WHY MA BELL STILL BELIEVES IN SANTA

BY NICHOLAS JOHNSON

Christmas came a little early for Ma Bell last year—to be precise, two days early. On December 23, the Federal Communications Commission announced its decision to dismiss its six-year-old inquiry into AT&T's rate base and operating expenses, while continuing its generous effort to set ever higher rates of return for Bell. (Two of the seven commissioners, H. Rex Lee and I, dissented, and Commissioner Robert Bartley concurred "reluctantly.") The commission, which acknowledged that it hadn't been doing much to regulate the telephone company anyway, as usual chose a "graveyard time" to announce an important decision—the late afternoon of the last working day before Christmas—in the hope that the press would not particularly notice the announcement. Journalists, as well as consumers and public officials, are bored and confused by the subject of regulation of public utilities—or at least so the FCC thought, and no doubt AT&T officials thought so too.

After that holiday weekend, AT&T stock went nicely up, and telephone executives could gather round the hearth a few days later to toast what promised to be a vintage new year.

In the next few weeks a storm of public protest boiled up, stunning the majority of the FCC, which had never really understood the consumer movement or correctly measured its powerful influence on the press, citizens, and Congressmen. The first day Congress reconvened after the Christmas holiday, the AT&T matter came up for floor discussion. Even the Department of Defense, on behalf of all the federal executive agencies, said that without an inquiry the fairness of long-distance phone rates could not be determined. What had seemed to the FCC majority as merely a more candid way of dealing with business as usual ("As long as we're not really going to conduct a hearing anyway," one commissioner had said, "why not just cancel it?") was publicly denounced. On January 28 the FCC reinstituted the inquiry,

Last December, the FCC dismissed its hearing into the real issues of telephone rate regulation. Within a month, the hearing was on again. Now, at last, will the FCC really regulate AT&T?

and on February 1 Chairman Dean Burch was trying to explain to the Senate Commerce Committee why an investigation that involved billions of dollars in phone company charges had been dropped in the first place.

Before trying to unravel the implications of the December 23 decision and the January 28 reversal, we must understand a little about the economics of the Bell System and the FCC's so-called "rate regulation." It's not all that complicated. The Communications Act of 1934 gives the FCC the responsibility of regulating the rates of "common carriers by wire." The act states that these rates must be "just and reasonable" and that proposed rate increases must be "in the public interest." Any charges not in the public interest are prohibited. As it works out, the FCC sets the long-distance rates and state commissions set local rates.

Telephone rates are based on three variables: Bell's capital investment, or "rate base" (the value of the poles, your telephone, and so forth), the "rate of return" (or profit) on that capital investment, and Bell's expenses.

First, consider the rate of return. Suppose the FCC, after a hearing, decides that Bell should get, say, 7 per cent as a fair return on its investment. Taking Bell's capital investment figure, compute 7 per cent of it. Then, figure out how much revenue all our telephone bills have to generate so that, after all expenses are paid, Bell will be left with that 7 per cent figure as profit. Finally, figure out what long-distance telephone rates must be to provide their share of the money. Conceptually, it's a relatively simple process.

You would think that, since the public interest is the guiding criterion for this calculation, Ma Bell would use FCC hearings to tell us how the public will be better off in terms of faster dial tones, fewer busy signals, and more telephone installations if we would grant an 8 per cent return as opposed to a 7 per cent one. Right? Wrong. I asked a Bell attorney at the 1967 rate hearing how service would be affected if the company got 4 per cent—or 10 per cent. He was totally unprepared for such a question.

Instead, the hearings are concerned almost exclusively with the marketability of Bell stocks and bonds—stock prices and rates of interest. Ever higher stock prices are assumed to be necessary for the phone company to raise new money for construction. For some reason, the commission seems to buy this reasoning, in spite of the evidence that the quality of telephone service has declined during the very years Bell has enjoyed its highest earnings.

The size of Bell's capital investment, the rate base itself, may have a far more substantial effect on telephone rates than the rate of return. If we assume that Bell has a legitimate capital investment of $50-billion and is entitled to a 10 per cent rate of return, that's a $5-billion profit. An 8 per cent rate of return would give the company $4-billion—and the subscribers a $1-billion saving. But suppose the $50-billion figure is too high. Suppose that for any number of reasons—unreasonable depreciation practices, paying Western Electric, Bell's wholly owned subsidiary and supplier, too much for equipment, or counting items of operating costs as capital investments—Bell has inflated its rate base. Even at the higher 10 per cent figure, if the company's rate base ought to be valued at $20-billion, its return is only $2-billion—rather than $4- or $5-billion. I don't charge that Bell has done any of these things, I don't know any more than you do. The point is that nobody else at the FCC knows either and that the commission has not yet made any real effort to find out.

Let's look at an example. What's the

An FCC commissioner since 1966, Nicholas Johnson has been a persistent critic of the agency's regulatory shortcomings. He is the author of *How to Talk Back to Your Television Set*.

rate base value of the telephone instrument in your home? Bell purchased that phone from Western Electric, whose phones are produced only for Bell and are the only ones Bell buys. And Western Electric's price—including Western's *profit*—has never been regulated by the commission. As far as the Bell System is concerned, these purchases are merely bookkeeping entries. Bell's incentive, in general, is to put as much value as possible on a rate base item because every dollar "in the ground" immediately starts earning its own rate of return. When that dollar includes Western's *profit,* it means AT&T is making two profits on the same piece of equipment—a rate of return on a rate of return. The FCC's trial staff—the agency's "prosecuting attorneys"—now urges the commission to consider Western Electric's rate of return in any decision on AT&T's overall rate of return.

Most of your phone bill doesn't have anything to do with Bell's profits, but with the third variable, "expenses"—$13-billion of them. How much do the executives get paid—in salaries, stock options, expense accounts? Is there a cheaper way of installing a telephone than sending a man to take out the old phone one day and another man to put in an identical one in the same apartment two days later? Advertising, policies on accelerated depreciation, use of employees, and maintenance costs all go into Bell's expenses. You're paying every month for those telephone trucks you see running around your town—and the public relations firm that told Bell it was time to give up on the drab green paint and the nineteenth-century company emblem. The FCC is supposed to be ensuring that Bell—and you—are not paying too much. In the thirty-eight years since the 1934 act, the agency has yet to complete a single hearing examining expenses. We have always simply accepted the figures supplied by Bell itself. At best, that is a lot of trust in Bell's multibillion-dollar infallibility.

Finally, there is the manner in which AT&T apportions its phone rates among different classes of customers. FCC's jurisdiction over long-distance service is not limited to individual subscribers' calls. It includes rates for "free" (flat rate) long-distance calls (Wide Area Telephone Service, or "WATS" lines), TELPAK (cheaper-by-the-dozen rates for private lines), and other large corporate uses of long-distance lines for transmission of voice, picture, and computer data. In 1964, when AT&T earned a 7.5 per cent rate of return on its total long-distance investment, the rates charged reflected a rate of return ranging from 10 per cent for individual long-distance consumers like you and me to 0.3 per cent for corporate TELPAK users.

In years of off-again, on-again hearings, starting in 1965, the commission has been unable to come to grips with any of these questions essential to regulation. All that came out of the first two years' work was the determination of a reasonable rate of return and a few rate reductions, although not enough, as it turned out, to bring Bell down within the range determined by the commission to be reasonable. The commission really never did get around to Bell's capital investment, expenses, and the apportioning of rates. Then, in 1969 and without a hearing at all, the commission granted Bell a new, higher rate of return. Finally, in November 1970, Bell filed substantially higher rates still, and the FCC ordered the new hearing. None of the big issues were settled when the commission dismissed that part of the hearing that would have dealt with those larger issues last December.

Struggling to come up with explana-

ons of this dismissal, the FCC major-
y said it had neither the staff nor the
udget to carry out an AT&T hearing.
he commission implied that priori-
ies made it impossible to readjust on-
oing projects in order to find the
unds necessary to conduct a proper in-
uiry. It seemed to me the public indig-
ation was predictable. Chairman
Burch was surprised, however. In a let-
er to members of Congress, he said
hat the commission did and would
regulate Bell "vigorously and effec-
tively" through private, cozy, closed-
doors chats with Bell officials—or "con-
tinuous surveillance," as the commis-
sion prefers to call them.

Bell officials were of mixed mind about the decision. AT&T Vice President for Federal Relations E. B. Crosland said that the decision to dismiss the hearing into rate base items was "encouraging, because it should lead to a prompt commission decision" on the now pending rate increase case, and he applauded the long record of success of the FCC's practice of "thorough regulation without excessive costs and extended hearings." But AT&T Board Chairman H. I. Romnes later backtracked and called the dismissal "very unfortunate." As a Bell lawyer put it, the decision was embarrassing, because it "made it appear as if Bell isn't regulated." It is always unfortunate for an unregulated monopoly when the public learns the truth.

Now that the hearing is to be re-
pened, will it finally deal with all the
eal issues of regulating Ma Bell? It
kely won't be as broad a hearing as
he one originally planned, nor can we
xpect it to be accomplished as soon as
ve had hoped. Chairman Burch told
he Senate Commerce Committee in
anuary that he couldn't even indicate
a starting date.

The FCC still doesn't know where it
s going to get the manpower to con-
duct the inquiry. Indeed, it has ad-
mitted that it doesn't even have the re-
sources or expertise to determine what
resources it will need. After all, the
commission has never done so large a
study before, and it is difficult, if not
impossible, to find a suitable model. If
the commission intends to proceed
with the investigation using its current
resources, or with just a few additional
staff members, it will surely be engaged
in what Chairman Burch called "win-
dow dressing."

Senator Fred Harris and Congress-
man William Ryan, as well as Senator
Philip Hart and Congressman Jon-
athan Bingham, have introduced bills
to give the commission the necessary
funds. When given an opportunity to
support the Harris-Ryan bill, and ac-
cept the funds, Chairman Burch, in a
letter to Senator Harris, declined even
to comment on his proposed legisla-
tion.

What, in fact, has been the FCC's
budget position? In fiscal year 1972
Congress gave the FCC all the money it

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requested. Indeed, for fiscal 1973, after the criticism of the commission, the Office of Management and Budget insisted the commission take more than it had asked for AT&T regulation. Thus, if the FCC does not in fact have sufficient funds to conduct an investigation, the responsibility rests with the commission itself. It is hard to plead poverty when you get all you ask for, and more, and refuse to accept a $2-million gift from Senator Harris and Congressman Ryan.

What is the meaning of the AT&T caper? At least the days of bluntly "dismissing" such hearings seem to be over. But telephone users will continue to suspect, with some reason, that they are being charged more for long-distance service than the law permits. Beyond that, state public utility commissions, most of which have even fewer resources than the FCC, will be under pressure to permit excess charges for local and intrastate service as well. Many of them were legitimately concerned by the commission's admission of inability to regulate Bell.

It is difficult to predict precisely the dollar benefits that could come to you and me from the reopened inquiry. In establishing a rate base and expenses, there are, for example, hundreds of accounting decisions that affect your telephone bill—among them the proportion of debt and equity financing, using (or not using) accelerated depreciation, and the methods of evaluating property. But for the consumers dealing with a monopoly, these are more than "accounting practices." In an industry whose annual revenues are roughly twice the yearly income tax collected by all fifty states combined, a fraction of a per cent here and there may amount to millions of dollars in phone-bill savings.

There are implications to this whole affair that are bigger than our phone bills, however. The history of nonregulation of AT&T is a bad omen for the current efforts at broader economic regulation. Public utilities regulation is the closest working model we have to the current Phase II wage and price controls. In both, the guiding criterion is "fair and reasonable" profits, and the controlling question is where the balance should be struck between corporations and consumers. In both, the regulated industries are well organized and capable of hiring the finest lawyers and economists to plead their cases, while the affected public is essentially unrepresented. The inadequacies and biases of public utility regulation do not speak optimistically for the success of the much vaster Phase II regulation. If the FCC cannot effectively regulate one company, how can we expect to accomplish meaningful regulation of the entire economy by the Wage, Price, and Rent boards?

In the telephone industry, whose annual revenues are about twice the yearly income tax collected by all fifty states, a fraction of a per cent difference in accounting may amount to millions in phone bill savings.

The short-lived FCC dismissal of the AT&T hearing is only part of the current pattern of governmental deference to large corporations at the expense of the small consumer. Other examples include the continuing reluctance to reexamine, in a serious way, the Internal Revenue Code with its capital gains taxes, oil depletion allowances, prepaid interest deductions, bad debts reserves, tax-free municipal bond income, investment credits, and other "special interest" loopholes. The tax code, through these provisions, gives those earning more than $25,000 each year a "welfare payment" of at least $4,000 annually; those earning below $3,000 a year get $16 in such "welfare." The oil-import quota costs the consumer an additional 5 cents a gallon in gasoline prices. The maritime subsidy gives big ship companies and shipyards benefits estimated at $750-million annually from the Treasury, with no advantage to consumers or taxpayers whatsoever. The continuing refusal to require quality labeling of canned goods (labels describing the grade or the product, measured against government standards) produces a 20 per cent increase in the cost of such items. In virtually every area where government affects business, there is a battle between consumer interests and corporate interests, and the corporate interests generally win hands down. Publicity aside, the trend in the day-to-day decisions in government during the past three years is against the consumer on every front.

Possibly the most distressing aspect of this corporate-consumer imbalance is that those who make such decisions often honestly believe they are acting in the public interest. Just as supporters of the SST argued that the project provided jobs, and opponents of the recently vetoed day-care legislation felt the family was being threatened, so those who applaud the commission's decision in the AT&T case believe we are protecting the investments of countless "little people."

Maybe so. But if that is the justification, let those who make the decisions say so. If the public interest is to be found in some secondary gain, let the choice between the alternative ways of attaining that gain be given to the public. If American automobile production is to be encouraged not because it produces the best product for the money (it clearly doesn't) but because the planned obsolescence creates jobs and stimulates economic growth, let the American people decide that's the way they want to do it. If we can't—or won't—regulate AT&T, let's consider breaking it up into manageable pieces, or perhaps nationalizing it, and then find another way to support those who are holding its shares.

Some would argue that our decision to reinstate the AT&T rate base hearing is a step in the right direction. I would like to share their optimism, but in my eight years in Washington I have seen too much that leads me to believe otherwise. Until the finance company comes to repossess the Christmas loot, Ma Bell is going to go on believing in Santa Claus. □