let me answer you, Mr. Chairman.

First, they do not have only 30 days, they actually have 60 days. The expiration of the 30 days before it really is before them means they have 30 days more to actually make the prima facie judgment on the record.

Senator PASTORE. That is right. But the law you are talking about only gave 30 days. Then they took it upon themselves to stretch it out another 30 days. They found it necessary. The 30 days was too short, therefore they allowed 60 days.

Mr. BAKER. I don't say the law only gave them 30 days, Senator. The law said you have 30 days with a right with good cause to modify it. They have modified it to 60 days, and the courts have held that is perfectly reasonable.

Senator PASTORE. And they cannot go beyond the 60?

Mr. BAKER. No, I would not say that. I would disagree with Chairman Wiley's statement. The court did not find anything more than what was before it, namely, that an extension to 60 days on the basis of the Commission's presentation was a reasonable requirement. Had the Commission come along and found it really needed 90, and made a decent case for it, I have no reason to question but what the court would have found that 90 days would be justified.

Senator PASTORE. Didn't the telephone company object and go to court on the extension from 30 to 60 days?

Mr. BAKER. That is right. The telephone company went to court and found it was wrong about the law. It said modification only means to reduce. The court held that was not true. And we are bound by the law of the case at the present time. I don't know that it would make much difference if it were specified by Congress as long as the word "modified" is in there, I believe the Commission, if it could establish good cause for it, could extend it beyond that.

Senator PASTORE. How long does it take to put together a brief and schedule of tariffs?

Mr. BAKER. On the basis of the vast amount of information which the Commission now requires to be filed in justification of a rate increase, ostensibly on the grounds that it thereby makes it easier for the Commission and others to determine the reasonableness of the increase, it takes well over 3 months. It does not take 3 months to analyze the data once it is all collected. I don't think there is any question but what 30 days is adequate to make a fairly sound prima facie judgment.

Senator PASTORE. But, of course, I have no way of saying whether you are right or wrong. All I have is a feeling it is not enough time.

Mr. BAKER. May I go to the other question?

You raised the question with respect to the partial or temporary rates. The plain fact is that today the Commission has by implication the ability to put in temporary or to put in partial rate increases. It has done so. But it basically, what it basically does is, if it concludes there has been a prima facie case made for 70 percent of the proposed rate, but not for 100 percent, it has requested and given permission and carriers have filed on short notice a changed rate, lowering it to that amount. So, it is possible when they make a prima facie case for such to be done. As far as temporary rates are concerned, there is nothing more temporary than suspending a proposed rate for 1 day and putting it into hearing. It is now temporary, that is, it may be collected until the ultimate decision, and at that time whatever the Commission concludes on the basis of that record is the appropriate amount, and that is the rate therefore, and you can have a refund of anything in excess of that.

So, they have the power implicitly. They don't have it specifically. I have never said the Commission can have a partial rate, or can have a right for a temporary rate.

Senator PASTORE. Mr. Hinchman, will you come forward, please?

What do you have to say to this argument?

Mr. HINCHMAN. Well, Senator, we have no—

Senator PASTORE. I want to get this record straight. Here is a man that used to work for FCC. He claims you have 30 days, 60 days whatever you have got, and you have time. What do you have to say?

Mr. HINCHMAN. As to the power, Senator, we have no power, statutory power for a partial grant. If we can negotiate with the carrier and if the carrier agrees that we have made a case, that only 70 percent of the rate should go into effect, then the carrier may voluntarily agree to suspend the effective date, or to change or refile the tariff. But as far as the Commission's authority, we have no authority to order a partial.

Senator PASTORE. You say it is up to the carrier.

Mr. HINCHMAN. They have to accept our analysis, say, yes, you are right, we will amend our filing to incorporate only part of the increase.

Senator PASTORE. What about the argument that you have enough time under the present law to make a judgment?

Mr. HINCHMAN. Well, Senator, when you have something like 267 pages of tariffs filed with 8,000 pages of supporting testimony, developed over many, many months, with fairly sophisticated computer techniques, I think it is rather difficult to conceive of the Commission being able to evaluate that and determine within a 30-day period, and actually it is not a 30-day period we have, it is in the neighborhood of 2 to 3 weeks, and to reevaluate the comments which are also filed in opposition, purportedly showing that all of the data the carrier has filed is incorrect in various ways, I think it is impossible to consider that the Commission can evaluate that and make a fair determination in that period of time.

Senator PASTORE. All right. Thank you.

Now, you can take it from there.

Mr. BAKER. I would agree it is impossible to make a final decision within that period of time. I said it is not impossible to make a prima facie determination as to what is correct and what is not. That is all that is really required when you determine to let something go into effect, or you start a hearing to determine that it is the actual level that should be allowed to be put in.

Senator PASTORE. But the prima facie result might be to suspend, whereas ordinarily if they had a little more time, the result might be to grant. That is what we are talking about here. That is what they have been telling me. I don't know if it is right or wrong, but that is what I have been told by the FCC. You have been here all day. You see your argument is if the prima facie case has been made, that ought to be sufficient for the time being. The point is they may say the prima facie case has not been made, and we will suspend. Their argument is that usually they have had to suspend, whereas if they had more time, they might grant. I don't know, I know nothing about the business of the telephone company or about the FCC. All I am trying to do here is to arbitrate this thing and find out what is right in the public interest. Here I am, I am approached by two men I have heard before, and they have worked more or less in the same capacity at the FCC, and they don't agree between themselves.

All right, you may proceed.

Mr. BAKER. Senator, the question is not so much my opinion, Mr. Hinchman's opinion, but what the facts and the record has shown. We already have a situation where you may suspend for 90 days. There has never been a time within that 90-day period of suspension that the Commission on a paper basis has ever been able to come out with an adequate conclusion that the rates were or were not valid to be put in. If they made the first prima facie determination that maybe we should investigate it, I suggest extending the period of notice from 60 to 90 days, which is what you are being asked to do here, is not going to permit them to do something they have not been able to do within 90 days more after that.

Actually, there is nothing which has ever prevented the FCC from making the same kind of a temporary or partial determination during

the suspension period. The procedures are not so solidly locked into concrete that the Commission could not at the end of 60 days of that suspension period come in and say we have, on the basis of the additional documents that have been brought in here, concluded this is the result and we want it in effect.

Of course, there ought to be an opportunity to litigate that if, in fact, it is not justified, and we think in many cases that is what you are being asked to do, to permit somebody to make a determination without an adequate basis for a record on which we could demonstrate that that is the right amount.

In effect, your total package here is asking to build in an additional 7-month delay. No one really seriously believes that any really complicated rate case is going to be decided before 3 months, or before 9 months of suspension. What you are being asked to do is to put in an additional period of time during which no collection of any part of the required increased rates can be in effect. And those can never be recovered.

I am not saying that we should be able to collect and never pay back if we are wrong. I say that we should be permitted to at least have an equitable position, namely, that we get something during the period of time and we give it back if we are not able to justify it. Basically, this is what it comes down to.

Senator PASTORE. You are not saying give the FCC and the public something, you say give it all to us and then we may give part of it back.

Mr. BAKER. If I were taking that position, I would be saying in no case permit any suspension, merely start an investigation, and at the end of the time, then take back. In this situation, we already have built in a suspension under which you do not get anything you could justify. So it differs when you get the portion that you ultimately have justified for the first 5 months, or when you don't get any of it until after 12 months. That is really what we are talking about. That is why I say it is tilting against the interests of the carriers, because we can never get it back.

I want to point out that the rates that are filed by Bell are not simply Bell's rates. Under the statute Bell is required to file its rates for itself and all of the connecting carriers. And that means everyone of us. In other words, what rate is being proposed by Bell is a rate for people to call from cities that we serve to other points in the United States, not just between points that Bell serves. And we are concerned with approximately 25 percent of all of the telephone calls in the United States. I don't mean United, I mean the independent industry. It does affect us, because it will determine how much needed revenues we actually will ultimately obtain.

I think that the original decision by Congress to make the balancing of the equities between the ratepayers and the carriers was to say that being deprived for 4 months and having to pay back any excess you collect after that, is a reasonable balance. I cannot say that Congress today could not come along and say we think an equitable balance is 9 months or 12 months. What we do say is, though, that making that decision is taking more funds that are needed away from carriers which they can never get back. And it is not in any particular

way protecting the public. Because if we were wrong and we should not get 100 percent, the public gets it back.

Senator PASTORE. In the past year, have you been losing money?

Mr. BAKER. When you say have you been losing money, I think you have to answer this in terms of we have not been going bankrupt.

Senator PASTORE. You talk about taking the money away from the carrier, the carrier will be in a bad way financially. What is your financial picture?

Mr. BAKER. Our financial picture is that we have earned less than what we believe is a reasonable amount on our revenues, I mean on our investment. We have been earning more than our actual out of pocket costs, and we have had some return on our investment.

Senator PASTORE. What is your return on investment?

Mr. BAKER. I think last year on our equity investment, I believe it came out slightly over 10 percent, 10.6, I believe.

Senator PASTORE. That's not bad.

Mr. BAKER. Well, when we are paying 10.3 for some of the money that we have to borrow in bonds, it is not a very high return for the stockholders who have invested money. I think I wouldn't want to justify at this time what is a reasonable return on investment. That is what has been determined by the various regulatory agencies. Many of them have determined that more than that is justified, but in the overall we have not actually recovered that amount. I guess the other aspects of this bill which I was commenting on was related to the temporary or partial change in classification.

I raise here one specific point, and that is this: If this language which is proposed here, which is not exactly the model of clarity, is intended to be more than permitting part of the increase to go into effect, but in reality its meaning is to determine that some part of a filing which might be a reduction will go into effect, and suspending and not permitting to go into effect any other parts which would balance it out, we are faced with the fact of prescribing some portion of the carriers' rates.

Now, the language doesn't specifically say prescribe a reduction. But since the language has been changed here to apply not only to increases but to reductions, it is potentially possible that the language could be interpreted and used by the FCC to say, yes, put into effect those rates which you were going to reduce, but don't and you are not allowed to put into effect those which would have balanced your revenue requirements, that you were going to increase.

Senator PASTORE. Can they do that now under existing law without the consent of the applicant?

Mr. BAKER. No, they may not, because that is the point at the present time.

Senator PASTORE. That is what they are trying to cure, as I understand it, they would like to be able to do that.

Mr. BAKER. If that's the purpose, I think Congress should not permit it, because that permits the FCC, without going through a hearing or establishing on the basis of a record that there is a justification for the reduction, to actually deprive the carrier of what has been reasonable rates and return on their investment without going through an adjudicatory hearing. Therefore, you have no real basis for determining

whether that was arbitrary and a taking of the property of the carrier without due process.

I think it should not be done if that is the intent of this. I am not saying that they should not be permitted—

Senator PASTORE. I was told this morning that the whole caboodle is appealable. Am I right on that, Mr. Hinchman?

Mr. HINCHMAN. Yes, sir.

Mr. BAKER. You may appeal any decision of the FCC which is a final one.

Senator PASTORE. So if you feel what they allow is unfair, but you accept it because they have the discretionary power to grant it, and you take an appeal to the courts, that which you accepted is subject to review by the courts.

Mr. BAKER. There is no question about that. But if they compel me to reduce my rates and appeal to the courts, it does not do me very much good unless I get a stay and prevent the reduction from going into effect, because I can never collect back what I have lost.

Senator PASTORE. Yes, but if they suspend the whole thing, aren't you worse off?

I mean I understood today that the reason why they are inserting this—and this is the most important part, but it hasn't been dwelled upon by the people who are opposing this particular measure—as I get it, the real meat of the nut here is the ability to make a partial grant.

Am I right, Mr. Hinchman, on this?

Mr. HINCHMAN. That is correct.

Senator PASTORE. And this has not been discussed at all in any of these speeches I have been reading.

Mr. BAKER. I guess what I am coming to is the ability to make a partial grant is there now, if the carrier acquiesces in it.

The ability to make a partial reduction over the opposition of the carrier is not there under the present law. I think it would be arguable under what they are proposing.

That, I think, is the best explanation of why someone opposes it.

Senator PASTORE. Well, frankly, I don't think they would be entitled to the extension to 9 months if it would only mean an automatic delay.

But the mere fact they want the privilege of making the partial grant in the meantime to me has a tone of sincerity.

Now, maybe, of course, you don't go along with that. But I was told here by Mr. Wiley, and it was confirmed by Mr. Hinchman, that the purpose of it all is that if we extend the suspension period to 9 months, there ought to be some vehicle by which the FCC could make a grant of what is not questionable.

I would suppose in the filing of a tariff increase, there would be many aspects that would not be questionable.

Mr. BAKER. If the provisions were they could make a partial grant of an increase, I would have no objection because I don't think that that would be harmful.

It is the fact of making something applicable to reductions and increases both and the possibility they could do so without a hearing, that is, make a partial reduction without a hearing that raises the question in my mind.

Senator PASTORE. All right, Mr. Hinchman.

What do you say to that? Does this include making a partial decrease?

Mr. HINCHMAN. Mr. Chairman, without having a hearing we could not prescribe a reduction. If we were, for example, to grant only the reduction part, that would be at the carrier's option either to accept that partial grant or to go back to the original tariff. But he would not be required to accept a reduction. We could not do that without having a hearing under existing law.

Senator PASTORE. But even though the discretionary power to make a partial grant, would that mean a partial increase in rates if you saw fit?

The position taken by the witness is you couldn't under this law make a partial grant of an increase.

Mr. HINCHMAN. We could make a partial grant of an increase. That is the purpose.

Mr. BAKER. All I am saying is I would object—I think he can do that without the law, so I obviously can't see any objection if you change the law to say so.

I don't think he can make a partial reduction under the present law and I don't think—I would not like to see him authorized to make a partial reduction over the opposition of the carrier.

Senator PASTORE. He claims on that point you are right.

Mr. BAKER. If he claims this does not in fact authorize that, and that is basically part of it, then it doesn't make any difference.

Senator PASTORE. Would you tell him again?

Mr. HINCHMAN. Mr. Chairman, we could not prescribe a partial reduction without a hearing. We could grant a partial reduction as a part of a package, if the carrier had proposed both increases and decreases in certain rates, we could, under this legislation, as proposed, grant a part of each of those, a part of the increase, a part of the reduction.

The carrier would have the option of deciding whether it wanted to accept that, or to merely revert to the original rates pending the determination of the reasonableness of the new rates.

Senator PASTORE. All right.

Mr. BAKER. If that is the meaning of the language, I don't think I could have any objection to it.

Senator PASTORE. Well, I am glad you have it in the record, anyway.

Mr. BAKER. Fine.

The last thing I wanted to point out was that in fact seldom, if ever, has the FCC reached a final conclusion on a controverted rate matter within either the 5 months which it now can suspend or the 12 months which it would expect to effectively suspend if this bill was adopted.

They don't have to. All it does is, in reality, delay the period of time in which any change in the rate takes place, or then if they have put in an accounting order, a repayment, not simply a repayment of any excess collected, but a repayment with interest.

I wish it were possible that we could have merely some kind of bond put up that the subscribers would pay until it was ultimately found to have been required.

Unfortunately, there is no possible way to do that. So I think

basically the equity is you do permit, after a short suspension, rate increases to go into effect with the burden on the carrier ultimately of paying back with interest anything which the Commission ultimately finds is excessive.

Senator PASTORE. Well, you have made your points.

Mr. BAKER. Thank you. I really think that is basically in concert with the basic policies put into the Communications Act, which was to provide facilities and wire communication service to everyone in the United States, at reasonable rates.

Senator PASTORE. I think the members of the committee agree. It is unfortunate they are not here. They have business on the floor, and there are other meetings going on.

But I would hope, and will insist they read the record. You may all be sure of that.

Mr. BAKER. Thank you for the opportunity of appearing.

Senator PASTORE. It is always nice to have you. I enjoyed you even when you worked for the Government. Now you know how I feel.

Mr. BAKER. Oh, yes.

Senator PASTORE. Thank you very much.

[The statement follows:]

STATEMENT OF WARREN E. BAKER, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, UNITED TELECOMMUNICATIONS, INC.

My name is Warren E. Baker and I reside in Shawnee Mission, Kansas. I am Executive Vice President and General Counsel of United Telecommunications, Inc. ("United"), which is the second largest independent (non-Bell) telephone holding company in the United States. It owns all or substantially all of the common stock of 24 telephone operating subsidiaries which provide telephone service to over three million subscribers in 21 states.

During my 35 year legal career, I have been involved for more than 30 years in various areas of common carrier regulation both in government and industry. As a lawyer in government, I spent two years with the Maritime Commission, seven years with the CAB, and five years as General Counsel of the F.C.C. I spent the next ten years in private law practice during which time I represented various common carriers before various federal regulatory agencies and in the Courts and was General Counsel of the United States Independent Telephone Association for six years of this time. Since 1968 I have served as General Counsel of United. In this capacity I have represented United before the F.C.C. and a number of state utility commissions and in the various Courts.

I am here today on behalf of United to comment on S. 2054, a bill to amend Sections 203 and 204 of the Communications Act of 1934, as amended.

S. 2054 proposes three basic changes to the Communications Act; the most important being the proposed amendment to Section 204, to extend from three months to nine months the period of time for which the Commission may suspend new or revised tariff provisions relating to charges, classification, regulations, or practices. In addition, the bill proposes to amend Section 203 of the Act to extend from 30 to 90 days the notice period that a common carrier must give to the public and to the Commission of tariff changes before such changes can become effective. The cumulative effect of these proposed amendments would be to extend the period from the time a tariff provision is filed with the Commission to the time that a tariff provision can become effective from five months to one year.

ENLARGING THE SUSPENSION PERIOD BEFORE RATES MAY BE INCREASED WILL SERIOUSLY AFFECT THE FINANCIAL WELL BEING OF THE TELEPHONE INDUSTRY

It must be assumed that the F.C.C. would not have proposed this amendment to enlarge the period of suspension of new and increased rates if it did not intend to use the power to delay increases in rates filed by telephone companies. Thus the inevitable consequence of amending the Communications Act as proposed

would be to more than double the length of the delay period in obtaining increases in telephone revenues from telephone tariff filings. This would deprive such companies of funds that are already needed when the proposed changes in tariffs are filed. A tariff filing to increase charges is not and may not be based on a mere belief that revenues obtained will become inadequate at some date one or two years in the future. Rather it must be based on a factual showing that the revenues have already, at the time of the filing, become inadequate, based on actual accounting and financial records for a past period (usually called a test year). Thus any delay in putting into effect increased rates results in extending the time during which revenues obtained by the carrier are inadequate.

Obviously, the longer the suspension the larger the amount of revenue deficiency. Now I do not want to suggest that every penny requested in every rate increase filing is always found by the regulatory agencies to be needed. However, seldom have telephone companies sought increased rates and been found not to require any part of the proposed increase. In a very real sense then any delay in putting into effect carrier proposed rate increases imposes a loss of needed revenues on the carrier, at least of that portion of the requested increase in revenues ultimately found to be required. The longer the delay, the greater the amount of the loss in needed revenues. The grant of the requested authority to the F.C.C. to delay any increased rates for as much as a year rather than five months will have an adverse financial impact on a carrier. The result of this proposed amendment, from an actual real-world standpoint, is to insert a one-year delay in a carrier's ability to recover through increased rates its reasonable and just revenue requirements for rendering its services regardless of whether all or only some of the increased charges are found to be lawful and reasonable. Moreover, this delay is receiving a carrier's reasonable and just revenue requirement is a permanent financial loss affecting a carrier's financial well-being. Not one dollar of a carrier's reasonable and just increased charges for services during this proposed extended period of suspension can ever be recovered by the carrier. There can be no retroactive increase in charges for a carrier's services.

It is argued that a telephone company should not be allowed to charge rates one bit higher than determined by the Commission to be reasonably required or justified and therefore should not collect any increased charges until so determined by the Commission. Since it is possible, at least whenever the Commission sets proposed rate increases for investigation and hearing, that something less than 100% of the proposed increases will be ultimately determined to be just and reasonable, it is allegedly to protect the public from payment of any excess that suspension is authorized and utilized. However, such suspension is not, in fact, necessary to protect the rate payers. Unlike the carriers, who are unable to collect from telephone subscribers the increased rates ultimately found required, rate payers can recover any and all of the charges which have been collected by a carrier that might be found unjust and unreasonable even though the increased charges have gone into effect. The existing provision of Section 204 of the Communications Act already provides authority for the Commission to enter an "accounting order" with respect to any increased charges which go into effect after even a one day suspension and, thus, a refund with interest by the carrier of any collected charges later found unlawful by the Commission can be entered to make the rate payers whole.

While theoretically both the existing suspension authority in the Communications Act and the proposed enlarged suspension authority in the amendment apply to reductions in rates as well as increases, neither has, in reality, applicability to reductions. No Commission action has ever suspended a general rate reduction filed by a carrier. As to selective or limited rate reductions, however, no authority ought to be available to suspend reductions filed to meet competitive rates, and certainly the period of suspension now available should not be increased in this area. In those rare instances of alleged unlawful discrimination or undue preferences arising from rate reductions, it can hardly be argued that any additional seven month suspension period would materially effect an equitable decision.

THE RATIONALE OF SUSPENSION STATUTES

In evaluating the merits of the proposed amendment to Section 204 of the Act it is appropriate to consider the underlying rationale behind the suspension provisions of a statute. The statutory limitation on the duration of a tariff suspension period, such as now exists in Section 204 of the Communications Act, repre-

sents a Congressional recognition of the adverse economic impact upon carriers from the loss of revenues during the time it takes a regulatory agency to decide the lawfulness of new or revised tariff provisions and until such provisions can be put into effect by the carriers. The Court of Appeals for the Second Circuit in *American Telephone and Telegraph Company v. F.C.C.* 487 F.2d. 864 (1973) recognized the Congressional rationale for limiting the suspension period when it stated that the: Statutory scheme of the Communications Act reflects the realization of Congress that when a carrier is prevented from placing in effect new rate increases it may suffer irreparable loss which in turn may impede the provision of adequate service during a period of rising costs.

The extension of the suspension period from three months to nine months, as proposed in S. 2054, would have an even greater effect on the carriers in terms of revenue loss, the ability to provide adequate service to their subscribers, and their ability to attract capital than that currently flowing from the existing three month suspension period under Section 204.

THE RATEPAYER IS ADEQUATELY PROTECTED AGAINST UNLAWFUL RATES

As I previously stated, Section 204 of the Communication Act authorizes the Commission to suspend new or revised common carrier tariff provisions, including charges, for a period of three months. Thus if the tariff is suspended, the Commission may enter an "accounting order". The effect of this order is to require the carrier to keep an accounting of the charges collected during the pendency of the proceeding and to refund such amounts if the charges are ultimately found to be unlawful by the Commission. Consequently, the ratepayer is made whole by a refund with interest if the proposed charges are found to be unlawful.

The Supreme Court, in commenting on the refund provisions of the Interstate Commerce Act, stated in *United States v. SCRAP*, 442 U.S. 69 (1973): The suspension period was limited as to time to prevent excessive harm to the carriers, for the revenues lost during the period could not be recouped from the shippers. On the other hand, Congress was aware that if the Commission did not act within the suspension period, then the new rates would automatically go into effect and the shippers would have to pay increased rates that might eventually be found unlawful. To mitigate this loss, Congress authorized the Commission to require the carriers to keep detailed accounts and eventually to repay the increased rates if found unlawful.

The same basic rationale was applied when Congress enacted Section 204 of the Act which authorizes the Commission to order a refund of unjust and unreasonable rates and charges.

Thus, a continuation of the three month suspension period and the refund provision of the Act balances the interests between the ratepayer and the common carrier. However, it should be emphasized that when new or revised rates are filed by a carrier, then suspended by the Commission, and thereafter found to be lawful, the carrier can never recover the revenues which it would otherwise have received.

In essence, any substantial period of suspension is clearly harmful to the financial well-being of the carrier and is not required to equitably protect the ratepayer. Indeed, if any change is needed in the length of the suspension period, it would be more fair and equitable to reduce rather than increase the authorized length of suspension.

ENLARGING THE NOTICE PERIOD FROM THIRTY DAYS TO NINETY DAYS WILL ALSO ADVERSELY AFFECT THE FINANCIAL WELL-BEING OF THE TELEPHONE INDUSTRY AND IS NOT REQUIRED

S. 2054 proposes to amend Section 203 of the Communications Act by extending from thirty days to ninety days the period of time notice to the public and the Commission is required before a tariff provision may be changed.

The same reasons that I have previously discussed with respect to our opposition to enlarging the suspension period are equally applicable to the proposal for enlarging the notice provision of Section 203 and need not be repeated. However, I wish to stress that any delay as a result of an enlarged notice period for putting rates in effect deprives telephone companies of funds that are needed when the proposed rates are filed with the Commission—not months or years in the future.

Although Section 203 presently provides for a 30-day notice provision, the Commission in 1973 modified its rules to provide that "every tariff publication

which constitutes a rate increase shall bear an effective date and . . . give not less than 60 days notice to the public and to the Commission." (47 CFR § 61.58). This rule modification was challenged in the Courts on the basis that the Commission lacked the statutory authority to extend the notice requirement. The Court rejected this argument and clearly stated that the Commission had the authority to modify the notice requirement for "good cause" shown. *American Telephone and Telegraph Company v. F.C.C.*, 503 F.2d 612 (1974). In view of the Court's interpretation of the notice requirements of Section 203, it is difficult to understand the necessity for such an amendment. Under the rationale of the Court's decision it appears that the Commission has the authority to modify the notice requirements if "good cause" is shown. Accordingly, the proposed amendment to Section 203 does not appear to be necessary. Should Congress decide, however, to change the notice requirement from 30 to 90 days, it should restrict the Commission's authority to further extend the notice requirement.

AUTHORIZATION OF TEMPORARY OR PARTIAL CHARGE, CLASSIFICATION, REGULATION, OR PRACTICE BY THE F.C.C.

S. 2054 adds a new paragraph (b) to Section 204 of the Act to provide authority to the Commission to authorize a temporary or partial charge, classification, regulation, or practice to become effective. Under the existing law the Commission does not have any specific grant of such authority but, in fact, has been able to do so by "permitting" carriers to put in effect a portion of the proposed tariff changes by submitting a new voluntary filing of a changed tariff. In essence, the Commission also authorizes a temporary change by permitting proposed tariffs to go into effect after a short suspension pending a decision after hearing. If the language in the new proposed paragraph is intended to authorize the F.C.C. to impose selective parts of or a partial change in tariffs without the acquiescence of the carrier, such as the specific voluntary act of a new filing, it really, in effect, is authorizing the Commission to prescribe changes in charges, practices, and classifications without basing such prescription on a record in an evidentiary hearing. For example, a proposed tariff may contain adjustments in charges involving increases for some services and decreases for others without involving any overall change in revenues. Permitting the reductions without the increase on a selective basis against the wishes of a carrier is effectively prescribing a reduction in charges. This would not only be a major and basic change in rate making as presently authorized under the Communications Act, which has in no way been justified or shown to have been needed, but it also would raise a substantial constitutional question as to the taking of property without due process of law. The so-called paper proceeding contemplated by the proposed amendment as a basis for prescribing rates can hardly be said to conform with the requirements of due process.

If it is deemed desirable to provide specific rather than implied authority for the Commission to allow part of a carrier's proposed tariff changes to become effective, it should be made clear that such a grant of authority is for the Commission to permit not to mandate a tariff change and that such authority would not authorize. The Commission to prescribe any tariff changes in any different manner or under any procedure other than as set forth in Section 205 of the Communications Act. Absent clarification in this regard we submit Congress ought to reject the proposal to add Section 204 (b) as set forth in S. 2054.

SUMMARY

In summary, it is our view that the amendments to Sections 203 and 204 which would more than double the period of time during which a carrier's proposed increased rates are delayed by a suspension order will cause substantial financial harm to telephone carriers and are not needed to protect telephone ratepayers. Depriving carriers of needed revenues is not a benefit to the telephone subscribers nor the sine-qua-non of public interest. It can only result in inadequate service to the subscriber. The goal of proper, indeed lawful, regulation over the charges of a common carrier ought to be the preventing of excessive charges for telephone services, but not the denying or delaying of collection of adequate revenues for telephone services. The basic policy set forth in Section 1 of the Communications Act of 1934 is to "make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges. . . ." not at inadequate

charges; let alone the delaying of adequate, reasonable charges. The adoption of the proposed amendments in this bill will result in just that and for these reasons we submit that S. 2054 should not be adopted.

Thank you very much for this opportunity to have our views heard on this proposed legislation.

Senator PASTORE. Our next witness is Edward B. Crosland, who is accompanied by a former chairman of the FCC—this must be reunion day—and another gentleman.

STATEMENT OF EDWARD B. CROSLAND, VICE PRESIDENT, AMERICAN TELEPHONE & TELEGRAPH CO.; ACCOMPANIED BY NEWTON N. MINOW; AND JOHN F. PRESTON, JR.

Mr. CROSLAND. Mr. Chairman, in the interest of time, both Mr. Minow and I will summarize our statements, but we request that the entire statements be incorporated into the record.

Senator PASTORE. Without objection, that will be ordered.

Mr. CROSLAND. Thank you very much.

Mr. Chairman, I am Edward B. Crosland, vice president of the American Telephone & Telegraph Co., With me are Mr. Newton N. Minow, a distinguished student of regulation who served as Chairman of the FCC in the early 1960's, and is now a partner in Sidley & Austin, a Chicago law firm that regularly represents the Bell System. Also with me is Mr. John F. Preston, Jr., general solicitor of A.T. & T., who has had broad experience representing the company in proceedings before the FCC and State regulatory bodies for more than 20 years.

We appreciate this opportunity to review with the committee concerns we have with respect to the effect of S. 2054, a bill which could prolong the procedures of the FCC in arriving at decisions on rates for services offered by communications common carriers, and which we believe would be contrary to the best interest of consumers.

Based on the valuable insights gained from his experience in regulatory matters, Mr. Minow will discuss the public-interest objectives of regulation, the procedures he believes would best achieve them, and the impacts of S. 2054. With your permission, I will then cite specific experiences of A.T. & T. which illustrate and reinforce the broader principles developed by Mr. Minow. Thereafter, the three of us will be pleased to respond to questions by the committee at any time during our presentation.

Mr. MINOW. Mr. Chairman, it is good to be back here to see you again. I listened very carefully to the testimony earlier, and since my statement is going in the record, I would like to begin by commenting on some things I felt were left a little bit unclear.

Senator PASTORE. All right.

Mr. MINOW. You asked several times, Mr. Chairman, what the sequence of events is now, what has to be decided at certain times under the present law; specifically, at one time you used the example of "Let's assume the Bell System filed a tariff for a new rate on April 1." I think it would be useful if we went through that.

Senator PASTORE. Go ahead.

Mr. MINOW. If the Bell Cos. had filed on April 1 a new tariff, let's assume it was an increase, they would have been complying with very comprehensive detailed specifications already given in regulations of the FCC as to what they had to file. There is a very enormous amount

of data that the FCC tells them to give, so the FCC will not be surprised by anything they file.

Second, a lot of the papers they file are material the FCC already has. The Bell System files some 2,600 reports, I believe, with the FCC every year, monthly reports of all kinds. So what they are filing is really not that new. It has been assembled in a different form prescribed and specified to them by the agency. Once it is filed on April 1, within 60 days of that date the FCC must make one decision: it must decide whether they should have a hearing.

The FCC does not have to wait any length of time to commence that examination and analysis; in fact, it should start the day the tariff is filed.

Comments can come in from different interested people within a specified period, within I think 25 or 30 days, but there is no reason to await those comments before undertaking the analysis and researching of the material that has been filed. During the 60 days the FCC must decide: Are hearings required? Is this sufficiently important and controversial so we have to spend more time on it? Or is it a routine matter that we can tell on its face? At the end of the 60-day period, they could reach a decision to hold a hearing, in which event they suspend the effective date of the new rates for a period of up to 90 days.

An order to suspend is not appealable to the courts. Also, an order not to suspend is not appealable to the courts. That is a very preliminary decision at that point. Neither side can appeal at that point. During the 90-day period of suspension, the rates cannot go into effect. The carrier cannot put them into effect at all. During that time the FCC can do several things. They can commence a hearing and, hopefully, maybe it can even be concluded within that period. If they can't conclude it, the Congress specified, at the time the Communications Act was written in 1934, a very careful balancing of interests between the customer and the company. It said that after the 90-day suspension period the rates go into effect, but the Commission has the statutory authority spelled out in the law to order an accounting, a keeping of careful records, and a refund to the customers—

Senator PASTORE. Let me interrupt you for a minute there. After 90 days what happens?

Mr. MINOW. After 90 days, the rates go into effect, with or without an accounting order as specified by the Commission. If there is an accounting order, a refund may be with interest. Mr. Chairman, if it is determined later than the rate should not have been put into effect, the company would be obliged to refund it with interest as specified by the Commission.

Senator PASTORE. Well now, that is just the point. Are you saying that within the 90 days that the Commission has enough time to make a judgment that will stand up in court as an official decision?

Mr. MINOW. I would say sometimes yes and sometimes no.

Senator PASTORE. Now, isn't that the reason why they want the extension?

Mr. MINOW. I think that is why they want the extension. But I think it rests on a misconception, because they are suggesting they have to conclude the matter within that period.

Senator PASTORE. If you gave them the 9 months, maybe they could conclude it.

Mr. MINOW. I think human nature—

Senator PASTORE. Then you would have equity done to you, and the ratepayers, subscribers would have equity done to them as well.

Mr. MINOW. In my own judgment, Mr. Chairman, and I mean this sincerely, applying to those of us in the Government or private life, if we have 9 months, we will take 9 months, if we have 18 months, we will take 18 months. That is the nature of life. That is why the Congress specified a period of time.

Now, Mr. Chairman, you mentioned earlier, very properly, that your principal concern is obviously not the carriers, but the consumer. It should be. I would argue that the consumer's interest here is in not having regulatory lag. The consumer is going to pay in the end, anyway. He is going to pay in the end. The only question is when he is going to pay.

Senator PASTORE. And the question is how much.

Mr. MINOW. And how much?

Senator PASTORE. Of course, that is the important thing.

Mr. MINOW. I would argue that if there is a lag, he will end up paying more. On the record I am right, and I will tell you why. Because if there is a lag, then the company does not have the money to attract investment; it cannot build a new plant which increases productivity and reduces its rates.

Now, you are the chairman of a committee, Mr. Chairman. I don't have to tell you, one of the few committees governing a regulated industry, that the industry is not here today saying to the Government, bail us out, finance us, help us, we are in trouble. We are not in that situation yet. But that is because there has been a balancing of the law, permitting us to raise rates. The Bell people tell me they borrowed money this morning at a rating of 9.7 percent, which is higher than we are earning.

Senator PASTORE. You don't get the letters from subscribers that I get complaining about what is happening. I realize, I tell you very frankly, if I represented the telephone company, I would say exactly what you are saying. I think if you were here sitting in my chair, you would be saying what I am saying. That's true. I am out to protect the consumer. But when you say it is my primary interest, no, my primary interest is seeing that justice is done. I don't want to make a scapegoat of the telephone company any more than I want to hurt the consumer. The point is, I am being confronted here by people who are experts in this area, and for some reason they can't seem to get together.

Now, there has got to be some solution to this problem. If 90 days is not sufficient, there ought to be a longer extension period. If 9 months is too much, somebody ought to tell me. Whether or not you need 60 days or 90 days on the notice, that is another thing that ought to be discussed.

I am quite impressed, you see, that maybe 90 days is too long. But I don't see that the 9 months is such a bad thing if the FCC actually feels that they can make a conclusive decision that will expedite the whole thing.

Mr. MINOW. Mr. Chairman, I think the record would indicate that a conclusive decision is not being made by the Commission whether it be in 5 months or 9 months or a year. This morning you heard

from Mr. Harris, speaking for one of the other carriers, MCI, and he attached an appendix to his statement of the chronology of one rate proceeding. This is where the Bell System filed rates which didn't go into effect even for 16 months. We have cases pending at the FCC that are going on for years and years and years.

Senator PASTORE. You are telling me. It happened even when you were down there.

Mr. MINOW. That's right. And I think any further extension of the regulatory lag works against the consumer's interest as well as the company's interest. And that's really the basic point I wanted to make. I would underline, Mr. Chairman, that when a company gets in trouble—whether it be in the telephone business or the power business, or the electric business, or the railroads or whatever—the one who gets hurt the worst is the consumer, because it ends up costing him a lot more. And unless you have—the courts have recognized this—a healthy utility, not one that is profiting too much, obviously, but healthy, then the consumer in the long run will be one to pick up the bill.

One other comment I want to make—

Senator PASTORE. But you have to admit one thing: We are working in a unique area here where a regulated company is allowed to increase rates before the increase is justified.

Now I know of no other area in our whole framework of government activity where that applies. Everywhere else you have to justify before you can charge.

But here you are charging before you justify. And, there is a reason for it. The Bell System is a beautiful, wonderful system; there is no question at all. The argument was made here we have the best communications in the world. Of course we do. I have had to pick up the phone in foreign countries and I am telling you, it is an agonizing experience. That doesn't happen here in America. We all know that. No one here is chastising the Telephone Co.

But we are being told by the FCC, of which you were one time a member, that apparently they don't have enough time to work this thing out, and do equity to the company and the people, and they would like to have more time.

I hope that somebody will come along and say well, look, maybe 9 months is too much, it ought to be 7 months, or 6 months. But I think that you people are intelligent enough to understand what the situation is, and that it ought to be ameliorated.

I think you ought to be helpful to this committee.

Mr. MINOW. Mr. Chairman, if our experience had been that 9 months was in fact a period in which the Commission decided cases, I would respond differently to you. But it is not. And that is why I think at this point I will turn to my statement, except to add one other thing.

You asked a very important question this morning, Mr. Chairman, of one of the witnesses, it was Mr. Harris. You asked him at one time, "Why does a rate reduction hurt competition?" You asked that question this morning.

Senator PASTORE. That is right.

Mr. MINOW. He said, "Well, it hurts competition because a competitor would have to lower its rates in order to keep a customer."

We would submit to you, Mr. Chairman, that that is the very es-

sence of competition. That is the competitive process, that you should not worry about competitors, but worry about competition.

Senator PASTORE. Provided it is not to kill off.

Mr. MINOW. Yes.

Senator PASTORE. We went through that with regard to reducing freight rates, as to whether or not that would hurt the large carriers, or the truckers. The argument was being made that certain rates are going up and other rates are going down, in order to kill off competition. That is an old argument.

Mr. MINOW. I understand.

Senator PASTORE. But frankly any time anybody reduces anything around here, they have my blessing.

Mr. MINOW. Precisely, except that we haven't been able to put it into effect, that is the only point I wanted to make.

Mr. Chairman, to save time, I would want to summarize a few things.

There are ways, I believe, in which the Commission could improve the speed with which it reaches decisions. There are ways to do that.

The fundamental way I would suggest would be to get the Commissioners, as opposed to the staff, involved in the process very early.

As it is now, when the Commission starts a rate case, it turns the matter over to an administrative law judge. He takes the parties off into another room for months and the Commissioners never see the matter again until they get a batch of papers delivered to them years later.

Now this is as if you, as the Senator and chairman of this committee, conducted hearings by turning the matter over to your staff and getting a written report later, rather than looking people in the eye and seeing what they have to say. That is the principal thing I believe could be done to speed things up.

Senator PASTORE. I have been here for 25 years and I haven't been able to cure bureaucracy yet.

Mr. MINOW. Bureaucracy grows with the number of people involved in dealing with problems, we all know that. If you got the Commissioners in early—there are two kinds of rate cases, and they have to be distinguished. Nobody has commented on this today, and this is what is in my statement, really.

The first is a rate of return case, that does not deal with specific rates as such. But it is simply the case where the carrier comes to the agency and says we are not making enough money, we can't attract capital, we must have a better return on investment, or we can't sell bonds or stock or whatever, so we need an adjustment.

Now a rate of return case, which is what the Bell System has been forced to do in the last few years—

Senator PASTORE. Let me ask you this question: Can you remove or separate the case you have just mentioned from one that involves rates?

Mr. MINOW. Not 100 percent, but basically you can distinguish them from a rate structure case, because sometimes the company will file a rate structure case that has no effect whatever on the rate of return. It will keep the same rate of return, but distinguish between what services will bear what burdens of providing the return.

In a rate of return case, it doesn't require reinventing the wheel every time you have such a case. The data is there. As Chairman Wiley said this morning, the matter of computing what it costs to borrow

money is an arithmetical calculation that doesn't require anything but an adding machine.

What is required is some judgment—judgment, on what it costs to attract equity capital. And that is a judgment which must be made under the law by the Commissioners. And what I am saying is that the Commissioners should be involved at the outset since they have to make that judgment anyway. It is a judgment decision, it is not a mathematical formula that comes out of a computer somewhere, it is a judgment, that they should participate in it from the beginning.

On the other things, don't forget that the Commission is constantly receiving data from the telephone company. Chairman Wiley said today he was moving toward what he called a more full continuous surveillance. This is desirable. And the Commission should not feel, nor should the staff feel, that when a new case comes in that they have to start all over from scratch with a blank piece of paper. It is something that can be done a lot more promptly.

Senator PASTORE. Was Mr. Wiley down there when you were Chairman?

Mr. MINOW. No, he came later, Mr. Chairman. I knew him from Chicago as a Chicago lawyer before he came to Washington.

The other point I made is whether a rate reduction goes up or down, it ought to be put into effect quickly. Certainly, if it goes down, all of us would agree on that, because the consumer—nobody gets up here and says if a carrier puts in a decrease it should be delayed, although in fact, that has happened. But all of us agree it should go down quickly.

The same thing is true if it goes up, because—

Senator PASTORE. Oh, there is a big difference, you know that.

Mr. MINOW. It is a big difference, in the short run, but it is not a big difference in the long run. Because in the long run if the carrier does not have its rates in order, what happens? Then interest rates go up, they have to borrow money at a higher interest rate. Second, they have to borrow more money, because what they are going to build now, because of inflation, costs more than it did before.

So they are going to end up charging the consumer more. So I argue promptness, whether up or down, is in the public interest and consumers' interest.

As you will see in my statement, clearly the courts have recognized that over and over again.

Now on speeding up the decisional process, I guarantee you, Mr. Chairman, that were you sitting in one of these cases, as complex as they sound, you would not take years to decide them, because you would go to the guts and heart of the issue and isolate it and decide that.

That is what is needed here. What has really happened is that in recent years the complexity which has been referred to, a thousand pages of tariff filing material, are the Commission's own requirements which did not exist before. That is largely because the Commission has introduced some new elements into the thing, where they have introduced the concept of competition.

And when one carrier files a rate to compete with another, that is when they get into the difficulties.

Senator PASTORE. This case that has been pending for 2 years, what is that about?

Mr. MINOW. That is the so-called *Hi/Lo* case. In fact, I think it is more than 2 years now—January 1973.

Senator PASTORE. Who took an appeal in that case?

Mr. PRESTON. The Commission has not yet decided it.

Mr. MINOW. I would like to read the last paragraph or two of my statement.

The case I just referred to, arose in 1973 when the Bell System tried to respond to competition in the provision of intercity private line services. That is the so-called *Hi/Lo* tariff. And they sought to file those rates in February 1973. The tariff filing was delayed under the Commission's rule, which the court of appeals later found to be unlawful.

The Commission finally allowed the rates to go into effect in November 1973, but it requested Bell further delay, so they didn't take effect until June 1974, and the case is still pending there now.

Now, the point I would like to leave with you is this. The problem presented by the Commission's efforts to introduce a competitive environment for telecommunications transcends the issues we are talking about here. I don't propose to get into that, but I would respectfully, Mr. Chairman, and very sincerely ask that at the appropriate time you and your committee conduct a searching inquiry and hearing into this, because you are dealing with very basic principles as to how utilities should be regulated, the objective of regulation. And I would ask that the committee at an appropriate time, under your leadership, conduct a hearing about that.

With that, I would just say, Mr. Chairman, that the Bell System is not perfect, but it is one of the few regulated industries, as I mentioned to you, not here today asking you for money, and asking the Government to help it.

We are trying under the law. The Communications Act has entrusted a basic and precious responsibility on its private companies, and has put the burden on them to provide the service and to finance themselves, and we want to continue to do that; but we can't do it if the balance is changed.

Senator PASTORE. Thank you.

Mr. CROSLAND. Mr. Chairman, first, I would like to point out to you our experience under the existing law with respect to rate changes, and the impact on the public.

I suggest, sir, that you refer to the first chart attached to my statement, in which I specifically enumerate and have charted here the impacts on the Bell System such as the CPI increases from 1953 to date. From 1953 to 1974 the CPI for all items has increased by more than 84 percent. Disposable personal income per capital increased almost 192 percent. The Bell System material costs increased 90 percent, labor costs increased about 190 percent.

Against this background, I think it is somewhat remarkable that interstate telephone rates have not increased at all since that time. Indeed, they are 7 percent below the levels of 1953.

Now how has this come about? This has come about through the efforts that Mr. Minow recognized and mentioned earlier, the so-called continuing surveillance reviews which have been conducted by the

FCC. In 1959 there was a continuing surveillance review that required exactly $2\frac{1}{2}$ months to complete and resulted in a savings to the public, a rate reduction, if you will, sir, of \$193 million. In 1962 we had a second continuing surveillance review because our earnings had improved considerably, and the Commission followed our earnings situation, our operating results on a continuing basis. As a result of these some 6,000 documents filed regularly with the Commission, they conducted another surveillance review that lasted 6 months, and that resulted in a \$95 million rate reduction on today's volume of business. Incidentally, I have converted all of these dollars to today's volumes of business, in order to get a common denominator.

In 1964, the Commission conducted another continuing surveillance review. The figure on the chart is incorrect, Mr. Chairman. It is \$255 million on today's volume and not \$225 million.

In 1970, over a period of $5\frac{1}{2}$ months, the Commission reviewed our earnings very carefully, and it resulted in a reduction of \$220 million.

I think that very vividly shows, Mr. Chairman, that the Commission can act with expedition and with care in meeting the public interests and the interests of the consumer, as well as the company.

As I mentioned, the surveillance proceedings all resulted in rate reductions, and they require only about one-fourth of the time of the protracted rate cases to which we have been subjected.

As reflected on the chart up there, the two adjudicatory type proceedings concerning the rate of return have required much more time than any of these continuing surveillance reviews seen up there.

As a matter of fact, each of them has taken about 2 years.

Docket 16258 took 23 months to complete and resulted in a \$243 million reduction.

You see that took almost 2 years to complete a formalized adjudicatory type case.

Docket 19129 required 25 months and that was a rate increase case in which we received a \$380 million increase.

Now, a third proceeding, known as docket 20376, is still pending.

As Mr. Minow pointed out, I think there is no question but that the rate adjustments should be reflected as soon as possible and as soon as economic conditions are well known, and should be made very promptly.

This should be done whether the rate adjustment is up or down.

I might just mention, Mr. Chairman, that in connection with our ability to keep intrastate local exchange rates lower, in addition to the three-quarters of a billion dollars achieved in rate reductions which I mentioned were effected through the continuing surveillance reviews, during that same period over \$1 billion in annual intrastate revenues which otherwise could have been used for interstate rate reductions was transferred to intrastate jurisdictions to hold down rates for local telephone service through separations procedures adopted by the FCC and the State commissions.

In other words, our interstate rates could have been more than \$1 billion lower than they are today, but for the fact that the investment and expenses were transferred from intrastate, thus increasing the revenue requirements on the interstate side and reducing the revenue requirements on the intrastate side of the business.

Senator PASTORE. How much have the rates gone up intrastate on the average?

Mr. CROSLAND. From 1953, sir? They have gone up 28 percent.

Senator PASTORE. Twenty-eight percent?

Mr. CROSLAND. 28.1 percent; yes, sir.

And that is as compared with an increase in CPI of 84 percent, and the other items reflected on the earlier chart.

Now, we submit that no public interest purpose would be served if the Commission were allowed a full year from the time a tariff was filed before it may become effective whether up or down, sir.

We do not suggest, of course, continuous or frequent tinkering with rates to reflect every temporary blip on the economic screen.

But when there is solid evidence of a significant change in economic conditions upon which rates must be based, then rates we feel should reflect this change without needless delay.

The changed economic conditions to which I refer may be a change which affects overall earnings requirements or it may be a change in market conditions, and competitive responses affecting particular services or rates.

Mr. Minow mentioned earlier we don't think the proposed subsection 204(b) which has been debated today is at all necessary since the Commission has been able to achieve the same result under the existing law.

However, if it is to be used, the delay in granting full rate relief can be and will be very damaging, we think.

I think the effect may be illustrated by docket 19129 to which I referred earlier.

A.T. & T. filed an increase in interstate rates of \$385 million on November 20, 1970, to become effective January 26, 1971.

At the Commission's request, revised rates designed to reduce the increase by more than one-half were filed with the FCC while the FCC conducted an expedited hearing with respect to the remainder of the request.

As it turned out, the "expedited" hearing resulted in a decision some 2 years after the original filing, concluding that the public interest did indeed require revenues above the increase already permitted.

The net effect was that during this long period of the proceeding more than \$200 million in revenues were irretrievably lost.

As Mr. Minow pointed out, I think that is damaging not only to the consumer, but as well to the company, of course.

This history, Mr. Chairman, is repeating itself in the Commission's current rate case investigation, in docket 20376.

Responding to increased costs since the Commission's 1972 rate of return decision, Bell filed a general rate increase on January 3, 1975.

After the 60-day notice period, the Commission allowed only part of the increase to take effect, to compensate Bell for the uncontrolled increased debt costs to Bell.

The Commission allowed nothing for the increase in the cost of equity capital, but promised another expedited investigation to determine whether changes in the cost of equity warranted a further change in rate of return.

Proposed findings have now been submitted in the proceeding and even the Commission's trial staff recommends a further increase in the minimum level based on the higher cost of equity.

Therefore, if the Commission were to adopt even this low view of Bell's interstate earnings requirements, Bell would have again lost substantial revenues.

The A.T. & T. rate cases I have cited are two examples of an acute national problem—not just alone with the telephone company—the difficulties faced by utilities in attracting the capital to sustain good service to the public.

Certainly there are other complex factors, but regulatory lag in adjusting rates to current needs is one of the underlying causes of the severe financial problems now facing utilities.

The Congress has indicated its painful awareness of the plight of America's transportation industry.

The electric utilities are also seriously threatened. As their debt ratios increase and interest coverages decline because of inadequate earnings, some companies find they are unable to raise the funds they need to maintain good service to consumers; others continue to borrow, but at higher interest rates, which represent an increased cost to be borne by consumers today and for decades in the future.

Since January 1968 the bonds of 56 electric utilities have been downgraded by the financial rating agencies.

The telephone industry has so far sustained a somewhat healthier financial picture but, unfortunately, the same adverse trends are developing here.

Since 1964 the Bell System's debt ratio has increased from 32 percent to 50 percent; the System's interest coverage has dropped from over 6 times to about 2½ times; the market price of A.T. & T.'s common stock declined by one-third, from 2 times book value in 1974 to even less than book value recently.

The bond ratings of three of the Bell System companies have already been downgraded resulting in higher interest costs.

The System has been warned that the rating of its debt securities is in serious jeopardy unless the fall in its interest coverage and increase in its debt ratio can be halted.

Present and future generations of consumers would pay for the higher costs that inevitably result from any downgrading of Bell's debt obligations.

Let me emphasize my confidence that more and more regulators are beginning to recognize that unhealthy financial conditions for a utility lead in the long run to even higher costs and poorer service for the public.

The impetus in the States has been to reduce the delay in effectuating utility rate changes.

In these circumstances, I am certain you can understand our serious concern that S. 2054 would aggravate rather than reduce the already severe problems of regulatory lag.

As I have stated, the additional administrative delay contemplated by S. 2054 would apply to decreases as well as rate increases.

Indeed, two proceedings specifically referred to by the Commission—Hi/Lo and WATS—are rate structure cases, not overall revenue cases.

Thus, another disadvantage to the public in prolonging the procedure for tariff adjustments is that it could hamstring the existing telephone carriers in responding to the type of "competition" advocated by the FCC.

In this regard the Bell System believes that while the introduction of competition in certain segments of the communications business might bring lower rates to a relatively few customers, mostly large business firms, this would be at the expense of higher rates for some 67 million households and nearly 9.5 million small business customers.

We seriously question that such a shift in regulatory philosophy is in the broader public interest.

But even the questionable result of true competition will not be achieved if administrative delays prevent appropriate competitive responses.

This is a very complex subject with many significant long-term implications for the public.

We sincerely urge this committee to explore the competition issue thoroughly, and as soon as your other priorities permit.

Perhaps the principal deficiency in the bill, Mr. Chairman, is that it does not even address the fundamental causes of regulatory lag by providing anything to expedite the decisionmaking process. It seems to seek to sanction delay instead of reducing it.

If I may repeat for emphasis, if you will recall, through a rate review in 1970, rate reductions of 3 percent were determined by the FCC to be appropriate within less than 6 months.

Similarly, in 1974 a rate reduction of 4 percent was achieved in about 5 months.

But the rate reduction of 3 percent resulting from docket 16258, which required 23 months to complete because of its extended adjudicatory proceedings, required 2 years before consumers could receive any benefit.

Not only time is involved, Mr. Chairman, but excessive costs are borne by all concerned in these adjudicatory proceedings.

By way of summary, Mr. Chairman, we respectfully suggest that the existing statutory scheme permits regulatory efforts toward quicker and more expeditious procedures.

We sincerely regret S. 2054 moves very much in the opposite direction, a move that would hurt both consumers and carriers.

Senator PASTORE. How long does it take to put a rate case together?

Mr. CROSLAND. Mr. Chairman, I would say within 2 or 3 months, roughly speaking.

Senator PASTORE. Two or three months?

Mr. CROSLAND. Yes, sir. If it is a large increase we are seeking it would take no more than that, sir.

We are constantly abreast of this problem, and so is the FCC, Mr. Chairman. These are nothing new; they are not new figures we present to the Commission.

As a matter of fact, of the 8,000 pages Mr. Minow referred to earlier which are required by rule 61.38 of the FCC, I believe in our last application for a rate increase, only 200 were devoted to the matter of rate of return. The rest had to do with items that the FCC requires.

And most of this information, sir, they have before them on a continuing basis.

The point I am trying to make, Mr. Chairman, is that I just don't believe that 9 months would adequately satisfy any problems they may have in these protracted adjudicatory proceedings.

None of the cases we have had so far have been decided within 9 months, where they have had these protracted hearings.

You can see there, 23 months were required for docket 16258, which is only rate of return.

Phase 1 of 19129, 25 months, with respect to rate of return.

Yet when the Commissioners themselves were present at all of these other hearings, which I indicate on this chart above, we completed these matters within—the longest one required 6 months, and I am sure that could have been completed in less than 6 months' time.

There were intervening holidays at that time.

As a matter of fact, I recall I went to the hospital myself during that period and the Commission delayed the matter for me to get out of the hospital and return to active duty.

Senator PASTORE. So they are not all bad.

Mr. CROSLAND. No, sir; they are not all bad.

Mr. MINOW wouldn't be with me today if they were all bad.

Senator PASTORE. All right, gentlemen. Thank you very much.

Mr. CROSLAND. Thank you, Mr. Chairman.

Mr. MINOW. Mr. Chairman, thank you very much.

Senator PASTORE. The committee will take it under advisement.

[The statements follow.:]

STATEMENT OF EDWARD B. CROSLAND ON BEHALF OF AMERICAN TELEPHONE
AND TELEGRAPH COMPANY

I am Edward B. Crosland, Senior Vice President of the American Telephone and Telegraph Company. With me are Mr. Newton N. Minow, a distinguished student of regulation who served as chairman of the Federal Communications Commission in the early 1960's, and is now a partner in Sidley & Austin, a Chicago law firm that regularly represents the Bell System. Also with me is Mr. John F. Preston, Jr., General Solicitor of AT&T, who has had broad experience representing the company in proceedings before the Federal Communications Commission and state regulatory bodies for more than twenty years.

We appreciate this opportunity to review with the Committee concerns we have with respect to the effects of S. 2054, a bill which could prolong the procedures of the Federal Communications Commission in arriving at decisions on rates for services offered by communications common carriers, and which we believe would be contrary to the best interests of consumers.

Based on the valuable insights gained from his experience in regulatory matters, Mr. Minow will discuss the public-interest objectives of regulation, the procedures he believes would best achieve them, and the impacts of S. 2054. With your permission, I will then cite specific experiences of AT&T which illustrate and reinforce the broader principles developed by Mr. Minow. Thereafter, the three of us will be pleased to respond to questions by the Committee.

Our combined testimony, Mr. Chairman, will develop these principal points:

Extended delays in decision-making by regulatory agencies are contrary to the best interests of consumers and the companies serving them. Many government leaders and economists recognize that regulatory lag is not favorable to consumers and are calling for more timely procedures.

S. 2054 works in the opposite direction from this growing national consensus. It would tend to delay rather than to expedite the regulatory process and we believe it would hurt rather than advance the public interest.

Finally, we suggest there are ways to shorten and improve the FCC's regulatory procedures, and we would like to propose them as an alternative to S. 2054.

Now I would like to present Mr. Minow . . .

* * * * *

As indicated earlier, Mr. Chairman, my statement will document more specifically some of the general principles developed by Mr. Minow, focusing in large part upon AT&T's experience with rate regulation.

I would like to emphasize that AT&T's experience tends to confirm a conclusion reached by many others—that the impact of regulatory lag adversely affects the interests both of the carriers and the public they serve. As you know so well, many leaders in Congress and in the Administration have joined in a call for a searching examination of government regulation to determine if it is really

servicing the best interest of consumers. And while there may be sharp differences of opinion on many aspects of regulatory reform, there is strong consensus on at least one point. Leaders representing a wide variety of political and economic persuasions have agreed that regulatory procedures take too much time and that long delays in making rate changes effective are harmful to the public.

For example, the Congressional Democratic Policy Statement, presented to the June 25 White House conference on regulatory reform, declared "there is a clear and pressing need to strengthen the quality of regulation and to overcome chronic problems of administrative delay . . ." and the paper stated that "regulatory lag" is one of the principal failures of the current regulatory process.

Robert R. Nathan, a noted economist and chairman of the National Consumers' League, testified before the House Ways and Means Committee last January that "the lag between the time when increases in costs occur and the time when they can be reflected in higher tariffs has caused utility earnings to be too low and upward adjustments to come too late . . . [R]egulatory lag is still a nearly insoluble problem for utilities . . . [A]s a result, financial structures of utilities have deteriorated." Mr. Nathan added that "steps must be taken to avoid the dangers of power blackouts, the costly consequences of inadequate transportation facilities, the insufficiencies associated with poor communications services, and declines in the excellent quality of service we have come to expect and demand and need from our public utilities."

In view of the clear consensus that regulatory procedures should be expedited, it is disappointing that the FCC has asked Congress, in S. 2054, to extend the statutory timetable for changes in common carrier tariffs. The bill would increase by three times—from three months to nine months—the period during which the Commission may suspend a proposed tariff change while proceeding to consider it. This together with the notice period could mean a full year's delay in making rate changes effective.

Before addressing specifically the provisions of the proposed amendment, let us first consider the experience under the present statute.

The first chart attached to my statement illustrates the record with respect to telephone rates: From 1953 through 1974, the Consumer Price Index for all items increased more than 84 percent; Disposable Personal Income per capita increased almost 192 percent; The Bell System's materials costs increased 90 percent while its labor costs increased 190 percent. Against this background, it is remarkable that interstate telephone rates have increased not at all—rates today are approximately 7 percent lower than in 1953.

Now let us look at our experience under existing law with respect to the time required to effectuate rate changes. As indicated by Mr. Minow, over the years the Commission has employed two general types of proceedings to determine the carrier's overall rate of return: continuing surveillance procedures and formal adjudicatory proceedings. The continuing surveillance process was commenced shortly after the FCC was established and was designed to avoid the protracted ratemaking proceedings which have plagued other administrative agencies. Thus, very early in its history the Commission decried as ineffective and inefficient the use of extended proceedings for regulating telephone rates. (Final Report of Telephone Rate and Research Dept. p. 2, (1939)). In recommending regulation by continuing surveillance methods, the Commission explained: ". . . The aspect of a game or contest which inevitably envelops the respective advocates (be they lawyers, accountants, engineers, or what not) in formal rate cases makes for bickering and bitterness, as well as for delay and expense." (id. at pp. 94-95).

Recognizing that "in ratemaking, time is always of the essence," the Commission embarked upon a program of continuing intensive monitoring of carriers' operations, financial results, and the underlying economic circumstances. That program was pursued with commendable results until its replacement during more recent years with protracted adjudicatory procedures.

It is highly illuminating to examine the results of these two types of proceedings over the past 15 years—I refer you to the second chart attached to my testimony. (For comparative purposes, all the rate changes are expressed in terms of current volumes of business.)

In 1959, a surveillance review was completed in slightly over two months and resulted in a rate reduction that now saves consumers \$193 million a year.

In 1962-63, a surveillance examination was completed in six months and resulted in a rate reduction that now amounts to \$95 million a year.

In 1964-65, a surveillance review required five months and resulted in savings to consumers now totalling \$255 million a year.

In 1970 another continuing surveillance review, initiated in the latter part of

1969, was completed in a little more than five months. This review resulted in rate reductions of \$220 million a year.

As reflected on the chart, the two adjudicatory-type proceedings concerned with rate of return undertaken by the Commission have required much more time—each approximately two years. The result of the first (Docket 16258) was a \$243 million rate reduction. The second case (Docket 19129) resulted in a rate increase of \$380 million. A third such proceeding (Docket 20376) is still pending.

Although the trend naturally has been toward rate increases in the past few years of unprecedented inflation, over the last two decades there have been twice as many rate decreases as increases. When all these changes—including the rate changes permitted to become effective in March of this year—are translated into current volumes of business, the decreases exceed the increases by more than \$260 million a year.

The surveillance proceedings, all resulting in rate reductions, required only about one-fourth the time of the protracted cases. It would appear obvious, therefore, that the public would have paid much more if these rate proceedings had been conducted under formal adjudicatory procedures. The public is best served when rate adjustments needed to reflect changed economic conditions are effected promptly. And this is so whether the change is up or down.

In addition to the three-quarters of a billion dollars achieved in rate reductions under the process of continuous critical review, during this same period the effect of over \$1 billion in annual interstate revenues, which otherwise could have been used for interstate rate reductions, was transferred to intrastate jurisdictions to hold down the rates for local telephone service through separations procedures adopted by the FCC and State regulatory bodies.

We submit that no public interest purpose would be served if the Commission were allowed a full year from the time a tariff is filed before it may become effective.

We do not suggest, of course, continuous or frequent tinkering with rates to reflect every temporary blip on the economic screen. But when there is solid evidence of a significant change in the economic conditions upon which rates must be based, then rates should reflect this change—up or down—without needless delay. And I should add that the change economic conditions to which I refer may be a change which affects overall earnings requirements or may be a change in market conditions and competitive responses affecting particular services or rates.

Although we do not object to the provision for partial relief described in Section 2 of S. 2054 (proposed new sub-section 204(b) of the Communications Act of 1934, as amended), it is not required because it does not add to the Commission's existing power. Furthermore, whatever temporary relief the Commission might grant could be more than offset by a longer delay in making the rates effective.

The effect may be illustrated by Docket 19129, which I mentioned earlier. AT&T filed an increase in interstate rates of \$385 million on November 20, 1970, to become effective January 26, 1971. At the Commission's request, revised rates designed to reduce the increase by more than half were filed while the FCC conducted an "expedited" hearing with respect to the remainder of the request. As it turned out, the "expedited" hearing resulted in a decision some two years after the original filing, concluding that the public interest did indeed require revenues above the increase already permitted. The net effect was that during the long proceeding more than \$200 million in revenues were irretrievably lost, since, during the interim period, the Bell Companies were not able to earn at the level that the Commission ultimately found to be justified.

This history is repeating itself in the Commission's current rate of return investigation in Docket 20376. Responding to increased costs since the Commission's 1972 rate of return decision, Bell filed general rate increases on January 3, 1975. After the 60-day notice period, the Commission allowed only part of the increases to take effect to compensate Bell for the uncontroverted increased cost of debt. The Commission allowed nothing for the increase in the cost of equity capital, but promised another nine-month "expedited" investigation to determine whether changes in the cost of equity warranted a further change in rate of return. Proposed findings have now been submitted in that proceeding, and even the Commission's Trial Staff recommends a further increase in the minimum earnings level, based on the higher cost of equity. Therefore, if the Commission were to adopt even this low view of Bell's interstate earnings requirements, Bell will have again lost substantial revenues due to the protracted procedures employed by the Commission for a rate of return decision.

The AT&T rate cases I have cited are two examples of an acute national problem—the difficulties faced by utilities in attracting the capital to sustain good service to the public. Certainly, there are other complex factors, but regulatory lag in adjusting rates to current needs is one of the underlying causes of the severe financial problems now facing utilities. The Congress has indicated its painful awareness of the plight of America's transportation industry. The electric utilities are also seriously threatened. As their debt ratios increase and interest coverages decline because of inadequate earnings, some companies find they are unable to raise the funds they need to maintain good service to consumers; others continue to borrow but at higher interest rates, which represent an increased cost to be borne by consumers today and for decades in the future. Since January 1968, the bonds of 56 electric utilities have been downgraded by the financial rating agencies.

The telephone industry has so far sustained a somewhat healthier financial picture, but, unfortunately, the same adverse trends are developing here. Since 1964, the Bell System's debt ratio has increased from 32 percent to 50 percent; the System's interest coverage has dropped from over six times to about 2½ times; the market price of AT&T's common stock declined by one-third, from two times book value in 1964 to even less than book value recently. The bond ratings of three of the Bell System companies have already been downgraded resulting in higher interest costs. The System has been warned that the rating of its debt securities is in serious jeopardy unless the fall in its interest coverage and increase in its debt ratio can be halted. Present and future generations of consumers would pay for the higher costs that inevitably result from any downgrading of Bell's debt obligations.

Let me emphasize my confidence that more and more regulators are beginning to recognize that unhealthy financial conditions for a utility lead in the long run to even higher costs and poorer service for the public. The impetus in the states has been to reduce the delay in effectuating utility rate changes. In these circumstances, I am certain you can understand our serious concern that S. 2054 would aggravate rather than reduce the already severe problems of regulatory lag.

As I have stated, the additional administrative delay contemplated by S. 2054 would apply to decreases as well as rate increases. Indeed, two proceedings specifically referred to by the Commission (Hi-Lo and WATS) are rate structure cases, not overall revenue cases. Thus, another disadvantage to the public in prolonging the procedure for tariff adjustments is that it could hamstring the existing telephone carriers in responding to the type of "competition" advocated by the FCC.

In this regard, the Bell System believes that while the introduction of competition in certain segments of the communications business might bring lower rates to a relatively few customers, mostly large business firms, this would be at the expense of higher rates for some 67 million households and nearly 9½ million small business customers. We seriously question that such a shift in regulatory philosophy is in the broader public interest. But even the questionable result of true competition will not be achieved if administrative delays prevent appropriate competitive responses. This is a very complex subject with many significant, long-term implications for the public. We sincerely urge this Committee to explore the competition issue thoroughly, and as soon as your other priorities permit.

Perhaps the principal deficiency in the bill, Mr. Chairman, is that it does not even address the fundamental causes of regulatory lag by providing anything to expedite the decision-making process. It seems to seek to sanction delay instead of reducing it.

We believe that administrative procedures should be developed to permit more timely decisions in ratemaking cases. Expedited processes in dealing with rate of return cases, as outlined by Mr. Minow, have produced good results in the past and, as he suggests, can be improved for the future. As one who has participated in many such proceedings, I can attest that direct evidentiary presentations before the Commissioners, involving all interested parties, can penetrate to the most important facts and arrive at sound decisions much more expeditiously. The face-to-face give-and-take in such sessions can be most beneficial to all sides in getting at the essential facts and key issues. Perhaps the greatest benefit to the public, aside from the promptness of their decision, is that the Commissioners have an opportunity to participate directly rather than vicariously on the basis of filtered, summarized and stale records.

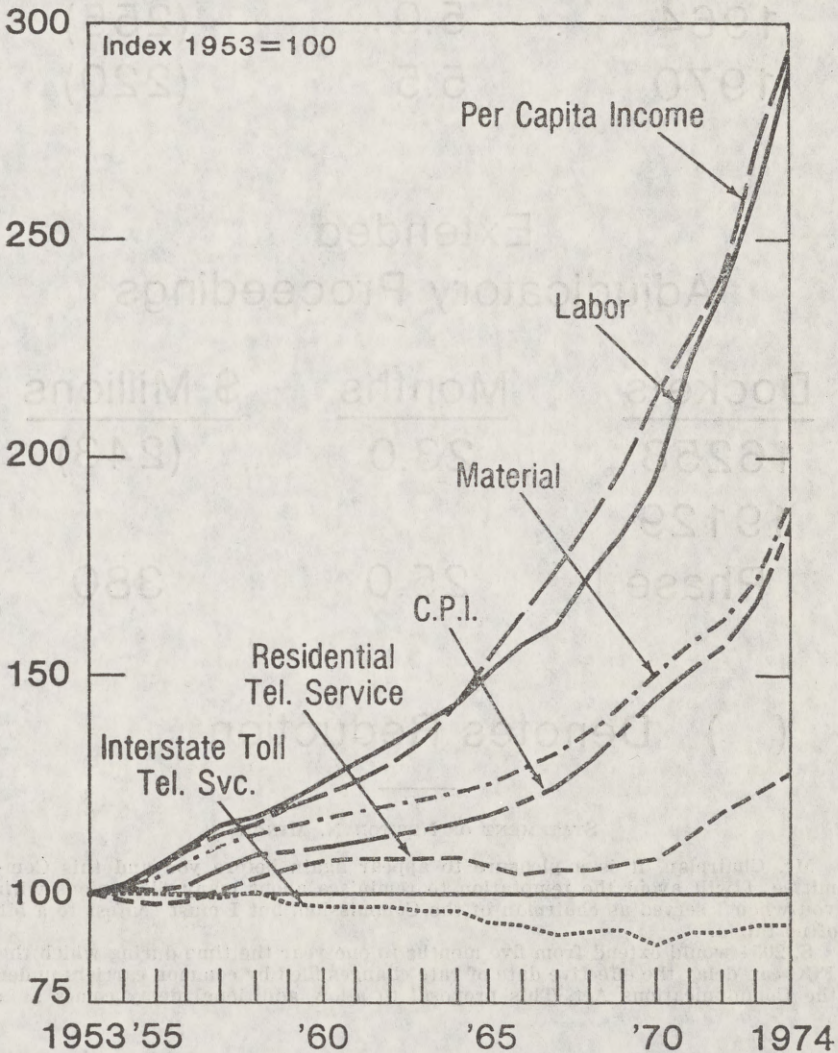
If I may repeat for emphasis . . . through a rate review in 1970, rate reductions of 3 percent were determined within less than six months. Similarly, in

1964, a rate reduction of 4 percent was achieved in about five months. But the rate reduction of 3 percent resulting from Docket 16258, with its extended procedures, required two years before consumers could receive any benefit. Not only time is involved, but excessive costs are borne by all concerned in these adjudicatory proceedings.

In summary, Mr. Chairman, we respectfully suggest that the existing statutory scheme permits regulatory efforts toward quicker and more expeditious procedures. We regret that S. 2054 moves very much in the opposite direction . . . a move that would hurt both consumers and carriers.

CHART 1

Charges for Telephone Service vs Income per capita, consumer prices and Bell System costs . . .



AT&T Rate Changes

Surveillance Reviews

<u>Date</u>	<u>Months</u>	<u>\$ Millions</u>
1959	2.5	(193)
1962	6.0	(95)
1964	5.0	(255)
1970	5.5	(220)

Extended Adjudicatory Proceedings

<u>Dockets</u>	<u>Months</u>	<u>\$ Millions</u>
16258	23.0	(243)
19129		
Phase I	25.0	380

() Denotes Reduction

STATEMENT OF NEWTON N. MINOW

Mr. Chairman, it is a pleasure to appear again before you and this Committee. I will avoid the temptation to reminisce about many discussions with you when I served as chairman of the Commission, but I must confess to a bit of nostalgia.

S. 2054 would extend from five months to one year the time during which the FCC can delay the effective date of rate changes filed by common carriers under the Communications Act. This proposal to allow additional delay comes at a

time of severe national inflation when the inability of many regulated companies to obtain prompt revenue relief is threatening their financial stability and the quality of service they provide to the public. Under these circumstances, the additional delay proposed in S. 2054 would work to the disadvantage of telephone customers and carriers alike.

By extending the period of regulatory lag, S. 2054 points in the wrong direction, and its passage would only build additional delay into the ratemaking process. The way to improve regulation is to obtain the Commissioners' prompt resolution of the key issues involved in ratemaking proceedings. I am convinced that with improved procedures, the Commission can resolve these matters more expeditiously with full opportunity for all interested parties to be heard and for the Commission to deliberate carefully over all the pertinent facts and judgments. And the public would benefit from these more timely decisions.

In evaluating the proposed legislation, two different types of rate proceedings should be borne in mind. One is a general rate increase or rate reduction designed primarily to adjust the overall revenues and earnings of carriers to the level necessary to attract capital under current economic conditions. Here, the public-interest objective is to permit carriers to earn at a level required to sustain good service, while protecting consumers from paying more than is needed. The second type of case is not designed to increase or decrease overall earnings but involves the restructuring of rates for individual services. Such cases may typically represent rate reductions in response to the rate and service offerings of competing carriers. I will refer to both of these kinds of rate cases in my statement and will show that the public's interest is in having each type of rate filing take effect promptly.

THE PUBLIC INTEREST IN PROMPT EFFECTIVENESS OF RATE CHANGES

In the United States we have entrusted to private enterprise the responsibility to furnish telecommunications service to the public. This is the fundamental basis of the Congressional policy reflected in the Communications Act, which provides for the regulation of privately financed common carriers in the public interest.

This policy is unique to this country since virtually every other country in the world provides telephone service on a nationalized basis, in the manner we provide postal service. Under this policy the people in this nation have enjoyed the best telephone service in the world at the lowest cost to the public. Indeed, our nationwide communications system stands out among our own institutions as one that has a remarkable record of achievement in meeting the needs of consumers.

Since we are committed to a policy which relies on privately financed corporations to provide the facilities, research, and development required to meet the growing public need for communications services, we must consider carefully any proposal for amending the Communications Act which would jeopardize the ability of the telephone utilities to raise necessary capital in the highly competitive money markets.

I believe that the proposed legislation, permitting a one-year freeze on rate changes, would seriously undermine the capital attracting ability of this nation's telecommunications common carriers. With the increasing volatility of costs, including cost of money, no business could long survive as a privately financed enterprise if it were subjected to a one-year freeze on any needed price changes.

The courts have repeatedly recognized the public's interest in the prompt effectiveness of rate changes needed to meet current business realities. The Supreme Court has asserted that consumers have a "vital stake" in the financial stability of their utilities, and that the public interest is protected only if the "financial health of the [regulated utilities] in our economic system remains strong."¹ I will not try to improve on Mr. Justice Harlan's statement of the simple economic necessity for utility price increases. Referring to regulated companies, he wrote: "Business reality demands that [these] companies should not be precluded by law from increasing the prices of their product whenever that is the economically necessary means of keeping the intake and outgo of their revenues in proper balance; otherwise procurement of the vast sums necessary

¹*United Gas Pipe Line Co. v. Memphis Gas, Light & Water Division*, 358 U.S. 103, 113 (1958); *FPC v. Memphis Gas, Light & Water Division*, 411 U.S. 458, 474 (1973). See also *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *American Telephone & Telegraph Co.*, 9 F.C.C. 2d 30, 52 (1967).

for the maintenance and expansion of their systems through equity and debt financing would become most difficult, if not impossible."²

Business realities today, more than ever, require that regulated companies should be able to respond promptly to the volatile economic and financial conditions they now face. Otherwise these capital intensive enterprises will not be able to obtain the vast amounts of new financing required to provide service to the consuming public. Yet S. 2054 would confer Congressional sanction for imposing additional regulatory lag on the telecommunications common carriers at a time when regulatory lag is recognized as one of the most serious problems threatening the continued viability of this nation's public utilities. While the Administration is seeking to reduce the regulatory lag in the states to a maximum of five months, this proposed legislation seeks to expand it from five months to one year. Enactment of this proposed legislation, therefore, would compound the financial problems now confronting the regulated communications carriers and would undermine the very policy of private enterprise upon which the nationwide telecommunications system has been built.

RATE CHANGE TO AFFECT OVERALL RATE OF RETURN

No one seems to argue with the proposition that when economic circumstances permit carriers to reduce rates, while maintaining good service, consumers benefit from procedures that place the reductions in effect as soon as is practical. The converse is equally true. The prompt adjustment of prices to reflect changed economic circumstances is in the public interest, whether the needed change in price is up or down.

The postponement of a rate increase that is later found by the Commission to have been necessary to meet rising costs and to sustain good service will produce three effects—all adverse to the consumer. First, it will increase the cost of capital that must be raised by the carrier during the period of abnormally depressed earnings and uncertainty about the ultimate regulatory decision. Moreover, if investors believe that similar delays will occur in the future, the carrier's cost of capital will remain higher than it otherwise would be. Second, because of the low earnings, the carrier will be required to borrow more money than would normally be the case. The higher interest rates paid on a larger debt will be a burden on consumers for decades after the regulatory proceeding has been completed. Finally, if depressed earnings and regulatory uncertainty endure too long, they will force postponement of the construction of new plant and acquisition of new equipment needed to provide good service and increase efficiency. When the needed facilities are eventually constructed or purchased, they likely will cost much more than if procured when they were first needed. The end result of such regulatory lag is that the carrier's costs will be higher than necessary and service to the public will deteriorate.

The fundamental point is that the objective of regulation should not be to delay rate increases and speed rate reductions, or vice versa. Rather, the public interest is best served when regulation promptly adjusts rate levels—up or down—to reflect current needs and circumstances. If conditions require rate increases to sustain a service that is vital to the national economy and to social well-being, the ratepayers are better served if the increase takes effect promptly. And it is equally true that when circumstances permit rate reductions, without impairing good service, the reductions should take effect just as promptly. Unnecessary delay in the regulatory process will always be a disservice to the public.

Under either present law or S. 2054, the carrier may put a proposed tariff change into effect after a temporary suspension by the FCC, even though the Commission's proceedings on the matter are not yet completed. But when a rate increase is involved, the Commission may order the carrier to keep a record of all increased charges, and refund any amounts above the rates permitted by the Commission at the end of the proceeding.

You can see, then, that the consumer is protected regardless of whether the suspension period is three months, as under present law, or nine months as proposed in S. 2054. In either case, if the carrier places rates in effect that are higher than those eventually permitted, the consumer receives a full refund with interest.

On the other hand, when justified increases are suspended, the carrier irrevocably loses this needed revenue throughout the full suspension period,

² *United Gas Pipe Line Co. v. Memphis Gas, Light & Water Division, supra*, 358 U.S. at 113.

even though the increases are later approved. During the suspension period the carrier suffers irreparable harm because it forever loses the opportunity to collect higher revenues while the effectiveness of the rate changes is delayed. Thus, tripling the duration of the suspension period can triple the irreparable loss suffered by the carrier.

Such irretrievable losses of revenue have serious consequences for the company's ability to serve the public well. The Court of Appeals for the Second Circuit recently recognized these problems when it struck down a Commission rule that would have allowed the Commission to block any Bell rate increase for an indefinite period. The court stated: "[I]t is abundantly clear to us that the statutory scheme of the Communications Act reflects the realization of Congress that when a carrier is presented from placing in effect new rate increases it may suffer irreparable loss which in turn may impede the provision of adequate service during a period of rising costs."³

The limited statutory suspension period and the provisions for refund and reparations have been recognized by the courts as a "careful balance of interests" struck by Congress between regulated companies and their customers.⁴ Again, I refer to the language of the Supreme Court, this time in a case involving the Interstate Commerce Act, upon which the Communications Act was directly patterned: "The suspension period was limited as to time to prevent excessive harm to the carriers, for the revenues lost during that period could not be recouped from the shippers. On the other hand, Congress was aware that if the Commission did not act within the suspension period, then the new rates would automatically go into effect and the shippers would have to pay increased rates that might eventually be found unlawful. To mitigate this loss, Congress authorized the Commission to require the carriers to keep detailed accounts and eventually to repay the increased rates if found unlawful."⁵

S. 2054 proposes a new balance of interests—one that would more than double (from five months to a year) the period in which carriers suffer irretrievable revenue losses while their rate increases are delayed. Actually, although the present statutory scheme of the Communications Act provides a "careful balance of interests" between the regulated utilities and their customers, during inflationary times this balance has been tilting against the regulated carrier—which already is subjected to a five month irretrievable loss of revenues. Increasing this imbalance to 12 months under present conditions would not only be highly detrimental to the carriers but would adversely affect the long-term interest of users in quality service at the lowest possible cost.

The present accounting and refund provisions of the Communications Act provide appropriate safeguards for consumers. It has been recognized that when rate changes affect large numbers of individual users, there will be problems associated with the mechanics of record keeping and the cost of administering on an individual customer basis. This may be especially true for the smaller independent telephone companies. But these administrative difficulties do not constitute any sound reason to impose additional regulatory lag on the regulated carriers. If circumstances require, customers can be adequately protected by administering accounting and refund provisions on a customer class basis as the Commission has done in the past.⁶

In view of the acute financial problems facing regulated carriers today, the appropriate legislative course is not to impose additional regulatory lag but to seek remedies that ameliorate the irretrievable losses that carriers suffer when urgently needed rate changes are impeded. I would favor amending the Communications Act specifically to allow carriers to recoup in future periods any revenues that are lost as a result of government-imposed delay. Such legislation would result in greater equality and fairness in the treatment of carriers which are now penalized by the delay in effectuating rate changes during periods of rising costs. As Mr. Crosland points out in his statement, the delay imposed on

³ *American Telephone & Telegraph Co. v. FCC*, 487 F.2d 865, 873-74 (2d Cir. 1973).

⁴ *United States v. Students Challenging Regulatory Agency Procedures (SCRAP)*, 412 U.S. 669, 697 (1973).

⁵ *Id.* See also, *Arrow Transportation Co. v. Southern Ry.*, 372 U.S. 658, 668 (1963); *American Telephone & Telegraph Co. v. FCC*, 487 F.2d 865, 881 (2d Cir. 1973).

⁶ See, e.g., *AT&T*, 27 F.C.C. 2d 151, 158 (1971), where the Commission ordered, with respect to Bell's rate increases under investigation in the Docket 19129 proceeding, that accounting records be kept according to customer classes for revenues collected from coin box ("pay telephone") and hotel guest initiated calls. See also *Western Union Telegraph Company*, 48 F.C.C. 2d 445 (1974); *Western Union Telegraph Company*, 15 F.C.C. 2d 361 (1968); 21 F.C.C. 2d 546 (1970).

the Bell System companies as a result of the Docket 19129 proceeding in the 1971-72 period meant an irretrievable revenue loss of over \$200 million during that period since Bell was not able to earn at the minimum level the Commission ultimately found to be justified. The Act should permit the recoupment of those lost revenues through temporary rate adjustments over a reasonable future period.

THE NEED TO SPEED UP THE DECISIONAL PROCESS

The problem facing regulated utilities today point up the need to devise procedures that will expedite the decision-making machinery in ratemaking cases. I recognize, of course, the Commission's statutory responsibility to judge the reasonableness of interstate revenues and, in so doing, to determine a carrier's allowable interstate rate of return. But the focus should not be on legislating new impediments to the effectuation of rate changes. The direction of the regulatory efforts should be toward enhancing the procedures to permit rate of return decisions within the five month notice and suspension period. It is entirely possible, in my opinion, for the Commission to complete its rate of return decisions within this period through the development of administrative procedures that allow the Commissioners themselves to resolve the pertinent issues at a much earlier stage in the process.

At this point, I should make it clear that a rate of return determination is not as complicated as the Commission may have suggested when it proposed S. 2054.⁷ A rate of return proceeding essentially involves a single issue: the current cost of equity capital. The annual cost of the company's debt is usually ascertainable as a fixed amount and requires only an arithmetic calculation. Although Chairman Wiley has correctly noted that "communications media" have become more "complex,"⁸ the determination of a carrier's proper overall rate of return involves essentially the same issues now as it always has.

The last three instances in which the Commission has undertaken rate of return determinations indicate that there is much room, within the existing statute, to improve the promptness of decision-making. In the rate of return investigations in Docket 16258 (1965-67), in Phase I of Docket 19129 (1971-72) and in Docket 20376 (1975), the Commission ordered adjudicatory-style proceedings which began with the production of massive amounts of data by the carriers, and were followed by an exchange of the parties' testimony and then extensive hearings before an Administrative Law Judge. After hearings, these proceedings generally involve proposed findings, briefs and reply briefs to the Administrative Law Judge, an initial decision by the Judge, more briefs and reply briefs to the Commission, and finally oral argument before the Commissioners themselves. In the first two cases—one a rate reduction and the other a rate increase—more than two years transpired after the case was commenced, Docket 20376 is still in progress.

We should always be alert to developing methods that can improve the feasibility and swiftness of administrative agency decisions. Writing for the Supreme Court in 1939, Mr. Justice Douglas identified as some of the "most valuable qualities" of the administrative process its "ease of adjustment to change, flexibility in light of experience, [and] swiftness in meeting new or emergency situations."⁹ The administrators who carry out this process are, in the language of an earlier Supreme Court opinion, "called upon to exercise the trained judgment of a body of experts."¹⁰

An FCC rate of return determination, for example, requires the Commissioners' informed judgment on matters of current financial policy. Yet, in recent cases the Commissioners have been effectively removed from any participation in the rate of return proceedings until its final stages. And when the Commissioners finally do consider the issue, the record is likely to be unduly long and in need of updating because of the volatility of the underlying financial and economic data.

Well before the time I arrived at the Commission, rate adjustments designed to change a carrier's overall earnings level were matters that were resolved expeditiously at the Commission's initiative without extended proceedings. While

⁷ 121 Cong. Rec. S11965-67 (July 8, 1975) (Letter from Chairman Wiley and Explanation of Proposed Amendments).

⁸ *Id.* at S11966.

⁹ *Helvering v. Wilshire Oil Co.*, 308 U.S. 90, 101 (1939).

¹⁰ *Humphrey v. United States*, 295 U.S. 602, 624 (1935).

I was at the Commission, we devised procedural methods whereby the Commissioners themselves participated in on-the-record hearings in which we heard witnesses from the carrier and outside expert consultants. These procedures permitted prompt action on rate changes affecting the carriers' interstate rate of return.

We also developed other continuing surveillance methods whereby all aspects of the carriers' operations were continuously monitored by the Commission. I described such continuing surveillance procedures to this Committee once before in 1963 when, as Chairman of the FCC, I presented the Commission's annual progress report. While I will discuss these methods briefly in this statement, I refer the Committee members to my 1963 presentation for a more detailed description of those methods of regulation.

An essential feature of the continuing surveillance methods used by the Commission is the constant monitoring of extensive data on all aspects of the regulated carriers' operations. The Bell System telephone companies file with the Commission a variety of weekly, monthly, quarterly and annual reports setting forth a vast array of operating, financial, and earnings data. The material from these reports can be used by the Commission staff to prepare monthly operating results for AT&T's interstate operations, and to observe and analyze trends in operating revenues, expenses, and investments. The volume of the company's filings was already enormous when I was chairman of the Commission and there are far more reports now; so the availability of data from the carriers poses no obstacle to a continuing and searching inquiry. If more data are needed on any particular question, the Commission can obtain it readily. Moreover, modern electronic data processing methods permit the conversion of masses of such information into meaningful reports on a current basis.

In resolving the critical question of the carriers' overall rate of return, I believe that the Commission should combine the best features of the formal hearing procedures (as in Docket 19129 and Docket 20376) with the features of the continuing surveillance method. Two important aspects which should be adopted are that (1) the Commissioners themselves should be involved at the earlier stages of the decisional process, and (2) there should be a continuous monitoring of the current financial and economic data relevant to the cost of capital and the fair rate of return.

As to the first aspect, I believe that when an explicit rate of return finding is to be made, the Commissioners themselves must participate from the very beginning of the evidentiary hearings. The Commission should not be removed from the live hearings, but all seven of the Commissioners should sit down at the outset and listen to the presentations of their staff, the carriers, and other interested parties, as well as to the testimony of outside experts retained by any party.

Since the Commissioners must exercise essentially financial judgments in these rate of return cases, I see little merit in their being removed from participating in the evidentiary hearings. The time taken for these hearings could be limited to several days because of the narrow issues involved and the relatively small number of parties, outside of the carriers and the Commission staff, who actively participate in these cases. Moreover, procedures could be formulated to limit the time for live hearings through prior written submissions and requiring that questions be submitted in advance of hearings. I believe that it would be well worth the several days of the Commissioners' time to form their judgments through their participation in the evidentiary hearings rather than through reliance on a cold, somewhat stale record and arguments of counsel.

Having rendered frequent rate of return decisions in the last several years, the Commission does not have to start from scratch in each rate of return proceeding. Moreover, the continuous review of the current financial and economic data pertinent to the carrier's cost of capital is a necessary element of the decisional process. The Commission's professional staff could not only monitor all data from AT&T, but could also continually review the general financial and economic conditions in the capital markets that control a utility's fair rate of return. The staff would be equipped with and become expert in the various analytical techniques that recur regularly in rate of return cases and that are used by the Commission to arrive at an allowable rate of return. The Commission should also retain outside consultants on a continuing basis to make pertinent financial analyses. This permits the Commission to have an extensive

factual and analytical foundation at any time it commences a general rate case involving overall earnings level.

All the Commissioners must do is render their judgment on the basis of that current data. Filtering and rehashing the data through a number of intermediate decisional steps does little to aid the Commissioners in making their ultimate policy decision. Besides, keeping current enables the Commission to act more quickly in the event that inflation subsides sufficiently and, hopefully, we can return to the era of general rate reductions consistent with an adequate earnings level.

The perceptive insights gained through continuous monitoring of matters other than overall rate of return should enable the Commission to conduct expedited proceedings to resolve more precisely defined issues. The Commission can conduct these reviews on the record with sworn witnesses, with full opportunity for participation by any interested parties who desire intervention.

While I have given only a brief overview of the procedures which could be usefully employed to facilitate decision-making in ratemaking cases, I want to stress my belief that the regulatory processes can be expedited and there is no need for legislative sanction of greater regulatory lag. What is crucial to the public in such regulatory proceedings is to get the Commissioners' judgment promptly on the basis of current economic and financial conditions. S. 2054 goes in the wrong direction by adding further delay to a process that already suffers from excessive administrative impediments to prompt effectuation of rate changes.

RATE CHANGES RELATING TO THE DESIGN AND STRUCTURE OF SPECIFIC RATES AND RATE SCHEDULES

In addition to its regulation of carriers' earnings, the Commission is responsible for evaluating the lawfulness of specific rate changes and changes in rate structure that do not affect overall rate of return. In recent years, more rate changes of this type have been required in response to the new "competitive environment" the Commission has introduced in the industry. Such rate filings include rate reductions for existing services and rates to be charged for entirely new services. If competition is to be at all effective, carriers must be able to respond quickly to moves by their competitors. If there is to be true competition, price changes to meet competitive conditions should become effective immediately—not be delayed for substantially longer than they already are.

The problem is that delays in effecting rate changes are actually retarding any genuine competition. For example, in 1972 the Commission adopted a special rule that prevented any major rate change without the Commission's prior approval. This rule was invoked to bar private line rate reductions for television transmission services, and AT&T had to go to court to have the rule declared invalid as a violation of the statutory scheme for changing rates under the Communications Act.¹¹

In 1973, AT&T responded to competition in the provision of intercity private line services by proposing rate reductions over high density routes (the Hi-Lo tariffs). Bell sought to file these competitive rates in February 1973, but the tariff filing was delayed under the Commission rule which the Court of Appeals later found to be unlawful. The Commission finally allowed the rates to be filed in November 1973, but it requested that Bell further delay their effective date so that the competitive rates did not take effect until June 1974, over 15 months after they were first submitted. However, when Bell's rates did become effective the Commission allowed Bell's competitors to file still lower rates on only one-day's notice.

The experience with these rate structure adjustments illustrates my concern that legislative authorization permitting greater delay in effectuating rate changes can be used as a means to handicap the competitive process. Enlargement of the period of regulatory lag, as proposed in S. 2054, would permit the Commission to allow some competitors to file competitive rates on one day's notice while imposing on others a notice and suspension period of up to 12 months.

The Commission's request for authority to delay rate changes for an additional seven months is symptomatic of deeper problems and issues: How should utilities be regulated? If there are to be departures from the common carrier concept of a regulated monopoly franchise, should the Commission permit

¹¹ *American Telephone & Telegraph Co. v. FCC*, 487 F.2d 865 (2d Cir. 1973).

genuine competition or may it divide and allocate the market, protecting certain companies rather than enhancing true competition?

The problems presented by the Commission's efforts to introduce a competitive environment in telecommunications far transcend the particulars of the suspension period and are far broader than the matters appropriate for discussion at these hearings on S. 2054. I would respectfully urge that this Committee conduct an oversight investigation devoted specifically to the effect on the public interest of the Commission's actions with respect to so-called competition. Congress should satisfy itself as to where the public interest lies before it is too late to reverse the course now being pursued by the Commission.

In conclusion, I will simply emphasize my opposition to S. 2054. The bill proposes amendments to the Communications Act that would exacerbate the already acute problems of regulatory lag. Whether it is overall earnings level or competitive rate adjustments, the public's interest is not in delaying needed rate changes, but in obtaining the Commissioners' expert policy judgments as rapidly as possible on the basis of current economic data.

Senator PASTORE. We are adjourned.

[Whereupon, at 3:20 p.m., the committee hearing was adjourned.]

[The following information was subsequently received for the record:]

AMERICAN TELEPHONE & TELEGRAPH CO.,
New York, N.Y., November 3, 1975.

JOSEPH R. FOGARTY, Esquire,
*Communications Counsel, Subcommittee on Communications, Committee on
Commerce, Russell Senate Office Building, Washington, D.C.*

DEAR MR. FOGARTY: At the conclusion of the hearing on S. 2054 before the Communications Subcommittee of the Committee on Commerce, held September 17, 1975, I was asked to respond to certain questions posed by Senator Cannon, who was unable to be present for the hearing.

I enclose herewith a copy of my replies to those questions which I mailed to Senator Cannon today.

Respectfully yours,

EDWARD B. CROSLAND,
Senior Vice President.

AMERICAN TELEPHONE & TELEGRAPH CO.,
New York, N.Y., November 3, 1975.

Hon. HOWARD W. CANNON,
*U.S. Senate,
Washington, D.C.*

DEAR SENATOR CANNON: At the conclusion of the hearing on S. 2054, before the Communications Subcommittee of the Committee on Commerce, held September 17, 1975, Mr. Joseph R. Fogarty, Communications Counsel, gave me a list of questions that you desired to be answered for inclusion in the record on S. 2054. Your questions and my answers thereto follow:

Question 1. I have expressed earlier in these hearings the concern that I have for the policies being pursued by the FCC, with regard to increased number of parties, such as specialized common carriers providing private line services and terminal equipment, will have an adverse impact on the telephone user in the State of Nevada. We long ago made the determination in this country that two telephone companies were not in the public interest serving the same customer, as a matter of convenience and economics. I would hope that we are not beginning to return to that two telephone company per person concept, or three telephone companies, or what have you.

What do you see, Mr. Crosland, as the direction which this policy is leading us?

Answer. Senator Cannon, I do not anticipate that our nation will return to the days when two or more telephone companies will provide local exchange telephone service to the same customer. However, I do see another serious possible problem arising that adversely affects the telephone user.

Today the nation's telephone companies meet demands for service in several broad categories. One such category, and I might add a very important one to the very nature of our society, is basic local telephone service. The revenues from customers for this service cover substantially less than the costs telephone companies would have to incur to provide basic local telephone service by itself.

The revenues from other service categories such as intercity services, optional services and equipment make substantial contributions to the coverage of various joint and common costs thereby permitting rates for basic local telephone service to be lower than they would otherwise be. Under this rate structure our nation has come close to achieving universal telephone service, with over 90% of all households having telephones.

The movement away from a regulated single-supplier environment in favor of a multi-supplier environment in certain segments of telecommunications, which FCC policies are causing, will shift the nation's telecommunications system to a different kind of rate structure that will decrease, and probably substantially decrease, some of the contributions that revenues from other services make toward keeping basic local service rates low.

Question 2. Will there be an adverse impact on the telephone consumer, and more particularly, the individual telephone subscriber in Nevada?

Answer. Yes, the introduction of multiple suppliers of telephone service most definitely will have an adverse impact on telephone consumers.

Our studies indicate that if it were not for contributions from intercity services and optional services and equipment, basic local telephone service rates, on the average, might have to be more than 70% above the rates now prevailing. It is not suggested that the full impact of this potential effect would be realized in the immediate future. It is not known how soon or what portion of such a rate increase might be caused by changes from a single-supplier environment to a multi-supplier environment. Nevertheless, it is manifest that competition always drives a firm to cost-oriented pricing which ultimately could have a serious impact on the users of basic local exchange service.

The specific effect on local exchange telephone service rates in Nevada also could be substantial. Inasmuch as the Bell System serves only a portion of Nevada, we cannot furnish data regarding the entire State. In the territory the Bell System serves, however, intercity service revenue contributions are extremely high compared to the national average. If all contributions from intercity services and optional services and equipment were lost, basic local telephone service rates in that portion of Nevada would have to go up over 140%, twice the national average.

Question 3. What do you suggest as a course of action that should be pursued by this Subcommittee in solving that?

Answer. In this period of growing interest in examining steps that would re-examine regulatory processes that clearly need attention, it is to be expected that our telecommunication system and its regulation would also be reviewed. We believe that such a national review is in order, and we stand ready, of course, to cooperate in any way that might be helpful.

On the matter of the rate structure, to which I have alluded, national policy could arrive at one of two basic decisions. One is that a portion of the costs for basic local services should be defrayed by contributions from the revenues of other types of service. That is the present system.

The result of present policy espoused by the FCC is the cartelization of markets among multiple suppliers and basic local services would lose much of the contribution from other services. The end result, as I indicated above, would be higher rates for basic local telephone service.

Adopting the latter course would simply leave the nation's telephone companies with one part of the business, basic local services, operating at a level which not meet relevant costs and with another part of the business, intercity services, that could not be priced to provide the necessary revenue offset. That clearly is a blueprint for disaster for the telephone user as well as the industry.

Question 4. Do you feel that this Subcommittee should hold further hearings regarding the impact on the telephone consumer?

Answer. Yes sir, I do. The economic impact which I have touched on should be explored in greater detail together with other areas of potential impact such as quality of service, speed and cost of innovation, and overall efficiency.

Question 5. Would AT & T be prepared to present any sort of studies at such hearings?

Answer. Yes sir, we would provide substantial evidence. If there is information that the Subcommittee would request that is not available, we would do our best to obtain it.

Question 6. Are any such studies available now?

Answer. The Bell System has undertaken and will continue to undertake studies in an effort to evaluate the impact of policies seeking to impose regulated

competition in the industry. Several studies are available now and have been submitted to the FCC in its Docket 20003, an inquiry into the economic impact of competition. These and additional studies which now are available from other sources should be most useful to this Subcommittee in addressing these important issues.

Question 7. Mr. Crosland, Nevada, as I am sure you are aware, is a sparsely settled State with many small and sometimes remote communities. My grave concern is whether adequate telephone service will continue to be available to the residents of those communities if the FCC continues to pursue this policy they embarked upon. If this Committee were to hold further hearings regarding this unlimited competition in telecommunications, would AT&T be prepared to present detailed studies as to the impact such competition would have on the type of telephone service that would be provided in these areas?

Answer. Yes sir.

Question 8. Could those studies also show what the impact would be on those small telephone companies who today serve some of the sparsely settled areas?

Answer. Yes sir. I understand such studies have been made, and I am confident this information could be made available.

* * * * *

Relevant to S. 2054 is a decision of the United States Court of Appeals for the District of Columbia in the case of *Nader v. FCC*, 520 F. 2d 182, handed down on September 29, 1975. In that case, the court affirmed an FCC order of November 22, 1972, on a rate application AT & T had filed two years earlier. At the conclusion of its opinion the court referred to some of its earlier decisions involving appeals of FCC decisions and stated: "This court has cautioned the Commission that it must pick up the pace of its proceedings." 520 F. 2d at 207.

I believe that this action of the Court of Appeals illustrates the need for regulatory procedures that expedite rather than prolong the administrative process. Under existing FCC procedures, AT & T must file proposed rate increases 60 days in advance of their becoming effective and the FCC may suspend such proposed rates for an additional period of 3 months, a total of 5 months from the date of filing. To extend that 5 month period to 12 months, as proposed in S. 2054, could build additional delay into the ratemaking process.

I have directed your attention to this development following the hearing on September 17, 1975, because of its significance to the FCC's proposal.

Respectfully yours,

EDWARD B. CROSLAND,
Senior Vice President.

[The following was taken on a separate transcript at the hearings held on September 17, 1975:]

Senator PASTORE. Mr. Inouye has a matter to bring up. Mr. Wiley.

Senator INOUE. Mr. Chairman, with your permission I would like to make a brief statement which, although not technically germane to the legislation under consideration, is a matter which concerns the committee and the FCC.

There is a special urgency, I believe, in what I have to say because it is my understanding that the Chief of the FCC's Common Carrier Bureau is meeting with interested carriers on this matter this afternoon.

As this committee knows, various unresolved policy and legal issues in the field of telecommunications still prevent the State of Hawaii from being fully and equitably included in the telecommunications systems established in the continental United States.

As a consequence, comparable rate structures and communications services are not available to the residents of Hawaii, nor, I might add, are they available to those in other States who may wish to communicate with Hawaii.

This situation exists despite the express mandate of the Communications Act of 1934 as amended, directing the FCC to regulate communications by wire and radio so as "to make available, so far as

possible, to all of the people of the United States, a rapid, efficient, nationwide and worldwide wire and radio communications service with adequate facilities at reasonable charges."

At this juncture I would like to point out that it has been rather frustrating, at times galling, to see the TV ads which say: "Call your loved ones, call your sweetheart at a very low rate anywhere in the United States;" then a little line appears on the bottom of the ad saying "except in Hawaii and Alaska."

Hawaii and Alaska happen to be part of the United States.

For many years the chairman of this subcommittee has urged the FCC and other responsible agencies of the Federal Government to formulate an overall telecommunications policy.

Failure to do so, as you have so often stressed, Mr. Chairman, has resulted in inefficiency and waste, and deprived the American public of timely benefits which communications technology offers.

Mr. Chairman, you will recall the hearings your subcommittee held in August 1966, to receive a progress report on space communications.

At those hearings the Chairman of the FCC and the Director of Telecommunications Management both testified that because there were conflicting filings before the FCC by communications common carriers for the construction and ownership of Earth stations for satellite communications, the FCC authorization for construction of these facilities would be delayed. If this occurred, there was a likelihood of a shortage of U.S. Earth station capacity to meet the buildup of Earth stations and communications traffic in and from the rest of the world.

At the heart of this impasse was the policy question to be resolved by the FCC as to whether conventional communications common carriers should be permitted to participate in the ownership of these U.S. Earth stations.

Your leadership at that time, Mr. Chairman, was instrumental in correcting what otherwise could have been a disastrous situation for the position of the United States in international telecommunications.

During those hearings you said the following to the Chairman of the FCC:

I think it would be a sorrowful situation to allow procrastination to enter this. I realize there are a lot of complex decisions to be made. These things are not easy, especially when you have so many conflicting interests and sometimes we are apt to simplify the problem when it is quite complex and complicated. I realize there are many ramifications. But by the same token, if we are able to make an interim solution with reference to three, I don't see why we can't make an interim solution with reference to more and get going on the job and resolve these very

The rest is history. The FCC was able to effect agreement among the interested carriers and adopted an interim policy providing for joint ownership of Earth stations in the United States by Comsat and the conventional common carriers.

One of the new communications services which was introduced in 1970 is an electronic mail service, mailgram, which is currently offered throughout the continental United States by Western Union Telegraph Co. A similar service is not available to or from Hawaii although my State has sought extension of the service since 1972.

Again, although the service is technologically feasible, and various carriers have filed competing applications to provide it, legal and

policy issues regarding the appropriate class of carrier to offer the service have caused delay.

Recently, on September 3, at a meeting of the interested carriers, representatives of the Hawaii State government, and the U.S. Postal Service, the Chief of the FCC's Common Carrier Bureau, proposed an interim arrangement in the nature of a joint venture whereby Western Union Telegraph Co., the three international record carriers serving Hawaii, and the Hawaiian Telephone Co. would provide a "mailgram" service pending a final decision in the matter by the FCC.

This proposal is merely to expedite long overdue service to Hawaii and is explicitly without prejudice to the rights or position of any of the competing carriers.

On September 10, the carriers met again at the FCC in an attempt to reach an agreement on the interim arrangement. That meeting was inconclusive, and it is my understanding another meeting is scheduled at the FCC for today.

I cannot help but conclude that had the responsible agencies of Government responded to your warnings about the necessity for an overall telecommunications policy, the present situation would not have developed. Nevertheless, it has, and the people of the United States, especially those in Hawaii, are deprived of the benefits of communications technology.

I commend the Chief of the FCC's Common Carrier Bureau in his effort to reach an interim arrangement, and wish him every success. I would hope the negotiating carriers will be cooperative and statesmanlike because it is the public who will suffer if they fail to do so.

Mr. Chairman, this concludes my prepared statement. With your permission, I have a few questions I would like to ask Chairman Wiley.

Senator PASTORE. Proceed.

Senator INOUE. Mr. Wiley, would any interim arrangement for mailgram service for Hawaii proposed or approved by the FCC assure that the rates and service are at least comparable to those on the mainland?

Mr. WILEY. Senator, I am going to ask Mr. Hinchman to address this, since he is directly involved in the negotiations and the meeting this afternoon.

Mr. HINCHMAN. Senator Inouye, yes, our concept is that the rates would be integrated with those mainland rates.

Exactly what that formula will be hasn't been determined, and won't be until we get an agreement among the carriers. But it would be an integrated rate structure.

Senator INOUE. Mr. Hinchman, has progress been made in the negotiations?

Mr. HINCHMAN. Yes, Senator, I am very hopeful that this afternoon we will reach agreement. We have been in touch with each of the carriers separately since the last meeting last week. We believe we now have ironed out the difficulties that were raised at that time, and we are expecting, hoping at least, that we will have at least the basis for agreement this afternoon.

Senator INOUE. If the negotiations, as you claim, will be successfully concluded, approximately how long before mailgram service will be operational in Hawaii?

Mr. HINCHMAN. We have had indications, Senator, that the Hawaiian Telephone Co. is prepared, has the equipment ready, and could be operational in a very short time.

I would imagine that it would be perhaps 30 days, or in that neighborhood, before we could implement this.

Senator INOUE. I presume if the interim agreement is not successfully concluded, a hearing will be necessary?

Mr. HINCHMAN. Yes, Senator, a hearing will be necessary to determine the ultimate disposition of this matter anyway.

If the interim agreement is not reached, we will institute that proceeding and expedite it.

Senator INOUE. What would be the time schedule on that? How long would it take for a decision to be rendered?

Mr. HINCHMAN. For a final decision?

Senator INOUE. Yes.

Mr. HINCHMAN. Again, Senator, that is sometimes very much determined by the parties in the proceeding. We would have to have a hearing, we would have to have oral testimony, and the parties can stretch that out. We would attempt to expedite it, within 3 to 6 months.

Senator INOUE. You still have appeals to the courts then?

Mr. HINCHMAN. Yes.

Senator INOUE. Petitions for reconsideration.

Mr. HINCHMAN. Yes. There is a possibility our recent decision even to consider Western Union as an applicant will be appealed to the court and be stayed. I can't really tell you except that our intent would be to try to complete action within 3 to 6 months if we have a hearing.

Senator INOUE. I would like to thank you sir, once again, for the effort you are making to assist us in Hawaii.

I hope you are successful.

Thank you very much.

[An additional transcript was taken on a matter unrelated to the announced subject of the hearings. That transcript is printed as part of "hearings before the Subcommittee on Communications of the Committee on Commerce, U.S. Senate, 94th Congress, 1st Session, on Oversight of Federal Communications Commission Broadcast Regulation," November 5, 6, and 11, 1975.]

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ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

U.S. SENATE,
Washington, D.C., September 19, 1975.

Hon. JOHN PASTORE,
Chairman, Communications Subcommittee, Senate Commerce Committee, Wash-
ington, D.C.

DEAR JOHN: I was unable to attend the hearings you held this week and would like to request that several questions be submitted to FCC Chairman Wiley and to Mr. Edward Crosland:

For Mr. Wiley:

1. Pending before the Commission is Docket #20003 which proposes to study the economic impact of competition upon telephone rates paid by the local consumer. What is the status of that Docket? When do you expect to complete those studies?

2. What will be the impact on the individual consumer in a state such as Utah which has sparsely settled areas?

3. Since the FCC has continued to grant authorizations to specialized common carriers and is also considering further expansion of customer owned equipment, will this not render Docket #20003 meaningless? Does this suggest the need for public hearings?

For Mr. Crosland:

I do not believe that Congress envisioned the introduction of competitive specialized common carriers or customer owned equipment when it enacted the Communications Act of 1934. Do you feel that the Communications Act of 1934 provides sufficient public policy directives to the FCC to resolve the competition conflicts that have arisen?

Do you feel that the Committee on Commerce should hold hearings and re-examine the purpose and direction of the Communications Act in light of existing conditions?

Sincerely,

FRANK E. MOSS,
U.S. Senator.

FEDERAL COMMUNICATIONS COMMISSION,
Washington, D.C., November 4, 1975.

Hon. FRANK E. MOSS,
U.S. Senate,
Washington, D.C.

DEAR SENATOR MOSS: The following information is being submitted in response to certain questions you have asked in your September 19, 1975 letter to Senator John Pastore concerning the legislature hearings on S. 2054. These questions were:

1. Pending before the Commission is Docket No. 20003 which proposes to study the economic impact of competition upon telephone rates paid by the local consumer. What is the status of that Docket? When do you expect to complete those studies?

2. What will be the impact on the individual consumer in a state such as Utah which has sparsely settled areas?

3. Since the FCC has continued to grant authorizations to specialized common carriers and is also considering further expansion of customer-owned equipment, will this not render Docket No. 20003 meaningless? Does this suggest the need for public hearings?

We do not feel that our continuing grant of authorization to specialized common carriers and consideration of further expansion of use of customer-owned equipment renders Docket No. 20003 meaningless. We are enclosing a copy of our Notice of Inquiry, released April 10, 1974. In paragraphs 1, 2 and 3 we express our reasons for entering into this inquiry and I believe you will

note that the areas of our concern are similar in many respects to yours. The Commission released a First Supplemental Notice on December 17, 1974 which incorporated in this matter additional issues and sub-issues raised by the filed comments. The Commission also urged all participants in the proceeding to address fully the issues raised in both the inquiry and the supplemental notice and requested responses by April 21, 1975, which have been received and are being considered.

It is anticipated that we will have an initial report for the Commission by next June.

As to the impact on the individual consumer in a state such as Utah, preliminary data submitted by Bell and other parties in Docket No. 20003 suggests that the effect on the individual monthly charges from competition seems to be determined by two key factors, (1) the degree of competitive penetration and (2) the amount of contribution or cross subsidy received by local exchange service from other services. For 1974 the interconnection suppliers (IC) revenue from private branch exchange-key telephone system (PBX-KTS) service, as stated by Bell in its service area under Bell equivalent unit revenue, amounted to \$96.7 million. This amount represents about 3.68% of total market (Bell plus IC) revenues for the same services as estimated by Bell.

The underlying assumption of this analysis is that all revenues generated by IC are lost to Bell. This circumstance may not be so. One of our objectives in Docket 20003 is to determine whether it is realistic to assume that all of the IC's business has taken away business from Bell, or whether the total market has been expanded as a result of this competition.

The other factor, degree of contribution, must be ascertained in order to determine any end effect on the rate payer. Accepting arguendo Bell's figure of \$96.7 million, we can make some rough estimates. If one varies the percentage of revenue supplied for contribution from 5% to 30% and assumes that all of it is lost to competition, then the amount of loss per residential main telephone per month varies from \$.0079 to \$.0471 respectively, based on the Bell data. This outcome assumes that the total loss will be spread across the *residential* telephone base and not the entire base, which includes both residential and business telephones. The result is also based on all the penetration assumptions plus the further assumption that a contribution does exist and that we can determine its size, which we can't. How much, if any, is a key issue. We do not have and have not been supplied with cost data for each service to determine the level of contribution. Therefore, any impact statement is subject to considerable qualification at this time. The assumptions, as with any analysis, are critical and must be substantiated to reach any firm conclusion on final economic impact. We hope to shed some further light on this matter through our continuing investigation in Docket 20003.

I am enclosing a copy of my letter to Senator Howard W. Cannon which provides further information on this subject.

It is hoped that you will find the foregoing responsive to your inquiry. If I may be of further assistance to you, please advise.

Sincerely,

RICHARD E. WILEY, *Chairman.*

Enclosures.

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

In the Matter of Economic Implications and Interrelationships Arising From Policies and Practices Relating to Customer Interconnection, Jurisdictional Separations and Rate-Structures—Docket No. 20003.

NOTICE OF INQUIRY

Adopted: April 9, 1974; Released: April 10, 1974, by the Commission:

1. We hereby give Notice of Inquiry into the effect of current pricing practices and regulatory policies on the level and distribution of customer charges for various telecommunication services, and in particular on the extent to which various categories of customers are now or will be under alternative pricing practices and regulatory policies subsidizing the services received by others. We are particularly interested in obtaining information as to the comparative economic effects on both overall telecommunications costs and charges and on

the costs and charges for different categories of both public and business customers, of such factors as the interconnection and use of customer-provided facilities, the use of specialized common carrier services in lieu of common carrier private line services, the use of flat-rate and other cost-insensitive pricing practices for local exchange services, and the jurisdictional separation of revenues and expenses for plant and facilities commonly used for both intrastate and interstate (including foreign) services. Finally, we are interested in comparative information concerning any secondary economic costs or benefits to specific categories of customers or to the public at large which result from either present or alternative pricing and regulatory policies and practices.

2. Our purpose in instituting this inquiry is to obtain information, views and comments from all interested persons that will be useful not only to this Commission in discharging its statutory obligations under the Communications Act but will also be beneficial to other agencies, including the State utility commissions, in carrying out their responsibilities. We are also of the view that the regulated carriers themselves, as well as the using public and the various elements of the non-regulated communications industry, will benefit from the information that we expect to obtain as a result of this inquiry.

3. We wish to make clear that this is primarily a fact-finding inquiry and that we are not proposing in this particular proceeding to adopt any rules or policies, as such. However, we expect that the record developed in this inquiry will be used in part to facilitate the resolution of questions of fact, law or policy involved in certain other rule-making proceedings now pending before us as hereinafter identified. Moreover, the information and views gleaned from this inquiry may form the basis for separate regulatory actions by us or by other regulatory agencies. Furthermore, we recognize that we may find it necessary to obtain, through contract, the assistance of resources from outside the Commission and its staff for adequate research and treatment of one or more of the issues herein. Finally, we should state that, although the impetus for this inquiry is due in large part to our desire to obtain probative and meaningful evidence as to the economic effects of customer interconnection, i.e., the trend toward increased use of customer-provided terminal and other facilities in connection with the switched telephone network, our inquiry is broader in scope and extends also to the interrelated questions of the competitive supply of various specialized communications services, and alternative regulatory approaches to jurisdictional separations and rate structures, as hereinafter discussed.

DISCUSSION

General

4. In response to several recent Commission decisions¹ opening up related, specialized segments of the market for telecommunications services to competitive vis-a-vis traditional monopoly supply, the established carriers as well as some State regulatory authorities have raised the issue of possible adverse economic impact on other users of the basic nationwide switched telephone network. Concurrently, state regulatory authorities are urging that a larger proportion of the revenues derived from interstate services be diverted to the support of local exchange plant and facilities used in common for intrastate and interstate services. Finally, many parties including the Commission, the Bell System, and independent regulatory analysts have become aware of and concerned over the effect of usage—insensitive pricing on the requirements for and efficiency of use of plant and facilities, and correspondingly on both the overall level and distribution of charges among various user categories.

5. These several economic issues are highly interrelated, and cannot be treated consistently or comprehensively, in a manner which best serves the public interest, through separate, independent proceedings. The use of customer-provided facilities in lieu of those offered by the carriers may affect the rates for services to other customers; but the nature, extent, and public interest considerations of any such effect are highly dependent on the nature, extent and public interest considerations of any existing cross-subsidies among different categories of customers, as a result of traditional pricing practices and cost/revenue alloca-

¹ *Carterfone*, 13 FCC 2d 420 (1968); Denial of Petitions for Reconsideration of *Carterfone*, 14 FCC 2d 571 (1968); *MCI*, 18 FCC 2d 953 (1969); Denial of Petitions for Reconsideration of *MCI*, 21 FCC 2d 190 (1970); *Specialized Carriers*, 29 FCC 2d 870 (1971); Denial of Petitions for Reconsideration in *Specialized Carriers*, 31 FCC 2d 1106 (1971); *Domestic Satellites*, 35 FCC 2d 844 (1972).

tions. Thus, we believe it essential, in addressing any question of economic impact or harms from specific individual regulatory or pricing policies or actions, that we gain a thorough appreciation of the economic implications and inter-relationships which arise from all the major existing policies and practices. In this way, we will be able to deal fairly and realistically with the concerns not only of the various industry segments but of the public as well.

Customer Interconnection

6. Following our Carterfone decision in 1968, petitions for reconsideration were filed which contended, *inter alia*, that we had not given adequate consideration to the economic effects from the interconnection of customer-provided communications facilities to the nation-wide switched telephone network. We found, in denying these petitions, that there was at that point no evidence demonstrating any adverse economic effects from such interconnection and that we could not accept tariff conditions based on such unsubstantiated presumptions. Specifically, we found that the contentions made in that case by the carriers that the public would be adversely affected by "a loss of revenue" from existing interconnection equipment was "unsubstantiated and unsubstantial". Thus, we laid down the principle in that decision that, although economic impact was an appropriate issue to consider in evaluating the public interest aspects of customer interconnection, we expected any showing of economic impact to be supported by substantial and substantiated evidence. We agreed specifically with the contentions of the carriers that economic effects of customer interconnection on the rate structure of the carriers might well be a public interest question (14 FCC 2d 571, page 573 (1968)) and have instituted this inquiry, in part, to acquire the data necessary to analyze such effects.

7. In June 1972, we established a Federal-State Joint Board, in Docket 19528, to make recommendations to us on the question of whether and to what extent the carriers should be permitted or required to extend to users of the switched telephone network additional interconnection options not available under the tariffs that are currently on file with us (35 FCC 2d 539 (1972)). Among the many proposals now before the Joint Board for consideration are recommendations for one or more certification programs whereby customers could obtain certified or approved terminal and other facilities from non-telephone company sources for direct connection to the network without the necessity of complying with the present tariff provisions that generally require that the telephone company supply network control signalling units and connecting arrangements for all direct connection of customer-provided facilities to the network. At the time we established the Board we gave no specific consideration to any questions concerning possible economic impact resulting from any further liberalization of interconnection options available to customers. Our concern at that time was to explore first the technical feasibility of possible standards and certification programs rather than the economic implications of any further liberalization of interconnection option.

8. Accordingly, in our First Supplemental Notice of April 3, 1973, in Docket 19528, we stated that we would cover economic impact questions in an appropriate manner by further supplemental notices in Docket 19528 (40 FCC 2d 315 (1973)). Furthermore, in our recent decision in *Telerent Leasing Corp. et al.*,² we stated that we intended to broaden our consideration of the economic issues as they relate to customer interconnection by instituting an investigation not only into the economic effects of any further liberalization of interconnection options to customers as proposed by many interested parties in Docket 19528, but also the economic effects which may result from currently permitted use of customer-provided facilities under the presently effective tariffs of the carriers. We explained that our decision in this regard was based upon concerns expressed by certain carriers and elements of the regulatory community that our policies on interconnection have resulted and will continue to result in certain harmful economic effects on local telephone exchange service, rates and revenue requirements. These concerns were based on the allegations that carriers are compelled to reduce their local exchange rates applicable to terminal equipment and systems in order to meet the competition for such facilities and that this would cause a loss of revenue to the carriers which prior to competition had been available to offset revenue requirements related to basic exchange service. This alleged revenue loss has been cited as mandating higher rates for such basic

² FCC 74-109; released February 5, 1974.

services, particularly service to residential and rural subscribers in order to maintain a reasonable magnitude of overall revenue to the established carriers.

9. Accordingly, one of the fundamental purposes of this inquiry is to explore fully the effects on the costs and availability of basic local telephone exchange services of (a) the regulatory actions we have taken to date on customer interconnection as reflected in the currently effective tariff provisions offering interconnected interstate message toll and wide area telephone services to customers subject to certain protective provisions initiated and devised by the telephone companies to insure against technical harm to the network; and (b) the regulatory actions we are urged to take by many parties in Docket 19528 to remove the present condition that interconnection may only be made through carrier-provided network control signalling units and connecting arrangements. As we clearly indicated in both our Carterfone and Telerent decisions we expect all parties claiming any such harmful economic effects to substantiate their contentions by showing the specific nature and extent of the economic effects alleged as a consequence of customer interconnect as presently permitted or as may be liberalized under any of the proposals in Docket 19528.

10. We also expect that each party claiming harmful economic effects of interconnection will address the question of whether the supply of customer-operated facilities is a "natural monopoly" according to accepted economic definition of that term; and if not, whether and for what reasons the Commission should consider granting a de facto monopoly position as being in the public interest. In our Telerent decision we stated our view of the underlying regulatory philosophy that should govern in this area as follows: "In fairness to all parties concerned, we deem it in order to state our view at this time that under a free enterprise system, particularly in this instance where there is an existing and growing competitive market for customer-provided interconnect equipment, any governmental action designed to prohibit or restrict the competitive operation of such a market would be of questionable validity and legality unless supported by compelling and cogent public policy considerations. Our purpose in enlarging the proceedings in Docket 19528 (or in a separate proceeding) will be to ascertain whether such public policy considerations are present as to warrant the extension of the natural monopoly concept to the interconnect market."

Accordingly, we expect the parties to make a factual showing as to whether, to what extent, and in what specific areas the markets for interconnect equipment and systems have the unique characteristics which would warrant relegating that market to monopoly supply by the telephone companies rather than to competitive sources of supply.

11. If the markets for interconnect equipment and systems do not have the unique characteristics which would warrant such monopoly treatment, we also solicit views as to what, if any, special conditions should be placed on telephone company participation in these markets. For example, should such suppliers of both monopoly and competitive services be required to establish separate corporate entities, maintain separate accounts, use separate operating personnel and facilities or adopt other measures to avoid the cross-subsidization of their competitive offerings by their monopoly services?

12. Finally, we invite data, information and comments from all parties on the extent to which there is or may be different or separate economic effects from customer interconnection on different groups, such as the carriers, the users (both interconnect and non-interconnect) and the independent suppliers of interconnect equipment. To enable us to assess fairly the economic implications of interconnection we need to know the benefits and costs thereof to each of these groups as well as the benefits and costs among the different members within each group. Benefits and costs of interconnection will likely be distributed differently among various classes and sub-classes of customers; and what is a cost to one group may be a benefit to another. Because of the wide variety of these many interrelationships, it would be necessary to assess the overall impact of all such interrelated benefits and costs in arriving at an optimal decision in the public interest. Accordingly, we request interested parties to submit their data and information with the foregoing in mind.

Jurisdictional Separations

13. Closely related to the matters discussed above, are the concerns which we have with respect to the currently effective methods and procedures for separating and allocating plant investment and operating expenses between intrastate and interstate operations of telephone companies. We are particularly interested

in the bearing that such methods and procedures have upon the carriers' operations and rates for basic exchange telephone service.

14. It has been alleged, in the connection, that under our regulatory approach to interconnection, telephone companies stand to lose a substantial portion of the station equipment market, particularly PBXs, to competitive suppliers and that this will result in substantial increases in intrastate revenue requirements thereby requiring increases in basic local exchange rates. Under the present separations procedures, the basic revenues derived by the local companies from the provision of station equipment, such as PBXs, are assigned to intrastate operations whereas a significant portion (about 18%) of the investment and expenses of station equipment are assigned to interstate operations.³ Thus, if the telephone companies can show that they will lose a significant amount of station equipment business to competitors, their intrastate revenues would be decreased without an offsetting decrease in their investment and expenses due to separations procedures which may be improper under present circumstances.

15. In evaluating the true and actual benefits and costs of our interconnection policies, careful consideration should be given to making proper allowances for the effect of the present separations procedures thereon. Also, questions are raised as to whether and to what extent revisions should be made in such procedures to reflect appropriately under current circumstances the proportion of plant and expenses related to the interconnect market that should be assigned to intrastate versus interstate services. We, therefore, invite comments on this question.

Rate Structure Practices

16. We are also of the view that, in assessing the economic implications of our regulatory actions on customer interconnection and other modes of competitive choice, we should consider the extent to which the rate structures and pricing practices of the carriers and regulatory agencies affect the need for increased intrastate revenue for basic telephone exchange service and the relationship of such structures and pricing practices to these actions.

17. In this connection we addressed a letter to the Chairman of the Committee on Communications of the National Association of Regulatory Utility Commissioners (NARUC) on December 11, 1973, in which we raised certain questions about the effects of cost-insensitive rate structures, which generally apply to exchange services, on the revenue requirements for intrastate as well as interstate services. Although our principal concern in our letter to NARUC was directed to the relationship of such cost-insensitive pricing for local exchange service on jurisdictional separations procedures, we believe that the questions we raised are pertinent to questions of the economic implications of our interconnect and other competitively oriented policies. In our letter we framed the questions as follows: (a) What are the effects of existing cost-insensitive pricing practices for exchange and related local services on the consumer's usage of such plant, as compared with that to be expected from measured rate or otherwise cost-related pricing? (b) What are the corollary affects of these pricing practices and resultant usage patterns on required investment and operating expenses, and the allocation of these between state and interstate services? (c) What methods are available to convert from flat rate, cost-insensitive exchange service pricing to measured rate, cost-related pricing; what would be their costs and benefits over time; what industry plans now exist for such conversion, and what would be a realistic schedule for their implementation?

18. For example, if more liberal rules are adopted for interconnection, the result of such liberalization could cause changes in the relative usage of the exchange plant by the interconnect customers vis-a-vis noninterconnected users. Any such changes should be considered in weighing the benefits and costs of more liberalized interconnection. Moreover, the public interest might better be served by converting from flat-rate, cost-insensitive exchange service pricing to measured rate or cost-related pricing in order to prevent any unwarranted losses in intrastate revenue requirements from customer interconnection. We have reached no conclusion in this area and we solicit data, information and views on this aspect of customer interconnection.

³ A portion of the toll rates in the interstate message toll tariffs is designed to recover the costs of station equipment to the extent used for interstate purposes. We would welcome comments on whether and to what extent the interstate charges for station equipment should be separately stated from the toll rates in the interstate tariffs.

19. We are also concerned with the contentions of certain carriers and regulatory agencies that the revenues from station equipment subsidize the basic telephone service provided to residential and rural areas. It isn't clear whether these contentions are based upon the use of fully allocated costs or some other methods of cost determination. We express no views on whether fully allocated cost or some other basis should be used in pricing interconnect equipment and systems. However, we believe that any contentions concerning alleged cross-subsidization of this nature should be accompanied by data showing the fully allocated costs thereof for comparison and testing against whatever other basis may be used for pricing such equipment. We, of course, invite, the submission of all such relevant and material data and information in response to our inquiry.

ITEMS OF INQUIRY

20. In view of the foregoing, there is hereby instituted, pursuant to the provisions of Sections 4(i) and 403 of the Communications Act of 1934, as amended, an inquiry into the foreign matter.

21. We have attempted in the foregoing paragraphs to indicate the principal areas that concern us in this proceeding and to set forth in varying terms of specificity the nature of the issues which we desire to investigate in this proceeding. However, in view of the nature and importance of the matters discussed above, it appears desirable to us that interested persons be afforded an opportunity to suggest to us what issues and sub-issues should be specified by us that will insure the development of the most meaningful and probative facts and information and material that are relevant to the questions discussed herein. We will therefore afford an opportunity for interested parties to suggest other areas or issues not discussed above which are pertinent to the general objectives of this proceeding. To this end, all interested persons are invited to submit appropriate recommendations on or before May 15, 1974. All filings in this proceeding shall conform to Sections 1.49 and 1.419 of the Rules (47 CFR 1.59 and 1.419).

Federal Communications Commission.

VINCENT J. MULLINS,
Secretary.

AMERICAN TELEPHONE & TELEGRAPH CO.
New York, N.Y., November 3, 1975.

Hon. FRANK E. MOSS,
U.S. Senate, Washington, D.C.

DEAR SENATOR MOSS: This is in reply to your letter of September 19, 1975 to Senator Pastore, requesting me to answer certain questions for inclusion in the record on S. 2054. Your questions and my responses thereto follow:

Question 1. I do not believe that Congress envisioned the introduction of competitive specialized common carriers or customer-owned equipment when it enacted the Communications Act of 1934. Do you feel that the Communications Act of 1934 provides sufficient public policy directives to the FCC to resolve the competition conflict that has arisen?

Answer. I agree thoroughly that Congress did not envision the introduction of competitive specialized common carriers or customer-owned equipment when it enacted the Communications Act of 1934.

Title I of the Act provides a most explicit public policy directive ". . . to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges . . ."

In carrying out this mandate a rate structure has evolved in which the revenues from customers for basic local telephone service covers substantially less than the costs telephone companies would have to incur to provide such a service by itself. The revenues from other services categories such as intercity services and optional services and equipment substantial contributions to the coverage of various joint and common costs thereby permitting rates for basic local telephone service to be lower than they could otherwise be. With this system our nation has come close to achieving universal telephone service, with over 90% of all households having telephones.

The trend away from a regulated single-supplier environment in favor of a multi-supplier environment, which recently adopted FCC policies induce, will shift the nation's telecommunications system to a different kind of rate struc-

ture that will decrease, and probably substantially decrease, the contributions that revenues from other services can make toward keeping basic local service rates low. This represents the foresaking of a national objective—universal telephone service.

What would, in short, seem to start out as a move toward the advantages of greater reliance on market forces would actually produce as an end result a degraded, less universal, national telecommunications system.

Question 2. Do you feel that the Committee on Commerce should hold hearings and re-examine the purpose and direction of the Communications Act in light of existing conditions?

Answer. Yes, sir. I firmly believe the fundamental changes in the structure and pricing of telecommunication services which appear to be evolving must be reviewed by the Congress which is vested with the authority of determining how communications should be furnished the people of the United States.

Following the hearing before the Subcommittee on Communications on S. 2054, held September 17, 1975, you introduced S. 2502, a bill to reform electric utility rate regulation, in which you propose that regulatory authorities would be prohibited from suspending electric utility rate applications for more than 5 months. Your proposal, in this regard, is comparable to the provisions in the Federal Power Act which require a 30-day notice of proposed rate changes followed by a maximum suspension period of 5 months, for a total of 6 months. (16 U.S.C.A. Section 824 (d) and (e)).

Under S. 2054, however, the Federal Communications Act would be changed to prolong the notice period from 30 days to 90 days, and the suspension period from 3 months to 9 months, for a new total of 12 months. We are hopeful that you will oppose such an extension of the FCC's suspension authority in keeping with the principle embodied in your bill S. 2502.

Relevant to both S. 2054 and your S. 2502, is a decision of the United States Court of Appeals for the District of Columbia in the case of *Nader v. FCC*, 520 F. 2d 182, handed down on September 29, 1975. In that case, the court affirmed an FCC order of November 22, 1972, on a rate application AT&T filed two years earlier. At the conclusion of its opinion the court referred to some of its earlier decisions involving appeals of FCC decisions and stated: "This court has cautioned the Commission that it must pick up the pace of its proceedings." 520 F.2d at 207.

I believe that this action of the Court of Appeals illustrates the need for regulatory procedures that expedite rather than prolong the administrative process. Under existing FCC procedures AT&T must file proposed rate increases 60 days in advance of their becoming effective and the FCC may suspend such proposed rates for an additional period of 3 months, a total of 5 months from the date of filing. To extend that 5 month period to 12 months, as proposed in S. 2054 could build additional delay into the ratemaking process.

I have directed your attention to these developments following the hearing on September 17, 1975, because of their significance to the FCC's proposal.

Respectfully yours,

EDWARD B. CROSLAND,
Senior Vice President.

TYMSHARE,
Cupertino, Calif., September 23, 1975.

Hon. JOHN O. PASTORE,
Chairman, Subcommittee on Communications, Senate Committee on Commerce,
Dirksen Senate Office Building, Washington, D.C.

DEAR CHAIRMAN PASTORE: As a businessman whose service depends entirely on the common carrier network, I am vitally interested in the passage of Bill S2054 to amend Sections 203 and 204 of the Communications Act. This Bill will eliminate a patently unfair procedure for implementing changes in the phone company rate structure. The current thirty days is entirely too short a time to react or reply to proposed changes by the phone company that could vitally affect our business.

I urge your support of the Bill.

Sincerely yours,

T. J. O'ROURKE,
President and Chairman of the Board.

GENERAL TELEPHONE & ELECTRONICS CORP.,
Washington, D.C., September 24, 1975.

Hon. JOHN O. PASTORE,
Chairman, Subcommittee on Communications, Senate Commerce Committee,
Dirksen Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: Submitted herewith in quintuplicate for the record is the statement of General Telephone & Electronics Corporation in opposition to the Federal Communications Commission's bill to amend Sections 203 and 204 of the Communications Act of 1934, S. 2054.

GTE respectfully submits that the referenced proposal to extend the suspension period proceeds from erroneous legal assumptions to pernicious economic results. Such an extension would be in the best interests of neither the telephone companies nor telephone customers. The extension of the notice period would aggravate the problem of "regulatory lag," and the requested authority for the Commission to grant temporary or partial increases would not offset the detrimental effects of the proposed extended suspension period.

Any questions with respect to the statement may be directed to the undersigned or to Mr. William E. Neumeier, Assistant Vice President—Legislative Affairs in this office.

Respectfully yours,

WILLIAM MALONE,
Vice President.

Enclosures.

STATEMENT OF GENERAL TELEPHONE & ELECTRONICS CORPORATION

General Telephone Electronics Corporation (GTE), on behalf of the domestic GTE telephone operating companies,¹ opposes enactment of S. 2054, a bill to amend Sections 203 and 204 of the Communications Act of 1934 to triple the statutory suspension period and make other changes.

GTE respectfully submits that the proposal to extend the suspension period proceeds from erroneous legal assumptions to pernicious economic results. Such an extension would be in the best interests of neither the telephone companies nor telephone customers. The extension of the notice period and the authority to grant temporary or partial increases, also proposed by the Federal Communications Commission, would not offset the detrimental effects of the proposed extended suspension period.

GTE telephone operating companies provide interstate communications services subject to regulation by the Federal Communications Commission (FCC) and thus would be adversely affected by the proposed amendments. The rates for interstate message toll telephone service (MTS) and certain other interstate services are uniform throughout the United States and are filed on behalf of the telephone industry by American Telephone and Telegraph (AT&T). In connection with certain interstate services, GTE companies have separate tariffs which are filed with the FCC. In both cases the interstate rates which the GTE companies charge their customers would be subject to the proposed amendments.

I. THE SUSPENSION PERIOD PROPOSAL

The Commission's proposal to extend the statutory suspension period proceeds on the assumption that the purpose of the suspension period is to allow the Commission to complete its examination of the new tariff. Such an assumption is without legal foundation. In fact Congress, in specifying a maximum three-month suspension period, weighed the supposedly competing interests of the ratepayer against the irreparable losses to the carriers and then consciously specified

¹ The fifteen domestic GTE telephone operating companies serve nearly 12,000,000 telephones in more than 7,500 communities of about 21,000,000 population in thirty-three states. These GTE companies are part of the Independent telephone industry, which consists of some 1600 telephone operating companies serving over 25 million telephones through 11,048 exchanges in over one-half of the served geographic areas of the nation. A map showing Independent-served areas of the United States and a state-by-state tabulation of Independent company statistics are attached as Exhibits A and B. These companies, together with the operating companies of the Bell System, provide exchange and inter-exchange telecommunications service through the integrated facilities of the telephone network.

a suspension period less than that usually required for completion of a rate hearing. The Commission's proposal is not consistent with Congress' original intent and would plainly represent a repudiation of the weighing of interests that Congress performed in its original enactment of Section 204.

An examination of the statutory scheme will make this clear. The Communications Act provides generally that tariff changes filed by the carriers go into effect automatically at the end of the requisite notice period unless the Commission takes affirmative action otherwise. Section 204 of the Act authorizes the Commission to designate a tariff filing for hearing and, pending completion of such hearing, to suspend the operation of the tariff for a period not longer than three months beyond the time when it would otherwise take effect. If the hearing process is not completed by the expiration of the suspension period, the tariff automatically takes effect, and, in the case of an increase in rates, the Commission may require a carrier to account for funds received pursuant to the new tariff. Then, upon completion of the hearing, the Commission may order refunds with interest if the tariff, or some portion thereof, is found to be lawful.

The Commission attempts to justify its proposal on the grounds that it has been unable to conclude tariff hearings prior to the expiration of the present three-month suspension period and that a longer suspension period is therefore necessary.² Undeniably, two recent rate cases before the Commission have run over two years!³

Such a justification is not consistent with the rationale of Section 204. The statutory limit on the duration of a tariff suspension represents a Congressional recognition of the economic harm to carriers, investors, and ultimately the ratepayers resulting from lost revenues during the time it takes a regulatory agency to decide the lawfulness of a tariff change. Indeed, the legislative history of Section 204 makes this clear. Both the House and Senate Commerce Committees requested the Interstate Commerce Commission, which then regulated interstate telephone service, to submit a detailed study report on the common carrier provisions of the communications bill. In its report the I.C.C. criticized the three-month period—which represented a reduction from the seven-month period then specified in Section 15(7) of the Interstate Commerce Act, as amended.⁴ Notwithstanding the I.C.C.'s criticism, Congress adopted the three-month period.

That the suspension periods represent a balancing of interests has been explicitly recognized by the courts. The U.S. Court of Appeals in New York City has stated that the statutory scheme "reflects the realization of Congress that when a carrier is prevented from placing in effect new rate increases it may suffer irreparable loss which in turn may impede the provision of adequate service during a period of rising costs." *AT&T Co. v. FCC*, 487 F.2d 864, 874 (2d Cir. 1973); see also *Arrow Transportation Co. v. Southern Ry. Co.*, 372 U.S. 658, 664-66 (1963). It is this commonality of interests that is not recognized in the proposed legislation.

Similarly, the Supreme Court, in discussing the limited suspension authority granted to the Federal Power Commission, stated: Business reality demands that natural gas companies should not be precluded by law from increasing the prices of their product whenever that is the economically necessary means of keeping the intake and outgo of their revenues in proper balance; otherwise procurement of the vast sums necessary for the maintenance and expansion of their systems through equity and debt financing would become most difficult, if not impossible. [*United Gas Pipeline Co. v. Memphis L., G. and W. Div.*, 358 U.S. 103, 113 (1958)]

The statutory schemes specifically contemplate that new tariffs may go into effect prior to a determination as to lawfulness. Within the past two years the Supreme Court has noted this Congressional awareness, in *U.S. v. S.C.R.A.P.*, 412 U.S. 669 (1973), where the Court said: . . . Congress was aware that if the Commission did not act within the suspension period, then the new rates would automatically go into effect and the shippers would have to pay increased rates that might eventually be found unlawful. To mitigate this loss, Congress

² Explanation of Proposed Amendments to Sections 203 and 204 of the Communications Act of 1934 (FCC 75-219) at 1-3 (February 20, 1975).

³ Phase I of the Bell rate case (Docket No. 19,129) consumed two years between the filing and Commission decision (November 20, 1970, to November 22, 1972.) Still pending before the Commission in Docket No. 19,989 are WATS rates filed as early as 1973.

⁴ See Hearings on H.R. 8301, before the House Committee on Interstate and Foreign Commerce, 73rd Cong., 2d Sess., at 93 (1934).

authorized the Commission to require the carriers to keep detailed accounts and eventually to repay the increased rates if found unlawful. [412 U.S. at 697]

It is clear from the foregoing that the existing statutory suspension provision embodies Congress' judgment as to the appropriate balance between the interests of the rate-payers and carriers with regard to tariff increases.

The suspension period cannot be lengthened without upsetting the Congressional balance, since the suspension is an inherently non-reciprocal mechanism. A lengthening of the suspension period might reduce the amount of time prior to any refund order during which the rate-payers would be deprived of the use of their money, but such a lengthening would work irreparable injury on the carriers. For even if the new rates are ultimately found lawful after completion of the hearing, the carrier would be unable to recover the revenues which it otherwise would have received but for the suspension, whereas the subscribers would have the benefits of the refund provisions with interest if the rates are found unlawful.

In effect, an increase in the suspension period would simply increase "regulatory lag." Such an increase in regulatory lag comes at a particularly unpropitious time, since the delay between the time when increased costs are incurred and the time when they are reflected in higher tariffs is much more harmful in an inflationary period.

The carriers are not in a financial position to casually absorb this increase in regulatory lag. The present financial plight of the utilities, which results from a combination of factors, including record inflation, high interest rates, inadequate depreciation, and strained debt capacity, should be a matter of serious and immediate concern to Congress, to this Committee, and to the telephone customers. The statement filed on behalf of the U.S. Independent Telephone Association with the Joint Economic Committee in February of this year describes the financial posture of the utilities in some detail. A copy of that statement is appended to this statement.⁵

The seriousness of the adverse effects of regulatory lag in the electric utilities, for example, was the genesis of the Administration's recent proposal to reform state regulatory processes by "setting a maximum limit of 5 months for rate or service proceedings." See *White House Fact Sheet*, p. 39 (January 15, 1975). Counting the sixty-day notice period, the Commission is already at that limit!

The practical effect of tripling the statutory suspension period in a time of inflation can be seen in the rapidity with which a utility's rate of return can deteriorate under rising costs. During a single calendar year, 1974, the interstate settlement rate of return declined nearly 15 percent on an annualized basis.⁶ This decline in interstate settlement rate of return represented an annualized loss of revenues to the GTE telephone operating companies of more than \$30 million—in a time of high interest rates and rapidly increasing costs.

The proposed extension of the statutory suspension period would make it virtually impossible for the telephone companies to engage in sound financial planning to minimize long-run costs to their subscribers. The total minimum elapsed time from time of filing to assurance of increased revenues to cover increased costs, under the Commission's proposal, would be one full year—by which time costs would undoubtedly have increased further. These increases could never be recovered by the carriers.

As the USITA statement to the Joint Economic Committee makes clear, the utilities must constantly go to the money markets for capital funds. They must be able to offer new investors the assurance of adequate earnings to support current and future borrowings. The ordinary manufacturer can simply decide not to increase production facilities and thus to leave increased demand for his product unfilled pending more favorable opportunities to go to the money markets for the funds to build additional capacity. The utilities, however, do

⁵ Appendix A of the USITA statement contains a detailed explanation of the effect of regulatory lag, with a numerical example.

⁶ Because interstate MTS is a service furnished jointly by all telephone companies under uniform rates, it is necessary to divide the revenues among the participating companies through an arrangement called "settlements" or "division of revenues". Under this settlement arrangement, the GTE telephone operating companies, as do the Bell telephone operating companies, earn the rate of return produced by this business on the investment required to furnish this service. Therefore, the decline in the interstate settlement rate of return from approximately 8.09 percent in December, 1973, to 6.90 percent in December, 1974, resulted in an annualized loss of revenue to the GTE telephone operating companies of more than \$30 million.

not have that option since they are obliged by law to construct plant to meet current demand.

This inflexibility in timing financings in the money markets has recently resulted in the issuance of utility common stocks below book—a practice that cannot be continued without serious impairment of the financial strength of the utilities.⁷ Last fall GTE sold 6,000,000 shares at a net of \$15.55 per share, although GTE's book value was \$21.71 per share. Continental also sold equity below book in 1974, and United likewise was forced to sell equity at relatively unfavorable prices during this period. More recently, AT&T has announced the sale of twelve million new common shares, which at current prices would represent the sale of shares some seven dollars below AT&T's book value.

It is naive to think that an extension of the suspension period favors the consumer of utility services in the long run. As Professor Weidenbaum's recent study, "Financing the Electric Utility Industry," states: Although it may be difficult for those unfamiliar with the industry to grasp the notion quickly, the way to maintain relatively low utility rates in the long run is to grant adequate rate increases in the short run. The basic reason is that a utility that impresses potential investors as providing a relatively assured return on their investment can raise new capital at lower rates than companies that are considered to be higher risks. [Op. cit. at 13 (1974)]

A further detriment to telephone customers of the added delay that the Commission's proposal could impose is even more obvious in the case of rate reductions. An additional suspension period would simply delay the customer benefit of such rate reductions, and the consumer loss would be a permanent one, since the accounting and refund provisions are not applicable.

Tariffs for reduced rates or new services have often been the result of competitive pressures on the established carriers in various communications submarkets. It has been recognized that long delays in the implementation of tariffs for new services and lower rates can also have an adverse impact on carriers. The court explicitly recognized this fact in *AT&T v. FCC*, *supra*, where it stated, "the loss sustained when an agency delays a rate reduction can be equally damaging, for during the delay customer may turn elsewhere and be permanently lost to the carrier." 487 F.2d at n. 18.

II. PARTIAL AND TEMPORARY RATE INCREASES

The Commission has also proposed an amendment to Section 204 that would permit it to authorize temporary or partial tariff changes. Such statutory changes, contrary to the Commission's claim, would not avoid irreparable loss of revenues in most cases if the suspension period were lengthened beyond the present three months and, in any event, should not be adopted in the form proposed.

A simple numerical example will show why the temporary increase or partial suspension proposed by the Commission may not offset lost revenues. Assume a \$100 annual tariff increase filed on January 1, \$50 of which reflects increased cost of debt and \$50 of which reflects increased wages and other costs. If the Commission suspends 100% of the increase for three months beyond the sixty-day notice period under the current statute, the revenues lost to the carrier total five-twelfths of \$100 or about \$42. Under the Commission's proposal, if the Commission decides to suspend one-half of the increase for nine months (or alternatively temporarily grants one-half of the increase), the revenue lost to the carrier is three-twelfths (the notice period) plus nine-twenty-fourths (nine-twelfths of the suspended fifty percent of the requested increase) or about \$63. Thus, in this example the carrier loses irretrievably fifty percent more to regulatory lag under the Commission's proposal than under the existing statute.

These changes purport to be a response to the 1972 recommendation of the Administrative Conference of the U.S. that regulatory statutes should be amended, to the extent that existing authority is lacking, to authorize temporary and partial rate increases.

The Commission, in our view, already has all the powers contemplated by the Administrative Conference recommendation—short, of course, of extending the suspension period beyond three months. We submit that its existing power to suspend tariffs includes the lesser power to partially suspend tariffs or to enter partial accounting and refund orders. In practical effect, a temporary increase is

⁷ This point is discussed at the bottom of page 3 of the USITA statement to the Joint Economic Committee, attached hereto.

likely to be encompassed by the terms of a partial suspension and accounting order, *i.e.*, the Commission would not likely grant a temporary rate in excess of that filed by the carrier and subject to suspension. The Commission in the past has achieved the same result as a partial suspension order by suspending the filed tariff and allowing a lesser tariff increase to be filed on short notice.

In any event the language of the amendment proposed by the Commission seems unclear. The report of the Administrative Conference states that temporary increases should be authorized "only when the agency makes a preliminary judgment on the basis of a written showing by the regulated company and an opportunity for comment thereon by affected persons, that a proposed increase is justifiable at least in part." See Report of the Administrative Conference of the United States for 1971-72 at page 86. The language proposed by the Commission differs from this recommendation in certain respects. The Commission's amendment, for example, eliminates the "preliminary judgment" aspect of the Conference's recommendation, and the Commission's standard of "just, fair, and reasonable" is somewhat ambiguous. GTE submits that a more precise standard should be developed, lest the deliberations regarding a partial or temporary authorization become as protracted as an overall rate inquiry. A *prima facie* showing of entitlement should suffice.

III. THE EXPANDED NOTICE PERIOD

The Commission's proposal to extend the statutory notice period from thirty to ninety days should be rejected as adding unduly and unnecessarily to regulatory lag.

Moreover, the Commission's proposal to extend the statutory notice period on tariff filings is unnecessary. Under Section 203(b) of the existing statute the Commission already has the power to extend the thirty-day period "for good cause shown." The U.S. Court of Appeals for the Second Circuit approved the Commission's extension of the period to sixty days in the case of tariff increases. See *AT&T v. FCC*, 503 F.2d 612 (1974). If the Commission cannot meet the "good cause" test of the existing statute, then there is no reason for the Congress to legislate an added delay in the absence of good cause.

The Commission claims it needs more time to analyze materials supporting the tariff filing before the effective date. This is surely not true as to most of the thousands of routine tariff filings referred to in the Commission's testimony before this Subcommittee. Thus, there would seem to be no reason to rigidly impose an additional sixty days of delay in such cases.

As to the masses of materials supplied in other cases, it is of the Commission's own doing that such allegedly unmanageable quantities of materials are submitted pursuant to Section 61.58 of the Commission's rules, 47 CFR § 61.58. The statute never contemplated that the Commission should analyze all the evidence before the effective date, and indeed much of the materials required to be filed is never introduced in evidence in resulting rate cases. Thus, presumably, such materials are regarded as irrelevant to even the ultimate merits of the rate filing. Accordingly, the Commission has failed to demonstrate as a matter of logic a need for additional time to analyze such materials for only a threshold determination of the question of suspension *vel non*.

A far sounder approach would be for the Commission to limit its pre-effective-date examination to the time allowed under the existing statute. In no event should Section 203(b) be amended by merely substituting "ninety" for "thirty." At least the Congress should withdraw from the Commission the ability to "bootstrap" yet an additional delay on a statutorily extended period.

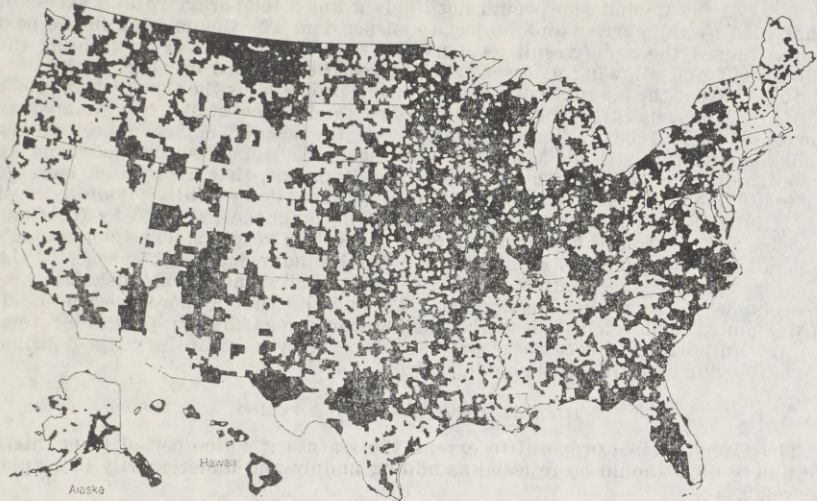
SUMMARY

In sum, GTE opposes any extension of the statutory suspension period as legally and economically unsound. The Commission's proposals as to temporary increases and partial suspensions would not assure offset of the increased losses inflicted if the statutory suspension period were so extended.

Moreover, any statutory increase in the notice period should be rejected as (i) increasing regulatory delay and (ii) as unnecessary under existing case law. In no event should any amendment permit the Commission to "bootstrap" yet further extensions of the notice period onto an extended statutory period.

September 24, 1975.

EXHIBIT A



INDEPENDENT TELEPHONE COMPANIES
SERVE 51% OF THE SERVED LAND AREA
OF THE UNITED STATES

EXHIBIT B

INDEPENDENTS BY STATE

Year End

STATE	COMPANIES 1974	TELEPHONES 1974	STATE	COMPANIES 1974	TELEPHONES 1974
ALABAMA	34	317,000	MONTANA	18	76,000
ALASKA	23	167,000	NEBRASKA	55	445,000
ARIZONA	6	47,000	NEVADA	4	319,000
ARKANSAS	35	322,000	NEW HAMPSHIRE	12	28,000
CALIFORNIA	26	3,328,000	NEW JERSEY	5	112,000
COLORADO	28	28,000	NEW MEXICO	9	81,000
CONNECTICUT	2	15,000	NEW YORK	50	1,155,000
FLORIDA	17	2,096,000	NORTH CAROLINA	32	1,491,000
GEORGIA	41	450,000	NORTH DAKOTA	21	116,000
HAWAII	1	545,000	OHIO	49	1,723,000
IDAHO	12	99,000	OKLAHOMA	42	223,000
ILLINOIS	61	1,447,000	OREGON	39	372,000
INDIANA	58	1,219,000	PENNSYLVANIA	53	1,533,000
IOWA	167	581,000	SOUTH CAROLINA	28	425,000
KANSAS	47	261,000	SOUTH DAKOTA	36	77,000
KENTUCKY	21	514,000	TENNESSEE	25	405,000
LOUISIANA	22	123,000	TEXAS	90	1,392,000
MAINE	20	69,000	UTAH	11	26,000
MARYLAND	2	4,000	VERMONT	8	39,000
MASSACHUSETTS	3	3,000	VIRGINIA	26	676,000
MICHIGAN	52	754,000	WASHINGTON	38	572,000
MINNESOTA	98	523,000	WEST VIRGINIA	14	118,000
MISSISSIPPI	23	57,000	WISCONSIN	116	826,000
MISSOURI	50	611,000	WYOMING	11	16,000
			TOTAL :	1,641	25,826,000

STATEMENT OF THEODORE F. BROPHY, PRESIDENT, GENERAL TELEPHONE & ELECTRONICS CORP. ON BEHALF OF THE UNITED STATES INDEPENDENT TELEPHONE ASSOCIATION¹

The financial plight of the utilities—both telephones and electrics—threatens to undermine the basic infrastructure of our economy. A combination of factors, including record inflation, high interest rates, inadequate depreciation to fund replacement of obsolescent plant and equipment, and strained debt capacity has produced serious doubt as to the ability of the utilities to finance adequately their required construction programs.

Perhaps the most dramatic manifestation of this fundamental problem came a year ago when Consolidated Edison passed its quarterly dividend. Because of similar underlying problems, other electric and telephone utilities have announced drastic cutbacks in their construction programs. In 1975, for the first time in twenty-seven years, the budget for new construction of the Independent telephone industry will be less than for the previous year. While the industry has shown an annual average construction growth of 12.2 percent over the last decade, the forecast for 1975 indicates a decline of close to 7 percent, thereby making the decline close to 20 percent below normal growth. Taking inflation into account, the cutbacks are much greater in real terms. In terms of dollars, the cutbacks in 1975 construction amount to around \$400 million for the Independent telephone industry. In terms of jobs, a \$400 million cutback in construction would result in a direct loss of 12,000 jobs further aggravating the recession.² Unless this trend can be reversed, it will inevitably lead to degradation of service, serious damage to our economy, and jeopardy to the public's safety and welfare.

These construction cutbacks reflect the continuing difficulty the utilities have experienced during the past several years in raising funds externally. Recently, there have been further (i) downgradings of utility bond ratings, (ii) cutbacks in the sizes of security offerings, and (iii) sales of common stock below book value. As an example of sales below book, GTE—the largest Independent—recently sold 6,000,000 shares at a net of \$15.55 per share, although GTE's book value was \$21.71 per share.

The current scarcity and high cost of capital have a peculiarly adverse impact on the utilities. The utility business inherently requires large amounts of capital relative to revenues (Exhibit 1). U.S. Department of Commerce figures show that total expenditures for plant and equipment have been rising more rapidly in the utility area than in the economy in general (Exhibit 2). Historically, the construction expenditures by the telephone utilities are almost as large as those of the electric utilities, and they have been increasing about as fast (Exhibit 3). These utilities compete directly with each other and with all others for the limited amount of available capital.

The ability of telephone and electric utilities to fund their necessary construction programs adequately is seriously impaired. First, the ability to issue additional debt is practically foreclosed by high debt-equity ratios (Exhibit 4) and inadequate interest coverages. The average interest coverage of the electric and Independent (non-Bell) telephone utilities is estimated to be below 3.0 times in 1974 (Exhibit 5), and individual companies were close to the 2.0 ratio below which point they would be foreclosed by indenture limitations from issuing additional long-term debt.

Secondly, the ability to shore up the sagging capital structures with the sale of additional common stock equity is sharply limited by marketability and the spectre of dilution.³ The average return on equity of the utilities barely exceeds

¹The United States Independent Telephone Association (USITA) represents the independent (non-Bell) segment of the telephone industry in the United States. The independent telephone industry consists of 1,697 operating telephone companies serving over 25 million telephones through 11,100 exchanges in over one-half of the served geographical areas of the nation. These companies, together with the operating companies of the Bell System, provide exchange and interexchange telecommunications services through the integrated facilities of the telephone network.

²The 12,000 figure is an extrapolation from our estimate for the GTE domestic telephone operating companies that a \$100 million cutback in construction would cause a direct loss of 3,000 jobs. This figure would be substantially increased by the addition of indirect job losses.

³Dilution occurs when there is an increase in the number of shares of stock outstanding without a corresponding increase in assets and earning power.

the average of Moody's "A" utility bond interest rates (Exhibit 6). Many utilities have bond ratings below the single-"A" rating. The depressed market prices of utility stocks reflect their relatively poor earnings. A comparison of the ratio of market-to-book values and return on equity (ROE) for 106 utilities listed on the New York Stock Exchange shows that all but eight are selling below book value (Exhibit 7). Thus, common equity can be raised by the utilities only by introducing the degenerative spiral of dilution.^{4, 5}

Because of limitations on sales of debt and the unfavorable common equity market, many telephone and electric utilities have attempted to sell preferred stock. However, the market for preferred in its present form is extremely thin and consequently has not provided a large source of equity capital.

Capital conservation programs based on construction cutbacks and stretch-outs are not a satisfactory solution. These programs threaten the ability of American industry to move forward with the assurance of the availability of adequate, basic utility services. If the utilities are to be able to meet the demands for additional service and to replace obsolescent plant, the availability of funds to them must be promptly increased.

The flow of funds can be increased (i) internally, through improving cash flow, and (ii) externally, through the sale of securities. Tax relief, if promptly enacted, will promote restoration of financial health and will help provide the funds necessary for the utilities' construction programs in the near term. But fundamental regulatory reforms are needed as well.

I. THE CONGRESS SHOULD PROMPTLY INCREASE THE INVESTMENT TAX CREDIT AND FACILITATE THE RAISING OF PREFERRED AND COMMON EQUITY.

To alleviate the serious and immediate problems facing all utilities and to stimulate the economy and encourage full employment, the Congress should immediately adopt the following three tax proposals:

(1) Permanently increase the investment tax credit (ITC) to 12 percent, equalizing the non-utility and utility ITC rates, and remove the 50 percent limitation;

(2) Allow a corporate tax deduction by the issuer at its option for dividends paid on designated new issues of preferred stock; and

(3) Allow tax deferral for shareholders' automatic reinvestment of corporate dividends, or reinstate the Citizens Utilities ruling.

These proposals offer significant benefits not only to the utilities but to the economy as a whole. The major immediate benefit to the economy is that they are anti-recessionary and will provide jobs. These proposals will help the utilities finance the basic services that are needed for a growing, prosperous, and efficient economy. Moreover, investment as a percent of Gross National Product in the United States is less than in the rest of the world,⁶ and these proposals will provide needed capital to help correct this imbalance. The resulting increased investment will also help to increase productivity and thereby make domestic products more competitive in world markets.

(1) INCREASED INVESTMENT TAX CREDIT

In the past, the investment tax credit has proven to be an effective tool for fighting recession, unemployment and inflation. Without an increase in this credit, we foresee continued widespread construction cutbacks in the telephone and electric utility industries which will result in increased unemployment, higher costs and degradation of vital utility services which are so necessary for a healthy economy. A permanent 12 percent investment tax credit will immediately provide corporations, including the telephone and electric utilities, with needed cash flow strengthening their capital structures and improving their return on

⁴ Dilution is an unsound financial policy for any company which must go to the equity market for financing. Repeated sales of equity below book value eventually result in a situation where equity cannot be sold at any price. See Roseman, "Utility Financing Problems and National Energy Policy", 94 Public Utilities Fortnightly, No. 6, page 19, (September 12, 1974).

Dilution is particularly pernicious for utilities which are subject to governmental limitations on potential return. Utility shareholders earn only on the utility's investment (rate base). Thus, dilution results in a division of the investment among a greater number of stockholders—a dilution of the very earning power of the stock itself.

⁵ The dilution problem is not confined to the utilities. Other capital intensive industries, such as banks, also face the same problem (Exhibit 8).

⁶ Statement of the Honorable William E. Simon, Secretary of the Treasury, before the House Committee on Ways and Means, Washington, D.C., January 23, 1975; Table No. 7.

common equity and interest coverage. In addition, the proposal will reduce the external demand for funds, thus relieving the strained capital markets. Furthermore, it will help to restore business and investor confidence.

Congress should eliminate anomalous discrimination in the investment tax rate which currently favors industrial corporations (7%) over public utilities (4%). Congress should also eliminate the 50 percent limitation on the use of the credit.⁷ This arbitrary limitation deprives those capital intensive companies with the poorest earnings—the ones which need help the most—of the full benefits of the investment tax credit.

(2) OPTIONAL DEDUCTIBILITY BY THE ISSUER FOR TAX PURPOSES OF DIVIDENDS PAID ON NEW ISSUES OF PREFERRED STOCK⁸

Enactment of the proposal to allow a corporate tax deduction by the issuer (if the issuer so elects) for dividends paid on new issues of preferred stock would make an important and substantial contribution to the ability of the financial markets to meet the capital needs of the economy. Most importantly, the adoption of the proposal will help combat recession by supporting capital spending programs, which will bolster the economy in general and employment in particular. In addition, the proposal will reduce the net cost of capital to issuing corporations and thereby help to retard the rising cost of utility and other services to the public.

Implementation of the proposal would immediately broaden the market for preferred stock, because the issuer would be enabled to pay a higher dividend rate on the new type of preferred stock than is currently available on most fixed income securities of similar quality without adversely impacting internally generated funds. Whereas the attractiveness of traditional preferred stock has been largely limited to corporate investors, such as fire and casualty companies and savings banks which can utilize the 85 percent dividend-received deduction (IRC § 243), the new preferred will be attractive to pension funds and other tax-exempt institutions, and mutual funds, as well as individuals. The new market thus created will particularly benefit the companies having limited or strained debt capacity. It will afford American industry a means of reducing debt ratios, broadening financial bases, and supporting or restoring bond and other credit ratings. The use of the new preferred will improve net earnings, cash flow, and return on common equity, and thereby help to restore and preserve capital investment programs and jobs.

A company not electing the new alternative because it cannot utilize the tax deduction, or for any other reason, could continue to sell, with reduced competition, traditional preferred stock to institutional investors who would continue to utilize the 85 percent dividend-received deduction (IRC § 243). Indeed, some companies may offer both types of preferred stock.

In addition to this indirect benefit, it is expected that utilities which do not currently pay taxes, ultimately will improve their earnings sufficiently to enable them to obtain the direct benefits outlined above.

(3) DEFERRED TAXATION OF REINVESTED DIVIDENDS

Deferral of taxation of dividends on common stock of all corporations reinvested by stockholders⁹ will materially contribute to the solution of the fundamental, long-term problem of inadequate savings and capital formation. The proposal will create a new and significant source of needed equity funds for all corporations issuing new stock under these programs. The increased cash flow will support capital expenditures and related jobs and will reduce the strain on the capital markets as well as improving investor confidence. It will

⁷ Currently, the investment tax credit is limited to 50% of the tax liability of the corporation.

⁸ Under his proposal, dividends paid on qualified preferred stock would be allowed as a tax deduction to the payor corporation. The deduction would only be available for cash dividends paid on new preferred stock issued after December 31, 1974, for cash or pre-existing bona fide debt of the issuing corporation. The provision of the IRS Code providing for exclusions for dividends received by corporations would not be applicable to these dividends.

⁹ Under this proposal, dividends on common stock which are directly reinvested under automatic dividend reinvestment programs by stockholders in the same company paying the dividend would be exempt from taxation until disposition of the shares so acquired. Normal capital gains tax treatment would apply when the stock was ultimately sold. In effect, the stockholder would be taxed as though he had received a stock dividend as under the IRS' 1956 Citizens Utilities ruling.

help cash-starved utilities maintain existing dividend levels and thus forestall further shocks to the capital markets such as followed the omission of a quarterly dividend by Consolidated Edison in 1974.

Deferral of taxation on reinvested dividends will materially increase stockholder participation in existing automatic dividend reinvestment plans and will also encourage other companies to establish such plans for their shareholders.

Further, the deferral of taxation will equalize the tax treatment of investors in high-growth, low-payout and low-growth, high-payout companies, thereby permitting the utilities to broaden their investor groups. The broadened market and the increase in the effective return on the shareholder's investment will facilitate the sale of additional securities on improved terms. The equity generated will thereby strengthen the capital structure of American industry and stimulate increased employment.

II. THE REGULATORY PROCESS MUST RESPOND TO CHANGING ECONOMIC CONDITIONS

Fundamental to the long run financial health and stability of the utilities are adequate earnings. Without adequate earnings, a utility can neither raise needed equity capital nor float long-term debt at reasonable cost. Since nearly half of the utilities' construction budgets are funded through external financing, continued adequate earnings are necessary to sustain new construction and to avoid deterioration of service quality. Without adequate earnings, telephone and electric utilities will not be able to raise the capital necessary to provide adequate utility service to the public.

The existing regulatory process has largely failed to respond adequately to changing economic conditions. More specifically, it has failed to respond adequately to the inflation we are experiencing (Exhibit 9). While inflation has forced utility bond interest rates up sharply (Exhibit 10), the regulatory commissions have not allowed the earnings of the utilities to keep pace. The "spread" between bond interest rates and return on equity has narrowed practically to extinction (Exhibit 6).

Too often rate increases have been too little and too late. Substantial delays between the filing of requests for rate increases and commission disposition are, unfortunately, not uncommon.¹⁰ Furthermore, the rate allowed is seldom earned (see appendix). To the extent such results reflect attempts by the regulators to "fight inflation" by holding down telephone rates, they are misguided. For the telephone companies are not the cause of inflation (Exhibit 12); they are the victims.

The primary thrust of regulatory reform must be to obtain a substantially higher return on equity. The restoration of a reasonable differential between return on equity and long-term interest rates that will compensate for the added risk element in equity investment is necessary to attract investors.

In addition to making it possible for the utility industry to earn a reasonable return on equity, it is imperative that steps be taken immediately to eliminate the excessive regulatory lag. There are a number of different mechanisms which might accomplish this objective.

(A) Rate increases should be authorized to go into effect immediately upon the filing of new rates, with a refund bond to protect the customer. Such increases could be limited to a maximum of 15 percent (for example) of existing rates in any twelve-month period.

(B) Utilities should be permitted to use a forecasted test period in filing rate applications. Presently, in most jurisdictions, rates are based upon a company's revenue needs as determined by historical operating or earnings results. Consequently, by the time rates are approved and made effective, the effects of inflation have further eroded earnings and the utility fails to earn the rate of return on equity determined to be fair by the regulatory authority. (The lag and attrition problems are discussed in detail in an appendix to this statement.) The use of forecasted test period results would facilitate the determination of revenue requirements more in line with current costs of providing service.

(C) Regulatory authorities should be required to issue final decisions with regard to applications for rate adjustments within a reasonable, finite period of time after the applicant files an application. This would greatly assist companies in their short and long-range financing plans, which must be geared to meet demands for service.

¹⁰ Exhibit 11 shows the regulatory lags experienced by the domestic GTE telephone operating companies.

(D) A comprehensive program of automatic rate adjustment procedures should be adopted. Automatic rate adjustment provisions will eliminate delay and unnecessary expense both on the part of the utility and the commission with respect to clearly defined items that really require no hearings and are based on undisputed and indisputable facts.

Automatic rate adjustment clauses not only permit the utilities to obtain justifiable rate increases without attrition and lag but could serve to unburden the regulatory commissions from the tremendous load occasioned by the almost unbroken chain of rate cases which utilities must file in order to keep pace with inflation. This, in turn, would permit commissions to devote their valuable time and expertise to those important issues which would not be subject to the automatic rate adjustment clauses.

Some steps are being taken in certain states to implement these reforms. These efforts must be expanded as soon as possible in order to counteract the damaging effects of inflation and to help the industry procure badly needed capital. The deleterious effects of regulatory lag have been recognized by many, including Dr. Arthur Burns in his testimony before your Committee on October 10, 1974 when he urged the Administration to move quickly in urging regulators to speed up decisions on rate increase applications.

In addition to regulatory reform including the elimination of regulatory lag, certain accounting reforms to offset inflationary pressures, such as liberalization of depreciation rates and inclusion of construction work in progress in the rate base, should be adopted by the regulators.

Many of these regulatory reforms are incorporated in Title VII of H.R. 2633 and in S. 594—but limited to electric utilities. The regulatory problem should be treated on a unified basis, with the telephones included.

CONCLUSION

The utility financing problem is a serious one. It has a direct impact on the economy as a whole and threatens to undermine the basic infrastructure on which the health and growth of American industry depend. Moreover, the utilities, through their large capital expenditures for required construction programs, directly employ a significant portion of the American labor force. The utilities, through their large purchases of capital goods, indirectly support jobs in the manufacturing and service sectors as well.

The utility financing problem affects all utilities—not just the electric. The pertinent financial ratios of the electric and telephone utilities demonstrate that the financing problems of both are acute.²¹ Therefore, any solution to the “utility” problem must include the telephone utilities.

Solutions to the utility problem must embrace tax relief, making the regulatory process more responsive to changing economic conditions, and necessary accounting reforms.

Tax relief should include: (1) permanent increase and liberalization of the investment tax credit, (2) optional deductibility of dividends on designated new issues of preferred stock, and (3) tax deferral of automatically reinvested dividends.

Reform of the rate making process is equally essential to a long-term solution of the utility financing problem. Congress has a direct and immediate responsibility to see that the Federal regulatory agencies employ sound rate making policies and procedures. Congress has an indirect and equally urgent responsibility to foster—and require, where necessary and appropriate—sound rate making procedures by the state regulatory commissions.

Accounting reform should include liberalization of depreciation rates and inclusion of construction work in progress in the rate base.

The proposals discussed above would not only help to alleviate the critical financial problems of the capital intensive utility industry, but would provide a much needed stimulus to the economy in general and employment in particular.

The entire utility industry, including the telephone sector, is committed to providing required public service. We share with the Congress this responsibility to the American public. We need the Joint Economic Committee's enthusiastic endorsement and active support to accomplish the essential reforms discussed in this statement.

²¹ See Exhibits 1, 3-7, and 10.

APPENDIX

REGULATORY LAG AND ATTRITION

An important part of the problem is regulatory lag and attrition. In GTE telephone operations we have averaged, over a three-year period, nine months' delay for a rate case from the time of filing to the grant of rate relief. One case settled in January 1975 required over two years to receive an order and we still have one case which has been on file for over three years. Another case, settled in 1973, was decided in three months, but we were allowed no increase.

The following hypothetical example illustrates the impact of lag and attrition (Exhibits 13, 14, and 15).

It is assumed that the utility has 60 percent debt and 40 percent equity; that it has a 6 percent embedded interest rate; that depreciation represents 20 percent of operating costs and that the remaining operating costs increase at the rate of inflation. It is also assumed that the inflation rate is 8 percent and will remain steady for the three-year period to be discussed; that the income tax rate is 50 percent; and that it is necessary to wait twelve months from the date of application for the rate increase to the date of the award.

Exhibit 15 shows the back-up figures for Exhibit 14. Exhibit 14 is a schematic diagram of the effect of lag and attrition. Lag is defined as the impact of the delay between the time of filing and the time of granting of the rate increase, assuming no impact from inflation. Attrition is defined as the effect of inflation on return on equity. In the example, it is assumed that the utility was earning a 10.5 percent return on equity and needed a 15 percent return on equity. It filed a rate case asking for sufficient revenue to give it that 15 percent rate of return.

At the end of one year, immediately prior to the granting of the rate award, the return on equity, because of attrition, had declined to 9 percent. Assuming that the entire amount of revenue requested was awarded, on the date of the award, because of attrition, the return on equity realized would only be 13.5 percent. A year later, because of continued attrition, the return on equity would be 12 percent. Two years after the award, the return on equity would be 10.4 percent, actually lower than the return on equity at the time the original rate case was filed.

For each \$1,000 of assets invested, the utility actually required \$180 in net income over the three-year period in order to earn the required 15 percent return on equity. Because of lag, it lost all the earnings indicated in the rectangle on the left side of Exhibit 14. Because of attrition, it lost all the earnings indicated by the scalloped segments of the diagram with the result that its actual total earnings for the three-year period were only \$135. The other \$45 required was lost forever. In other words, the utility fell 25 percent short of achieving earnings necessary to meet the financial integrity of the utility and to attract equity money from the marketplace at a price in excess of book value.

EXHIBIT 1

An Asset - Intensive Business

Assets Required to Generate One Dollar of Sales Revenue

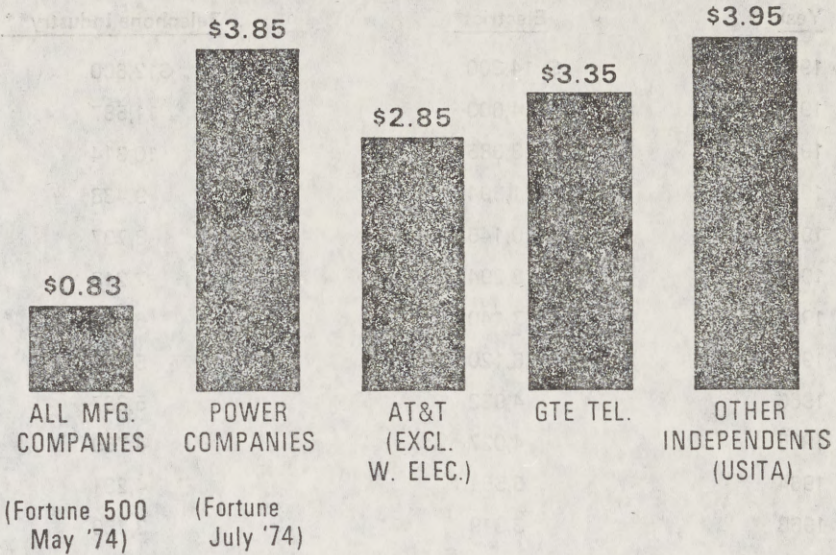


EXHIBIT 2

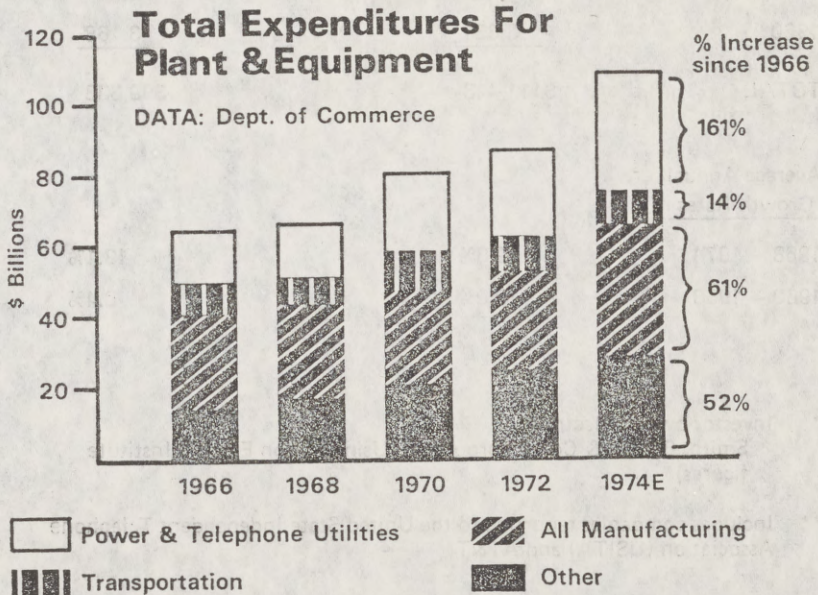


EXHIBIT 3

CONSTRUCTION EXPENDITURES

(\$ Millions)

<u>Year</u>	<u>Electrics*</u>	<u>Telephone Industry**</u>
1974 (Est.)	\$ 14,300	\$12,600
1973	14,600	11,587
1972	13,385	10,314
1971	11,894	9,438
1970	10,145	8,737
1969	8,294	7,213
1968	7,140	6,033
1967	6,120	5,469
1966	4,932	5,237
1965	4,027	4,769
1964	3,551	4,231
1963	3,319	3,759
1962	3,154	3,557
1961	3,256	3,221
1960	<u>3,331</u>	<u>3,168</u>
TOTAL	\$111,448	\$99,333
 <u>Average Annual Growth Rates</u>		
1968 - 1974	12.3%	13.1%
1960 - 1968	10.0%	8.4%

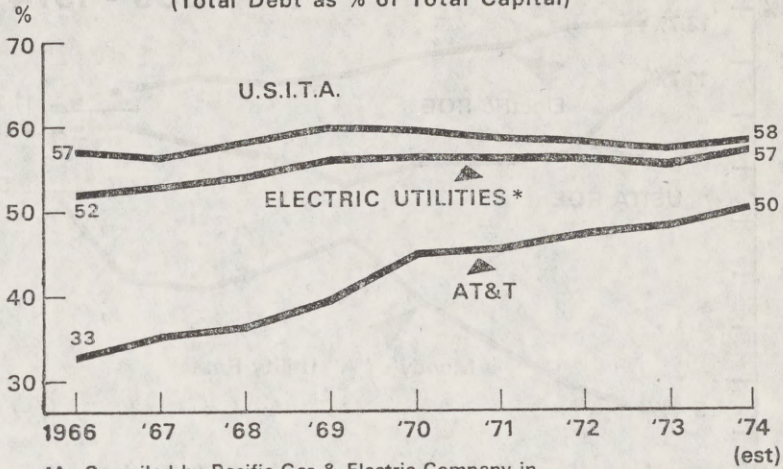
* Investor-owned Electrics
Smith, Barney & Co., Incorporated (Using Edison Electric Institute figures)

** Includes companies reporting to the United State Independent Telephone Association (USITA) and AT&T

EXHIBIT 4

Comparison of Telephone Leverage With Electric Utilities

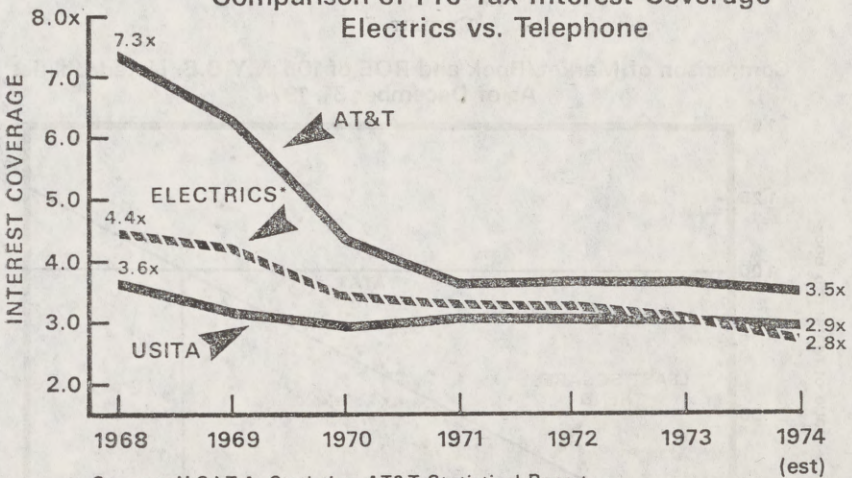
(Total Debt as % of Total Capital)



*As Compiled by Pacific Gas & Electric Company in Comparative Financial Data: Fifty Largest Utility Companies
 Source: As Above: AT&T Statistical Report, and U.S.I.T.A. Statistics

EXHIBIT 5

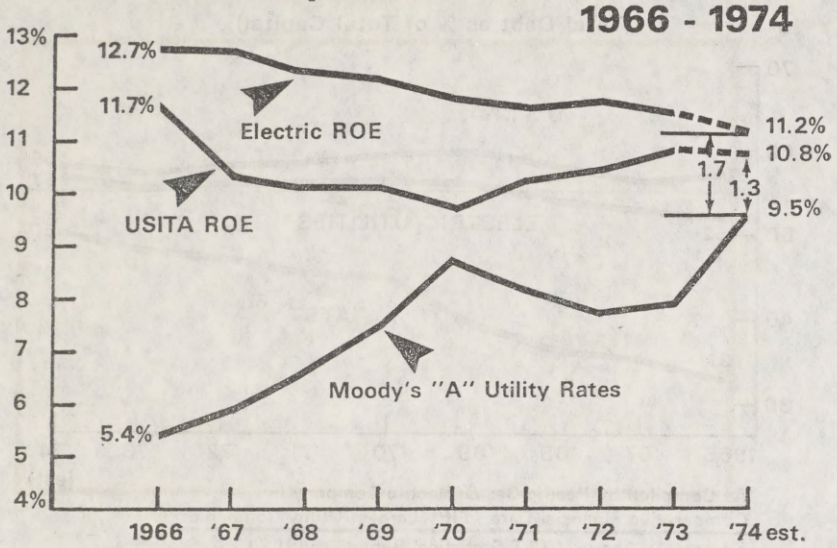
Comparison of Pre-Tax Interest Coverage Electrics vs. Telephone



Sources: U.S.I.T.A. Statistics, AT&T Statistical Report
 *Pacific Gas & Electric's 29 Largest Straight Electrics in Comparative Financial Data: Fifty Largest Utility Companies

EXHIBIT 6

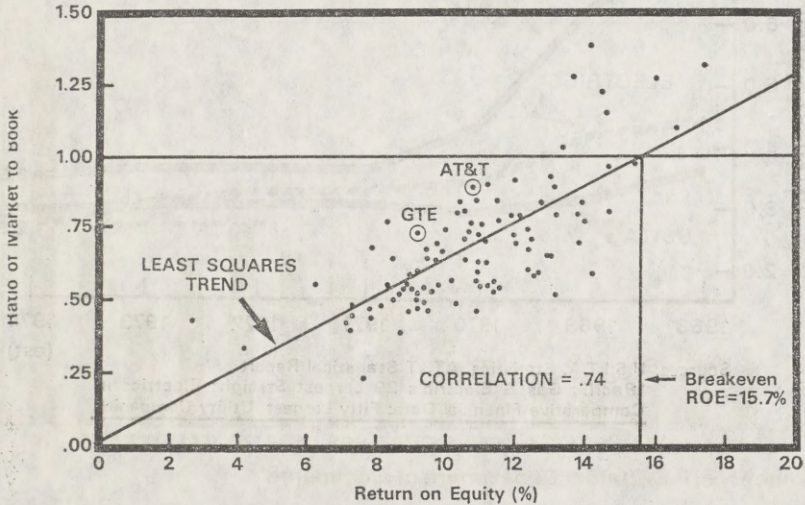
Electric & Telephone ROE vs. "A" Utility Rates



SOURCES: Edison Electric Institute Statistical Yearbook
 USITA Statistics, Vol. 1
 Moody's Investors Service

EXHIBIT 7

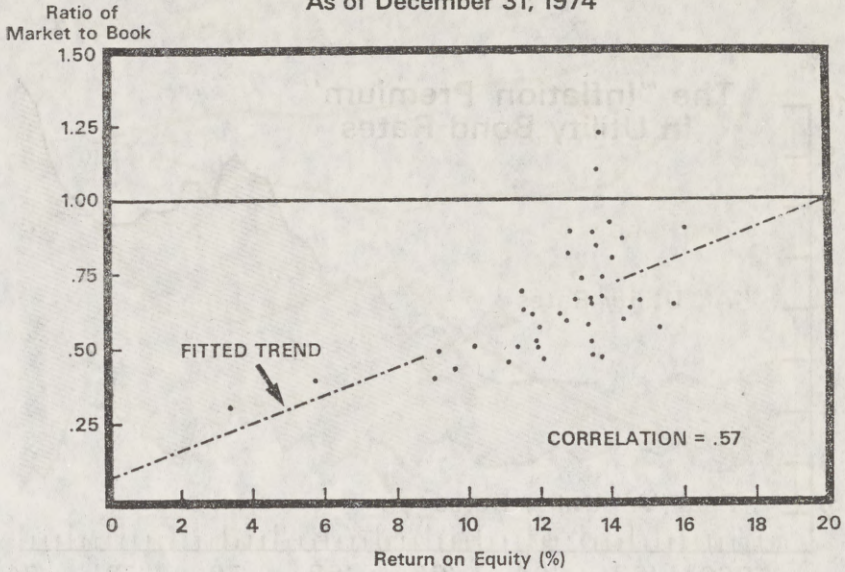
Comparison of Market/Book and ROE of 106 N.Y.S.E. Listed Utilities As of December 31, 1974



SOURCES: Media General Financial Weekly
 Time Sharing Resources

EXHIBIT 8

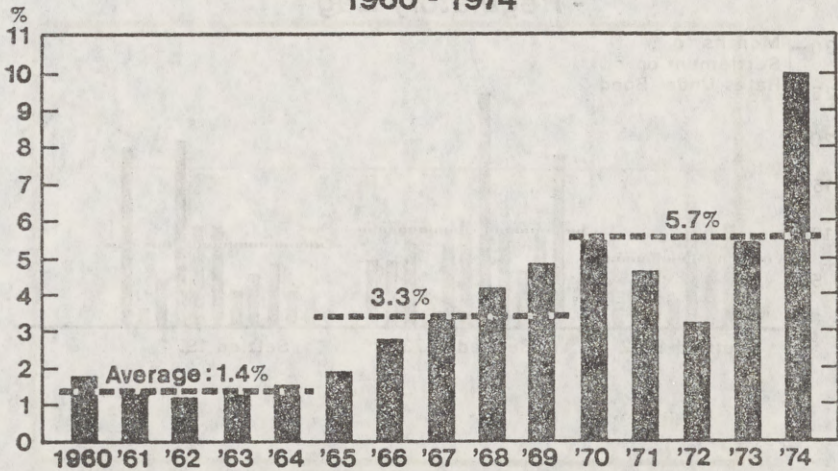
Comparison of Market/Book and ROE of 42 Major Banks
As of December 31, 1974



SOURCES: Standard & Poor's Stock Guide
Time Sharing Resources

EXHIBIT 9

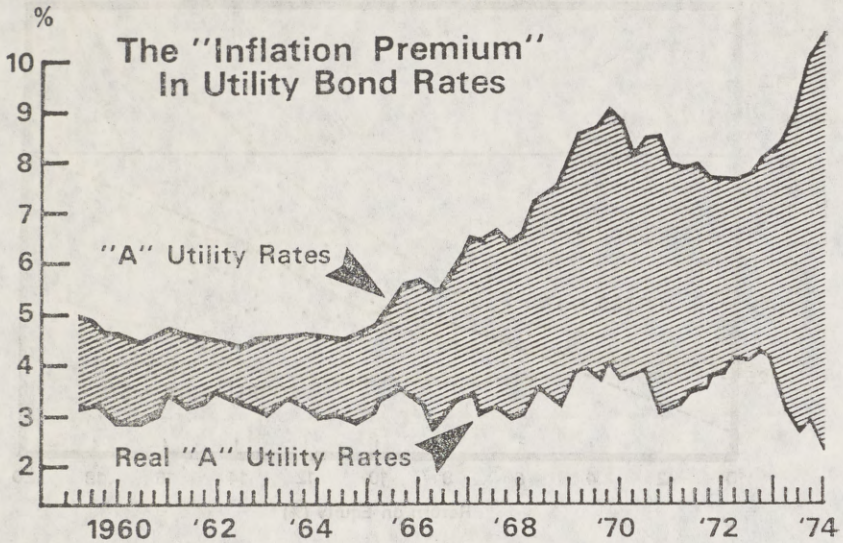
INFLATION
1960 - 1974



Source: GNP Deflator, Department of Commerce

EXHIBIT 10

"Inflation Premium"



Basic Source: Moody's Investors Service and U.S. Dept. of Commerce

EXHIBIT 11

GTE TELEPHONE COMPANIES - Regulatory Lag

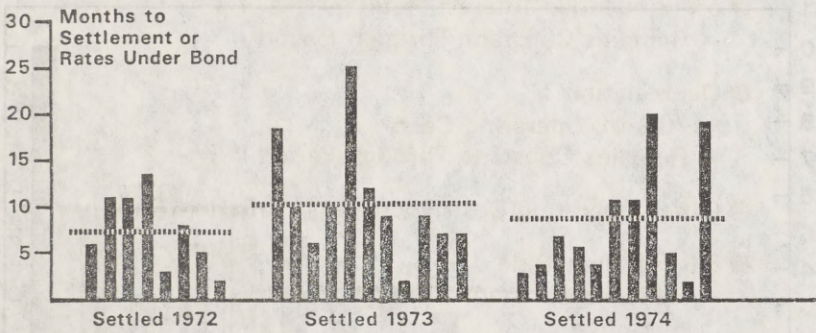
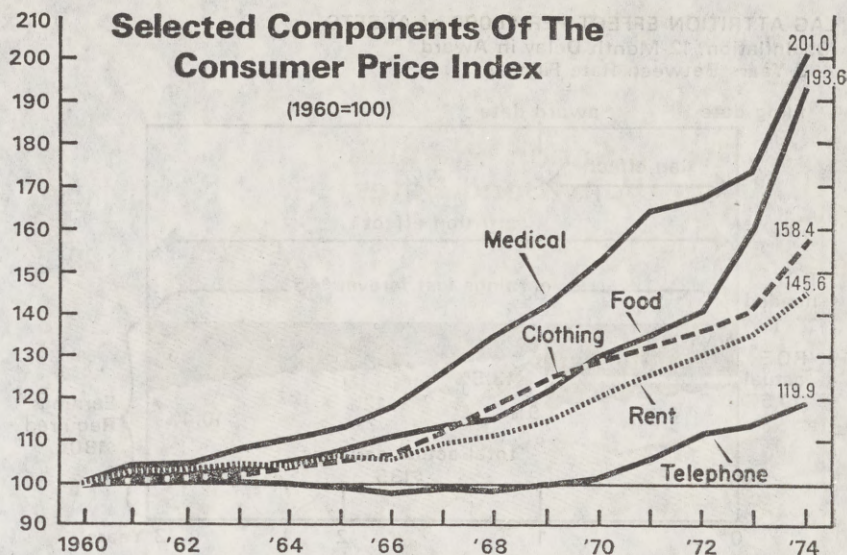


EXHIBIT 12



SOURCE: Bureau of Labor Statistics

EXHIBIT 13

ILLUSTRATION OF LAG/ATTRITION EFFECTS

ASSUMPTIONS:

- 60/40 Debt/Equity
 - Remains Constant Through Period
- 6% Embedded Interest Rate
 - Remains Constant Through Period
- Depreciation
 - 20% of Operating Costs
 - Remains Constant Through Period
- Other Operating Costs increase at Inflation Rate
- 8% Inflation Rate
 - Remains Constant Through Period
- 50% Income Tax Rate
 - Remains Constant Through Period
- 12 Month Period Between Rate Filing and Rate Award

EXHIBIT 14

LAG-ATTRITION EFFECT PER \$1,000 of ASSETS
 (8% Inflation, 12-Month Delay in Award
 — 3 Years Between Rate Filings)

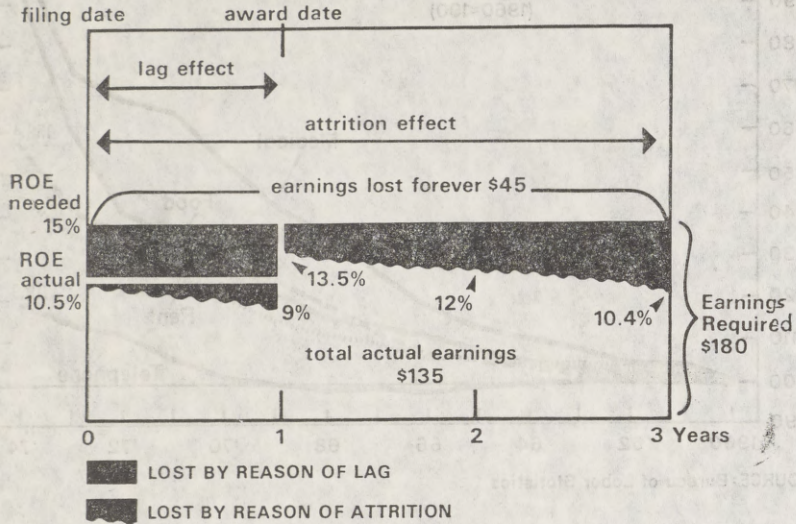


EXHIBIT 15

Lag-Attrition Effect

8% Inflation, 12 Month Delay in Award
 (per \$1000 assets)

	Filing Date		1 Year Later (Before Award)	1 Year Later (After Award)	2 Years Later	3 Years Later
	Actual	Requested				
Revenue	300	336	300	336	336	336
Op. Cost	180	180	192	192	204	217
Income Tax	42	60	36	54	48	41.5
Net Op. Inc.	78	96	72	90	84	77.5
Interest	36	36	36	36	36	36
Net Profit	42	60	36	54	48	41.5
ROE	10.5%	15%	9%	13.5%	12%	10.4%
Cum. Earn. Loss				(21)	(30)	(45.2)
Cum. Act. Earnings				39	90	134.8

RCA GLOBAL COMMUNICATIONS, INC.,
Washington, D.C., September 24, 1975.

Hon. JOHN O. PASTORE,
Chairman, U.S. Senate, Subcommittee on Communications, Dirksen Senate Office
Building Washington, D.C.

DEAR SIR: RCA Global Communications, Inc. (RCA Globcom) would like to take this opportunity to comment on S. 2054, the bill to amend Sections 203 and 204 of the Communications Act of 1934. Specifically, this bill would: (1) extend to ninety days the period of notice required before a common carrier tariff may be changed; (2) extend from three months to nine months the period new or revised tariff schedules may be suspended in whole or in part pending hearing and decision on the lawfulness thereof; or whether temporary authorization of a tariff filing should be permitted.

RCA Globcom is a communications common carrier engaged in the business of furnishing a wide range of communications services to the public and as such is subject to regulation by the FCC. The Communications Act requires that all interstate and foreign common carrier services must be provided at rates and upon terms contained in tariffs filed with the FCC and a major portion of FCC regulation is effectuated through review of charges and terms of service contained in such tariffs. Therefore, RCA Globcom has a direct interest in the proposed amendments.

RCA Globcom believes that as a practical matter in the case of the vast majority of tariff filings the imposition of an additional notice period would result in unnecessary and unreasonable delays in the provision of service to the public and unjustified administrative burden on the Commission staff and on the carriers. Of the hundreds of tariff revisions filed annually with the Commission, only a relative handful are of other than a routine nature and even fewer generate petitions seeking investigation of their lawfulness. Thus, during the first eight months of 1975, RCA Globcom made 74 tariff filings of which only five required more than routine handling. Three of those proceedings were resolved within 60 days of the initial tariff filing, the fourth was mooted and the fifth incorporated into a pending FCC hearing.

Another problem associated with extending the notice period as proposed would be that such change could adversely affect the competitive positions of carriers in competitive communications markets by unduly restricting the ability of such carriers to make rate adjustments to meet changed competitive conditions. If a carrier is restricted by statute from making a competitive rate change for 90 days, it could be exposed to the risk of substantial injury in terms of loss of existing business and inability to compete for new business.¹ Under the circumstances, we submit it would be counterproductive to place such undue limitations on the reaction time of an industry to public demand.

	Tariff filings
New rates and/or reductions-----	23
Rate reductions-----	15
Rate increases ¹ -----	1
Discontinuance of service ² -----	3
Miscellaneous -----	32
 Total -----	 74

¹ Adjustment of AIRCON rates pursuant to FCC Order.

² Discontinuance of obsolete or HF radio service offerings for which no customer requirements existed.

With respect to the second proposed amendment to extend from three to nine months the period for which the FCC can suspend tariff schedules, it is again the position of RCA Globcom that proposed legislation deals with the exceptional filing, rather than the normal, and that the result ultimately would not serve the public interest. Indeed, with respect to the time necessary to investigate a major increase in monopoly telephone rates, nine months may be inadequate; on the other hand, with respect to the majority of cases, particularly those matters in competitive communications markets such as the international voice/record

¹ For example, the FCC recently allowed one of four competing carriers in a market served by RCA Globcom to lower a rate and required the other carriers in that market to wait until the expiration of the statutory notice period before allowing their competing rates to become effective.

market, there is often no justification for a suspension of even the ninety days currently provided for under existing law.²

The FCC bases its request for this legislation on the increased number and complexity of tariff filings since Section 204 was initially enacted. RCA Globcom agrees that improvements in technology and the increased public demand for more sophisticated communications services have resulted in a tremendous growth of the industry. Therefore, the practical issue presented by this amendment is whether the public is better served by the industry restricting itself or whether the FCC should take appropriate action to match the growth of the industry.

Turning to the proposed Section 204(b), RCA Globcom initially is concerned with the absence of any language which would set a time limit on the preliminary written proceeding. The apparent purpose of this subsection is to mitigate the effects of "regulatory lag"; however, without a specific statement implementing the effective date of the tariff, this preliminary proceeding could apparently last indefinitely.

Moreover, as a practical matter, the introduction of a new preliminary proceeding would undoubtedly result in additional work for the FCC and the carriers, with the result that the Commission's energies and staff would be diffused even further. Additionally, it is likely that the result of such a proceeding would not satisfy all interested parties. Thus, a formal hearing would still be required and the public would have no assurance of the stability of the rates which they would be required to pay for a given service offering.

Although the Commission expresses concern over the possibility that customers will make changes in their communications operations based upon rate schedules ultimately found to be unlawful, the Commission at the same time urges the Congress to grant it authority to allow "temporary" tariff changes" pending further order of the Commission." The Commission does not propose any time limit on the temporary authority. If the ultimate concern is protection of the public from unexpected changes in the various communications service offerings, it would appear to be more productive for the Commission to direct its efforts to the prompt resolution of any issues raised by tariff filings rather than foster the uncertainty attendant with granting changes on the indefinite "temporary" basis.

With respect to the request for authority to grant "partial authorization" under Section 204(b), it is to be noted that the Commission presently exercises such authority. (See Section 61.192(c) of the Commission's Rules and Regulations.) Thus, the only apparent practical effect of the requested legislation would be to extend the time period for such partial authorizations. Again, RCA Globcom submits that the proposed amendments would serve to delay the implementation of new and improved services and that in only exceptional circumstances can such delay be justified.

In sum, it is clear that the proposed amendments would tend to promote additional and we submit in the majority of cases unnecessary delay and thereby deny to the public the prompt initiation of new rates and services. Thus, while we do not dispute that the Commission's burdens and responsibilities are increasing, we submit that the total effect of the proposed amendments would not serve the public interest. Rather, if the public interest is to be served, any legislative proposals in this regard should be directed toward implementing expedited procedures in order to allow the public the immediate benefit of new services and rates.

Accordingly, we urge that the proposed amendments to Section 203 and 204 of the Communications Act of 1934 be rejected and the original language of these Sections be retained.

Very truly yours,

LEONARD A. TUFT.

²It is noteworthy that the cases cited by the Commission in support of the proposed legislation are rate cases involving AT&T.

CONTROL DATA CORP.,
Arlington, Va., October 13, 1975.

HON. JOHN O. PASTORE,
Chairman, Subcommittee on Communications, Senate Committee on Commerce,
Dirksen Senate Office Building, Washington, D.C.

DEAR SENATOR PASTORE: I am writing on behalf of the Control Data Corporation to urge, as an interested corporate citizen, the passage of Senate Bill 2054 which would revise the Communications Act of 1934. Our position as a world-wide computer manufacturing and data services organization with network facilities extending across this country and into Canada and Europe assures our interest in the bill.

Your Committee is currently considering Senate Bill 2054 to amend sections 203 and 204 of the act. The proposed amendments would increase from 30 to 90 days the time between the filing date and the effective date of tariffs and tariff revisions filed with the Federal Communications Commission by Common Carriers. It would also allow the commission to suspend a tariff or tariff revision for due cause for a period of nine months rather than the current 90 days.

Control Data is a substantial user of Common Carrier services with charges running to millions of dollars per month as is the case with other companies not only in the data services industry but throughout industry generally. Because of the substantial cost of these services, it is vitally important that users closely analyze all tariffs and tariff revisions to determine the effect on their business and in our case, for one, the effect on our customers who utilize Common Carrier services in conjunction with Control Data data processing equipment and services.

The time needed to fully analyze a tariff or tariff revision has increased substantially over the last few years. This can be traced to the ever increasing complexity of the tariffs and the increasing amount of documentation and statistics furnished by the Common Carriers in support of the tariff or tariff revision. We are presently reaching a point where it is impossible for any user to analyze all the necessary material to determine the effect, make a decision to object to the filing, and file a motion for FCC action—all within the currently allowable 30 day period.

We further find that the constantly increasing workload of the FCC makes it impossible for the members to hold hearings, analyze all data and issue a final judgment within the 90 day suspension period now allowed. Because of this many new rates go into effect, or new services are offered, or services are discontinued on a temporary basis even before hearings are held. Thus, the user is left at a complete disadvantage in trying to plan his future communications costs and fulfill his responsibilities.

Control Data as a user of Common Carrier services fully supports these revisions to the communication act and urges passage of Senate Bill 2054.

Sincerely,

HUGH P. DONAGHUE,
Assistant to the Chief Executive Officer.

STATEMENT OF ROSEL H. HYDE AND HERBERT E. MARKS ON BEHALF OF
WILKINSON, CRAGUN & BARKER

Mr. Chairman and Members of the Subcommittee, we wish to thank you for the opportunity to submit this statement on S. 2054 for the record.

This statement is filed on behalf of the law firm of Wilkinson, Cragun & Barker of Washington, D.C., which for many years has represented clients in matters before the Federal Communications Commission (FCC). These clients are concerned with a wide variety of subjects before the Commission, including broadcasting, CATV, transmitting equipment certification, multipoint distribution and common carrier rate and regulation matters. It is representation of clients in the latter area that has provided experience with and occasioned

concern over the issues presented in the legislation before the Subcommittee. Our clients concerned with telephone and telegraph matters include the users of carrier services, particularly in the area of computer communications, and manufacturers of data communications equipment that is competitive with carrier equipment offerings. However, it should be noted that this statement is filed on behalf of the firm, as counsel who must work and live with the Commission's procedure, and not on behalf of any client.

Rosel H. Hyde is of counsel to the firm. Between 1928 and 1969 he was with the F.C.C. and its predecessor the Federal Radio Commission. Mr. Hyde was appointed as a Commissioner in 1946 by President Truman and served on the Commission until his retirement in 1969, having been reappointed by Presidents Eisenhower and Johnson. Mr. Hyde served as Chairman of the Commission from 1953 to 1955, and again from 1966 to 1969. During the greater part of his tenure, he was a member and Chairman of the Commission's Telephone Committee.

Herbert E. Marks is a partner in the firm. He has appeared before the Commission in numerous matters involving carrier rates and regulations, including rate and rulemaking proceedings as well as in a variety of other procedural formats utilized by the Commission. Mr. Marks' experience in F.C.C. related matters has involved everything from the filing of informal and formal pleadings to the actual trial of cases.

S. 2054

S. 2054 was introduced upon the request of the Federal Communications Commission for the purpose of: extending the period of notice required before a tariff change may become effective from the present 30 days provided in the Act to 90 days; extending the period during which the Commission may suspend new or revised tariff schedules from the presently provided three months to nine months; enabling the Commission to conduct preliminary written proceedings to determine whether a tariff filing may become effective in whole or in part, as well as to authorize temporary changes in the tariff pending the outcome of hearings. Having summarized the purposes of the Bill, we would now like to present some of our views as to how current provisions in the Act affect those concerned with telecommunications common carrier rates and regulations. Based on actual experience, as will be outlined below, it is submitted that the proposal in general is appropriate, long overdue and that S. 2054 should be enacted, with certain modifications.

It is patently clear that the present 30 day filing provision is grossly inadequate.¹ A few simple examples readily illustrate this. The Commission's Rules call for comments on tariff filings to be filed 14 days prior to the effective date of the proposed tariff. Thus, if a tariff is filed on 30 days notice, a party desirous of commenting has only 16 days in which to prepare petitions. However, tariff provisions often are very complex and usually involve complicated economic and technological data and issues. Accordingly, an interested party has to first learn about the tariff, consult with counsel and/or the various necessary technical experts and then prepare a pleading for the Commission. The Commission obviously is not assisted in its analysis of a tariff filing if such pleadings fail to be complete and thoughtful. Thus, it is clear, in view of the complexity of the issues involved, that time is necessary for the preparation of meaningful comments and that the time now actually afforded is inadequate.

The problem of the statutory time limit is further compounded by the fact that at the present time there is no meaningful form of public notice to interested parties concerning the filing of tariff revisions. While tariff revisions are filed with the Commission, there is no requirement that notice of such filings be published in either the Commission's public releases or in the Federal Register. The only colorable² attempt made at public notice is found in the fact that transmittals are forwarded to a contractor charged with duplication of materials who then distributes them to persons on a subscription basis. However, after several years experience, it is apparent that this process is equivalent to having no notice at all, since the contractor usually takes anywhere up to two weeks or more to convey duplicated tariff transmittals, if the transmittals are disseminated at

¹ Even where the Commission by rule has adopted a 60 day period, pleadings are due 35 days before the effective date leaving only 25 days in which to learn of, investigate, analyze the tariff and supporting economic data, and file a pleading.

² A few tariff revisions are described in the Commission's notices, but this occurs well after filing.

all. While it has been argued that tariff provisions are so numerous as to constitute a burden should publication in Commission press releases or otherwise be required, a random review of the numerous notices already given by the Commission in broadcast matters suggests that such an assertion lacks substance. Indeed, a way has been found to provide public notice with respect to all sorts of minor and routine broadcast related items. Accordingly, there is no persuasive reason why similar notice could not be given of tariff filings.

Consequently, while Congress should adopt an amendment to Section 203(b) of the Communications Act to extend the time periods now provided, it should in doing so also require that public notice be given of tariff revisions. Only in this way can it be assured that the Commission will receive meaningful and truly substantive comments from all interested parties. Given the undisputed fact of the growing complexity of telecommunications issues in general, it is vitally important that procedures be provided to fully ensure adequate participation by interested parties. Interested parties make resources available to Commission in the forms of varying assessments of such filings. This adversary process should serve to highlight both the benefits and detriments of any particular filing. The Courts have long recognized the public interest in having interested parties participate in governmental action as reflected in the judicial concept of "private attorney generals." Thus, it is an anachronism that tariff notice provisions have not been significantly improved. It must be reiterated that the issue of whether a tariff is lawful is not a private matter between the Commission and the carrier, but rather includes a role for interested parties.

We do not wish to create the impression that our comments are intended to be totally critical of the Commission in this regard. The Commission has certainly come a long way in recognizing the rights of interested parties. However, on the issue of public notice of tariff filings, the Commission's lack of response seems to be antithetical to its action with respect to other similar issues.

S. 2054 would also increase the period during which the Commission can suspend tariff rates, pending investigation. The current three month period is not realistic, and no one familiar with the complexities of modern economics or technology, including such things as econometric models, computer based market models, etc., could possibly believe that a three month period is adequate. Recent filings have seen carriers submit initial rate support documentation of up to three thousand pages which included computer runs, etc. A review of these materials, often reveals that they are summaries of a larger data base of materials. Consequently, it is not unusual in a major rate proceeding to be dealing with a documentary base many times larger than the initially submitted supporting materials. Accordingly, present provisions in the Act providing for proceedings to be completed in three months are unrealistic. Indeed, the nine month period urged by the Commission in S. 2054 is really a minimum. A one year period would be more realistic.

While expedition is desirable, so too is fairness. The expedition of proceedings would be facilitated by major increases in the size of the Common Carrier Bureau Staff. However, this point need not be belabored since this Committee is aware that good staff work takes time. Given the complexities of the cases involved, the amounts of time suggested above for suspension periods are quite modest and indeed assume expedited procedures in order to comply with them.

S. 2054 would provide the Commission with some flexibility in providing interim, temporary, and partial rates. Often a rate change may involve a number of tariff provisions and problems may vary among the various components. Further, it may be clear that some rate change is called for, but the amount requested appears excessive. Accordingly, this type of flexibility is needed.

Further, the Commission is encountering another type of problem that was obviously not foreseen in 1934. Claims have recently been made that rate reductions were intended to be predatory or that rate reductions were below cost or otherwise subsidized from monopoly services with an intent to eliminate competition in the provision of competitive services. These are serious charges. Without arguing the merits of such contentions, it is clear that there have been significant rate reductions for competitive rates at the same time carriers have asked for and been permitted to implement major increases in other rates. There has been no real remedy in such situations. A rate reduction will now go into effect after 90 days, regardless of the merit or substance of objections made by interested parties who will then be adversely affected during the significant period in which it takes to complete a hearing. Such parties can find them-

selves pushed out of business or suffering from adverse effects without any viable recourse. The relationship of competitive to monopoly services for certain carriers is such that any harm resulting to them from lower than cost, or slightly above cost, sales in competitive areas could not possibly affect overall earnings in any significant way. Therefore, cross-subsidization of the kind just described does not affect the carrier, only the carrier's competition.

Obviously, there is a need for a mechanism to protect against a predatory price reduction. At present, the Act contains no equivalent of the accounting order used for rate increases. An accounting order requires that the carrier keep track of customers who pay the increased rates, with a view toward refunding excessive charges if the rate increase is deemed inappropriate. At present, there is no requirement that carriers keep track of customers who receive the benefits of low predatory rates or any means by which additional amounts can be recouped to make the rates, if initially found unlawful, reasonable. A "negative accounting order" would have a meaningful effect on the competitive marketplace pending the completion of an investigation. Such a provision would put the customer on notice that the customer may be liable for additional charges if the rates are not sustained. In the real world of business and economics this would be a very sound approach. Whether it is politically feasible, we are not in a position to state. If it is not, then Congress must provide a remedy against the predatory rate cut.

The amendments prepared for Section 204 would provide the Commission with some remedy for predatory pricing as well as with the power to stipulate temporary rates in the situation where there is rate reduction. This would certainly be of significant assistance and the Subcommittee should give it serious consideration.

Again, we wish to thank you for the opportunity of submitting this statement for the record. You will note that a possible amendment, the purpose of which is to require public notice as discussed above, is attached as Appendix 1.

APPENDIX 1

203(b) "No change shall be made in the charges, classifications, regulations, or practices which have been so filed and published except after *90 days following the issuance of public notice by the Commission of the acceptance for filing of such change* which shall be published in such form and contain such information as the Commission may by regulations prescribe; but the Commission may in its discretion and for good cause shown, modify the requirements made by or under authority of this section and in particular instances or by a general order applicable to special circumstances or conditions."

EXPLANATORY NOTE

The amendment requires the Commission to issue public notice of tariff filings, although it is given authority to revise the requirement. This should allow suitable flexibility, although it should be made clear that notice for each class of revision should be adequate.



